

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS
EASTERN DIVISION

)	
In re)	
)	Chapter 11
SW BOSTON HOTEL VENTURE LLC, et al.,¹)	Case No. 10-14535 (JNF)
)	
Debtors.)	Jointly Administered
)	

OBJECTION BY THE PRUDENTIAL INSURANCE COMPANY OF AMERICA TO DEBTORS’ CONTINUED USE OF CASH COLLATERAL

As and for its Objection (this “Objection”) to the Debtors’ Motion to Continue the Use of Cash Collateral on the Same Terms and Conditions, filed on September 19, 2011 [Dkt. No. 821] (the “Cash Collateral Motion”), The Prudential Insurance Company of America on behalf of and solely for the benefit of, and with its liability limited to the assets of, its insurance company separate account, PRISA (“Prudential”), by and through its undersigned counsel, respectfully states as follows:

PRELIMINARY STATEMENT

1. These chapter 11 cases have now been pending for almost seventeen months. The Debtors have sought and received numerous extensions of their use of Prudential’s cash collateral. The Debtors’ most recent extension, granted at the conclusion of the confirmation hearing to consider the Debtors’ Plan, runs until September 30, 2011. With that deadline fast approaching, the Debtors now seek another extension through the end of October. That extension, however, should not be granted. The Debtors have failed to meet their own

¹ The “Debtors” are SW Boston Hotel Venture LLC (Case No. 10-14535-JNF), Auto Sales & Service, Inc. (Case No. 10-14528-JNF), General Trading Company (Case No. 10-14532-JNF), Frank Sawyer Corporation (Case No. 10-14533-JNF), 100 Stuart Street, LLC (Case No. 10-14534-JNF), 30-32 Oliver Street Corporation (Case No. 10-16173-JNF), General Land Corporation (Case No. 10-16174-JNF), and 131 Arlington Street Trust (Case No. 10-16177-JNF).

projections (i) having sold, through September 23rd, approximately \$5.6 million of units instead of the nearly \$8 million that was projected, (ii) having paid Prudential \$300,000 less than what was projected in the budget for the period through August 30th, and (iii) having achieved a price per square foot during the current budget period of only \$830 instead of the more than \$920 that was set forth in the Disclosure Statement. Aware of their performance, the Debtors fail to include an aggregate reconciliation with the exhibits filed with the Cash Collateral Motion. As such, Prudential continues to watch the value of its collateral continually diminish during these chapter 11 cases under the Debtors' management and, therefore, now objects to the Debtors' continued use of cash collateral. In the alternative, if the Debtors are permitted to continue to use Prudential's cash collateral, Prudential requests that the Debtors be required to make current post-petition interest payments at the default rate in accordance with Section 506 of the Bankruptcy Code.

BACKGROUND

2. As this Court is aware, Prudential is a secured creditor of the Debtors, having provided up to \$192.2 million in financing (the "Prudential Loan") for the construction of a mixed use hotel and residence complex (the "W Hotel and Residences") consisting of a "W" brand hotel (the "Hotel") and 123 residential condominium units (the "Residences").²

3. On April 28, 2010 (the "Petition Date"), five of the Debtors commenced their cases in the United States Bankruptcy Court for the District of Massachusetts (the "Bankruptcy Court"). On June 4, 2010, the remaining three Debtors commenced their chapter 11 cases. Pursuant to sections 1107 and 1108 of the Bankruptcy Code, the Debtors, whose cases are being jointly administered, are operating their businesses as debtors in possession.

² Prudential, SW Boston, and the other parties thereto are parties to that certain Construction Loan Agreement, dated as of January 15, 2008 (as amended, the "Prudential Loan Agreement").

4. On March 28, 2011, SW Boston filed two motions with the Bankruptcy Court seeking, among other things, approval of the sale of the Hotel and certain other related facilities (the “Hotel Sale”). In connection with the Hotel Sale, the Debtor entered into a purchase and sale agreement with Razorbacks Owner LLC, an affiliate of Pebblebrook Hotel Trust, with a purchase price of \$89.5 million.

