

## Bankruptcy Remote Entities in Capital Markets: The Evolution of SPE Independent Director Requirements

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**The landscape of bankruptcy remote special purpose entities (SPE) in commercial real estate finance has undergone significant market adoption since the savings and loan crisis. The role and fiduciary duties of independent directors in SPEs, have become critically important structures in real estate finance. This analysis examines the historical SPE requirements, the challenges posed by the Corporate Family Doctrine, and the implications of a recent judicial decision for structured finance.**

### **The Rise of SPEs in Commercial Real Estate Finance**

Bankruptcy remote SPEs have long been an integral structural necessity in capital markets transactions to obtain more desirable credit rating agency (CRA) investment grade ratings. The advent of commercial mortgage securitization in the wake of the S&L crisis introduced real estate lawyers and their clients to the CRA requirements for borrowers to be organized as SPEs for the first time.

The CRAs each independently developed additional organizational provisions and prophylactic covenants for the new entrants. These must be incorporated in two areas: the borrower's organization documents and the lender's mortgage loan documents. These provisions are required for an entity to be considered a SPE and bankruptcy remote for purposes of the credit rating process and necessary for broader market acceptance. The CRAs often mandate that an SPE borrower must have an "independent director or member" whose affirmative vote would be required to authorize a voluntary bankruptcy filing by a borrower.

### **The Corporate Family Doctrine Challenge**

In nearly four decades, bankruptcy remote SPE borrowers have become a commonplace requirement for commercial mortgage loan transactions. They are now regularly required in the primary and secondary mortgage

markets as well as the capital markets. However, there had not been a definitive case that directly addressed the ability of an SPE entity to limit the independent member's fiduciary duty solely to the debtor and its creditors while eliminating any fiduciary duty or liability to the members of the SPE entity.

### **GGP CASE**

To the contrary, in 2009 during the Global Financial Crisis, General Growth Properties (GGP) filed for voluntary bankruptcy jointly with hundreds of its single asset bankruptcy remote SPE subsidiaries including its property-specific subsidiaries. For procedural purposes, the court consolidated the filings giving GGP access to an existing centralized cash management system and allowed it to use the cash flow from its property-specific SPEs' properties in its Chapter 11. The creditors objected arguing that the property-specific entities were solvent, legally separate and their assets isolated from GGP.

In its decision, the bankruptcy court decided that pursuant to Delaware law independent members of a solvent SPE entity only owe fiduciary duties to the entity and its members and the only time that they can consider the interests of the creditors is when the entity is insolvent. Moreover, the consequence of the court's application of the Corporate Family Doctrine allowed the parent entity to present the interests of the corporate group as a whole for consideration in spite of the creditors' objections to the SPE subsidiaries' being permitted to file for voluntary bankruptcy when the hundreds of individual SPE subsidiaries were actually not in the so-called "zone of insolvency." See Forte, Leonard and Burce, "The GGP Bankruptcy So Far: Grounds for Concern, Sources for Hope" CRE Finance World, Summer 2009 for a detailed discussion of the case.

After the GGP decision, SPE entity governing documents were generally modified to include: limitation of fiduciary duties to the borrower and its creditors and waiver of any fiduciary duty or liabilities to members and affiliates, requiring independent directors to be sourced only from nationally recognized corporate service providers and which directors can be fired only for cause and after notice. These are the provisions that are the subject of this article.

### **Working Around GGP**

A recent Bankruptcy case has provided important clarity to addressing the certain provisions in the SPE borrower organization documents and the lender loan documents. On the motion of the mortgagee to dismiss a Debtor's voluntary bankruptcy filing made without the required

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affirmative consent of the SPE's independent manager, a Bankruptcy Court dismissed the filing for cause. In re 301 WN. Ave., LLC, 666 B.R. 583 (Bankr. N.D. Ill. 2025). However, the court did not impose the requested bar on the Debtor's refiling with the required independent member's consent.

The Court conducted a detailed analysis of the relevant provisions of the mortgage loan and SPE organization documents, applicable Delaware LLC law, and the facts provided in the motion and reply papers. Based on this analysis, the Court held that the SPE borrower had no authority to file for voluntary bankruptcy without the required affirmative vote of the independent member consenting to the filing.

