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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In Re GENERAL GROWTH PROPERTIES, INC., et al., Debtors.	Chapter 11 Case No. 09-11977 (ALG) (Jointly Administered)

**AMENDED BRIEF OF AMICI CURIAE
WITH RESPECT TO THE FILING OF VOLUNTARY PETITIONS IN
BANKRUPTCY BY THE INDIVIDUAL PROPERTY OWNER SUBSIDIARIES
IN THE GENERAL GROWTH PROPERTIES, INC. BANKRUPTCY**

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With permission of the Court, Commercial Mortgage Securities Association and Mortgage Bankers Association, by their undersigned counsel, file this their Brief *Amici Curiae*.

PRELIMINARY STATEMENT

In filing for a Chapter 11 reorganization, General Growth Properties, Inc. ("GGP") is availing itself of legal rights available to all American companies. However, the filings by the myriad single-purpose subsidiaries (the "Property Owners") of GGP that actually hold title to the real estate assets, along with the declarations filed by GGP, raise a critical issue at the heart of the market for commercial real estate finance, as well as for structured finance markets in general that in the aggregate constitute a significant share of non-bank lending in the United States.[1] The issue, central to the functioning of these markets, is asset isolation and the critical role it plays in almost all forms of structured finance, particularly in the market for commercial mortgage-backed securities ("CMBS"). This brief is not being delivered in opposition to any particular motion but to present information on the implications for commercial real estate finance of certain positions that GGP takes in its filings to date with respect to this issue from the perspective of a wide range of market participants, including capital providers, servicers, investors and major trade associations committed to preserving and expanding the flow of debt capital into commercial real estate.

STATEMENT OF INTEREST

[1] Recent articles have put the share of securitization in total credit creation in the economy at more than seventy percent. Saskia Scholtes, *Banks Lending Activity Grows Despite Criticism*, FINANCIAL TIMES, February 13, 2009, *available at* http://www.ft.com/cms/s/0/4b360222-f94a-11dd-90c1-000077b07658.html.

Commercial Mortgage Securities Association ("CMSA") is an international trade organization whose members represent a broad cross-section of firms and individuals that are actively engaged in commercial real estate capital market finance activities, including the largest banks and investment banks; insurance companies; investors such as money managers and specialty finance companies; servicers, other service providers to the industry; and the credit rating agencies. CMSA and its members are the leaders in setting standards and maintaining a favorable investing environment for the nearly one trillion dollars in outstanding commercial mortgage backed securities issuance in the United States.

The Mortgage Bankers Association ("MBA") was formed on May 8, 1914, and has been a leader in representing the concerns of the real estate finance industry for more than ninety years. MBA represents more than 2,700 members—residential, multifamily and commercial companies, as well as industry-related service providers—who link housing and community financing needs to capital sources, both domestic and global. MBA's members include mortgage companies, mortgage brokers, commercial banks, thrifts, credit unions, savings and loan associations, and savings banks. MBA seeks, among other things, to ensure the continued strength of the nation's residential, multifamily and commercial real estate markets; to extend access to affordable housing to all Americans; and to expand the availability of financing for the development of residential, multifamily and commercial real estate.

CMSA and MBA and their members are gravely concerned with the filings by the individual Property Owners as part of the GGP Chapter 11 filing and the catastrophic impact such a precedent, if it stands, could have on the CMBS market, as well as on structured finance and the broader capital markets that rely on the same underlying principles of asset isolation in the architecture of securitization.

ARGUMENT

A. Real Estate Capital Markets Overview

Prior to the development of the CMBS market, commercial real estate was often financed on a recourse basis[2] by banks, thrifts, specialty finance companies and other lenders. Such financing included a first mortgage lien on the real estate and a recourse note or guaranty allowing the lender to seek payment on the mortgage debt from the note obligor (customarily the property owner) or its constituent owner(s) as sureties. The holder of such a mortgage loan might hold the loan in its own portfolio as a whole loan or perhaps sell one or more pieces of it, often through traditional loan syndication or participation structures. With the advent of the CMBS market came the greater availability of non-recourse,[3] asset specific financing for commercial real estate through the use of capital markets, an expansion that attracted new and varied sources of capital to this sector and permitted property owners to acquire and more easily finance real estate without putting their personal balance sheets at risk. In a simple CMBS structure, a lender would make a number of disparate mortgage loans to unrelated entities, then deposit each of the loans into a trust that would issue securities in the public or private

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[2] Many borrowers were, however, corporate shell nominees (before the liberalization of usury laws and the imposition of due on sale clauses) which transferred mortgaged properties to partnerships subject to the mortgage (with no personal liability) after closing. Yet life insurances companies and some other lenders did provide non-recourse financing in their small segment of the market before the CMBS market developed. In this brief, our use of the term commercial real estate financing refers to permanent rather than construction financing or, put another way, the financing of completed projects similar to the malls owned by the Property Owners.

