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Rake's Progress: Cure and Reinstatement of Secured Claims in Bankruptcy Reorganization

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Articles

RAKE'S PROGRESS: CURE AND REINSTATEMENT OF SECURED CLAIMS IN BANKRUPTCY REORGANIZATION

by
*David Gray Carlson**

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I. INTRODUCTION

It is well known that a bankruptcy trustee may assume a debtor's prepetition executory contract.¹ Less known is the trustee's (or debtor's) ability to cure and reinstate certain *executed* contracts—loan agreements—in reorganization cases.

How is it profitable for a trustee or debtor² to assume and reinstate a loan agreement when the obligation to pay is all on the debtor's side, and the *jouissance* of receiving payment entirely on the creditor's side? There are three sources of profit. First, if the con-

¹ See 11 U.S.C. § 365(a) (1994).

² Chapter 11 provides for a debtor in possession—a fox standing guard over the henhouse. This principle is nowhere stated expressly. We learn, however, that an independent trustee or examiner can be appointed for cause or if such an appointment is in the best interests of the creditors. See 11 U.S.C. § 1104(a) (1994). This implies that, until such an event occurs, the debtor in possession serves as the trustee. See 11 U.S.C. § 1107(a) (1994) (“A debtor in possession shall have all the rights . . . of a trustee serving in a case under this chapter.”); *Sumitomo Trust & Banking Co. v. Holly's, Inc.* (*In re Holly's, Inc.*), 140 B.R. 643, 685 (Bankr. W.D. Mich. 1992) (Gregg, J.) (“In a chapter 11 case, the debtor in possession retains management of the business unless a party in interest demonstrates that appointment of a trustee is necessary.”).

In chapters 12 and 13, the debtor does not serve as the trustee. See 11 U.S.C. §§ 1202, 1302 (1994). The trustee is a “standing” official who receives postpetition payments from the debtor and distributes them to the creditors mentioned in the plan. Meanwhile, the debtor has sole power to file a plan. See 11 U.S.C. §§ 1221, 1321 (1994).

tract rate of interest is lower than the market rate, a debtor profits by reinstating the contract. If the security agreement is not reinstated, the debtor in possession may have to pay cram down interest at the market rate.³ Accordingly, reinstatement is obviously preferable when the contract rate is favorable and the creditor is oversecured.⁴

The second advantage adheres only in chapter 12 (farm reorganizations) and chapter 13 (wage earner reorganizations). In these chapters, reinstatement is valuable because the reorganization plans can last only three (or, with court permission, five) years.⁵ A reinstated security agreement, however, may last longer⁶ and obviate the need for refinancing.

Third, in chapter 13⁷ (and, since 1994, in chapter 11),⁸ long term mortgage agreements secured only by the debtor's residence may not be modified.⁹ This same mortgage agreement can be as-

³ "Cram down" is slang for the notion that, where the provisions of 11 U.S.C. § 1129(b) are met, creditors can be made subject to the plan, despite the fact that the class of creditors to which they belong voted against it. It also refers to 11 U.S.C. § 1225(a)(5) and 1325(a)(5), which provide that dissenting secured parties are entitled to the value of their collateral as a condition of plan confirmation.

⁴ See *In re Madison Hotel Assocs.*, 749 F.2d 410, 420 (7th Cir. 1984) (Coffey, J.). Even when the creditor is undersecured, a debtor might still benefit financially, but this advantage would depend on a cost-benefit calculus. See *infra* text accompanying notes 88-89. In the case of assumption and reinstatement, the lower contractual interest rate is the benefit, but the cost will be that the debtor must pay the unsecured deficit at 100 cents on the dollar. In cram down, a debtor-in-possession would only have to provide the unsecured deficit claim with the amount it would have been allocated in a liquidation of the bankruptcy estate. When the debtor is insolvent, such an allocation will be less than 100 cents on the dollar. Thus, even when a contractual interest rate is low, an insolvent debtor in possession may not wish to assume and reinstate loan agreements when a creditor is radically undersecured.

⁵ See 11 U.S.C. §§ 1222(d), 1322(d) (1994).

⁶ See *In re Pruetit*, 178 B.R. 7 (Bankr. N.D. Ala. 1995) (Caddell, J.) (holding that if a security agreement is not reinstated, the secured claim must be paid within the life of a chapter 13 plan); *Brown v. Shorewood Fin., Inc. (In re Brown)*, 175 B.R. 129, 132-33 (Bankr. D. Mass. 1994) (Feeney, J.) (same); *In re Comans*, 164 B.R. 539 (Bankr. S.D. Miss. 1994) (Ellington, J.) (same). A short-term note with a balloon payment may have connected with it the expectation that the creditor will renew it, but this alone does not authorize a plan to extend the note to a twenty year stream of payments. See *Citizens Trust & Savs. Bank v. Schafer (In re Schafer)*, 99 B.R. 352 (W.D. Mich. 1989) (Enslin, J.). Similarly, a perpetual guaranty of advances made to another does not justify extension beyond the five year limit, where the actual advances are themselves short-term obligations of the third party. See *In re Dinsmore*, 141 B.R. 499, 504-05 (Bankr. W.D. Mich. 1992) (Howard, J.).

⁷ See 11 U.S.C. § 1322(b)(2) (1994).

⁸ See 11 U.S.C. § 1123(b)(5) (1994). Congress added this provision to discourage wage earners from defecting from chapter 13 to chapter 11 in order to cram down a residential mortgage. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 206(3), 108 Stat. 4106, 4123 (codified at 11 U.S.C. § 1123(b)(15) (1994)).

⁹ In 1994, Congress added an exception to this principle. Under new § 1322(c)(2), a

sumed and reinstated.¹⁰ Therefore, reinstatement is vital to a chapter 13 wage earner who aspires to save the family homestead. But for reinstatement, the mortgagee would be entitled to relief from the automatic stay because the home would be superfluous to effectuation of a chapter 13 plan.¹¹

If a debtor elects to assume and reinstate a security agreement, the debtor must "cure" certain past defaults.¹² What constitutes a "cure," however is as controversial in bankruptcy law as it is in medicine. In *Rake v. Wade*,¹³ the Supreme Court, per Justice Clarence Thomas implied that cure was governed by two Bankruptcy Code provisions pertaining to secured claims—§ 506(b) (which guarantees postpetition interest only to oversecured creditors) and cram down.¹⁴ As this article shows, cure claims are not coherently viewed as secured claims when the collateral is insufficient to cover both the reinstated principal and the price of cure. Hence, *Rake v. Wade* caused many conceptual problems with cure and reinstatement of security agreements.

Displeased by *Rake v. Wade*, Congress intervened in 1994 with some disturbing amendments to the reorganization chapters.¹⁵ These amendments shift the paradigm of cure from the inadequate

chapter 13 debtor may bifurcate a home mortgage if "the last payment on the original payment schedule . . . is due before the date on which the final payment under the plan is due . . ." Section 301(2), 108 Stat. at 4131 (codified at 11 U.S.C. § 1322(c)(2) (1994)). Since chapter 13 plans last no more than three years (or, with court permission, five years), see 11 U.S.C. § 1322(d) (1994), a great many home mortgages will be immune from bifurcation.

¹⁰ See 11 U.S.C. §§ 1123(a)(5), 1322(b)(5) (1994). Controversy exists over whether a debtor may pay the reinstatement amounts directly to the secured party or whether the payments must be made through the chapter 13 trustee. Compare *Wagner v. Armstrong (In re Wagner)*, 36 F.3d 723 (8th Cir. 1994) (Bowman, J.) (outside payment permitted in chapter 12); *In re Bernard*, 201 B.R. 600 (Bankr. D. Mass. 1996) (Feeney, J.) (outside payment permitted in chapter 13); *United States v. Donald (In re Donald)*, 170 B.R. 579 (S.D. Miss. 1994) (Pickering, J.) (same) with *Fulkrod v. Savage (In re Fulkrod)*, 973 F.2d 801 (9th Cir. 1994) (per curiam) (outside payment permitted in chapter 12); *In re Harris*, 200 B.R. 745 (Bankr. D. Mass. 1996) (Kenner, J.) (outside payments not permitted in chapter 13). The standing trustee, whose fee is calculated as a percentage of money handled, obviously prefers that reinstatements be run through the plan. See Michaela M. White, *The Effects of Chapter 13 Plan Confirmation and Case Conversion on Property*, 26 CREIGHTON L. REV. 785 (1993).

¹¹ See *Di Pierro v. Taddeo (In re Taddeo)*, 685 F.2d 24, 26 (2d Cir. 1982) (Lumbard, J.).

¹² See *id.*; see also 11 U.S.C. §§ 1124(2)(A), 1222(b)(2), 1322(b)(2) (1994).

¹³ 508 U.S. 464 (1993).

¹⁴ *Id.* at 470-71.

¹⁵ These amendments affect any bankruptcy proceeding filed on or after October 22, 1994. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394 § 702(a), 108 Stat. 4106-4150. A different effective date applies for the new definition of "cure." See *infra* note 268 and accompanying text.

Rake v. Wade theory to an equally unsatisfactory contractual theory.¹⁶ Under this contractual theory, secured creditors may provide the terms of their own cure in their agreements. The physician may heal herself, choosing such luxury medicines and comforts as may indulge her notion of financial wellness. As always, it is the unsecured creditors who will pay the bill of reinstatement. Because cure is not compensatory,¹⁷ assumption and cure of loan agreements surely will become more expensive and less common, as debtors and trustees will find the cure to be worse than the disease.

The purpose of this article is to pose an alternative theory of cure. According to this new theory, cure should be compensatory, federal, and noncontractual—a matter of tort, if you will. Such a theory defines cure as the price of reinstating a security agreement which, if unaccelerated, still requires future payments of principal or interest going forward. The theory calculates the cure price as repayment of amounts past due under the contract, as augmented by a market rate of interest between the time of default and the time the cure price is calculated. In addition, if the cure price is to be paid over time after confirmation (permitted in chapters 12 and 13), the present value of those deferred payments must equal the calculated cure price. In short, both preconfirmation interest and postconfirmation interest at the market rate will be required. Thus, coupled with reinstatement of the agreement, the cure price would make the creditor indifferent to the fortuity of bankruptcy.

The difference between a pure compensatory theory and the *Rake v. Wade* theory is that the compensatory theory would apply to over- and undersecured creditors alike. In contrast, the *Rake v. Wade* theory applies § 506(b) and § 1325(a)(5) only to oversecured creditors,¹⁸ leaving no theory of cure for undersecured creditors. A sa-

¹⁶ One part of the amendment is noncontractual. In 1994, Congress set a federal deadline (the foreclosure sale) for cure and reinstatement, regardless of the content of the contract or state law. See *infra* notes 161-86 and accompanying text.

¹⁷ Economists may object that since cure is defined in the contract, and because a secured creditor will have surrendered benefits to the debtor in exchange for the concessions on cure is inherently compensatory. This point must be conceded—at least at the level of economic theology. I have in mind a narrower concept of “compensatory.” A “compensatory” theory of cure would equate the cure price with the monetary defaults or principal and ordinary interest payments, augmented by the lender’s actual opportunity cost (*i.e.*, market rate of interest) incurred because the lender failed to receive payment on time. The cure therefore “compensates” for, or renders the debtor indifferent to, the fact of bankruptcy.

¹⁸ To be more precise, § 1325(a)(5) governs the secured portion of an undersecured claim. See 11 U.S.C. 1325(a)(5) (1994). Arrears become part of the secured claim only if a

lient difference between a compensatory theory and the contractual theory of the 1994 amendments is that, under the compensatory theory, courts could ignore default penalties and postdefault interest rates called for in the contract.

This suggestion might have been instituted without the need of legislation until 1994, when Congress provided an explicit definition of "cure." In light of the 1994 amendments, it is possible that legislative intervention will be needed. Ordinarily, it might seem quixotic and vain to suggest that Congress should open its ponderous and marble jaws to cast up legislation so recently enacted. Yet, along with amending the Bankruptcy Code in 1994, Congress also established a Commission to review the Bankruptcy Code in general.¹⁹ Presumably, this Commission will not flinch at reviewing and suggesting changes in the 1994 legislation. Therefore, a proposed new theory of cure may yet undeaf congressional ears.

Even if the wind and tempests of politics do not blow in the direction of legislative reversal, a compensatory theory of cure might still be useful to have on the following basis. The 1994 amendments allow the contract to govern the cure price. They do not permit the institution of punitive measures. Penalties are not cures. Hence, it is open for courts to declare that any given contract penalizes the debtor and therefore must be disregarded. The difference between a penalty and a cure is that the former is disconnected with compensation, while the latter merely compensates a creditor for harms done. Hence, even under the current regime, courts must have a notion of what compensation means. When a contract deviates from that concept, the courts will know that they are faced with punishment dressed up in the benevolent clothes of cure. In short, the devil hath power to assume a pleasing shape. Although the 1994 amendments indicate that the contract is the theme of cure's tongue, in fact cure inevitably speaks for itself in a noumenal way. Cure already has a covert federal soul. The contract is merely evidence of that soul—the appearance and not the reality of cure.

In order to compare the cure with the underlying concept of reinstatement, Part II of this article reviews the relevant statutory criteria of reinstatement and their differences in the various reorganization chapters. Part II will help emphasize the distinction between

court consciously allocates them to the secured portion and the reinstated amount to the unsecured portion.

¹⁹ Section 601-10, 108 Stat. at 4147-50.

reinstatement and cure, the latter idea being nothing else but the price a debtor must pay to achieve reinstatement. Part III will then assess the state of cure prior to and in light of the 1994 amendments. Finally, Part IV will discuss the new theory of cure and reinstatement being presented.

II. REINSTATEMENT

A. Chapter 7

Chapter 7 liquidation does not allow for the reinstatement of loan agreements. Although "executory contracts" may be assumed and assigned by trustees to the profit of unsecured creditors,²⁰ loan agreements may not. They are "executed" contracts. That is, under definitions developed in case law,²¹ loan agreements are not executory because they do not usually provide for material duties on each side of the contract. Nor do they provide for material nonmonetary obligations from either side. Accordingly, loan agreements do not fall within the ambit of § 365.²²

In the absence of reinstatement in chapter 7, the Bankruptcy Code automatically accelerates loans, making principal payments due in the future presently payable. This proposition is established in subsection 502(a) and (b) which provide that:

- (a) A claim . . . proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects.

²⁰ Section 365(a) allows for the general assumption of executory contracts. See 11 U.S.C. § 365(a) (1994). Section 103(a) makes § 365(a) applicable in chapter 7. See 11 U.S.C. § 103(a) (1994).

²¹ See generally Jay L. Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227 (1989).

²² A great many courts would hold that a chapter 7 trustee has neither a theory under which nor an incentive to assume and reinstate a loan agreement. While it is true that a debtor and a creditor may, under close court supervision, agree to reinstate a prepetition loan agreement under § 524(c), such reinstatement requires creditor consent. Nevertheless, a minority of courts think that they could declare a security agreement to be out of default and reinstate it for the benefit of the debtor. Coupled with this declaration of no default is a judicial injunction extending beyond the chapter 7 distribution, preventing any foreclosure of collateral until the debtor actually defaults in the future. This controversial theory is beyond the scope of this essay, which will consider only the type of cure and reinstatement authorized in the reorganization chapters. For a discussion of the unilateral reinstatement of security agreements in chapter 7, see David Gray Carlson, *Redemption and Reinstatement in Chapter 7 Cases*, 4 AM. BANKR. INST. L. REV. 289 (1996).

(b) . . . if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount . . .²³

The language in section 502(b) allows a claim for any principal amount due and owing in the future, which shall be treated as due and owing "as of the date of the filing of the petition."²⁴

Since a claim is allowed "as of" the petition date, postpetition interest is implicitly never part of an allowed claim, so far as § 502(b) is concerned.²⁵ For good measure, an exception to § 502(b) disallows any claim for "unmatured interest."²⁶ Putting the preamble together with the exception, any creditor is entitled to claim prepetition interest and principal, plus an acceleration of any principal due and owing in the future. A creditor may not claim postpetition interest,²⁷ except that oversecured creditors may have postpetition interest pursuant to § 506(b), which states:

To the extent that an allowed secured claim is secured by property the value of which, after any recovery under [§ 506(c)], is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.²⁸

If, however, all creditors have been paid in a chapter 7 liquidation, § 726(a)(5) indicates that all of the unsecured creditors are to be paid interest on their claims at the legal rate.²⁹

These rules apply in chapter 7, but, indirectly, in reorganization as well. Each reorganization chapter accords creditors the right to

²³ 11 U.S.C. § 502(a)-(b) (1994).

²⁴ Section 502(b).

²⁵ See *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 944 F.2d 542, 543 (9th Cir. 1991) (Leavy, J.).

²⁶ 11 U.S.C. § 502(b)(2) (1994).

²⁷ In the 1980's, a theory arose that an undersecured creditor deserves postpetition interest as part of her right to adequate protection, but this theory was rejected by the Supreme Court in the important case of *United Savings Assn. of Texas v. Timbers of Inwood Forest Associates*, 484 U.S. 365 (1988) (Scalia, J.); see generally David Gray Carlson, *Postpetition Interest Under the Bankruptcy Code*, 43 U. MIAMI L. REV. 577 (1989).

²⁸ 11 U.S.C. § 506(b) (1994).

²⁹ This residual entitlement to postpetition interest for unsecured creditors will play a part in the analysis to follow. See *infra* notes 93-94, 393-94 and accompanying text.

receive as much from a reorganization plan as from a chapter 7 liquidation.³⁰ Accordingly, chapter 7 distribution rights establish a minimum entitlement of a creditor in any reorganization proceeding.

B. Chapter 11 and "Disimpairment"

Chapter 11 authorizes the "curing or waiving of any default."³¹ The effect of cure on a security agreement in chapter 11 can be significant. To see why, an excursus on chapter 11 voting is required.

1. Voting

In chapter 11, the creditors vote on the mode of distribution. This makes chapter 11 different from chapter 7. While general creditors in chapter 7 elect the trustee,³² they may not vote on distribution, which is dogmatically fixed by Bankruptcy Code § 726.³³ In chapter 11, however, creditors may vote on the distributional system promulgated by the plan.

Voting in chapter 11 is by class. There is good reason for this. Prior to the enactment of Bankruptcy Act section 77B³⁴ and the reorganization chapters that soon followed,³⁵ businesses were reorganized by means of equity receiverships under the pre-*Erie* federal common law. The receiver could not force a creditor to compromise her claim. A creditor could hold out against a consensual plan in order to obtain a greater recovery.³⁶ Accordingly, while the princi-

³⁰ See 11 U.S.C. §§ 1129(a)(7)(A)(ii), 1225(a)(4), 1325(a)(4) (1994). Section 1129(a)(7)(A)(ii) indicates that a creditor may waive this right by voting in favor of the plan. The rules in chapter 12 and 13 apply only to unsecured creditors. Secured creditors are guaranteed the value of their collateral. See 11 U.S.C. §§ 1225(a)(5), 1325(a)(5) (1994). To the extent they have unsecured deficit claims, they are entitled to the protection of § 1225(a)(4) and § 1325(a)(4).

³¹ See 11 U.S.C. § 1123(b)(5)(G) (1994).

³² See 11 U.S.C. § 702 (1994).

³³ See 11 U.S.C. § 726 (1994); *United States v. Noland*, 116 S. Ct. 1524 (1996) (Souter, J.) (equitable subordination doctrine may not be used legislatively to change chapter 7 priorities).

³⁴ See Act of June 7, 1934, ch. 424, Pub. L. No. 296, 48 Stat. 911, 913-22.

³⁵ Chandler Act, ch. 575, 52 Stat. 840 (1938) (repealed 1978).

³⁶ See *Werner, Harris & Buck v. Equitable Trust Co.*, 35 F.2d 513, 514 (10th Cir. 1929) (McDermitt, J.) ("Each bondholder has the absolute right to determine for himself, in case of default, whether he shall take his loss and quit, or continue to gamble . . ."); E. Merrick Dodd, *Reorganization Through Bankruptcy: A Remedy For What?*, 48 HARV. L. REV. 1100, 1100-03 (1935). The Bankruptcy Act of 1867 and the little-used creditor compositions of § 12 of the Bankruptcy Act of 1898 also contained class voting. See Chaim J. Fortgang & Thomas Moers

pal creditors worked and sacrificed to save the going concern of a firm, the lesser creditors soon recognized the profit in protesting too much; such creditors were cashed out in full, so that the larger creditors—the ones who really stood to lose if the company were not reorganized—could proceed by compromise to reorganize the company.

The reorganization legislation therefore introduced class voting, so that marginal creditors could not hold up the entire proceeding in order to get paid.³⁷ The Bankruptcy Code continues these rules. It requires that two thirds of claims (by amount) in the class vote affirmatively, and that a flat majority (by head count) also vote affirmatively.³⁸ If the class votes in favor of the plan, dissenting creditors within the class are forced to go along with the majority, at least for voting purposes.³⁹ If the class votes negatively, then the plan may still be confirmed, but only if the debtor “crams down” the plan under § 1129(b).⁴⁰

It is easy to overestimate the importance of voting in chapter 11. Generally, even if creditors vote negatively, the plan can be confirmed nevertheless, provided that the so-called “cram down” rules of § 1129(b) are met. This principle is established by the following phrase in § 1129(b)(1):

if all of the applicable requirements of subsection (a) of this section *other than paragraph (8)* are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph⁴¹

Mayer, *Trading Claims and Taking Control of Corporations in Chapter 11*, 12 CARDOZO L. REV. 1, 87 (1990).

³⁷ See Herwig v. Neuses (*In re Herwig*), 119 F.2d 941, 943 (7th Cir. 1941) (Sparks, J.) (emphasizing that old § 77B was founded on the principle of stifling dissent).

³⁸ 11 U.S.C. § 1126(c) (1994).

³⁹ Thus, in *In re 11,111, Inc.*, 117 B.R. 471 (Bankr. D. Minn. 1990) (Kressel, C.J.), two minor creditors, classified together with huge yes-voting creditors, demanded separate classification, so that they could preserve their cram down rights.

⁴⁰ See 11 U.S.C. § 1129(b) (1994); see generally *Olympia & York Fla. Equity Corp. v. Bank of New York* (*In re Holywell Corp.*), 913 F.2d 873, 879-80 (11th Cir. 1990) (Cox, J.) (describing the relationship between Bankruptcy Code §§ 1129(a) and 1129(b)); *Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co.* (*In re U.S. Truck Co.*), 800 F.2d 581, 583 (6th Cir. 1986) (Kennedy, J.) (“Confirmation under subsection (b) is commonly referred to as a “cram down” because it permits a reorganization plan to go into effect over the objections of one or more impaired classes of creditors.”).

⁴¹ 11 U.S.C. § 1129(b)(1) (1994) (emphasis added).

Section 1129(a) (8) in turn requires:

- With respect to each class of claims or interests—
- (A) such class has accepted the plan; or
 - (B) such class is not impaired under the plan.⁴²

Thus, if an impaired class votes negatively, the plan may still be confirmed by means of cram down.⁴³ A negative vote, then, does nothing more than trigger the cram down protections⁴⁴—with this important exception: if *no* class of impaired creditors votes affirmatively, the plan cannot be confirmed, by virtue of the rule in § 1129(a)(10). This surprisingly important rule will be discussed presently.⁴⁵

2. Impairment

Only impaired creditors may vote in chapter 11. Unimpaired creditors are deemed to accept the plan.⁴⁶ As the legislative history puts it, “the holder of a claim or interest who under the plan is restored to his original position, when others receive less or get nothing at all, is fortunate indeed and has no cause to complain.”⁴⁷

Section 1124 of the Code describes *all* claims in chapter 11 as impaired, with two exceptions: (1) if the plan leaves the creditor's rights unaltered, or (2) if the plan cures all past defaults and rein-

⁴² See 11 U.S.C. § 1129(a) (8).

⁴³ On what cram down requires, see Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 CARDOZO L. REV. 1495 (1993).

⁴⁴ See *In re Polytherm Indus., Inc.*, 33 B.R. 823, 838 (W.D. Wis. 1983) (Crabb, J.) (“The impairment determination can be viewed as a statutorily prescribed measurement for determining when the protections established in [§ 1129(b)] should be accorded a class of creditors.”).

⁴⁵ See *infra* notes 70-76 and accompanying text.

⁴⁶ See 11 U.S.C. § 1126(f) (1994). Conclusively so, since 1984. Prior to 1984, some courts thought that creditors who *actually* voted negatively would be entitled to cram down rights, like other negatively-voting creditors, thereby depriving the debtor of the benefits of disimpairment. See Charles D. Booth, *The Cramdown on Secured Creditors: An Impetus Toward Settlement*, 60 AM. BANKR. L.J. 69, 84 (1986).

⁴⁷ S. REP. NO. 95-989, 120 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5906. This remark perhaps underestimates the nearly boundless power of complaint that resides in creditors. Creditors might complain that, but for bankruptcy, the debtor would have defaulted and creditors could have reinvested liquidation proceeds at a higher rate of interest. Yet Congress has clearly decided that this excess value in the loan agreement belongs to the general creditors—not to the specific creditor whose agreement is reinstated.

states the security agreement.⁴⁸ In either of those situations, the claim is considered not impaired, and the creditor in question is deemed to vote affirmatively on the plan. The presumption that chapter 11 tends to impair all secured claims accords with what the typical layperson would say about the bankruptcy process. For example, the automatic stay prohibits foreclosure.⁴⁹ Moreover, if undersecured, the creditor gets no postpetition interest.⁵⁰ Thus, these routine features of chapter 11 would seem to be impairment itself.⁵¹

Because of the strong presumption in favor of impairment, virtually any change in rights proves that a plan does not leave creditor rights unaltered. Thus, a change in the maturity date⁵² or a substitution of debtors⁵³ or collateral⁵⁴ is an impairment, even if the col-

⁴⁸ Section 1124(2) provides:

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

...

