“Bankruptcy Remote” Special Purpose Entities in Commercial Mortgage Lending: Characteristics, Enforcement and Limitations

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Part I — Introduction

It has become common practice in commercial mortgage lending for the borrower to be structured as a "single purpose" or "special purpose" entity. In its simplest form, a special purpose entity is simply an entity formed solely to own a specific property and any personal property ancillary thereto. Regardless of lender requirements, many property owners regularly use special purpose entities to own properties as a method to ring-fence particular assets and their associated liabilities into independent silos. At the other end of the spectrum is a full-fledged "bankruptcy remote" special purpose entity. The organizational documents for such an entity will contain a long laundry list of separateness covenants, independent director/manager requirements and various other provisions relating to bankruptcy remoteness. At this end of the spectrum it is also common in many larger commercial loan transactions for lenders to require a non-consolidation opinion and a recourse guaranty of the sponsor for a voluntary or collusive involuntary bankruptcy filing of the borrower.

Although common in many types of lending transactions, full-fledged bankruptcy remote structures are routinely utilized in loans that will be included in commercial mortgage-backed securitizations ("CMBS"). This requirement has been a part of CMBS since its inception, is expected by bond buyers, and impacts the ratings of the CMBS by the rating agencies (i.e. not utilizing special purpose entities will have a negative impact on the ratings of the bonds).[2] Although not quite as ubiquitous as in CMBS lending, and often with fewer bells and whistles, bankruptcy remote special purpose entities are often required in non-CMBS mortgage loans and many lenders have the same requirements for their balance sheet and CMBS loans.

This article will address some of the background and rationale for the use of special purpose entity structures in commercial real estate loan transactions and is intended as a training piece on the subject.

Bankruptcy Remoteness

"Bankruptcy remote" is often misunderstood. Many people mistakenly interpret it to mean "bankruptcy proof." These entities are not (and ultimately cannot be) bankruptcy proof; many have legitimately gone insolvent and/or voluntarily or involuntarily filed for bankruptcy. What a lender, bondholder or rating agency relies on when making, investing in, or rating a mortgage loan is that the collateral property and its financial and legal structure can essentially be boxed and then evaluated, so that things outside of that box (like the insolvency of an affiliate) will not have an adverse effect. In other words, a lender, investor or rating agency wants to know that the collateral and cash flow securing the loan will be available to satisfy the loan and that the individual property's operating performance and value can be isolated from other properties and entities. This enables these parties to evaluate the risk of the loan, i.e., its probability of full repayment, by considering the attributes of the collateral alone. If the collateral property could be available to satisfy the debts of others, or if credit events of affiliates or owners could impact the property, that would change the analysis. In fact, this desire for separateness is so acute that these loans are often non-recourse to the sponsor (except for specified bad acts) to ensure that the bankruptcy of the parent would not lead to a consolidation of the borrower with its bankrupt parent.

A primary goal of bankruptcy remoteness is to prevent a borrower from filing a "strategic" bankruptcy. A "strategic" bankruptcy filing is "when an otherwise solvent and financially sound borrower entity nevertheless files for bankruptcy

[2] CMBS trusts issue "certificates," not "bonds," but such certificates are often referred to as bonds in the industry. When we refer to bonds herein we are referring to the certificates issued by CMBS trusts

as part of its (likely less stable) corporate parent's legitimate insolvency proceeding."[3] The view that the bankruptcy of General Growth Properties, Inc. ("GGP") meant bankruptcy remoteness was broken is why *In Re General Growth Properties, Inc.*,[4] was fascinating to many people. Many of the individual debtors in *General Growth* were special purpose entities whose malls were performing. In other words, the cash flow and value from a performing mall were sufficient to satisfy the debt on that individual mall, and yet the special purpose entity owner (with the consent of the independent directors/manager[5]) was able to voluntarily file for bankruptcy. Thousands of pages have been written on *General Growth*. The purpose of this paper is not to get into the detail, but we note that the case (i) was a hard lesson for some that bankruptcy remote does not mean "bankruptcy proof" and (ii) led to many changes in the way borrowers and loans are now structured to be considered "bankruptcy remote," including the use of recourse for voluntary bankruptcy filings, "professional" independent directors and certain fiduciary duty waivers.

In addition to the desire to keep the assets "in a box" as described above, lenders have other reasons to avoid bankruptcy to the maximum extent possible. The uncertainty of cram-down risk (simply put: changing the terms of the loan to potentially reduce the interest rate, lengthen the amortization schedule, extend the term, etc.) is an unsettling thought to the lending community, especially when the loan in question will be backstopping rated bonds. Anything that could make that event less likely is highly valued. In addition to cram-down and other risks, costs and delays, a borrower's bankruptcy filing has several other potential negative effects on the noteholder(s), including, but not limited to, the suspension of payments to creditors and the limitation of enforcement actions that a creditor may take in response to such nonpayment (the "automatic stay").[6]

Bankruptcy remoteness highlights the tension between the United States Bankruptcy Code[7] (the "Bankruptcy Code") and the freedom of contract afforded by state law, and particularly, Delaware law. Special purpose entities are usually organized under Delaware law to satisfy lender and/or rating agency requirements, since Delaware law provides great flexibility in structuring entity governance, including the reduction or elimination of certain fiduciary duties owed by directors or managers.

Federal public policy advanced by the Bankruptcy Code dictates that persons and entities must have access to federal bankruptcy protection. As a result, limitations placed on the governance of special purpose entities that amount to a complete prohibition on bankruptcy filings have generally been rejected by bankruptcy courts. Pre-petition waivers of the right to file for bankruptcy protection are unenforceable, as are pre-petition waivers of the automatic stay, except under limited circumstances. Therefore, although state law may permit the elimination of fiduciary duties, an argument could possibly be made that a federal bankruptcy court may hold that such provision is invalid as a matter of federal public policy if it totally restricts an entity's right to file bankruptcy. Bankruptcy remoteness has its limits. It significantly reduces the risk of a bankruptcy filing by a special purpose entity, but it does not eliminate the risk. As such, lenders utilize other features to "encourage" the borrower to comply with special purpose entity provisions to increase the likelihood of the timely repayment of its debt obligations. For example, "bad boy" guaranties

[3] Moody's Investors Service, Inc., *CMBS – US: Sector update – Q3 2019: Slight Improvements in credit metrics amid falling interest rates*, Dec. 5, 2019, p. 4.

[4] *In Re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

[5] The terms "independent director" and "independent manager" are used interchangeably throughout this paper and a reference to either includes both.

[6] Moody's Investors Service, Inc., *Cross Sector Rating Methodology: Bankruptcy Remoteness Criteria for Special Purpose Entities in Global Structured Finance Transactions*, Oct. 7, 2014, p. 1-2.

[7] 11 U.S.C. §101, *et seq*.

from a controlling party, typically the transaction sponsor, provide an alternate source of repayment of the loan if a borrower commits certain bad acts specified in the loan documents, specifically including violations of special purpose entity provisions.

Special Purpose Entities

Special purpose entities are designed to insulate an entity from the risks of bankruptcy and also decrease the risk that the entity's assets will be consolidated into the bankruptcy estate of an affiliated entity. A special purpose entity is typically bound by requirements in its organizational documents and/or loan documents which: (i) restrict its purpose and powers; (ii) limit its ability to incur additional indebtedness, other than ordinary course debt related to its ownership and operation of the mortgaged property or other encumbered assets; (iii) impose separateness covenants with respect to its business operation; (iv) restrict merger, consolidation, dissolution and any amendment to the provisions in its organizational documents related to its separateness; (v) require an independent director whose vote is necessary to file bankruptcy; and (vi) impose other restrictions on its ability to file for bankruptcy.[8] Sample separateness covenants are discussed below and included in **Appendix A** attached to this article.

Restrictions on the activities of a special purpose entity reduce the possibility that it will become insolvent. For example, a prohibition on incurring additional debt limits the pool of potential creditors eligible to file an involuntary petition against the company. Other restrictions placed on the activities of a special purpose entity protect it from the risk of dissolution while a CMBS loan or rated securities remain outstanding, including a prohibition on liquidation and consolidation.

To decrease the risk that a special purpose entity's assets will be consolidated into the bankruptcy estate of an affiliate, separateness covenants require the entity to observe corporate formalities. The observance of these formalities, such as conducting business in its own name and paying its liabilities out of its own funds, decreases the risk of an entity's corporate structure being disregarded by a court. Additionally, a lender may require a non-consolidation opinion whereby legal counsel opines that the special purpose entity will not be consolidated with its parent entities or affiliated property manager in the event that the related entity becomes insolvent or files for bankruptcy. Restrictions on a special purpose entity also minimize the effect of the entity's own insolvency by limiting who may authorize a bankruptcy filing on its behalf, typically by the appointment of an independent director or manager, and thereby reducing the likelihood a petition will be filed in situations where the borrower is not actually insolvent.

Types of Special Purpose Entities

In recent times, the vast majority of borrowers in commercial real estate loans are organized as single member limited liability companies, often under Delaware law. Once in a while borrowers are structured as limited partnerships. If the borrower is structured as a limited partnership, its general partner must also be structured as a special purpose entity. This is because the general partner typically has authority to act on behalf of a limited partnership, which would include authorizing the filing for voluntary bankruptcy. Under the Delaware Revised Uniform Limited Partnership Act (the "Partnership Act"),[9] the bankruptcy of its general partner may result in the dissolution of a limited partnership unless the remaining partners act to continue or reconstitute the partnership. This poses a risk for lenders, which is reduced if the general partner is structured as a special purpose entity, with provisions in the

[8] Standard & Poor's, *U.S. CMBS Legal and Structured Finance Criteria*, May 1, 2003, p. 91.

[9] 6 Del. C. §17-101, *et seq.*

organizational documents of both the general partner and the limited partnership requiring the general partner to obtain an independent manager or director whose consent is required to authorize a voluntary bankruptcy filing on behalf of itself or the limited partnership.

When a borrower is structured as a multi-member limited liability company, at least one member in the borrower should also be a special purpose entity, which is most commonly its managing member. When a borrower is a multi-member limited liability company there is an increased risk that the bankruptcy of any of its non-special purpose entity members will cause the bankruptcy or dissolution of the borrower. This risk is mitigated by the addition of at least one special purpose entity as a member. Similarly, if the special purpose entity member is in turn a multi-member limited liability company or limited partnership the above requirements apply to the equity holders of the member. Since the general partner of a limited partnership or managing member of a multiple-member limited liability company is also typically required to be a special purpose entity, most sponsors elect to structure borrower entities as single member limited liability companies to avoid the need for an additional special purpose entity.

Some rating agencies may treat as credit negative borrowers which are structured as Delaware corporations in CMBS transactions. This is because the Delaware General Corporation Law (the "Corporation Law")[10] restricts the ability of the directors of a corporation to waive their fiduciary duties. Section 102(b)(7) of the Corporation Law requires that provisions which purport to restrict or eliminate "the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director" may not restrict or eliminate such liability "[f]or any breach of the director's duty of loyalty to the corporation or its stockholders ..."[11] The Delaware Limited Liability Company Act (the "Act")[12] and the Partnership Act do not similarly restrict the elimination of the fiduciary duties a director or manager owes to the company or partnership.

While borrowers in large commercial loans are most commonly structured under the laws of the State of Delaware, this does not mean that borrowers must be Delaware entities to be treated as credit neutral by rating agencies. Delaware law is unique in its deference to the freedom of contract and provides the equity holders of a company or partnership a great deal of flexibility in structuring the company or partnership.[13] It is rare, but not unheard of, for a company to be organized under the laws of a jurisdiction other than the State of Delaware. A limited liability company which is not organized under Delaware law generally should nevertheless have a managing member which is a Delaware limited liability company in order to satisfy certain rating agency requirements. Additionally, the organizational documents of a non-Delaware limited liability company should prohibit the changing of the managing member from a Delaware limited liability company to another entity type without the vote of the independent director.

Part II — Restrictions on the Activities of a Special Purpose Entity

Restrictions on the structure and activities of a special purpose entity may be found in (i) its organizational documents; (ii) the covenant provisions of the underlying transaction documents; and (iii) applicable law. What follows is a more detailed look at the typical restrictions placed on special purpose entities in CMBS and other loan

[10] 8 Del. C. §101, *et seq.*

[11] 8 Del. C. §102(b)(7).