[3] To be precise, it is actually limited recourse rather than non-recourse financing, as described in more detail below.

markets backed by the cash flow and collateral from the pool of mortgage loans. These securities would be created in a senior/junior structure such that the more senior securities would have payment priority as to both interest and principal during the term as well as at liquidation (and hence a lower coupon rate reflecting the lower risk) over the more junior securities.[4] Ratings would be obtained on the securities from one or more of the major rating agencies on the list maintained by the Securities and Exchange Commission as recognized national statistical rating agencies,[5] and then marketed in the public or private markets in accordance with prevailing securities laws. As many fixed income bond investors—that would otherwise not be active real estate lenders—could now participate in the commercial real estate market through the purchase of CMBS, the flow of capital to the commercial real estate mortgage markets increased significantly and played a major role in leading the country out of the nationwide real estate depression caused by the savings and loan crisis of the late 1980s.[6] As a concrete measure of the importance of CMBS to commercial real estate finance generally, in 2007, CMBS issuance (a near dollar-for-dollar proxy for the amount of credit created through first mortgage lending to property owners via the CMBS process) in the United States was approximately $230 billion. This equates to approximately forty percent of the overall debt capital flows to commercial and multifamily real estate for that year and approximately $788 billion of $3.3 trillion of the total outstanding amount of commercial

[4] In the jargon, this structure is referred to as "credit tranching" and colloquially this can be said to be the structure in structured finance.

[5] U.S. Securities and Exchange Commission, Nationally Recognized Statistical Rating Organizations ("NRSROs"), http://www.sec.gov/divisions/marketreg/ratingagency.htm (last visited May 1, 2009).

[6] Joseph Philip Forte, *From Main Street to Wall Street: Commercial Mortgage-Backed Securities*, PROBATE & PROPERTY 8 (Jan./Feb. 1996).

and multifamily mortgage debt.[7] With the recent seizure in global credit markets, CMBS lending, along with almost all other forms of commercial real estate financing, dropped precipitously in 2008. While the industry remains moribund to date in 2009, as and when the systemic risks to the financial system begin to recede and the broader economy stabilizes, many commercial real estate finance professionals anticipate the re-opening of the CMBS market and the consequent return of capital flows into the commercial real estate market, albeit with more stringent underwriting and credit guidelines based upon lessons learned from the prolonged credit market collapse. As to the importance of securitization markets to the U.S. economy generally, Treasury Secretary Geithner recently said "because this vital source of lending has frozen up, no plan will be successful unless it helps restart securitization markets for sound loans."[8] While there are many aspects of the CMBS process under discussion, the basic structure as described in this brief, including with respect to asset and cash flow isolation, is not in question.

B. Non-Recourse Financing and Asset Isolation

One of the bedrock elements of a CMBS financing is the isolation of the asset to be financed. This is the essential bargain between borrower and lender that permits financing on a non-recourse basis: the lender agrees not to pursue recourse liability directly or indirectly against the borrower or its owners, provided that the lender can comfortably rely on the assurance that the financed asset will be "ring-fenced" from all other endeavors, creditors and liens related to the parent of the property owner or affiliates, and from the performance of any assets owned by such parent entity or

[7] The charts set forth on the Schedules attached were prepared by JPMorgan Chase based on data from multiple governmental and non-governmental sources.

