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Clients&Friends Alert

GGP Bankruptcy Court Denies Motions to Dismiss Twenty Property Level Bankruptcy Cases as Bad Faith Filings

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On August 11, 2009, in one of the most significant rulings to date in the GGP bankruptcy proceeding, the Bankruptcy Court denied motions to dismiss as bad faith filings the bankruptcy cases of 20 GGP property-level subsidiaries. In denying the motions, the court stated that the fundamental creditor protections negotiated in the special purpose entity structures at the property level are in place and will remain in place during the pendency of the chapter 11 cases. Those protections include adequate protection of the lenders' interest in their collateral and protection against the substantive consolidation of the project-level debtors with any other entities.

The moving lenders argued that the 20 project-level bankruptcy filings were premature and improperly sought to restructure the debt of solvent entities for the benefit of equity holders. The Bankruptcy Code does not require that a voluntary debtor be insolvent or unable to pay its current debts. A bankruptcy petition generally will not be dismissed as a bad faith filing as long as the debtor has a legitimate rehabilitation objective. One of the issues before the Bankruptcy Court was whether the need to restructure debt with a large principal payment due on maturity in the next 1 to 4 years constitutes a legitimate rehabilitation objective under the facts and circumstances of the cases.

In opposition to the lenders' motions, GGP argued that financial difficulties at the parent level and the fact that nine loans at its property-level subsidiaries have already matured and could not be refinanced justified filing 166 property-level subsidiaries as an integrated group. GGP also argued that each of the project level subsidiaries had a good faith reason to file for bankruptcy because there is "little or no possibility of refinancing outside of bankruptcy" as the loans mature. Finally, GGP argued that the lenders are not being harmed by the bankruptcy filings, because they are over-collateralized and receiving current interest payments at the non-default contract rate.

The moving lenders replied that good faith must be analyzed separately for each debtor and could not be demonstrated by considering the debtors as a group. The lenders also argued that certain lenders are being harmed by not receiving principal payments on loans that require amortization and that certain mezzanine lenders are not receiving any current interest payments.

Judge Gropper agreed with GGP on all major points. After finding that all of the relevant debtors were in varying degrees of financial distress due to factors such as cross defaults, the need to refinance in 1 to 4 years, and other considerations, the court stated that it was not required to analyze each debtor in isolation. The question, in the court's view, was whether a parent company that had filed its bankruptcy case in good faith could include in the filing subsidiaries that are crucial to the parent's reorganization.

The lenders' motions also argued that the firing and replacement of various independent managers shortly before the commencement of the bankruptcy cases demonstrated subjective bad faith. On that issue, the court stated that the independent managers did not have any expertise in the real estate business and were replaced by seasoned individuals who could commit significant time to the restructuring challenges the project level debtors were facing. The court also found that the independent managers were properly removed and replaced in accordance with the terms of the applicable organizational documents.

In denying the motions to dismiss, the Bankruptcy Court concluded that the lender's rights with respect to the property-level debtors were not materially impaired by the debtors' chapter 11 filings. The lenders are being adequately protected through the timely payment of interest at the non-default contract rate, the timely payment of property level expenses, a replacement lien on excess cash that is being upstreamed for the payment of budgeted expenses of the parent entities, and a replacement lien on the GGP group's common cash management account. The court also stated that the lenders are being protected against substantive consolidation of the project-level debtors with any other entities and that the debtor in possession financing approved by the court did not include a lien on the properties of the project-level debtors. With respect to the interruption of current amortization payments on the minority of loans requiring such payments and the payment of interest on the few mezzanine loans at issue, the court stated that the affected lenders had not sought additional adequate protection and had not waived their rights to recover full principal and interest and post-petition interest upon the confirmation of a plan of reorganization. It remains to be seen whether lenders that think they are not being adequately protected will seek additional adequate protection and whether such protection will be granted.

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