[12] 6 Del. C. §18-101 *et seq.*

[13] "It is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements." 6 Del. C. §18-1101(b); *see also* 6 Del. C. §17-1101(c).

transactions. A special purpose entity's compliance with these restrictions is intended to provide sufficient confidence that it will not be subject to an involuntary bankruptcy by an external creditor or have its assets consolidated into the bankruptcy estate of a corporate affiliate.[14]

Limited Purpose. The organizational documents of a special purpose entity should strictly limit its purpose. In a large loan transaction, a mortgage borrower's purpose should be limited to the ownership and operation of the property or the other assets securing the loan and any activities incidental thereto. If the equity holder in a borrower is a deal required special purpose entity, its purpose should be limited to the ownership of the borrower.[15]

Additional Debt. A special purpose entity should generally be prohibited from incurring debt other than the loan(s) backed by rated securities. A mortgage borrower may however be permitted to incur unsecured trade debt in the ordinary course of its business. Such unsecured trade debt is subject to restrictions set forth in the underlying transaction documents, including, without limitation, that it (i) not exceed a maximum amount, ideally not to exceed two percent (2%) (although it is not uncommon for the threshold to be up to five percent (5%) if the borrower has bargaining power or a legitimate need to incur a higher amount of trade payables) of the outstanding principal balance of the indebtedness (an equity owner is typically limited to only *de minimis* trade debt); (ii) be incurred in the ordinary course of business and relate to the ownership or operation of the mortgaged property; (iii) be required to repay any such debt within sixty (60) days after the date it is first incurred; and (iv) not be evidenced by a promissory note. Limitations on the outstanding debt obligations of the borrower reduce the number of creditors (and the amount owed to creditors) it has, which in turn reduces the risk that a creditor will institute involuntary bankruptcy proceedings against such entity.[16]

Consolidation, Merger, and Liquidation. For so long as the underlying loan and/or any rated securities remain outstanding, both the organizational documents of a special purpose entity and the underlying transaction documents should prohibit its liquidation or dissolution. Additionally, the entity should be restricted from merging with any other entity or selling substantially all of its assets without the prior written consent of the lender and, if the loan is securitized, a confirmation from each rating agency rating the transaction that such event shall not result in a downgrade, qualification or withdrawal of its rating(s).[17]

Independent Director/Manager. Special purpose entities in large commercial financings are typically required to engage an unaffiliated independent director or manager from a nationally recognized corporate services provider who must consent to any bankruptcy filing by the entity. The independent director or manager serves as a check on a corporate parent's ability to put a solvent borrower into strategic bankruptcy, which may be more likely, for example, if each of the directors on the board of a borrower also serve on the board of its corporate parent.

Independent directors have been common practice in large CMBS loan origination since the mid-1990s. Common practice for decades was to require a special purpose entity to engage two independent directors for larger loans (generally above $50 million) to protect against a situation where an independent director is a close friend or other individual, who is not truly "independent," and is more willing to approve a bankruptcy filing at the behest of a

[14] Moody's Investors Service, Inc., *Bankruptcy Remoteness Criteria, supra* note 5, at 1.

[15] Standard & Poor's, *CMBS Criteria, supra* note 7, at 92.

[16] Standard & Poor's, *CMBS Criteria, supra* note 7, at 91-92.

[17] Standard & Poor's, *CMBS Criteria, supra* note 7, at 92.

corporate parent. The reasoning was that it would be much more unlikely that an entity would be able to appoint two interested "independent" directors. However, following the ruling in *General Growth,* where the debtors terminated their independent directors and replaced them with directors willing to file for bankruptcy, lenders have required that organizational documents specify that an independent director must be hired from a nationally recognized corporate service provider so that institutional and reputational constraints prevent the appointment of an "interested" director. The following sample definition sets forth the typical requirements for an independent director or manager in CMBS transactions:

> "Independent [Director/Manager]" shall mean an individual who has prior experience as an independent director, or independent manager with at least three years of employment experience and who is provided by CT Corporation, Corporation Service Company, National Registered Agents, Inc., Wilmington Trust Company, Stewart Management Company, Lord Securities Corporation or, if none of those companies is then providing professional Independent [Managers/Directors], another nationally-recognized company reasonably approved by Lender, in each case that is not an affiliate of the Company and that provides professional Independent [Managers/Directors] and other corporate services in the ordinary course of its business, and which individual is duly appointed as an Independent [Manager/Director] and is not, and has never been, and will not while serving as Independent [Manager/Director] be, any of the following:
>
> (a) a member, partner, equity holder, manager, director, officer or employee of the Company or any of its equity holders or affiliates (other than as an Independent [Manager/Director] of the Company or an affiliate of the Company that is not in the direct chain of ownership of the Company and that is required by a creditor to be a single purpose bankruptcy remote entity, provided that such Independent [Manager/Director] is employed by a company that routinely provides professional Independent [Managers/Director] or managers in the ordinary course of its business);
>
> (b) a creditor, supplier or service provider (including provider of professional services) to the Company or any of its equity holders or affiliates (other than a nationally recognized company that routinely provides professional Independent [Managers/Directors] and other corporate services to the Company or any of its affiliates in the ordinary course of its business);
>
> (c) a family member of any such member, partner, equity holder, manager, director, officer, employee, creditor, supplier or service provider; or
>
> (d) a person that controls (whether directly, indirectly or otherwise) any of (a), (b) or (c) above.
>
> A natural person who otherwise satisfies the foregoing definition and satisfies subparagraph (a) by reason of being the Independent [Manager/Director] of a "special purpose entity" affiliated with the Company shall be qualified to serve as an Independent [Manager/Director] of the Company, provided that the fees that such individual earns from serving as an Independent [Manager/Director] of affiliates of the Company in any given year constitute in the aggregate less than five percent (5%) of such individual's annual income for that year. For purposes of this paragraph, a "special purpose entity" is an entity, whose organizational documents contain restrictions on its activities and impose requirements intended to preserve such entity's separateness that are substantially similar to those contained in this agreement.

In response to such additional lender protections which have significantly reduced the likelihood that a borrower will appoint an interested "independent" director, most rating agencies now require only one (1) independent director to be rated as credit neutral.

CMBS lenders also generally require provisions preventing the removal of an independent director or manager without cause and without prior written notice to lender to avoid the situation in *General Growth* where the debtors, special purpose entities with property specific loans, contravened a requirement that their independent managers

must consent to any bankruptcy filing by simply replacing them with individuals that would consent to a bankruptcy filing. The court in *General Growth* rejected a motion to dismiss the debtors' bankruptcy cases for bad faith filing because the debtors' operating agreements did not prohibit the removal of the independent managers. GGP, which at the time owned and managed more than 200 shopping malls across the country through hundreds of property-level subsidiary special purpose entities, included more than one hundred sixty (160) of its solvent property-level subsidiaries in its bankruptcy.[18] The property-level subsidiaries deposited revenue from their respective properties into a commingled main operating account from which GGP would make loan payments, pay operating expenses for each property and provide intercompany loans. Shortly before filing for bankruptcy, many of these special purpose entities replaced their existing independent managers with managers who would authorize the bankruptcy filings. Their lenders sought to dismiss the voluntary bankruptcy filings because (i) the entities did not obtain the consent of their existing independent managers as required by the loan agreements and (ii) the petitions were filed in bad faith since the existing independent managers were replaced prior to the filing and the special purpose entities were not insolvent.[19] On the question of bad faith, the court stated it is a two-prong test requiring "subjective bad faith and objective futility"[20] under the totality of the circumstances and did not find bad faith in this case. The debtors' organizational documents did not prohibit the termination or replacement of the independent managers and the replacement independent managers satisfied the requirements of the position. Further, the independent managers did not have a duty to prevent the debtors from filing for bankruptcy but rather, "[a]s managers of solvent companies charged to act in the same fashion as directors of a Delaware corporation, they had *a prima facie* fiduciary duty to act in the interests of 'the corporation and its shareholders.'"[21]

In response to the focus in *General Growth* on the absence of restrictions on the termination or replacement of independent managers in the debtors' organizational documents, lenders now require language in the organizational documents of special purpose entities which limits the termination of independent directors or managers to "for cause" termination. Inclusion of the following definition of "cause" for the removal of an independent director or manager in the organizational documents of a special purpose entity addresses the concerns raised by *General Growth:*

> "Cause" shall mean, with respect to an Independent [Manager/Director], (i) acts or omissions by such Independent [Manager/Director] that constitute willful disregard of, or gross negligence with respect to, such Independent [Manager's/Director's] duties, (ii) such Independent [Manager/Director] has engaged in or has been charged with or has been indicted or convicted for any crime or crimes of fraud or other acts constituting a crime under any law applicable to such Independent [Manager/Director], (iii) such Independent [Manager/Director] has breached its fiduciary duties of loyalty and care as and to the extent of such duties in accordance with the terms of the Company's organizational documents, (iv) there is a material increase in the fees charged by such Independent [Manager/Director] or a material change to such Independent [Manager's/Director's] terms of service, (v) such Independent [Manager/Director] is unable to perform his or her duties as Independent [Manager/Director] due to death, disability or incapacity, or (vi) such Independent [Manager/Director] no longer meets the definition of Independent [Manager/Director].

[18] *General Growth*, 409 B.R. at 47-48.

[19] Brian M. Resnick and Steven C. Krause, *Not So Bankruptcy-Remote SPEs and In re General Growth Properties Inc.*, 28 Am. Bankr. Inst. J. 8, at 2 (October 2009).

[20] *General Growth*, 409 B.R. at 65 (citing *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship*), 113 F.3d 1304, 1309-1310 (2d Cir. 1997)).

[21] *General Growth,* 409 B.R. at 68.

"Golden Shares"

A less common approach that lenders take to limit the ability of a special purpose entity to file for voluntary bankruptcy is to require the entity to grant the lender a so-called "golden share" of equity paired with a blocking right over any voluntary bankruptcy filing. Lenders long considered "golden share" arrangements as an effective means of safeguarding their investments from bankruptcy. However, bankruptcy courts have recently displayed some hostility towards "golden shares," construing such creditor-held bankruptcy blocking rights as a total restriction on an entity's ability to file for bankruptcy protection when a creditor holds only nominal equity interest. In such instances, a creditor likely does not have adequate incentive to approve a bankruptcy filing in any instance, as it would harm its primary interests as a creditor of the entity.

In *In re Intervention Energy Holdings, LLC,* 553 B.R. 258 (Bankr. D. Del. 2016), Intervention Energy Holdings, LLC ("Intervention") and Intervention Energy, LLC (collectively, the "Intervention Debtors") entered into a note purchase agreement with an institutional investor, EIG Energy Fund XV-A, L.P. ("EIG"). The Intervention Debtors then defaulted under the note and entered into a forbearance agreement with EIG pursuant to which Intervention issued one common equity unit to EIG for $1.00 (a "golden share"). The operating agreement of Intervention was also amended to require the unanimous approval of all of its members to file for bankruptcy.[22] The Intervention Debtors filed for Chapter 11 bankruptcy protection without obtaining EIG's consent as required by Intervention's operating agreement and EIG filed a motion to dismiss the bankruptcy.

The United States Bankruptcy Court for the District of Delaware held that EIG's "golden share" amounted to an absolute waiver of Intervention's right to file bankruptcy in violation of federal public policy. The court explained that "[a] provision in a limited liability company governance document obtained by contract, the sole purpose of which is to place into the hands of a single minority equity holder the ultimate authority to eviscerate the right of that entity to seek federal bankruptcy relief, and the nature and substance of whose primary relationship with the debtor is that of creditor — not equity holder — and which owes no duty to anyone but himself in connection with a limited liability company's decision to seek bankruptcy relief, is tantamount to an absolute waiver of a right, and, even if arguably permitted by state law, is void as contrary to federal public policy."[23] Such a "golden share" arrangement drops the veil of independence that an independent manager or director provides when considering a vote to file for bankruptcy.

The Fifth Circuit was less critical of the "golden share" arrangement in *In re Franchise Services of North America, Inc.,* 891 F.3d 198 (5th Cir. 2018), where the creditor which held a "golden share" was the holder of 49.76% of the preferred equity interest in the debtor. The debtor's certificate of incorporation required the approval of the holders of a majority of its preferred and common stock to file for bankruptcy.[24] The Fifth Circuit reasoned that, unlike *Intervention,* "[t]his case does not involve a contractual waiver of the right to file for bankruptcy... [i]nstead, this case involves an amendment to corporate charter, triggered by a substantial equity investment, that effectively grants a preferred shareholder the right to veto the decision to file for bankruptcy."[25] *Franchise Services* highlights the difference between a situation where a creditor, in connection with entering into a transaction with the debtor, negotiates for itself a nominal equity interest accompanied by a veto right over any bankruptcy filings and where an

[22] *Intervention,* 553 B.R. *at* 261.

[23] *Intervention*, 553 B.R. at 265.

[24] *Franchise Services*, 891 F.3d at 203.

