

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF MASSACHUSETTS  
EASTERN DIVISION

	)	
<b>In re</b>	)	
	)	<b>Chapter 11</b>
<b>SW BOSTON HOTEL VENTURE LLC, et al,</b>	)	<b>Case No. 10-14535 (JNF)</b>
	)	
<b>Debtor.</b>	)	
	)	<b>(Jointly Administered)</b>

**CITY OF BOSTON’S OPPOSITION TO PRUDENTIAL INSURANCE COMPANY OF AMERICA’S MOTION FOR AN ORDER AUTHORIZING THE APPLICATION OF PAYMENTS RECEIVED DURING THE CHAPTER 11CASES TO THE PAYMENT OF POSTPETITION INTEREST PURSUANT TO SECTION 506(b) OF THE BANKRUPTCY CODE**

The City of Boston, a municipal corporation in the Commonwealth of Massachusetts, acting by and through its Public Facilities Commission by the Director of the Department of Neighborhood Development (“City”) hereby opposes the Motion of Prudential Insurance Company of America (“Prudential”) for an Order Authorizing the Application of Payments Received During the Chapter 11 Cases to Payment of Postpetition Interest Pursuant to Section 506(b) of the Bankruptcy Code (“Motion”)<sup>1</sup>. In support hereof, the City states as follows:

**Preliminary Statement**

1. Prudential and the City are the Debtors’ pre-petition secured lenders. Prudential holds a first priority lien and security interest on most of Debtors’ property. As of the petition date (and following the draw on Debtors’ \$17.3 million letter of credit), the Debtors owed Prudential approximately \$163.5 million. The City holds a second priority lien and security interest on most of Debtors’ property, and also holds a first priority position with

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<sup>1</sup>All capitalized terms shall have the meanings ascribed to them in the Motion unless otherwise indicated.

regard to \$4 million held in the name of the City at Boston Private Bank pursuant to a pre-petition escrow agreement. As of the petition date, the Debtors owed the City about \$10.7 million.

2. Until the date of the Motion, Prudential consistently took the position that it was “woefully undersecured” (See e.g. Prudential Objection to Debtors’ Cash Collateral Motion dated June 1, 2010, Docket Entry 105, pg. 8; Prudential’s Lift Stay Motion, Docket Entry 197, pg 2, *et seq.*; Docket Entry 376, pg. 2 *et seq.*). Indeed on January 28, 2011, following a three day trial on Prudential’s Lift Stay Motion, this Court found that the Debtor lacked equity with respect to the W Hotel and Residences, and that Prudential was undersecured as to that property. (Lift Stay Memorandum, Docket Entry 436, pg. 42).
3. Only now that Debtor has entered into a purchase and sale agreement and sold the Hotel portion of the Property at a price significantly higher than the appraised value submitted by both the Debtors and Prudential in connection with the Lift Stay Motion, does Prudential assert it is oversecured and entitled to interest and fees for the entire post-petition period.
4. Because valuation of collateral can fluctuate during the pendency of a bankruptcy, it is appropriate to make valuations, for different purposes, at various times throughout the bankruptcy. Financial Security Assurance, Inc. v. T-H New Orleans LP, 116 F.3d 790, 798 (5<sup>th</sup> Cir. 1997). In this case, the Debtors effectuated the sale of the Hotel on June 8, 2011, thereby establishing a new arms-length value. It is appropriate to use the Hotel sales date as the new valuation date to consider Prudential’s claim for interest. If

Prudential becomes oversecured as a result of the new valuation, it may be appropriate for the Debtors to pay some amount of post-petition interest, beginning at the point in time that Prudential became oversecured.