[8] U.S. Department of the Treasury, Secretary Geithner Introduces Financial Stability Plan, http://www.treasury.gov/press/releases/tg18.htm (last visited May 1, 2009).

affiliates. More specifically, it is not just the isolation of the real property asset, but the isolation of the cash flows coming from the operation of the real property, from which debt service is paid on the mortgage loan and subsequently distributed to the holders of the securities issued backed by such mortgages. Protecting the integrity of such uninterrupted cash flow is the *sine qua non* of CMBS. It is not an exaggeration to say that if a CMBS lender cannot get comfortable with the isolation of the real property asset to be financed and hence the cash flows derived from the operation of such asset, then no such financing will occur.[9]

The twin components of asset isolation are (i) separateness covenants (the "Separateness Covenants") and (ii) narrow limitations on the lender's general agreement not to pursue recourse liability (the "Limited Recourse Provisions"). This structure was developed directly from and in reliance on decisional law over the last generation. To say that the CMBS market and structured finance in general rely upon the concept of asset isolation truly means reliance upon this body of case law. In briefs being delivered on behalf of many of the lenders and special servicers, the specifics of these cases are discussed in detail, but our point on behalf of the CMBS industry more broadly is the that this reliance would be shattered if GGP and the Property Owners are permitted to ignore the structures to which they have agreed and from which they have profited handsomely.

[9] The criteria issued by the major rating agencies rating CMBS provide that the ratings issued relate to the timely payments of interest and the ultimate repayment of principal. *See, e.g.*, STANDARD & POORS, STRUCTURED FINANCE CMBS PROPERTY EVALUATION CRITERIA 11 (January 2004). Even if the ultimate liquidation value of an asset was not impaired, an event or circumstance disrupting an otherwise stable flow of operating cash flow from a property could lead to a downgrade in the ratings assigned to securities backed by the mortgage loan on such property. If there were a more widespread concern about the structures that protect the integrity of property cash flow, this could lead to revisions of the ratings process ultimately resulting in a higher cost of capital for owners of commercial real estate.

C. **<u>Separateness Covenants</u>**

The Separateness Covenants, while often referred to and discussed as a unitary concept, are really a package of separate and independent covenants made by a borrower to a CMBS lender. The following is a sample set of Separateness Covenants, taken from the form documents for a CMBS lender:[10]

The borrower has not and, for so long as the mortgage loan shall remain outstanding, shall not:

(i) engage in any business or activity other than the ownership, operation and maintenance of the mortgaged property, and activities incidental thereto;

(ii) acquire or own any assets other than (A) the mortgaged property, and (B) such incidental personal property as may be necessary for the operation of the mortgaged property;

(iii) merge into or consolidate with any person, or dissolve, terminate, liquidate in whole or in part, transfer or otherwise dispose of all or substantially all of its assets or change its legal structure;

(iv) fail to observe all organizational formalities, or fail to preserve its existence as an entity duly organized, validly existing and in good standing (if applicable) under the applicable requirements of law of the jurisdiction of its organization or formation, or amend, modify, terminate or fail to comply with the provisions of its organizational documents;

(v) own any subsidiary, or make any investment in, any person;

(vi) commingle its assets with the assets of any other person;

(vii) incur any debt, secured or unsecured, direct or contingent (including guaranteeing any obligation), other than (A) the mortgage loan, (B) trade and operational indebtedness incurred in the ordinary course of business with trade creditors and/or (C) financing leases and purchase money indebtedness incurred in the ordinary course of business relating to personal property on commercially reasonable terms and conditions;

[10] Each of the rating agencies regularly rating CMBS has promulgated criteria with respect to Separateness Covenants. *See e.g.*, STANDARD & POORS, U.S. LEGAL AND STRUCTURED FINANCE CRITERIA FOR CMBS 37 (April 10, 2003).

(viii) fail to maintain its records, books of account, bank accounts, financial statements, accounting records and other entity documents separate and apart from those of any other person; except that the borrower's financial position, assets, liabilities, net worth and operating results may be included in the consolidated financial statements of an affiliate, provided that such consolidated financial statements contain a footnote indicating that the borrower is a separate legal entity and that it maintains separate books and records;

(ix) enter into any contract or agreement with any general partner, member, principal, guarantor of the obligations of the borrower, or any affiliate of the foregoing, except upon terms and conditions that are intrinsically fair, commercially reasonable and substantially similar to those that would be available on an arm's-length basis with unaffiliated third parties;

(x) maintain its assets in such a manner that it will be costly or difficult to segregate, ascertain or identify its individual assets from those of any other person;

(xi) assume or guaranty the debts of any other person, hold itself out to be responsible for the debts of any other person, or otherwise pledge its assets for the benefit of any other person or hold out its credit as being available to satisfy the obligations of any other person;

(xii) make any loans or advances to any person;

(xiii) fail to file its own tax returns or files a consolidated federal income tax return with any person (unless prohibited or required, as the case may be, by applicable requirements of law);

