BANKRUPTCY-REMOTE SPECIAL PURPOSE ENTITIES: AN OPPORTUNITY FOR INVESTORS TO MAXIMIZE THE VALUE OF THEIR RETURNS WHILE UNDERGOING MORE CAREFUL AND REALISTIC RISK ANALYSIS

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I. INTRODUCTION

The world of business and finance has become increasingly complex. Within the recent past, we have experienced significant improvements to finance as novel structures and concepts are created to meet people's varied needs. For example, new business structures have emerged, including limited partnerships, limited liability companies, and even series LLCs.[1]

1. *See, e.g.*, Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 3–4 (1995) (describing the emergence of the LLC); Donald M. Scotten, *Series LLCs: An Organizational Form That Should Be Used Cautiously (For Now)*, BUS. L. NEWS, no. 2, 2009, at 7 (profiling series LLCs and issues that remain as of yet unresolved because of their newness).

Simple lending and borrowing has changed to make debt more desirable and to further the economic growth of businesses.[2] Commercial mortgage-backed securities allow companies to raise capital at lower interest rates.[3] Parent-subsidiary relationships enable businesses to isolate their liability.[4] Debt can be structured with numerous mezzanine tiers, each comprised of perhaps an unidentifiable number of investors.[5]

Generally, the purpose of all of these novel devices is to improve the benefits for all parties involved.[6] For example, sub-prime mortgages enable people who might otherwise not be able to obtain a loan to get access to credit so that they might purchase a home.[7] Lenders benefit from such loans by charging higher interest rates and enforcing other stringent terms upon these less credit-worthy individuals; this setup offers a greater sense of financial security to the lenders who might otherwise fear that the borrower will default on the loan.[8] Another example that highlights the benefits to all participants is that of mezzanine capital financing.[9] Using this device, borrowers essentially create a middle or "mezzanine" tier of financing, between debt and equity.[10] As a result, this mezzanine tier creates a blend of debt and equity such that the advantages and disadvantages are more moderate and less extreme.[11] The mezzanine tier of debt can be viewed as either junior or subordinate debt, or it can be viewed as a preferred level of equity.[12] The debt holder undertakes higher risk in

2. *See, e.g.*, *In re* Gen. Growth Props., Inc., 409 B.R. 43, 61 (Bankr. S.D.N.Y. 2009) (noting improved benefits for both lenders and borrowers through a complex financial scheme).

3. *See id.* at 51.

4. *See* 18A AM. JUR. 2D *Corporations* § 733 (2012) (stating that a parent company has "legal separation from its subsidiary and resulting protection from liability"); 1 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 43 (2012) ("[U]nder ordinary circumstances, a parent corporation will not be liable for the obligations of its subsidiary.").

5. *See, e.g.*, *In re* Extended Stay, Inc., 418 B.R. 49, 54 (Bankr. S.D.N.Y 2009) (explaining the mezzanine debt structure of Extended Stay to include ten tranches of junior mezzanine loans and multiple certificates which represented interest in the mortgage loans); *In re Gen. Growth*, 409 B.R. at 51 (noting that securitized mortgages of General Growth were pooled together and sold to numerous certificate holders, thereby entitling them to varying principal and interest payments, rates of return, and control rights).

6. *See supra* text accompanying note 2.

7. *See* Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1087 (2009) (defining subprime mortgages and their main design features).

8. *Id.*

9. James D. Prendergast, *Real Estate Mezzanine Lending Collateral Foreclosure: Insurance Tailored to the Operation of the U.C.C. Is Not a Luxury—It's a Necessity*, 27 PRAC. REAL EST. LAW. 11, 11–12 (2011).

10. *Id.*

11. *Id.*

12. *Id.*

exchange for relatively high rates of return.[13] The borrower benefits from the fact that payments are often deferred and from the fact that these debt holders have a lower priority of payment compared to other debt holders.[14] Additionally, the borrower has an intermediate choice between debt and equity when choosing the best capital structure.[15] Sub-prime mortgages and mezzanine financing are but two examples of the complex structures that investors and businesspeople use.[16]

With the creation of these complex financial structures, one major issue that businesspeople, investors, and their lawyers face is the fact that there is a great deal of uncertainty remaining regarding how these structures will fare during times of economic crisis or when new legal issues arise.[17] The existing precedent is limited, so in many ways investors are taking a gamble as to how the law will protect their investments and their highly complex financing devices. At the same time, investors always desire to decrease their risk, often preferring more stable financial structures where their investment returns are more certain. As a result, any information that bolsters or threatens the stability of a financial investment warrants careful scrutiny.

A recent bankruptcy case perfectly illustrates the gamble that investors take when relying on highly complex but new (and often imperfect) financial structures. As a result of the recent financial crisis, General Growth Properties ("General Growth" or "GGP")—a multi-billion dollar real estate investment trust company[18]—filed for bankruptcy in April 2009,[19] pioneering new legal precedent as the company dragged its special purpose entities ("SPEs") into the Chapter 11 proceedings along with it.[20]

13. MARK J. ANSON, FRANK J. FABOZZI & FRANK J. JONES, THE HANDBOOK OF TRADITIONAL AND ALTERNATIVE INVESTMENT VEHICLES: INVESTMENT CHARACTERISTICS AND STRATEGIES 424–25 (2011); Bar-Gill, *supra* note 7, at 1087.

14. ANSON, FABOZZI & JONES, *supra* note 13, at 425.

15. *Id.* at 425–26 (discussing the utility of "equity kickers" in mezzanine financing).

16. *See supra* text accompanying notes 1–4.

17. *See, e.g.*, Bar-Gill, *supra* note 7, at 1074–75 (noting that 2006 saw the origination of almost three million subprime loans, but that the subprime mortgage crisis ensued just a few months later, destroying the notion that such loans constitute a good financial device); Scotten, *supra* note 1, at 8, 41–42 (examining areas of uncertainty for the use of Series LLCs, including treatment by foreign jurisdictions, treatment by federal bankruptcy courts, and tax implications).

18. *In re* Gen. Growth Props., Inc., 409 B.R. 43, 47 (Bankr. S.D.N.Y 2009).

19. Ilaina Jonas & Emily Chasan, *General Growth Files Historic Real Estate Bankruptcy*, REUTERS (Apr. 16, 2009, 3:26 PM), http://www.reuters.com/article/2009/04/16/us-generalgrowth-bankruptcy-idUSLG52607220090416.

20. *General Growth Properties, Inc. Files Additional Subsidiaries for Chapter 11 Protection*, BLOOMBERG (Apr. 23, 2009), http://www.bloomberg.com/apps/news?pid=conewsstory&refer=conews&tkr=GGWPQ:US&sid=aoUR7YdstGeo; Aleksandrs Rozens, *Not So Bankruptcy-Remote: Special*

This event was shocking because the SPEs were designed to avoid bankruptcy proceedings altogether[21]—so their very function was called into question.[22] The case highlighted the risks that the SPE investors had undertaken, and it created a sense of panic as other similarly situated investors considered their own financial undertakings.[23] In light of this occurrence, it became important to question the strength of the special purpose entity altogether and consider practical ways of improving it, if possible.

Part II of this note will introduce some background information about SPEs, their general purpose, and the way in which the entities are structured to achieve that purpose. This Part will also explain the value of SPEs to the business world—for both lenders and borrowers. Part III will examine the circumstances surrounding the General Growth Properties bankruptcy and consider some possible implications for the future of SPEs. Part IV will provide an overview of various lawyers' and scholars' advice for investors seeking to remedy the problem, lower their risks, and meet their original expectations. Part V will evaluate those viewpoints and determine whether they are beneficial to today's investors. Finally, Part VI will use the practical analysis from Part V to encourage investors to take steps to eliminate the risk of bankruptcy and will recommend that investors use these recent cases as a cautionary tale. This Part will argue that the *In re General Growth* case poses a real risk for investors in the future and is likely to occur again. Ultimately, this Note will argue that investors should reevaluate their perceptions of risk before investing in SPEs in the future.

II. AN INTRODUCTION TO SPECIAL PURPOSE ENTITIES

A special purpose entity—also known as a single purpose entity or a

Purpose Entities Cascade into Bankruptcy with General Growth Properties, Stunning Some CMBS Investors, INV. DEALERS' DIG., May 8, 2009, at 24.

21. *See In re Gen. Growth*, 409 B.R. at 61 ("There is no question that the SPE structure was intended to insulate the financial position of each of the [SPEs] from the problems of its affiliates, and to make the prospect of a default less likely.").

22. *See, e.g.*, Richard J. Corbi, *How Remote is "Bankruptcy Remote" for Special Purpose Entities*, NORTON BANKR. L. ADVISER, Nov. 2009, at 5, 8 (questioning whether SPEs are truly bankruptcy remote).

23. Numerous law firms sent out press releases or client letters to assuage fears. *E.g.*, Press Release, Ropes & Gray, LLP, Bankruptcy Maintains the Status Quo, Allaying Fears of CMBS Industry (June 10, 2009), http://www.ropesgray.com/files/Publication/69a7874f-e3bc-45b4-b0d0-305f41e1708c/Presentation/PublicationAttachment/7485f5c6-626a-42b7-9954-019885c3a57f/RopesGray_Alert_bankruptcycourtmaintainsthestatusquoallayingfearsofcmbsindustr.pdf; Press Release, Gibson, Dunn & Crutcher, LLP, In re: General Growth Properties, Inc.—Court's Denial of Motion to Dismiss Will Affect Single Purpose Borrowers (Sept. 4, 2009), http://www.gibsondunn.com/publications/pages/InreGeneralGrowthPropertiesInc.aspx.

bankruptcy-remote vehicle ("BRV")[24] —is an entity that a parent company controls and maintains separately from itself.[25] The parent company then transfers assets, often real estate, to the SPE, thereby isolating the assets from itself.[26] Next, the property is mortgaged to leverage more capital for the parent company, creating tremendous amounts of secured debt.[27] Investors lend money to the SPE itself as part of the mortgage structure, and interest is paid to them from the SPE's own generation of cash flow.[28]

The reason for this setup is that it enables the parent company to obtain capital with low interest rates, under the premise that the debt is low-risk for SPE investors.[29] The key to achieving low risk is separateness; by treating the entities as wholly independent from the parent and each other, the risk is isolated—despite the fact that the entities are substantively linked under the umbrella of the parent company.[30] The parent company thus has the ability to finance its endeavors without having to compensate investors for the risk associated with its other affiliated companies.[31]

At the same time, the appeal of the SPEs for investors is that the low risk can be guaranteed by the structure of the financial devices.[32] The SPEs are designed to be "bankruptcy-remote," indicating that the likelihood that the borrower will file for bankruptcy or subject the SPE to bankruptcy

24. Note that the SPE is also sometimes referred to as a Special Purpose Vehicle ("SPV") or Bankruptcy-Remote Entity ("BRE").

