Viewpoint

One of a series of opinion columns by bankruptcy professionals

General Growth: Reality Check For Real-Estate Finance Industry?

By Faye B. Feinstein and Christopher Combest

As any property owner today knows, market corrections can be painful; while aligning practice with reality, they can wreak havoc with expectations. Like markets, courts can impose corrections, when practices - or assumptions underlying them - get ahead of the law. Recall the 2004 Kmart ruling, severely restricting "critical vendor" payments, and the 2008 Clear Channel case, reminding courts of the law's limits on extinguishing junior creditors' rights in bankruptcy sales.

The bankruptcy court in *In re General Growth Properties, Inc., et al.* has issued another such reality check, this one aimed at the asset securitization and real estate finance industries. General Growth Properties financed many of its shopping centers through securitizations, under which a special-purpose entity, or SPE, takes ownership of the financed asset. An SPE's organizational documents restrict its business to owning and financing the asset and require it to maintain its separateness from the business and finances of its parent and affiliates. So isolated, the SPE can issue debt securities with higher ratings, and at lower interest rates, than could the parent.

For lenders, the key characteristics of an SPE are encompassed in the phrase bankruptcy-remoteness: the SPE and its assets are to be isolated, or remote from, the consequences of the parent's or affiliates' financial distress or bankruptcy. In particular, a lender wants assurance that, in the bankruptcy of the parent or an affiliate, the SPE's assets and liabilities will not be substantively consolidated with those of the parent or other affiliate, which would result in the assets of the SPE becoming available to satisfy debts of the parent/affiliate creditors, and the liabilities of each being treated as liabilities of the consolidated group.

However, the phrase bankruptcy-remoteness has acquired a more problematic connotation: that of "remoteness" from the bankruptcy process itself. In an effort to keep SPEs from filing bankruptcy cases, lenders require SPE boards to have at least one "independent director" not affiliated with the SPE's parent, whose vote is required to authorize an SPE bankruptcy filing. However, an SPE cannot be absolutely barred from filing a bankruptcy case.

When General Growth filed, it took 166 of its affiliated SPEs with it, ensuring a fight with many of the SPE lenders. The first round took place on familiar bankruptcy terrain: General Growth's motions for the use of cash collateral (including cash generated by the SPEs); approval of postpetition financing, to be secured by liens on SPE assets; and continuation of its centralized cash-management system, which concentrated cash from the SPEs in one account, to be used by GGP for the purposes of the corporate group, a practice followed pre-bankruptcy by GGP without complaint from the SPE lenders.

Numerous SPE lenders and servicers objected, arguing, among other things, that the relief requested in General Growth's motions would, in effect, substantively consolidate the SPEs with General Growth. Several lenders also moved to dismiss the cases of their SPE borrowers for "bad faith," citing the solvency of the SPEs, General Growth's replacement of some independent directors before the filings and the alleged impropriety of those directors having considered the needs of the entire General Growth corporate group, rather than just the isolated SPE, in deciding to authorize bankruptcy filings.

The court overruled the objections to General Growth's motions and denied the lenders' motions to dismiss. The objectors and others in the industry may have been surprised by those decisions, but they should not have been. The Bankruptcy Code permits a debtor to use cash collateral and to obtain postpetition secured credit over an existing creditor's objection, so long as that creditor is "adequately protected" against diminution of its prepetition interest in its collateral, which protection may include additional liens on a debtor's property and/or regular payments on debt. In General Growth, the SPE lenders retained *senior* liens on their collateral (rare in postpetition financing transactions) and are to be paid principal and interest on their loans during the cases. General Growth also committed to insure and maintain the properties. The court rightly found that the lenders were adequately protected.

The court similarly applied long-established bankruptcy law and principles of corporate governance to deny the motions to dismiss. The court found that the replacement of directors did not violate SPE corporate documents; the independent directors have a fiduciary duty to do what is in the best interest of the SPE, which may mean taking account of the health of the corporate group, as it impacts the SPE, and may also mean voting for a bankruptcy filing. Insolvency, of course, is not a prerequisite for filing a bankruptcy case. Finally, while it acknowledged the lenders' concerns regarding

continued on next page

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Viewpoint

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continued from page 7

substantive consolidation, the court stressed (with some annoyance) that it will respect all parties' rights and has not ordered substantive consolidation of any entities. To the repeated invocation of "bankruptcy-remoteness," the court pungently replied that "the parties did receive, I assume, in all of these matters, reasoned…opinions that recognize that the Bankruptcy Code does exist."

While lenders should review and, if necessary, amend their form documents to restrict, as far as possible, the ability of an SPE or parent to replace directors without lender consent, the overall lesson of General Growth is broader. Participants in the securitization industry may well have persuaded themselves that their transactions are untouchable by federal bankruptcy law - i.e., "bankruptcy-proof." One loan servicer's testimony encapsulates this illusion: "an independent board member…was…from the lender's point of view, meant to prevent a bankruptcy filing…such filings were not anticipated to happen." The General Growth court disabused the lenders of that assumption, while recognizing their rightful concerns over substantive consolidation. The game-changing motion, if it comes, will be General Growth's, to substantively consolidate one or more SPEs with the parent.

Liens are entitled to protection in bankruptcy court. But the General Growth lenders asked the court to validate assumptions about the intersection of bankruptcy law and finance that are not, and never were, justified by the law. The bankruptcy court's General Growth opinions were, to some, a startling correction to those assumptions.

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Airlines

continued from page 4

As the financial crisis took hold from late 2007, the global economy ground to a virtual halt, with airlines seeing traffic numbers tumble even as they grappled with soaring fuel prices.

"This is the worst crisis we have ever seen," International Air Transport Association head Giovanni Bisignani said in May, as passenger and cargo figures showed continued losses.

Ryanair, seen as the market leader, returned to profit in the three months to June after a run of losses but attributed the better performance largely to a sharp fall in fuel prices.

Chief Executive Michael O'Leary said when the results were released in July that Ryanair would "be the only major European airline to deliver passenger and profit growth in the current year."

Low-cost carriers, unlike their traditional, full-service rivals, cannot rely on governments to bail them out if they get into trouble, Cunningham said.

However, there may be a silver lining to the recession cloud - however much they suffer, the traditional airlines are doing much worse.

"Ryanair and easyJet have done much better than the large national companies such as Lufthansa, Air France and British Airways. Passengers looking to keep costs down are going to them," said Johannes Braun, analyst at Commerzbank.

The established airlines have suffered particularly as their premium business class customers have either moved down cabin or taken the low-cost route to save money.

With a high and inflexible full-service cost base, they have been on the defensive while the more adaptable low-cost carriers have been able to keep their expenses down, analysts said.

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