5. On May 24, 2011, this Court approved the Hotel Sale [Docket No. 627]. The Hotel Sale closed on June 8, 2011, and in connection therewith, Prudential received \$83,322,017 in net sales proceeds.

6. The Debtors continue to finance their broader operations and these chapter 11 cases almost exclusively through the use of Prudential’s cash collateral. For over two months, since the Hotel Sale, the Debtors have been without the revenue generated by the Hotel, spa and restaurant. They remain obligated, however, to continue to fund the completion of the Theme Bar, as well as pay other ongoing operational expenses and professional fees. Aside from SW Boston, only two of the other Debtors generate *any* revenue, which is barely sufficient to cover such Debtors’ costs. Pursuant to the prior cash collateral orders entered in these cases [Docket No. 114], the Debtors have been paying a portion of the proceeds from sales of condominium units to Prudential. While the Loan Agreement requires payment to Prudential of 92% of the Residence sales proceeds, actual payments of proceeds have been significantly less, and in August, such payments equaled only 75% of the proceeds as a result of the ongoing expenses the Debtors were required to pay.

7. Beginning on June 27, 2011, this Court held a three-day evidentiary hearing to consider confirmation (the “Confirmation Hearing”) of the Modified First Amended Joint Plan of the Debtors, filed on June 27, 2011 [Dkt. No. 722] (as amended, the “Plan”). At the conclusion

of the Confirmation Hearing, the Court took the matter under advisement and requested post-trial briefing and proposed findings of fact and conclusions of law, which the parties submitted on August 1, 2011.

8. Less than two weeks before the Confirmation Hearing, the Debtors filed their Motion to Continue the Use of Cash Collateral on the Same Terms and Conditions [Dkt. No. 660] (the “June Cash Collateral Motion”), which was approved by the Court on June 30, 2011 [Dkt. No. 766]. The Debtors’ continued use of cash collateral was approved through September 30, 2011. As before, the Debtors’ use of cash collateral was, and is, subject to the current cash collateral budget (the “Current Budget”), which was attached to the June Cash Collateral Motion as Exhibit C. The Current Budget projected that the Debtors would generate nearly \$8 million in condo sales proceeds for the period July 1, 2011 through September 30, 2011 (the “Current Budget Period”), of which approximately \$6.2 million would be paid to Prudential. Notwithstanding this projection, however, during the Current Budget Period through September 23rd, the Debtors’ consummated only the following sales:

Sales During Current Budget Period Through September 23, 2011					
Unit	Adjusted Sales Price (\$)	Square Feet	Price/Sq. Ft (\$)	Closing Date ³	Avg PSF for Line (\$)
19E	1,500,000	1,715	875	7/5	N/A
19D	400,000	427	937	7/12	\$929
20I	342,844	512	669	8/5	\$736
25F	885,000	857	1,032	8/8	\$842
25I	400,000	512	781	8/12	\$736
21A	630,000	878	717	9/16	\$680
20H	784,000	1040	754	9/15	\$787
20F	704,000	857	821	9/16	\$842
Total	\$5,645,844	6,798	830		

As is evident from these sales, the Debtors have fallen well short of the projected \$8 million for the period. In addition, the price per square foot (“PSF”) achieved in these sales of \$830 is not

³ Dates are approximate.

only well short of the Plan projections of \$921-985 PSF, but also well short of the historical average *from inception* of the project through confirmation of \$900 PSF. The record of actual current sales clearly contradicts the testimony of the Debtors' "experts" at confirmation who projected increased prices for sales and stated that prior sales would not be indicative of future performance.

OBJECTION

I. The Debtors Cannot Provide Prudential Adequate Protection

9. The Debtors' ability to continue to use Prudential's cash collateral is subject to a finding that Prudential's interest in its collateral will be adequately protected. "In any determination of adequate protection pursuant to §§ 361 and 363, the debtor has the burden of proof on the issue of adequate protection." In re Harrington & Richardson, Inc., 48 B.R. 431, 433 (Bankr. Mass. 1985).