(xiv) fail either to hold itself out to the public as a legal entity separate and distinct from any other person or to conduct its business solely in its own name or fail to correct any known misunderstanding regarding its separate identity;

(xv) fail to maintain adequate capital for the normal obligations reasonably foreseeable in a business of its size and character and in light of its contemplated business operations;

(xvi) without the unanimous written consent of all of its members and directors, including any independent directors, (a) file or consent to the filing of any petition, either voluntary or involuntary, to take advantage of any bankruptcy, insolvency, creditor's rights or similar laws or regulations, (b) seek or consent to the appointment of a receiver, liquidator or any similar official, (c) take any action that might cause such entity to become insolvent, or (d) make an assignment for the benefit of creditors;[11]

(xvii) fail to allocate shared expenses (including, without limitation, shared office space and services performed by an employee of an affiliate) among the persons sharing such expenses and to use separate stationery, invoices and checks;

(xviii) fail to remain solvent or pay its own liabilities (including, without limitation, salaries of its own employees) only from its own funds;

(xix) acquire obligations or securities of its partners, members, or other affiliates, as applicable;

(xx) violate or cause to be violated the assumptions made with respect to the borrower and its principals in any opinion letter pertaining to substantive consolidation delivered to lender in connection with the loan, if any; or

(xxi) fail to maintain a sufficient number of employees in light of its contemplated business operations.

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[11] The appointment of one or more independent directors is another element of asset isolation. To qualify as an independent director of a CMBS borrowing entity, a person must have no affiliation with nor derive any meaningful income from the borrower. An independent director, while required pursuant to CMBS loan documents, is expressly not under the control or direction of the lender and has the same fiduciary duty as all other directors to the entity for which it serves as a director, but not to any parent of such entity. *In re Kingston Square Associates*, 214 B.R. 713 (Bankr. S.D.N.Y. 1997). So long as the borrower and its directors abide by appropriate corporate protocols, including the business judgment rule with respect to the decisions made by directors, actions taken by the borrower would be *prima facie* valid, even if an independent director voted for an action adverse to the interest of the mortgage lender. If however, independent directors were dismissed in contravention of the organizational documents, or appropriate corporate formalities were not observed, an argument can be made that a bankruptcy filing constitutes an ultra vires act and should be dismissed on its face. Even though a solvent entity may avail itself of the protection afforded by the Bankruptcy Code, an independent director's vote in favor of bankruptcy for a solvent entity whose only asset is performing vis-à-vis its liabilities would be open to attack under the business judgment rule. In the GGP bankruptcy, there are rumors in the market that the independent directors of the Property Owners were terminated immediately prior to the Chapter 11 filing. If the facts regarding the status and voting record of the independent directors substantiate these allegations, this may form the basis of an argument for dismissal of the bankruptcy filings with respect to the Property Owners.

Distilled down a bit, the crucial role of the Separateness Covenants is to provide that the owner of the financed asset can own only that asset, can only engage in activities consistent with the ownership of that asset, cannot incur debt or other liabilities (other than customary property related trade credits) that could result in a lien or claim against the asset and will take appropriate steps to declare the independence and separateness of such entity to the outside world. While on a first read, the Separateness Covenants might seem to be onerous or burdensome, in fact they comport with the economic realities of owning and operating commercial real estate. Unlike a construction or development loan, once construction on a project is completed, the actual ownership of commercial real estate becomes more passive investment than active operation of a business—more investment than enterprise. There are the obvious ongoing matters, ranging from periodic decisions, such as negotiating the lease terms for a large tenant and making capital improvements, to the day-to-day affairs of paying utility bills, repairing wear and tear and arranging for snowplows and security guards, but many such matters are usually handled by a property manager (whether a true third party or an affiliate of the property owner) pursuant to a management contract. The Separateness Covenants reflect this reality and, in effect, acknowledge the more passive investment nature of the actual ownership of the real property.

