



so, in what amount and at what rate and whether Prudential is entitled to post-petition legal fees and expenses.

Otherwise, the City of Boston joins in the Debtors' Proposed Findings of Fact and Rulings of Law.

### **PROPOSED FINDINGS OF FACT**

#### **A. City Loan**

1. In order to prevent a shut-down of the entire project and to allow the Hotel to open under the W Flag, on December 9, 2009, SW Boston and the City of Boston entered into the City Loan Documents, whereby the City of Boston agreed to provide \$10.5 million to finance the completion of the Restaurant, Spa and Theme Bar. The Debtors approached the City of Boston as a lender of last resort. *Docket No. 703-1, Hunt Declaration at ¶5.*

2. The City Loan was made 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 ("HUD 108 Loan") to stimulate local real estate development. The developments assisted by the Loan Pool have helped the City of Boston 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 of Boston 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. Due to the economic downturn in 2009, the need was especially acute.

The City of Boston determined that the proposed funding for the Restaurant, Spa and Theme Bar met the criteria of the Loan Pool. The City of Boston was very aware that the Project needed to be finished quickly, and that there would be an immediate positive economic impact. If finished, the Project would create new jobs and provide significant economic development in Boston's Theatre District. *Id. at* ¶¶3, 6, 7.

3. The City of Boston made the City Loan and entered into the Intercreditor Agreement out of necessity to avoid a catastrophic shut-down of a large-scale project in the middle of the Theatre District. The City of Boston was not motivated to make the City Loan in order to turn a profit. *Docket No. 703-1, Hunt Declaration at* ¶13.

4. The City Loan enabled the project to open under the W flag in a timely manner, and resulted in the hiring of over 250 persons, the majority of whom were low and moderate income people and residents of the City of Boston. *Id. at* ¶8.

5. The City of Boston borrowed the \$10,500,000 from HUD, pursuant to the HUD 108 Loan program in order to fund the City Loan. As security for the HUD 108 Loan the City of Boston provided to HUD a note secured by a pledge of present and future Community Development Block Grant (“CDBG”) revenues. CDBG funding is critically important to the City of Boston because it provides dollars for the City of Boston’s affordable housing and economic development programs. *Id. at* ¶9.

6. SW Boston executed a Promissory Note in favor of the City of Boston on December 9, 2009 in the principal amount of \$10,500,000 to finance the completion of the Restaurant, Spa and Theme Bar. *Prudential Exhibit 8*. As collateral for the City Loan, SW Boston granted the City of Boston a second mortgage on and assignment of leases and rents with respect to the W

Hotel and Residences. Sawyer Corporation, General Land, 30-32 Oliver Street and 131 Arlington Street also guaranteed SW Boston's obligations under the City Loan Documents. *Id. at pg. 2*. Two non-debtor affiliates, SE Berkeley and SE McClellan also guaranteed the note. *Id.* The interest rate on the note was 8%, and SW Boston was permitted to defer up to 3% of the interest. *Id. at pg 1*. SW Boston was prohibited from making principal repayment during the first five years of the loan. *Id.*

7. As further security for the City Loan, Sawyer Corporation provided cash collateral of \$4 million, which has been held at Boston Private Bank and Trust Company ("City Account"). The City of Boston has a perfected security interest in this account which is held in the name of the City.

8. Prudential and the City of Boston entered into an Intercreditor and Subordination Agreement on December 29, 2009 ("Intercreditor Agreement"). *Prudential Exhibit 9*. The Intercreditor Agreement disclosed that the City of Boston's source of the funds was "to be loaned pursuant to Section 108 of the United States Department of Housing and Urban Development ("HUD") Community Development Block Grant Program." *Id. at pg. 2*.

