

General Growth Properties and the Future of the Independent Manager

I. Introduction

Since the decision of the U.S. Bankruptcy Court for the Southern District of New York (the “Court”) in the *General Growth Properties, Inc.* bankruptcy matter regarding the role of independent managers in special purpose entities (“SPEs”) organized as Delaware limited liability companies (“LLCs”)¹, much has been written about the Court’s refusal to dismiss from the bankruptcy proceeding the SPEs which filed for bankruptcy protection together with their ultimate parent, General Growth Properties, Inc. (“GGP”). There was particular attention given to the Court’s discussion of the fiduciary obligations of the independent managers (“Independent Managers”) under the terms of the LLC operating agreements (“LLC Agreements”) which governed the SPEs at issue in the case. Specifically, the Court found that the Independent Managers were required to consider the interests of the ultimate equity holders of the LLCs (described as GGP Group), as well as the creditors of the LLCs notwithstanding the language of the LLC Agreements.² This decision has resulted in a call by rating agencies and lenders for changes to LLC operating agreements, including deleting any provision which purports to impose on independent managers a fiduciary duty similar to that of a director or officer of a Delaware corporation.

II. The Court’s Findings

The Court’s decision was perhaps most notable in the “bankruptcy remote” area of the law for its refusal to dismiss from the case those SPEs which were owned or controlled by the GGP Group, notwithstanding that they were not insolvent and thus allegedly not needing of bankruptcy protection. Indeed, most were of the view that these entities had been structured to avoid this very fate by insuring that they were remote from the financial perils of their owners. Although the Court sought to make clear it was not, in this decision, consolidating the assets of the SPEs with GGP, the decision not to dismiss the SPEs from the case was alarming to many.

But most significant to the Delaware practitioner was the Court’s interpretation of the LLC Agreements at issue. Specifically, the Court found, in assessing the actions of the Independent Managers who had been designated for the purpose of considering whether to consent to the filing of bankruptcy of their respective SPE, that such Independent Managers were justified, and in fact required, to consider the interests of the GGP Group, as well as the LLCs’ creditors. The Court pointed to a provision in the LLC Agreements which provided that the Independent Managers had a duty similar to that of directors and officers of a Delaware corporation. However, that same provision provided

¹ The decision is styled *In re: General Growth Properties, Inc., et al.*, Case No. 09-11977 (ALG) (August 11, 2009 Bank. S.D.N.Y.)

² *Id.* At 32-33.

that it was subject to another provision of the LLC Agreements which specifically set forth the standard of conduct to be followed by an Independent Manager when making a determination whether to file for bankruptcy. That language provided that “the Independent Managers shall consider only the interests of the [LLC], *including its respective creditors*, in acting or otherwise voting on [a bankruptcy filing]...”³ The Court’s apparent journey away from one of the standard rules of contract interpretation – the specific controls over the general – has led to changes in the terms of LLC agreements governing SPEs.

III. The New SPE LLC Agreement

The LLC agreement which governs any new SPE, as well as any recently amended LLC agreement, has changed significantly in at least one respect – the duties of independent managers or independent directors (referred to collectively herein as “independent managers”). Although the interests to be considered by an independent manager when asked to vote on a bankruptcy filing are much the same -- “the interests of the LLC including its respective creditors”-- other terms have been either deleted or substantially changed as a result of demands from rating agencies and/or lenders. The most prominent deletion [**and one which these authors have urged and in fact required in advising independent directors or independent managers**], is the removal of the language which purports to impose on independent managers any duty similar to that of directors and officers of a Delaware corporation. Even though the Court arguably should have ignored that language in favor of the standard which was to specifically apply when considering a request to file bankruptcy, it was the ambiguity that this language created which led to the findings of the Court. Accordingly, it is now apparently mandatory, as it should have been, that an LLC agreement not include any reference to fiduciary duties of directors of a Delaware corporation when defining the conduct of independent managers.

One of the more prominent additions to the provisions governing the conduct of independent managers, is to clarify that the interests of the LLC do not include interests of the member or equity holder in the LLC other than economic interests, or interests of affiliates of the LLC. In addition, language has been proposed to specifically provide that the independent managers have no other duties other than that stated in the LLC agreement when acting on a request to file bankruptcy, and the implied covenant of good faith and fair dealing.

IV. Conclusion

The essence of an LLC is that it is a contractual entity, governed by, for the most part, the terms of an operating or LLC agreement. In an SPE, the intention is that the role of independent managers is not to be governed by the common law which crafts the duties of fiduciaries. Mixing the concepts of common law fiduciary principles with contractual obligations, as in the case of the GGP matter, proved fatal to the creditors

³ *Id.* at 31 (emphasis in original).

which challenged the bankruptcy filings of the SPEs. The obligations of independent managers should be limited and purely contractual in nature, requiring an independent manager to consider only the interests of the LLC, including its creditors, without consideration of the interests of the ultimate equity holders or affiliates of the LLC.