25. DANIEL M. GLOSBAND ET AL., REAL ESTATE LAW & INDUS. REPORT, CMBS BANKRUPTCY REMOTE STRUCTURING AND THE RECESSION: REVISITING THE BENEFITS 2 (2009), *available at* http://www.goodwinprocter.com/~/media/Files/Publications/Attorney%20Articles/2009/Menna_Glosban_Opper_Richardson_BNA_6_2_09.ashx. *See also In re Gen. Growth*, 409 B.R. at 49.

26. GLOSBAND ET AL., *supra* note 25, at 2. *See also In re Gen. Growth*, 409 B.R. at 49.

27. GLOSBAND ET AL., *supra* note 25, at 2.

28. *See In re Gen. Growth*, 409 B.R. at 49 (noting the complete separateness of the SPE entity); Brian M. Resnick & Steven C. Krause, *Not So Bankruptcy-Remote SPEs and* In Re General Growth Properties, Inc., AM. BANKR. INST. J., Oct. 2009, at 1, 60 (indicating that "financing obligations" of the General Growth SPEs were "owed directly by those SPEs," and only their own resulting cash flows could pay off their debts).

29. *See In re Gen. Growth*, 409 B.R. at 49 (noting that the purpose of the SPE is to "protect the interests of [its] secured creditors by ensuring that the operations of the borrower [are] isolated from business affairs of the borrower's affiliates and parent so that the financing of each loan stands alone on its own merits, creditworthiness and value" (second alteration in original) (internal quotation marks omitted)).

30. Resnick & Krause, *supra* note 28, at 60 (stating that a "ring fence" around each SPE would separate each entity's credit risk in the *In re General Growth* case).

31. *Id.* at 1 (noting that borrowers utilizing SPEs may "obtain less expensive financing than might otherwise be available").

32. *See* W. Rodney Clement, Jr. & H. Scott Miller, General Growth*: Special Purpose Entities (Barely) Survive First Bankruptcy Test*, PROB. & PROP., Mar.–Apr. 2011, at 31, 31 (noting that SPEs "attempt to isolate their collateral from the claims of affiliates of their borrower").

proceedings is negligible.[33] This means that if the parent company does face financial difficulty and file for bankruptcy, this event should have no effect on the financial stability of the SPEs.[34] Therefore, the structure provides reassurance to the investors as to the separateness of the entity, appeasing any fears that the financial attributes of the parent company or its affiliates might affect their own returns.[35] It also permits investors to focus on the riskiness of the assets in the SPE, rather than the entire enterprise.[36]

SPEs can maintain their identities as "bankruptcy-remote" structures not only through the transfer of assets by the parent company but also through a number of provisions that decrease the likelihood of bankruptcy.[37] For example, often times the SPE covenants will include a formal separateness requirement, which mandates that the parent company and the SPE maintain separate existences, which would include maintaining and managing their own separate debts, operations, records, and other obligations.[38] Another typical attribute is a requirement for one or more independent directors on the board.[39] As a result of such a provision, at least one member of the board of the SPE must not also be a board member for the parent company, nor can this director have any material affiliation with the parent company itself.[40] Having this requirement ensures that the director has the best interests of the SPE and its investors in mind when making decisions.[41] Independence is particularly important because there is an inherent conflict of interest if the parent company is in financial distress, the SPEs have positive cash flow that the parent might wish to use, and the director is affiliated with the parent company. A final restriction that often is included to increase bankruptcy-remoteness is the

33. 2 MICHAEL T. MADISON, JEFFRY R. DWYER & STEVEN W. BENDER, THE LAW OF REAL ESTATE FINANCING § 13:38 (2012).

34. *In re Gen. Growth*, 409 B.R. at 58–59 (discussing the lenders' argument that a lack of financial distress of the individual SPEs precluded them from entering bankruptcy proceedings); Corbi, *supra* note 22, at 6 (same). *See also* 4 BAXTER DUNAWAY, LAW OF DISTRESSED REAL ESTATE § 56:52 (2011) ("One of the principal reasons for setting up a SPE is to protect the investors from a bankruptcy of the originator.").

35. Corbi, *supra* note 22, at 7 (citing *In re Gen. Growth*, 409 B.R. at 61).

36. *See In re Gen. Growth*, 409 B.R. at 49 (explaining that the purpose of the SPE structure is so that the "financing of each loan stands alone on its own merits, creditworthiness and value").

37. *E.g.*, *id.* (listing typical attributes of SPEs); Jason Lynch, *Reevaluating Bankruptcy Remoteness: Transfers of Risk, Implications of the GGP Reorganization*, AM. BANKR. INST. J., July–Aug. 2010, at 58, 59 (2010) (listing typical provisions of SPEs that help preserve bankruptcy-remoteness).

38. *In re Gen. Growth*, 409 B.R. at 49; Lynch *supra* note 37, at 59.

39. *In re Gen. Growth*, 409 B.R. at 49.

40. *Id.*

41. *Id.*; GLOSBAND ET AL., *supra* note 25, at 7.

requirement that there be unanimous consent of the directors before the SPE is permitted to enter into bankruptcy proceedings.[42] This particular provision gives a powerful voice to the independent director on the board, preventing the SPE from being dragged into bankruptcy proceedings when not in the SPE's best interests.[43] The previous provisions as well as others are meant to assure investors that their risk is limited by imposing strong safeguards against the possibility of bankruptcy.

Even with all of these precautions and intricate provisions, it is important to note that an SPE or its parent company cannot have blanket prohibitions on filing for bankruptcy.[44] This means that no party (be it the SPE or the parent company) can agree to voluntarily waive its right to file for Chapter 11 at any point in the future.[45] Courts view such provisions as unenforceable and against public policy.[46] Allowing for such provisions would be contrary to the purpose of allowing debtors to file for bankruptcy, remedy their financial problems, and essentially start anew.[47] Nevertheless, while an outright prohibition is not technically enforceable, the SPE has been accepted as a functional alternative.[48] With its many restrictive provisions, the SPE substantively achieves the same goal because it is designed to prevent a bankruptcy filing.[49] Much like a bankruptcy waiver, the parties' goals and incentives align such that bankruptcy is undesirable or impossible for either of them.[50]

After examining SPEs from the perspectives of both parties, the bankruptcy-remote structure seems almost infallible. It meets the needs of both the borrower and the investor, seemingly aligning their interests through the use of the SPE.[51] Furthermore, any systematic failure of bankruptcy-remoteness would likely ruin the use of it for all investors in the future; avoiding the potential destruction of the SPE would be a strong deterrent against filing bankruptcy and including an SPE in the proceedings. Considering this analysis, it would seem that an SPE would

42. Lynch, *supra* note 37, at 59.

43. *See In re Gen. Growth*, 409 B.R. at 49 (noting that some investors viewed the independent director as being required to be "devoted to the interests of the secured creditors").

44. DUNAWAY, *supra* note 34, § 56:52; Kenneth N. Klee & Brendt C. Butler, *Asset-Backed Securitization, Special Purpose Vehicles and Other Securitization Issues*, 35 UCC L.J. 23, 33–34 (2002).

45. Klee & Butler, *supra* note 44, at 33–34.

46. *Id.*

47. *Id.* at 34.

48. *Id.*

49. DUNAWAY, *supra* note 34, § 56:52; Klee & Butler, *supra* note 44, at 34.

50. *See* Klee & Butler, *supra* note 44, at 34.

51. *See supra* text accompanying notes 29–36.

never be forced to enter into the borrowers' bankruptcy proceedings. Nevertheless, an SPE was pulled into bankruptcy proceedings when General Growth Properties filed for Chapter 11 bankruptcy in mid-2009.[52]

III. SHELLSHOCK: THE GENERAL GROWTH PROPERTIES BANKRUPTCY CASE

Given people's general understanding of the bankruptcy-remoteness concept, it is no surprise that the *General Growth* bankruptcy case astonished and frightened investors and their lawyers.[53] Many people sought to analyze what went wrong and whether the *General Growth* case was a sign that SPEs were no longer viable investment options.[54] The case itself serves as the best starting point for exploring the reason that General Growth's SPEs were included in the bankruptcy proceedings and whether or not it was due to a flaw in the SPE structure.

A. WHAT HAPPENED IN *GENERAL GROWTH*

General Growth is a real estate investment trust company and the parent company in this case.[55] Just before its Chapter 11 filing, the real estate conglomerate included hundreds of affiliated companies, maintained and managed more than two hundred shopping centers as its primary business operation, and had annual revenues of billions of dollars.[56] In running its operations, GGP also maintained numerous sources of debt as part of its capital structure, which included secured debts that were structured to function as multiple individual SPEs.[57] Generally, each individual SPE owned a separate mortgage, and GGP had such mortgages on over one hundred properties.[58] To further complicate matters, many of the mortgage loans were financed with commercial mortgage-backed securities ("CMBS").[59] This meant that the secured debt was issued to the SPE and was subsequently sold to hundreds of certificate holders or debt holders who would be given a right to a specified amount of the principal

52. Jonas & Chasan, *supra* note 19.

53. Rozens, *supra* note 20, at 24.

54. *See, e.g.*, Clement & Miller, *supra* note 32; Lynch, *supra* note 37; Rozens, *supra* note 20; Patrick C. Sargent, Charles T. Marshall & Peter K. McKee, Jr., *General Growth Properties Bankruptcy: SPE Structure Survives, but Consideration of Corporate Group Permitted*, REAL EST. FIN., Oct. 2009, at 16, 16. In addition, numerous law firms sent out press releases notifying their clients of the case and its influence on their investments. *See supra* note 23 and accompanying text.