As to the specific content of the Separateness Covenants, if the borrower were a single member limited liability company or a corporation, the foregoing list of covenants would typically apply solely to the borrowing entity. If the borrower were a limited partnership or a multi-member limited liability company, then in addition to the covenants at the borrower level, a similar set of restrictions would apply to its general partner as well. As the various rating agencies promulgated slightly different criteria, lenders also had variations in their exact formulations of the Separateness Covenants, including incorporating them in, alternatively, the promissory note, the security instrument or the loan agreement, as well as, in many cases, the organizational documents, but the core of the Separateness Covenants could fairly be said to be present in the loan documents and/or the organization documents in the vast majority of CMBS loans. From a CMBS lender's perspective, the ideal structure would be to have the real property owned by a newly formed entity created solely to own the real property being financed and which entity agreed to abide by the Separateness Covenants from the date of its formation. There were, however, many instances of borrowing entities that had operated without the limitations imposed by the Separateness Covenants prior to incurring CMBS debt that would agree to abide by the Separateness Covenants for the entire term of the CMBS loan.[12] The key point with respect to these slight distinctions is not what changes, but what stays the same, namely, the core principles embodied in the Separateness Covenants with respect to the independent ownership of the financed asset and only that asset and the concept that the performance of any assets owned by the parent or affiliates of the borrower would not adversely affect the stream of cash flow coming from the operation of the mortgaged property. Put another way, no Separateness Covenants equals no CMBS financing.

[12] In addition to the forward looking covenants, CMBS lenders would typically require borrowers to represent and warrant as to compliance (or non-compliance) with the Separateness Covenants prior to the date of the CMBS financing. With respect to entities formed prior to a CMBS borrowing, the rating agencies issued additional criteria to ensure that any prior activities would not result in the interruption of cash flow from a claim or action by an earlier creditor. *See, e.g.*, STANDARD & POORS, U.S. LEGAL AND STRUCTURED FINANCE CRITERIA FOR CMBS 243 (April 10, 2003).

D. <u>Limited Recourse Provisions</u>

The Limited Recourse Provisions are the other key element of asset isolation in CMBS financings. It is important to note that the nature and purpose of this limited recourse is different from a financing that relies on recourse to the borrower, its parent or sponsor for additional credit enhancement beyond the security offered by the mortgaged property. In a CMBS financing, in the event of certain "bad acts" (the "<u>Recourse Triggers</u>") on the part of the borrower and/or its affiliates, the lender's basic agreement not to pursue recourse liability against a borrower or its owners or principals has limited application, allowing the lender to pursue recourse as part of its remedies. The Recourse Triggers would typically be divided into two categories, with differing recourse consequences. In the first category, the recourse would be limited to the amount of any losses incurred by the lender. These Recourse Triggers include:

(i) fraud or intentional misrepresentation by the borrower or its affiliates;

(ii) the misapplication or misappropriation of rents received by borrower if the loan were in default;

(iii) the misapplication or misappropriation of tenant security deposits or rents collected more than one month in advance;

(iv) the misapplication or the misappropriation of insurance proceeds or condemnation awards;

(v) borrower's failure to pay real estate, except to the extent that there is insufficient cash flow from the operation of the mortgaged property, or to pay charges for labor or materials or other charges that can create liens on the mortgaged property beyond any applicable notice and cure periods specified herein; or

(vi) any act of actual waste or arson by borrower or any affiliate.

To pursue recourse under any of the foregoing Recourse Triggers, a lender would have to establish not only the existence of the Recourse Trigger, but also determine the magnitude of its resulting loss.

For the second category of Recourse Triggers, the lender could seek recourse liability against the borrower in the amount of the total outstanding balance of the mortgage loan, plus any accrued and unpaid interest, regardless of whether the lender had actually suffered a loss. These Recourse Triggers are:

(i) a material breach by borrower or its affiliates of the Separateness Covenants;

(ii) any breach of the due-on-transfer or due-on-encumbrance provisions of the loan documents; or

(iii) any voluntary or collusive involuntary bankruptcy or insolvency filing by or on behalf of the borrower.

This list of Recourse Triggers, taken from the document template for a CMBS lender, is representative of the limitations on recourse found in most CMBS loans. Both with respect to the Recourse Triggers tied to actual losses and those triggering full recourse liability for the entire loan amount, the purpose is the same, namely to provide a credible and enforceable disincentive for the borrower to engage in any act that would constitute a Recourse Trigger. This is wholly different in concept as compared to a recourse-based financing that relies on a direct payment obligation by the borrower or a payment guaranty from its parent as credit support for the loan.

As with the Separateness Covenants, the Limited Recourse Provisions are designed to discourage and punish certain behavior that could impair or defeat the isolation of the financed asset and the cash flows derived from its operation. The distinction between actions triggering liability for losses only versus for full recourse relates to the seriousness of the relevant acts in terms of impairing the isolation of the asset. In essence, permitting the lender to pursue full recourse liability for breach of the Separateness Covenants is simply the strongest incentive for the borrower to comply with the Separateness Covenants.

