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Update on General Growth Properties Bankruptcy

The Chapter 11 filings on April 16, 2009 by General Growth Properties, Inc. ("GGP"), GGP Limited Partnership ("GGP LP") and 166 of their shopping center subsidiaries, many of which were formed as bankruptcy-remote, special purpose entities ("SPEs"), raised concerns for the commercial mortgage-backed securities ("CMBS") industry.

Many of the SPEs had financed their properties with CMBS loans, most of which were not in default and continued to be adequately collateralized. Moreover, many of the SPEs are solvent entities with excess cash flow. The Chapter 11 filings did not include a subsidiary that manages the shopping centers nor certain other subsidiaries that own shopping centers together with unaffiliated joint venture partners. The cases have been procedurally consolidated and are being jointly administered before Judge Allan L. Gropper in the U.S. Bankruptcy Court for the Southern District of New York. Although many questions remain to be determined, Judge Gropper's rulings in the case to date have maintained in important respects the separateness of the SPEs.

The SPEs were formed in accordance with standards adopted by the rating agencies in order to isolate their assets from creditors of their affiliates. Each SPE is required under its organizational documents and/or loan documents to comply with detailed separateness provisions. Each SPE had one or more independent directors whose consent was required in order for the SPE to file a voluntary bankruptcy petition. Although the issue has yet to be litigated, it appears from the pleadings that the independent directors may have been replaced prior to the filing of the bankruptcy petitions.

The debtors filed first-day motions seeking the court's approval to, among other things, continue using their prepetition cash management system, use the secured lenders' cash collateral and obtain debtor-in-possession ("DIP") financing. Prior to the filings, the SPEs and other GGP subsidiaries upstreamed their income to a commingled account (the "Main Operating Account") from which the expenses of all subsidiaries were paid and intercompany loans were made. According to the pleadings, the debtors track and record all upstreamed cash and intercompany loans. Initially, the debtors proposed that a DIP loan would be made to GGP and GGP LP and guaranteed by the SPEs. The DIP lender would receive junior liens on each SPE's property and a priority lien on cash in the Main Operating Account.

Many of the SPE debtors' secured lenders objected to the debtors' motions. The secured lenders argued, among other things, that the debtors' use of their cash collateral, the continuation of the cash management system and the court's approval of the DIP loan (which required the guaranty by the SPEs and the use of the shopping centers as additional collateral) would constitute a *de facto* substantive consolidation of the debtors' estates and violate the terms of the SPE debtors' organizational documents and/or loan documents. Additionally, the Commercial Mortgage Securities Association and the Mortgage Bankers Association argued in an amicus brief that the bankruptcy filings by the SPEs present systemic risk to the CMBS market.

Following a bidding process, the debtors obtained DIP financing from a different lender on terms that proved to be better for the secured lenders. With the court's approval, the debtors entered into a $400 million DIP loan agreement with Farallon Capital Management, L.L.C. and other holders of unsecured obligations of some of the debtors. The SPEs were not required to guarantee the DIP loan and the DIP lender did not receive junior liens on the real properties owned by the SPEs. As collateral for the DIP loan, the DIP lender received, among other things, a junior lien on the Main Operating Account and first mortgages on shopping center properties (the "Unencumbered Properties") that are owned by SPEs whose prepetition mortgage loans will be satisfied through proceeds of the DIP loan. As adequate protection for the use of their cash collateral, each secured lender will be paid interest at the non-default contract rate and received a first-priority lien on its respective debtor's intercompany claims and the Main Operating Account as well as a second-priority lien on the Unencumbered Properties. The first-priority lien on the Main Operating Account benefits secured lenders that did not previously have the right to restrict the use of the SPE debtors' excess cash flow.

At the May 13 hearing on the debtors' motions, Judge Gropper rejected the amicus parties' claims of systemic risk to the CMBS market, stating that his approval of the DIP loan and the cash collateral motion did not result in a substantive consolidation of the debtors' estates. In addition to approving the DIP loan, the judge also approved the debtors' cash collateral and cash management motions. While there are still important unresolved issues, the angst generated in the CMBS market by the bankruptcy filings of the SPEs has abated, at least temporarily, because the court's orders have respected the separateness of the SPEs.

A few secured lenders have moved to dismiss the cases of some of the SPEs for cause on the ground that they were filed in bad faith. The lenders argue that the loans made to these SPEs are not in default, that each property is generating cash flow that is more than sufficient to cover the debt service, property taxes and operating expenses, and that the loans will not mature for at least a year. According to each of these lenders, its respective SPE debtor's bankruptcy case was not filed for a legitimate reorganizational purpose. The motions to dismiss raise many of the same issues about the debtors' bankruptcy-remote status and the negative impact of the filings on the CMBS market that were raised in the various objections to the debtors' motions relating to cash collateral, cash management and the DIP loan. Additionally, one lender has argued that its SPE debtor's case should be dismissed because the corporate resolutions that authorized its bankruptcy filing were ineffective under state law and the filing violated the SPE's organizational documents. That lender is pursuing discovery to determine the facts relating to the authorization of the bankruptcy filing, including the identity of any independent directors who consented to the filing and whether they met the requirements to serve as independent directors. A hearing on the motions to dismiss is scheduled for June 17. Additional motions to dismiss may be filed. It is expected that the issues of bankruptcy remoteness of the SPEs and substantive consolidation will once again be before the court on June 17.

We will continue to monitor developments in this case and provide further Client Advisories. If you would like further information, please contact one of the attorneys listed below.

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