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law; and

(D) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

11 U.S.C. § 1124(2) (1994). The preamble to § 1124 refers to § 1123(a)(4) as an exception. Section 1123(a)(4) requires that a plan provide equal intraclass treatment of creditors, unless the creditors vote otherwise. Its presence as an exception to disimpairment suggests that discriminatory intraclass treatment makes any claim impaired.

⁴⁹ See 11 U.S.C. § 362(a)(5) (1994).

⁵⁰ See *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365 (1988) (Scalia, J.).

⁵¹ Cf. *In re Dixon*, 151 B.R. 388, 393 (Bankr. S.D. Miss. 1993) (Ellington, C. J.) (suggesting bankruptcy is always a modification of a creditor's rights, and that "modification" prohibited in § 1322(b)(2) is therefore a term of art).

⁵² See *Ronit, Inc. v. Block Shim Dev. Co.-Irving* (*In re Block Shim Dev. Co.-Irving*), 118 B.R. 450, 455 (N.D. Tex. 1990) (Fitzwater, J.).

⁵³ See *In re Barrington Oaks Gen. Partnership*, 15 B.R. 952, 956 (Bankr. D. Utah 1981) (Mabey, J.).

⁵⁴ See *In re Gagel & Gagel*, 30 B.R. 627, 629-30 (Bankr. S.D. Ohio 1983) (Anderson, J.).

lateral is better in quality and more in quantity.⁵⁵ Lump sum payment in lieu of installments is likewise an impairment.⁵⁶ By some accounts, even an improvement in position is an impairment.⁵⁷ On the other hand, courts might overlook minor "technical" impairments.⁵⁸

Impairment had been defined under old chapter X as a "material and adverse" effect on a claim.⁵⁹ Such a standard entailed vexing valuation criteria. Obviously, the Bankruptcy Code has lightened the standard,⁶⁰ and it has been suggested that the standard should not depend on any quantitative effects on the value of a creditor's claim, but merely on qualitative change of any sort.⁶¹ Impairment should be found easily, and chapter 11 plans should rise and fall on cram down criteria.⁶²

⁵⁵ See MARTIN J. BIENENSTOCK, *BANKRUPTCY REORGANIZATION* 596 (1987).

⁵⁶ See *In re Otero Mills, Inc.*, 31 B.R. 185, 186 (Bankr. D.N.M. 1983) (McFeeley, J.).

⁵⁷ See *In re Temple Zion*, 125 B.R. 910, 919 (Bankr. E.D. Pa. 1991) (Scholl, J.). In *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc.* (*In re L&J Anaheim Assocs.*), 995 F.2d 940 (9th Cir. 1993), a secured party proposed its own chapter 11 plan, which consigned the unsecured deficit claim to a unique class and awarded the unsecured deficit claim improved rights. See *id.* at 941-42. This unique class was the only one voting affirmatively on the plan. Judge Diarmuid F. O'Scannlain ruled that the class was impaired by virtue of its *improved* rights. See *id.* at 943. As a result, the plan could be confirmed because, by this dubious means, the secured party had met the requirements of § 1129(a)(10). Nevertheless, courts disagree as to whether an improvement in position is an impairment. In *Bustop Shelters of Louisville, Inc. v. Classic Homes, Inc.*, 914 F.2d 810 (6th Cir. 1990), a plan assumed a security agreement and provided for a secured party to obtain a surety in addition to the debtor's continued liability. See *id.* at 812. The additional surety—an improvement in position—was held not to be an impairment, even though the debtor's equity in the collateral was transferred to the surety. Although these changes "altered" the creditor's prepetition rights, Judge Cornelia Kennedy ruled that the secured party was not impaired, and its vote could not count in aid of the plan. See *id.* at 815-16. *Bustop* might be reconciled with *Anaheim Associates* by observing that the contractual relations between the secured party and the original debtor were left untouched; the creation of *new* relations between the secured party and the surety did not therefore alter the original debtor-creditor relationship.

For another case denying that improvement in position is an impairment see *In re Boston Post Road Ltd.*, 145 B.R. 745, 747 (Bankr. D. Conn. 1992) (Krechevsky, C. J.), *aff'd*, 154 B.R. 617 (D. Conn. 1993), *aff'd*, 21 F.3d 477 (2d Cir. 1994), *cert. denied*, 115 S. Ct. 897 (1995).

⁵⁸ See *In re Orlando Tennis World Dev. Co.*, 34 B.R. 558, 562 (Bankr. M.D. Fla. 1983) (Proctor, J.) (change of management violated covenant but was overlooked on the grounds that it was "technical").

⁵⁹ See *In re Witt*, 60 B.R. 556, 561 (Bankr. N.D. Iowa, 1986) (Hill, J.).

⁶⁰ See *id.* at 560.

⁶¹ See *L & J Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc.* (*In re Anaheim Assocs.*), 995 F.2d 940, 942 (9th Cir. 1993) (O'Scannlain, J.) (citing *In re Barrington Oaks Gen. Partnership*, 15 B.R. 952, 962 (Bankr. D. Utah 1981) (Mabey, J.)).

⁶² Thus, in *Toibb v. Radloff*, 501 U.S. 157 (1991), Justice Harry Blackmun held that, under the literal words of the Bankruptcy Code, a consumer could file a chapter 11 plan. When the

A major purpose of reinstatement in chapter 11 is for the security agreements to stand as an alternative to cram down rights under § 1129(b). Only creditors in no-voting classes are entitled to invoke cram down protection. Reinstated creditors are presumed to vote affirmatively. Reinstated creditors are thus denied the two important principles of cram down. According to the first, a secured creditor class voting no on the plan, must, in effect, be given the equivalent of the collateral. This may be in one of three forms: (A) the present value of the collateral, in the form of debt payable over time,⁶³ (B) the present value of the cash proceeds,⁶⁴ or (C) the indubitable equivalent of the claim.⁶⁵ A second principle applies only to unsecured creditors, but is relevant to undersecured creditors with unsecured deficit claims. Unsecured creditors are entitled to assert the absolute priority rule, according to which no junior creditor or interest holder is entitled to any property until the negatively-voting creditor is paid in full.⁶⁶

Neither of these principles applies to unimpaired or disimpaired claims. Thus, a secured creditor whose claim is reinstated is not necessarily entitled to the value of collateral or its indubitable equivalent. And no reinstated creditor has standing to assert the absolute priority rule when the plan provides for the retention of ownership by equity participants.

Given the purpose of impairment as an alternative to cram down, Judge Ralph Mabey, in the influential case of *In re Barrington Oaks General Partnership*,⁶⁷ suggested that a creditor is impaired if she could benefit from cram down protection. According to Judge Mabey, the statutory definition was merely the "formal" approach, whereas his more creative suggestion was the "functional" approach. This broader definition encouraged him to declare that, any time the collateral is sold to a third party contrary to a "due on sale"

objection was raised that consumers under chapter 11 could keep their postpetition wages when chapter 13 debtors could not, Justice Blackmun dismissed the objection by noting that creditors are at least as well off in chapter 11 as they are in liquidation. *See id.* at 164. In other words, Justice Blackmun ruled that creditor welfare, not technical criteria, should decide the appropriateness of a chapter 11 plan. This instinct supports a very broad definition of impairment.

⁶³ See 11 U.S.C. § 1129(b)(2)(A)(i) (1994).

⁶⁴ See 11 U.S.C. § 1129(b)(2)(A)(ii).

⁶⁵ See 11 U.S.C. § 1129(b)(2)(A)(i).

⁶⁶ See 11 U.S.C. § 1129(b)(2)(B)(ii).

⁶⁷ 15 B.R. 952 (Bankr. D. Utah 1981).

clause (i.e., a clause that accelerates the loan whenever the debtor sells the collateral to a third party), the secured party is impaired, even if the third party assumes the loan obligation, because a different debtor constitutes a different risk. He admitted, however, that the slow-footed "formal" approach would have sufficed to reach this result.⁶⁸

Judge Mabey's innovation seems to presume that the creditor in mind is voting negatively on the plan. His rule succeeds in giving such a negative-minded creditor access and passage to cram down. If followed, the rule must shake the debtor from her fell purpose of capturing value from the secured creditor. Under the *Barrington Oaks* definition of impairment, a plan could be confirmed only if the present value of the reinstated security agreement equalled the value of the collateral. Yet no debtor would reinstate a contract *unless* it was cheaper than cram down. Hence, Judge Mabey's rule deprives reinstatement of all utility as an alternative to cram down. In recent years *Barrington Oaks* has not been followed—though the Ninth Circuit has recently cited the case with approval.⁶⁹

3. One Class Must Vote Affirmatively

Class voting controls whether cram down standards must be applied to a chapter 11 plan. It does so in two ways. First, by virtue of class voting, dissenting creditors who are outvoted by the other members of their class do not have standing to insist on the cram down standards.⁷⁰ Second, if *no* class votes affirmatively, then § 1129(a)(10) prevents confirmation, even if cram down standards could be met.⁷¹

According to § 1129(a)(10), confirmation can occur "if a class of claims is impaired under the plan, [only if] at least one class of claims that is impaired under the plan has accepted the plan, deter-

⁶⁸ *Id.* at 966; *cf.* *Bustop Shelters of Louisville, Inc. v. Classic Homes, Inc.*, 914 F.2d 810, 814-15 (6th Cir. 1990) (Kennedy, J.) (sale of collateral without more not *per se* impairment).

⁶⁹ *See* *L. & J. Anaheim Assocs. v. Kawasaki Leasing Int'l, Inc.* (*In re* *Anaheim Assocs.*), 995 F.2d 940, 942-43 (9th Cir. 1993) (O'Scannlain, J.).

⁷⁰ To be sure, dissenting creditors may occasionally insist that various parts of § 1129(a) prevent confirmation of the plan. For example, even if a class votes "yes," the outvoted members of the class may still insist that they receive as much from the plan as they would have received from a chapter 7 liquidation of the bankruptcy estate. *See* 11 U.S.C. § 1127(a)(7)(A) (1994).

⁷¹ *See* 11 U.S.C. § 1129(a)(10) (1994).

mined without including any acceptance of the plan by any insider."⁷² This provision is the source of a secured creditor's "classification veto."⁷³ The veto depends on the rule (contained nowhere in the Bankruptcy Code) that like claims must be placed in the same class.⁷⁴ According to this important strategy, the undersecured creditor admits that the secured portion of her claim deserves unique classification because its priority to the collateral is unique.⁷⁵ The unsecured deficit claim, however, is alleged to be identical to the claim of any other unsecured creditor.⁷⁶ If this rule is enforced, and if the undersecured creditor's deficit claim is large enough (one third of the unsecured claims in dollar amount or greater) to assure a no vote from the class, the undersecured creditor hopes to prevent any class from voting yes.⁷⁷ The classification veto obviously depends on the comparative size of the unsecured deficit claim of the secured creditor to the other unsecured claims. In single asset cases, where a secured party with a large deficit claim is by far the largest creditor in the chapter 11 case, the secured party often may assure that no class votes affirmatively. The strategy stakes all on classification. If the court allows separate classification of the unsecured deficit claim, the secured creditor cannot dominate. The happy unsecured creditors are likely to vote affirmatively, allowing the debtor to leap the hurdle of § 1129(a)(10) into the briar patch of cram down.

Cure and reinstatement of a security agreement cannot help a debtor in possession meet the provisions of § 1129(a)(10), which requires the affirmative vote of an *impaired* class of noninsider credi-

⁷² *Id.*

⁷³ See David Gray Carlson, *The Classification Veto in Single Asset Cases Under Bankruptcy Code Section 1129(a)(10)*, 44 S.C. L. REV. 565 (1993).

⁷⁴ See *id.* at 573-77. Section 1122(a) prevents different claims from being put in the same class, but it does not bar similar claims from being put into different classes.

⁷⁵ Secured creditors are almost always separately classified for this reason. See *In re Richard Buick, Inc.*, 126 B.R. 840 (Bankr. E.D. Pa. 1991) (Scholl, J.).

⁷⁶ On whether this vital premise is valid, see Carlson, *supra* note 73.

⁷⁷ One problem that nonrecourse lenders presently face is that their deficit claims are *not* given the same priority as other unsecured claims. In chapter 11, nonrecourse creditors are given "artificial recourse" under § 1111(b)(1)(A), 11 U.S.C. § 1111(b)(1)(A) (1994) but these artificial recourse claims have a lower priority than recourse claims. This is due in large part to the workings of § 1129(a)(7)(A), which requires every creditor in chapter 11 to obtain at least as much as they would in chapter 7. 11 U.S.C. § 1129(a)(7)(A) (1994). In chapter 7, the artificial recourse claim does not exist, and so artificial recourse claimants are never entitled to payment, whereas other unsecured creditors are entitled to some positive amount (where at least some unencumbered assets exist in chapter 7). See Carlson, *supra* note 73, at 582-87.

tors.⁷⁸ Thus, even if a debtor-in-possession disimpairs large numbers of angry creditors, the debtor still lacks the necessary yes vote. For this reason, debtors sometimes locate a happy class of creditors and nick them only slightly so that they scarcely feel their impairment and are still pleased to vote affirmatively. If this can be accomplished, the debtor will have met the provisions of § 1129(a)(10).

Prior to 1994, the Bankruptcy Code deemed a claim unimpaired if the creditor received full cash payment on the effective date of the plan.⁷⁹ Thus, any class of creditors receiving cash on the effective date of the plan were deemed to be voting in the affirmative. This concession, however, was counterproductive to debtors because such a class could no longer help the debtor meet the § 1129(a)(10) requirement.⁸⁰ Debtors therefore preferred to write plans in which the happy unsecured classes received 100 cents on the dollar thirty days after the effective date.⁸¹ Since a thirty-day wait was considered an impairment, the class was impaired and their affirmative vote could be counted as satisfying § 1129(a)(10)'s stern challenge.

To save their classification veto, secured creditors would claim that delaying cash payment for thirty days was an impairment of such a minor or *de minimis* nature as to be unnecessary or artificial.⁸² Artificial impairment, they argued, should be disregarded in the name of equity—an equity that supposedly demanded their right to veto an otherwise qualified chapter 11 plan. Although the matter was controversial, prior to 1994 the howl of artificial impairment was enough to shatter many a chapter 11 plan.⁸³

The slanderous insult of "artificial,"⁸⁴ however, depended great-

⁷⁸ See 11 U.S.C. § 1129(a)(10) (1994).

⁷⁹ See 11 U.S.C. § 1124(3) (repealed 1994).

⁸⁰ Venturing through the mists of history—to the days before 1984—§ 1129(a)(10) was unclear as to whether an unimpaired class must expressly vote affirmatively for a plan, or whether the deemed affirmative vote of an unimpaired class might suffice. Since § 1129(a)(10) initially failed to specify whether the affirmatively voting class was required to be impaired, courts were bitterly divided on the question. See Ethan D. Fogel, *Confirmation and the Unimpaired Class of Creditors: Is a "Deemed Acceptance" Deemed an Acceptance?*, 58 AM. BANKR. L.J. 151 (1984). In 1984, Congress made clear that the affirmatively voting class needed to be impaired under the plan. See Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-953 § 512(a)(9), 98 Stat. 333, 386 (1984) (codified at 11 U.S.C. § 1129(a)(10) (1994)). This 1984 amendment greatly strengthened the possibility of a classification veto for undersecured creditors.

⁸¹ David Gray Carlson, *Artificial Impairment and the Single Asset Real Estate Bankruptcy*, 23 CAP. U. L. REV. 339 (1995).

⁸² See *id.* at 361-62.

⁸³ See *id.* at 353-68.

⁸⁴ "It is said that upon being shown the newly built St. Paul's cathedral, King Charles II

ly on the insinuation that a debtor in possession *could* have paid cash to the affirmative voters on the effective date, but did not. In 1994, Congress amended the definition of "impairment" to delete the notion that those paid cash on the effective date are unimpaired.⁸⁵ Today, such creditors are deemed to be *impaired* creditors.

Ironically, Congress did not make this deletion to weaken the classification veto. Rather, Congress sought to reverse a notorious case—*In re New Valley Corp.*⁸⁶—in which a solvent debtor in possession avoided paying postpetition interest to unsecured creditors by means of disimpairment. According to § 1129(a)(7)(A)(ii), every creditor must be paid at least as much as the creditor would have received in a chapter 7 liquidation.⁸⁷ Where a chapter 7 debtor is solvent, unsecured creditors are entitled to postpetition interest at the legal rate under § 726(a)(5).⁸⁸ Section 1129(a)(7), therefore, demands that all unsecured creditors similarly receive interest at the legal rate.⁸⁹ Yet § 1129(a)(7)(A)(ii) does not apply if the individual creditor "has accepted the plan."⁹⁰ As previously stated, unimpaired creditors are deemed to accept the plan automatically.⁹¹ Hence, Judge Winfield ruled logically enough that if creditors were paid cash for the allowed claim on the effective date of the plan and thus rendered unimpaired, then § 1129(a)(7)(A)(ii) does not apply to require payment of postpetition interest.⁹²

Congress, enraged that a solvent debtor could avoid interest payments by this low trick, struck § 1124(3) from the Bankruptcy Code.⁹³ In so doing, Congress little realized how much baby went out with little bathwater. As of October 22, 1994, an undersecured creditor can no longer claim that the affirmative vote of a separate class of happy creditors should be disregarded because the debtor

exclaimed 'How awful! How artificial!' and promptly knighted Christopher Wren." Jeanne L. Schroeder, *The Vestal and the Fasces: Property and the Feminine in Law and Psychoanalysis*, 16 CARDOZO L. REV. 805, 849 n.163 (1995). In those days "artificial" was a compliment, meaning "made with great art." "Awful" meant capable of inspiring awe.

⁸⁵ See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 213(d)(3), 108 Stat. 4106, 4126.

⁸⁶ 168 B.R. 73 (Bankr. D.N.J. 1994).

⁸⁷ *Id.* at 79; see also 11 U.S.C. § 1129(a)(7)(A)(ii) (1994).

⁸⁸ 11 U.S.C. § 726(a)(5) (1994).

⁸⁹ See *New Valley*, 168 B.R. at 79.

⁹⁰ 11 U.S.C. § 1129(a)(7)(A)(i).

⁹¹ See *supra* note 46 and accompanying text.

⁹² See *New Valley*, 168 B.R. at 79.

⁹³ Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 213(d), 108 Stat. 4106, 4126.

could have disimpaired them by giving cash on the effective date.⁹⁴ Receipt of cash no longer disimpairs them. Rather, undersecured creditors now have to argue that the happy class should be disregarded because the debtor *could* have reinstated and cured the creditor's agreement under § 1124(2). Courts are much less likely to disenfranchise the affirmative voting class on the basis of a mere potential for assumption and reinstatement. Often, there is nothing to reinstate, such as where the creditors are suppliers who have already performed and simply wish to be paid.⁹⁵ If paying creditors (as a means of cure) is the same as assuming and reinstating their contracts, then Congress will have failed to overrule *New Valley*. Solvent debtors in possession could still disqualify creditors from § 1129(a)(7)(A)(ii) by paying them, and once again these creditors would lose their § 726(a)(5) right to postpetition interest. Yet this is precisely what Congress hoped to prevent by repealing old § 1124(3).⁹⁶

C. Chapters 12 and 13

Chapter 13 is the well known reorganization chapter for wage earning debtors. Chapter 12, pertaining to the reorganization of farmers, is its lesser known country cousin. Passed during the farm crisis in 1984,⁹⁷ chapter 12 is simply a marked-up version of chapter 13, with changes appropriate to the context of distressed farmers. There are nevertheless some important differences. In chapter 12,

⁹⁴ See *Equitable Life Ins. Co. v. Atlanta-Stewart Partners* (*In re Atlanta-Stewart Partners*, 193 B.R. 79 (Bankr. N.D. Ga. 1996) (Kahn, J.) (holding against an artificial impairment claim in light of these amendments).

⁹⁵ See *infra* notes 388-89 and accompanying text.

⁹⁶ We shall revisit this argument later, in the course of determining what events finally terminate a debtor's right to cure and reinstate a security agreement. See *infra* text accompanying notes 310-12.

⁹⁷ For a good description of chapter 12, see Janet A. Flaccus, *A Comparison of Farm Bankruptcies in Chapter 11 and the New Chapter 12*, 11 U. ARK. LITTLE ROCK L. J. 49 (1988-89). For an article tracing the history of chapter 12 back to the Frazier-Lemke Act in the Depression, see James J. White, *Taking From Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. LAW 1 (1987); Barry G. Grandon, Note, *The Family Farm Bankruptcy Act of 1986 and the Elimination of Lost Opportunity Costs Under Chapter 12*, 14 OHIO N.U.L. REV. 103 (1987).

Chapter 12 originally had a "sunset" provision that cancelled the chapter on October 1, 1993. See Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, § 302(f), 100 Stat. 3088, 3124. But the popularity of chapter 12 was strong enough that in 1993, Congress extended the chapter for another five years. See Act of Aug. 6, 1993, Pub. L. No. 103-65, 107 Stat. 311.

any secured claim may be modified, including a home mortgage.⁹⁸ Thus, in chapter 12, a farmer need not reinstate a mortgage agreement in order to save the family home. Cram down of the home mortgagee is always possible. In contrast, both chapter 11 and chapter 13 prevent modification of loan agreements in which the debtor's residence is the only collateral.⁹⁹

1. *Voting*

Neither chapter 12 nor 13 has any notion of impairment, mainly because there is no class voting in these chapters. To be sure, voting-like phenomena may be observed in both chapters. For example, secured creditors may waive the right to receive the value of collateral.¹⁰⁰ In addition, if even one unsecured creditor (or the standing trustee) disapproves of the reorganization plan, the plan can only be confirmed if the debtor's "projected disposable income" is dedicated to the payment of creditors.¹⁰¹ Thus, in this very rough sense, creditors "vote." But there is certainly no *class* voting. A creditor who somehow found herself in a *class* of creditors could not be outvoted into accepting a plan. Each creditor may stand on her rights regardless of what the class does by way of democratic deliberation.

2. *Cram Down*

In chapter 11, voting has the main significance of triggering the cram down standards with regard to negatively voting classes. Reinstatement generates an automatic yes vote, thereby disqualifying the reinstated creditor from cram down. Reinstatement is therefore an alternative to cram down in chapter 11. In chapters 12 and 13, reinstatement became an alternative to cram down only after 1994.

In 1993, the Supreme Court, in *Rake v. Wade*,¹⁰² insinuated

⁹⁸ See 11 U.S.C. § 1222(b)(2) (1994).

⁹⁹ See 11 U.S.C. §§ 1122(b)(5), 1322(b)(2) (1994). In 1994, Congress added an exception to this principle with regard to mortgages whose terms do not extend beyond the length of a chapter 13 plan. See 11 U.S.C. § 1322(c)(2) (1994). No similar provision was adopted in chapter 11, perhaps because chapter 11 plans can last indefinitely, and any such provision would have subverted the privilege accorded to home mortgages. See *infra* note 138.

¹⁰⁰ See 11 U.S.C. §§ 1225(b)(5)(A), 1325(b)(5)(A) (1994).

¹⁰¹ See 11 U.S.C. §§ 1225(b)(1), 1325(b)(1) (1994).

¹⁰² 508 U.S. 464 (1993).

that reinstatement is merely a supplement to cram down. Under the logic of this ruling, a secured creditor can block a chapter 12 or 13 plan whenever the present value of the reinstated agreement is less than the value of the collateral.¹⁰³ For example, suppose a secured party claims \$100 against collateral worth \$120. Cram down therefore demands that the secured party receive a distribution of collateral worth \$100. Reinstatement, however, might make the claim worth only \$95, because the contract rate of interest is lower than the market rate. *Rake v. Wade* implied that the reinstatement in this example can be blocked, because the secured party is entitled to the full \$100.

To be sure, Justice Clarence Thomas addressed a different issue when he exalted § 1325(a)(5) cram down over § 1322(b)(5) cure.¹⁰⁴ He used § 1325(a)(5) to reason that if cure was to be accomplished over time, the present value of the cure must equal the full cure price.¹⁰⁵ In other words, he took § 1325(a)(5) to require that cure payments must be supplemented by "cram down" interest. Yet, if the overriding nature of § 1325(a)(5) governs cure for this purpose, it surely restricts reinstatement (as opposed to cure of past defaults) as well.

The 1994 amendments to the Bankruptcy Code have reversed *Rake v. Wade's* position on § 1325(a)(5)'s applicability to cure. According to § 1322(e):

notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.¹⁰⁶

Clearly this provision exempts *cure of past defaults* from the cram down rules in § 1325(a). Less clear, however, is whether this provision exempts *reinstatement of the agreement going forward*. Nevertheless, the above analysis of *Rake v. Wade* (a cure case) depended on the principle that what is sauce for the goose of cure is sauce for the gander of reinstatement. If we apply this principle to the 1994

¹⁰³ See *id.* at 469.

¹⁰⁴ See *id.* at 471, 473.

¹⁰⁵ See *id.* at 475.

¹⁰⁶ 11 U.S.C. § 1322(e) (1994) (emphasis added).

amendments, then Congress has established reinstatement as an independent alternative to cram down. Thus, a reinstated agreement may freely contradict the rules of § 1325(a)(5). A reinstatement worth \$95 can be instituted even though the collateral is worth more than \$95.