**Argument**

5. Contrary to Prudential's assertion, §506(b) determinations as to a secured creditor's claim are not made universally as of the petition date. When collateral fluctuates in value and a secured creditor's claim is being reduced by periodic payments during the course of a bankruptcy, it is appropriate for the court to exercise discretion as to the timing of valuing the creditor's claim and the collateral. Id. Here, it is appropriate to value both Prudential's claim and the collateral as of the date the Hotel was sold.
6. A secured creditor claiming to be entitled to post-petition interest bears the burden of proving, by a preponderance of the evidence, that its claim is oversecured, "to what extent, and for what period of time." In re Grabill Corp., 121 B.R. 983, 992 (Bkrcty.N.D.Ill.,1990), citing In re Mitchell, 81 B.R. 171, 173–174 (Bankr.D.Colo.1988) and In re Bradley, 94 B.R. 563, 567 (Bankr.N.D.Iowa 1988). Prudential bears the burden of proving that its claim is oversecured and for what period of time.
  - A. **Prudential's Claim and the Collateral Should Be Valued as of the Date of Sale of the Hotel.**
7. Financial Security Assurance, Inc. v. T-H New Orleans LP, 116 F.3d 790 (5<sup>th</sup> Cir. 1997) is highly instructive with regard to Prudential's instant Motion. Much like the present case, Financial Security involved a Chapter 11 bankruptcy in which the primary asset was a hotel where the value of the collateral and the amount owed to the secured lender

fluctuated during the bankruptcy. At the petition date, the senior secured lender was undersecured by about \$6 Million. Pursuant to a cash collateral order, the debtor made post-petition payments of about \$4.5 Million, thereby lowering the amount of the senior lender's claim. During the course of the bankruptcy, the value of the hotel increased. Following a hearing to determine the fair market value of the hotel, the bankruptcy court valued it at \$13.7 Million. After a hearing to determine the amount of the secured lender's allowed claim, the bankruptcy court determined that the allowed claim (after applying the cash collateral payments) was \$13,748,055. Accordingly, the senior lender was undersecured by about \$48,000 as of the time the court determined the amount of the allowed claim. By the time of confirmation about six months later, the value of the hotel had further increased, and additional further cash collateral payments had been made. At some point during that six month period, the secured lender had become oversecured.

8. The secured lender argued that because it was oversecured at confirmation, it should receive post-petition interest dating back to the time of filing. *Id.* at 796. The 5<sup>th</sup> Circuit firmly rejected that argument, noting that “[n]either Bankruptcy Code §506(b) nor the Bankruptcy Rules define or establish the time for determining valuation of collateral for purposes of §506(b).” *Id.* at 798 (citations omitted); see also In re Alpine Group, Inc., 151 B.R. 931, 935 (9<sup>th</sup> Cir. BAP (Wash.),1993) (point of sale, not petition date, is relevant time for determining whether a creditor is oversecured).

[F]or the purposes of determining whether a creditor is entitled to accrue interest under §506(b) in the circumstance where the collateral's value is increasing and/or the creditor's allowed claim has been or is being reduced by cash collateral payments, such that at some point in time prior to confirmation of the debtor's plan the creditor may become oversecured, valuations of the collateral and the

creditor's claim should be flexible and not limited to a single point in time, such as the petition date or confirmation date.

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Financial Security, 116 F.3d at 798.

9. Here, Prudential acknowledged that it was undersecured with respect to the W Hotel and Residences throughout the Lift Stay proceedings. The Court agreed, and made a factual finding that, as of January 28, 2011, Prudential was, indeed, undersecured with respect to the W Hotel and Residences. (Lift Stay Memorandum, Docket Entry 436, pg. 42). There has been no appraisal of the Debtor's property since the Court's Lift Stay Memorandum.
10. "When secured collateral has been sold, so long as the sale price is fair and is the result of an arm's-length transaction, courts should use the sale price, not some earlier hypothetical valuation, to determine whether a creditor is oversecured and thus entitled to postpetition interest under § 506(b)." Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 870 (4<sup>th</sup> Cir. 1994); In re Alpine Group, Inc., 151 B.R. at 936.
11. Here, on March 28, 2011, the Debtor filed the Sale Motion with the Court to approve a potential sale of the Hotel to a disinterested, third-party investor. The Sale Motion indicated that Debtor has entered into a purchase and sale agreement for the Hotel portion of the Property, for the gross sum of \$89.5 Million. The hearing on Debtor's Sale Motion was held on May 24, 2011. The sale of the Hotel took place on June 8, 2011. The Hotel's value is established as of that date. Prior to the actual sale, the prospective sales price was merely hypothetical
12. Once a sales price is determined, the costs of sale must be deducted out, to determine the actual value of the collateral. In re Lane, 108 B.R. 6, 8 (Bankr. D. Mass 1989); Ford

Motor Credit 35 F.3d at 870, citing In re Broomall Printing Corp., 131 B.R. 32, 34 (Bankr.D.Md.1991).