[25] *Franchise Services*, 891 F.3d at 207.

equity holder with a significant stake in a company is also a creditor and has a vote over any decision to file for bankruptcy, with the court noting: "[i]t is one thing to look past corporate governance documents and the structure of a corporation when a creditor has negotiated authority to veto a debtor's decision to file a bankruptcy petition; it is quite another to ignore those documents when the owners retain for themselves the decision whether to file bankruptcy."[26] An equity holder with a material stake in a company is sufficiently incentivized to consent to a bankruptcy filing under appropriate circumstances and so its vote does not function as a complete veto right over all filings.

Thus, if the creditor holds a sufficient equity stake in a company, a court is less inclined to override state law, which governs the internal affairs of an entity, with federal public policy since the debtor is not effectively prevented from filing for bankruptcy protection. The Fifth Circuit in *Franchise Services* held that: (i) state law governs who has the authority to file bankruptcy on behalf of a company; (ii) it is not against federal public policy for an equity holder to have preemptive bankruptcy voting rights solely because the equity holder is also a creditor of the company;[27] and (iii) a minority non-controlling shareholder does not owe a fiduciary duty to the company which would affect its decision to approve or reject a voluntary bankruptcy filing. The court also noted that the question of whether a minority shareholder controls the company is a matter of state law.[28]

For further discussion on court treatment of independent director or manager provisions and "golden share" arrangements please refer to **Part III** below.

Separateness Covenants. Separateness covenants serve to insulate a special purpose entity from the obligations and liabilities of its affiliates. A special purpose entity's compliance with separateness covenants reduces the risk that (i) it will be subject to an involuntary bankruptcy by a creditor and (ii) its separate existence will be disregarded by a bankruptcy court upon the bankruptcy filing of its affiliate. Separateness covenants in the organizational documents of a special purpose entity require that the entity and its directors, member(s) or other controlling persons observe corporate formalities and otherwise operate it as a separate legal entity and mirroring covenants in the loan documents also require each deal-required special purpose entity to observe such formalities and operate as a separate legal entity. Separateness covenants address many of the concerns discussed elsewhere herein, including restrictions on the permissible activities of an entity, the prohibition on most additional debt and requirements to observe common corporate formalities, including, without limitation, keeping separate financial statements and books and records, conducting business in its own name, paying its liabilities out of its own funds, correcting any known misunderstandings regarding its separate existence and otherwise holding itself out as a separate entity. Lenders and rating agencies normally require these separateness covenants to be included in both the organizational documents of each special purpose entity, in order to benefit from the *ultra vires* doctrine, as well as in the loan documents to ensure that any subsequent transferees of the loan are similarly restricted in their activities. Attached hereto as **Appendix A** is an example of a complete, common list of required separateness covenants typically found in a CMBS loan.

Amendment to Organizational Documents and Prohibition of Division. Many of the lender protections afforded by the use of a special purpose entity are laid out in the entity's organizational documents. The entity must be prohibited

[26] *Id.* at 208 (quoting *Squire Court Partners Ltd. v. Centerline Credit Enhanced Partners* LP (*In re Squire Court Partners Ltd.*), 574 B.R. 701, 708 (E.D. Ark. 2017); *see also In re Global Ship Systems, LLC*, 391 B.R. 193, 199, 203 (Bankr. S.D. Ga. 2007)).

[27] "There is no prohibition in federal bankruptcy law against granting a preferred shareholder the right to prevent a voluntary bankruptcy filing just because the shareholder also happens to be a secured creditor..." *Franchise Services*, 891 F.3d at 208.

[28] *Id.* at 209.

from amending provisions in its operating agreement related to, among other things, its limited purpose, special members and independent directors, separateness covenants, third party beneficiaries, fiduciary duties and certificated interests as well as any defined terms related to the foregoing, for so long as the underlying loan and/or any rated securities remain outstanding.

On a similar note, although not specifically a special purpose entity requirement, the organizational documents of a special purpose entity which is a Delaware limited liability company should prohibit the division of the company into two or more separate Delaware limited liability companies. Before the Act was amended in 2018 to permit divisions, Lenders typically required a borrower's operating agreement to prohibit its merger, consolidation, dissolution, winding up or liquidation or a transfer of its assets while the loan remained outstanding. In August, 2018, Delaware enacted Section 18-217 of the Act,[29] which permits a Delaware limited liability company to divide itself into two or more Delaware limited liability companies and to allocate the assets and liabilities of such dividing company among itself (if it survives the division) and the newly formed limited liability company or companies. The language of Section 18-217 makes clear that a division is not considered an assignment or transfer of assets or liabilities and therefore would not be covered under the above-mentioned provisions intended to prevent transfers.[30] To address this concern, lenders now typically require borrower operating agreements to specifically prohibit division (whether pursuant to a plan or otherwise) while the loan remains outstanding.

Non-Consolidation Opinions. If a bankruptcy court finds that the activities of a special purpose entity borrower are sufficiently intertwined with those of its bankrupt affiliate, it may substantively consolidate the non-debtor borrower with its debtor affiliate. Substantive consolidation exposes the borrower's assets to the claims of its affiliates' creditors. As further assurance that a special purpose entity will not become liable for the financial obligations of its affiliates, lenders and rating agencies typically expect to see a non-consolidation opinion for loans larger than $20 million whereby legal counsel opines that the separateness covenants in the applicable organizational documents and/or in the transaction documents are sufficient under Delaware law to prevent substantive consolidation with a non-special purpose entity affiliate that is in bankruptcy proceedings as well as the effect of the deal structure, guaranties and other deal-specific factors on the likelihood of substantive consolidation. Please refer to **Part IV** below for a more in-depth discussion of substantive consolidation.

"Bad Boy" Recourse Carve-out Guaranties. Lenders in CMBS transactions commonly require a guaranty from a controlling party, typically the transaction sponsor, to provide an alternate source of repayment of the loan if a borrower commits certain bad acts specified in the loan documents. The recourse carve-out guaranty backstops the liabilities of the borrower for the "bad acts" of the borrower and its affiliates. The provisions of a recourse carve-out guaranty vary from loan to loan based on the unique risks of the mortgaged property and the situation of the particular borrower and guarantor; however, recourse carve-out guaranties typically contain carve-outs for (i) voluntary and collusive involuntary bankruptcy filings of the borrower, and (ii) the failure of a special purpose entity borrower to comply with its separateness covenants. The key benefit afforded by recourse carve-out guaranties is that they dissuade bad behavior such as bankruptcy filings. The recourse carve-outs in such guaranties are split between (1) "above the line" carve-outs, for which lender's recourse is limited to the actual losses it incurs as a result of the occurrence of a carved-out event, and (2) "below the line" carve-outs, for which lender may demand payment

[29] 6 Del. C. §18-217.

[30] For example, Section 18-217(1)(8) of the Act states that, "[t]he rights, privileges, powers and interests in property...as well as the debts, liabilities and duties of the dividing company that have been allocated to such division company pursuant to a plan of division, shall remain vested in each such division company and shall not be deemed, as a result of the division, to have been assigned or transferred to such division company for any purpose of the laws of the State of Delaware." 6 Del. C. §18-217(1)(8).

of the entire loan amount from the guarantor as a result of the occurrence of a carved-out event. A bankruptcy of the borrower is typically included as a "below the line" carve-out entitling lender recourse in the full amount of the loan, although a limited number of large loan sponsors may be able to limit damages to a percent of the total loan amount (which percent should still equal a very large amount). The sponsor or principal of the borrower acting as guarantor is adequately incentivized to ensure that the borrower complies with the lender's bankruptcy remoteness and separateness requirements when they are potentially on the hook for any failure of the borrower to comply. Please refer to **Part IV** below for a brief discussion of the potential effect of "bad boy" guaranties on substantive consolidation of a special purpose entity borrower with its bankrupt affiliates.

Recycled Special Purpose Entities. A newly formed entity created for a specific transaction is the preferable vehicle for a special purpose entity in CMBS transactions. A newly formed entity provides assurances that there are no prior dealings or liabilities that could have a negative effect on its cash flow. A pre-existing entity may have existing claims that could later result in a lawsuit to be satisfied out of the mortgaged property or other assets securing the loan or rated securities. If the mortgaged property or other assets are in distress, any additional liabilities could push the special purpose entity into involuntary bankruptcy. However, at times it is costly or otherwise difficult to transfer assets, particularly real property, from an existing entity to a newly-formed special purpose entity. In such cases, an entity may remove any potential liabilities from the existing entity and amend its organizational documents to comply with special purpose entity restrictions.

In rating a transaction with a "recycled" special purpose entity as the borrower, a rating agency will consider factors such as how long the entity has existed and whether it has been involved in any prior CMBS activity. To prevent a pre-existing entity from having a credit negative effect on the rating of a CMBS transaction, the "recycling" should also include an officer's certificate (or often such certifications are contained directly in the loan agreement itself) whereby an executive officer certifies that, among other things, the entity (1) is and always has been duly-formed, validly existing and in good standing in its state of formation and qualified to do business in any state where it is required to be so qualified for the purpose of its business; (2) has no outstanding liens or judgments other than any tax liens not yet due and payable; (3) is in compliance with all laws and regulations related to its business as well as all necessary permits to operate its business; (4) has no knowledge of any pending or threatened litigation against it and has never been subject to any litigation, arbitration or legal proceeding; (5) has paid all of its taxes and is not involved in a contest with any taxing authority; (6) has never owned property or engaged in any business other than the property securing the transaction and business related to the ownership and operation of such property; and (7) it has no material contingent or actual obligations not related to the mortgaged property. Rating agency criteria generally provide that the recourse carve-out guaranty in a deal involving a recycled special purpose entity should include recourse for any violations of the recycled entity representations. Other requirements for a recycled special purpose entity may include a non-consolidation opinion, a new Phase I environmental report for all previously-owned property and/or additional representations related to compliance with applicable environmental standards (as liability for such non-collateral properties continues with the recycled entity) and an audit of such entity's financial statements.[31]

Part III — Court Enforcement of Independent Directors

As discussed in **Part II** above, lenders and rating agencies generally require that special purpose entities in large commercial financings engage an unaffiliated independent director or manager from a nationally recognized corporate services provider whose consent is required for any bankruptcy filing. While the use of an independent director is commonplace, the requirements and limitations of its role have been subject to debate by bankruptcy

[31] Standard & Poor's, *CMBS Criteria, supra* note 7, at 240-241.

courts. Court treatment of independent directors and similar bankruptcy "blocking" vote arrangements such as "golden shares" has largely focused on (i) fiduciary duties of the directors to a special purpose entity, and (ii) contravention of the federal public policy requiring an entity to have access to bankruptcy protection. Each of these concerns is discussed in turn below.

Fiduciary Duties. Delaware law is unique in the broad discretion that it gives in structuring a company, particularly by permitting the elimination of fiduciary duties that directors, managers or members owe to the company. The Act explicitly permits the members of a limited liability company to include provisions in its organizational documents which restrict or eliminate fiduciary duties:

> To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.[32]
>
> A limited liability company agreement may provide for the limitation or elimination of any and all liabilities for breach of contract and breach of duties (including fiduciary duties) of a member, manager or other person to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement; provided, that a limited liability company agreement may not limit or eliminate liability for any act or omission that constitutes a bad faith violation of the implied contractual covenant of good faith and fair dealing.[33]

The Partnership Act contains almost identical provisions permitting the restriction or elimination of fiduciary duties.[34] In the context of bankruptcy proceedings, although state law governs who is authorized on behalf of an entity to file for bankruptcy, such provisions must be consistent with federal public policy which seeks to ensure access to bankruptcy protections.

Delaware statutes do not explicitly detail the fiduciary duties of loyalty and care, so common law and equity govern. The fiduciary duties of loyalty and care generally require that the members, directors and/or managers of a company protect the interests of the company and act in good faith. The duty of loyalty requires the actor to consider what is in the best interest of the company above the interests of any interested party, including his or her own personal gain. The requirement to act in good faith is a subset of the duty of loyalty. Bad faith is displayed through both (1) intentional acts committed with a purpose inconsistent with the best interests of the company or in the violation of law, and (2) the intentional failure to act where there is a known duty to do so.[35]

As stated above, although Delaware permits the elimination of fiduciary duties it does not permit elimination of the implied contractual covenants of good faith and fair dealing. The fiduciary duty of good faith differs from the contractual covenant of good faith which is designed to prevent an abusive use of discretion. The test for satisfying

[32] 6 Del. C. §18-1101(c).

[33] 6 Del. C. §18-1101(e).

[34] *See* 6 Del. C. §17-1101(d) and (f).

[35] Gardner F. Davis and John J. Wolfel Jr., Bloomberg Law, *Blocking Director May Not Prevent Bankruptcy Remote Entity From Filing Bankruptcy* (March 22, 2017), https://news.bloomberglaw.com/banlcruptcy-law/blocking-director-may-not-prevent-banlcruptcy-remote-entity-from-filing-banlcruptcy.

the implied covenant of good faith is whether the actor subjectively believes it is acting in the best interest of the company but objective facts known to the actor remain relevant to such inquiry.