As in chapter 11, reinstatement in chapters 12 and 13 now serves an alternative to cram down. In addition to this function, reinstatement has another significant utility in chapter 12 and 13. Whereas chapter 11 imposes no restriction on how long a reorganization plan might last, a plan in either chapter 12 or 13 must be concluded within three years (or perhaps five years, if the court condescends to grant that small extension).¹⁰⁷ A reinstated agreement, however, can last much longer than the plan. Where refinancing is not available on a short term basis, the reinstatement procedure could be very useful indeed to a debtor in chapter 12 or 13.¹⁰⁸

One line of cases, however, allows cram down *and* extension of payments beyond the five-year maximum of § 1322(d). According to Judge James Queenan in *In re McGregor*,¹⁰⁹ § 1322(b)(5) does not merely refer to reinstatement of long term security agreements. It also permits long term payouts on cram down, so long as the interest rate and amortization of principal are according to the contract. Under this line of reasoning, if an undersecured creditor's claim can be bifurcated consistent with § 1322(b)(2), cram down is not necessarily subject to the five year maximum. Judge Queenan admits that bifurcation of home mortgages is not permitted in chapter 13¹¹⁰—nor may any other right of a home mortgagee be modified.¹¹¹ But where bifurcation or other cram down tortures are permitted, § 1322(b)(5) provides a mode for extending the plan beyond five years.¹¹² This view may be criticized, however, for chang-

¹⁰⁷ See 11 U.S.C. §§ 1222(c), 1322(c).

¹⁰⁸ See *Justice v. Valley Nat'l Bank*, 849 F.2d 1078, 1082 (8th Cir. 1988) (Gibson, J.) (holding that reinstatement is the sole means of extending payments beyond five years in chapter 12).

¹⁰⁹ 172 B.R. 718 (Bankr. D. Mass. 1994).

¹¹⁰ This is the famous holding of *Nobleman v. American Savs. Bank*, 508 U.S. 324 (1993) (Thomas, J.), discussed *infra* in the text accompanying notes 120-28.

¹¹¹ See *In re Hatcher*, 202 B.R. 626 (Bankr. E.D. Okla. 1996) (Cornish, J.) (because mortgage agreement called for insurance, debtor had to provide it, in the name of "adequate protection"); *In re Legowski*, 167 B.R. 711 (Bankr. D. Mass. 1994) (Boroff, J.) (debtor could not reinstate and also eliminate contractual right to accelerate payment after five years).

¹¹² See *McGregor*, 172 B.R. at 721 ("Subsection (5) does not require the plan proponent to

ing an "and" to an "or." According to § 1322(b)(5), the plan may:

provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

Judge Queenan views cure and maintenance of payments to be disjunctive, so that, so long as contract payments are maintained, cram down can last in excess of five years. No doubt the "and" should be taken seriously; extension of payments beyond the five year maximum of the plan should accompany the cure of all past defaults—a principle which would limit cram down to the five year maximum allowed for chapter 13 plans.

3. *Bifurcation*

One advantage of cram down is the bifurcation of undersecured claims into two claims—one perfectly secured and one perfectly unsecured.¹¹³ Bifurcation allows the unsecured part of the claim to be paid only a pro rata dividend, like the other unsecured creditors. Reinstatement, however, is inconsistent with bifurcation of an undersecured claim. Rather, reinstatement implies that the entire unsecured deficit claim must be paid according to the terms of the contract. For this reason, reinstatement of a radically undersecured claim is not a good strategy for many debtors. In many reorganizations, unnecessary payment on the unsecured deficit claim will outweigh the advantage won by capturing the low contract interest rate.¹¹⁴

That reinstatement precludes bifurcation was clear enough under chapter 11. Recall that unimpaired creditors are deemed to vote affirmatively. Only no-voting creditors are entitled to cram down.

avoid modification of the 'rights' of the secured claim holder. Its command is complied with so long as payments are maintained on the 'secured claim.'"); accord, *In re Kheng*, 202 B.R. 538 (Bankr. D.R.I. 1996); *In re Murphy*, 175 B.R. 134, 137 (Bankr. D. Mass. 1994) (Feeney, J.); *Brown v. Shorewood Fin., Inc.* (*In re Brown*), 175 B.R. 129 (Bankr. D. Mass. 1994) (Fenney, J.).

¹¹³ See 11 U.S.C. § 506(a) (1994). This is sometimes called "lien stripdown." *Lomas Mortgage, Inc. v. Louis*, 82 F.3d 1 n.1 (1st Cir. 1996) (Lynch, J.). After some controversy, it is now clear that a final bifurcation can occur if the collateral is sold or if a reorganization plan is confirmed. See David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1 (1996).

¹¹⁴ See MARTIN BIENENSTOCK, *BANKRUPTCY REORGANIZATION* 597 (1987).

Section 1124(2) states that a secured claim is deemed unimpaired if the maturity of the original loan is reinstated "as such maturity existed before such default."¹¹⁵ Such a reinstatement applies to the prebifurcated claim, and so reinstatement in chapter 11 is not consistent with bifurcation. In addition, the chapter 11 plan must not "otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest."¹¹⁶ This language similarly precludes bifurcation.

In chapter 13, bifurcation of home mortgages and reinstatement were not initially seen as mutually exclusive. Section 1322(b)(2) prevents "modification" of a "claim secured only by a security interest in real property that is the debtor's principal residence."¹¹⁷ Four appellate courts had read the language of § 1322(b)(2) very closely and noticed that the *secured claim* could not be "modified."¹¹⁸ By negative pregnant, the unsecured portion of the claim therefore *might* be modified. The entire allowed claim might then be bifurcated, with no offense to § 1322(b)(2). In effect, these courts read section 1322(b)(2) to mean that, after bifurcation, the debtor was required to reinstate principal and interest payments according to the old schedule, but the mortgage debt would be written down drastically. For example, a twenty year mortgage might become a thirteen year mortgage. Such a possibility provided distressed debtors no immediate relief, but many years hence, with the financial crisis passed and the kids safely graduated from college,

¹¹⁵ 11 U.S.C. § 1124(2)(B) (1994).

¹¹⁶ 11 U.S.C. § 1124(2)(D) (1994).

¹¹⁷ 11 U.S.C. § 1322(b)(2) (1994). Some debtors have argued that a court *must* confirm a plan when all the requirements of § 1325(a) are met. Since the antimodification rule is found in § 1322(b)(2), this argument reasons that plans which modify but do not cure home mortgages can be confirmed. In other words, since the antimodification rule is not found in § 1325(a), it is simply not relevant. This argument has been rejected, on the grounds that the antimodification rule is an implicit condition of confirming a chapter 13 plan. *See* First Nat'l Fidelity Corp. v. Perry, 945 F.2d 61, 66 (3d Cir. 1991) (Stapleton, J.). Now that chapter 11 has the same antimodification rule, a like implication will have to be drawn. In contrast, cure and reinstatement are directly implicated in the confirmation standard of § 1129(a) because reinstatement establishes the creditor as an automatic affirmative voter. As such, reinstatement becomes an alternative to cram down, because only negative voters can trigger that right. *See* 11 U.S.C. §§ 1129(a)(8), 1129(b)(1).

¹¹⁸ *See* Bellamy v. Federal Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176 (2d Cir. 1992) (Cardamore, J.); Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410 (10th Cir. 1991) (per curiam); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990) (Sloviter, J.); Houghland v. Lomas & Nettleton Corp. (*In re* Houghland), 886 F.2d 1182 (9th Cir. 1989) (Fernandez, J.).

debtors in their waning years would obtain the welcome but quite gratuitous benefit of no further mortgage debt service.¹¹⁹

In *Nobelman v. American Savings Bank*,¹²⁰ the Supreme Court ruled that bifurcation of an undersecured claim into its secured and unsecured parts, followed by a cram down of both claims, "modifies" the secured creditor's *rights* (even though it does not, strictly speaking, modify the secured *claim*).¹²¹ Hence, bifurcation was ruled out. By implication, reinstatement suggests that the entire unbifurcated claim of an undersecured creditor must be honored.

Because bifurcation of the home mortgage became impossible after *Nobelman*, courts began to take a new look at just what it means for a creditor to hold "a claim secured only by a security interest in real property that is the debtor's principal residence."¹²² Thus, if the mortgage lien encumbers things other than the residence, *Nobelman* was said to be inapplicable.¹²³ For instance, if the mortgage agreement covers personal property, the entire mortgage may be modified.¹²⁴ Some courts even ruled that extension of the mort-

¹¹⁹ See *In re Honett*, 116 B.R. 495, 497-98 (Bankr. E.D. Tex. 1990) (Sharp, J.) (payments maintained, but maturity date foreshortened).

¹²⁰ 508 U.S. 324 (1993) (Thomas, J.).

¹²¹ See *id.* at 331-32; see also 11 U.S.C. § 506(a) (1994).

¹²² 11 U.S.C. § 1123(b)(5) (1994).

¹²³ See *Lomas Mortgage, Inc. v. Louis*, 82 F.3d 1 (1st Cir. 1996) (Lynch, J.) (mortgage on multifamily dwelling where debtor-landlord lived could be modified); *In re DaCosta*, 204 B.R. 1 (Bankr. D. Mass. 1996) (Feeney, J.) (same, where family members lived in other apartment rent-free). *But see Brunson v. Wendover Funding, Inc.* (*In re Brunson*), 201 B.R. 351 (Bankr. W.D.N.Y. 1996) (Kaplan, J.) (antimodification rule applicable to multi-family dwelling where predominant intent was to provide debtor a residence); *In re Spano*, 161 B.R. 880, 885-87 (Bankr. D. Conn. 1993) (Shiff, J.) (where debtor rented out part of his home after the mortgage was executed, secured creditor was still entitled to protection of § 1322(b)(2)). The test for whether extra collateral exists to spoil § 1322(b)(2) protection should be performed on the day of the chapter 13 petition, to prevent creditors from shedding collateral in order to qualify for it. See *In re Dinsmore*, 141 B.R. 499, 505-06 (Bankr. W.D. Mich. 1992) (Howard, J.); *In re Green*, 7 B.R. 8 (Bankr. S.D. Ohio 1980) (Sidman, J.) (holding postpetition attempt to cancel security interest in personal property to be in bad faith and not permitted).

¹²⁴ See *Hammond v. Commonwealth Mortgage Corp.* (*In re Hammond*), 27 F.3d 52 (3d Cir. 1994) (Hutchinson, J.); *Sapos v. Provident Inst. of Savs.*, 967 F.2d 918, 925 (3d Cir. 1992) (finding security interest on wall-to-wall carpeting fatal to § 1322(b)(2) protection); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 124 (3d Cir. 1990) (Sloviter, J.) (unperfected security interest on "appliances, machinery, furniture and equipment" held fatal); *Mellon Bank v. Crystan* (*In re Crystan*), 197 B.R. 803 (Bankr. W.D. Pa. 1996) (Fitzgerald, J.) (escrow funds made mortgage modifiable). Judge Ruggiero Aldisert, in *Sapos*, reversed and remanded because the debtor had not cured past defaults of the mortgage, but, having ruled that the mortgagee had no rights under § 1322(b)(2), cure was no longer strictly necessary. Cram down would have sufficed, except that the debtor wished to extend payment beyond the five-year maximum for chapter 13 plans. See *Sapos*, 967 F.2d at 928.

gage to fixtures¹²⁵ or insurance proceeds¹²⁶ is fatal. Sometimes, mere language in the agreement claiming nonqualifying collateral cancels § 1322(b)(2) protection, even though the actual extra property does not exist.¹²⁷ Other courts more sensibly said that the encumbrance of fixtures did not take a mortgage out of the antimodification rule; what is a building after all but a great pile of fixtures?¹²⁸ In support of this view, it has been suggested that the mortgage in *Nobelman* itself covered minerals, oil and gas, and profits, showing that such additional collateral cannot strip a residential mortgagee of the immunity from bifurcation.¹²⁹

Surprisingly, cases involving mobile homes have rarely delved into the issue of whether the mobile homes are personal property or fixtures. The antimodification rule of § 322(b)(2) requires that the mortgage be "in real property."¹³⁰ At least some courts have held that mobile homes are not real property,¹³¹ but a great many

A contrary case, refusing to find bastardly in a mixed mortgage, is *PNC Mortgage Co. v. Dicks*, 199 B.R. 674 (N.D. Ind. 1996), where the mortgage agreement extended to "equipment now or hereafter attached to or used in connection with said premises." Judge Allen Sharp still extended the antimodification rule to this mortgage, claiming that "the evidence . . . leads inexorably to the conclusion that the items of collateral described in the PNC mortgage are nothing more than enhancements capable of becoming component parts of the debtor's principal residence." *Id.* at 682. Thus, a security interest on the vacuum cleaner did not disqualify this mortgagee from claiming antimodification protection.

¹²⁵ See *In re Escue*, 184 B.R. 287 (Bankr. M.D. Tenn. 1995) (Paine, J.); see also *In re Jones*, 201 B.R. 371 (Bankr. D.N.J. 1996) (Stripp, J.) (fixtures, condemnation awards, and insurance proceeds).

¹²⁶ See *Transouth Fin. Corp. v. Hill*, 106 B.R. 145 (W.D. Tenn. 1989) (Todd, J.); *In re Selman*, 120 B.R. 576, 578 (Bankr. D.N.M. 1990) (McFeeley, J.); *In re Klein*, 106 B.R. 396 (Bankr. E.D. Pa. 1989) (Scholl, J.) (insurance proceeds plus other personalty). *Contra*, *Allied Credit Corp. v. Davis* (*In re Davis*), 989 F.2d 208, 211 (6th Cir. 1993) (Peck, J.); *Resolution Trust Corp. v. Washington* (*In re Washington*), 967 F.2d 173 (5th Cir. 1992) (Garza, J.).

¹²⁷ *In re Libby*, 200 B.R. 562, 567-68 (Bankr. D.N.J. 1996) (Tuohey, J.); *In re Pinto*, 191 B.R. 610, 613 (Bankr. D.N.J. 1996) (Stripp, J.).

¹²⁸ See *In re French*, 174 B.R. 1, 4 (Bankr. D. Mass. 1994) (Boroff, J.); *Miami Valley Bank v. Lutz* (*In re Lutz*), 164 B.R. 239, 242 (Bankr. W.D. Pa. 1994) (Bentz, J.); *In re Pruitte*, 157 B.R. 662, 664 (Bankr. E.D. Mo. 1993) (Schermer, J.); *In re Jackson*, 136 B.R. 797, 800 (Bankr. N.D. Ill. 1992) (Katz, J.); see also *Lievsay v. Western Fin. Savs. Bank* (*In re Lievsay*), 199 B.R. 705 (B.A.P. 9th Cir. 1996) (Volinn, J.) (use of home office did not repeal antimodification protection for home mortgage).

¹²⁹ See *Citicorp Mortgage, Inc. v. Hirsch* (*In re Hirsch*), 166 B.R. 248 (E.D. Pa. 1994) (Dalzell, J.).

¹³⁰ 11 U.S.C. § 1322(b)(2) (1994). See *United Cos. Lending Corp. v. Witt* (*In re Witt*), 199 B.R. 890 (W.D. Va. 1996) (Turk, J.) (ruling mobile homes a fixture, because Virginia taxes mobile homes as if real estate).

¹³¹ See *Homeowners Funding Co. v. Skinner*, 129 B.R. 60, 64 n.2 (E.D. N.C. 1991) (Fox, J.); *In re Comans*, 164 B.R. 539, 542 (Bankr. S.D. Miss. 1994) (Ellington, J.).

courts simply pass over the issue.¹³² If mobile homes are personal property, then reinstatement and cram down are equally possible for chapter 13 debtors.¹³³

Courts have also ruled that when a home mortgage is entirely under water, it is not a secured claim at all, and therefore not entitled to the protections of § 1322(b)(2).¹³⁴ This claim however, is deeply problematic, in that it associates the existence of property rights with a positive value in the marketplace. Not all property rights hold esteem in the marketplace, yet they are "property" nonetheless. In *United States v. Whiting Pools, Inc.*,¹³⁵ Justice Harry Blackmun ruled that a valueless debtor equity was part of the bankruptcy estate. If a debtor owns a valueless property interest, so might a secured creditor. These cases therefore must be viewed as conceptually unsound—a testimony to how far lower courts would bend logic in order to get around the hated *Nobelman* opinion.

In 1994, Congress partly overruled *Nobelman* with respect to shorter-term mortgages. According to new § 1322(c)(2):

in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to § 1325(a)(5) of this title.¹³⁶

Under this provision, if the scheduled mortgage payments¹³⁷ runs

¹³² See *Green Tree Acceptance, Inc. v. Hoggle (In re Hoggle)*, 12 F.3d 1008 (11th Cir. 1994) (Anderson, J.); *Landmark Fin. Services v. Hall*, 918 F.2d 1150 (4th Cir. 1990) (Hall, J.); *Southtrust Mobile Servs., Inc. v. Englebert*, 137 B.R. 975, 982-83 (N.D. Ala. 1992) (Acker, J.) (applying § 1322(b)(2) to mobile home, even though security interest apparently covered just the home, not the land).

¹³³ A creditor obtaining a security interest on a fixture before it is installed has not been able to claim that the security agreement governing the fixture is entitled to the antimodification rule, even if the fixture lender also has a mortgage on the preexisting real estate. See *In re Reeves*, 65 B.R. 898 (N.D. Ill. 1986) (Todd, J.); *In re Cotton*, 199 B.R. 967 (Bankr. D. Neb. 1996) (Mahoney, J.). These opinions applied to mobile homes would tend to deprive the mobile home lender of the antimodification rule of § 1322(b)(2), since attachment of the security interest will typically precede affixation to real estate.

¹³⁴ See *Carlson*, *supra* note 113, at 24-25.

¹³⁵ 462 U.S. 198 (1983) (Blackmun, J.).

¹³⁶ 11 U.S.C. § 1322(c)(2) (1994).

¹³⁷ Notice this amendment is carefully written to preclude the argument that, once a debt is accelerated, a debtor may freely modify the home mortgage. Rather, the invitation to modification insists that the "original payment schedule" be consulted to determine whether the

out before a chapter 13 plan is finished, the mortgage may be modified.¹³⁸ In such a case, a debtor might keep her home without reinstating the mortgage agreement. It is not clear how valuable a concession this is to debtors, since chapter 13 plans must conclude within three to five years.¹³⁹ A debtor in the lag end of a long-term home mortgage is likely to have paid down so much of the principal that the mortgagee will likely be oversecured and therefore no longer in danger of bifurcation. Nevertheless, short term mortgages have become popular. These mortgages are fully subject to bifurcation¹⁴⁰ and other cram down tortures.¹⁴¹

When bifurcation of a home mortgage is impossible, § 1322(b)(5), "notwithstanding paragraph (2) of this subsection," authorizes a chapter 13 plan to "provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due."¹⁴² This provision, containing a direct override of the antimodification rule of § 1322(b)(2), covers the cure and reinstatement of long-term home mortgages. It permits the

mortgage is short term or long term.

¹³⁸ This is true regardless of whether the scheduled payments mature prior to the chapter 13 petition or before the plan ends. See *In re Sarkese*, 189 B.R. 531, 535 (Bankr. M.D. Fla. 1995) (Proctor, J.); *In re Lobus*, 189 B.R. 216, 218 (Bankr. S.D. Fla. 1995) (Crystol, J.); *In re Jones*, 188 B.R. 281 (Bankr. D. Ore. 1995) (Higdon, J.); *In re Chang*, 185 B.R. 50 (Bankr. N.D. Ill. 1995) (Schmetterer, J.).

As of 1994, chapter 11 forbids the modification of home mortgages. See 11 U.S.C. § 1123(b)(5) (1994). Congress added no exception for mortgages maturing soon after the chapter 11 petition, perhaps because chapter 11 plans need not end within five years, as chapter 13 requires. See 11 U.S.C. § 1322(d) (1994). Thus, in *In re Clay*, 204 B.R. 786 (Bankr. N.D. Ala. 1996), where a chapter 11 debtor owed a balloon payment on a short-term mortgage, Judge Benjamin Cohen ruled that only in chapter 13 could such a mortgage be modified.

¹³⁹ See 11 U.S.C. § 1322(d) (1994).

¹⁴⁰ See *In re Young*, 199 B.R. 643, 647 (Bankr. E.D. Tenn. 1996) (Parsons, J.). But see *United Cos. Lending Corp. v. Witt (In re Witt)*, 199 B.R. 890 (W.D. Va. 1996) (Turk, J.) (Congress did not intend to permit bifurcation of short-term home mortgage by enacting § 1322(c)(2)).

¹⁴¹ New § 1322(c)(2) could be viewed as the adoption of a minority position, which said that § 1322(b)(2)'s restriction on modification of home mortgages should not apply to short-term mortgages, but only to the long-term traditional real estate mortgage. See *In re Williams*, 109 B.R. 36, 41 (Bankr. E.D.N.Y. 1989) (Eisenberg, J.); *In re Shaffer*, 84 B.R. 63, 65 (Bankr. W.D. Va. 1988) (Pearson, J.), *rev'd on other grounds*, 116 B.R. 60 (W.D. Va. 1988).

¹⁴² 11 U.S.C. § 1322(b)(5) (1994). The rule in chapter 12 is identical. See 11 U.S.C. § 1222(b)(5) (1994). The implication should not be drawn from § 1322(b)(5) that, since "maintenance of payments" must be continued during the plan, it need not be continued after the plan. The spirit of reinstatement is that the contractual right to payment or interest may not be altered from the terms of the contract. No one has yet suggested otherwise.

reinstated agreement to extend itself beyond the life of the plan.¹⁴³ Notice that § 1322(b)(5) refers only to mortgage agreements as to which "the last payment is due after the date on which the final payment under the plan is due."¹⁴⁴ After 1994, any agreement in which the preacceleration scheduled payments run out *before* the chapter 13 plan is simply not entitled to the benefit of the antimodification rule of § 1322(b)(2).

4. Acceleration

Prior to 1994, a lively controversy existed as to whether short-term mortgages could be cured at all. It was sometimes noted that, whereas § 1322(b)(5) (long-term mortgages) provided a direct override of § 1322(b)(2)'s antimodification rule,¹⁴⁵ § 1322(b)(3) (permitting cure in general) permitted none.¹⁴⁶ One extreme implication was that, once the maturity date of a long term mortgage agreement was accelerated, the entire mortgage agreement precipitated out of the jurisdiction of § 1322(b)(5) into the short-term jurisdiction of § 1322(b)(3), which was incapable of overriding the antimodification rule. In short, once a mortgage debt was accelerated, it was too late to cure and reinstate it.¹⁴⁷ Such a holding would have all but terminated cure and reinstatement of home mortgages in chapter 13 cases, because acceleration is very common and often automatic upon default.

This disastrous argument was rejected on the ground that, regardless of what the statute says, Congress intended something else.¹⁴⁸ It was suggested that the language from § 1322(b)(5) ("the last payment is due after the date on which the final payment under

¹⁴³ This is also an advantage in chapter 12. See 11 U.S.C. § 1222(b)(5) (1994).

¹⁴⁴ See 11 U.S.C. § 1322(b)(5) (1994).

¹⁴⁵ That is to say, § 1322(b)(5) allows cures *notwithstanding* § 1322(b)(2).

¹⁴⁶ See 11 U.S.C. § 1322(b)(3) (1988).

¹⁴⁷ See *Grubbs v. Houston First Am. Savs. Ass'n*, 718 F.2d 694, 696 (5th Cir.) (Jolly, J.), *rev'd*, 730 F.2d 236 (5th Cir. 1984) (en banc); *Western & S. Life Ins. Co. v. Soderlund* (*In re Soderlund*), 18 B.R. 12, 16 (S.D. Ohio 1981) (Kinneary, J.); Susan L. Russell-Chema, *Saving the Family Homestead: Home Mortgages Under Chapter 13*, 43 OHIO ST. L.J. 905 (1982); Eric Taube, Comment, *Accelerated Mortgages: An Unsolved Problem of Interpretation in Chapter 13*, 19 HOUS. L. REV. 951, 968 (1982).

¹⁴⁸ See *In re Roach*, 824 F.2d 1370, 1374-75 (3d Cir. 1987) (Stapleton, J.). As Judge Edward Lumbard put it, "we do not believe that Congress labored for five years over this controversial question only to remit consumer debtors—intended to be primary beneficiaries of the new Code—to the harsher mercies of state law." *Di Pierro v. Taddeo* (*In re Taddeo*), 685 F.2d 24, 25 (2d Cir. 1982) (Lumbard, J.).

the plan is due") referred to last payment assuming no acceleration.¹⁴⁹ In support of this notion, it was claimed that "cure must comprehend the power to 'de-accelerate.'"¹⁵⁰ Furthermore, it was often suggested that a cure was not a "modification" of the security agreement at all.¹⁵¹ On this last view, even cure and reinstatement under § 1322(b)(3) were completely consistent with the antimodification rule for the simple reason that cures were not modifications.¹⁵² Meanwhile, policy arguments were asserted to prove that accelerated mortgage claims are subject to cure, in spite of § 1322(b)(5)'s unavailability. De-acceleration thus prevents a race to the court house, and encourages debtors to negotiate with the mortgagee, in lieu of filing for bankruptcy.¹⁵³

In any event, now that the antimodification rule of § 1322(b)(2) *never* applies to short-term mortgages whose scheduled payment last less time than the chapter 13 plan,¹⁵⁴ these disputes are outmoded. Indeed, if debtors turned the tables on secured creditors and used acceleration to prove that mortgages fell under § 1322(b)(3)—instead of § 1322(b)(5)—then the accelerated mortgage is fully subject to modification and cram down by any means. Fortunately for the secured creditors, this argument has been precluded by § 1322(c)(2). That section, added in 1994, conditions the power to modify upon the "last payment on the original payment schedule" falling before the end of the chapter 13 plan.¹⁵⁵ Hence, debtors may not claim that accelerated mortgages are always modifiable.¹⁵⁶

In *Nepil*,¹⁵⁷ however, Judge Novalyn Winfield ruled that a foreclosure judgment merges with the mortgage agreement and renders a long-term mortgage into a short-term one—regardless of the language of § 1322(c)(2). Such a decision is quite unnecessary—federal

¹⁴⁹ See *Grubbs*, 730 F.2d at 241 n.7; *Crestline Bldg. & Loan Ass'n v. Allen (In re Allen)*, 42 B.R. 360, 362 (N.D. Ohio 1984) (Krenzler, J.).