55. *In re* Gen. Growth Props., Inc., 409 B.R. 43, 47 (Bankr. S.D.N.Y 2009).

56. *Id.*; Resnick & Krause, *supra* note 28, at 60.

57. *See In re Gen. Growth*, 409 B.R. at 48 (describing the capital structure of General Growth).

58. *Id.*

59. *Id.* at 50–51.

and interest.[60] The material terms of those certificate holders' debt could not be modified except by a special servicer and with consent of the certificate holders.[61] Therefore, because of the structure of this type of secured debt, it would be difficult to alter the loan, even if necessary to prevent the borrower from going bankrupt.[62]

Initially, GGP experienced significant growth and success through the use of its capital structure.[63] The company was able to generate large amounts of capital to finance its growing business operations, and at the same time it became the "largest borrower in the CMBS market."[64] Despite initial success, problems for GGP began with the financial crisis of 2008.[65] Because GGP's business plan depended on a presumed ability to refinance its secured debt, the crisis in the real estate market made that plan virtually unviable.[66] To make matters worse, GGP could not sell assets to obtain the funding to pay for its numerous debts.[67] Another roadblock that GGP faced was the fact that it could not effectively negotiate with either the master servicer or the special servicer to alter the loan agreements for any of its SPEs, further compounding GGP's liquidity problems.[68] The master servicer managed the regular loan administration, but had no authority to alter loan agreements; the special servicer had the ability to alter the loan agreement but only if given authority under specific circumstances, such as a failure to make a payment.[69] When General Growth attempted to negotiate the terms of its lease, neither the master servicer nor the special servicer was willing or able to discuss the loans.[70] Due to all of these difficulties, GGP filed for Chapter 11 in March of 2009.[71]

The most controversial aspect of the bankruptcy proceedings was the fact that GGP's solvent SPEs voluntarily filed for bankruptcy, and GGP requested that cash be upstreamed from the solvent SPEs to the parent

60. *See id* at 48–51 (describing General Growth's capital structure).

61. *Id.* at 51.

62. *See id.* (implying that limitations requiring the use of the special servicer and consent of the certificate holders would make any changes to the loans' terms nearly impossible to achieve).

63. *See* Resnick & Krause, *supra* note 28, at 60 (noting the tremendous size of GGP's overall operations and its equally large debt obligations).

64. *Id.*

65. *See In re Gen. Growth*, 409 B.R. at 53 (noting that the "events of 2008–2009" led to the downward spiral of GGP).

66. *See id.* (noting GGP's inability to refinance a significant number of its loans).

67. *Id.*

68. *Id.* at 54.

69. *Id.* at 51.

70. *Id.* at 54.

71. *Id.*

company so that it might use the cash to settle its own financial problems.[72] In an early proceeding Judge Gropper approved a cash collateral order, which permitted General Growth to use the cash flows from its solvent SPEs in order to fund its bankruptcy.[73] The SPEs were also granted adequate protection, which would assure them that they would have a claim against the assets of their parent company.[74] Outraged investors opposed this idea, arguing that it was a clear violation of the fundamental purpose of the SPE, which is to be treated separately from the parent company altogether.[75] Furthermore, investors protested the idea based on the fact that many of the SPEs themselves were profitable and thus did not need bankruptcy restructuring in order to improve their own financial strength.[76] Thus, the investors argued that the Chapter 11 filings were done in "bad faith" and that this form of financing should not be permitted.[77]

Despite the vehement protests from the investors and their legitimate concerns, Judge Gropper rejected the investors' motions to dismiss,[78] thereby allowing the bankruptcy proceedings to continue with the SPEs as debtors too.[79] He enumerated a number of reasons for the decision, which offer insight into how the decision might affect SPEs in general.[80] To begin with, it was established that the SPEs did not need to be insolvent in order to be subject to Chapter 11 proceedings.[81] Rather, the opinion seems to imply that any financial conditions that might suggest future profitability problems mean that an entity could file for Chapter 11 without a bad faith dismissal.[82] Next, the opinion explained that it is proper to consider the interests of the entire business group as a whole with respect to the issue.[83] The opinion expressly rejected the notion that each SPE should be

72. *Id.* at 55.

73. *In re* Gen. Growth Props., Inc. (*In re Gen. Growth II*), 412 B.R. 122, 123–24 (Bankr. S.D.N.Y 2009) (authorizing the use of cash collateral from the SPEs); Christopher Scinta, *General Growth Wins $400 Million Bankruptcy Loan, Use of Cash*, BLOOMBERG (May 14, 2009, 12:01 AM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aRqD. 0uCw5Sk.

74. *See In re Gen. Growth II*, 412 B.R. at 134–36 (defining the adequate protection provisions).

75. *In re Gen. Growth*, 409 B.R. at 55.

76. *See id.* at 57–59 (recognizing that some of the project-level entities (SPEs) were in fact solvent, but nevertheless separately voted to enter the bankruptcy proceedings).

77. *Id.* at 57.

78. *Id.* at 72.

79. *See id.* at 61 (establishing that a debtor need not be insolvent in order to file for Chapter 11).

80. *See generally id.* (considering each of the movants' arguments and reinforcing the decision to reject the motions to dismiss).

81. *Id.* at 61.

82. *See id.* (stating that "it is well established that the Bankruptcy Code does not require that a debtor be insolvent prior to filing" and that "[m]any other cases have denied motions to dismiss, despite the fact that the subject debtors were able to meet current expenses").

83. *Id.*

considered in isolation with respect to its financial strength, despite recognizing that the SPE was designed with that notion in mind.[84] Because the investors were aware of the existence of the larger business group, they should have considered both the positive and negative potential consequences of such a structure.[85] Consequently, it would hardly be a stretch to deduce that the financial strength of the subsidiaries would be affected by that of their parent.[86]

The opinion further explained that the fact that GGP failed to even attempt to negotiate with the lenders was not cause for dismissal.[87] This conclusion was reached in part because there was no evidence that such negotiations would have been successful; the lenders probably would not have been willing to renegotiate any terms of the loan, and there was evidence that GGP was unable to foster negotiation with the special servicer or master servicer in order to resolve the issues.[88] Based on the evidence, it was deemed reasonable for the debtor, GGP, to choose not to negotiate before filing for Chapter 11.[89]

The *General Growth* opinion further rejected the investors' argument that the SPEs' decision to join in the bankruptcy proceedings was done in bad faith because of suspicious circumstances that indicated a lack of independence by the SPEs' Boards of Directors.[90] As previously noted, a key attribute of many bankruptcy-remote vehicles is the requirement of independent directors, and in this case the SPEs were required to have two independent directors on the board.[91] On the eve of filing for bankruptcy, the two "independent" directors were replaced by GGP, so the board could include two experts that might determine a best course of action to help with the restructuring of GGP.[92] With these two new members on the board, the SPEs ultimately voted to join in the Chapter 11 proceedings.[93] Due to the timing of the board members' dismissals, investors argued that filing for bankruptcy was in bad faith and that the so-called "independent" directors were wrong to vote in favor of a position that was not in the

84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.* at 66.
88. *Id.* at 66–67.
89. *Id.* at 67.
90. *Id.*
91. *Id.*
92. *Id.* at 68.
93. *See id.* (the SPEs filed for bankruptcy after the replacement of two independent directors).

investors' best interests.[94] In response to these contentions, the court stated that the independent directors were not forbidden from filing for bankruptcy; they merely had a prima facie duty to "act in the interests of the corporation and its shareholders,"[95] and that duty had not been clearly breached in this instance.[96] Plus, the mere fact that investors were "inconvenienced" by an interruption of their cash flows was not a reason to dismiss the bankruptcy proceedings; rather, as previously discussed, it was appropriate to consider the interests of the rest of the corporate group.[97]

B. IMPLICATIONS OF THE CASE

The *General Growth* case itself highlights a number of potential problems with the SPE structure.[98] At the same time, it may be difficult to determine if one of those problems was the reason for the bankruptcy filing, if each of them was a significant problem, or whether their effects taken in combination with each other are what caused the situation in *General Growth*. Through examination of the case details, we can gather insight into the identifiable weaknesses of the SPE and General Growth's SPEs in particular.[99] A careful examination highlights potential areas for improvement, but to some extent it also raises more questions that need to be answered for investors before they can decide what to make of the SPEs' bankruptcy filings.

1. The SPE Is Not Bankruptcy Proof

With the SPEs' entry into the bankruptcy proceedings of General Growth, it became clear that bankruptcy was not a true impossibility.[100] Many scholars and lawyers responded to the case opinion with articles and press releases, highlighting as a key takeaway the fact that "bankruptcy remote is not bankruptcy proof."[101] A central question is whether this

94. *Id.*

95. *Id.* (quoting N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007)) (internal quotation marks omitted).

96. *See id*. at 69 (implying that the independent directors may have "voted in favor of the Chapter 11 filings" because it was in the company's best interests).

97. *Id.*

98. *See supra* Part III.A.

99. *See* Corbi, *supra* note 22, at 8 ("Lenders will study the *General Growth* decision for clues about how to write the next generation of loan documents to avoid the pitfalls of having an SPE file bankruptcy."); GLOSBAND ET AL., *supra* note 25, at 10 (noting that the GGP case has afforded "the opportunity, directly or indirectly, to provide more clarity with respect to the bankruptcy remote structure").

100. *See generally* Rozens, *supra* note 20 (calling SPEs "not so bankruptcy-remote").