In *Allen v. El Paso Pipeline GP Co. LLC,* 113 A.3d 167 (Del. Ch. 2014), the court considered a limited partnership agreement that eliminated all fiduciary duty and held that its general partner did not have to consider the interests of the limited partner to satisfy good faith.[36] The court determined the test for good faith is subjective and that it is satisfied "if the actor subjectively believes that it is in the best interest of [the Partnership] ... [o]bjective facts remain logically and legally relevant to the extent they permit an inference that the defendant lacked the necessary subjective belief."[37] Relevant factors that the court noted may be considered in making such inquiry are the personal knowledge and experience of the person or entity accused of wrongdoing and measuring the consequences of their decision to approve or disapprove of a transaction against their knowledge of the surrounding facts and circumstances.[38] Members, managers and directors of a company must also comply with the implied contractual covenant of "fair dealing," which is a requirement to act consistently with the terms and purpose of an agreement between parties.

In re Kingston Square Associates, 214 B.R. 713 (Bankr. S.D.N.Y. 1997) is a pivotal case analyzing the fiduciary duties that a director or manager owes to a company in the context of bankruptcy remoteness protections. The court in *Kingston* set forth the standard for determining whether a director or manager acted in "bad faith" in filing for bankruptcy on behalf of a company as a "totality of the circumstances" inquiry which is both objective and subjective. A bankruptcy petition should be dismissed "if both objective futility of the reorganization process and subjective bad faith in filing the petition are found."[39] The lenders in *Kingston* filed a motion to dismiss the bankruptcy filings of a group of debtors on the grounds of bad faith because the debtors circumvented bankruptcy blocking provisions in their operating agreements by soliciting friendly creditors to institute involuntary bankruptcies against the companies. The individual acting as independent director of each of the borrower debtors was not truly "independent" as he was a prior employee and current consultant of an affiliate of the lenders and his fees were being paid in part by the lenders. The independent director failed to observe his fiduciary duties by keeping involved with, and informed of, the debtors' affairs and the court reasoned that "[i]f he was the "independent" director, it was in name only."[40]

The court permitted the bankruptcies to proceed and stressed the lack of corporate formalities exercised by the board of directors of the companies and particularly, the failure of the independent director to stay informed about the properties, the lack of communication amongst the board, and the lack of circulation of financial reports or updates on the legal proceedings.[41] The independent director testified at trial that he understood his role as *preventing* the properties of the borrowers from being swept into the bankruptcy of a principal and that he was not aware of any

[36] *El Paso Pipeline,* 113 A.3d at 178.

[37] *Id.*

[38] *Id* at 179.

[39] *Kingston*, 214 B.R. at 725.

[40] *Id.* at 736.

[41] *Id.* at 735.

fiduciary duties owed to the debtors in his role as a director.[42] He did not review any documents regarding the debtors and was long unaware of the foreclosure proceedings against the subject properties.[43]

The court noted the solicitation of an involuntary bankruptcy filing suggests bad faith, but this solicitation, which was not specifically prohibited by the debtors' organizational documents, court order or statute, is not alone enough to warrant dismissal. Distinguishing *Kingston* from prior cases where debtors solicited involuntary bankruptcy filings, the court found that the lenders failed to demonstrate that the debtors' coordination of efforts to file these cases had a "fraudulent or deceitful purpose" and instead saw the filings as intended "to prevent the [lenders] from continuing on their path of foreclosure which threatened to wipe out the claims of the [d]ebtors' unsecured creditors and the interests of its limited partners...the [debtors] had a reasonable belief that they could reorganize, which, in turn, suggests that they were not acting in bad faith when they coordinated the filing of the bankruptcy petitions."[44] The independent director's conduct in contravention of fiduciary duties to the debtors, their creditors and equity holders served as a mitigating factor in favor of the debtors in analyzing their intentions in soliciting an involuntary bankruptcy.[45] The independent director prevented the boards of directors from approving voluntary bankruptcy filings which would have benefited all parties other than the lenders, and as such was not fulfilling his fiduciary duties. Under such circumstances, the court concluded that the debtors did not act with subjective bad faith in filing for bankruptcy to protect their interests and those of their equity holders. Since the ruling in *Kingston* and the court's criticism of the actions of the independent director as being in contravention of his fiduciary duties to the borrowers, lenders generally no longer appoint the independent director(s) of a borrower and it is now common practice for borrowers to engage independent directors from a nationally recognized provider.

Later cases have further developed who owes fiduciary duties to a company and its equity holders by stressing the importance of "control." In *Intervention,* EIG relied on Delaware state law in arguing that limited liability companies may eliminate fiduciary duties. The court disagreed and held that even where the elimination of fiduciary duties is permitted by state law it is "void as contrary to federal public policy" when the result is that a creditor who owes no duty to anyone but itself has the power to block a company from seeking federal bankruptcy relief.[46] This suggests that while modifications of fiduciary duties are generally acceptable, the total elimination of fiduciary duties of those with control over the decision of a company to file bankruptcy, whether or not permissible under applicable state law, may be held against federal public policy. In *Franchise Services,* the court found that a minority non-controlling shareholder is generally free to act in its own self-interest but that a majority shareholder or minority controlling shareholder which exercises control over the company's business affairs does owe fiduciary duties.

Other case law focuses on to whom a director or manager owes a fiduciary duty. Courts have generally held that a director or manager must consider the interests of the company and may also be required to consider the interests of its equity holders and creditors as well. In *In re Lake Michigan Beach Pottawattamie Resort LLC,* 547 B.R. 899 (Bankr. N.D. Ill. 2016), the lender was designated as a "special member" with an approval right over any decision by

[42] *Id.* at 722.

[43] *Id.* at 721.

[44] *Id.* at 734.

[45] *Id.* at 735-737.

[46] *Intervention*, 553 B.R. at 265.

the borrower to file for bankruptcy.[47] The operating agreement explicitly stated that the lender did not have to consider any interests other than its own in exercising its approval right and "had no duty or obligation to give any consideration to any interest of or factors affecting the [borrower] or its [m]embers."[48] The court held that by eliminating any fiduciary duties the lender had as a special member of the borrower it removed the key feature that prevents an independent director structure from being a total restriction on a company's access to bankruptcy protection, explaining that,

> [c]ommon wisdom dictates that corporate control documents should not include an absolute prohibition against filing bankruptcy. Even though the blocking director structure...impairs or in operation denies a bankruptcy right, it adheres to that wisdom. It has built into it a saving grace: the blocking director must always adhere to his or her general fiduciary duties to the debtor in fulfilling the role. That means at least theoretically, there will be a situation where a blocking director will vote in favor of a bankruptcy filing, even if in so doing he or she acts contrary to purposes of the secured creditor for whom he or she serves.[49]

The court further reasoned that a special member with a bankruptcy "blocking" right owes the same fiduciary duties as an independent director with such power. Because of the removal of any fiduciary duties the lender had as a special member of the company, its bankruptcy "blocking" right amounted to a total prohibition on the right to file bankruptcy and was held as contrary to public policy.[50]

The holding in *Lake Michigan* is consistent with the court's reasoning in *General Growth* that the purpose of an independent director is not to prevent or prohibit any bankruptcy filing but rather, "[a]s managers of solvent companies charged to act in the same fashion as directors of a Delaware corporation, they had a *prima facie* fiduciary duty to act in the interests of 'the corporation and its shareholders.'"[51] As such, if a reorganization is likely to be successful and is in the best interest of the company and its shareholders, an independent director may have the duty to approve a bankruptcy filing in order to fulfill its fiduciary duties. The lenders and the independent director in *General Growth* misconstrued the role of an independent director or manager as to block any voluntary bankruptcy filing on behalf of the lender. Although the organizational documents of the borrowers in *General Growth* were set up correctly and expressly stated that the duties of the independent director were similar to those of corporate directors, which include fiduciary duties, documents and testimony presented during the course of the case suggested that the lenders and independent director still incorrectly understood the independent director's role as to prevent all bankruptcy filings.[52] The court clarified that if a lender is convinced that an 'independent' manager is engaged solely for the purpose of "voting [against] a bankruptcy filing because of the desires of a secured creditor, they were mistaken. As the Delaware cases stress, directors and managers owe their duties to the corporation and, ordinarily, to the shareholders."[53] Lenders must ensure that the provisions of a borrower's operating agreement governing the conduct and fiduciary duties of an independent director are carefully constructed so as to both adequately protect the

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[47] *Lake Michigan*, 547 B.R. at 904, 913.

[48] *Lake Michigan*, 547 B.R. at 904.

[49] *Lake Michigan,* 547 B.R. at 912.

[50] The borrower in *Lake Michigan* was a Michigan limited liability company and the court also reasoned that the elimination of fiduciary duties is in contravention of Michigan state law in its holding.

[51] *General Growth,* 409 B.R. at 68.

[52] *Id.* at 63.

[53] *General Growth,* 409 B.R. *at* 64-65.

lender's interests in reducing the likelihood the borrower will be able to file bankruptcy and to ensure that an independent director must still adhere to basic fiduciary duties owed to the company.

To address concerns raised by bankruptcy courts regarding the elimination of fiduciary duties, prudent CMBS lenders incorporate modifications to, but not the complete elimination of, an independent director's fiduciary duties to the company and its equity holders in a borrower's operating agreement. Lenders also explicitly permit an independent director to consider the interests of the company's creditors in executing its duties. Lenders may also include a savings clause to limit the scope of an extensive limitation on fiduciary duties owed by an independent director to the extent that any such limitations are permissible under applicable state law. The following is a sample provision for CMBS loans which meets rating agency bankruptcy remoteness requirements but also includes language meant to appease public policy concerns expressed by bankruptcy courts.

> "To the fullest extent permitted by law, including Section 18-1101(c) of the Act, and notwithstanding any duty otherwise existing at law or in equity, the Independent [Manager/Director] shall consider only the interests of the Company, including its creditors, in acting or otherwise voting on [bankruptcy matters]. Except for duties to the Company as set forth in the immediately preceding sentence (including duties to the member and the Company's creditors solely to the extent of their respective economic interests in the Company but excluding (i) all other interests of the member, (ii) the interests of other affiliates of the Company, and (iii) the interests of any group of affiliates of which the Company is a part), the Independent [Manager/Director] shall not have any fiduciary duties to the member or any other person bound by this agreement; provided, however, the foregoing shall not eliminate the implied contractual covenant of good faith and fair dealing. To the fullest extent permitted by law, including Section 18-1101(e) of the Act, an Independent [Manager/Director] shall not be liable to the Company, the member or any other person bound by this agreement for breach of contract or breach of duties (including fiduciary duties), unless such Independent [Manager/Director] acted in bad faith or engaged in willful misconduct."

Although this language is widely accepted, it may be irrelevant to a bankruptcy court whether the elimination or restriction of fiduciary duties is permissible under state law if it is found to amount to a total prohibition on filing for bankruptcy. This tension between state law, particularly Delaware law, and the public policy advanced by the federal Bankruptcy Code is discussed further below.

Public Policy.

Bankruptcy remoteness highlights the tension that exists between Delaware law and federal public policy. As noted above, "bankruptcy remoteness" does not mean "bankruptcy proof" Bankruptcy remote special purpose entities are not bankruptcy proof and many have been legitimately insolvent and voluntarily or involuntarily filed for bankruptcy. "Bankruptcy proof" provisions whereby a borrower is totally prevented from filing for bankruptcy contravene federal public policy, which requires access to federal bankruptcy protection. The focus of bankruptcy remoteness should therefore be on restricting the ability of owners of a *solvent* borrower to file for bankruptcy.

Prepetition waivers of bankruptcy protection are the most concrete example of the limits of freedom of contract when it comes to federal bankruptcy policy. The general rule is that an express contractual waiver of an entity's right to file for bankruptcy is unenforceable because such a waiver "violates public policy in that it purports to bind the debtor-in-possession to a course of action without regard to the impact on the bankruptcy estate, other parties with a legitimate interest in the process or the debtor-in-possession's fiduciary duty to the estate."[54] Courts have also generally rejected pre-bankruptcy waivers of the automatic stay except under limited circumstances.

[54] *In re Trans World Airlines, Inc.,* 261 B.R. 103, 114 (Bankr. D. Del. 2001).