¹⁵⁰ *In re Taddeo*, 685 F.2d at 27.

¹⁵¹ See *infra* notes 374-77 and accompanying text.

¹⁵² See, e.g., *Grubbs*, 730 F.2d at 247 (using § 1322(b)(3) to cure junior mortgage of less than three years); *In re Ford*, 84 B.R. 40, 42-43 (Bankr. E.D. Pa. 1988) (Scholl, J.).

¹⁵³ See *In re Taddeo*, 685 F.2d at 27; Barry L. Zaretsky, *Some Limits on Mortgagees' Rights in Chapter 13*, 50 BROOKLYN L. REV. 433, 443 (1984); Douglas A. Winthrop, Note, *The Chapter 13 Cure Provisions: A Doctrine in Need of a Cure*, 74 MINN. L. REV. 921, 930 (1990).

¹⁵⁴ See 11 U.S.C. § 1322(c)(2) (1994).

¹⁵⁵ *Id.* (emphasis added).

¹⁵⁶ See *In re Sims*, 185 B.R. 853, 857 (Bankr. N.D. Ala. 1995) (Sledge, J.).

¹⁵⁷ 206 B.R. 72 (Bankr. D.N.J. 1997).

court have pierced through the merger doctrine and have proclaimed the long-term mortgage still in existence.¹⁵⁸ Furthermore, the decision puts secured creditors in a dilemma. If they proceed too diligently in foreclosing their mortgages, the debtor can, with a properly timed bankruptcy opinion, win the right to modify the mortgage.

Nevertheless, Judge Winfield had a very intriguing argument from legislative history—a lesson to staff members who write the reports that are so influential in litigation. According to the legislative history:

The changes made by this section, in conjunction with those made in section 305 of this bill, would also overrule the result in *First National Fidelity Corp. v. Perry*, with respect to mortgages on which the last payment on the original payment schedule is due before the date on which the final payment under the plan is due. In that case, the Third Circuit held that subsequent to foreclosure judgment, a chapter 13 debtor cannot provide for a mortgage debt by paying the full amount of the allowed secured claim in accordance with Bankruptcy Code section 1325(a)(5), because doing so would constitute an impermissible modification of the mortgage holder's right to immediate payment under section 1322(b)(2) of the Bankruptcy Code.¹⁵⁹

In *First National Fidelity Corp. v. Perry*,¹⁶⁰ Judge Walter Stapleton ruled that a chapter 13 plan could not be confirmed which purported to cram down a foreclosure judgment, on the grounds that the secured creditor was entitled to the benefit of the antimodification rule. We do not know from the *Perry* opinion whether the mortgage agreement (merged out of existence by the judgment) extended beyond the plan. If so (as was likely), then to overrule *Perry* is to permit any judgment of foreclosure to be crammed down, even though the original mortgage was long-term.

Judge Winfield thought the legislative history to be too vague to rely on. She preferred to cite the policy of chapter 13 to relieve debtors, and so she ruled that the debtor could cram down a long-term mortgage, if a judgment of foreclosure had been entered.

¹⁵⁸ This was done to extend the deadline for cure past the foreclosure judgment. See generally *infra* Part III.

¹⁵⁹ 140 Cong. Rec. H10752, H10769 (citation omitted).

¹⁶⁰ 945 F.2d 61 (3d Cir. 1991).

D. *The End of the Right to Cure and Reinstate*

The right to reinstatement must eventually come to an end. For example, after a foreclosing secured party sells collateral to a buyer, cure and reinstatement necessarily divests the buyer in favor of the debtor, which we may assume is manifestly unfair. Such a rule would chill prices bid at foreclosure sales, to the detriment of debtors.¹⁶¹

We have seen how, prior to 1994, acceleration of the debt had been soundly rejected as the deadline for reinstatement.¹⁶² However, a division existed as to what the deadline really was. The most common view was that the foreclosure sale marked the termination date of the right to cure and reinstate.¹⁶³ Some courts thought the end of the redemption period was the end of reinstatement, because the collateral was still "property of the estate" until the end of that time.¹⁶⁴ A few courts took the view that any judgment of default or foreclosure, even prior to the sale, was the deadline. The theory behind this last position was that the foreclosure judgment merges with and eliminates the mortgage agreement. Since the contract was dead, it could no longer be reinstated.¹⁶⁵

¹⁶¹ See *Federal Land Bank v. Glenn (In re Glenn)*, 760 F.2d 1428, 1436 (6th Cir. 1985) (Engel, J.).

¹⁶² See *supra* notes 145-48 and accompanying text.

¹⁶³ See *Commercial Fed. Mortgage Corp. v. Smith (In re Smith)*, 85 F.3d 1555, 1560 (11th Cir. 1996) (Birch, J.) (interpreting Bankruptcy Code as it existed prior to 1994); *Federal Land Bank*, 760 F.2d at 1436 (chapter 13); *In re Madison Hotel Assocs.*, 749 F.2d 410, 412 (7th Cir. 1984) (Coffey, J.). Sale was proclaimed the deadline even when the buyer was also the mortgagee. See *Justice v. Valley Nat'l Bank*, 849 F.2d 1078, 1084-85 (8th Cir. 1988) (Gibson, J.). A dissent by Judge Gerald Heaney was entered on this score. He did not emphasize the bid in quality, *id.* at 1089-90, but presumably he would not allow property to be taken back from a third party buyer who had paid cash. See also *Goldberg v. Tynan (In re Tynan)*, 773 F.2d 177, 178 (7th Cir. 1985) (Wright, J.) (holding that third party buyer's payment extinguished secured creditor's claim and terminated any possibility of cure).

¹⁶⁴ See *Jim Walter Homes, Inc. v. Spears (In re Thompson)*, 894 F.2d 1227, 1229-30 (10th Cir. 1990); *Oregon v. Hurt (In re Hurt)*, 158 B.R. 154, 159-60 (B.A.P. 9th Cir. 1993) (Ashland, J.); *In re Read*, 131 B.R. 188 (Bankr. M.D. Ala. 1991) (Gordon, J.). Judge Stanley F. Birch argues against the end of the redemption period as a deadline because:

"[A]fter a foreclosure sale occurs, there is no 'unsecured claim on which the last payment is due after the day on which the final payment under the plan, is due.'

There is also no 'default' to cure or waive. Therefore, there is no ability to cure and maintain mortgage payments under 11 U.S.C. § 1322(b)(3) or (5)."

Smith, 85 F.3d at 1559 (quoting *In re McKinney*, 174 B.R. 330, 335 (Bankr. S.D. Ala. 1994) (quoting 11 U.S.C. § 1322(b)(5)). But this argument proves too much. It sustains acceleration of the debt as the deadline, as all the above attributes are true in case of acceleration.

¹⁶⁵ See *Midlantic Nat'l Bank v. DeSeno (In re DeSeno)*, 17 F.3d 642, 644 (3d Cir. 1994) (Roth, J.) (holding also that the foreclosure "judgment lien" might be crammed down); *Demers v. Federal Land Bank*, 89 B.R. 48, 50-51 (D.S.D. 1987) (Porter, J.), *aff'd*, 853 F.2d 605

When the foreclosure judgment was held to be the deadline prior to 1994, merger of the security agreement into the judgment was implicitly held to be fatal to reinstatement. However, a contrary view existed under which cure and reinstatement were seen as preemptive federal rules that could cancel what state law dictated.¹⁶⁶ That is, security agreements could be separated from the foreclosure judgment. Indeed, if reinstatement was to be viewed as a federal rule, merger was no bar to cure and reinstatement. Only if reinstatement was viewed as a nonbankruptcy concept was merger fatal. Meanwhile, the federal rule was free to develop prudential or equitable limits (such as the sale or the end of the postsale redemption period) as the final deadline for cure and reinstatement.

Although the 1994 amendments to the reorganization chapters favor deference to local law, they reversed the field with regard to the deadline. Section 1322(c)(1) now provides:

Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—

(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable

(8th Cir. 1988); *In re Celeste Court Apts., Inc.*, 47 B.R. 470, 476 (D. Del. 1985) (Schwartz, J.); *see generally* Joseph M. Gaynor, *Impairment*, 3 BANKR. DEV. J. 579, 589-90 (1986).

Incidentally, if the logic underlying the use of foreclosure judgments as the deadline for cure and reinstatement is that the contract is merged into the judgment, then the "judgment" is not a contract, and § 1322(b)(2) no longer applies. *See* *First Nat'l Fidelity Corp. v. Perry*, 945 F.2d 61, 63 (3d Cir. 1991) (Stapleton, J.) ("Upon entry of a foreclosure judgment, New Jersey establishes a new relationship between the mortgagor and mortgagee which includes a right on the part of lender to immediate payment of the debt from proceeds of a sale of the property."); *In re Garner*, 13 B.R. 799, 801 (Bankr. S.D.N.Y. 1981) (Schwartzberg, J.). Section 1322(b)(2) prevents modification of the rights of holders of claims "secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2) (1994). If there really is no contract, then the judgment lien is not a "security interest," because the Bankruptcy Code defines security interest as a "lien created by an agreement." 11 U.S.C. § 101(51) (1994). Accordingly, foreclosure liens could be bifurcated and crammed down, in spite of *Nobelman*. They need not be cured at all. In *First Nat'l Fidelity Corp.*, Judge Walter Stapleton evaded this point by noting that the foreclosure lien was indeed a security interest, because it was "created" by a mortgage agreement. *First Nat'l Fidelity Corp.*, 945 F.2d at 64-65.

¹⁶⁶ *See Jim Walter Homes, Inc.*, 894 F.2d at 1230 ("Somewhere on the continuum of the mortgagor's interests under state foreclosure law we must draw a line beyond which there can be no cure of default."); *Boromei v. Sun Bank*, 92 B.R. 516 (M.D. Fla. 1988) (Hodges, J.).

nonbankruptcy law¹⁶⁷

The amendment has the indirect effect of making clear that reinstatement includes the concept of de-acceleration (because acceleration precedes the foreclosure sale). In addition, it clarifies that reinstatements under § 1322(b)(3) are capable of overriding the antimodification rule of § 1322(b)(2). Of course, § 1322(c)(2) simply repeals the antimodification rule outright for short term mortgages.¹⁶⁸ Between these two new provisions, it is clear that short-term mortgages and accelerated mortgages may be cured and reinstated.

This amendment sets the foreclosure sale as the deadline in the case of a home mortgage, but it leaves many questions unanswered. For instance, some courts ruled that reinstatement could occur even after the foreclosure sale, where a postsale right of redemption existed.¹⁶⁹ Section 1322(c)(1) states that the plan *may* reinstate a security agreement up to the time of the foreclosure sale, but it does not exactly rule out reinstatement after that time. Hence, it is possible that the statute sets no effective deadline at all, except to overrule the cases holding that the presale *judgment* was the deadline. Legislative history supports this view.¹⁷⁰ Nevertheless, this view has already been rejected.¹⁷¹ In *In re Ross*,¹⁷² Judge Judith Wizmur ruled that the deadline implicit in § 1322(c)(1) does not depend on whether the debtor owns a property interest in the home, such as a right to redeem after the sale. Rather, "[t]he relevant text of § 1322(b) [and now § 1322(c)(1)] speaks of obligations of the debtor as to which cure of a default is authorized" ¹⁷³ Thus, according to Judge

¹⁶⁷ 11 U.S.C. § 1322(c)(1) (1994).

¹⁶⁸ See 11 U.S.C. § 1322(c)(2) (1994).

¹⁶⁹ See *Smith*, 85 F.3d at 1561; *In re Ragsdale*, 155 B.R. 578 (Bankr. N.D. Ala. 1993) (Mitchell, J.).

¹⁷⁰ According to this legislative history:

This section of the bill safeguards a debtor's rights in a chapter 13 case by allowing the debtor to cure home mortgage defaults at least through completion of a foreclosure sale under applicable nonbankruptcy law. However, if the State provides the debtor more extensive "cure" rights (through, for example, some later redemption period), the debtor would continue to enjoy such rights in bankruptcy.

140 CONG. REC. H10752, H10769 (daily ed. Oct. 4, 1994).

¹⁷¹ Sometimes with regret. See *In re Sims*, 185 B.R. 853, 863 (Bankr. N.D. Ala. 1995) (Sledge, J.); *In re Rambo*, 199 B.R. 747, 751 (Bankr. W.D. Okla. 1996) (Lindsey, J.).

¹⁷² 191 B.R. 615 (Bankr. D.N.J. 1996).

¹⁷³ *Ross*, 191 B.R. at 617 (quoting *In re Roach*, 824 F.2d 1370, 1372 n.1 (3d Cir. 1987) (Stapleton, J.)).

Wizmur, the amendment establishes the sale as the absolute latest deadline possible.¹⁷⁴

The 1994 amendments mention the sale as a deadline, but when are foreclosure sales *final*? In *Ross*, Judge Wizmur wrote:

We believe the statute is ambiguous in this regard. On the one hand, the preposition "at" in the phrase "sold at a foreclosure sale" might signify the intention of Congress to situate the termination point at a defined and certain event, i.e. the foreclosure auction. On the other hand, the phrase "that is conducted in accordance with applicable nonbankruptcy law" modifies "foreclosure sale," and requires resort to state law to determine the procedural regularity of the actual sale. The term "sold" might refer to the process employed in each state to complete a foreclosure sale.¹⁷⁵

Judge Wizmur ruled that New Jersey law governed the finality of the sale and hence the deadline for cure and reinstatement. In her judgment, New Jersey law pointed to the delivery of a deed by the sheriff to the buyer at the foreclosure sale.¹⁷⁶ In contrast, other judges interpreting New Jersey law have pushed the deadline forward to the time the auction is concluded, even if the sheriff has not yet issued a deed; this was the point at which the buyer obtained equitable title to the land in question.¹⁷⁷

Even other points could have been chosen. For example, New Jersey law requires deeds to be recorded; otherwise, the grantor has power to convey better title to a bona fide purchaser for value.¹⁷⁸ Why is not recordation the final moment of "alienation" of the collateral?¹⁷⁹ Often foreclosure sales must be confirmed by a court;

¹⁷⁴ See *id.* at 617.

¹⁷⁵ *Id.* at 618.

¹⁷⁶ See *id.* at 621.

¹⁷⁷ *In re Simmons*, 202 B.R. 198 (Bankr. D.N.J. 1996) (Winfield, J.); *In re Little*, 201 B.R. 98 (Bankr. D.N.J. 1996) (Gambardella, J.); *In re Ziyambe*, 200 B.R. 790 (Bankr. D.N.J. 1996) (Gambardella, J.).

¹⁷⁸ See N.J. STAT. ANN. § 46:22-1 (1996).

¹⁷⁹ See *In re Reid*, 200 B.R. 265, 267 (Bankr. S.D. Fla. 1996) (Mark, J.); *In re Jaar*, 186 B.R. 148 (Bankr. M.D. Fla. 1995) (Glenn, J.) (describing deadline as when clerk files certificate of sale). In *In re Johnson*, 171 B.R. 613 (Bankr. M.D. Tenn. 1994), Judge Keith Lundin rejected recordation and put forth execution of the deed as the relevant deadline. He did so as a matter of federal law, however, under the authority of *Federal Land Bank v. Glenn (In re Glenn)*, 760 F.2d 1428 (6th Cir.) (Engel, J.), which expressly rejected state law as setting the deadline. In contrast, Judge Wizmur ruled that the 1994 amendments require state law to define when a sale occurs, which reopens the possibility that recordation is the relevant deadline after all. See

the § 1322(c)(1) deadline has therefore been set at this late point.¹⁸⁰ In North Carolina, "upset bids" are allowed by any person ten days after the auction; the end of this period has been identified as the deadline.¹⁸¹

The effect of the new federal cutoff may be to overrule cases holding that the deadline was the end of the redemption period, which, in the case of real property, might occur well after the foreclosure sale. But this holding does not mean that redemption is useless. Rather, it implies that redemption must be accomplished through a lump sum payment, as per state law, as supplemented by the minor extension granted in Bankruptcy Code § 108(a).¹⁸² "Cure" on the other hand, could have been accomplished over time.¹⁸³

In addition, the new deadline only covers home mortgages pro-

Ross, 191 B.R. at 618.

¹⁸⁰ See *McEwen v. Federal Nat'l Mortgage Ass'n*, 194 B.R. 594 (N.D. Ill. 1996) (Grady, J.); *In re Rambo*, 199 B.R. 747, 750-51 (Bankr. W.D. Okla. 1996) (Lindsey, J.); *In re Blair*, 196 B.R. 477 (Bankr. E.D. Ark. 1996) (Scott, J.).

McEwen was "overruled" by Judge Eugene Wedoff in *In re Christian*, 199 B.R. 382 (Bankr. N.D. Ill. 1996), who decreed that the right to cure ended earlier than the order of confirmation. Rather, it ended with the foreclosure auction. As for *McEwen*, Wedoff thought the decision was entitled to "substantial deference, but as the opinion of a single judge in a multi-judge district, it cannot establish precedent for the district binding on the bankruptcy courts." *Id.* at 387 (citation omitted).

¹⁸¹ See *In re Barham*, 193 B.R. 229, 232 (Bankr. E.D.N.C. 1996) (Small, J.).

¹⁸² According to § 108(b):

Except as provided in subsection (a) of this section, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor or an individual protected under section 1201 or 1301 of this title may . . . cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the trustee may only file, cure, or perform, as the case may be, before the later of—

- (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
- (2) 60 days after the order for relief.

11 U.S.C. § 108(b) (1994). Although this provision does not mention redemption after a foreclosure sale, the section has been held relevant to redemption. See *Glenn*, 760 F.2d at 1436-37; *Johnson v. First Nat'l Bank*, 719 F.2d 270, 278 (8th Cir. 1983) (Roberts, J.); Shawn A. Holcombe, Comment, *The Power to Cure Default Under Chapter 12*, 7 BANKR. DEV. J. 261, 270 (1990); Patrick J. Potter, *How Much Time Do Vendees Have to Cure Their Land Contract Defaults After Filing for Bankruptcy? Or Does Section 362(a) Really Stay Time?*, 11 THOMAS M. COOLEY L. REV. 45 (1994). Note that § 108(b) governs a trustee who wishes to redeem. In chapter 12 or 13, the debtor (not a trustee) will wish to redeem. Courts assume, however, that this rule applies to debtors as well as to trustees. See *First Nat'l Fidelity Corp. v. Perry*, 945 F.2d 61, 65 (3d Cir. 1991) (Stapleton, J.).

¹⁸³ See *In re Sims*, 185 B.R. 853, 863 (Bankr. N.D. Ala. 1995) (Sledge, J.); *In re Ragsdale*, 155 B.R. 578, 587 (Bankr. N.D. Ala. 1993) (Mitchell, J.).

tected from modification under § 1322(b)(2). What rule shall apply for other types of security agreements in chapter 13?¹⁸⁴ What rule shall apply in chapter 11 or 12? In chapter 11, the question becomes relevant because new § 1123(b)(5) prohibits modification of the home mortgage, yet no reinstatement deadline is set. Hence, the same controversy that plagued chapter 13 will now infest chapter 11, unless the courts simply borrow the new chapter 13 rule for chapter 11 cases. This, of course, is subject to the dubious criticism that Congress must have known what it was doing when it set a deadline in one chapter but not the other.¹⁸⁵

Sometimes, real estate mortgages come to an end without a sale. In Illinois and Michigan, installment contracts can provide that a debtor's equitable interest in a home mortgage is forfeited to the seller. Forfeiture had been held to be the deadline prior to 1994.¹⁸⁶ What shall the rule be as to such cases, which do not involve sales at all?¹⁸⁷ In *In re Hart*,¹⁸⁸ a junior mortgagee exercised

¹⁸⁴ *In re Pluta*, 200 B.R. 740 (Bankr. D. Mass. 1996) (Boroff, J.) (Massachusetts law on cure of default could not limit right of debtor to cure reinstate security agreement governing car in chapter 13).

¹⁸⁵ See, e.g., *Johnson v. Home State Bank*, 501 U.S. 78, 87 (1991) (Marshall, J.) (arguing that expressly providing for bad faith dismissals in one case proves that Congress must have intended no dismissal in other cases). For a refusal to borrow from chapter 13 to solve a different chapter 11 mortgage problem, see *In re Clay*, 204 B.R. 786 (Bankr. N.D. Ala. 1996) (Cohen, J.) (refusing to permit modification of short-term mortgage just because chapter 13 now permits it).

¹⁸⁶ See *In re Layton*, 138 B.R. 219 (Bankr. N.D. Ill. 1992) (Squires, J.); see generally Potter, *supra* note 182.

¹⁸⁷ See *In re Carr*, 52 B.R. 250, 259 (Bankr. E.D. Mich. 1985) (Spector, J.) (holding that end of redemption period after forfeiture is deadline). A commentator, Patrick J. Potter, complains that this opinion in effect holds that the automatic stay prevents time from running—that the automatic stay always extends the redemption period. See Potter, *supra* note 182, at 65-69. It is also possible to read this case as simply holding that the right to cure accrues with the bankruptcy petition. So long as it accrues during the redemption period, it may be exercised after the redemption period actually expires. From this perspective, the automatic stay is irrelevant and does not extend time. Rather, cure becomes a vested right if it accrues during the redemption period.

Potter also points out that, at least in the Sixth Circuit, conditional sales of real estate are executory contracts, not security interests. *Terrell v. Albaugh (In re Terrell)*, 892 F.2d 469, 473 (6th Cir. 1989) (Kennedy, J.); see Potter, *supra* note 182, at 68-69. On this basis, he proclaims *Carr* to be overruled. See Potter, *supra* note 182, at 69. Therefore, § 1322(b)(5), which applies to "executed security agreements," does not apply to the cure of a conditional sale of real estate. Nevertheless, chapter 13 plans may cure and assume executory contracts. 11 U.S.C. § 1322(b)(7) (1994). Executory contracts may be cured and assumed "at any time before the confirmation of a plan." 11 U.S.C. § 365(d)(2) (1994). While cure of a security agreement must occur *in* the plan, the deadline for curing an executory contract is not much different. In either case, the right to cure should outlast the redemption period, so long as it accrued

its right to pay off a senior mortgage. It then added that amount to its own fully matured claim.¹⁸⁹ Judge Paul Glenn ruled that the senior mortgage could not be reinstated because it was dead. Any reinstatement of the junior mortgage had to be according to the terms of the junior mortgage.¹⁹⁰ Since no sale occurred, can it be clear this case is rightly decided, in light of the new deadline in § 1322(c)(1)? The answers to these questions are unknown.

E. *Unfair Discrimination*

All of the reorganization chapters prohibit unfair discrimination between classes of creditors. Chapter 11 provides this rule as part of cram down. Thus, § 1129(b)(1) requires that "the plan does not discriminate unfairly . . . with respect to each class of claims . . . that is impaired under, and has not accepted, the plan."¹⁹¹ This language means that the negatively voting classes can block confirmation if they can show unfair discrimination against them, compared to some other class.

Chapter 11 makes classification of creditors largely mandatory.¹⁹² Not so chapters 12 and 13. Yet chapters 12 and 13 do state that, *if* a plan classifies claims, the plan "may not discriminate unfairly against any class so designated," with the exception that co-signed consumer debt may be treated differently from other classes of claims.¹⁹³ Nevertheless, in a case where no classes at all were set forth in a chapter 13 plan, Judge Stephen Mitchell, in *In re DeLauder*,¹⁹⁴ ruled that a reinstated security agreement was inherently a different class from that of other creditors, where the debtor proposed to pay the secured party outside the plan.¹⁹⁵

This holding required Judge Mitchell to explore whether rein-

during that period. *But see In re Delex Management*, 155 B.R. 161, 166-67 (Bankr. W.D. Mich. 1993) (Gregg, J.) (prohibiting assumption of conditional sale of real estate after redemption period lapsed).

¹⁸⁸ 184 B.R. 849 (Bankr. M.D. Fla. 1995) (Glenn, J.).

¹⁸⁹ *See id.* at 851.

¹⁹⁰ *See id.* at 858.

¹⁹¹ 11 U.S.C. § 1129(b)(1) (1994).

¹⁹² *See* 11 U.S.C. § 1123(a)(1) (1994) (providing for classification of claims, but also providing that administrative creditors, "gap" creditors in involuntary cases, and tax creditors need not be classified).

¹⁹³ *See* 11 U.S.C. §§ 1222(b)(1), 1322(b)(1) (1994).

¹⁹⁴ 189 B.R. 639 (Bankr. E.D. Va. 1995).

¹⁹⁵ *See id.* at 647.

stating an undersecured creditor was unfair, because the unsecured deficit of the creditor would be payed in full, whereas other unsecured creditors would not receive such favorable treatment. Judge Mitchell applied a cumbersome five-part test to discover whether reinstatement was unfair. According to this test, reinstatement must (1) have a rational basis, (2) be necessary to the debtor's rehabilitation, (3) be in good faith, (4) provide meaningful payments to other creditors, and (5) impose no great loss on the regular creditors.¹⁹⁶ Applying these factors, Judge Mitchell confirmed a plan that reinstated a security agreement pertaining to the debtor's automobile.¹⁹⁷ Thus, unfair discrimination may conceivably prevent reinstatement of a security agreement, if the secured party is undersecured and the above fairness test is offended.

Other courts have suggested that, as a matter of law, the debtor may always reinstate a contract, regardless of discriminatory effect.¹⁹⁸ Of course, unsecured creditors are still entitled to assert the "best interest of the creditors" test,¹⁹⁹ which guarantees them at least as much as they would have received in a liquidation proceeding.

F. Discharge

Reinstatement is inconsistent with discharge, but in different ways from chapter to chapter. In chapter 11, a debtor is discharged as soon as the plan is confirmed, unless the plan provides otherwise.²⁰⁰ Of course, if a security agreement is reinstated, it is part of the plan itself. Hence, the security agreement is obviously not discharged. Rather, the postconfirmation debtor must live up to the

¹⁹⁶ See *id.* at 643.