### Key Court Findings

In rendering its decision, the Bankruptcy Court's memorandum opinion undertakes a detailed factual journey through the process of the authorization for the Debtor's voluntary filing:

- The mortgage loan and SPE organization documents "speak for themselves" with respect to Debtor's authority and the independent member's obligations.
- The other LLC members failed to inform or confer with the independent member about the intended filing.
- They also failed to request the independent member's required consent to authorize the filing.
- The independent member's resignation post-bankruptcy filing did not constitute acquiescence in the filing.
- The backdating of her resignation to before the filing is consistent with the independent member's repudiation of the earlier unauthorized filing.
- The Debtor's LLC Agreement ("Agreement") did not impermissibly restrict its right to file for bankruptcy by requiring the independent member to participate and affirmatively consent.
- Such a requirement is not presumptively void.
- The Agreement imposed fiduciary obligations on the independent member to consider the Debtor's interests when deciding whether to vote to file for relief under the Bankruptcy Code.
- The Agreement did not require the independent member to consider the economic interests of the LLC members or third parties.
- The independent member expressly only owes a fiduciary duty to the Debtor and its creditors, which is consistent with Delaware law.

### Market Reaction and Implications for Structured Finance

This decision represents the first full-throated ratification of what (until now apparently only) Delaware permits: the waiver of fiduciary duties to LLC members. This development serves as the magic bullet post-GFC intended to neutralize the "corporate family doctrine" that powered the

2009 GGP bankruptcy fiasco. The court's holding is clear: to the extent the LLC Agreement restricts or eliminates the Independent Manager's fiduciary duty to the Members, it is entirely consistent with Delaware law and cannot be construed to contravene public policy. It is an important decision for structured finance.

This decision provides legal counsel with a reasoned roadmap for drafting SPE entity formation agreements. It shows how to avoid the GGP "corporate family doctrine" by limiting the independent member's fiduciary duty to the Debtor and its creditors only. The decision also demonstrates how to expressly eliminate any fiduciary obligation to any third parties, including shareholders and members of the SPE entity, when drafted consistent with Delaware law.

To be clear, this workaround to the Corporate Family Doctrine would only be effective if the SPE is formed under Delaware Law. The SPE organization agreement must also expressly incorporate the permitted fiduciary duty and liability limitations. The State of Texas recent entry into the formation of SPEs is problematic for market acceptance.

### Texas Emerges as an Alternative Jurisdiction

Earlier this year, the State of Texas took a significant legislative step in its continuing efforts to become an alternative business-friendly jurisdiction for the formation of LLCs and LLPs. Texas amended its Business Organizations statute to allow for the elimination of fiduciary duties from the respective formation agreements of SPEs.

Both LLCs and LLPs are now expressly permitted to eliminate all duties and liabilities of the managers, managing members or general partners. This includes duties of loyalty, care and good faith. The only requirement is that such eliminations must be expressly stated in the entity governing documents.

Delaware's law differs significantly from the new Texas law. Delaware expressly prohibits the waiver of the implied covenant of good faith and fair dealing. Without that explicit statutory prohibition in Texas, it remains unclear how Texas courts will rule. This uncertainty leaves investors at risk, without recourse, for mismanagement, self-dealing, non-disclosures and self-interested transactions.

Investors and lenders must conduct in-depth due diligence for Texas entities. Investors will need to focus on incorporating contractual protections as well as explicit remedies. Unless an investor can obtain these contractual protections, it faces a "Hobson's Choice" of state of formation, ie no choice at all.

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### Conclusion

The *301 W.N. Ave.* decision provides the structured finance market with much-needed clarity on the enforceability of independent director provisions. Delaware law offers a tested framework for limiting fiduciary duties within carefully crafted parameters. Meanwhile, the emergence of Texas as an alternative jurisdiction with broader waiver provisions presents significant risks and uncertainties for investors. As the commercial real estate finance market continues to evolve, careful structuring of SPEs and selection of appropriate jurisdictions will remain critical. These elements are essential to achieving defensible bankruptcy remoteness while balancing the interests of all stakeholders.