Although bankruptcy remoteness places limits on an entity's right to file for bankruptcy, restrictions in a borrower's governing documents which amount to the complete prohibition of its ability to file for bankruptcy are unenforceable. Entities, like individuals, have the right to bankruptcy protection. As a Delaware bankruptcy court explained recently in *In re Pace Industries, LLC,* Transcript of Hearing, Case No. 20-10927 (MFW) (Bankr. D. Del. May *5,* 2020), "persons—which, by definition include corporations—have a constitutional right to avail themselves of a right to file a bankruptcy, to negotiate with their creditors and other stakeholders."[55] Lenders must be careful when drafting bankruptcy remoteness provisions to ensure the limitations cannot be construed as a complete restriction on the right to file for bankruptcy.

Several common bankruptcy remoteness tactics tread a thin line between enforceable and unenforceable. One such tactic is the use of a bankruptcy "blocking" vote, whether bestowed upon an independent director or the creditor itself. Lenders, such as those in *General Growth,* have often misconstrued the role of an independent director as to block any voluntary bankruptcy filing by a special purpose entity for the benefit of the lender even where the underlying organizational and/or transaction documents are correctly drafted to prevent only bad faith bankruptcy filings. In its discussion of the fiduciary duty of loyalty in *Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345 (Del. 1992), the Supreme Court of Delaware determined a director is only independent when its "decision is based entirely on the corporate merits of the transaction and is not influenced by personal or extraneous considerations. By contrast, a director who receives a substantial benefit from supporting a transaction cannot be objectively viewed as disinterested or independent."[56] Although some lenders may still misconstrue the role of an independent director as to totally prohibit bankruptcy filings, the appointment of an independent director whose role is properly constrained as only a limitation of a borrower's ability to file for bankruptcy under certain circumstances is the norm in CMBS and other large loan transactions and lenders and rating agencies act under the consensus that such restrictions will be enforceable if subject to court challenge.

There is less court consensus on enforceability when a bankruptcy "blocking" vote is held by a creditor rather than an unaffiliated independent director. The issue is whether there would ever be circumstance when a lender would consent to the bankruptcy of its borrower. Court enforcement of "golden shares" has focused on whether a creditor holding a "golden share" has adequate incentive to vote in favor of a proper filing by an insolvent borrower. The court in *Global Ship Systems* suggested that a lender with a significant equity interest in the borrower, Drawbridge Special Opportunities Fund, L.P. ("Drawbridge"), which held twenty percent (20%) of the equity in the debtor, could have enough motivation in its position as an equity holder to consent to a bankruptcy that would benefit the debtor. The *Global Ship Systems* court enforced the bankruptcy blocking provisions, reasoning that "[a]s an equity interest holder, Drawbridge was granted certain protections in the governance of the LLC. [The debtor] could not sell substantially all its assets, merge with another company, or file a voluntary bankruptcy case without the consent of Drawbridge. An absolute waiver of the right to file bankruptcy is violative of public policy if asserted by a lender. However, since Drawbridge wears two hats in this case, as a Class B shareholder, it has the unquestioned right to prevent, by withholding consent, a voluntary bankruptcy case."[57] The court's reasoning also suggests that a "golden share" held

[55] *Pace Industries,* Transcript of Hearing, Case No. 20-10927 at 39. The authors do not take the position that there is a "constitutional right" to bankruptcy protection, but include the foregoing quote solely to emphasize the strong tone of the *Pace Industries* court in its defense of federal bankruptcy public policy.

[56] *Cede & Co.,* 634 A.2d *at* 362.

[57] *Global Ship Systems,* 391 B.R. *at* 203.

by a creditor which is not also an equity holder would be unenforceable as the lender would not be incentivized to ever consent to a bankruptcy that benefits the debtor.

Ten years later, a Kentucky bankruptcy court held that a bankruptcy blocking right held by a creditor, which held a significant equity interest in the debtor, was unenforceable as against public policy. In *In re Lexington Hospitality Group, LLC,* 577 B.R. 676 (Bankr. E.D. Ky. 2017), a subsidiary of PCG Credit Partners, LLC ("PCG Subsidiary") was granted a 30% membership interest in the debtor until its loan was repaid in full. Pursuant to the debtor's amended operating agreement, the independent director was instructed to consider the interests the debtor as well as the creditors and the economic interest of PCG Subsidiary. The independent director's fiduciary duties to other members or managers of the debtor were eliminated and the vote of at least seventy-five percent (75%) of the members of the debtor was also required to ratify the independent manager's authorization for the debtor to file for bankruptcy. As the holder of a thirty (30%) interest in the debtor, PCG Subsidiary was afforded a veto right over any authorization for the debtor to file bankruptcy. The Court held that the restrictions at issue were unenforceable because they "create[d] an absolute waiver of [the debtor's] right to file bankruptcy" since they "enabl[ed] an entity controlled by PCG to carry the deciding vote."[58] Additionally, the court noted that "[a] requirement that an independent person consent to bankruptcy relief...is not necessarily a concept that offends federal public policy,"[59] but the independent manager in *Lexington* was not fully independent from a creditor's interests. The court was also troubled that the debtor's amended operating agreement eliminated the independent manager's fiduciary duties to the debtor, reasoning that "[a]n independent decision maker cannot exist simply to vote 'no' to a bankruptcy filing, but should also have normal fiduciary duties."[60] As discussed in more detail in **Part II** above, the Fifth Circuit in its 2018 *Franchise Services* ruling diverged from *Lexington,* holding that the "golden share" amendment to the debtor's governing documents was permissible as the result of a substantial equity investment in the debtor by a creditor, rather than a case whereby a creditor negotiates for itself a veto over a debtor's decision to file a bankruptcy petition.

Just recently, a Delaware bankruptcy court expressly diverged from the Fifth Circuit's ruling in *Franchise Services* that a minority shareholder with a bankruptcy "blocking" right does not create a fiduciary duty of the minority shareholder. In *Pace Industries,* the debtor filed for bankruptcy in contravention of a bankruptcy consent right held by Macquarie Septa (US) I, LLC ("Macquarie"), the holder of 62.5% of Series A Preferred Stock in the debtor. In contrast to prior cases, Macquarie was only a minority shareholder of the debtor and not also a creditor. Following the ruling in *Franchise Services,* Macquarie argued that it was not a controlling minority equity holder and therefore did not owe a fiduciary duty to the company because a shareholder with a bankruptcy consent right did not have actual control over the debtor's conduct.[61] Judge Walrath rejected the reasoning in *Franchise Services,* instead finding that, "under Delaware state law, contrary to the Fifth Circuit's interpretation of that law [in *Franchise Services],* would and does find that a blocking right, such as exercised in the circumstances of this case, would create a fiduciary duty on the part of the shareholder; a fiduciary duty that, with the debtor in the zone of insolvency, is owed not only to other shareholders, but also to all creditors."[62] The court further reasoned that a minority shareholder should have no more

[58] *Lexington,* 577 B.R. *at* 684.

[59] *Id.*

[60] *Id. at* 685.

[61] *Pace Industries,* Transcript of Hearing, Case No. 20-10927 at 15-16.

[62] *Id.* at 40.

power to block the constitutional right of a company to file for bankruptcy than a creditor.[63] Citing to the ruling in *Basho Techs. Holdco B, LLC v. Georgetown Basho Investors, LLC,* 2018 WL3326693 (Del. Ch. 2018), *aff'd,* 221 A. 3d 100 (Del. 2019), the court stated that Delaware law imposes fiduciary duties on a minority shareholder if it controls a particular transaction, and held that a blocking right over a debtor's right to file for bankruptcy gives a minority shareholder such contro1.[64] Further, Macquarie's bankruptcy consent right effectively prevented the debtor from filing for bankruptcy in violation of federal public policy.

The court in *Pace Industries* reiterated that the test for the fulfillment of fiduciary duty is "what is in the best interest of all"[65] and in its reasoning focused on how the debtor was in clear need of bankruptcy at the time of filing as it was experiencing a severe lack of liquidity and had its business operations largely disrupted by the worldwide COVID-19 pandemic. Bankruptcy was in the best interests of the debtor and most stakeholders. The court considered several factors in ruling that Macquarie failed to fulfill its fiduciary duties to the company. Macquarie admittedly did not consider the interest of any other party in attempting to block the bankruptcy; moreover, federal public policy favors a debtor's constitutional right to file for bankruptcy, particularly where a blocking party "has said clearly it is not considering the rights of others in its decision to file the motion to dismiss."[66] *Pace Industries* presents an important split in authority on the tension between the application of Delaware state law and federal public policy. The split will likely be addressed by courts in the near future.

Part IV — Substantive Consolidation

Substantive consolidation is the process whereby the assets and liabilities of separate entities are pooled together by a bankruptcy court in order to effect a more equitable distribution of property among the creditors of a corporate family. A bankruptcy court may seek to substantively consolidate a non-debtor special purpose entity with its bankrupt affiliate if it finds that its activities are sufficiently intertwined with those of the debtor. Bankruptcy remoteness practices seek to prevent substantive consolidation of a borrower with its bankrupt affiliates to avoid exposing its assets to the claims of its affiliates' creditors.

The Bankruptcy Code does not explicitly authorize substantive consolidation but bankruptcy courts are generally in agreement that the consolidation of a debtor with another debtor is implicitly permitted by the Bankruptcy Code. Bankruptcy courts most commonly cite to their general equitable powers under Section 105(a) of the Bankruptcy Code, which permits bankruptcy courts to "issue any order, process or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.[67] Section 105(a) has been interpreted as a broad grant of authority to the bankruptcy courts. Furthermore, Section 1123(a)(5)(C) of the Bankruptcy Code permits a Chapter 11 bankruptcy plan to include the "merger, consolidation of the debtor with one or more persons."[68] Circuits have employed different standards for determining whether substantive consolidation is appropriate in a particular case but all of them focus on a fact intensive analysis and the impact of consolidation on creditors. In *Union Savings Bank v.*

[63] *Id.*

[64] *Id.* at 40-41.

[65] *Id.* at 42.

[66] *Id.*

[67] 11 U.S.C. §105(a).

[68] 11 U.S.C. §1123(a)(5)(C).

Augie/Restivo Baking Co., Ltd.,[69] the Second Circuit held that when analyzing a request for substantive consolidation courts should address two general inquiries: "(i) whether creditors dealt with the entities as a single economic unit and did not rely on their separate identity in extending credit,...or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors."[70] The Court then went on to list relevant factors to consider when "balancing the equities favoring consolidation against the equities favoring continuation of separate bankruptcy estates," which include, among other things: (i) the absence of corporate formalities; (ii) the inadequate capitalization of the corporation; (iii) an overlap in ownership and management of affiliated corporations; (iv) the payment or guarantee of debts of the dominated corporation by other affiliated corporations; and (v) commingling of affiliated corporations' funds.[71] The Second Circuit factor test has also been adopted by other circuits, including the Ninth Circuit, while other circuits, such as the Third Circuit, have preferred a more open-ended equitable approach over specific factors.

Substantive Consolidation of Non-Debtors

Although substantive consolidation of a debtor with another affiliated debtor is generally accepted by all bankruptcy courts under appropriate circumstances, bankruptcy courts disagree as to whether a non-debtor can be substantively consolidated with a debtor. For example, in *Audette v. Kasemir (In re Concepts America, Inc.),*[72] the District Court held that substantive consolidation of a non-debtor was not permitted in the Seventh Circuit. Courts which prohibit the consolidation of non-debtors note that Section 105(a) of the Bankruptcy Code is not a jurisdictional grant and also argue that substantive consolidation of non-debtors circumvents the requirements for involuntary bankruptcy petitions set forth in Section 303 of the Bankruptcy Code.[73] By circumventing the requirements of Section 303, substantively consolidating a non-debtor with a debtor "effectively forces the non-debtor into an involuntary bankruptcy proceeding without an opportunity for its creditors to participate. The Bankruptcy Code already provides a mechanism for filing an involuntary petition that protects the rights of the proposed debtor and its creditors."[74] On the other hand, courts recognizing the ability to bring in a non-debtor cite to the broad authority of bankruptcy courts under Section 105(a) of the Bankruptcy Code as well as a bankruptcy court's mandate to ensure the equitable treatment of all creditors. Although the majority view taken by bankruptcy courts is that a non-debtor may be consolidated with a debtor under the appropriate circumstances, the courts taking such view agree it is a rare and extraordinary remedy that must be used sparingly, and have imposed various practical limitations on the ability of a non-debtor to be consolidated.[75]

Additional limitations imposed on the power of substantive consolidation over a non-debtor have largely focused on creditor rights. Substantive consolidation should only be permitted when it does not adversely affect creditor rights provided by the bankruptcy. Using such reasoning, recent cases have focused on the rights of the creditors of the

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[69] *Union Savings Bank v. Augie/Restivo Baking Co., Ltd. (In re Augie/Restivo Baking Co., Ltd.),* 860 F.2d 515 (2nd Cir. 1988).

[70] *Id.* at 518.