¹⁹⁷ See *id.* at 647.

¹⁹⁸ See *In re Sullivan*, 195 B.R. 649, 657-58 (Bankr. W.D. Tex. 1996) (Clark, J.); *In re Cox*, 186 B.R. 744, 746 (Bankr. N.D. Fla. 1995) (Killian, J.); *In re Benner*, 156 B.R. 631, 634 (Bankr. D. Minn. 1993) (Dreher, J.). These are student loan cases in which the debtor reinstated a long-term student loan while paying other creditors a regular unsecured creditor dividend.

¹⁹⁹ 11 U.S.C. §§ 1129(a)(7)(A), 1225(a)(4), 1325(a)(4) (1994).

²⁰⁰ See 11 U.S.C. § 1141(d)(1)(A) (1994). A chapter 11 plan, by its terms, may defer discharge. If so, it apparently extends the automatic stay. See *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 589-90 (9th Cir. 1993) (Reinhardt, J.); *In re Arlington Village Partners, Ltd.*, 66 B.R. 308 (Bankr. S.D. Ohio 1986) (Waldron, J.) (plan reserved jurisdiction in bankruptcy court, and secured creditors assumed they had to move to lift the stay before seeking remedies); Alan M. Ahart & Lisa Elaine Meadows, *Deferring Discharge in Chapter 11*, 70 AM. BANKR. L.J. 127, 146-47 (1996).

reinstated security agreement.

In chapters 12 and 13, a discharge can only be granted after the entire plan is completed,²⁰¹ though a court has some discretion to grant a discharge even if the debtor defaults on the plan.²⁰² A reinstated claim, however, is never discharged, because chapters 12 and 13 exempt from discharge any claim provided for under § 1222(b)(5) or § 1322(b)(5), respectively.²⁰³ These are the sections that refer to reinstated loan agreements.

Because reinstated mortgages cannot be discharged, some debtors a few years back preferred to file for chapter 7 liquidation, obtain a discharge, establish the mortgage as nonrecourse, and then file a chapter 13 case. These were the so-called "chapter 20" cases—a practice approved by the Supreme Court itself.²⁰⁴ Prior to *Nobelman*, a chapter 20 debtor with a general discharge in chapter 7 could bifurcate the undersecured nonrecourse claim in a subsequent chapter 13. The "secured claim" of the mortgagee could not be modified, but the unsecured deficit was quite vulnerable. The mortgagee had to be paid the value of the collateral, on the schedule provided in the original loan agreement. But, since the unsecured deficit had been discharged, the debtor could allocate zero dividends on this part of the mortgagee's claim.²⁰⁵ After *Nobelman*, cure and reinstatement must provide for the payment of the entire mortgage debt, including the unsecured deficit, even if it is nonrecourse.²⁰⁶ Hence, the utility of chapter 20 is much diminished for debtors.

Suppose a plan illegally modifies a home mortgage, but the secured party mounts no protest at the confirmation hearing. The

²⁰¹ See 11 U.S.C. §§ 1228(a), 1328(a) (1994).

²⁰² See 11 U.S.C. §§ 1228(b), 1328(b) (1994).

²⁰³ See 11 U.S.C. §§ 1228(a)(1), 1228(c)(1), 1328(a)(1), 1328(c)(1) (1994).

²⁰⁴ See *Johnson v. Home State Bank*, 501 U.S. 78, 80 (1991) (Marshall, J.). The informal name "chapter 20" results from the witty practice of summing the chapter 7 case with the later chapter 13 case. See Joann Henderson, *The Gaglia-Lowry Brief: A Quantum Leap from Strip Down to Chapter 7 Cram Down*, 8 BANKR. DEV. J. 131, 173-80 (1991).

²⁰⁵ See *Jim Walters Homes, Inc. v. Saylor* (*In re Saylor*), 869 F.2d 1434, 1436 (11th Cir. 1989) (Vance, J.); Lex A. Coleman, *Individual Consumer "Chapter 20" Cases After Johnson: An Introduction to Nonbusiness Serial Filings Under Chapter 7 and Chapter 13 of the Bankruptcy Code*, 9 BANKR. DEV. J. 357, 371-74 (1992).

²⁰⁶ In *Citicorp Mortgage, Inc. v. Lumpkin (In re Lumpkin)*, 144 B.R. 240 (Bankr. D. Conn. 1993), the mortgagee claimed that nonrecourse mortgages could not be cured because the debtor does not "owe" the arrearages. Judge Robert Krechevsky read *Johnson* to mean that the arrearages could be cured as if the debtor really owed those amounts. See *id.* at 241-42.

security agreement *should* have been cured and reinstated under § 1322(b)(5), in which case the claim would not be discharged. A good argument exists that "equity regards as done what ought to be done."²⁰⁷ Thus, since the mortgage agreement should not have been modified, it will be treated as if it were reinstated, in which case, once the plan is over, the secured claim will not be discharged. This argument, however, was rejected in *In re Chappell*,²⁰⁸ where Judge Kenneth Ripple asserted *res judicata* to prevent the secured creditor from enforcing any rights against the debtor, once the plan had finished and the discharge was awarded.²⁰⁹

G. Breach of the Reinstated Agreement

If the reinstated contract is breached, the automatic stay may prevent a secured creditor from foreclosing on the collateral which secures the reinstated obligation. Thus, § 362(a)(5) prevents "any act to create, perfect, or enforce against property of the debtor any lien to the extent such lien secures a claim that arose before the commencement of the case under this title."²¹⁰ Also relevant is § 362(a)(6), which prohibits "any act to collect, assets, or recover a claim against the debtor that arose before the commencement of the case under this title."²¹¹ Taken in isolation, these provisions are quite extreme. They forever bar collection of even undischarged debts. These provisions are much tempered, however, by § 362(c), which governs the duration of the automatic stay. According to § 362(c):

Except as provided in subsections (d), (e), and (f) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of—

²⁰⁷ Chase Manhattan Mortgage & Realty Trust v. Bergman (*In re Bergman*), 585 F.2d 1171, 1177 (2d Cir. 1978) (Mansfield, J.).

²⁰⁸ 984 F.2d 775 (7th Cir. 1993).

²⁰⁹ *Id.* at 782.

²¹⁰ 11 U.S.C. § 362(a)(5) (1994) (emphasis added).

²¹¹ 11 U.S.C. § 362(a)(6) (1994).

- (A) the time the case is closed;
- (B) the time the case is dismissed;
- (C) if the case is a case under . . . chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.²¹²

In all of the reorganization chapters, the plan divests the estate of its property in favor of debtors in their private capacity.²¹³ Hence, § 362(c)(1) is always met by the time a security agreement is reinstated. The end of the stay will therefore be decided by § 362(c)(2), which terminates the stay when the debtor is generally discharged. Of course, the reinstated agreement is immune from discharge. The discharge refers to the other various claims, not the reinstated security agreement.²¹⁴

In chapter 11, discharge (of unreinstated claims) is granted when the plan is confirmed.²¹⁵ Thus, in chapter 11, if a reinstated security agreement goes into default, the stay is no longer a consideration, unless the plan provides otherwise.²¹⁶

In chapters 12 and 13, the stay is prolonged, because chapters 12 and 13 defer discharge until that time.²¹⁷ Thus, only when the chapter 12 or 13 plan is completed does the automatic stay lapse. Prior to that time, a secured creditor must move for relief from the automatic stay in order to foreclose upon the collateral.

Sections 362(a)(5) and (a)(6) refer to the collection of *prepetition* claims. A reinstated security agreement, however, is reinstated *postpetition* in the plan. Therefore, §§ 362(a) and (a)(6) apply only if the reinstated agreement is considered a prepetition obligation. If it is a postpetition obligation, then §§ 362(a)(5) and (6) cannot apply. For that matter, no part of § 362(a) applies, once the property leaves the bankruptcy estate. Hence, the applicability of the automatic stay to reinstated agreements during a chapter 12 or 13 plan depends on whether the agreement is viewed as prepetition or

²¹² 11 U.S.C. § 362(c) (1994).

²¹³ See 11 U.S.C. §§ 1141(b), 1227(b), 1327(b) (1994).

²¹⁴ See *supra* notes 200-09 and accompanying text.

²¹⁵ See 11 U.S.C. § 1141(d)(1)(A) (1994).

²¹⁶ See *supra* note 196.

²¹⁷ See *Hagel v. Drummond (In re Hagel)*, 184 B.R. 793 (Bankr. 9th Cir. 1995) (Meyers, J.); *Allen v. Jim Walter Homes, Inc. (In re Hartley)*, 75 B.R. 394, 397 (S.D. Ala. 1987) (Hand, J.); *In re Davis*, 64 B.R. 358, 359 (Bankr. S.D.N.Y. 1986) (Schwartzberg, J.).

postpetition.

In *In re Nicholson*,²¹⁸ Judge Charles Matheson declared the reinstated agreement to be a postpetition obligation. As a result, §§ 362(a)(5) and (6) did not protect the debtor.²¹⁹ Once the plan was confirmed, the automatic stay utterly lapsed. For this reason, Judge Matheson declared that a postpetition foreclosure could proceed without the secured party moving to lift the automatic stay under § 362(d).²²⁰ Other courts, however, find reinstated agreements to be prepetition in nature.²²¹ In these cases, the automatic stay prevents unilateral action upon default of the reaffirmed agreement.

If the stay applies, then, upon breach, the secured party must move to lift the stay. Default on the terms of the reinstated agreement then becomes grounds for this relief.²²² In contrast, *res judicata* prevents the secured creditor from obtaining relief from the stay when the debtor is *not* in default under the plan.²²³ Once the stay is lifted, the reinstated agreement may be enforced according to the parcels and particulars of state law.

Nevertheless, a chapter 12 or 13 debtor might prevent the lifting of the stay upon the promise to reinstate the agreement yet again.²²⁴ Both chapter 12 and 13 provide for liberal modification of the plan.²²⁵ In contrast, chapter 11 plans may not be revoked, except for fraud, and even then revocation must occur within 180 days

²¹⁸ 70 B.R. 398 (Bankr. D. Colo. 1987).

²¹⁹ *See id.* at 400.

²²⁰ *See id.* at 400-01.

²²¹ *See* Far West Fed. Bank v. Vanasen (*In re Vanasen*), 81 B.R. 59, 60-61 (D. Or. 1987) (Panner, J.); Mellon Fin. Servs. Corp. v. Broman (*In re Broman*), 82 B.R. 581, 582 (Bankr. D. Colo. 1988) (Brumbaugh, J.); *In re Ford*, 84 B.R. 40, 45 (Bankr. E.D. Pa. 1988) (Scholl, J.).

²²² *See* Ellis v. Parr (*In re Ellis*), 60 B.R. 432, 435 (B.A.P. 9th Cir. 1985) (Abrahams, J.); *In re Randall*, 98 B.R. 916, 918-19 (Bankr. N.D. Ill. 1989) (Squires, J.); *In re Durben*, 70 B.R. 14, 15-16 (Bankr. S.D. Ohio 1986) (Sellers, J.) (denying motion because breach was not material); *In re Davis*, 64 B.R. 358, 359 (Bankr. S.D.N.Y. 1986) (Schwartzberg, J.).

²²³ *See* Rhode Island Cent. Credit Union v. Zimble (*In re Zimble*), 47 B.R. 639 (Bankr. D.R.I. 1985) (Votolato, J.).

²²⁴ *See In re Raymond*, 99 B.R. 819, 822-23 (Bankr. S.D. Ohio 1989) (Cole, J.). It has been suggested that, when a secured party moves to lift the stay because of defaults in the reinstated agreement, adequate protection is never an issue because of *res judicata*. *See In re Smith*, 104 B.R. 695, 700 (Bankr. E.D. Pa. 1989) (Scholl, J.); *In re Davis*, 64 B.R. 358, 359-60 (Bankr. S.D.N.Y. 1986) (Schwartzberg, J.). This would be true when there are no defaults, but, given the defaults and given the intent to cure and reinstate the agreement yet again, the court should insist on adequate protection between the time of the motion to lift the stay and the time of the second reinstatement.

²²⁵ *See* 11 U.S.C. §§ 1229(a), 1329(a) (1994).

of confirmation.²²⁶ Hence, only chapter 12 and chapter 13 debtors will have the opportunity to modify their plans. In *Green Tree Acceptance, Inc. v. Hoggie (In re Hoggie)*,²²⁷ Judge Lanier Anderson ruled that modification of the plan and reinstatement of the contract a second time did not violate the rule in § 1322(b)(2) against modifying home mortgages. Rather, just as cure under § 1322(b)(5) overrode the antimodification rule of § 1322(b)(2) the first time, it could do so again and again.²²⁸ Indeed, Judge Anderson explained that any "contrary interpretation of the statutory scheme would result in a rigid default rule under which a payment tendered one day late would result in an immediate, incurable default."²²⁹ Judge Anderson warned that debtors who purposefully reinstated security agreements in anticipation of multiple defaults were subject to court discipline.²³⁰ But, assuming no bad faith, the continuance of chapter 13 implies multiple opportunities to cure a default that occurs after the first reinstatement.²³¹ Some courts insist that the debtor show cause or changed circumstances;²³² otherwise *res judicata* prevents the modification that is permitted in § 1329.²³³ But, given such a showing,²³⁴ second or third reinstatements are permissible.

Some courts, however, disagree and hold that postconfirmation modification of the plan is unavailable to cure and reinstate a previously reinstated agreement.²³⁵ For example, courts have held that

²²⁶ See 11 U.S.C. § 1144 (1994).

²²⁷ 12 F.3d 1008 (11th Cir. 1994).

²²⁸ See *id.* at 1010. Judge Anderson emphasized that § 1322(b)(5), in allowing cures, broadly refers to postpetition as well as to prepetition defaults.

²²⁹ *Id.* at 1011.

²³⁰ See *id.* at 1011-12.

²³¹ *Accord*, *Metmor Fin., Inc. v. Bailey (In re Bailey)*, 111 B.R. 151, 154 (W.D. Tenn. 1988) (McRae, J.); *Far West Fed. Bank v. Vanasen (In re Vanasen)*, 81 B.R. 59 (D. Ore. 1987) (Panner, J.); *In re Bellinger*, 179 B.R. 220, 223-25 (Bankr. D. Idaho 1995) (Hagan, J.); *In re Mannings*, 47 B.R. 318, 321-22 (Bankr. N.D. Ill. 1985) (Eisen, J.). One argument against *Hoggie* is that § 1322(b)(5) refers to "maintenance of payments while the case is pending." 11 U.S.C. § 1322(b)(5) (1994), see *In re Smith*, 179 B.R. 437, 448 (Bankr. E.D. Pa. 1995). One creditor argued that § 1322(b)(5) becomes unavailable if payments were not made after bankruptcy—if postpetition defaults occurred. See *Smith*, 179 B.R. at 448. This was rejected in *In re Comans*, 164 B.R. 539, 542-43 (Bankr. S.D. Miss. 1994) (Ellington, J.).

²³² See *In re Gadlen*, 110 B.R. 341, 344-45 (Bankr. W.D. Tenn. 1990) (Brown, J.).

²³³ See *In re Bereolos*, 126 B.R. 313, 326 (Bankr. N.D. Ind. 1990) (Lindquist, J.).

²³⁴ Judge Paul Lindsey has suggested that no hearing need be held on a debtor's proposal to cure postpetition defaults on its commitment to cure prepetition defaults, unless the secured party objects. *In re Steele*, 182 B.R. 284, 292 (Bankr. W.D. Okla. 1995) (Lindsey, J.).

²³⁵ In *In re Nicholson*, 70 B.R. 398 (Bankr. D. Colo. 1987) (Matheson, J.), Judge Matheson ruled that the automatic stay never applies to a reinstated agreement. In so ruling, he suggest-

§ 1322(b)(5) requires "maintenance of payments while the case is pending."²³⁶ Yet if major plan defaults have occurred, this provision of § 1322(b)(5) cannot be met. Because modification under § 1327(b)(1) requires that § 1322(b)(5) be met, defaults on the reinstated agreement would therefore preclude a second reinstatement through modification.²³⁷ This argument, however, overlooks the fact that § 1322(b)(5) allows *cure* of past defaults as well as reinstatement of payments going forward. A debtor wishing to reinstate the security agreement a second time indeed promises to maintain payments going forward. The past defaults are cures. "Maintenance of payments" is always future-oriented—starting from the time the agreement is reinstated.

Sometimes it is argued that curing postpetition defaults is not mentioned in § 1329(a) as one of the reasons for modification. Section 1329(a) provides:

At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to—

- (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
- (2) extend or reduce the time for such payments; or
- (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan.²³⁸

Creditors thus protest that adding a cure claim to the plan is not authorized by the above provision. This argument has been rejected.²³⁹ Each of the subparagraphs quoted above may be fairly interpreted as describing cure.

In any case, a chapter 13 debtor could always refile a second chapter 13 petition. In this second proceeding, the mortgage, earlier

ed that plan modifications to reinstate mortgage agreements a second time were always inappropriate. *See id.* at 400-01.

²³⁶ *See supra* note 231.

²³⁷ *See In re Sensabaugh*, 88 B.R. 95, 96 (Bankr. E.D. Va. 1988) (Shelley, J.).

²³⁸ 11 U.S.C. § 1329(a) (1994).

²³⁹ *See In re Mannings*, 47 B.R. 318 (Bankr. N.D. Ill. 1985) (Eisen, J.).

reinstated, could be reinstated once again. While sequential petitions are generally viewed as *evidence* of bad faith,²⁴⁰ they are not conclusively so.²⁴¹ If successive petitions are an option, there is no sense in *per se* opposition to modifications of an existing chapter 13 plan.

III. CURE

And thou, too careless patient as thou art
 Committ'st thy 'nointed body to the cure
 Of those physicians that first wounded thee.²⁴²

Before a debtor can reinstate a security agreement, she must first "cure" any defaults. "Cure" is distinct from reinstatement and can be thought of as the price the debtor must pay for the privilege of reinstatement. Cure is retrospective while reinstatement is prospective in nature.

Each reorganization chapter encourages the "cure" of loan agreements.²⁴³ Prior to 1994, however, the Bankruptcy Code did not define what this term might mean.²⁴⁴ In 1994, Congress added the following definition in new § 1123(d), "[n]otwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."²⁴⁵ Nearly identical provisions were added to chapters 12 and 13.²⁴⁶ While the cross-references in the versions appended to chapters 12 and 13 are different, the effect is the same. According to § 1222(d) "[n]otwithstanding subsection (b)(2) of this section and sections 506(b) and 1225(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default

²⁴⁰ See *Blatnick v. Sanders (In re Sanders)*, 198 B.R. 326, 329 (Bankr. N.D. Cal. 1996) (Bowie, J.); *In re Herrera*, 194 B.R. 178, 187 (Bankr. N.D. Ill. 1996) (Squires, J.).

²⁴¹ See *Johnson v. Home State Bank*, 501 U.S. 78, 87 (1991) (Marshall, J.); *In re Johnson*, 708 F.2d 865, 868 (2d Cir. 1983) (per curiam) (successive chapter 13 petitions).

²⁴² WILLIAM SHAKESPEARE, *RICHARD II* act 2, sc. 1.

²⁴³ See 11 U.S.C. §§ 1123(a)(5)(G), 1222(b)(3), 1222(b)(5), 1322(b)(3), 1322(b)(5) (1994).

²⁴⁴ See *Rake v. Wade*, 508 U.S. 464, 471 (1993) (Thomas, J.). Section 1124(2)(C) may be relevant. See *infra* notes 323-38 and accompanying text.

²⁴⁵ 11 U.S.C. § 1123(d) (1994).

²⁴⁶ See 11 U.S.C. §§ 1222(d), 1322(e) (1994).

shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."²⁴⁷ And according to § 1322(e) "[n]otwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law."²⁴⁸ These various provisions enact a contractual theory of cure.

In defining what cure is, the 1994 amendments attempt to mediate a disagreement on the nature of cure that arose in the case law prior to 1994. One school of thought held cure to be defined by the state law of contract, supplemented by local regulation. According to Judge Kenneth Hall in *Landmark Financial Services v. Hall*.²⁴⁹

A mortgage cure, in a sense, occurs outside the ambit of the Code. Any charges such as late fees may indeed be payable by the mortgagor who elects to cure, but such charges would be mandated not by section 506(b) but, rather, because they are integral elements of the cure The valuation of the claim or the collateral is simply immaterial when the original agreement is reinstated and the debtor elects to make all the payments called for by the agreement. The mortgagee receives only the interest and other charges to which it is entitled under the agreement and applicable nonbankruptcy law.²⁵⁰

Apparently, older security agreements (as reflected in the early case law) tended to be silent about the consequence of monetary defaults and the price of cure. The contract theory initially enriched debtors with cures that undercompensated their creditors.²⁵¹ In effect, because the early contracts were silent, debtors could cure by paying defaults on principal and interest, without providing interest compensation between the time of the default and the time at which the

²⁴⁷ 11 U.S.C. § 1222(d) (1994).

²⁴⁸ 11 U.S.C. § 1322(e) (1994). For the sake of convenience, I will refer only to § 1123(d), but, unless otherwise indicated, everything stated about § 1123(d) applies equally to the analogous amendments in chapters 12 and 13.

²⁴⁹ 918 F.2d 1150 (4th Cir. 1990) (Hall, J.).

²⁵⁰ *Id.* at 1155 (citation omitted).

²⁵¹ See, e.g., *Shearson Lehman Mortgage Corp. v. Laguna* (*In re Laguna*), 944 F.2d 542, 545 (9th Cir. 1991) (Leavy, J.); *Hall*, 918 F.2d at 1154-5; *In re Capps*, 836 F.2d 773 (3d Cir. 1987) (Stapleton, J.); *In re Terry*, 780 F.2d 894, 896-97 (11th Cir. 1985) (Roney, J.); *In re Sanchez*, 137 B.R. 214 (Bankr. E.D. Tex. 1992) (Sharp, J.); *In re Small*, 65 B.R. 686, 689 (Bankr. E.D. Pa. 1986) (Scholl, J.), *aff'd*, 76 B.R. 390 (E.D. Pa. 1987).

cure price was calculated. Furthermore, in chapters 12 and 13, the price had to be paid within "a reasonable time."²⁵² Given the silence of the contract about cure, the price could be paid over time without paying postconfirmation interest (or "cram down" interest) to equate the present cure price with the deferred payment of the price.²⁵³

The victory, however, was strictly Pyrrhic. Creditors soon learned to add all sorts of penalties, default interest rates, provisions for interest on interest, and various other boilerplate tortures. Such provisions might have been supplemented or curtailed by state law. The contract theory took for granted that local regulation would control the contractual definition of cure.²⁵⁴ In any case, the price of cure increased as creditors learned to maximize their returns with new clauses that tested the limits of nonbankruptcy regulation.²⁵⁵

The second school held that the cure was to be governed by § 506(b) and § 1325(a)(5)—provisions that generally apply to secured claims. Hence, when the cure was added to the principal amount still due and owing on the reinstated contract, and when the value of the collateral exceeded this sum, the cure was an oversecured claim. Accordingly, § 506(b) commanded that the secured party receive postpetition interest between the time of the default and the time that the cure price was calculated. In addition, if payment of the cure price was to be deferred over time, § 1325(a)(5) required that the present value of the deferred payment equal or exceed the value of the collateral.²⁵⁶

²⁵² Cf. 11 U.S.C. §§ 1222(b)(5), 1322(b)(5) (1994).

²⁵³ For example, suppose the debtor had defaulted on \$100 due on March 1, 1990. The debtor had to cure this default in a plan confirmed on July 1. Because the contract was silent on what "cure" meant, the debtor could pay \$100 to cure on July 1 even though interest would have accrued between March and July. Furthermore, the \$100 would not have had to be paid in cash on July 1. It could have been paid in a "reasonable time." 11 U.S.C. § 1322(b)(5) (1994). If the contract did not require "cram down" interest, the debtor might have gotten away with giving entitlements on July 1 worth less than \$100. Cure was thus twice cursed under the contract theory where the contract was silent on the terms of cure.

²⁵⁴ See *Hall*, 918 F.2d at 1155-56 (holding that state law applies but finding no supplement in Virginia law).

²⁵⁵ Thus, one creditor's agreement awarded postdefault interest at "the highest rate permitted by law." *In re Laymon*, 117 B.R. 856, 857 (Bankr. W.D. Tex. 1990) (Clark, J.), *rev'd*, 958 F.2d 72 (5th Cir. 1992).

²⁵⁶ See *Cardinal Fed. Savs. & Loan Ass'n v. Colegrove* (*In re Colegrove*), 771 F.2d 119, 122 (6th Cir. 1985) (Wellford, J.). In chapter 12, this result would flow from § 1225(a)(5). This point about cram down would not apply in chapter 11, because in chapter 11, reinstatement is overtly an alternative to cram down. Section 506(b) could apply to chapter 11 cures, however.

In *Rake v. Wade*,²⁵⁷ Justice Clarence Thomas applied § 506(b) to establish the secured creditor's right to preconfirmation interest, and he applied § 1325(a)(5) to establish the secured creditor's right to postconfirmation interest. In so doing, he emphasized that § 506(b) and § 1325(a)(5) are of general application and did not expressly exclude the idea of cure from their domains.²⁵⁸

Section 506(b) applies only to oversecured creditors. Therefore, Justice Thomas left open the question whether *undersecured* creditors were entitled to preconfirmation interest. Accordingly, courts fell into immediate and unseemly disarray over the entitlement of undersecured creditors to preconfirmation interest. Some courts continued to assert the contract theory to supply preconfirmation interest.²⁵⁹ Others inferred that, if § 506(b) was the operative theory of *Rake v. Wade*, undersecured creditors must be disentitled to preconfirmation interest.²⁶⁰

Equally problematic was Justice Thomas's reliance on § 1325(a)(5) to establish a creditor's right to cram down interest. Section 1325(a)(5) requires that for a chapter 13 plan:

with respect to each *allowed secured claim* provided for by the plan—

- (A) the holder of such claim has accepted the plan;
- (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
- (C) the debtor surrenders the property securing such claim to such holder²⁶¹

This is chapter 13's "cram down" provision. By invoking the notion of present value, § 1325(a)(5)(B)(ii) suggests that postconfirmation interest must be paid in order to equate the value of payments with

See supra notes 102-08 and accompanying text.

