BANKRUPTCY

Bankrupt Manhattan Hotel Owner Should Pay Default Interest, Judge Rules

Owner of a 50-story Holiday Inn should pay penalty interest and fees related to its default if it wants to keep its low-rate mortgage as it leaves chapter 11, bankruptcy judge decides

The Holiday Inn, owned by Golden Seahorse, is in Manhattan's Financial District.

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By Becky Yerak
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A bankrupt Holiday Inn in downtown Manhattan can't use chapter 11 to maintain its low-rate mortgage without paying penalty interest linked to its default, a judge ruled in a setback for borrowers seeking to hold on to more affordable loans as interest rates rise.

Judge Philip Bentley of the U.S. Bankruptcy Court in Manhattan said in this week's ruling that Golden Seahorse, owner of the 50-story hotel, should pay the default interest and fees charged by its lenders, totaling about $20 million, if it wants to keep its cheaper mortgage as it leaves chapter 11.

The judge, however, said that Golden Seahorse can return to his court to argue that its defaults should be excused because under New York state law, the Covid-19 pandemic made it impossible to keep up with its payments. A lawyer for Golden Seahorse, Scott Markowitz, said the company would do so.

Golden Seahorse arranged a 10-year, $137 million loan in 2018 and had been current until May 2020, when it failed to make a payment after the hotel closed because of the pandemic. Its lenders began charging default interest and Golden Seahorse filed for bankruptcy in November to avoid a seizure.

The hotel owner is among bankrupt companies that have been trying to keep their loans at their original, lower rates, known as a reinstatement. If successful, the move could help businesses avoid taking on new, more expensive debt as rates reached a 22-year high last month.

Lenders who object to reinstatement argue that they are missing out on higher rates and fees they are entitled to collect on defaulted loans.

Markowitz, the Golden Seahorse lawyer, said in a statement Wednesday that Judge Bentley's ruling was "thorough and thoughtful." But the lawyer added, "I strongly believe the bankruptcy code is designed to permit a debtor to reinstate a loan without paying the drastic penalty of default interest as long as the debtor pays reasonable fees to the lender."

The hotel owner will continue to argue before the judge that it doesn't owe the default interest under New York law, "based on the undisputed fact that the sole reason for the payment default in May 2020 was the Covid-19 pandemic," Markowitz said.

Ralph Brubaker, a University of Illinois law professor, said if other courts take a cue from Judge Bentley's ruling, it could greatly increase the costs for companies that were hoping to reinstate their cheap debt.

It could also hinder their successful reorganizations, affecting lower-ranking creditors in the process. "Even when it doesn't prevent reorganization, it requires payment of additional cash to secured creditors that would otherwise be available to pay other creditors or finance operations," he said.

To reinstate the loan under its chapter 11 plan, Golden Seahorse proposes to pay everything it owes except for the amounts triggered by its default. The penalty consists of $17.8 million in default-rate interest and at least $1.5 million in fees.

Golden Seahorse has said that it might not be able to pay that amount. Judge Bentley said he hasn't decided how much default interest and fees the hotel owner needs to pay.

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