[71] *Id.* at 518-519.

[72] *Audette v. Kasemir (In re Concepts America, Inc.)*, 2018 WL 2085615 (Bankr. N.D. Ill. May 3, 2018).

[73] 11 U.S.C. §303.

[74] *Concepts America*, *11 (quoting *Spradlin v. Beads and Seeds Inns, LLC (In re Howland)*, 518 B.R. 408, 414 (Bankr. E.D. Ky. 2014) (citations omitted), aff'd, 579 B.R. 411 (E.D. Ky. 2016), aff'd, 674 Fed. Appx. 482 (6th Cir. 2017)).

[75] *See In re Owens Corning,* 419 F.3d 195, 205-06 (3rd Cir. 2005); *Union Savings Bank*, 860 F.2d at 518; and *SE Property Holdings, LLC v. Stewart (In re Stewart)*, 571 B.R. 460 (Bankr. W.D. Okla. 2017).

non-debtor to be heard when determining whether consolidation of the non-debtor with an affiliated debtor is appropriate. In *SE Property Holdings, LLC v. Stewart (In re Stewart),*[76] the Oklahoma bankruptcy court held that creditors have standing to seek substantive consolidation so long as such relief will not interfere with the bankruptcy trustee's power to seek relief for the benefit of all creditors.[77] However, the court stated that when substantive consolidation of non-debtors is sought, the creditors of the non-debtors must be notified and be provided with an opportunity to be heard to protect their interests. As noted above, the *Concepts America* court rejected the idea that substantive consolidation could be used to merge non-debtors with debtors. However, the court reiterated the position taken in *Stewart* that even if it were to permit the substantive consolidation of non-debtors, it is required that the creditors of the non-debtors be given proper notice and an opportunity to be heard on the matter. In this case the trustee's complaint did not specifically identify any creditors of the non-debtors nor did it confirm whether the creditors were even aware of the possible substantive consolidation. As such, the court found that such a motion for substantive consolidation is not to the benefit all creditors. The position taken in *Stewart* and *Concepts America* that in the interest of fairness to all creditors notice to a non-debtor's creditors is required for substantive consolidation has also been taken by most other courts which have directly addressed the issue.[78] Such a notice requirement acts as an additional barrier to the substantive consolidation of non-debtors with their debtor affiliates as the creditor information for non-debtors is not always easily available.

Non-Consolidation Opinions

As discussed in **Part II** above, lenders and rating agencies commonly require a non-consolidation opinion as further assurance that a special purpose entity will not be substantively consolidated with its affiliates. Non-consolidation opinion counsel opines that the separateness covenants in the applicable organizational documents and/or in the transaction documents are sufficient under Delaware law to prevent substantive consolidation of a borrower with a non-special purpose entity affiliate that is in bankruptcy proceedings.

Opinion counsel reviews all transaction documents and relevant organizational documents and analyzes the facts and circumstances of the relationship of a particular special purpose entity with affiliates in its corporate structure, opining on the adequacy of the separateness covenants and other bankruptcy remoteness protections included in the documents. Typically a non-consolidation opinion examines whether the insolvency or bankruptcy of a guarantor of the loan or a direct or indirect equity owner (or group of equity owners) owning at least forty-nine percent (49%) of the equity in a deal required special purpose entity would result in the substantive consolidation of the special purpose entity with such equity owner(s). If there is a mezzanine loan or other non-deal required special purpose entities in the borrower's structure, such entities should be treated as non- special purpose entity equity owners in the pairing analyses of the opinion. Lenders and rating agencies may also require the opinion to cover substantive consolidation with an affiliated property manager involved in the transaction.

Bankruptcy court power to apply substantive consolidation is an equitable one and, as discussed above, there is not a clear consensus amongst courts on when to invoke substantive consolidation and even whether it is permitted in certain circumstances. Consolidation is a factual inquiry based on the structure of a particular transaction, so it is not possible to totally guaranty that a borrower will not be substantively consolidated with its affiliate. However, a non-

[76] *SE Property Holdings, LLC v. Stewart (In re Stewart)*, 571 B.R. 460 (Bankr. W.D. Okla. 2017).

[77] *Id.* at 467.

[78] *See also Leslie v. Mihranian (In re Mihranian)*, 937 F.3d 1214 (9th Cir. 2019); *Fid. & Deposit Co. of Md. v. U.S. Bank N.A. (In re Kimball Hill, Inc.*), 2014 WL 5615650, at *4 (N.D. Ill. Nov. 4, 2014); and *Mukamal v. Ark Capital Grp., LLC (In re Kodsi)*, 2015 WL 222493, at *2 (Baffler. S.D. Fla. Jan. 14, 2015).

consolidation opinion which analyzes the risks of substantive consolidation for a particular transaction is generally viewed by lenders and rating agencies as an effective mechanism for reducing the risk.

"Bad Boy" Recourse Carve-out Guaranties and Substantive Consolidation

As discussed in **Part II** above, a recourse carve-out guaranty backstops the liabilities of a borrower for its "bad acts" and those of its affiliates. Lenders require the sponsor or principal of a borrower to guaranty payment of the loan and/or the lender's losses caused by the "bad acts" of the borrower so as to adequately incentivize the sponsor or principal to ensure borrower's compliance with the lender's bankruptcy remoteness and separateness requirements. Recourse carve-out guaranties could potentially affect the bankruptcy remoteness of a special purpose entity borrower as the debt of the borrower is being guaranteed by an affiliate. Courts have generally enforced the express terms of recourse carve-out guaranties but lenders should still make clear that they relied on the separateness of the borrower and its guarantor affiliate when making the loan to ensure that a bankruptcy court will not seek substantive consolidation of the borrower with the guarantor in the event the guarantor files for bankruptcy. Obtaining a non-consolidation opinion is one way that a lender can demonstrate such reliance and get comfortable that its borrower will not be consolidated with its affiliate.

Non-consolidation opinion counsel are generally comfortable that "bad boy" guaranties will not result in a substantive consolidation of the borrower with the guarantor because, among other things: (i) the guaranteed obligations are conditional, taking effect only upon the happening of certain acts or occurrences, so such a guaranty is therefore not a guarantee of the payment of the loan; (ii) the obligations of the guarantor under a guaranty are independent from the obligations of the borrower; and (iii) such a guaranty is generally limited to the occurrence of certain "bad acts." Legal counsel may refuse to provide a non-consolidation opinion, or may qualify the opinion, if unique obligations in the recourse carve-out guaranty are deemed to constitute credit support for the loan. Payment guaranties limited to no more than 10-15% of the total loan amount are also generally acceptable, but anything greater could suggest that the lender relied on the guarantor's creditworthiness in making the loan, rather than the creditworthiness of the borrower itself. Lenders should be sure to complete adequate diligence to demonstrate their reliance on the separate creditworthiness of the borrower and guarantor. In the event that opinion counsel refuses to provide an opinion or qualifies its opinion based on a particular recourse item in the guaranty, the lender will need to weigh the relative value of such recourse item against the value of the opinion, and determine which is more valuable to the lender.

Part V — Conclusion

Recent case law on bankruptcy remoteness measures suggests that lenders should be cautious when drafting provisions intended to protect against a borrower's strategic bankruptcy filing. Provisions which put too much power over a borrower's bankruptcy filing in the hands of a creditor may be struck down by a court as amounting to a total prohibition on the borrower's right to file. The decisions in *Lake Michigan* and *Pace Industries* advise that bankruptcy "blocking" rights held by a creditor in exchange for equity in the borrower may not be enforceable. The use of an independent director hired by a nationally recognized service provider who may consider only the interests of the borrower and its creditors when voting on a bankruptcy filing is a more sound practice and should be enforceable when the applicable provisions are properly drafted. However, as demonstrated by *Pace Industries,* changes in commercial real estate sparked by the COVID-19 pandemic may generate more pro-debtor case law on bankruptcy remoteness. Moving forward, although lenders that follow current jurisprudence are likely protected, lenders should be aware of possible changes in court enforcement in areas of bankruptcy remoteness which may not yet be settled.

Appendix A

Separateness Covenants

If Borrower is a Single-Member Limited Liability Company:

Borrower hereby represents and warrants to, and covenants with, Lender that since the date of its formation and at all times on and after the date hereof and until such time as the loan obligations shall be paid and performed in full:

(a) Borrower (i) has been, is, and will be organized solely for the purpose of acquiring, developing, owning, holding, selling, leasing, transferring, exchanging, managing and operating the Property, entering into [this Agreement] with the Lender, refinancing the Property in connection with a permitted repayment of the Loan, and transacting lawful business that is incident, necessary and appropriate to accomplish the foregoing, (ii) has not owned, does not own, and will not own any asset or property other than (A) the Property, and (B) incidental personal property necessary for the ownership or operation of the Property [and (iii) has been, is, and will be organized for the purpose of investing the equity capital that was contributed to Borrower by the sole member of Borrower in compliance with the provisions of this [Schedule]. No equity capital was raised by Borrower. For the avoidance of doubt, there has been no direct or indirect commercial activity by the Borrower or a person or entity acting on its behalf to procure the transfer or commitment of capital by the sole member of the Borrower for the purpose of investing it in accordance with the provisions of this [Schedule]].

(b) Borrower has not engaged and will not engage in any business other than the ownership, management and operation of the Property and Borrower will conduct and operate its business as presently conducted and operated.

(c) Borrower has not and will not enter into any contract or agreement with any affiliate of Borrower, except upon terms and conditions that are intrinsically fair, commercially reasonable, and no less favorable to it than would be available on an arms-length basis with third parties other than any such party.

(d) Borrower has not incurred and will not incur any indebtedness other than [Permitted Indebtedness]. No indebtedness other than the Loan may be secured (senior, subordinate or *pari passu)* by the Property.

(e) Borrower has not made and will not make any loans or advances to any third party (including any affiliate or constituent party), and has not and shall not acquire obligations or securities of its affiliates.

(f) Borrower has been, is, and intends to remain solvent and Borrower has paid and intends to pay its debts and liabilities (including, as applicable, shared personnel and overhead expenses) from its assets; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(g) Borrower has done or caused to be done, and will do, all things necessary to observe organizational formalities and preserve its existence, and Borrower has not, will not (i) terminate or fail to comply with the provisions of its organizational documents, or (ii) unless (A) Lender has consented and (B) following a securitization of the Loan, the applicable Rating Agencies have issued a Rating Agency Confirmation, amend, modify or otherwise change its operating agreement or other organizational documents.

(h) Except to the extent that Borrower is (i) required to file consolidated tax returns by law; or (ii) treated as a “disregarded entity” for tax purposes and is not required to file tax returns under applicable law, (1) Borrower has maintained and will maintain all of its books, records, financial statements and bank accounts separate from those of its affiliates and any other person; (2) Borrower’s assets will not be listed as assets on the financial statement of any other person; it being understood that Borrower’s assets may be included in a consolidated financial statement of its affiliates provided that (i) appropriate notation shall be made on such consolidated financial statements to indicate the separateness of Borrower and such affiliates and to indicate that Borrower’s assets and credit are not available to satisfy the debts and other obligations of such affiliates or any other person, and (ii) such assets shall be listed on Borrower’s own separate balance sheet; and (3) Borrower will file its own tax returns (to the extent Borrower is required to file any tax returns) and will not file a consolidated federal income tax return with any other person. Borrower has maintained and shall maintain its books, records, resolutions and agreements in accordance with [this Agreement].

(i) Borrower has been, will be, and at all times has held and will hold itself out to the public as, a legal entity separate and distinct from any other entity (including any affiliate of Borrower or any constituent party of Borrower (recognizing that Borrower may be treated as a "disregarded entity" for tax purposes and is not required to file tax returns for tax purposes under applicable law)), shall correct any known misunderstanding regarding its status as a separate entity, shall conduct business in its own name, shall not identify itself or any of its affiliates as a division or department or part of the other and shall, to the extent reasonably necessary for the operation of its business, maintain and utilize separate stationery, invoices and checks bearing its own name.

(j) Borrower has maintained and intends to maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(k) (x) Neither Borrower nor any constituent party of Borrower has sought or will seek or effect the liquidation, dissolution, winding up, division (whether pursuant to Section 18-217 of the Act or otherwise), consolidation or merger, in whole or in part, of Borrower and (y) Borrower has not been the product of, the subject of or otherwise involved in, in each case, any limited liability company division (whether as a plan of division pursuant to Section 18-217 of the Act or otherwise).

(l) Borrower has not and will not commingle the funds and other assets of Borrower with those of any affiliate or constituent party or any other person, and has held and will hold all of its assets in its own name.

(m) Borrower has and will maintain its assets in such a manner that it will not be costly or difficult to segregate, ascertain or identify its individual assets from those of any affiliate or constituent party or any other person.