²⁵⁷ 508 U.S. 464 (1993).

²⁵⁸ *See id.* at 471-73.

²⁵⁹ *See In re Hardware*, 189 B.R. 273, 276-77 (Bankr. E.D.N.Y. 1995) (Duberstein, J.); *cf. In re Callahan*, 158 B.R. 898, 903 (Bankr. W.D.N.Y. 1993) (Ninfo, J.) (using contract theory to supply prepetition interest).

²⁶⁰ *See In re Jones*, 168 B.R. 146, 149 (Bankr. E.D. Tex. 1994) (Abel, J.).

²⁶¹ 11 U.S.C. § 1325(a)(5) (1994) (emphasis added).

the present value of the collateral.

The emphasized language indicates that § 1325(a)(5)(B)(ii) only applies to secured claims. Because the creditor in *Rake v. Wade* was oversecured, the cure price could be viewed as a "secured claim" within the meaning of § 1325(a)(5).

In the case of undersecured creditors, the application of § 1325(a)(5) was far less clear. Faced with an undersecured claim, some courts felt compelled to allocate cure between the secured and unsecured portions. Secured portions would be entitled to postconfirmation interest, as required by command of § 1325(a)(5)(B)(ii). Unsecured portions were not entitled to postconfirmation interest. Unsecured creditors in chapter 13 are not necessarily entitled to cram down interest—only to a distribution in excess of what they would have received in a chapter 7 liquidation.²⁶² Of course, reinstatement going forward would include an interest component. On this assumption, only the undersecured party's arrearage claim—comprised of defaults on principal and interest—could be denied interest.²⁶³

Under *Rake v. Wade*, courts had to make some sort of allocation, in order to determine whether the cure price was a secured claim within the meaning of § 1325(a)(5)(B)(ii) or not. Some courts simply labelled any cure claim as *per se* secured within the meaning of § 1325(a)(5), thereby entitling it to cram down interest.²⁶⁴ In other

²⁶² See 11 U.S.C. § 1325(a)(4) (1994).

²⁶³ For example, suppose a secured creditor claims \$100 on collateral worth only \$80. Of the \$100, \$20 constitutes past defaults. In order to apply cram down to the requirement of cure, a court would have to decide whether the \$20 cure price was part of the secured claim (subject to § 1325(a)(5)) or the unsecured claim (subject to the unsecured creditor cram down rule of § 1325(a)(4)). The former cram down rule has a postconfirmation interest component, because the rule is based on present value of payments, compared to the value of collateral. The unsecured creditor's provision has no present value concept and thus no clear requirement of cram down interest.

²⁶⁴ See, e.g., *Jones*, 168 B.R. at 149; *In re Casey*, 159 B.R. 963, 964 (Bankr. M.D. Ala. 1993) (Steele, J.); *Callahan*, 158 B.R. at 904. Professor Robert Lawless suggests that *Nobelman* redefines the "secured claim" of a home mortgagee as the entire debt, including arrearages. Accordingly, § 1325(a)(5) would have required interest to be paid on arrearages. Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYR. L. REV. 1, 69 (1996). This remark overlooks the fact that Justice Thomas preserved the § 506(a) meaning for "secured claim." Instead, Thomas referred to "rights" as that which could not be modified. See *Nobelman*, 113 S. Ct. at 2110 (§ 506(a) "does not necessarily mean that the 'rights' the bank enjoys as a mortgagee, which are protected by § 1322(b)(2), are limited by the valuation of its secured claim . . ."). *Nobelman* and *Rake* taken together therefore required the arrearage claim to be characterized as either secured or unsecured and gave no guidance how this might be done.

words, they applied secured creditor cram down to a claim that was really unsecured.²⁶⁵ Another possibility would split the difference. The arrearage claim would be added to the principal amount due under the reinstated contract; from this sum the value of the collateral would be subtracted. The difference defined the arrearage amount *not* entitled to interest going forward. The balance of the arrearage claim would be entitled to interest.²⁶⁶ These allocative difficulties with regard to undersecured claims were purely the product of *Rake v. Wade's* theory that made § 1325(a)(5) the basis of postconfirmation interest.

Meanwhile, *Rake v. Wade*, as applied to chapter 11, meant that only § 506(b) governed cure. Cram down could never do so, because cure and reinstatement in chapter 11 had the effect of rendering a creditor into an affirmative voter. Since reinstated creditors are almost certainly placed in their own unique class, no reinstated creditor could assert cram down protection. Hence, unlike in chapters 12 and 13, cram down cannot provide a justification for postconfirmation interest.

A. The 1994 Amendments

A year after *Rake v. Wade*, Congress made contract and nonbankruptcy law the theme of cure.²⁶⁷ In § 1123(d) and its

²⁶⁵ This comports with the "compensatory" theory which will be offered as an alternative to the contractual theory and the theory based upon § 506(b) and § 1325(a)(5). See generally *infra* Part IV.

²⁶⁶ This allocative system was modified in *In re Arvelo*, 176 B.R. 349 (Bankr. D.N.J. 1995) (Wizmur, J.). In *Arvelo*, Judge Wizmur chose a somewhat different allocation formula: take the value of the collateral and divide it by the sum of the arrearage claim and the reinstated claim for principal; the resulting percentage should then be multiplied by the arrearage claim. This amount then becomes the "secured" arrearage claim, entitled to interest going forward. The balance was not entitled to interest. See *id.* at 357.

It may be noted that under the formula utilized by Judge Wizmur, where the collateral was worth \$85,000, the arrearage amount was \$12,772, \$77,767 was principal owed under reinstatement, the total combined arrearage-reinstatement claim was \$90,543, the percentage of the arrearage claim considered secured was 90.375% ($\$77,767/\$85,000$). Hence, the total secured claim was \$89,313 ($\$77,767 (\$12,776) (.90375) = \$89,313$). In comparison, the value of the collateral was only \$85,000. Judge Wizmur's formula therefore over-allocated the arrearage claim to the secured portion.

Another court has ruled that the arrearage claim is unsecured, unless the creditor can show collateral is adequate to secure all or part of it—a burden of proof allocation. See *In re Johnson*, 203 B.R. 775 (Bankr. M.D. Fla. 1996) (Proctor, J.)

²⁶⁷ Congress also established the foreclosure sale as the deadline for curing defaulted security agreements. This deadline is purely a federal rule, since state law provides diverse dead-

analogues in chapters 12 and 13, the cure price is to be defined solely by the contract and by whatever nonbankruptcy law constrains or supplements the contract.²⁶⁸

Congress applied this theory to agreements entered into after the enactment of the 1994 amendments.²⁶⁹ Agreements prior to this time will continue to be governed by *Rake v. Wade*.²⁷⁰ The prospective effect is insidious, because it guarantees that secured creditors whose security agreements antedate October 22, 1994, are entitled to the market-based compensation of *Rake v. Wade*. All new agreements can provide their own cure by their own terms.²⁷¹ Thus, the old contracts will continue to obtain market-based compensation because these contracts may not have described their own self-cure. The new contracts, however, will be permitted to spell out what cure means. Moreover, since security agreements can last a very long time, *Rake v. Wade's* interpretation of cure shall be with us for decades to come.

The trouble with the contractual concept of cure is that chapter 11 debtors have every incentive to bargain away too much to their secured creditors, because they know that their unsecured creditors will ultimately pay any interest charges and fees. Therefore, one can expect security agreements will contain lavish "cure" provisions.²⁷² In the dubious patois of price theory, debtors will export this cost to others, thereby creating Pareto misallocations of resources.²⁷³ A

lines, based on whether the debtor continued to have an interest in the collateral. See *supra* text accompanying notes 167-70.

²⁶⁸ See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, §§ 305(a)-305(c), 108 Stat. 4106, 4134.

²⁶⁹ See *id.* § 702(b)(2)(D), 108 Stat. at 4150-51. This effective date impedes only §§ 1123(d), 1222(d), and 1322(e)—the new definitions of cure. All other relevant 1994 amendments became effective to any bankruptcy case that was commenced after October 22, 1994. See *supra* note 15.

²⁷⁰ See, e.g., *In re Johnson*, 203 B.R. 775 (Bankr. M.D. Fla. 1996) (Proctor, J.) (applying *Rake* to a case filed after 1994).

²⁷¹ See Marianne B. Culhane, *Home Improvement? Home Mortgages and the Bankruptcy Reform Act of 1994*, 29 CREIGHTON L. REV. 467, 494 (1996).

²⁷² See Roger M. Whelan & Mandy S. Cohen, *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 AM. BANKR. INST. L. REV. 165, 180 (1994).

²⁷³ See Kenneth N. Klee, *Adjusting Chapter 11: Fine Tuning the Plan Process*, 69 AM. BANKR. L.J. 551, 558-59 (1995). Judge Ralph Meskill assumes that debtors obtain value from agreeing to pro-creditor covenants about attorneys' fees; see also *United Merchants & Mfrs., Inc. v. Equitable Life Assurance Soc'y*, (*In re United Merchants & Mfrs., Inc.*), 674 F.2d 134 (2d Cir. 1982). Economically, this may be so. Since the debtor controls access to the ability to transfer wealth from the unsecured to the secured creditor, the debtor, in a competitive credit market, would be able to capture these rents for herself.

market-based notion of compensation would have prevented these abuses, since the contract would have been irrelevant in setting the cure amount, beyond establishing the times when payments would have been due.

The 1994 amendments permit contractual governance of the right to cure. Could the contract provide that it may not be cured and reinstated at all? If so, state law would then control the important question of bankruptcy jurisdiction over home mortgages and other security agreements. Yet such a contract clause would be tantamount to an ipso facto clause, elsewhere rendered illegal in bankruptcy.²⁷⁴ Secured creditors could then, in essence, have ipso facto rights in violation of this general principle.

Federal bankruptcy courts must honor contractual cure provisions, but they must not permit *ipso facto* clauses in the contract. To reconcile this contradiction, the idea of cure must have a federal component which yields to, but is not obliterated by, local law. Thus, § 1123(d) refers to the positive right to cure, indicating that the price of the cure will be determined by contract and local law.²⁷⁵ If the contract and nonbankruptcy law set an unreasonable price, a court could declare the price to be a penalty or an ipso facto contract—not a cure at all.²⁷⁶ In other words, courts can be expected to insist that “cure” have a compensatory essence. When a contract clause or nonbankruptcy regulation is within the domain of cure, the federal courts might defer to these sources. But federal law should not allow the contract to smuggle in a penalty in the name of cure. Imposing penalties in the name of cure is precisely the kind of ipso facto intervention that federal law prohibits.

Cure, then, must be fundamentally compensatory, not punitive or opportunistic. The secret message of the 1994 amendments, then, is that the contract can only be *evidence* of what constitutes compensation to the secured creditor for past defaults. The contract can never be applied without deciding that the contract is in fact credible evidence of what constitutes market-based compensation.

This critique does not work so well for chapter 12 and 13 debtors. Here, the debtor—not the unsecured creditors—pays the tab. Hence, a rational debtor has the incentive to resist lavish cure provisions.

²⁷⁴ See 11 U.S.C. §§ 365(e)(1), 541(c)(1) (1994).

²⁷⁵ See 11 U.S.C. § 1123(d) (1994).

²⁷⁶ See *In re Orlando Tennis World Dev. Co.*, 34 B.R. 558, 561-62 (Bankr. M.D. Tenn. 1983) (Proctor, J.) (excluding “penalty” late charges from the cure price).

B. *Elements of Cure*

According to the covert compensatory theme of cure that has just been developed, the cure price will be set by four factors: (1) breach of the promise to pay principal at set times, (2) breach of the promise to pay interest at set times; (3) attorneys' fees, costs and charges (whether or not provided for in the contract); and (4) interest running from the time of breach to the time the price is calculated—that is to say, "preconfirmation interest."

1. *Principal*

Prior to 1994, only the first of these items — principal — was incontrovertibly conceded to be part of cure.²⁷⁷ Thus, in *Sapos v. Provident Institution of Savings*,²⁷⁸ the debtor wished to bifurcate a home mortgage into its secured and unsecured parts, with the debtor paying the secured claim at the contractual rate.²⁷⁹ Judge Ruggiero Aldisert ruled that the bifurcation was permissible.²⁸⁰

The debtor proposed to make the payments on the secured claim serve a double purpose. First, the payment would satisfy the reinstated claim going forward. Second, the same payment would satisfy the backward looking cure of past defaults.²⁸¹ According to the debtor, when the secured claim was paid, the mortgage agreement was automatically cured.²⁸² Indeed, thanks to this double-dip, the debtor's proposed plan in effect excused the debtor from paying any cure price at all, so long as the secured claim was eventually paid. Judge Aldisert ruled that such a plan could not be confirmed. Rather, the cure price had to be distinguished in the plan from the secured claim.²⁸³ Each had to be paid separately. In effect, arrears were assumed to be the unsecured deficit which nevertheless had to

²⁷⁷ As any student of bankruptcy knows, there is always a case that gets in the way of claiming that a "universal" principle of law exists. Thus, in *In re Hunt*, 140 B.R. 333 (Bankr. D. Conn. 1992), Judge Alan Schiff excused the cure of postpetition defaults altogether. As a result, the debtor had to cure prepetition defaults and had to reinstate the mortgage from the time of confirmation. Missed payments in the interim were simply forgiven. *See id.* at 336.

²⁷⁸ 967 F.2d 918 (1st Cir. 1992) (Aldisert, J.).

²⁷⁹ *See id.* at 926-27. This bifurcation was precisely what the Supreme Court ruled illegal in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993) (Thomas, J.), nearly one year later.

²⁸⁰ *See id.* at 929.

²⁸¹ *See id.* at 923.

²⁸² *See id.*

²⁸³ *See id.* at 926-27.

be paid in full. As a result, payment of arrears could transform an undersecured creditor into an oversecured one. For example, if the secured party claimed \$100 against collateral worth only \$80, a cure price of \$25 would reduce the total claim to \$75, rendering the secured party oversecured.²⁸⁴

2. Preconfirmation Interest

*Rake v. Wade*²⁸⁵ is an interpretation of § 506(b). As such, it implies that the market rate of interest is the appropriate choice of a rate for § 506(b).²⁸⁶ This was because the contract itself in *Rake* was silent as to whether the debtor had to pay interest on interest in case of default. In deciding for the market rate of interest, Justice Thomas cited *United States v. Ron Pair Enterprises, Inc.*,²⁸⁷ which held that involuntary lien creditors were entitled to interest under § 506(b) if they were oversecured, even though no contract existed at all. That is, § 506(b) establishes a noncontractual right to interest on all amounts past due, including interest payments past due.²⁸⁸

²⁸⁴ *Accord*, *Brown v. Shorewood Fin., Inc. (In re Brown)*, 175 B.R. 129, 133-34 (Bankr. D. Mass. 1994) (Feeney, J.). *But see In re Cruz*, 152 B.R. 866, 868 (Bankr. S.D.N.Y. 1993) (Schwartzberg, J.); *In re Terranova*, 152 B.R. 20, 24 (Bankr. D. Conn. 1993) (Shiff, J.).

As a result of *Rake v. Wade's* reliance upon § 1325(a)(5)(B)(ii) to establish the right to cram down interest, courts had to allocate the cure price between the secured and the unsecured part of the debt. *See supra* notes 260-63 and accompanying text. The allocation in *Sapos* simply establishes that payment of principal does not simultaneously constitute payment of the cure price.

²⁸⁵ 508 U.S. 464 (1993) (Thomas, J.).

²⁸⁶ *See Dean Pawlowic, Entitlement to Interest Under the Bankruptcy Code*, 12 BANKR. DEV. J. 149, 160 (1995) (so interpreting *Rake*). *But see In re Cureton*, 163 B.R. 494, 495 (Bankr. E.D. Mich. 1994) (Spector, J.) (reading *Rake* to mean that the market rate for cures should be used only where the contract does not specifically govern). Judge Spector's reading is based on the idea that § 1322(b)(2) prevents modification of the contract, but he overlooks the fact that § 1325(b)(5) allows for cures "notwithstanding" § 1322(b)(2). Hence, *Rake* did not merely invoke the market rate in the absence of a contractual cure provision. It simply applied ordinary standards from § 506(b) and cram down.

For a post-*Rake* case blithely ruling that § 506(b) requires any arrearage claim to receive contract interest, see *In re Harris*, 167 B.R. 813 (Bankr. D.S.C. 1994) (Bishop, J.). This case also holds that cram down interest need not be paid on any arrearage claim that includes defaults on interest, because that would be interest on interest. *See id.* at 815.

²⁸⁷ *Rake*, 503 U.S. at 467-8 (citing *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989) (Blackmun, J.)).

²⁸⁸ Section 506(b) provides that, to the extent there is an equity cushion, "there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." 11 U.S.C. § 506(b) (1994). Notice that, according to § 506(b), the *contract* governs for fees and costs. Thus, if the contract does not provide for costs, they cannot be awarded. It is impossible, however, to tell

Although *Rake v. Wade* has been overruled for cure, this holding should continue to be good law for the meaning of § 506(b) in noncure cases. Congress did not overrule *Rake v. Wade* insofar as it governs noncure situations.

After 1994, cure, newly defined by § 1123(d), is "notwithstanding" § 506(b), and according to the contract. Thus, the law of cure and the law of the oversecured creditor are now entirely divorced, although a great many courts continue to apply the contract rate of interest for § 506(b), in spite of *Rake v. Wade*.²⁸⁹

Under any of the theories operating prior to 1994, an oversecured creditor and perhaps even an undersecured creditor could have obtained postpetition interest on the amount of default as part of the cure. The cure price then includes the dollar amounts of interest that should have been paid under the contract. If, in addition, an interest component is added to reflect the fact that time had passed between the default and the calculation of the cure price, then cure represents, in part, interest on interest.

Interest on interest begins an infinite regress that inflames the ire of equity. In the pre-Code case of *Vanston Bondholders Protective Committee v. Green*,²⁹⁰ interest on interest was declared inequitable as a matter of federal law. In *Vanston*, a secured debenture called for periodic interest payments. If the debtor were to default on these

whether the contract also governs on the rate of interest a secured party may collect. The placement of the comma after "interest on such claim" is ambiguous. The comma separates the right to interest from the existence of a contract.

In *Ron Pair*, Justice Harry Blackmun rested heavily on this fatal comma in ruling that the contract is irrelevant to an oversecured creditor's right to postpetition interest. See *Ron Pair*, 489 U.S. at 241-42. This ruling affirmed the entitlement of statutory lienors to postpetition interest, when such lienors have no contractual relation with the debtor. According to Justice Blackmun:

The phrase "interest on such claim" is set aside by commas and separated from the reference to fees, costs, and charges by the conjunctive words "and any." As a result, the phrase "interest on such claim" stands independent of the language that follows. "Interest on such claim" is not part of the list made up of "fees, costs, or charges," nor is it joined to the following clause so that the final "provided for under the agreement" modifies it as well. The language and punctuation Congress used cannot be read in any other way. By the plain language of the statute, the two types of recovery are distinct.

Id. at 242 (citation omitted). In other words, the right to interest is *unconnected* to the contract, and from this it follows that the contract rate need not be used, *even if* there is a contract. The proper rate of interest is open to choice.

²⁸⁹ See, e.g., *Bradford v. Crozier (In re Laymon)*, 958 F.2d 72, 74 (5th Cir. 1992) (Thornberry, J.).

²⁹⁰ 329 U.S. 156 (1946).

payments, the debenture called for interest on interest.²⁹¹ The lower courts decided that New York law should decide whether interest on interest could be added to the secured claim. But they disagreed as to what New York law was. The District Court found that New York law permitted, while the Court of Appeals found that it prohibited, interest on interest.²⁹²

Justice Hugo Black decided that a federal rule of equity prohibited interest on interest. He emphasized that interest on interest is a penalty—not compensation.²⁹³ Since bankruptcy delay is a fortuity imposed by law, Justice Black reasoned that creditors with favorable contracts should not obtain interest on interest at the expense of creditors whose contracts have no such provision.²⁹⁴ This ground is not entirely satisfactory. Justice Black also admitted that oversecured creditors were entitled to straight interest at the expense of unsecured or undersecured creditors.²⁹⁵ Straight interest allowed oversecured creditors to do precisely what Justice Black thought was inequitable with regard to compound interest, albeit at a lesser level. Given the exception for straight interest (as governed by the contract), a prohibition on contractual interest on interest seems arbitrary.²⁹⁶

*Rake v. Wade*²⁹⁷ obviously interferes with this conclusion. In *Rake*, Justice Clarence Thomas reasoned that cure and reinstatement had to be reconciled with various other portions of the Bankruptcy Code, such as §§ 506(b) and 1325(a)(5).²⁹⁸ Part of the cure price represented defaults on interest past due.²⁹⁹ Justice Thomas noted that the secured creditor was entitled to interest, even if the contract was silent on the matter. Hence, he found that the right to interest on interest (for an oversecured creditor) is automatic, even if the

²⁹¹ See *id.* at 159.

²⁹² See *id.* at 160. New York has since reversed itself and acquiesced to interest on interest. See N.Y. GEN. OBLIG. LAW § 5-527 (McKinney Supp. 1997) (enacted June 1989).

²⁹³ See *Vanston*, 329 U.S. at 166.

²⁹⁴ See *id.*

²⁹⁵ See *id.* at 164.

²⁹⁶ Interestingly, Justice Black justified his decision on the ground that it would avoid intractable controversy over choice of law. See *id.* at 162. Ironically, the 1994 amendments to the Bankruptcy Code opt for state law in calculating the cure price, thereby reimposing the necessity for choice of law. See, e.g., 11 U.S.C. § 1123(d) (1994).

²⁹⁷ 508 U.S. 464 (1993) (Thomas, J.).

²⁹⁸ See *id.* at 468-69.

²⁹⁹ See *id.* at 475 n.12.

loan agreement is silent on the matter.³⁰⁰ In contrast, *Vanston* concerned a contract that specifically called for interest on interest, which the Supreme Court refused to enforce.³⁰¹ It is safe to say that *Vanston* is overruled by *Rake v. Wade*.³⁰²

Rake v. Wade's reliance on § 506(b) has clearly been repealed in the 1994 amendments, at least insofar as cure is concerned. Specifically, § 1123(d) and its analogs provide for a contractual cure *notwithstanding* § 506(b). Hence, if the contract does *not* call expressly for interest on interest, the cure price will be calculated free and clear of any such interest.³⁰³ But what if the contract *does* call for interest on interest? After 1994, may courts, citing *Vanston*, still refuse to award interest on interest?

There is some evidence in the legislative history that *Vanston* is dead. According to Congressman Jack Brooks, § 1123(d) is supposed to overrule *Rake v. Wade*.³⁰⁴ Brooks's complaint about that case, however, was very limited. He did not oppose *Rake* because of interest on interest. He only opposed it when local law prohibited interest on interest. When state law blessed compound interest, Congress was all for it.³⁰⁵ In short, Congressman Brooks (or at least his aide-de-camp) saw the 1994 amendments as directly overruling *Vanston*.³⁰⁶ However, the *contract* must call for interest on interest,

³⁰⁰ See *id.* at 475.

³⁰¹ See *Vanston*, 329 U.S. at 160.

³⁰² In *Equitable Life Assurance Society v. Sublett (In re Sublett)*, 895 F.2d 1381, 1385 (11th Cir. 1990), Judge Frank Johnson ruled that *Vanston* was likewise overruled in § 506(b), because contractual interest on interest can be equated with "fees, costs, or charges" within the meaning of Bankruptcy Code § 506(b). In light of § 506(b)'s sanctification of the loan contract in this regard, Johnson thought that *Vanston* must be considered overruled. See *id.* at 1385-86; see also *In re Martindale*, 125 B.R. 32, 37 (Bankr. D. Idaho 1991) (Pappas, J.) (allowing interest on interest because debtors "cite to the [c]ourt no authority which would allow the [c]ourt to simply disregard these otherwise valid contractual provisions"). However, it must be said in *Vanston*'s favor that fees, costs, or charges must be *reasonable*. *Vanston* amounts to a holding that interest on interest is "not reasonable." Hence, just because the contract is validated with regard to fees, costs, or charges does not necessarily prove that *Vanston* is overruled.

³⁰³ One commentator points out that, if a creditor bargains to receive principal or interest at a certain time, part of the contract is actually to receive such payment in order to have the reinvestment opportunity. Accordingly, interest on arrears is ordinary contract damages and always part of the contract. See Jonathan S. Fields, Note, *Taking Interest in a Cure: Compensation for Time Value of Chapter 13 Residential Mortgage Arrears*, 13 CARDOZO L. REV. 2119 (1992).

³⁰⁴ See 140 CONG. REC. H10752, H10770 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks).

³⁰⁵ See *id.*

³⁰⁶ Kenneth Klee calls for a clarifying amendment to prevent any charge of interest on interest, because he (wrongly) supposes that the statute fails to conform to congressional in-

in case of defaults on interest past due, and state law must validate such a contract.

3. *Interest on the Accelerated Debt*

It has been suggested that once a loan agreement has been accelerated because a debtor has missed a few installments, interest should be awarded between the time of default and the time of cure not on the missed installments, but on the full accelerated amount.³⁰⁷ In fact, this is not a meaningful question because interest is always due and owing on principal. In other words, interest on missed installments is the *same* as interest on accelerated principal plus installments, as the following example proves.