(1) CITY ACCOUNT EXCLUDED FROM INTERCREDITOR AGREEMENT

9. The Intercreditor Agreement expressly provided that the \$4,000,000 pledged to the City of Boston by Sawyer Corporation (i.e. the City Account) and the City of Boston's security interest in the SE Berkeley and SE McClellan properties are "Additional Junior Loan Collateral" that are not subject to the terms of the Intercreditor Agreement:

Senior Lender acknowledges that Junior Lender has and will have collateral securing the Junior Loan that does not secure the Senior Loan consisting solely of the following (collectively, the "Additional Junior Loan Collateral"): (i) that

certain security account held by UBS, or such other financial intermediary as Borrower and Junior Lender may choose, in the name of [Frank] Sawyer [Corporation] with an initial value of Four Million Dollars (\$4,000,000), as it may be increased by interest or accretions . . . and which is the subject of a Pledge and Security Agreement between Sawyer and Junior Lender. . . and (ii) a Second Mortgage, Security Agreement, Assignment of Leases and Rents and Fixture Financing Statement and a Second Assignment of Leases and Rents, respectively, on each of the properties at 142 Berkeley Street, Boston. . . and 415 McClellan Highway, Boston . . . Senior Lender further acknowledges that it holds no direct or indirect interest in or lien on the \$4,000,000 Pledge Amount or on the 142 Berkeley Property or on the McClellan Property and agrees that it shall not at any time acquire any such interest or lien. **The above-referenced second mortgages and second assignments of leases and rents on the 142 Berkeley Property and the McClellan Property, respectively, and the obligations which are secured thereby and the \$4,000,000 Pledge and Security Agreement are not Junior Loan Documents which are the subject of or which are subject to this Agreement.**

*Prudential Exhibit 9, §1(b)(Emphasis added). See also Intercreditor Agreement at Sections 4, 5(d), 7(a) and 8(c) (Prudential has no rights with regard to the Additional Junior Loan Collateral).*

10. The Intercreditor Agreement provides that any money received by the City as a result of Debtors' bankruptcy is to be held in trust and paid over to Prudential until Prudential has been paid in full, except for payments received from the City Account or on account of the other Additional Junior Loan Collateral. *Prudential Exhibit 9, §8(c).*

11. Prudential has demanded that the City of Boston turn over to it any payments it may receive under the Plan on account of the City Account pursuant to Section 8(c) of the Intercreditor Agreement. The City of Boston has replied that the City Account is outside the scope of the Intercreditor Agreement, according to the Intercreditor Agreement's own clear terms.

(2) PAYMENTS TO CITY OF BOSTON PURSUANT TO LOAN ESCROW MOTION.

12. Pursuant to the City Loan Documents which include an escrow agreement ("Fidelity

Escrow Agreement") (a copy of which is attached to docket no. 128 as Exhibit A) with Fidelity National Title Insurance Company ("Fidelity"), a portion of the City Loan (about \$6.5 million) was funded into an escrow account ("Fidelity Account") in the name of SW Boston at Fidelity. The purpose of the Fidelity Account was to fund the build-out of the Restaurant, Bar and Spa and the City's interest, expenses and fees relating to the Project. The build-out of the Restaurant was completed and paid out of the Fidelity Account prior to the Petition Date. The Spa is now complete. The Theme Bar is still being completed using the proceeds of the Fidelity Account.

13. The City holds a perfected first priority security interest in the Fidelity Account.

14. The Debtors filed a Loan Escrow Motion (*Docket No. 128*), seeking continued access to the Fidelity Account in accordance with the terms of the Fidelity Escrow Agreement. Section 3 of the Fidelity Escrow Agreement makes provision for the disbursement of the escrow funds. In particular, section 3.4 provides as follows:

[The City] may request from [Fidelity] one or more disbursements to pay interest and other charges due to, or costs or expenses incurred by, the [City] under the documents evidencing the [City Loan] (including attorneys' and professional fees and any costs or expenses reasonably incurred by [the City] in association with each Requisition of funds hereunder and in connection with the [City's] obtaining funds from HUD) by written direction to the Title Company . . .

Debtors' Loan Escrow Motion stated that the Debtors sought authority to continue to use the Fidelity Account in accordance with the terms of the Fidelity Escrow Agreement, including "to make payments to the City on account of interest, costs and other charges on account of the City Loan" (*Docket No. 128 at ¶20*).

15. Prudential did not object to the allowance of the Loan Escrow Motion. The Court allowed the motion in its entirety and entered an Order on June 11, 2010 (*Docket No. 138*). Prudential never appealed from the Order.

16. Since that time, the Fidelity Account funds have been used to complete the build-out of the Spa, to continue the on-going build-out of the Theme Bar, and to make other payments authorized by the Fidelity Escrow Agreement, including payments to the City.