13. Once the values of Prudential's claim and the collateral have been established, it will be apparent whether or not Prudential became oversecured within the meaning of §506(b) on June 8, 2011.
14. Utilizing a flexible approach to the timing of valuation of Prudential's claim and the collateral is consistent with this court's equitable powers. Id. at 798.

**B. Accrual of Interest If Prudential Is Oversecured**

15. Prudential will be entitled to accrue interest on its claim beginning only at the time (if any) that it became oversecured. If Prudential, in fact, became oversecured at some point in time, only then interest will begin to accrue on its claim. Financial Security, 116 F.3d at 799 (“[A] secured creditor’s entitlement to accrue interest under §506(b) matures at the point in time where the creditor’s claim becomes oversecured.”). Even then, the interest will only begin to accrue; it is to be paid only upon plan confirmation or the plan’s effective date. 4 Collier on Bankruptcy ¶506.04[4], 506-112.
16. It is difficult to understand, therefore, why Prudential would argue that the post-petition payments its has received to date should be applied to post-petition interest and costs when such amounts only become payable upon confirmation of a plan or its effective date. Any payments that the Debtor has made to Prudential during the pendency of the bankruptcy should have been applied to reduce Prudential’s claim when received.

**C. Contract Default Interest Rate is Inappropriate in this Context.**

17. Assuming, *arguendo*, that Prudential, at some point in time, became an oversecured

creditor, and therefore is entitled to the payment of some amount of interest going forward, it would be inequitable to permit it to recover interest at the default rate set forth in the Prudential Loan Documents (which Prudential asserts total \$23.6 million as of April 15, 2011). The City is the Debtor's only other secured creditor. The City Loan is pursuant to an innovative loan program called the *Boston Invests in Growth Loan Pool* ("Loan Pool") which is structured under the United States Department of Housing and Urban Development ("HUD") Section 108 Loan Guaranty program to stimulate local real estate development. The developments assisted by the Loan Pool help the City meet a number of important economic development goals, including the promotion of tourism, which remains a crucial aspect of Boston's economy, and the generation of additional retail activity. Furthermore, such developments are important generators of jobs and tax revenues for the City and have a variety of secondary economic impacts. One of the purposes of the Loan Pool is to provide economic assistance to projects which are having difficulty obtaining conventional commercial financing, such as the W Hotel and Residences.

18. If Prudential is permitted to recover postpetition interest at the default rate of 14.5%, the City's standing to recover its affordable housing money will be severely compromised. It would be inequitable to reward Prudential with the default rate, where the City funds have been used, and are continuing to be used to increase the value of Prudential's collateral (e.g. completion of the Spa and Theme Bar). Even after the sale of the Hotel, the City's funds are going to be used to complete the build-out of the Theme Bar, which will continue to add value to the remaining condominium units.

19. The default rate may be appropriate in some circumstances, such as where there is only one secured party and no remaining unsecured claims (see e.g. In re Courtland Estates Corp., 144 B.R. 5, 9 (Bkrcty. D. Mass. 1992), but that is certainly not the case here. The City has gone to great lengths to assist in the viability of this project using its affordable housing money, and it should not be penalized for doing so. The City would be penalized if Prudential were permitted to charge a 14.5% postpetition rate of interest.

WHEREFORE the City respectfully requests that this Court deny Prudential's Motion for an Order Authorizing the Application of Payments Received During the Chapter 11 cases to the Payment of Postpetition Interest Pursuant to Section 506(b) of the Bankruptcy Code.

Respectfully submitted,

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Dated:  
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**CERTIFICATE OF SERVICE**

I hereby certify that this document filed through the ECF system will be sent electronically to the registered participants as identified on the Notice of Electronic Filing (Exhibit A) and copies will be sent by electronic mail to those indicated as non-registered participants (Exhibit B).

June 21, 2011

/s/ E. Kate Buyuk

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