E. Underwrite-able Risk

Another way to analyze the theory of asset and cash flow isolation is from the perspective of defining credit risk that can be underwritten. A borrower seeks the substantial benefit of financing its real property asset on a non-recourse basis. A CMBS lender agrees to such financing so long as the borrower accepts the Separateness Covenants and the Limited Recourse Provisions. To say that the lender is relying on the Limited Recourse Provisions to motivate the borrower away from bad behavior simply means that the lender is relying on the courts to enforce the applicable remedial provisions of the loan documents following a breach of the Separateness Covenants or a breach of one of the other Recourse Triggers. So long as there is a reasonable and credible basis in law for expecting such enforcement, a CMBS lender[13] can underwrite the value of the real estate and the cash flow generated from its operation. If the asset performs as expected, the loan is repaid or refinanced in the ordinary course and within the requirements of the loan documents. If the asset does not perform well and the loan defaults, the lender's sole remedy is to look to the value of the real property, a risk that can be underwritten and priced by the marketplace. The viability of the CMBS structure will be seriously threatened by the violation of the essential bargain between borrower

[13] This analysis is undertaken not just by the CMBS lender, but by the investors in CMBS, the rating agencies, and often the underwriters of the securities offering, so it is indeed the entire market that relies on this structure and the assumptions as to its enforceability.

and lender that underlies financing on a non-recourse basis in the capital markets to the extent CMBS investors (and CMBS lenders and the rating agencies) begin to doubt whether the courts will enforce the Limited Recourse Provisions or to suspect that courts will permit borrowers to commingle assets in direct violation the Separateness Covenants with impunity. The risk that a borrower that agreed to operate within this structure in return for non-recourse financing could then disavow the structure without risk of enforcement is a risk that cannot be underwritten. If this perception takes hold in the marketplace, investors will falter and the market will stall.

From a bankruptcy perspective, it would not be inaccurate to say that the approach taken by CMBS lenders with respect to isolation of assets is designed to mitigate the risk of substantive consolidation. In most CMBS transactions above a given monetary threshold,[14] one condition precedent to closing was the delivery of an opinion by counsel for the borrower with respect to substantive non-consolidation. Even though these opinions were invariably delivered on a reasoned basis with significant qualifications, they provide comfort to the lender that, based on the then current case law, compliance with the Separateness Covenants would greatly reduce the risk that a creditor of a parent company could prevail in making a consolidation claim that the assets of the subsidiary should be available to satisfy the debts of the parent or affiliates. One of the express Separateness Covenants provides that the borrower will not violate any assumptions taken by counsel in the opinion. In a CMBS loan, this agreement as to how the borrower will conduct its affairs in compliance with the Separateness Covenants is as

[14] The dollar amount varied by lender, ranging from certain lenders who required such opinions in all financings above ten million dollars to other lenders for whom forty million dollars was the number.

critical as the agreement to pay debt service and an essential part of the benefit of the bargain for the lender. In this sense, these opinions further supported the basic CMBS structure and the isolation of assets and cash flows by mitigating a risk that could otherwise not be underwritten.

F. <u>GGP Filings</u>

Certain of the filed statements made on behalf of GGP and the Property Owners raise serious concerns as to the characterization of the relationship between GGP and the Property Owners. In many of the filings, GGP and the Property Owners are defined collectively as the "Debtors",[15] without acknowledgement of the separate and independent nature of these entities. "The Debtors operate a nationwide network of approximately 200 shopping centers in 44 states. The business is run as [an] integrated enterprise with management centralized in its Chicago headquarters."[16] "The GGP Group (defined as the Debtors together with non-Debtor affiliates) operates its business on an integrated basis with centralized administration, leasing and management that enable the GGP Group to achieve operating efficiencies and revenue enhancement benefitting the overall enterprise."[17]

As the Property Owners agreed to the Separate Covenants in many individual CMBS financings, these statements are extraordinarily troubling. They suggest that the

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15 Debtors' Motion Requesting (I) Entry of (A) Interim and Final Orders (1) Authorizing the Debtors' Use of Cash Collateral and Granting Adequate Protection Therefore Pursuant to Sections 361 and 363 of the Bankruptcy Code and Bankruptcy Rule 4001, and (2) Modifying the Automatic Stay, and (B) A Final Order Authorizing Borrowing With Priority Over Administrative Expenses and Secured by Liens on Property of the Estates Pursuant to Section 364(c) of the Bankruptcy Code, and (II) Scheduling of a Final Hearing on Each Requested Final Order at 2.

