

GGP Interest Stub Claim

Investments dependent on judge rulings are not our forte, and we would not make an investment for our holdings, but we wanted to mention an example of bankruptcy court rulings and the resulting payoff.

GGP was the 2nd largest US mall REIT which filed for bankruptcy protection when they had difficulty refinancing their mortgage due to the tightening of credit during the financial crisis. The group of lenders, who lent out the loans, never received defaulted interest on their loan. The court normally rules the post-petition, or post-CH. 11 filing interest default as payable. However, prior to the bankruptcy filing, the conditions listed below need to be met before the lenders could receive interest repayment.

I always thought if an agreement, in this case, a credit agreement, was signed, the law would ensure repayment of the interest and principal, even after a bankruptcy filing, given I was a senior lender. This may not be the case.

"Law & precedent around default interest claims:

As one financial advisor involved with the case said "I mean, it's pretty straightforward: The company was in default. There is a default interest provision in the Credit Agreement, so creditors should be entitled to default interest, right?" Well, no—historically, ipso facto default in and of itself is not a sufficient condition to merit default interest. There are a number of criteria that need to be met for default interest to be paid, as detailed in Morrison & Foerster's response to GGP's objections to paying default interest (docket #6635) and Judge Gropper's ruling as of July, 2011. Specifically:

- 1. Default interest is only payable when a debtor is solvent. Payments must not impair other creditors' recoveries. All GGP creditors received a par principal recovery plus accrued interest as part of GGP's emergence from Ch. 11, so this condition is met.**
- 2. Default interest is only payable if it does not impede the debtor's successful exit from bankruptcy. As we have seen, GGP did successfully exit Chapter 11—this was never in dispute.**
- 3. Default interest cannot be construed as a "penalty". Tough to prove this out definitively, but one affidavit on the docket notes that GGP would never have been able to borrow at such a low interest rate without this default interest clause, and 2% certainly not an onerous rate.**
- 4. Default interest may not be paid if creditors do not follow proper procedure in declaring a default has occurred and claiming default interest. This is a specific point of contention in the GGP case. GGP asserted that the 2006 Lenders had not properly notified the company that it was in default and had not taken the proper steps to claim default interest before GGP filed for Ch. 11 protection. However, the 2006 Lenders produced interest rate modification notices and emails sent to GGP's counsel before GGP filed for bankruptcy that gave the company the options of either paying default interest or the creditors accelerating payment on their loans. In his decision, Judge Gropper agreed that the 2006 Lenders had taken proper steps to claim default interest. "**