101. Corbi, *supra* note 22; David Neier, Laura Swihart & Robert Boudreau, *'Bankruptcy Remote' Is Not 'Bankruptcy Proof,'* N.Y. L.J., Jun. 29, 2009; Press Release, Bingham McCutchen LLP, General

"novel" concept truly altered the expectations of investors, given the fact that the SPEs were previously called "bankruptcy-remote"—a name which in itself implies that bankruptcy is at least a slight possibility.[102]

Even if investors were initially aware that bankruptcy was a minor possibility, perhaps they were shaken by the fact that they did not know exactly how remote that possibility was.[103] This raises the question as to whether *General Growth* was a landmark case or a mere fluke.[104] Other issues highlighted in the *General Growth* case may not be present in all SPE structures,[105] so perhaps the structure itself was not actually flawed.[106] Conversely, the case might be an indicator of what is to come, signifying that the SPE structure is significantly less beneficial to investors than originally anticipated.[107] The answers to such questions directly impact the investors' levels of risk when lending to SPEs, and it would be imprudent for lenders to remain in the dark regarding the truth about these issues.[108] As a result, investors need to evaluate the information and determine which of these viewpoints is true, so that they might adjust their expectations and demands going forward.

2. The Financial Crisis of 2008 Played a Significant Role in the Problems Associated with SPEs

The financial crisis of 2008 is certainly one of the main reasons why General Growth decided to file for bankruptcy.[109] With the collapse of the

Growth Properties and the Boundaries of Bankruptcy Remoteness (Aug. 17, 2009), http://www.bingham.com/Media.aspx?MediaID=9557. *See also supra* note 23 and accompanying text.

102. *See* Klee & Butler, *supra* note 44, at 38–42 (discussing bankruptcy-remote vehicles in 2002, before the General Growth crisis of 2009). Furthermore, Klee and Butler's article expressly stated that these structures "can never be truly 'bankruptcy proofed.'" *Id.* at 38.

103. *See* Corbi, *supra* note 22, at 5–8 (evaluating "how remote" the possibility of bankruptcy is for SPEs); Lynch, *supra* note 37, at 59–61 (same).

104. *See* Elaine Misonzhnik, *An Isolated Occurrence*, NAT'L REAL EST. INVESTOR (Oct. 1, 2009), http://nreionline.com/mag/isolated-occurrence (calling the *General Growth* ruling "noteworthy" because of the design of SPEs but an "anomaly" with respect to future expectations).

105. *See id.* (reporting one lawyer as saying that "there [were] some unique features in this case you don't see in a lot of other cases"). *See also In re* Gen. Growth Props., Inc., 409 B.R. 43, 67–69 (Bankr. S.D.N.Y 2009) (discussing the "coincidental" discharge of the independent directors on the eve of filing).

106. *See* Misonzhnik, *supra* note 104 (calling the General Growth bankruptcy an "anomaly, not a glimpse of things to come").

107. *See* GLOSBAND ET AL., *supra* note 25, at 9 ("When combined with other significant external market factors, it will not be surprising if the uncertainties relating to the bankruptcy remote structure highlighted by the GGP bankruptcy filing lead to . . . loans with significantly higher interest rates than prior to the start of the current financial crisis.").

108. *See supra* Part II.

109. *See supra* text accompanying notes 65–67.

entire real estate market, General Growth's business plan failed, and there was no viable way to improve conditions because the company could not obtain any refinancing.[110] Had the financial crisis not occurred, it can be easily argued that the General Growth proceedings never would have turned out the way that they did.[111]

Thus, while investors may be concerned with the fact that an SPE entered bankruptcy proceedings, perhaps the events should be viewed from a larger economic standpoint. 2008 marked a year of severe economic recession—one that affected millions of people who lost their investments in various ventures and sectors of the economy.[112] With such widespread losses and economic effects, perhaps the GGP problems cannot accurately be blamed on a failure of the SPEs themselves but rather on a failure of the entire economic system. Taking this viewpoint, it is entirely possible that the *General Growth* case merely brought to light the fact that SPEs may be weak in times of economic downturn—an attribute that is true of almost all investments. The investors did not foresee the economic crash, and maybe the court was right to disregard the SPE structure under such circumstances. Therefore, perhaps the *General Growth* case is accurately classified as an "anomaly"[113] and need not be an additional cause for worry, at least until the next economic crisis. On the other hand, perhaps this economic crisis merely brought to light what would have inevitably been discovered—a serious weakness in the structure of the SPEs that make them more susceptible to bankruptcy proceedings than initially thought and planned for by investors. With multiple possible interpretations of the economic recession, it is again apparent that there is uncertainty as to the meaningful impact of *General Growth* on the future of SPEs.

3. There Is Danger in Having a Lack of Safeguards Against the Removal of Independent Directors by the Parent Company

Another obvious cause of the SPEs' bankruptcy filing was the fact that the independent directors were removed and replaced by GGP on the eve of the filing.[114] The *General Growth* opinion itself indicates that investors cannot rely on the incorrect assumption that the directors must exclusively

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110. *See supra* note 66 and accompanying text.

111. *See In re* Gen. Growth Props., Inc., 409 B.R. 43, 53–54 (Bankr. S.D.N.Y. 2009) (explaining fully the effects of the "events of 2008–2009" and their impact on GGP).

112. Chris Isidore, *It's Official: Recession Since Dec. '07*, CNNMONEY (Dec. 1, 2008, 5:40 PM), http://money.cnn.com/2008/12/01/news/economy/recession/index.htm.

113. Misonzhnik, *supra* note 104.

114. *See supra* text accompanying notes 90–97.

consider their needs and interests.[115] Consequently, it may not be prudent for investors to think that the existence of independent directors alone is enough to ensure that bankruptcy proceedings will not commence.[116]

Again, the analysis raises additional questions that investors will want to be answered. Investors will want to know whether the provisions regarding the independent directors can be altered to better meet their expectations and wants.[117] For example, investors might wish to put limitations on the parent company's ability to remove and replace a director. Such replacement could, for instance, be valid only if the director is approved or appointed by the investors themselves.[118] Alternatively (or additionally), investors might consider a requirement that the directors' fiduciary duties be altered such that they are only responsible for considering the needs of the investors, rather than considering the best interests of the company itself and other stakeholders.[119]

In addition to suggesting these new provisions, the investors will want reassurance that the provisions will be effective against the director problem that occurred in *General Growth*,[120] and more importantly, they will want assurance that the provisions will prevent the overall outcome of permitting solvent SPEs to voluntarily enter the bankruptcy proceedings of their parent company.[121]

115. Sargent, Marshall & McKee, *supra* note 54, at 17 (noting that the independent directors without direct ties to the parent company may still be "friendly individual[s] more inclined to vote in accordance with the [parent company]"). *See In re Gen. Growth*, 409 B.R. at 68 (suggesting that the independent managers in that case may have voted to file for bankruptcy based on the best interests of the corporation, notwithstanding the best interests of the lenders).

116. *See* Sargent, Marshall & McKee, *supra* note 54, at 20 ("Lenders have relied too heavily on independent directors and their perceived duty to consider the lenders' interests in voting on voluntary bankruptcy.").

117. *See* GLOSBAND ET AL., *supra* note 25, at 9 ("In light of the impact of the GGP filing on the integrity . . . of the bankruptcy remote structure, alternatives . . . will need to be revisited to reassess their effectiveness in deterring bankruptcy filings."); Sargent, Marshall & McKee, *supra* note 54, at 20 (offering "some lessons learned," which include ways in which to change SPE provisions in order to avoid the pitfalls of *General Growth*).

118. *But see* Sargent, Marshall & McKee, *supra* note 54, at 20 (suggesting that although investors may want appointment or approval rights, they might be void as being against public policy because they would have the same "substantive effect" as a bankruptcy waiver or prohibition).

119. *See* GLOSBAND ET AL., *supra* note 25, at 9 (noting the flexibility under Delaware corporate law to alter the duties of the independent directors).

120. Sargent, Marshall & McKee, *supra* note 54, at 20.

121. *See* GLOSBAND ET AL., *supra* note 25, at 9 ("The fundamental question is how can . . . the governance provisions relating to the independent directors[] be improved for the benefit of the CMBS market as a whole . . . .").

IV. SCHOLARS AND LAWYERS ADVISE FUTURE INVESTORS REGARDING THE IMPLICATIONS OF *GENERAL GROWTH*

Scholars, lawyers, and other legal analysts have responded to the *General Growth* case in various ways.[122] Many have merely noted the potential implications of the *General Growth* case from a very broad standpoint—sometimes noting only the existence of the issue and the potential importance of it.[123] Often, these legal commentators fail to commit to a definitive standpoint on what exactly caused the failure of the SPE structure in *General Growth* or how to remedy it.[124] Because there is so much uncertainty surrounding the implications of the case itself, many of these scholars are unable to offer any substantive recommendations to lenders in response to the General Growth crisis.[125]

While some scholars have chosen not to comment on the perceived threat to the SPE structure or offer advice to future investors, others offer a myriad of viewpoints as to the future of SPEs. Some contend that the *General Growth* case has little or no effect on the viability of the SPE as an investment vehicle—arguing that investors need not panic or change investment strategies in response to the opinion.[126] Other legal commentators argue that *General Growth* highlights ways in which the SPE can be improved upon so that the mistakes from that case are not repeated and all potential loopholes are closed.[127] Still others think that the SPE's bankruptcy-remoteness was seriously called into question and its worth should perhaps be reevaluated before more investors rely on the SPE

122. *Compare id.* at 9 (predicting that the weaknesses of the SPE structure will spur increases in interest rates), *with* Resnick & Krause, *supra* note 28, at 62 (noting that the *General Growth* case "has in some ways respected the separateness of the corporate entities and perhaps, strengthened the expectation[s]" of SPE investors).

123. *See, e.g.*, Lynch, *supra* note 37, at 61 (concluding that investors must keep an eye on *General Growth* and future cases because of its effect on the value of securitized assets); Resnick & Krause, *supra* note 28, at 62 (concluding that *General Growth* creates challenges for the SPE structure).