17. The Intercreditor Agreement contains provisions at Sections 2(a)(vii) and 2(b)(vii) that Prudential and the City both represent and warrant that the Intercreditor Agreement is “subject to (A) applicable bankruptcy, reorganization, insolvency and moratorium laws, and (B) general principals of equity which may apply regardless of whether a proceeding is brought in law or in equity”. *Prudential Exhibit 9*.

(3) ASSIGNMENT OF VOTING RIGHTS.

18. The Intercreditor Agreement provides that in the event of bankruptcy, the City will “assign to [Prudential] the voting rights of [the City] in such proceeding.” *Prudential Exhibit 9, §8(c)*. However as noted in paragraph 17, *supra*, the Intercreditor Agreement contains overriding provisions that it is subject to applicable bankruptcy law and general principals of equity. *Id. at §§ 2(a)(vii) and 2(b)(vii)*.

19. Prudential has demanded that the City of Boston assign its voting rights to Prudential. The City of Boston has declined.

20. The City of Boston and Prudential both cast ballots relative to Debtors’ Plan. The City of Boston voted in favor of the Plan. Prudential voted to reject the Plan on the City of Boston’s behalf.

**B. Post-petition Interest Payable to Prudential**

21. As of the Petition Date, Debtors owed Prudential \$182,078,243. *Debtors' Exhibit 6.*
22. Two days later, Prudential drew on the Sovereign letter of credit in the amount of \$17,300,000, thereby reducing the debt balance to \$164,778,243. *Id.*
23. Between the Petition Date and June 8, 2011, Debtors paid Prudential \$25,621,267, representing the net proceeds from the sales of condominium units. *Id.*
24. On March 28, 2011, SW Boston filed a *Motion For Order (I) Authorizing the Sale of the Debtor's Commercial Unit, Parking Garage Unit and Related Assets Free and Clear of All Liens, Claims, Interests and Encumbrances, (II) Authorizing the Assumption and Assignment of Certain Executory Contrast and Unexpired Leases in Connection Therewith and (III) Granting Related Relief (Docket No., 495)* to sell the Hotel to an affiliate of Pebblebrook Hotel Trust for \$89,500,000.
25. The Court approved the sale on May 24, 2011.
26. Immediately prior to the sale, the outstanding debt to Prudential was \$139,156,976. *Debtors' Exhibit 6.* The closing on the Hotel took place on June 8, 2011. The net sales proceeds of \$83,322,017 were paid to Prudential, and the new balance on the Prudential debt was \$55,834,959. *Debtors' Exhibit 6.*
27. The value of the Debtors' remaining condominium units as of June 8, 2011 was \$66,069,353. *Debtors' Exhibit 6.*
28. The contract rate of interest on the Prudential Loan was 9.5%. *Prudential Exhibit 3.* The default rate of interest listed in the Prudential Loan Documents was 14.5%. *Id.*

29. Prudential has asserted that it is entitled to its reasonable fees and costs pursuant to 11 U.S.C. §506(b). It submitted no evidence of its fees or costs, and did not provide any evidence of their reasonableness.

### PROPOSED CONCLUSIONS OF LAW

#### A. City Loan.

(1) CITY COLLATERAL EXCLUDED FROM INTERCREDITOR AGREEMENT

30. Generally, subordination agreements are enforceable under the Bankruptcy Code, 11 U.S.C. §510(a)<sup>2</sup>. The terms of the Intercreditor Agreement between the City of Boston and Prudential make it unambiguously clear, in at least 5 separate sections, that the City Account (and the other Additional Junior Loan Collateral) are completely excluded from the ambit of the Intercreditor Agreement.

31. Prudential has no right to, or interest in, the City Account (and the other Additional Junior Loan Collateral), and it is not entitled to recapture any funds paid to the City of Boston on account of the City Account, either pursuant to a bankruptcy plan or for any other reason.

(2) PAYMENTS TO CITY OF BOSTON PURSUANT TO LOAN ESCROW MOTION.

32. Prudential was fully aware of the terms of the Fidelity Escrow Agreement, which was attached to the Loan Escrow Motion (Docket No. 128). It was similarly aware that the Debtors expressly sought authority “to make payments to the City on account of interest, costs and other charges on account of the City Loan” (*Docket No. 128 at ¶20*).

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<sup>2</sup>As will be discussed in detail (*see §(3) infra*) there are circumstances in which particular provisions of a subordination agreement are unenforceable.