(n) Borrower has not and will not assume or guarantee or become obligated for the debts of any other person and does not and will not hold itself out to be responsible for or have its credit available to satisfy the debts or obligations of any other person.

(o) The organizational documents of Borrower shall provide that the business and affairs of Borrower shall be (A) managed by or under the direction of a board of one or more directors designated by Borrower's sole member (the "***Sole Member***") or (B) a committee of managers designated by Sole Member (a "***Committee***") or (C) by Sole Member, and at all times there shall be at least [one (1)][79] duly appointed Independent Director or Independent Manager. In addition, the organizational documents of Borrower shall provide that no Independent Director or Independent Manager (as applicable) of Borrower may be removed or replaced without Cause and unless Borrower provides Lender with not less than three (3) Business Days' prior written notice of (a) any proposed removal of an Independent Director or Independent Manager (as applicable), together with a statement as to the reasons for such removal, and (b) the identity of the proposed replacement Independent Director or Independent Manager, as applicable, together with a certification that such replacement satisfies the requirements set forth in the organizational documents for an Independent Director or Independent Manager (as applicable).

(p) The organizational documents of Borrower shall also provide an express acknowledgment that Lender is an intended third-party beneficiary of the "special purpose" provisions of such organizational documents.

(q) The organizational documents of Borrower shall provide that the board of directors, the Committee or Sole Member (as applicable) of Borrower shall not take any action which, under the terms of any certificate of formation, limited liability company operating agreement or any voting trust agreement, requires an unanimous vote of the board of directors (or the Committee as applicable) of Borrower unless at the time of such action there shall be (A) at least [one (1) member] of the board of directors (or the Committee as applicable) who is an Independent Director or Independent Manager, as applicable (and such Independent Director or Independent Manager, as applicable, has participated in such vote) or (B) if there is no board of directors or Committee, then such Independent Manager shall have participated in such vote. The organizational documents of Borrower shall provide that Borrower will not and Borrower agrees that it will not, without the unanimous written consent of its board of directors, its Committee or its Sole Member (as applicable), including, or together with, the Independent Directors or Independent Managers (as applicable) (i) file or consent to the filing of any petition, either voluntary or involuntary, to take advantage of any applicable insolvency, bankruptcy, liquidation or reorganization statute, (ii) seek or consent to the

[79] Note that some lenders may require two (2) Independent Directors or Independent Managers.

appointment of a receiver, liquidator or any similar official of Borrower or a substantial part of its business, (iii) take any action that might cause such entity to become insolvent, (iv) make an assignment for the benefit of creditors, (v) admit in writing its inability to pay debts generally as they become due, (vi) declare or effectuate a moratorium on the payment of any obligations, or (vii) take any action in furtherance of the foregoing. Borrower shall not take any of the foregoing actions without the unanimous written consent of its board of directors, its Committee or its Sole Member, as applicable, including (or together with) all Independent Directors or Independent Managers, as applicable. In addition, the organizational documents of Borrower shall provide that, when voting with respect to any matters set forth in the immediately preceding sentence of this [clause (q)], the Independent Directors or Independent Managers (as applicable) shall consider only the interests of Borrower, including its creditors. Without limiting the generality of the foregoing, such documents shall expressly provide that, to the greatest extent permitted by law, except for duties to Borrower (including duties to the members of Borrower solely to the extent of their respective economic interest in Borrower and to Borrower's creditors as set forth in the immediately preceding sentence), such Independent Directors or Independent Managers (as applicable) shall not owe any fiduciary duties to, and shall not consider, in acting or otherwise voting on any matter for which their approval is required, the interests of (i) the members of Borrower, (ii) other affiliates of Borrower, or (iii) any group of affiliates of which Borrower is a part; provided, however, the foregoing shall not eliminate the implied contractual covenant of good faith and fair dealing.

(r) The organizational documents of Borrower shall provide that, as long as any portion of the [loan obligations] remains outstanding, upon the occurrence of any event that causes Sole Member to cease to be a member of Borrower (other than (i) upon an assignment by Sole Member of all of its limited liability company interest in Borrower and the admission of the transferee, if permitted pursuant to the organizational documents of Borrower and the Loan Documents, or (ii) the resignation of Sole Member and the admission of an additional member of Borrower, if permitted pursuant to the organizational documents of Borrower and the Loan Documents), each of the persons acting as an Independent Director or Independent Manager (as applicable) of Borrower shall, without any action of any person and simultaneously with Sole Member ceasing to be a member of Borrower, automatically be admitted as members of Borrower (in each case, individually, a "***Special Member***" and collectively, the "***Special Members***") and shall preserve and continue the existence of Borrower without dissolution or division (whether pursuant to Section 18-217 of the Act or otherwise). The organizational documents of Borrower shall further provide that for so long as any portion of the [loan obligations] is outstanding, no Special Member may resign or transfer its rights as Special Member unless (i) a successor Special Member has been admitted to Borrower as a Special Member, and (ii) such successor Special Member has also accepted its appointment as an Independent Director or Independent Manager (as applicable).

(s) The organizational documents of Borrower shall provide that, as long as any portion of the [loan obligations] remains outstanding, except as expressly permitted pursuant to the terms of [this Agreement], (i) Sole Member may not resign, and (ii) no additional member shall be admitted to Borrower.

(t) The organizational documents of Borrower shall provide that, as long as any portion of the [loan obligations] remains outstanding: (i) Borrower shall be dissolved, and its affairs shall be wound up, only upon the first to occur of the following: (A) the termination of the legal existence of the last remaining member of Borrower or the occurrence of any other event which terminates the continued membership of the last remaining member of Borrower in Borrower unless the business of Borrower is continued in a manner permitted by its operating agreement or the Delaware Limited Liability Company Act (as the same may be amended modified or replaced, the "***Act***"), or (B) the entry of a decree of judicial dissolution under Section 18-802 of the Act; (ii) upon the occurrence of any event that causes the last remaining member of Borrower to cease to be a member of Borrower or that causes Sole Member to cease to be a member of Borrower (other than (A) upon an assignment by Sole Member of all of its limited liability company interest in Borrower and the admission of the transferee, if permitted pursuant to the organizational documents of Borrower and the Loan Documents, or (B) the resignation of Sole Member and the admission of an additional member of Borrower, if permitted pursuant to the organizational documents of Borrower and the Loan Documents), to the fullest extent permitted by law, the personal representative of such last remaining member shall be authorized to, and shall, within ninety (90) days after the occurrence of the event that terminated the continued membership of such member in Borrower, agree in writing (I) to continue the existence of Borrower, and (II) to the admission of the personal representative or its nominee or designee, as the case may be, as a substitute member of Borrower, effective as of the occurrence of the event that terminated the continued membership of such member in Borrower; (iii) the bankruptcy of Sole Member or a Special Member shall not cause such Sole Member or Special Member, respectively, to cease to be a member of Borrower and upon the occurrence of such an event, the business of Borrower shall continue without dissolution; (iv) in the event of the dissolution of Borrower, Borrower shall conduct only such activities as are necessary to wind up its affairs (including the sale of the assets of Borrower in an orderly manner), and the assets of Borrower shall be applied in the manner, and in the order of priority, set forth in Section 18-804 of the Act; (v) to the fullest extent permitted by law, each of Sole Member and the Special Members shall irrevocably waive any right or power that they might have to cause Borrower or any of its assets to be partitioned, to cause the appointment of a receiver for all or any portion of the assets of Borrower, to compel any sale of all or any

portion of the assets of Borrower pursuant to any applicable law or to file a complaint or to institute any proceeding at law or in equity to cause the dissolution, division (whether pursuant to Section 18-217 of the Act or otherwise), liquidation, winding up or termination of Borrower and (vi) Borrower shall be prohibited from effectuating a division (whether pursuant to Section 18-217 of the Act or otherwise).

(u) Borrower shall conduct its business so that the assumptions made with respect to Borrower in the [non-consolidation opinion] shall be true and correct in all respects. In connection with the foregoing, Borrower hereby covenants and agrees that it will comply with or cause the compliance with, (i) all of the facts and assumptions (whether regarding Borrower or any other person) set forth in the [non-consolidation opinion], (ii) all of the representations, warranties and covenants on this [**Schedule**], and (iii) all of the organizational documents of Borrower.

(v) Borrower has paid and intends to pay its own liabilities and expenses, including the salaries of its own employees (if any) from its own funds, and has maintained and shall maintain a sufficient number of employees (if any) in light of its contemplated business operations; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(w) Borrower has not permitted and will not permit any affiliate or constituent party independent access to its bank accounts.

(x) Borrower has compensated and shall compensate each of its consultants and agents from its funds for services provided to it and pay from its own assets all obligations of any kind incurred; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(y) Borrower has allocated and will allocate fairly and reasonably any overhead expenses that are shared with any affiliate, including shared office space.

(z) Except in connection with the Loan, Borrower has not pledged and will not pledge its assets for the benefit of any other person.

(aa) Borrower has and will have no obligation to indemnify its officers, directors, members or Special Members, as the case may be, or has such an obligation that is fully subordinated to the Loan and will not constitute a claim against it if cash flow in excess of the amount required to pay the Loan is insufficient to pay such obligation.

(bb) Borrower has not, does not, and will not have any of its obligations guaranteed by an affiliate (other than from the Guarantor with respect to the Loan).

<u>If Borrower is a Limited Partnership or Multi-Member Limited Liability Company</u>:

Borrower hereby represents and warrants to, and covenants with, Lender that since the date of its formation and at all times on and after the date hereof and until such time as the [loan obligations] shall be paid and performed in full:

(a) Borrower (i) has been, is, and will be organized solely for the purpose of acquiring, developing, owning, holding, selling, leasing, transferring, exchanging, managing and operating the Property, entering into [this Agreement] with the Lender, refinancing the Property in connection with a permitted repayment of the Loan, and transacting lawful business that is incident, necessary and appropriate to accomplish the foregoing, (ii) has not owned, does not own, and will not own any asset or property other than (A) the Property, and (B) incidental personal property necessary for the ownership or operation of the Property [and (iii) has been, is, and will be organized for the purpose of investing the equity capital that was contributed to Borrower by the [members] [limited partners] of Borrower in compliance with the provisions of this [**Schedule**]. No equity capital was raised by Borrower. For the avoidance of doubt, there has been no direct or indirect commercial activity by the Borrower or a person or entity acting on its behalf to procure the transfer or commitment of capital by the [members] [limited partners] of the Borrower for the purpose of investing it in accordance with the provisions of this [**Schedule**]].

(b) Borrower has not engaged and will not engage in any business other than the ownership, management and operation of the Property and Borrower will conduct and operate its business as presently conducted and operated.

(c) Borrower has not and will not enter into any contract or agreement with any affiliate of Borrower except upon terms and conditions that are intrinsically fair, commercially reasonable, and no less favorable to it than would be available on an arms-length basis with third parties other than any such party.

(d) Borrower has not incurred and will not incur any indebtedness other than [Permitted Indebtedness]. No indebtedness other than the Loan may be secured (senior, subordinate or *pari passu*) by the Property.

(e) Borrower has not made and will not make any loans or advances to any third party (including any affiliate or constituent party), and has not and shall not acquire obligations or securities of its affiliates.

(f) Borrower has been, is, and intends to remain solvent and Borrower has paid and intends to pay its debts and liabilities (including, as applicable, shared personnel and overhead expenses) from its assets; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(g) Borrower has done or caused to be done, and will do, all things necessary to observe organizational formalities and preserve its existence, and Borrower has not, will not, nor will Borrower permit any SPC Party to, (i) terminate or fail to comply with the provisions of its organizational documents, or (ii) unless (A) Lender has consented and (B) following a securitization of the Loan, the applicable Rating Agencies have issued a Rating Agency Confirmation in connection therewith, amend, modify or otherwise change its partnership certificate, partnership agreement, articles of incorporation and bylaws, operating agreement, trust or other organizational documents.

(h) Borrower has maintained and will maintain all of its books, records, financial statements and bank accounts separate from those of its affiliates and any other person. Borrower's assets will not be listed as assets on the financial statement of any other person, provided, however, that Borrower's assets may be included in a consolidated financial statement of its affiliates provided that (i) appropriate notation shall be made on such consolidated financial statements to indicate the separateness of Borrower and such affiliates and to indicate that Borrower's assets and credit are not available to satisfy the debts and other obligations of such affiliates or any other person, and (ii) such assets shall be listed on Borrower's own separate balance sheet. Borrower will file its own tax returns (to the extent Borrower is required to file any such tax returns) and will not file a consolidated federal income tax return with any other person. Borrower has maintained and shall maintain its books, records, resolutions and agreements in accordance with [this Agreement].

