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## "THE ONE-MINUTE HEDGE FUND LITIGATION NEWS"

### **Subject: The General Growth Properties Case and the Specter of the Busted Bankruptcy Remote Vehicle**

The recently-filed bankruptcy case of General Growth Properties, Inc. (“General Growth”) has placed front and center a question that has lurked, but rarely been adjudicated, in big bankruptcy cases for nearly two decades – are “bankruptcy remote vehicles” actually remote from bankruptcy?

On April 16, 2009, General Growth and 338 of its affiliates, including so-called “bankruptcy remote” special purpose entities, commenced chapter 11 cases in the United States Bankruptcy Court for the Southern District of New York. General Growth is a publicly traded Real Estate Investment Trust with approximately 750 debtor and non-debtor affiliates that collectively comprise one of the largest shopping center REITs in the United States.

On the same day that the General Growth debtors filed for bankruptcy, they filed a single motion seeking approval to use cash collateral (i.e., property of the debtors that secures obligations of the debtors) and to authorize the debtors to enter into secured debtor in possession financing. That motion attracted numerous objections and even an amicus curie brief filed by the Commercial Mortgage Securities Association (“CMSA”) and the Mortgage Bankers Association (“MBA”). The objections and the CMSA/MBA’s concerns revolved around the interplay between the Bankruptcy Code and the purposes of a company raising debt through the use of asset securitization and “bankruptcy remote vehicles.”

The vast majority of the General Growth debtors apparently are designed to be “bankruptcy remote vehicles” or BRVs also (sometimes referred to as “special purpose entities” or SPEs). Bankruptcy remote vehicles are essentially means to raise capital cheaply. They do so by placing assets in a company, which issues debt secured by such assets. The sole purpose of the BRV is to hold the assets and engage in no other business.

Being bankruptcy remote vehicles, these entities are not supposed to end up in bankruptcy; indeed, near-universal requirements of a bankruptcy remote vehicle are that (a) an independent director be appointed to the BRVs board of directors; (b) a voluntary bankruptcy filing be authorized only by a unanimous consent of the board of directors

(i.e., including the vote of the independent director);<sup>1</sup> and (c) the BRV take steps to avoid incurring other debt so as to attempt to eliminate the risk of an involuntary bankruptcy filing being commenced against the BRV.

The BRVs involved in the General Growth cases each voluntarily commenced their own cases. Not surprisingly, several of the objections questioned the legitimacy of the BRV bankruptcy filings. One objection expressly stated that certain BRV lenders “have requested, from the Debtors, copies of the record of the vote of the Independent Managers to authorize the petition[s]” for the BRVs but the debtors had not produced any such document signed by independent directors authorizing the bankruptcy filings.

Further, as a general rule, BRVs are designed such that the assets they hold can be used only to pay the secured lenders who loaned the funds to the BRV and no other creditors. Yet the General Growth debtors’ cash collateral/DIP financing motion, as initially filed, made no express effort to strictly maintain the separateness of the BRVs. The CMSA/MBA amicus brief complained that the debtors’ motion suggested that “GGP looks to summarily recharacterize each of the Property Owners and all GGP affiliates as one enterprise with all assets held for the benefit of the collective whole.” One set of objecting lenders stated the common theme relating to cash collateral that it was patently objectionable for the debtors to “request to use the Property Level Lenders’ cash collateral, which is derived from the operations of the single asset real estate SPE Property Level Debtors, to maintain and fund the Other Debtors and Non-Debtors.”

Last, if designed correctly, BRVs are never supposed to face a meaningful risk of substantive consolidation. Indeed, as pointed out by the CMSA and MBA amicus brief, it is quite common for lenders to companies using BRVs to require the delivery of an opinion by counsel for the borrower with respect to substantive *non*-consolidation. This last issue may be the most critical one for general unsecured creditors – absent substantive consolidation, there may be little, if any assets, available to satisfy general unsecured claims. The interests of general unsecured creditors to tap into the value of assets held by BRVs necessarily directly clash with the purpose of why the BRV vehicle exists – if a company desires to obtain financing cheaply, it may be required to isolate the assets securing such financing from the claims of other creditors.