16 *Id.*

17 *Id.* at 15.

agreement that each Property Owner made with its lender is a sham and that *prima facie* respect for the corporate structure—among the most settled principals in the law of business organizations—is discarded without reason or analysis. In each of the individual CMBS loans involving some of the various Property Owners, a separately formed company that owned a shopping mall sought non-recourse financing from an institutional lender and executed documents expressly agreeing to, and providing representations and warranties with respect to the Separateness Covenants. Through its many subsidiaries, GGP was one of the most active and aggressive participants in the CMBS market and it is quite reasonable to assume that they understood the content of the Separateness Covenants. In GGP's most recent annual report, the company describes the bulk of its mortgage debt payable as "non-recourse notes collateralized by individual properties."[18] It now appears that GGP looks to summarily recharacterize each of the Property Owners and all GGP affiliates as one enterprise with all assets held for the benefit of the collective whole. This approach would be disastrous to the world of real estate finance. If a lender cannot rely on the basic corporate formality of entity separateness, especially when added to it are the express provisions of the Separateness Covenants, the structural underpinning for non-recourse asset specific financing is destroyed.

The other troubling aspect of GGP's attempt to ignore organizational formalities and see only one large enterprise is centered on the passive, independent nature of investment in commercial real assets. If GGP directly or indirectly owns an interest in a Property Owner that owns a shopping mall in Boston, and also owns an interest in

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[18] GENERAL GROWTH PROPERTIES, INC., 2008 Annual Report, Notes to Consolidated Financial Statements F-42 (2008).

another Property Owner that owns a shopping mall in San Francisco, the business necessity of seeing the two malls, or the two entities owning the malls as part of one large enterprise is not compelling. There may be efficiencies gained through the management company in terms of operating logistics, but the argument that the two assets (or entities) are necessarily part of one larger enterprise does not persuade in the same way that a company producing umbrellas might claim that its two plants, one producing the handle and shaft and the other producing the canopy, were truly part of one enterprise as each plant produced a component part of the final product that would be worthless without the other. The difference is that, with commercial real estate finance, even with respect to a real estate investment trust ("REIT") such as GGP, the valuation process is at the property level, not at some perceived value either to or from a larger business enterprise, and each property's value is independent of the others.[19] Prior to its bankruptcy, an analyst valuing GGP common stock might typically compute a price based on a sum of values ascribed to each individual property, with a premium or discount applied based on perceived management skill, rather than estimating some form of top-down enterprise value. Net asset value ("NAV") is a critical metric for analyzing the performance of REITs, NAV being the sum of the values of the individual assets, not the enterprise value of the REIT.[20] This view is supported in the mortgage loan documents for most commercial real estate transactions that permit the property owner/borrower to sell the property to a third party subject to such third party assuming the financing on the

[19] The industry standard MAI Appraisal looks solely at the real estate asset being financed without regard to the ultimate ownership of the asset.

[20] National Association of Real Estate Investment Trusts, The Investor's Guide to REITs, (2009), http://www.reit.com/AllAboutREITs/GuidetoREITInvesting/tabid/61/Default.aspx (follow "Investing in REITs" hyperlink).

property. Such a provision only makes sense if the value is perceived to reside in the asset and not in its participation in the scheme of a larger enterprise.

There are other aspects of the GGP filing that may be pursued by one or more of the CMBS lenders holding first mortgage liens. For example, a lender holding a first mortgage on a shopping mall could make the argument that such mall should be considered Single Asset Real Estate for purposes of the Bankruptcy Code.[21] Under decisions such as *In re Scotia Dev., L.L.C.*,[22] (interpreting single asset real estate "according to an active-versus-passive criterion that inquires into the nature of revenue generation on and by the property, that is, whether the revenue is the product of entrepreneurial, active labor and effort and thus is not single asset real estate – or is simply and passively received as investment income by the debtor as the property's owner – and thus is single asset real estate"), a strong argument can be made that the shopping center assets under consideration in this case fit squarely within the definition of single asset real estate for purposes of the Bankruptcy Code.[23] With respect to

[21] The Bankruptcy Code defines "single asset real estate" as "real property constituting a single property or project . . . which generates substantially all of the gross income of a debtor . . . [and] on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental." 11 U.S.C. §101 (51B).