(i) Borrower has been, will be, and at all times has held and will hold itself out to the public as, a legal entity separate and distinct from any other entity (including any affiliate of Borrower or any constituent party of Borrower), shall correct any known misunderstanding regarding its status as a separate entity, shall conduct business in its own name, shall not identify itself or any of its affiliates as a division or department or part of the other and shall maintain and utilize separate stationery, invoices and checks bearing its own name.

(j) Borrower has maintained and intends to maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(k) (x) Neither Borrower nor any constituent party of Borrower has sought or will seek or effect the liquidation, dissolution, winding up, division (whether pursuant to Section 18-217 of the Act or otherwise), consolidation or merger, in whole or in part, of Borrower and (y) Borrower has not been the product of, the subject of or otherwise involved in, in each case, any limited liability company division (whether as a plan of division pursuant to Section 18-217 of the Act or otherwise).

(l) Borrower has not and will not commingle the funds and other assets of Borrower with those of any affiliate or constituent party or any other person, and has held and will hold all of its assets in its own name.

(m) Borrower has and will maintain its assets in such a manner that it will not be costly or difficult to segregate, ascertain or identify its individual assets from those of any affiliate or constituent party or any other person.

(n) Borrower has not and will not assume or guarantee or become obligated for the debts of any other person and does not and will not hold itself out to be responsible for or have its credit available to satisfy the debts or obligations of any other person.

(o) Each of Borrower's general partner or managing member, as applicable, (each, an "***SPC Party***") shall be a Delaware limited liability company or a corporation formed under the laws of any jurisdiction of the United States whose sole asset is its interest in Borrower and each such SPC Party (i) will cause Borrower to be a [Special Purpose Entity]; (ii) will at all times comply with each of the representations, warranties and covenants contained on this [**Schedule**] (other than clauses [(a), (b), (d) and (y)]) as if such representation, warranty or covenant was made directly by such SPC Party; (iii) will not engage in any business or activity other than owning an interest in Borrower; (iv) will not acquire or own any assets other than its partnership or membership interest in Borrower; and (v) will not incur any debt, secured or unsecured, direct or contingent (including guaranteeing any obligation) other than unsecured trade payables incurred in the ordinary course of business related to the ownership of an interest in Borrower that (A) do not exceed at any one time $10,000.00, and (B) are paid within thirty (30) days after the date incurred. Upon the withdrawal or the disassociation of an SPC Party from Borrower, Borrower shall immediately appoint a new SPC Party whose articles or certificate of formation or incorporation are substantially similar to those of such SPC Party and deliver a new non-consolidation opinion to the Rating Agency or Rating Agencies, as applicable, with respect to the new SPC Party and its equity owners.

(p) The organizational documents of each SPC Party shall provide that at all times there shall be (and Borrower shall at all times cause there to be) at least [one (1)] duly appointed Independent Director or Independent Manager. In addition, the organizational documents of each SPC Party shall provide that no Independent Director or Independent Manager (as applicable) of such SPC Party may be removed or replaced without Cause and unless such SPC Party provides Lender with not less than three (3) Business Days' prior written notice of (a) any proposed removal of an Independent Director or Independent Manager (as applicable), together with a statement as to the reasons for such removal, and (b) the identity of the proposed replacement Independent Director or Independent Manager (as applicable), together with a certification that such replacement satisfies the requirements set forth in the organizational documents for an Independent Director or Independent Manager (as applicable).

(q) The organizational documents of Borrower and each SPC Party shall also provide an express acknowledgment that Lender is an intended third-party beneficiary of the "special purpose" provisions of such organizational documents.

(r) The organizational documents of each SPC Party shall provide that such SPC Party shall not take any action which, under the terms of any certificate of incorporation, bylaws or any voting trust agreement with respect to any common stock, requires a unanimous vote of the (A) the sole member of such SPC Party (the "***Sole Member***"), (B) the board of directors of such SPC Party or (C) the committee of managers of such SPC Party designated to manage the business affairs of such SPC Party (the "***Committee***"), unless at the time of such action there shall be at least [one (1)] duly appointed Independent Director or Independent Manager and such Independent Director or Independent Manager (as applicable) has participated in such vote. The organizational documents of each SPC Party shall provide that actions requiring such unanimous written consent, including the Independent Directors or Independent Managers (as applicable), shall include each of the following with respect to such SPC Party and Borrower: (i) filing or consenting to the filing of any petition, either voluntary or involuntary, to take advantage of any applicable insolvency, bankruptcy, liquidation or reorganization statute, (ii) seeking or consenting to the appointment of a receiver, liquidator or any similar official of Borrower or a substantial part of its business, (iii) taking any action that might cause such entity to become insolvent, (iv) making an assignment for the benefit of creditors, (v) admitting in writing its inability to pay debts generally as they become due, (vi) declaring or effectuating a moratorium on the payment of any obligations, or (vii) taking any action in furtherance of the foregoing. In addition, the organizational documents of each SPC Party shall provide that, when voting with respect to any matters set forth in the immediately preceding sentence of this clause [(r)], the Independent Directors or Independent Managers (as applicable) shall consider only the interests of Borrower, including its creditors. No SPC Party shall (on behalf of itself or Borrower) take any of the foregoing actions without the unanimous written consent of its board of directors, its member(s) or the Committee, as applicable, including (or together with) all Independent Directors or Independent Managers, as applicable. Without limiting the generality of the foregoing, such documents shall expressly provide that, to the greatest extent permitted by law, except for duties to Borrower (including duties to Borrower's equity holders solely to the extent of their respective economic interests in Borrower and to Borrower's creditors as set forth in the immediately preceding sentence), such Independent Directors or Independent Managers (as applicable) shall not owe any fiduciary duties to, and shall not consider, in acting or otherwise voting on any matter for which their approval is required, the interests of (i) the SPC Party or Borrower's other equity holders, (ii) other affiliates of Borrower, or (iii) any group of affiliates of which Borrower is a part; provided, however, the foregoing shall not eliminate the implied contractual covenant of good faith and fair dealing.

(s) Notwithstanding anything herein to the contrary, the SPC Party may be a Delaware single-member limited liability company provided that:

(t) the organizational documents of such SPC Party shall provide that, as long as any portion of the [loan obligations] remains outstanding, upon the occurrence of any event that causes the Sole Member of such SPC Party to cease to be a member of such SPC Party (other than (i) upon an assignment by Sole Member of all of its limited liability company interest in SPC Party and the admission of the transferee, if permitted pursuant to the organizational documents of SPC Party and the Loan Documents, or (ii) the resignation of Sole Member and the admission of an additional member of SPC Party, if permitted pursuant to the organizational documents of SPC Party and the Loan Documents), each of the persons acting as an Independent Director or Independent Manager (as applicable) of SPC Party shall, without any action of any person and simultaneously with Sole Member ceasing to be a member of SPC Party, automatically be admitted as members of SPC Party (in each case, individually, a "***Special Member***" and collectively, the "***Special Members***") and shall preserve and continue the existence of SPC Party without dissolution or division (whether pursuant to Section 18-217 of the Act or otherwise). The organizational documents of SPC Party shall further provide that for so long as any portion of the [loan obligations] is outstanding, no Special Member may resign or transfer its rights as Special Member unless (i) a successor Special Member has been admitted to SPC Party as a Special Member, and (ii) such successor Special Member has also accepted its appointment as an Independent Director or Independent Manager (as applicable);

(u) the organizational documents of SPC Party shall provide that, as long as any portion of the [loan obligations] remains outstanding, except as expressly permitted pursuant to the terms of [this Agreement], (i) Sole Member may not resign, and (ii) no additional member shall be admitted to SPC Party; and

(v) the organizational documents of SPC Party shall provide that, as long as any portion of the [loan obligations] remains outstanding: (i) SPC Party shall be dissolved, and its affairs shall be wound up, only upon the first to occur of the following: (A) the termination of the legal existence of the last remaining member of SPC Party or the occurrence of any other event which terminates the continued membership of the last remaining member of SPC Party in SPC Party unless the business of SPC Party is continued in a manner permitted by its operating agreement or the Delaware Limited Liability Company Act (as the same may be amended, modified or replaced, the "***Act***"), or (B) the entry of a decree of judicial dissolution under Section 18-802 of the Act; (ii) upon the occurrence of any event that causes the last remaining member of SPC Party to cease to be a member of SPC Party or that causes Sole Member to cease to be a member of SPC Party (other than (A) upon an assignment by Sole Member of all of its limited liability company interest in SPC Party and the admission of the transferee, if permitted pursuant to the organizational documents of SPC Party and the Loan Documents, or (B) the resignation of Sole Member and the admission of an additional member of SPC Party, if permitted pursuant to the organizational documents of SPC Party and the Loan Documents), to the fullest extent permitted by law, the personal representative of such last remaining member shall be authorized to, and shall, within ninety (90) days after the occurrence of the event that terminated the continued membership of such member in SPC Party, agree in writing (I) to continue the existence of SPC Party, and (II) to the admission of the personal representative or its nominee or designee, as the case may be, as a substitute member of SPC Party, effective as of the occurrence of the event that terminated the continued membership of such member in SPC Party; (iii) the bankruptcy of Sole Member or a Special Member shall not cause such Sole Member or Special Member, respectively, to cease to be a member of SPC Party and upon the occurrence of such an event, the business of SPC Party shall continue without dissolution or division (whether pursuant to Section 18-217 of the Act or otherwise); (iv) in the event of the dissolution of SPC Party, SPC Party shall conduct only such activities as are necessary to wind up its affairs (including the sale of the assets of SPC Party in an orderly manner), and the assets of SPC Party shall be applied in the manner, and in the order of priority, set forth in Section 18-804 of the Act; (v) to the fullest extent permitted by law, each of Sole Member and the Special Members shall irrevocably waive any right or power that they might have to cause SPC Party or any of its assets to be partitioned, to cause the appointment of a receiver for all or any portion of the assets of SPC Party, to compel any sale of all or any portion of the assets of SPC Party pursuant to any applicable law or to file a complaint or to institute any proceeding at law or in equity to cause the dissolution, division (whether pursuant to Section 18-217 of the Act or otherwise), liquidation, winding up or termination of SPC Party and (vi) SPC Party shall be prohibited from effectuating a division, whether pursuant to Section 18-217 of the Act (if such entity is a Delaware limited liability company) or otherwise.

(w) Borrower shall conduct its business so that the assumptions made with respect to Borrower in the [non-consolidation opinion] shall be true and correct in all respects. In connection with the foregoing, Borrower hereby covenants and agrees that it will comply with or cause the compliance with, (i) all of the facts and assumptions (whether regarding Borrower or any other person) set forth in the [non-consolidation opinion], (ii) all of the representations, warranties and covenants in this [**Schedule**], and (iii) all of the organizational documents of Borrower and any SPC Party.

(x) Borrower has not permitted and will not permit any affiliate or constituent party independent access to its bank accounts.

(y) Borrower has paid and intends to pay its own liabilities and expenses, including the salaries of its own employees (if any) from its own funds, and has maintained and shall maintain a sufficient number of employees (if any) in light of its contemplated business operations; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(z) Borrower has compensated and shall compensate each of its consultants and agents from its funds for services provided to it and pay from its own assets all obligations of any kind incurred; provided that the foregoing shall not require any direct or indirect member, partner or shareholder of Borrower to make any additional capital contributions to Borrower.

(aa) Borrower has allocated and will allocate fairly and reasonably any overhead expenses that are shared with any affiliate, including shared office space.

(bb) Except in connection with the Loan, Borrower has not pledged and will not pledge its assets for the benefit of any other person.

(cc) Borrower has and will have no obligation to indemnify its officers, directors, members or partners, as the case may be, or has such an obligation that is fully subordinated to the Loan and will not constitute a claim against it if cash flow in excess of the amount required to pay the Loan is insufficient to pay such obligation.

(dd) if such Borrower is (i) a limited liability company, has articles of organization, a certificate of formation and/or an operating agreement, as applicable, (ii) a limited partnership, has a limited partnership agreement, or (iii) a corporation, has a certificate of incorporation or articles that, in each case, provide that such entity (I) will not (A) dissolve, divide (whether pursuant to Section 18-217 of the Act or otherwise), merge, liquidate, consolidate; (B) sell, transfer, dispose, or encumber (except with respect to the Loan Documents) all or substantially all of its assets or acquire all or substantially all of the assets of any person; or (C) engage in any other business activity, or amend its organizational documents with respect to the matters set forth on this [**Schedule**] without the consent of the Lender and (II) shall not have the power to effectuate a division, whether pursuant to Section 18-217 of the Act (if such entity is a Delaware limited liability company) or otherwise.

(ee) Borrower has not, does not, and will not have any of its obligations guaranteed by an affiliate (other than from the Guarantor with respect to the Loan).

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