The General Growth motion was granted after eleventh hour haggling that provided additional protections to lenders of the BRVs. Such protections included the granting to BRV lenders of first priority security interests in a bank account that holds cash transferred from properties owned by BRVs, which had not been provided for in the initial relief requested.

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<sup>1</sup> As a general rule, only the board of directors of a corporation has the power to file a voluntary bankruptcy petition, and a valid board resolution is a prerequisite to a corporation’s filing of a bankruptcy petition. *See In re Runaway II, Inc.*, 159 B.R. 537 (Bankr. W.D. Mo. 1993).

Nonetheless, the difficult issues were left unresolved.

- Will the BRV bankruptcy cases be dismissed because the filings were unauthorized? Numerous lenders to General Growth BRVs have filed motions to dismiss. A hearing on the motions to dismiss is set for June 17, 2009.
- Will the debtors or the creditors' committee credibly seek substantive consolidation? Substantive consolidation of BRVs on the basis that General Growth operated as an integrated business enterprise may be all but impossible in light of the Third Circuit's decision in *Owens Corning*, which firmly articulated the rule that "[m]ere benefit to the administration of the case (for example, allowing a court to simplify a case by avoiding other issues or to make a postpetition accounting more convenient) is hardly a harm calling substantive consolidation into play."<sup>2</sup>
- Will the debtors' estates or the creditors' committee argue that the BRV structure results in transactions intended to hinder, delay, or defraud creditors?

These are not new issues. Numerous law review articles have debated whether the BRV structure, particularly within the context of asset securitization financing, should be disregarded in bankruptcy. See David Gray Carlson, *The Rotten Foundations of Securitization*, 39 Wm. & Mary L. Rev. 1055 (1998); Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 51 Stanford J. of L., Bus. & Fin. 133 (1994); Lynn M. LoPucki, *The Death of Liability*, 106 Yale L.J. 1 (1996).

Our observation is that, while General Growth *could* be the case that busts the BRVs, it is unlikely. In light of *Owens Corning* (and, assuming that the BRV transactional documents were drafted correctly), substantive consolidation is probably dead on arrival. The bankruptcy court appears ready to hear on June 17, 2009, motions to dismiss BRV cases, and the lenders' arguments are strong. Any successful fraudulent transfer claim necessarily questions the very purpose of asset securitization/BRV-structured financing, and a bankruptcy judge (especially one sitting in Manhattan) is unlikely to take any final actions that would signal to the mortgage lending industry that they should re-think their operating assumptions.

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<sup>2</sup> See *In re Owens Corning*, 419 F.3d 195, 211 (3d Cir. 2005). So far, the debtors have dodged the substantive consolidation issue by arguing that it is "common for multiple debtors with DIP financing arrangements involving joint and several obligations to the DIP Lender to continue to continue to use [] prepetition cash management systems that sweep cash from multiple subsidiaries and concentrate it at one entity."

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**Announcement:**

Quinn Emanuel is pleased to announce that Eric Winston joined the firm as partner in May 2009. Mr. Winston will broaden the firm's international bankruptcy and restructuring practice, adding West Coast presence to the existing New York and London practices. Formerly a partner of Los Angeles based bankruptcy boutique, Stutman, Treister & Glatt, Mr. Winston has appeared in bankruptcy cases around the country, and recently successfully settled on behalf of the unsecured creditors' committee two complex litigation matters in *Azabu Buildings, Ltd.*, a cross-border insolvency case involving parallel restructurings in Hawaii and Japan. He has also been advising clients in connection with out-of-court restructurings, opportunities to acquire distressed assets and distressed debt, and insolvency risks associated with counter-party transactions. With the addition of Mr. Winston, Quinn Emanuel can service clients' restructuring needs from our headquarters in Los Angeles, and also provide seamless global insolvency advice to our clients everywhere.

Quinn Emanuel is a 400+ lawyer business litigation firm -- the largest in the U.S. devoted solely to business litigation -- with offices in Los Angeles, New York, San Francisco, Silicon Valley, Chicago, Tokyo and London. Firm lawyers have tried over 1290 cases, winning over 91% percent of them. When representing plaintiffs, our lawyers have garnered over \$10 billion in judgments and settlements. We are the only firm in the U.S. that has won four nine-figure jury verdicts in the last seven years. We have also obtained four nine-figure settlements and two ten-figure settlements in the same period.

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