124. *See, e.g.*, Corbi, *supra* note 22, at 8 (concluding briefly that lenders will want to alter loan documents to prevent the same pitfalls as *General Growth*); Lynch, *supra* note 37, at 61 (generally noting that investors should reevaluate the SPE structure).

125. *See, e.g.*, Corbi, *supra* note 22 (carefully outlining each portion of the *General Growth* opinion, but very briefly concluding that lenders will use the case to "avoid the pitfalls of having an SPE file bankruptcy"); Lynch *supra* note 37, at 61 (concluding that investors will have to "keep a close eye on GGP" because of the importance of keeping SPEs from bankruptcy); Resnick & Krause, *supra* note 28, at 62 (analyzing the *General Growth* case, but summarizing future implications to suggest that stakeholders will "surely revisit and revise the organizational documents used by SPEs to further constrain their ability to file for bankruptcy").

126. *See infra* Part IV.A.

127. *See infra* Part IV.B.

structure.[128]

These varying arguments regarding future implications are supported by the use of the text of the *General Growth* opinion itself and the legal scholars' own experiences with corporate, bankruptcy, or real estate law.[129] Nevertheless, it seems that experts are unable to agree or even argue with certainty what will likely occur in the future for SPEs as a result of this hallmark case.[130] Because of the varying viewpoints, investors will have even more difficulty determining with certainty the effect that the *General Growth* case has on their future SPE investments. Investors will have to consider for themselves, using all the available information, whether or not their expectations should change.

A. MANY ARGUE THAT *GENERAL GROWTH* ACTUALLY SHOULD HAVE A LIMITED EFFECT ON THE EXPECTATIONS OF FUTURE INVESTORS

General Growth highlights a number of potential, identifiable flaws with SPEs' bankruptcy-remote structure.[131] Nevertheless, many have argued that the case actually has a limited effect on the overall practicability of the SPE.[132] They consider the *General Growth* case a mere fluke[133]—a case that demonstrates the reason why SPEs are called "bankruptcy remote . . . not bankruptcy proof."[134]

Some analysts claim that the SPE structure actually remained intact, based on the *General Growth* opinion itself. The opinion explicitly clarified that the SPE investors would still have "fundamental protections" throughout the Chapter 11 proceedings, including protection against substantive consolidation[135]—a method through which multiple entities are treated as one for the purposes of their financial information.[136] Following

128. *See infra* Part IV.C.

129. *See generally In re* Gen. Growth Props., Inc., 409 B.R. 43 (Bankr. S.D.N.Y. 2009); Clement & Miller, *supra* note 32; Corbi, *supra* note 22; Neier, Swihart & Boudreau, *supra* note 101; Resnick & Krause, *supra* note 28; Sargent, Marshall & McKee, *supra* note 54.

130. *See, e.g.*, GLOSBAND ET AL., *supra* note 25, at 2, 10 (noting a lingering lack of clarity with respect to the issues surrounding SPEs and the importance of the outcome of the *General Growth* case); Sargent, Marshall & McKee, *supra* note 54, at 20–21 (calling the *General Growth* case a "harbinger" of what the future of SPEs holds and urging investors to "[s]tay tuned" for the next chapters).

131. *See supra* Part III.B.

132. *E.g.*, Misonzhnik, *supra* note 104.

133. *Id.*

134. *See supra* text accompanying notes 100–01.

135. *In re* Gen. Growth Props., Inc., 409 B.R. 43, 69 (Bankr. S.D.N.Y. 2009).

136. TALCOTT J. FRANKLIN & THOMAS F. NEALON III, MORTGAGE & ASSET BACKED SECURITIES LITIGATION HANDBOOK §§ 7:5–6 (2012). *See In re Gen. Growth*, 409 B.R. at 69 (expressly rejecting the contention that the *General Growth* opinion requires or permits the "assets and liabilities of any of the [SPEs to] properly be substantively consolidated with those of any other entity").

the language itself, some argue that the result in the *General Growth* case could have been much worse—that in some ways the case could be considered a victory for the SPE investors despite the fact that their rights were limited to some extent.[137] Because the assets and liabilities of the SPEs were kept separately from those of the parent company, it is argued that there is no actual threat to the separateness of the SPEs.[138] Thus, the opinion might come as a relief to some investors or lenders because it eliminates uncertainty and draws a line—albeit a thin one—that cannot be crossed when it comes to the effect of a parent company's bankruptcy on the finances of the SPE itself.[139]

These arguments imply that despite the initial panic that ensued over the General Growth bankruptcy, investors' initial expectations need not be altered in light of the present circumstances.[140] Investors would consequently perceive the same low levels of risk because they could be assured that the court would respect the separateness of the SPE and the parent company.[141] If this argument is correct, the benefits of SPEs for both the borrower and the lender remain compelling.[142] The investments in SPEs could still be viewed as low-risk with respect to the rest of its affiliated entities, and low interest rates would remain appropriate.[143] Ultimately, SPEs could be viewed as even more appealing—especially as they become more commonplace, more legal precedent emerges, and the entities are constantly improved through creative innovations and minor adjustments.

Many lawyers, scholars, and financial analysts have remained proponents of the SPE structure—even post-*General Growth*.[144] There is evidence that the number of SPEs is increasing due to the fact that they are "advantageous when implemented properly."[145] In addition, today's investors and lenders often demand SPEs as terms of their lending agreements because of their concerns about a potential bankruptcy, which

137. Clement & Miller, *supra* note 32, at 31, 34.

138. *Id.*

139. Resnick & Krause, *supra* note 28, at 62.

140. *See id.* (stating that the case perhaps "strengthened the expectation" of the lenders); Clement & Miller, *supra* note 32, at 34 (arguing that the case may have "uph[eld] the integrity of the SPE structure").

141. *See supra* text accompanying note 31.

142. *See supra* text accompanying notes 29–36.

143. *See supra* text accompanying notes 29–36.

144. *See, e.g.*, Misonzhnik, *supra* note 104 (quoting a partner in a finance group as having the viewpoint that SPEs are not doomed by the *General Growth* case).

145. Eric Grasberger, *Increasing Presence of Special Purpose Entities*, DAILY J. COM. (Nov. 17 2011, 11:52 AM), http://djcoregon.com/news/2011/11/17/increasing-presence-of-special-purpose-entities/.

is a primary concern given the current economic conditions.[146] If investors are still willing to spend billions of dollars a year, it must be because they agree that there is value added by having SPEs as part of their securitization transactions.[147] Furthermore, if investors are continuing to use the SPEs in the aftermath of *General Growth*, perhaps these scholars have correctly hypothesized that the case has little or no true effect on investors' expectations. Alternatively, the investors might be unaware of a truly detrimental impact on SPEs, choosing to side with those who think the SPE structure has remained "substantially intact."[148]

B. OTHERS HAVE ARGUED THAT ANY POTENTIAL FLAWS IN THE SPE STRUCTURE CAN BE REMEDIED BY MAKING A FEW MINOR ADJUSTMENTS

Some scholars have argued that the *General Growth* case merely identified weaknesses of GGP's specific SPE structure (not SPE structures in general), and that most of these weaknesses can be remedied through minor adjustments or additional provisions.[149] Under this rationale, future investors need only worry that the SPEs they invest in contain the requisite safeguards to protect against the weaknesses in *GGP*.[150] Even though there is some agreement that the SPE structure can be improved, scholars have varying suggestions as to what provisions can best remedy the issues.[151]

According to many *General Growth* analysts, one of the primary reasons for GGP's SPEs' bankruptcy filing was the companies' lack of truly independent board members.[152] As previously discussed, there was controversy surrounding the SPEs' Chapter 11 filing because the

146. Richard E. Mikels & Ella Shenhav, *Bankruptcy's Impact on Financial Markets*, AM. BANKR. INST. J., Dec. 2011–Jan. 2012, at 28, 28.

147. *Id.*

148. Lynch, *supra* note 37, at 61 (quoting Jeffrey W. Levitan, *General Growth Properties: Casting a Cloud over Traditional Perceptions of Bankruptcy Remote Financing Structures*, BANKR. STRATEGIST, Oct. 2009) (internal quotation marks omitted).

149. *See* GLOSBAND ET AL., *supra* note 25, at 7–8 (insinuating that one major reason for the GGP bankruptcy debacle was due to the fact that the parent company was able to replace the independent directors in order to get the decision approved); William McInerney, *From Bankruptcy-Remote to Risk Remote*, N.Y. L.J., Aug. 23, 2010, *available at* http://www.cadwalader.com/uploads/books/088787 e8ce2b1c202936a512e5a74161.pdf (arguing that investors could decrease their risk, even if ultimately unable to prevent a bankruptcy filing).

150. *See generally* McInerney, *supra* note 149 (explicitly advising investors how to make their SPE investments low risk).

151. *Compare id.* at 2–3 (advocating a change in the role of the independent director and the inclusion of a "bad boy" guaranty), *with* GLOSBAND ET AL., *supra* note 25, at 8–9 (suggesting changes with regard to the role of the independent directors but also indicating that interest rates should increase).

152. GLOSBAND ET AL., *supra* note 25, at 7–8.

independent directors were replaced by the parent company on the eve of the decision to file for bankruptcy.[153] Perhaps these new directors who voted to approve the bankruptcy proceedings were influenced by the parent company and did not make an independent and objective decision.[154] Nevertheless, while typical bankruptcy-remote provisions require that there be at least one independent director, those documents often do not forbid the parent company from removing said director and replacing him or her with another one.[155] So long as the removal is legal under state law and the new director meets the "independence" requirement, the change cannot be legitimately challenged using the SPE provisions.[156] As a result of this "loophole," a parent company might have the ability "to 'director shop' for individuals willing to consent to a bankruptcy filing."[157] It appears that GGP took advantage of that tactic because the company seized an opportunity to replace the independent directors just before the decision to file for bankruptcy.[158]

In identifying the "surreptitious" replacement of the directors as one of the causes of the SPEs' bankruptcy filing, some have suggested that additional provisions be added to SPE agreements in order to prevent any similar occurrence from happening again.[159] For example, the SPE lender provisions could demand that the independent directors meet certain objective criteria such as a requirement that the directors be from a professional independent director company.[160] The inclusion of such a provision would increase the likelihood that the directors are truly independent, qualified, and dedicated to making the best decisions under the circumstances.[161] As a result, the parent company would no longer be

153. *See supra* text accompanying notes 90–94.