[22] 375 B.R. 764, 777 (Bankr. S.D. Tex. 2007).

[23] If a debtor's estate constitutes a single asset real estate (a "SARE"), the Bankruptcy Code contains certain restrictions designed to limit the length of the case and the economic imposition that may be placed on creditors whose claims are secured by the debtor's real property. This section was first added to the Bankruptcy Code in 1994 to prevent abuse of the automatic stay, while also giving the debtor an opportunity to create a workable plan of reorganization. With the turn in the credit markets and the recent downturn in the real estate market, SARE debtors will be required to propose a confirmable plan within a short time frame or commence making payments equal to the non-default contract rate of

property management, it is possible a lender will try to exercise its right under the loan documents to remove the property manager. This would have to be done in a manner that does not run afoul of the automatic stay, but it is another potential challenge to GGP's attempt to recharacterize the legal reality of multiple independent and separate entities into a perceived unitary enterprise. While non-debtor affiliates of GGP manage most if not all of the individual properties owned by the Property Owners pursuant to written management contracts, this type of contract would be subordinated and collaterally assigned to the lender in a CMBS financing, as in all real estate financings. The assignment and subordination document typically provides that, upon an uncured loan default, the lender may terminate the management contract and replace the property manager. So long as such replacement manager is reputable and experienced with comparable assets, most CMBS investors would not expect such replacement to have a material adverse impact on the value of the mortgaged property. If the property owned by a Property Owner could be operated by an unrelated third party replacement manager, this further challenges GGP's conclusory view of a single enterprise.

G. <u>Systemic Implications of the Property Owners Filing Within the GGP Corporate Bankruptcy</u>

While on a quick read a cynic might view this analysis as a knee-jerk lender-side rebuttal to anything that limits the exercise of the lender's remedies, the centrality of the CMBS market to commercial real estate finance and the absolute centrality of asset and cash flow isolation to the functioning of the CMBS market elevate this effort to

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> interest on the loan or be subject to foreclosure proceeding by their secured creditors after they obtain relief from the automatic stay.

Marcia L. Goldstein & John W. Lucas, *Single Asset Real Estate Bankruptcy & Recent Developments*, ABI 2008 NEW YORK CITY BANKRUPTCY CONFERENCE 109 (March 2008).

unilaterally modify the core asset isolation structure to a unique and, frankly, more dangerous level. As for the unintended consequences for the CMBS market of the Property Owners filing within the GGP corporate bankruptcy, a nationally recognized CMBS research analyst has observed that:

> The GGP bankruptcy filing is poised to stress some of the major tenets of the CMBS market, including:
>
> - The overall use of [single purpose entities] and the role independent directors plays in that entity;
> - The substantive consolidation of [single purpose entities] with other entities;
> - Recourse to sponsors for failure to comply with the [Separateness Covenants];
> - What constitutes a bad faith bankruptcy filing in the [context of single purpose entity borrowers]; and
> - The efficacy of cash management systems used for CMBS loans.

And further predicted the unintended consequences for the general market of GGP's attempt to extort concessions from the lenders to the Property Owners:

> Ultimately, if GGP is successful in its effort to consolidate [the Property Owners] into its corporate filing, it would set a very negative precedent for all securitizations, as it would tear down the legal isolation from corporate bankruptcies that underlies the structured-finance industry. It may be that the filings by [the Property Owners] prove to be a negotiating tactic to persuade CMBS special servicers to work with GGP to extend and otherwise modify CMBS loans. However, any success GGP meets in consolidating these CMBS . . . borrowers will have a chilling effect on all securitized markets that employ the [single purpose entity] structure.[24]

In summary, the entire architecture of securitization for CMBS and all other asset classes in the capital markets which constitute such a significant and critical part of the

[24] Lisa Pendergast & Todd Jaeger, *GGP Files for Bankruptcy*, ROYAL BANK OF SCOTLAND U.S. CMBS STRATEGY RELATIVE VALUE WEEKLY, 1, 4–5 (April 23, 2009).

economy and its eventual recovery is built upon the foundation of asset isolation and the consequent non-interruption of cash flow. Without that dual groundwork, the trumpeted engine of recovery will falter at best or collapse at worst.

CONCLUSION

WHEREFORE, Commercial Mortgage Securities Association and Mortgage Bankers Association respectfully submit the foregoing for consideration by the Court.

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