Take a very simple \$1 million loan due in five years. Interest is at 12% per annum or 1% per month—\$10,000 of interest is payable monthly. Suppose the debtor misses two installments of interest, and as the third becomes due, files for bankruptcy. The debtor then immediately seeks to cure and reinstate the loan agreement. It is clear that the debtor must pay the two missed \$10,000 payments. Let us assume that interest of 12% per annum (interest on interest) is owed on those installments. For the first installment, \$10,000 plus two months of interest is \$10,201.00 ($\$10,000 \times 1.01^2$). For the second installment, the debtor owes \$10,100 ($\$10,000 \times 1.01$). Finally, the third installment of \$10,000 is presently due. No interest has accrued for this installment. The cure price is therefore \$30,301.

Suppose now that we treat the entire \$1 million loan as accelerated, with interest accruing on this whole sum for three months. At the end of three months, the debtor owes \$1,030,301 ($\$1 \text{ million} \times 1.01^3$). Since reinstatement excuses the debtor from paying accelerated principal (and no regularly scheduled principal is due), the cure price is \$30,301. This is the exact same amount due when only interest on missed installments was charged. Therefore, interest on accelerated amounts is precisely identical to compound interest on accelerated principal showing acceleration has no effect on the amount of interest due and owing.

tent. See Kenneth N. Klee, *Adjusting Chapter 11: Fine Tuning the Plan Process*, 69 AM. BANKR. L.J. 551, 557-58 (1995).

³⁰⁷ See *In re Arlington Village Partners, Ltd.*, 66 B.R. 308, 316 (Bankr. S.D. Ohio 1986) (Waldron, J.); *In re Manville Forest Prods. Corp.*, 43 B.R. 293, 299 (Bankr. S.D.N.Y. 1984) (Lifland, J.), *rev'd on other grounds*, 60 B.R. 403 (S.D.N.Y. 1986).

4. *Default Rates of Interest*

In response to the contract theory of cure, modern secured creditors have learned to demand higher postdefault interest rates. As unsecured creditors must pay the price, debtors are apparently quite ready to agree to higher postdefault interest rates. Reinstatement of the security agreement reestablishes the predefault status quo, thereby allowing for the predefault rate going forward. But what of the cure price, which is retroactively calculated? The 1994 amendments invoke a contractual theory raising the question: must the cure be accomplished at the higher postdefault rate?

In chapters 12 and 13, there is no restraint on what secured creditors can demand by way of cure, save what local law prevents, and save for the "core" federal notion that penalty clauses must not be honored. In chapter 11, the 1994 amendments add a confusing new provision which may have an impact upon a debtor's obligation to pay higher postdefault rates, at least with regard to the cure. According to new § 365(b)(2)(D), cure of executory contracts does not require "the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease."³⁰⁸ This section was incorporated by reference into § 1124(2)(A), which requires the cure of any default *other than* "a kind specified in section section 365(b)(2) . . ."³⁰⁹

The meaning of this amendment is that postdefault rates are not part of cure, provided the debtor's defaults were nonmonetary. From this rule, one might infer that the slightest *monetary* default triggers the postdefault interest hike, at the expense of the unsecured creditors. This is an irrational distinction, yet one that arguably may be inferred from the 1994 amendments. Meanwhile, where § 1124(2)(A) contains a direct reference to § 365(b)(2)(D), the chapter 12 and 13 analogs do not. Hence, courts will have to decide whether cure is accomplished according to the contractual postdefault rate or the predefault rate. As § 1222(d) and § 1322(e) invoke the contract and nonbankruptcy law, postdefault rates arguably may now be imposed as part of the cure price.

Prior to 1994, courts often ruled that the cure price could be

³⁰⁸ 11 U.S.C. § 365(b)(2)(D) (1994).

³⁰⁹ 11 U.S.C. § 1124(2)(A) (1994).

calculated by paying predefault rates. Thus, in *Florida Partners Corp. v. Southeast Co. (In re Southeast Co.)*,³¹⁰ Judge Mary Schroeder held that cure can be accomplished at the predefault rate, even though the contract calls for the postdefault rate. According to Judge Schroeder "[t]o allow pre-petition interest at the post-default rate would completely eliminate the benefits of cure in this case, as it would fail to nullify a significant consequence of default."³¹¹

Here are terms unsquared, which seem hyperboles.³¹² Postdefault rates would result in a higher cure price, which helps the secured creditor at the expense of the unsecured creditors, but by no means would a higher price "completely eliminate the benefits of cure."³¹³ Indeed, if Judge Schroeder saw herself as following the "contractual" school of cure, it must be admitted that the contract calls for the higher rate at any time after default. While *reinstatement* might be based on reestablishing the predefault interest rate contrary to the contract, cure under the contractual school is not authorized to override the contract. Hence, there is a noncontractual, compensatory principle loose in Judge Schroeder's opinion.³¹⁴

Pretending the contract is not in default (when it is) and thereby invoking the predefault rate in violation of the contract cannot be called a contractual theory of cure. Indeed, subjunctive work of this sort (reimagining the world "as if" the contract were never breached) threatens to produce a cure price of zero. That is, if we can pretend the debtor never defaulted for the purpose of triggering postdefault interest, we can pretend no default for other reasons as well. Namely, we can pretend that the secured party was paid all amounts due and owing under the contract, plus attorneys' fees. If we unleash subjunctive imagination, there is no limit, save that which imagination chooses to impose upon itself, in reordering the

³¹⁰ 868 F.2d 335 (9th Cir. 1989) (Schroeder, J.).

³¹¹ *Id.* at 339.

³¹² "When he speaks, 'Tis like a chime a-mending; with terms unsquared, Which from the tongue of roaring Typhon dropp'd Would seem hyperboles." WILLIAM SHAKESPEARE, THE TRAGEDY OF TROILUS AND CRESSIDA Act 1 Sc.3.

³¹³ *In re Southeast*, 868 F.2d at 339.

³¹⁴ In *Casa Blanca Lenders, L.P. v. City Commerce Bank (In re Casa Blanca Lenders, L.P.)*, 196 B.R. 140 (B.A.P. 9th Cir. 1996), Judge Sidney Volinn held that the default rate was inappropriately charged. The lower court held that the 1994 amendments overruled *In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338 (9th Cir. 1988) (Snedd, J.) (the case upon which the decision in *Southeast* was based) but Judge Volinn said only that the 1994 amendments did not apply to cases filed before the effective date of the 1994 amendment. See *Casa Blanca Lenders*, 196 B.R. at 147.

contractual rights of the parties.

Reimagining the world and then proclaiming that the contract is not in default does not constitute following the contract. In enacting the 1994 amendments, Congress has decreed that the cure must occur according to the contract, and hence interest must accrue at postdefault rates. Nevertheless, it is still true that the contract must describe a "cure," not a penalty. If the contract describes a penalty, courts are not obliged to follow the contract.

5. Fees, Costs, and Charges

Prior to 1994, many courts held that attorneys' fees and the like must also be paid as part of cure.³¹⁵ These cases were, in part, overruled by *Rake v. Wade*,³¹⁶ which implied that § 506(b) was the basis of the conclusion that cure included postpetition interest. If an equity cushion was necessary for postpetition interest, it is likewise necessary for postpetition "fees, costs, or charges."³¹⁷

After 1994, even undersecured creditors may obtain postpetition fees, costs, and charges, provided they are sanctioned by the contract and by applicable nonbankruptcy law. Yet the 1994 amendments introduce some ironies. Oversecured creditors whose security agreement are *not* reinstated are entitled only to "reasonable" fees, costs, and charges.³¹⁸ "Reasonable," in the context of oversecured creditors, has taken on a *federal* meaning.³¹⁹ Courts are rigorous in scru-

³¹⁵ See 11 U.S.C. § 1124(2)(A) (1994) (cure applies to "any such default that occurred before or after the commencement of the case under this title . . ."); see also, e.g., *Green Tree Acceptance, Inc. v. Hoggle* (*In re Hoggle*), 12 F.3d 1008, 1010 (11th Cir. 1994) (Anderson, J.); *In re Hardware*, 189 B.R. 273 (Bankr. E.D.N.Y. 1995) (Duberstein, J.); *In re Henson*, 182 B.R. 588 (Bankr. N.D. Okla. 1995) (Wilson, J.) (so holding but reducing the fee to a reasonable amount); *Vitelli v. Cheltenham Fed. Savs. & Loan Ass'n* (*In re Vitelli*), 93 B.R. 889, 894-95 (Bankr. E.D. Pa. 1988) (Scholl, J.). Earlier, Judge David Scholl ruled that only prepetition attorneys' fees had to be paid as part of cure, unless § 506(b) applied. *Jackson v. Boulevard Co.* (*In re Nickleberry*), 76 B.R. 413 (Bankr. E.D. Pa. 1987). In *Vitelli*, however, he regretted his *Nickleberry* conclusion. *Vitelli*, 93 B.R. at 894.

³¹⁶ 508 U.S. 464 (1993) (Thomas, J.).

³¹⁷ 11 U.S.C. § 506(b) (1994).

³¹⁸ *Id.*

³¹⁹ See *Unsecured Creditors' Comm. v. Walter E. Heller & Co. Southeast, Inc.*, (*In re K.E. Stephenson Supply Co.*) 768 F.2d 580, 585 (4th Cir. 1985) (Ervin, J.); *In re Record Enters., Ltd.*, 189 B.R. 769 (D. Neb. 1986) (Beam, J.) (fee in violation of Nebraska law awarded); *In re Berry Estates, Inc.*, 47 B.R. 1004, 1007 (S.D.N.Y. 1985) (Schwartzberg, J.); *Longwell v. Banco Mortgage Co.*, 38 B.R. 709, 711 (N.D. Ohio 1984); *In re Hyer*, 171 B.R. 67, 70-71 (Bankr. W.D. Mo. 1994) (Koger, J.); *In re Saunders*, 130 B.R. 208, 211-13 (Bankr. W.D. Va. 1991) (Anderson, J.) (strongly stating that attorneys' fees could be allowed under federal law, but not actually

tinizing security agreements for reasonableness, in order to prevent secured creditors from taxing the unsecured creditors. Yet, unless cure has a covert federal compensatory soul,³²⁰ a reinstated security agreement is free to be unreasonable, so long as nonbankruptcy law approves. Fortunately, the contract and state law govern only when cure is provided for. An *unreasonable* fee, cost, or charge can be viewed as a penalty, not a cure. If this premise is accepted, even after 1994, courts may ignore any contract that sets up a penalty in lieu of a cure.

Another irony in the 1994 amendments is that a great many courts have ruled that, *even if* local law prevents fees, costs, and charges from being charged, oversecured creditors under § 506(b) are entitled to the enforcement of their contract as a matter of federal law.³²¹ That is, § 506(b) sets up a federal law of contract separate and apart from local regulation. New § 1123(d), however, establishes the suzerainty of nonbankruptcy law. Hence, reinstated oversecured parties could lose the right to an attorneys' fee that § 506(b) otherwise would have granted, where local law is hostile.³²²

finding that attorneys' fees violated state law); *In re Campbell*, 138 B.R. 184 (Bankr. S.D. Ohio 1991) (Calhoun, J.) (secured creditor could collect attorneys' fees under contract that was contrary to Ohio law); *Schlect v. Alaska (In re Schlect)*, 36 B.R. 236, 238-41 (Bankr. D. Alaska 1983) (Williams, J.); *In re American Metals Corp.*, 31 B.R. 229, 234 (Bankr. D. Kan. 1983) (Franklin, J.); see also David Gray Carlson, *Oversecured Creditors Under Bankruptcy Code Section 506(b): The Limits of Postpetition Interest, Attorneys' Fees, and Collection Expenses*, 7 BANKR. DEV. J. 381, 407-10 (1990) (criticizing this development).

³²⁰ See *Citicorp Savs. v. Oliver (In re Oliver)*, 183 B.R. 87, 90 (Bankr. W.D. Pa. 1995) (Bentz, J.) (suggesting that the federal rule of reasonableness in § 506(b) still applies when a debtor wishes to cure and reinstate the claim of an oversecured creditor).

³²¹ See *Joseph F. Sanson Inv. Co. v. 268 Ltd. (In re 268 Ltd.)*, 789 F.2d 674, 676 (9th Cir. 1986) (Goodwin, J.); *Unsecured Creditors' Comm. v. Walter E. Heller & Co. Southeast, Inc. (In re K.E. Stephenson Supply Co.)*, 768 F.2d 580, 585 (4th Cir. 1985) (Ervin, J.).

³²² Georgia has an unusual provision which allows creditors to add up to 15% to the principal amount as an attorneys' fee. This sum is owed to the lender, not to any attorney. Furthermore, in order to collect the premium:

The holder of the note . . . shall, after maturity . . . notify in writing the maker . . . that such maker has ten days . . . to pay the principal and interest without the attorneys' fees. If the maker . . . shall pay the principal and interest in full before the expiration of such time, then the obligation to pay the attorneys' fees shall be void . . .

GA. CODE ANN. § 13-1-11(a)(3) (1994). It has been held that cure and reinstatement relieves the debtor from having to pay the 15% premium, because cure and reinstatement authorizes a subjunctive calculation of the cure price that assumes no defaults had occurred. See *In re Centre Court Apts., Ltd.*, 85 B.R. 651, 656-69 (Bankr. N.D. Ga. 1988) (Bihany, J.).

Centre Court involved a very peculiar chapter 11 plan. The debtor proposed to reinstate

6. *Reliance Damages*

Under § 506(b), if the contract does not call for "fees, costs, or charges," then an oversecured party has no right to them if they accrue after the bankruptcy petition is filed. Does cure follow the same principle?

The 1994 amendments indicate that § 506(b) no longer governs the cure. Only the contract does. Hence, it is likely that in chapters 12 and 13, the contract had better provide for the payment of attorneys' fees if the secured creditor is to collect them in the name of cure. But chapter 11 has a different rule. Whereas § 1124(2)(A) requires the debtor to cure prepetition and postpetition defaults, § 1124(2)(C) requires the debtor to compensate a creditor "for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law."³²³ The phrase "damages," standing over against "cure" in § 1124(2)(A), must mean positive damages in excess of the cure amount.³²⁴ The phrase "reliance damages" implies that this provision covers *noncontractual* damages. Thus, if § 506(b) requires that an *agreement* provide for the payment of attorneys' fees, § 1124(2)(C) could be read as providing for reimbursement when, in "reliance" on a breach of contract, the creditor incurs collection expense.³²⁵

future payments on the mortgage, but also proposed to sell the collateral free and clear of the mortgage and pay cash proceeds to the mortgagee. Unless the debtor had a contractual right to prepay, such a sale would appear to be inconsistent with reinstatement. See *In re Newton*, 161 B.R. 207, 216-17 (Bankr. D. Minn. 1993) (Kishel, J.) (chapter 13) (so acknowledging but suggesting that payment of a claim under § 1322(b)(8) was not inconsistent with the rule against modifying home mortgages under the right conditions).

In any case, the secured party never objected to the sale—only to the failure of the debtor to pay the 15% fee. In relieving the debtor of this obligation, Judge Joyce Bihary remarked that "[t]he result might be different if the debtor had proposed a plan to sell the property without a cure and reinstatement, since requiring the creditor to wait until a sale was consummated might have resulted in an impairment under § 1124." *Id.* at 659. Had the secured party also objected that the sale free and clear was itself an impairment, the secured party might have won the 15% premium.

Judge Bihary also invited the secured party to seek attorneys' fees under § 506(b)—but only for the reasonable value of services rendered. The percentage required by the contract was held to be "unreasonable." *Id.* at 660-61. After 1994, cure and reinstatement would, of course, preclude the application of any § 506(b) rules.

³²³ 11 U.S.C. § 1124(2)(C) (1994).

³²⁴ See *In re Arlington Village Partners, Ltd.*, 66 B.R. 308, 316 (Bankr. S.D. Ohio 1986) (Waldron, J.); *In re Rolling Green Country Club*, 26 B.R. 729, 733 (Bankr. D. Minn. 1982) (Owens, J.).

³²⁵ See *Arlington Village Partners*, 66 B.R. at 316 ("Damages would include actual expenses

Meanwhile, "reliance" suggests more than mere passivity. A creditor who fails to obtain payment has obviously suffered a loss, but not a reliance loss. Although "reliance damages" has been thought to include amounts due and owing under the contract,³²⁶ what of the opportunity cost a creditor suffers, representing the return on reinvested money? Does a creditor "rely" in any sense of the word when the creditor is unable to reinvest?³²⁷ In other words, doing nothing is not reliance, but interest is necessary to provide full compensation. Yet since § 1124(2)(C) requires compensation for *reliance*, mere want of compensation is not enough to invoke the authority of that provision.³²⁸

In spite of these observations, courts have cited § 1124(2)(C) as proof that chapter 11 creditors deserve interest on all arrearages, including interest on defaulted interest.³²⁹ This interest is not to be a creditor's actual opportunity cost; this would be too speculative³³⁰ and inconsistent with the spirit of cure, which locks the creditor into the existing bargain.³³¹ Instead, some sort of interest rate must be assigned as part of the cure price.³³²

incurred by creditors pursuing their right to accelerate such as attorney's fees expended in a foreclosure action.").

³²⁶ See *In re Orlando Tennis World Dev. Co.*, 34 B.R. 558, 560 (Bankr. M.D. Fla. 1983) (Proctor, J.).

³²⁷ Professor Walter Blum thought a positive or negative answer was equally plausible: To qualify for compensation, a creditor presumably must show that he suffered damages from engaging in some course of conduct on the assumption that payment of the debt would be accelerated as a result of a default. Yet it is not implausible to interpret the statute as covering interest on an arrearage. Were an acceleration permitted, the creditor would receive payment of the debt and then be in a position to invest those funds at interest and to earn interest on that interest. Everyone who invests in interest-bearing securities, it can be assumed, anticipates being able to engage in such additional investment and hence can be considered to have relied on that opportunity. To ignore the value of a compound interest opportunity is to deny the creditor compensation for damages that go to the very essence of his investment.

Walter J. Blum, *Treatment of Interest on Debtor Obligations in Reorganizations Under the Bankruptcy Code*, 50 U. CHI. L. REV. 430, 437 (1984).

³²⁸ See *In re Manville Forest Prods. Corp.*, 43 B.R. 293, 301-02 (Bankr. S.D.N.Y. 1984) (Lifland, J.), *rev'd on other grounds sub nom.* Unsecured Creditors Comm. v. Manville Forest Prods. Corp. (*In re Manville Forest Prods. Corp.*), 60 B.R. 403 (S.D.N.Y. 1986).

³²⁹ See *Great Western Bank & Trust v. Entz-White Lumber & Supply, Inc.* (*In re Entz-White Lumber & Supply, Inc.*), 850 F.2d 1338, 1343 n.7 (9th Cir. 1988) (Sneed, J.); *Arlington Village Partners*, 66 B.R. at 315-17.

³³⁰ See *Arlington Village Partners*, 66 B.R. at 316.

³³¹ See *Manville Forest Prods.*, 43 B.R. at 303.

³³² See *Arlington Village Partners*, 66 B.R. at 319 (market rate, but predefault contract rate

Section 1124(2)(C) has been read to require interest on interest, even when local state law does not permit it. Thus, if interest can pass as "reliance" damages, which is questionable, interest on interest is surely allowed, because § 1124(2)(C) is a federal principle that overrides state law.³³³

It has been held that reliance damages do not include the difference between the present value of the loan at a low contract rate loan and the present value of a higher market rate loan. Such an award defeats the entire purpose of reinstatement—capturing the low contract rate for the benefit of a debtor's creditors.³³⁴

Courts sometimes assume that damages under § 1124(2)(C) refer only to prepetition damages,³³⁵ even while § 1124(2)(A) requires cure of "any such default that occurred before *or after* the commencement of the case"³³⁶ This assumption comes from a sole reference in the legislative history of § 1124(2)(C), wherein Congressman Jim Edwards remarks, "[A] class of claims is not impaired under the circumstances of § 1124(2) if damages are paid to rectify reasonable reliance engaged in by the holder of a claim . . . arising from the prepetition breach of contractual provision, such as an ipso facto or bankruptcy clause, or law."³³⁷ This is surely a casual or careless remark. There is no evidence that Congressman Edwards (or his staff, who undoubtedly wrote this line) specifically intended to exclude postpetition reliance. If the idea of cure is to render the reinstated creditor whole, what is the sense of making

was to be a minimum and postdefault contract rate was to be a maximum); *see also* Florida Partners Corp. v. Southeast Co. (*In re Southeast Co.*), 868 F.2d 335, 338 (9th Cir. 1988) (Schroeder, J.) ("reliance damage . . . 'does not comprise contractual penalty interest rates'") (quoting *In re Southeast Co.*, 81 B.R. 587, 592 (B.A.P. 9th Cir 1987) (per curiam), *aff'd*, 868 F.2d 335 (9th Cir. 1989)).

³³³ *See Manville Forest Prods.*, 43 B.R. 293 (refusing to award interest on interest on the strength of *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156 (1946)). Judge Richard Owen reversed, holding that interest on interest was indeed equitable. *See Unsecured Creditors Comm. v. Manville Forest Prods. Corp. (In re Manville Forest Prods.)*, 60 B.R. 403, 404 (S.D.N.Y. 1986) (Owen, J.). It is mystifying that Owen cited *Vanston* for this proposition. *See id.* at 404-05. A subsequent authority has theorized that the equity of interest on interest depended upon the solvent nature of the debtor in *Manville*. *See In re 360 Inns, Inc.*, 76 B.R. 573, 583 (Bankr. N.D. Tex. 1987) (Houston, J.).

³³⁴ *See In re Rainbow Forest Apts.*, 33 B.R. 576 (Bankr. N.D. Ga. 1983) (Kahn, J.); *In re Rolling Green Country Club*, 26 B.R. 729, 733 (Bankr. D. Minn. 1982) (Owens, J.).

³³⁵ *See Arlington Village Partners*, 66 B.R. at 315-16; *In re Tavern Motor Inn, Inc.*, 56 B.R. 449, 452 (Bankr. D. Vt. 1985) (Conrad, J.).

³³⁶ 11 U.S.C. § 1124(2)(A) (1994) (emphasis added).

³³⁷ 124 CONG. REC. H32406 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards).

this distinction? The cure price everywhere transcends the distinction between prepetition and postpetition matters, and it should do so with regard to "reliance damages" under § 1124(2)(C). In any case, if § 1124(2)(C) is read to provide that noncontractual damages for attorneys' fees are limited to prepetition fees, it still remains true that, where the contract expressly requires the debtor to pay postpetition attorneys' fees, postpetition defaults in violation of such a contract must be cured under § 1124(2)(A).³³⁸

C. *Deferred Payment*

The preceding discussion has established the elements of the cure price—the price that must be paid to reinstate a contract. But *when* must the price be paid? It does not necessarily follow that the cure price must be paid in cash on the effective date of a reorganization plan. At least in chapters 12 and 13, the claim might be paid over time. If so, the question arises as to whether deferred payment implies "cram down" (i.e., postconfirmation) interest so that the present value of the stream of payments precisely equals the present payment for which it is a substitute.

1. *Chapter 11*

Chapter 11 declines to give advice as to the time by which the cure must be accomplished, except that § 1124's preamble does indicate that "the plan" must accomplish the cure.³³⁹ This leaves open the possibility that the cure amount could be paid over time.

Some courts have insisted that cure be accomplished by the effective date of the chapter 11 plan—not stretched out over time.³⁴⁰ It has been suggested that cure on the effective date of the plan saves litigation and avoids implication into matters of valuation.³⁴¹ One of the justifications for permitting cure and reinstate-

³³⁸ In declaring that § 1124(2)(C) covers only prepetition reliance damages, Judge Francis Conrad suggested that postpetition interest could be awarded under § 506(b). See *Tavern Motor Inn*, 56 B.R. at 453. This suggests that, in chapter 11, postpetition interest is not part of the cure price when the creditor is undersecured. After 1994, however, the cure price is supposed to be calculated "notwithstanding" § 506(b). 11 U.S.C. § 1123(d) (1994).

³³⁹ 11 U.S.C. § 1124 (1994).

³⁴⁰ See *In re Holthoff*, 58 B.R. 216, 219 (Bankr. E.D. Ark. 1985) (Mixon, J.); cf. 11 U.S.C. § 365(b)(1)(A) (1994) (at the time of assumption of an executory contract, the trustee must cure or give adequate assurance of a prompt cure).

³⁴¹ See *In re Jones*, 32 B.R. 951 (Bankr. D. Utah 1983) (Clark, J.).

ment had been to avoid the valuations inherent in cram down hearings.³⁴² Yet, in opposition to this point, the only valuation needed in deferring payment of the cure amount is setting the cram down interest rate. Precisely the same valuation issue would have been required in deriving the cure amount, as it existed prior to the 1994 amendments.

If chapter 11 is opaque as to whether cures may be paid by deferred payments, chapters 12 and 13 are not. They specifically provide for payment over a "reasonable time."³⁴³ This comparison suggests by negative pregnant that, with regard to chapter 11, Congress intended for immediate payment on the effective date of the plan.

2. Chapters 12 and 13

In chapters 12 and 13, at least when the scheduled payments exceed the length of the plan, the cure price need only be paid "within a reasonable time."³⁴⁴ If the scheduled payments do not exceed the length of the plan, then neither § 1222(b)(5) nor § 1322(b)(5) apply to authorize cure within "a reasonable time." These short-term mortgages present the same dilemma on payment terms as do all security agreements in chapter 11: when must the cure price be paid for such security agreements?