33. Prudential never objected to the Loan Escrow Motion, which expressly stated that one of the purposes of the Motion was to allow payments to the City of Boston. Furthermore, the Fidelity Account holds the funds that the City of Boston provided to SW Boston to complete the Restaurant, Spa and Theme Bar. The City of Boston has a perfected first priority security interest in those funds. Prudential's interest in those funds, if any, is secondary to the City of Boston's. It would be unfair, inequitable and unreasonable for Prudential to recapture funds which the City of Boston had advanced on the project.

34. Post-petition payments of interest and other costs and charges were properly paid to the City of Boston from the Fidelity Account in accordance with the Loan Escrow Motion, and Prudential is not entitled to recapture those payments made to the City of Boston.

(3) ASSIGNMENT OF VOTING RIGHTS

35. This Court adopts the reasoning in *Bank of America, National Ass'n v. North LaSalle Street, LP (In re 203 North LaSalle Street Partnership)*, 246 B.R. 325 (Bankr. N.D. Ill. 2000); *In re Hart Ski Mfg. Co., Inc.*, 5 B.R. 734, 736 (Bkrtcy.Minn., 1980), and concludes that the purported assignment of voting rights in the Intercreditor Agreement is unenforceable in the present circumstances.

36. Subordination agreements do not trump Bankruptcy Code §1126(a), which provides that the holder of a claim or interest may vote to accept or reject a plan. *LaSalle*, 246 B.R. at 331.

“[I]t would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply.” *Id.* Here, the City of Boston is the holder of the City of Boston claim. *Cf. In re Avondale Gateway Center Entitlement, LLC*, No.

CV10-1772-PHX-DGC, 2011 WL 1376997 (D.Ariz. April 12, 2011) (subrogated claims, unlike

subordinated claims, may result in a transfer of voting rights). Accordingly, the City of Boston must be permitted to cast its ballots pursuant to Bankruptcy Code §1126(a).

37. While Bankruptcy Code §510(a) speaks to the enforcement of subordination agreements, that section only applies to a senior lender's right to payment, not to the assignment of voting rights. *LaSalle*, 246 B.R. at 331. "Subordination . . . affects the order of priority of payment of claims in bankruptcy, but not the transfer of voting rights." *Id.*

38. Bankruptcy Rule 3018(c) provides that a Chapter 11 ballot must be signed by "the creditor or equity security holder or an authorized agent." "An 'agent' is commonly understood to act at the direction of a principal." *Id.* at 331-332, citing *Brunswick Leasing Crop. V. Wisconsin Central Ltd.*, 136 F.3d 521, 526 (7<sup>th</sup> Cir. 1998). Prudential is not an authorized agent of the City of Boston. The City of Boston supports the Debtors' Plan. The Plan makes provision for the full payment of the Allowed City Claim in such a way that the City of Boston will be able to repay its HUD 108 Loan, thereby protecting the City of Boston's present and future CDBG revenues which would otherwise be at risk. Furthermore, Prudential has taken the position that it is entitled to default rate post-petition interest in an amount that exceeds \$24 million<sup>1</sup>. Such a position would wipe out any chance of the City of Boston recovering any amount on its claim from the project. Prudential does not support the Plan, and has attempted to cast the City of Boston's votes against the Plan. Prudential clearly is not acting at the direction of the City of Boston.

39. Although a creditor's claim is subordinated, it may very well have a substantial interest in the manner in which its claim is treated. Subordination affects only the

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<sup>1</sup>This figure does not include Prudential's unspecified, un-itemized "fees and costs" which it seeks to recover pursuant to §506(b).

priority of payment, not the right to payment. If the assets in a given estate are sufficient, a subordinated claim certainly has the potential for receiving a distribution, and Congress may well have determined to protect that potential by allowing the subordinated claim to be voted. This result assures that the holder of a subordinated claim has a potential role in the negotiation and confirmation of a plan, a role that would be eliminated by enforcing contractual transfers of Chapter 11 voting rights.

*LaSalle*, 246 B.R. at 332. The City of Boston and the citizens on whose behalf it acts clearly have an interest in how its claim is treated, as there is sufficient value in the estate to pay both Prudential and the City of Boston in full, so long as Prudential is only awarded post-petition interest at the contract rate from the date it became oversecured on June 8, 2011 to the Effective Date.