154. GLOSBAND ET AL., *supra* note 25, at 7.

155. *Id.* at 7–8.

156. *Id.* at 8.

157. *Id.* at 7.

158. *Id.* Investors protested the suspicious circumstances under which the "independent" directors were replaced. *See In re* Gen. Growth Props., Inc., 409 B.R. 43, 67 (Bankr. S.D.N.Y 2009).

159. *E.g.*, GLOSBAND ET AL., *supra* note 25, at 8–9; McInerney, *supra* note 149, at 2; Sargent, Marshall & McKee, *supra* note 54, at 20.

160. Sargent, Marshall & McKee, *supra* note 54, at 20. *See also* John T. Bycraft et al., *Single-Purpose Entities and Independent Directors: Does the General Growth Ruling Change Structured Finance*, NAT'L L. REV., May 15, 2010, http://www.natlawreview.com/article/Single-Purpose%20Entities%20and%20Independent%20Directors%3A%20%20Does%20the%20General%20 Growth%20Ruling%20Change%20Structured%20Finance%3F (noting the availability of "professional" independent directors for a fee).

161. *See* Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 884 (1991) (noting that despite having financial independence, directors are often "socially and ideologically tied to management" with no real incentive to monitor company activity, and furthermore the directors also often lack the time to dedicate

able to "shop" for directors who would be more likely to vote in favor of filing bankruptcy.[162] In addition, lenders can demand the inclusion of a provision that would require their approval (within reason) of a new independent director, if the parent ever decides to remove and replace one.[163] By also including a reasonableness standard, the term would be prevented from appearing too much like a total bankruptcy waiver,[164] which is generally thought to be unenforceable as against public policy.[165] At a minimum, the lenders could request that they be given advance notice in case of the replacement of a director, which would also help alleviate issues relating to surreptitious changes to the board.[166] As a result, it would seem that such provisions could and should be incorporated into future SPE documents and that they would be enforceable.[167]

Because SPEs are premised on the fact that investors have low levels of risk,[168] another potential way to solve the problems of *General Growth* is to create additional provisions and structures that ensure that the investors are not negatively impacted by bankruptcy proceedings, even if they have filed Chapter 11 against the wishes of the investors.[169] The investors could insist on the inclusion of a "bad boy" or "non-recourse" guaranty—a device which enables the investors to demand indemnification for certain bad acts of the SPE.[170] In this case, the punishable act would be the decision to file for bankruptcy, which would trigger the guaranty and force the SPE or its parent to compensate the investors.[171] Having a bad boy guaranty would have the impact of either deterring bankruptcy altogether or, alternatively, protecting the investors' money by giving them a remedy in the event of Chapter 11 proceedings.[172] It should be more reassuring to investors that courts generally uphold these guaranty agreements, even in cases involving bankruptcy proceedings.[173]

to making the best decisions).

162. *See* McInerney, *supra* note 149, at 2 ("[B]y ensuring that the initial independent directors have relevant experience and exposure to a restructuring environment, a parent may be unable to justify removing an already well-qualified independent director.").

163. GLOSBAND ET AL., *supra* note 25, at 9.

164. *Id.*

165. *Id. See supra* text accompanying note 46.

166. McInerney, *supra* note 149, at 2.

167. GLOSBAND ET AL., *supra* note 25, at 9.

168. *See supra* text accompanying note 29.

169. *See generally* McInerney, *supra* note 149 (arguing that investors can shift their overall goal from preventing bankruptcy to reducing their risk—which is the actual underlying purpose of the SPE).

170. *Id.* at 2.

171. *Id.*

172. *Id.*

173. *Id.* at 3.

C. SOME SCHOLARS CONTEND THAT THE RIGHTS OF INVESTORS HAVE BEEN SUBSTANTIALLY LIMITED BY *GENERAL GROWTH*

Given the attention that the *General Growth* case generated, it is no surprise that some scholars viewed it as significant and influential on the way that investors would view SPEs in the future. Many who are wary of the future of SPEs focus on the language of the *General Growth* case itself.[174] Judge Gropper explicitly avoided the issue of substantive consolidation, saying "[n]othing in this Opinion implies that the assets and liabilities of any of the [SPEs] could properly be substantively consolidated with those of any other entity."[175] While some have zeroed in on the fact that substantive consolidation was not required in this case,[176] others expressed concern about the fact that the opinion "failed to explicitly rule out substantive consolidation" for General Growth or for future bankruptcy cases.[177] The implication is that protection against substantive consolidation remains uncertain, and as a result of *General Growth*, the rights of the SPE investors have been "substantially limited."[178] The distinction between substantive consolidation and what actually occurred is perhaps only very slight;[179] the *General Growth* case permitted the parent company to use the cash from its separate SPEs, essentially treating the money as belonging to GGP rather than its subsidiaries.[180]

Many analysts agree that the challenge for investors is to draft new provisions and requirements that enable the SPE structure to maintain its value.[181] At the same time, there is a general understanding that the SPE can never be changed to completely eliminate the risk of bankruptcy.[182] Because bankruptcy waivers are not enforceable,[183] the only remedy is to improve the lender agreements to better represent and protect the interests of the investors in any foreseeable way.[184] Nevertheless, even if steps can

174. *E.g.*, Lynch, *supra* note 37, at 60–61 (discussing the court's opinion and concluding that "bankruptcy remote" is not the same as "bankruptcy proof").

175. *In re* Gen. Growth Props., Inc., 409 B.R. 43, 69 (Bankr. S.D.N.Y 2009).

176. *See supra* Part IV.A.

177. Lynch, *supra* note 37, at 61.

178. Clement & Miller, *supra* note 32, at 34.

179. *Id.*

180. *See supra* text accompanying notes 72–73.

181. Lynch, *supra* note 37, at 61.

182. Klee & Butler, *supra* note 44, at 38; Lynch, *supra* note 37, at 61.

183. *See supra* text accompanying note 44.

184. *See* Sargent, Marshall & McKee, *supra* note 54, at 20 (stating that independent directors are a "useful tool," but that additional safeguards, such as requiring that the director be hired from a professional independent director company, are necessary to ensure that the directors are truly independent).

be taken to strengthen the structure of the SPEs, they will never be bankruptcy-proof.[185] It is impossible to predict every potential way in which the SPE structure could be susceptible to a bankruptcy filing.[186]

Another reason why the SPEs will never be bankruptcy-proof is that, according to the *General Growth* opinion, it is appropriate to consider the financial circumstances of the entire corporate group, not just the parent company or SPE debtors independently.[187] The opinion further explained that "it was 'clearly sound business practice for [the parent] to seek Chapter 11 protection for its wholly-owned subsidiaries when those subsidiaries were crucial to its own reorganization plan.'"[188] The rationale was that the parent's reorganization was obviously dependent on the financial strength of its SPEs, which constituted a primary portion of GGP's general operations.[189] With the court's explicit rejection of the notion that only the creditors' interests matter when deciding whether to file bankruptcy, it becomes evident that any time a parent company suffers from financial instability, it increases the risk that even the SPEs will file.[190] To many, it is the principle of considering interests of the entire group that presents a true obstacle to the intended use of the SPE.[191] Given this duty of the directors, it is questionable whether the SPE and the parent company can ever be truly considered separate, and whether that prevents separate treatment in bankruptcy proceedings as well.[192]

V. AN EVALUATION OF SCHOLARS' ANALYSES OF *GENERAL GROWTH* AND ITS IMPLICATIONS FOR THE FUTURE OF THE SPE

It is evident that scholars' views regarding the implications of the

185. *See* Lynch, *supra* note 37, at 61 ("[T]he [SPV] structure may not provide protections from all bankruptcy risks." (second alteration in original) (quoting Jeffrey W. Levitan, *General Growth Properties: Casting a Cloud over Traditional Perceptions of Bankruptcy Remote Financing Structures*, BANKR. STRATEGIST, Oct. 2009) (internal quotation marks omitted)); Sargent, Marshall & McKee, *supra* note 54, at 20 (concluding that "SPEs are bankruptcy remote, not bankruptcy proof").

186. *See* Sargent, Marshall & McKee, *supra* note 54, at 20 (noting that improved SPE provisions can never guarantee that a bankruptcy filing will not occur).

187. *See supra* text accompanying notes 83–86.

188. *In re* Gen. Growth Props., Inc., 409 B.R. 43, 62 (Bankr. S.D.N.Y. 2009) (alteration in original) (quoting Heisley v. U.I.P. Engineered Prods. Corp. (*In re U.I.P. Engineered Prods. Corp.*), 831 F.2d 54, 56 (4th Cir. 1987)).

189. *Id.*

190. *See* Sargent, Marshall & McKee, *supra* note 54, at 20 (explaining that directors did not have a duty to creditors alone when deciding whether to file for voluntary bankruptcy).

191. *See* Clement & Miller, *supra* note 32, at 35 (arguing that the "duty to consider the interests of the entire GGP group" was the cause of a "setback" for investors).

192. *Id.*

General Growth case vary significantly.[193] Unfortunately, these competing views adversely affect investors' ability to evaluate their risk and determine the best plan of action with respect to their future investments in SPEs. A careful evaluation of these arguments may shed some light as to what the future implications might be and, at a minimum, give investors the tools to make that decision for themselves.