10. Pursuant to section 363(e) of the Bankruptcy Code:

"[o]n request of an entity that has an interest in property used, sold, or leased or proposed to be used, sold or leased ... the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest."

11 U.S.C. § 363(e).

11. As a preliminary matter, the Debtors make no effort whatsoever in the Cash Collateral Motion to show that Prudential will be adequately protected during the additional period of cash collateral use. Indeed, the words "adequate protection" appear nowhere in the Debtors' motion papers. On this basis alone, the Debtors' Cash Collateral Motion should be denied.

12. The Debtors have, in the past, argued that Prudential is adequately protected by virtue of the equity cushion that exists when all of Prudential's collateral is taken as a whole.

The Debtors have advanced this argument notwithstanding their contradictory position that Prudential is not entitled to post-petition interest since it is under-secured as to each Debtor. Having failed to address this issue, the Cash Collateral Motion should, again, fail as a matter of law. This question, and others, are pending before the Court as part of the decision on confirmation.

13. As part of the Confirmation Hearing, Prudential submitted the Expert Report of Marti P. Murray, dated June 16th 2011. Ms. Murray concluded that Prudential's claim, as of confirmation and when calculated using the default interest rate under the Prudential Loan Agreement, will exceed the value of Prudential's remaining collateral. In other words, the interest that has been accruing on the Prudential Loan during these chapter 11 cases will have consumed, as of confirmation, any remaining equity value the Debtors may have had in Prudential's collateral. Accordingly, whether viewed on a debtor-by-debtor basis, or as a consolidated group, no equity cushion remains in the collateral at this point in the chapter 11 cases that can provide Prudential adequate protection.

14. This is especially problematic in light of the Debtors' performance during the Current Budget Period. While the Debtors have missed their own projections by a material margin, the costs of maintaining the remaining Residences, including the payment of condo fees and real estate taxes, have continued to be incurred in their full amounts. In other words, collateral value continues to bleed out of these estates, forever lost to Prudential, while the cases remain pending and the Debtors struggle to meet, or even come close to, their own projections. Moreover, the Debtors have fallen far short in their ability to match, let alone push, current per-square-foot prices above their own historically meager amounts. The sales at substantial discounts to projections indicate a patent attempt to stuff sales into the period to demonstrate

“progress” on sales and to create cash flow solely to fund the Debtors’ continuing operations. As a result, the value of Prudential’s collateral continues to deteriorate.

15. In such circumstances, it is impossible for the Debtors to provide Prudential adequate protection. The Debtors, therefore, should be prohibited from continuing to use cash collateral beyond the expiration of the Current Budget Period.

II. If the Debtors’ Are Permitted to Use Cash Collateral, Post-Petition Interest Must be Paid and Limitations Set

16. The Debtors have admitted that Prudential is over-secured as to SW Boston Hotel Venture LLC, the main debtor in these cases. Accordingly, at this stage, there is no dispute that Prudential is entitled to post-petition interest. Although a dispute remains regarding the appropriate principal amount outstanding on the Prudential Loan, if the Debtors are granted permission to continue using cash collateral, the Debtors should be required to pay ongoing and accruing post-petition interest at the default rate (14.5%) as adequate protection.

17. In addition, it is clear from the Debtors own budgets that value continues to deteriorate in these cases. During these cases, the Debtors have used cash collateral to fund not only the costs of the Hotel and Residences, but also the costs and expenses of the other Debtors. With the sale of the Hotel, there is no longer any recurring revenue to support such expenses. As such, each month these cases linger, more and more of Prudential’s limited collateral value is eaten away by those unrelated costs. As such, Prudential respectfully requests that if the Debtors are permitted to continue to use cash collateral, that use be restricted to only those costs *necessary* to maintain the Residences.

WHEREFORE, Prudential respectfully requests (i) that this Court prohibit any further use by the Debtors of Prudential’s cash collateral, (ii) or, in the alternative, if the Court permits the Debtors to continue using cash collateral, it (A) require them to make ongoing post-

petition interest payments to Prudential and (B) restrict the use of cash collateral to those costs necessary to maintain the Residences.

Respectfully submitted,

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