40. The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. These rights include the right to assert and prove its claim, the right to seek Court ordered protection for its security, the right to have a stay lifted under proper circumstances, the right to participate in the voting for confirmation or rejection of any plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable. The above rights and others not related to contract priority of distribution pursuant to Section 510(a) cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination agreement, the “subordinator” gives up all its rights to the “subordinatee” would be totally inequitable.

*In re Hart Ski Mfg. Co., Inc.*, 5 B.R. 734, 736 (Bkrcty.Minn., 1980).

41. Here, the Intercreditor Agreement itself provides that it is subject to general principles of equity. *Prudential Exhibit 9 at Sections 2(a)(vii) and 2(b)(vii)*. Equity here dictates that the City of Boston must cast its own votes on the Debtors’ Plan. The City of Boston made the City Loan to save the project from catastrophic shut-down. The City of Boston’s motivation in making the loan was not to make money, but to serve the best interests of the City of Boston not only by completing a project that creates new jobs and provides significant economic development in

Boston's Theatre District, but also by preventing the specter of an unfinished 28 story tower looming over one of the City's most important commercial districts. The City of Boston was forced to do so because Prudential refused to lend the money. Having put the City into this position, it would be inequitable and unconscionable to permit Prudential now to assert and to exercise rights belonging to the City and its citizens, in a manner that is to the express detriment of the City and its citizens.

42. Throughout this entire bankruptcy proceeding, Prudential has made every effort to thwart the Debtors' efforts to reorganize and to minimize the chance that junior creditors would be able to recover the value of their claims.

43. Both law and equity dictate that Prudential cannot purport to exercise the City of Boston's voting rights to wipe out the City of Boston's ability to collect its claim.

**B. Post-petition Interest, Fees and Costs Payable to Prudential**

44. Prudential, 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).

45. "[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)." *In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790, 798 (5<sup>th</sup> Cir. 1997) (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).

46. 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. *T-H New Orleans*, 116 F.3d at 798.

47. An oversecured secured creditor is only entitled to accrue postpetition interest starting at the time it becomes over secured. *Id.* at 799.

48. "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.

49. It is appropriate to use the value, as of the date of sale of the Hotel, as opposed to the date of the Purchase and Sale Agreement, to value Prudential's collateral. Prior to the actual sale, the potential sale price was hypothetical and, in fact, the Purchase and Sale Agreement had several substantive "escape" clauses for the potential purchaser of the hotel.

50. 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).

51. Here, Prudential became oversecured on June 8, 2011, the date the Hotel sold. At that time, the Debtors were indebted to Prudential in the amount of \$55,834,959. The value of the remaining condominiums on that date was \$66,069,353. *Debtors' Exhibit 6*.

52. Prudential is entitled to postpetition interest from June 8, 2011 to the Effective Date of the Plan.

53. It would be inequitable to permit Prudential to recover interest at the default rate set forth in the Prudential Loan Documents. The City is the Debtor's only other secured creditor. The City Loan is structured under the HUD Section 108 Loan program to stimulate local real estate development. The City of Boston pledged its present and future affordable housing and economic development revenue to fund the City Loan. The City of Boston is not a traditional commercial lender looking to make a profit in this situation.

54. If Prudential is permitted to recover postpetition interest at the default rate of 14.5%, the City's standing to recover its affordable housing and economic development 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 being used to complete the build-out of the Theme Bar, which will continue to add value to the remaining condominium units.

55. While 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)), that is not the case here. The City has gone to great lengths to ensure the viability of this project using its affordable housing and economic development money, and it should not be penalized for doing so. The City's ability to collect its claim could be impaired by permitting Prudential to charge a 14.5% postpetition rate of interest during the period it was oversecured up to the Effective Date.

56. Prudential shall recover the contract rate of interest of 9.5% from the date it became oversecured (June 8, 2011) up to the Effective Date of the Plan.

57. Prudential bears the burden of establishing the reasonableness of its fees and costs that it seeks to recover pursuant to §506(b). Prudential has not produced any evidence, whatsoever, of the amount, reasonableness or nature of its fees or costs. Having failed to sustain its burden, Prudential's request for post-petition fees and costs is denied.

Respectfully submitted,

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