A. THE *GENERAL GROWTH* CASE CERTAINLY IDENTIFIES WEAKNESSES WITH THE SPE STRUCTURE, WHICH SHOULD CHANGE INVESTORS' PERCEPTIONS OF RISK

While some have argued that *General Growth* is not an indicator of what is to come,[194] it is unrealistic to believe that the case has had no impact on the structure of the SPE. The initial announcement of the bankruptcy proceedings, which included the SPEs, was met with panic,[195] indicating that it was not within the expectations of investors. In fact, the case exhibits similarities to another seminal bankruptcy case in 2001, in which a different issue relating to bankruptcy-remote structures was discussed.[196] In *In re LTV Steel Co.*, the bankruptcy court chose not to recognize the sale of assets to LTV's wholly owned subsidiary as a "true sale."[197] Under this theory, the subsidiary's assets could not be removed from the bankruptcy estate because they were not viewed as completely separate from the parent company, despite the fact that the transaction was designed to keep the assets out of the borrower's bankruptcy proceedings.[198] Much like in *General Growth*, this decision caused many to question the future of bankruptcy-remote structures.[199] Furthermore, a closer look at the *General Growth* opinion itself, the arguments of legal scholars, and subsequent circumstances all suggest that the SPEs are significantly less bankruptcy-remote than initially believed.

First of all, SPEs are not as bankruptcy-remote as initially planned based on *General Growth*'s proclamation that the investors' interests are secondary to those of a corporate group as a whole. The *General Growth*

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193. *See supra* Part IV.

194. *See supra* Part IV.A.

195. *See supra* text accompanying note 53.

196. *In re* LTV Steel Co., 274 B.R. 278 (Bankr. N.D. Ohio 2001) (permitting bankruptcy-remote structures' assets to be available to the parent company during its bankruptcy proceedings).

197. *See id.* at 285–86 (determining whether the receivables of the wholly owned subsidiary were part of the debtor's bankruptcy estate).

198. *Id.* at 280.

199. *See, e.g.*, Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1558 (2008) (stating that the LTV case was a "portent" of the future of securitization).

opinion explicitly stated that the directors are permitted—and even have a duty—to consider the interests of a corporate entity as a whole.[200] Thus, the opinion implies that investors cannot rely on directors to act in their best interests, which is a significant change from their initial expectations. Furthermore, including SPEs in the bankruptcy proceedings would likely be beneficial to a struggling parent company, so independent directors would probably vote to include the SPE in the Chapter 11 proceedings. In fact, the directors might even have a fiduciary duty to approve this strategy given the interests of the parent. As a result, the SPEs might not even be correctly described as bankruptcy-remote in instances when the parent company has a substantial number of solvent SPEs, is facing financial difficulty, and would benefit greatly from a reorganization that involved those entities.

Secondly, the economic recession of 2008, which was a main cause of the GGP bankruptcy,[201] cannot be classified as an unlikely future scenario, and investors should not regard SPEs as safe from a future recession. Investors cannot reasonably expect the economic conditions to remain constant or positive, which means that their perception of the risk of economic recession should also affect their perception of the risk that an SPE will file for bankruptcy.

Finally, within a few months of the GGP bankruptcy another large company filed for Chapter 11, including its solvent SPEs in the proceedings as well.[202] Extended Stay, Inc., a large hotel chain with over 680 properties and in excess of $7 billion in assets, filed for Chapter 11 in June 2009.[203] The proceedings included about seventy affiliated entities, which were solvent SPEs, and the decision to file was not a result of a replacement of the independent directors.[204] Thus, *In re Extended Stay, Inc.* clearly demonstrates that the controversial replacement of GGP's independent directors cannot be the only reason that the real estate investment trust company was able to include its solvent SPEs in the Chapter 11 proceedings. By comparing the similar situations of General

200. *See supra* text accompanying notes 95–97.

201. *See supra* text accompanying notes 109–11.

202. Ben James, *Bankruptcy Group of the Year: Weil Gotshal*, LAW360 (Jan. 19, 2011), http://www.law360.com/articles/221004/bankruptcy-group-of-the-year-weil-gotshal (noting that the 2009 Extended Stay bankruptcy proceedings involved "Chapter 11 filings by affiliates that were special purpose entities").

203. Bob Van Voris & David M. Levitt, *Extended Stay Chain Files for Bankruptcy, Hit by Debt*, BLOOMBERG (June 15, 2009, 11:38 PM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aSSgPmHvUslU.

204. *Id.*

Growth and Extended Stay, it is difficult to argue that SPEs are as low-risk as investors initially believed. This subsequent case is perhaps one of the strongest arguments that *General Growth* is not a mere fluke but an indicator of the potential future of SPEs.

A number of other bankruptcy cases also shed light on courts' tendencies to be more willing to use the finances of separate SPEs when they will enable bankruptcy proceedings to occur.[205] It seems that courts want to respect the integrity of securitization structures, unless doing so would destroy any chance of reorganization. For example, in *LTV Steel*, the court decided to permit the use of subsidiaries' money to fund the bankruptcy while arguing that the sale of assets to the subsidiaries was not a "true sale" such that the assets would thereby remain assets of the parent's bankruptcy estate.[206] A failure to permit the use of the subsidiaries' money would have ended the reorganization effort because the parent company had no other source of money.[207] Similarly, in *SEC v. Sunwest Management*, which involved the bankruptcy of an assisted living facilities empire,[208] the court decided to treat individual SEC receiverships as "a unitary enterprise" and to approve a "single chapter 11 filing,"[209] despite the fact that the entities had restricted purposes and were intended to be separate from each other.[210] Again, this action by the court seems to have had the purpose of encouraging reorganization efforts, despite its effect on the securitized structures.[211] These cases bear a striking similarity to both *General Growth* and *Extended Stay*, and offer insight as to why the solvent SPEs were permitted to be included in these bankruptcy proceedings.

At the same time another case, *In re Owens Corning*, firmly stands for

205. *See, e.g.*, *In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005); SEC. v. Sunwest Mgmt., No. 09-6056-HO, 2009 U.S. Dist. LEXIS 93181 (D. Or. Oct. 2, 2009); *In re* LTV Steel Co., 274 B.R. 278 (Bankr. N.D. Ohio 2001). This general sentiment is also consistent with bankruptcy courts' approval of the use of "carve outs," which are agreements that permit a secured lender to provide cash collateral to the debtor in order to pay for administrative expenses. Richard B. Levin, *Almost All You Ever Wanted to Know About Carve Out*, 76 AM. BANKR. L.J. 445, 445 (2002). The remaining issue of concern is, of course, how to allocate the carve out when there is not enough money to pay the secured creditors and all of the administrative claims. *Id.* at 460.

206. *See supra* text accompanying notes 197–98.

207. *See In re* LTV Steel Co., 274 B.R. 278, 286 (Bankr. N.D. Ohio 2001) (explaining that the "order was necessary to enable Debtor to keep its doors open and continue to meet its obligations," it adequately protected the subsidiary, and the "equities of th[e] situation highly favor[ed]" such a result).

208. *Sunwest Mgmt.*, 2009 U.S. Dist. LEXIS 93181, at *12–13.

209. *Id.* at *31.

210. *Id.* at *13.

211. *See id.* (stating that the "status quo is unsustainable" and recognizing that there was "neither an easy nor a perfect solution").

the proposition that substantive consolidation should be used only when equitable principles dictate that it is necessary.[212] The court refused to substantively consolidate the subsidiaries of a multinational corporate group for purposes of assessing creditors' claims.[213] Thus, the case represents the idea that securitized structures should be respected by bankruptcy courts in most instances.[214] Still, this idea remains consistent with what happened in *General Growth*; while courts might be interested in upholding the SPE structure and unwilling to concede to substantive consolidation, they are less inclined to uphold the SPE structure in its entirety when it serves as an obstacle to reorganization. Thus, while substantive consolidation can be viewed as a possible backstop on courts' willingness to ignore a securitized financial structure, the implications for investors remain significant. The past cases indicate that SPEs' cash may be made available to their struggling parent companies during bankruptcy proceedings, and investors must be aware that their risk levels increase with this tendency.

B. MAKING ADJUSTMENTS TO THE SPE STRUCTURE WILL STRENGTHEN BANKRUPTCY-REMOTENESS BUT WILL NOT ELIMINATE THE RISK OF BANKRUPTCY ALTOGETHER

Many legal scholars have noted some ways in which the SPE structure can be improved to increase bankruptcy-remoteness in light of *General Growth*.[215] Despite the fact that these adjustments might help remedy some of the problems, it is nearly impossible to foresee all of the possible ways in which the SPE structure could be manipulated to allow for voluntary bankruptcy.[216] Furthermore, upon further analysis it appears that many of the adjustments recommended will probably not be very effective at preventing bankruptcy of an SPE anyway.

For example, many have suggested several innovative ways to prevent the GGP problem of surreptitious replacement of independent directors on the eve of filing for Chapter 11.[217] Had the parent company not been able to replace those directors, it is possible that the Board would not have approved the voluntary bankruptcy filing.[218] As a result, implementing safeguards for the replacement of independent directors would seem like a

212. *In re* Owens Corning, 419 F.3d 195, 209–10 (3d Cir. 2005).
213. *Id.* at 200, 216.
214. *See id.* at 209 (stating that the doctrine should be used "sparingly").
215. *See supra* Part IV.B.
216. *See supra* text accompanying notes 185–86.
217. *See supra* text accompanying notes 159–67.
218. *See supra* text accompanying notes 152–53.

step toward increased bankruptcy-remoteness, but the Extended Stay bankruptcy further indicated that voluntary bankruptcy could be filed even without manipulation of the Board of Directors by the parent company.[219] Furthermore, as previously noted, one of the most important takeaways from *General Growth* was the fact that the directors have a duty to consider the interests of the entire group.[220] This implies that even truly independent directors might still decide that bankruptcy is in the best interest of the entire corporate group. Thus, having independent directors would not eliminate the risk that voluntary bankruptcy proceedings might include solvent SPEs. Because the main focus for investors is the risk of bankruptcy, any of these provisions would fail to significantly decrease that risk.

Some scholars have also suggested that a bad boy guaranty be included as part of the SPE provisions, but such a provision is probably ineffective. By requiring the parent company to indemnify the investors for bad acts such as voluntarily filing for bankruptcy, the investors attempt to create an additional incentive against filing for Chapter 11 and offer themselves some sort of recourse in case such an event happens anyway.[221] However, the clear problem with this idea is that the parent company is presumably insolvent in instances where it might file for Chapter 11. Having the parent as the guarantor would not actually provide the investors with any recourse because the parent does not have the money to indemnify them.[222] Without a guarantor that has the money to give teeth to the bad boy guaranty, it provides little more to investors than an empty assurance that their investments are low risk.

Another reason why minor adjustments will fail to make the SPEs bankruptcy-proof is the fact that the SPEs are often structured using mezzanine debt in which there can be hundreds of investors and debt holders of the mortgage-backed securities.[223] With so many investors, as in *General Growth*, there would be no simple way of identifying or contacting them in order to negotiate prior to filing for Chapter 11. Given this complication, it seems that the structure of the SPEs makes prebankruptcy negotiation nearly impossible and almost forces a struggling company to

219. *See supra* text accompanying notes 203–04.

220. *See supra* text accompanying notes 95–97.

221. *See supra* text accompanying notes 168–73.

222. This problem was also hinted at in Sargent, Marshall, & McKee, *supra* note 54, at 20. The authors noted that such a provision would not necessarily have been effective in *General Growth* because "it was of course the parent that filed for bankruptcy, so lenders would be wise to consider requiring a financially stout individual."

223. *See supra* text accompanying notes 59–60.

file for bankruptcy, given that there is no other viable option for altering the loan agreements. Consequently, investors should be wary of this complex structure because it indicates that if and when the parent company faces financial difficulty, it will likely be forced to file for bankruptcy even if that is not the most desirable outcome. Despite the existence of safeguards against bankruptcy, the SPEs also include attributes that make bankruptcy a more likely result.

VI. APPLICATION OF SCHOLARLY ADVICE: HOW INVESTORS SHOULD REALISTICALLY APPROACH THEIR FUTURE INVESTMENTS IN SPES

Investors have an opportunity to use *General Growth* to their advantage because it can help them obtain interest rates that closely reflect the risks that they undertake when investing in SPEs. By carefully analyzing what went wrong in *General Growth*, determining what can be fixed, and altering expectations accordingly, investors can once again make the SPEs a valuable investment device.

A. INVESTORS MUST BE SURE TO INVEST IN SPES THAT INCLUDE PROTECTIVE PROVISIONS TO INCREASE BANKRUPTCY-REMOTENESS AS MUCH AS POSSIBLE

Even if SPEs can never be truly bankruptcy-proof, it is important to make them as bankruptcy-remote as possible. Consequently, investors must demand provisions that strictly adhere to the guidelines of an SPE and refuse to issue loans to SPEs that fail to meet those requirements. The SPEs must be structured such that they are completely separate from the parent company, there must be provisions requiring independent directors, and there must be a requirement of unanimity for approving a voluntary bankruptcy. These provisions are the basis for achieving the underlying goal of the SPE because they make the structure less likely to be subject to bankruptcy proceedings.[224] In fact, a failure to include adequate bankruptcy-remote provisions might also threaten the financial structure if it is later argued that investors never really intended for the SPEs to be bankruptcy-remote in the first place. In addition to having these general features, the *General Growth* case teaches investors to demand the inclusion of safeguards that prevent "director shopping" by the parent company when it is preparing to file for Chapter 11. Learning from the errors of another company allows investors to avoid making the same

224. *See supra* text accompanying notes 39–43.

mistakes.

While these provisions and the additional safeguards are certainly not a guarantee that bankruptcy will not occur, they do substantially reduce the likelihood of such an event. It is still important to note that there have been only two cases so far which involved solvent SPEs voluntarily entering their parent companies' bankruptcy proceedings. Considering the prevalence of SPEs and commercial mortgage-backed securities, this statistic can still be viewed as somewhat reassuring to investors. The *General Growth* case does not indicate that bankruptcy proceedings for solvent SPEs are likely to occur, just that they are not as unlikely as initially believed. If investors are careful to invest only in SPEs that have these provisions to decrease the risk of bankruptcy, then the investors are in the best position that they can put themselves in.

B. INVESTORS MUST DEMAND HIGHER RATES OF RETURN IN EXCHANGE FOR THE INCREASED RISK THAT THEY ARE UNDERTAKING

Investors must also recognize that bankruptcy-remote in fact does not mean bankruptcy-proof, so there will always be a chance of bankruptcy, even when investors have required the implementation all of the safeguards available to them. Because there are other uncertainties and external factors that affect the strength of the SPE structure, interest rates associated with the use of SPEs should be increased because investors should demand to be compensated for their risk.[225]

As explained in the previous section, investors should carefully examine the bankruptcy-remote provisions of the SPE agreement. They should not rely solely on the opinions of credit rating agencies, such as Standard & Poor's, Moody's, and Fitch—even though they exist in order to help investors assess the risk of investments that they consider undertaking. Although the rating agencies can consider the "bankruptcy-remoteness" of an SPE when rating commercial mortgage-backed securities structures,[226] this should certainly not be enough to satisfy investors. Furthermore, these agencies' artificial inflation of the ratings of mortgage-backed securities is often considered to be what triggered the recent financial crisis.[227] As a

225. *See* GLOSBAND ET AL., *supra* note 25, at 9 ("[I]t will not be surprising if the uncertainties relating to the bankruptcy remote structure highlighted by the GGP bankruptcy filing lead to CMBS mortgage loans with significantly higher interest rates than prior to the start of the current financial crisis.").

226. THOMAS P. LEMKE, GERALD T. LINS & MARIE E. PICARD, MORTGAGE-BACKED SECURITIES § 12:9 (2012).

227. Rachelle Younglai & Sarah N. Lynch, *Credit Rating Agencies Triggered Financial Crisis,*

result, investors should be wary of making the same mistake that many made in recent years. Institutional investors have the resources to really examine the SPE structures and make an additional assessment as to the degree of their bankruptcy-remoteness. In addition to carefully examining the bankruptcy-remote provisions of the SPE agreement, investors should recognize that the risk of bankruptcy can never be completely eliminated, and they can choose not to invest in SPEs which fail to reflect that risk in their rates of return. While perhaps rating agencies should explicitly consider the implications of *General Growth* and downgrade the CMBS investment ratings accordingly, investors have no reason to trust that this will occur. Thus, what is most important is that investors themselves recognize the impact of the case on the SPE structure and evaluate this aspect of their investments' risks.

With a greater understanding of the risks, investors should be better equipped to demand an increased rate of return on their investments in SPEs. Increasing rates of return will not defeat the underlying purpose of the SPEs because the rates will still be relatively low, but they will merely be adjusted based on the newly acquired information regarding the SPE structure. Borrowers will still benefit from the somewhat reduced interest rates, and lenders will continue to be adequately compensated for the actual risk that they undertake. What investors cannot afford to do is to ignore the increased risk because it makes their compensation inadequate with respect to the risk levels, creating an unfair externality on investors while benefiting the borrowers. By adjusting interest rates now, when another *General Growth* or *Extended Stay* case happens—which it inevitably will—the desire for the SPE structure will remain intact because infrequent bankruptcies will be expected and compensated for. There will be no panic, but rather an understanding that the SPE, while imperfect, is still an overall benefit to the parties involved.

VII. CONCLUSION

Special purpose entities provide a valuable financial tool through which borrowers and investors can each benefit economically. The underlying idea behind them makes them very appealing, but their newness leaves much uncertainty. As SPEs become increasingly commonplace, it is important that they serve their function adequately and do not collapse when they are needed the most.

U.S. Congressional Report Finds, HUFFINGTON POST (Apr. 13, 2011, 8:57 PM), http://www.huffingtonpost.com/2011/04/13/credit-rating-agencies-triggered-crisis-report_n_848944.html.

It has been widely recognized that the usefulness of SPEs was challenged when General Growth Properties filed for bankruptcy and included its SPEs in the proceedings. Few could have predicted the outcome of the case, which highlighted the fragility of the financial structure. The SPE was noted to have "barely survived" its first test in bankruptcy proceedings.[228]

As legal scholars jumped to analyze what exactly went wrong and how the problems could be remedied, investors received advice that varied tremendously. Some commentators argued that the SPE structure was in no danger, that the problems with General Growth were unique to that company and could be easily avoided through proper implementation of the SPE provisions. Others argued that new, innovative techniques could be utilized to decrease investors' risk to their initial expectation levels. Still other scholars argued that *General Growth* was a shock to the system, highlighting a weakness with the SPE structure that could never be completely remedied. The only thing that was certain was that there was no clear right answer as to what would and should happen to the SPE.

Unfortunately, these conflicting arguments can only leave investors confused. With just about every possible argument available, lenders are basically forced into a standstill, unable to justify changing their expectations because there is evidence to support any number of different theories. What they really need is a thorough explanation of the risks they undertake and some advice as to the best ways to eliminate any risk that they can.

After a careful study of the existing theories, it becomes clear that the *General Growth* case did actually have a substantial effect on the utility of the SPE. For some investors, it may have had the impact of demonstrating that SPEs are not as bankruptcy-remote as initially anticipated. At a minimum, it solidified the fact that the SPEs were not bankruptcy-proof.

The solution for investors is to make sure they get the most out of their future investments in SPEs and have a clear understanding of the risks that they undertake. Investors must use the SPE wisely, knowing that a failure to include important provisions might prevent the SPE from being truly bankruptcy-remote. Upon recognizing any potential weaknesses, the investors must select SPE investments that include provisions that eliminate those weaknesses and create disincentives and obstacles to filing for Chapter 11. In addition, investors must demand higher interest rates on

228. *See generally* Clement & Miller, *supra* note 32 (commenting on the implications of *General Growth*).

the SPE loans, which would correspond to the newly perceived but real risk that the investors undertake when lending to SPEs. This would allow the SPE to remain a financial device that benefits both the borrower and the lender in a transaction. Ultimately, investors must recognize that an SPE is not certain to avoid bankruptcy proceedings, but investors can demand to be compensated for the uncertainty that they face.