At least we know that the cure price for long-term security agreements in chapters 12 and 13 need not be paid immediately but instead may be stretched over a reasonable time. But what is "a reasonable time?" It is quite often suggested that cure over the entire life of the chapter 13 plan is acceptable,³⁴⁵ but that spreading the cure over the life of the plan is not per se reasonable either.³⁴⁶ The

³⁴² See *supra* notes 62-66 and accompanying text. Furthermore, Judge Clark suggested if cure could be accomplished over time, then disimpairment would itself become a cram down technique in competition with § 1129(b). See *Jones*, 32 B.R. at 959. In truth, that is the role of reinstatement—to compete with cram down as a technique. This last remark therefore lacks bite.

³⁴³ See 11 U.S.C. §§ 1222(b)(5), 1322(b)(5) (1994).

³⁴⁴ *Id.*

³⁴⁵ See *In re Capps*, 836 F.2d 773 (3d Cir. 1987) (Stapleton, J.); *Central Fed. Savs. & Loan Ass'n v. King* (*In re King*), 23 B.R. 779 (B.A.P. 9th Cir. 1984) (Volinn, J.); *In re Hatcher*, 202 B.R. 626, 630-31 (Bankr. E.D. Okla. 1996) (Cornish, J.); *Epps v. Lomas Mortgage USA, Inc.* (*In re Epps*), 110 B.R. 691, 707 (E.D. Pa. 1990) (McGlynn, J.); *In re Chavez*, 117 B.R. 730 (Bankr. S.D. Fla. 1990) (Cristol, J.).

³⁴⁶ See *First Nat'l Bank v. Sidelinger* (*In re Sidelinger*), 175 B.R. 115, 117-20 (Bankr. D. Me.

time might even extend beyond the duration of the very agreement that is reinstated, where the agreement matured within the life of the plan.³⁴⁷ In any case, since the chapter 12 or 13 plan cannot last beyond five years,³⁴⁸ this five year period will surely be the maximum time in which the cure price may be paid.³⁴⁹ At least one appellate opinion exists, however, that found 25 years—the life of the mortgage—to be a reasonable time.³⁵⁰

The Bankruptcy Code is not explicit as to whether cram down interest must be paid in order to commensurate future payment with present value of the cure. In *Rake v. Wade*,³⁵¹ the Supreme Court made clear that postconfirmation interest compensation is required when a creditor is oversecured. In fact, Justice Clarence Thomas ruled that both preconfirmation and postconfirmation interest components were needed to accomplish the cure.³⁵² Yet because he relied on § 1325(a)(5), which applies only to secured claims, he left unclear whether undersecured creditors were entitled to cram down interest.

The 1994 amendment clearly reverses this holding. According to new § 1322(e), cure is governed by the contract *notwithstanding* § 1325(a)(5).³⁵³ Carefully read, this provision governs “the amount necessary to cure the default.”³⁵⁴ In other words, the cure price is to be defined by state law. How this price is to be paid—now or over time—is not necessarily consigned to contractual governance. Hence, courts might still decide that cram down interest is not nec-

1994) (Haines, J.) (so concluding but nevertheless allowing cure over life of plan); *In re Acevedo*, 9 B.R. 852 (Bankr. E.D.N.Y. 1981) (Parente, J.) (finding cure over three years unreasonably long). Judge Gregory Kishel has decreed that any payment lasting more than twelve months is presumed unreasonable. See *In re Newton*, 161 B.R. 207, 210-11 (Bankr. D. Minn. 1993). But see *In re Chavez*, 117 B.R. 730, 731 (Bankr. S.D. Fla. 1990) (Cristol, J.) (even suggesting a presumed deadline would be impermissible judicial legislation).

³⁴⁷ See *In re East*, 172 B.R. 861, 867 (Bankr. S.D. Tex. 1994) (Greendyke, J.).

³⁴⁸ See 11 U.S.C. §§ 1222(c), 1322(d) (1994).

³⁴⁹ See *Capps*, 836 F.2d at 776 (five-year cure allowed); *In re Molitor*, 133 B.R. 1020 (Bankr. D.N.D. 1991) (Hill, J.). In *In re Masterson*, 147 B.R. 295, 296-97 (Bankr. D.N.H. 1992), Judge James Yacos noted that court approval is needed for a chapter 13 plan to extend beyond three years. He thought the very need to stretch out payment of the cure price justified extension of the plan.

³⁵⁰ See *PNC Mortgage Co. v. Dicks*, 199 B.R. 674 (N.D. Ind. 1996) (Sharp, J.).

³⁵¹ 508 U.S. 464 (1993) (Thomas, J.).

³⁵² *Id.* at 475.

³⁵³ Prior to 1994, the “contractual theory” of cure held that § 506(b) was inapplicable to the amount of the cure price. See, e.g., *Landmark Fin. Servs. v. Hall*, 918 F.2d 1150, 1153 (4th Cir. 1990) (Hall, J.).

³⁵⁴ 11 U.S.C. § 1322(e) (1994).

essarily required to defer payment. That is, courts might decide that the cure price is contractual, but the payment terms are a matter of federal law.

The contrary argument is that § 1322(e) calls for the contract to govern "notwithstanding" § 1325(a)(5). This grammar suggests that Congress viewed the contract as capable of governing the way a cure price is to be paid. Of course, the contract cannot contradict any part of the Bankruptcy Code. Thus, the contract could not provide that the cure price must be paid in cash on the effective date of the plan, because § 1322(b)(5) indicates that the price may be paid over "a reasonable time." A contractual provision calling for postconfirmation interest, however, would not *contradict* the Bankruptcy Code. It would only supplement it. Therefore, it is possible that the contract or nonbankruptcy law could produce postconfirmation interest, but absent authority from those sources, the Bankruptcy Code itself does not provide for it.³⁵⁵

If cram down interest is awarded on deferred payment of the cure price, it will in part constitute interest on interest on interest. This thrice compounded interest rate might be raised to still higher powers if a chapter 13 debtor is permitted to cure defaults on cram down interest with the modification of the plan, as many courts allow.³⁵⁶

D. Avoidance Powers

Cure implies that a bankruptcy trustee must waive all sorts of rights that otherwise might be asserted against secured creditors to belittle and minimize their rights. Thus, cure should imply that a trustee waives all avoidance powers against a secured creditor.³⁵⁷

³⁵⁵ For a case in which the contract was allowed to set the cram down rate in lieu of the market, see *In re Cureton*, 163 B.R. 494 (Bankr. E.D. Mich. 1994) (Spector, J.). This conclusion is based on a reading of *Nobelman* and *Rake* whereby the contract was thought unmodifiable, even after calculation of the cure price. This is not a necessary reading of either Supreme Court decision and in addition overlooks the fact that cures are to be calculated "notwithstanding" § 1322(b)(2).

Judge Arthur Spector went on to note that the cure price consisted of overdue principal and overdue fees and charges. *Id.* at 496. Because the contract called for a high rate of interest on principal (but not other charges) Spector required that plan payment first be allocated to the charges and then to principal. *Id.* at 496-97. Presumably, Spector thought that no cram down interest was owed on the charges. His allocation thereby maximized the interest expense on the debtor.

³⁵⁶ See *supra* notes 224-53 and accompanying text.

³⁵⁷ When transfers are made pursuant to an executory contract which a bankruptcy trustee

The loss of a security interest is certainly an impairment of the prepetition rights of the creditor. For this reason, it has been held that, in spite of § 552(a), which destroys a secured creditor's after-acquired property rights in a prepetition security agreement, reinstatement of a security agreement implies the restoration of those rights.³⁵⁸

A few courts have suggested otherwise. In *Citicorp Acceptance Co. v. Ruti-Sweetwater (In re Sweetwater)*,³⁵⁹ the debtor wished to disimpair the secured claim and to reserve the right to avoid the mortgage after confirmation. Judge Bruce Jenkins held that reinstatement might still occur because "the threat of litigation arose by operation of law—not because of the plan."³⁶⁰ Because cure and reinstatement imply a Pavlovian affirmative vote on the plan, a creditor facing ruination by avoidance of a lien is not allowed to vote on a plan because, pending the actual avoidance, such a creditor is not deemed to be impaired. The fairness of this disenfranchisement has been found deserving of criticism.³⁶¹

A more extreme version of this principle outside the context of secured credit is *In re American Solar King Corp.*³⁶² In *American Solar King*, the debtor claimed that securities plaintiffs who sought to rescind the purchase of their equity securities were unimpaired, even though the plan would pay them nothing.³⁶³ The debtor argued that § 510(b) subordinated such claims. Therefore, paying the securities plaintiffs nothing constituted "leav[ing] unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest."³⁶⁴ Judge Leif Clark found merit in the claim.³⁶⁵ When applied to secured creditors, this case produces disturbing results. For example, suppose a secured party has received a voidable preference, but the debtor wish-

later assumes, the voidable preference authorities are divided as to whether voidable preference actions can be brought. See David Gray Carlson, *Security Interests in the Crucible of Voidable Preferences Law*, 1995 U. ILL. L. REV. 211, 350-56.

³⁵⁸ See *In re Blackwelder Furniture Co.*, 31 B.R. 878, 881-82 (Bankr. W.D.N.C. 1983) (Wooten, J.).

³⁵⁹ 57 B.R. 354 (D. Utah. 1985) (Jenkins, J.).

³⁶⁰ *Id.* at 357.

³⁶¹ Evan D. Flaschen, *The Mortgage and the Real Estate Reorganization Debtor*, 105 BANKING L.J. 188, 210 (1988).

³⁶² 90 B.R. 808 (Bankr. W.D. Tex. 1988) (Clark, J.).

³⁶³ See *id.* at 814.

³⁶⁴ *Id.* at 819 (citing 11 U.S.C. § 1124(1) (1988)).

³⁶⁵ See *id.* at 818.

es to disimpair the contract. According to Judge Clark's reasoning, if the plan gives to the secured creditor exactly what the Bankruptcy Code provides, the secured creditor is not impaired within the meaning of § 1124(1) and so cannot vote on the plan. "Leaves unaltered" cannot mean the post-Bankruptcy Code assessment of entitlements. If such meaning is given to § 1124(1), no creditor is ever impaired so long as the bankruptcy trustee gives every creditor what the Bankruptcy Code requires them to be given. In truth, the securities claimants should have been viewed as impaired and hence allowed to vote.

A similar line of reasoning was followed by Judge Francis Conrad in *In re Tavern Motor Inn, Inc.*³⁶⁶ Judge Conrad reasoned that since a debtor in possession does not have to pay postpetition interest to an undersecured creditor pursuant to § 502(b), such interest is never due and owing. Therefore, no default occurred when the debtor failed to pay postpetition interest. Yet, § 1124(2)(A) does compel the debtor to cure defaults "that occurred before or after the commencement of the case."³⁶⁷ It has been suggested that Judge Conrad's decision ignores this provision.³⁶⁸ But this does not exactly address Judge Conrad's point, which is that there were no postpetition defaults, once the effect of § 502(b) was considered. A better answer is that "cure" should not comprehend the postpetition entitlements of a creditor. Rather cure should only comprehend the rights stemming from breach of the contract, as if no bankruptcy proceeding had ever been commenced. On this view, some sort of postpetition interest would be due—whether at a market or contract rate. Section 502(b) could not be cited to prove that the creditor does not deserve postpetition interest.

E. *Is Cure a Modification?*

Prior to 1994, courts were bitterly divided over whether cure is a modification of a mortgage agreement. At that time, the question was important, because § 1322(b)(5) permitted "cure" of long term mortgages "notwithstanding" the antimodification rule in § 1322(b)(2). Cure of short-term mortgages, however, had to be

³⁶⁶ 56 B.R. 449 (Bankr. D. Vt. 1985) (Conrad, J.).

³⁶⁷ 11 U.S.C. § 1124(2)(A) (1994) (emphasis added).

³⁶⁸ See Flaschen, *supra* note 361, at 212.

accomplished under § 1322(b)(3), which lacked a "notwithstanding" clause. If cure constituted a modification, then the antimodification rule of § 1322(b)(2) prevented short term home mortgages from being cured.

To prevent this implication, many courts held cure is not modification. They pointed out that § 1322(b) itself distinguishes between "modification," permitted except for home mortgages under § 1322(b)(2), and "cure," permitted under § 1322(b)(3). This distinction was supposed to prove that cure does not offend the rights of a secured party claiming only the debtor's residence.³⁶⁹ On this view, a debtor may indulge in cures under § 1322(b)(3) without regard to the antimodification rule of § 1322(b)(2).³⁷⁰ Moreover, the function of § 1322(b)(5) was simply to empower a court to reinstate a security agreement beyond the life of the chapter 13 plan, something § 1322(b)(3) does not refer to. Cure per se was not in violation of § 1322(b)(2).

In *Wade v. Hannon*,³⁷¹ Judge James Logan vociferously insisted that to cure a security agreement implied that it had been modified.³⁷² According to Judge Logan, cure is a modification of the contract, and therefore cure, in general, must not be a contractual idea.³⁷³ This left Judge Logan free to award postpetition interest as part of cure, even though the contract didn't call for it.³⁷⁴ In the end, however, Judge Logan insisted (like Justice Thomas would later do on appeal) that §§ 506(b) and 1325(a)(5) apply to cure claims, in order to justify preconfirmation and postconfirmation interest

³⁶⁹ See *Grubbs v. Houston First Am. Savs. Ass'n*, 730 F.2d 236, 241 n.9, 247 (5th Cir. 1984) (en banc) (Tate, J.).

³⁷⁰ See *In re Roach*, 824 F.2d 1370, 1376 (3d Cir. 1987) (Stapleton, J.); *Grubbs*, 730 F.2d at 247 (using § 1322(b)(3) to cure junior mortgage of less than three years); *Di Pierro v. Taddeo (In re Taddeo)*, 685 F.2d 24, 28 (2d Cir. 1982) (Lumbard, J.).

³⁷¹ 968 F.2d 1036, 1040-42 (10th Cir. 1992), *aff'd sub nom. Rake v. Wade*, 508 U.S. 464 (1993) (Thomas, J.).

³⁷² Justice Thomas, on appeal, agreed. See *Rake v. Wade*, 508 U.S. 464, 473 n.9 (1993) (Thomas, J.).

³⁷³ See *Wade*, 968 F.2d at 1040.

³⁷⁴ See *id.* at 1040-42. If cure is *not* modification, then the language in § 1322(b)(5) allowing cure "notwithstanding" § 1322(b)(2) is surplusage, which at least one judge freely admitted. See *In re Roach*, 824 F.2d 1370, 1377 (3d Cir. 1987) (Stapleton, J.). It has also been suggested that, if cure is not modification, then § 1322(b)(2) and (3) would be superfluous as well. See *In re Clark*, 738 F.2d 869, 872 (7th Cir. 1984) (Marshall, J.). This is refutable. Cure might be a subset of modification. If so, § 1322(b)(2) has utility to explain that all other types of modifications *except cure* are prohibited. Section 1322(b)(2) and (3) therefore prevent every type of modification of a home mortgage—including cram down—that is *not* a cure.

payments respectively.³⁷⁵ These points are not affected by the characterization of cure as a modification one way or the other.³⁷⁶

Some courts had ruled that § 1325(a)(5)—cram down—only applies if a security agreement has been “modified.” Cure, they thought, is not a “modification.” Therefore, § 1325(a)(5) cannot apply to cure, and it cannot dictate cram down interest on the cure.³⁷⁷ What these courts are really suggesting is that cure is a sui generis claim that combines both prepetition and postpetition claims. In contrast, § 1325(a)(5) governs secured claims, which cover postpetition defaults only if the creditor is oversecured.³⁷⁸ This is the position that *Rake v. Wade* overruled,³⁷⁹ but which was ultimately vindicated when the 1994 amendments demanded the cure price be calculated “notwithstanding” cram down.

Whether cure constitutes a modification is now a useless question in chapter 13. Since adoption of the 1994 amendments, a chapter 13 debtor may modify a short-term mortgage.³⁸⁰ As to long-term mortgages, the cure may proceed “notwithstanding” the antimodification rule in § 1322(b)(2). Thus, absent a distinction in treatment between short and long term mortgages with regard to modification, the question of whether cure constitutes a modification is moot.

F. *Cure as Dependent on Reinstatement*

Often debtors owe a lump sum payment to a creditor, as where the security agreement, without an event of acceleration, has ended by its terms and requires a balloon payment to retire the entire debt. May a debtor “cure” this security agreement by paying off the loan agreement in the reorganization plan?

Since 1994, this question is of little import in chapter 13. Prior to 1994, home mortgages could not be modified.³⁸¹ Meanwhile,

³⁷⁵ See *Wade*, 968 F.2d at 1041.

³⁷⁶ Judge Logan also noted that *Ron Pair* had held oversecured creditors with no contractual rights were entitled to postpetition interest. Why not then oversecured mortgagees whose contracts were silent as to interest on interest as a mode of cure? See *id.* at 1041.

³⁷⁷ Landmark Fin. Servs. v. Hall, 918 F.2d 1150, 1154-55 (4th Cir. 1990) (Hall, J.); *Roach*, 824 F.2d at 1375; *In re Capps*, 836 F.2d 773, 776 (3d Cir. 1987) (Stapleton, J.).

³⁷⁸ See 11 U.S.C. § 506(b) (1994).

³⁷⁹ 508 U.S. 464 (1993).

³⁸⁰ See 11 U.S.C. § 1322(c)(2) (1994).

³⁸¹ 11 U.S.C. § 1322(b)(2) (1988).

cures under § 1322(b)(5) were authorized "notwithstanding" § 1322(b)(2) only when payments were due after the end of the chapter 13 plan. If a mortgage was fully mature (without the aid of acceleration), debtors were anxious to "cure" mortgages over the life of the chapter 13 plan under § 1322(b)(3). If payment of the entire mortgage (while reinstating nothing) was a cure (and if cure was consistent with the antimodification rule),³⁸² debtors could achieve the cure over the three to five year period of the plan, instead of paying immediate cash to the mortgagee.

Many courts held that cure did not contemplate payment of the entire amount due and owing. Rather, cure required some degree of "reinstatement." Accordingly, debtors could not use § 1322(b)(3) to override § 1322(b)(2)'s insistence that home mortgages not be modified. The plan could not defer payment over time but had to pay cash to any creditor with a mature claim.³⁸³

Other courts have disagreed, holding that payment in full is a cure.³⁸⁴ In *Great Western Bank & Trust v. Entz-White Lumber & Sup-*

³⁸² See *supra* notes 369-80 and accompanying text.

³⁸³ See *First Nat'l Fidelity Corp. v. Perry*, 945 F.2d 61, 65-66 (3d Cir. 1991) (Stapleton, J.); *Justice v. Valley Nat'l Bank*, 849 F.2d 1078, 1084-85 (8th Cir. 1988) (Gibson, J.); *Seidel v. Larson (In re Seidel)*, 752 F.2d 1382, 1383 (9th Cir. 1985) (Farris, J.); *In re French*, 174 B.R. 1, 7-8 (Bankr. D. Mass. 1994) (Boroff, J.); *Linzmeier v. Bull's Eye Credit Union (In re Linzmeier)*, 138 B.R. 59, 62 (Bankr. W.D. Wis. 1991) (Martin, C. J.); *In re La Brada*, 132 B.R. 512, 516 (Bankr. E.D.N.Y. 1991) (Duberstein, C. J.).

In *United States Trust Co. v. LTV Steel Co. (In re Chateaugay Corp.)*, 150 B.R. 529 (Bankr. S.D.N.Y. 1993), *aff'd*, 170 B.R. 551 (S.D.N.Y. 1994), Judge Burton Lifland ruled that a postmaturity interest rate had to be distinguished from a postdefault interest rate, where the original schedule of payments had not yet run out. Reinstatement might reestablish the predefault rate, but reinstatement could not be accomplished when the loan agreement reached its natural maturity. See *id.* at 542-43. This view implies that paying the secured claim does not cure it. If it did, it might be possible to pay the prematurity interest rate under the authorities that rule that the cure price can be calculated on the assumption of the predefault rate.

³⁸⁴ See *Grubbs v. Houston First Am. Savs. Ass'n*, 730 F.2d 236, 247 (5th Cir. 1984) (en banc) (Tate, J.) (suggesting that any claim accruing before bankruptcy might be cured under § 1322(b)(3)); *Larkins v. Commercial Bank (In re Larkins)*, 50 B.R. 984 (W.D. Ky. 1985) (Johnstone, J.); *In re Johnson*, 184 B.R. 570, 572-73 (Bankr. D. Minn. 1995) (Dreher, J.) (holding that since secured claim was paid in full, it was "cured," and the court would use its discretion to use predefault contract rate, rather than the postdefault contract rate); *In re Eason*, 181 B.R. 127 (Bankr. N.D. Ala. 1995) (Cohen, J.); *In re Hart*, 184 B.R. 849 (Bankr. M.D. Fla. 1995) (Glenn, J.); *In re Dixon*, 151 B.R. 388, 392-94 (Bankr. S.D. Miss. 1993) (Ellington, J.); *In re Aguirre*, 150 B.R. 922, 923 (Bankr. N.D. Tex. 1993) (Akard, J.); *In re PCH Assocs.*, 122 B.R. 181, 198 (Bankr. S.D.N.Y. 1990) (Blackshear, J.) (dictum); *Vitelli v. Cheltenham Fed. Sav. & Loan Ass'n (In re Vitelli)*, 93 B.R. 889, 894-95 (Bankr. E.D. Pa. 1988) (Scholl, J.). In *In re Watson*, 190 B.R. 32 (Bankr. E.D. Pa. 1995), involving a mortgage on commercial real estate, Judge David Scholl unnecessarily ruled that, where the mortgage had fully matured prior to the chapter 13 plan, it could still be "cured"—i.e., paid off over time. In fact, he should have sim-

ply, Inc. (*In re Entz-White Lumber & Supply, Inc.*),³⁸⁵ the loan at issue was entirely mature. The secured party was oversecured and hence entitled to postpetition interest under § 506(b). The loan agreement called for a higher postmaturity interest rate. The debtor proposed a chapter 11 plan that would pay cash to the secured creditor, but with interest calculated at the predefault rate. The secured creditor, on the other hand, claimed that it was entitled to the contract rate of interest, by which it meant the higher postdefault rate.³⁸⁶

Judge Joseph Sneed upheld the debtor's plan on grounds that the debtor was entitled to "cure" the claim at predefault rates.³⁸⁷ Cure meant the restoration of the status quo ante, which Sneed took to mean paying as if payment had occurred on the day the loan matured. Of course, under this premise, *no* interest was due and owing.

A better approach to resolving this issue would have been for Judge Sneed to rule that the payment of the full claim in cash is not "cure and reinstatement," but rather, that cure is the retrospective price of prospective reinstatement. Without reinstatement going forward, cure of past defaults is meaningless and not permitted. As to the interest rate to which the oversecured creditor in *Entz-White* was entitled, § 506(b) governed the proper interest rate for the oversecured creditor in question. Accordingly, that rate should have been the *market* rate, not the contract rate.

It is probable that Judge Sneed resorted to his definition of cure because he feared that § 506(b) would institute the contract rate. Indeed, ill-conceived dictum in the Ninth Circuit had stated so directly.³⁸⁸ Therefore, cure was apparently used by Judge Sneed to *displace* § 506(b) as the operative theory of the case.³⁸⁹ Ironically, *Rake v. Wade* declared § 506(b) to be the theme of cure after all,

ply ruled that the mortgage could have been *modified* through cram down. There was no sense in calling cram down a "cure," since there was no need to get past the antimodification rule of § 1322(b)(2).

³⁸⁵ 850 F.2d 1338 (9th Cir. 1988) (Sneed, J.).

³⁸⁶ See *id.* at 1339.

³⁸⁷ See *id.* 1342.

³⁸⁸ *Joseph F. Sanson Investment Co. v. 268 Ltd. (In re 268 Ltd.)*, 789 F.2d 674, 676 (9th Cir. 1986) (Goodwin, J.) (stating that interest under § 506(b) should be at the contract rate regardless of whether it is reasonable).

³⁸⁹ See *Entz-White*, 850 F.2d at 1343 n.7 (concluding that § 1124(2)(C) compels payment of interest even if no equity cushion exists); cf. *In re Johnson*, 184 B.R. 570, 574 (Bankr. D. Minn. 1995) (Dreher, J.) (reading *Entz-White* as assuming § 506(b) governs cure claims, but that cure leads to lower predefault interest rate).

thereby contradicting *Entz-White*, but *Rake* also implied that the appropriate rate for use was the market rate. Congress in turn has overruled *Rake* in this regard, but by no means does it follow that *Entz-White's* definition of cure should govern. The 1994 enactment of § 1123(d) only establishes that a cure price is to be calculated "notwithstanding" § 506(b). The question still remains open as to whether merely paying a creditor (without reinstating anything) is a cure. To summarize, if the idea is to prevent the postdefault interest rate from being charged, courts should define cure to require some degree of reinstatement (the opposite of *Entz-White*) and should rule that § 506(b) governs. Moreover, courts should hold that § 506(b) establishes the market rate, thereby disenfranchising the contract altogether.

Another part of the 1994 amendments can be taken to contradict *Entz-White*. Prior to 1994, disimpairment meant either cure or paying the claim in cash. Congress eliminated the latter and kept the former. If *Entz-White* is the law, then congressional elimination of disimpairment through payment is utterly defeated. That is, if payment in full is cure, then payment in full is disimpairment, contrary to legislative desire. Hence, Congress must have intended that cure is more than just payment in full. Cure must require some element of reinstatement. For this additional reason the 1994 amendments should be viewed as overruling *Entz-White*.

In *Entz-White*, Judge Sneed did not want to impose the default rate, but wished to honor Ninth Circuit dictum equating § 506(b) with the contract rate.³⁹⁰ Yet, in bowing down before this questionable dictum, Judge Sneed ran up against a second Ninth Circuit case. In *Seidel v. Larson (In re Seidel)*,³⁹¹ Judge Jerome Farris ruled that, absent some reinstatement going forward, payment in full could not be viewed as cure. Hence, a chapter 13 debtor could not cure a fully mature home mortgage debt by paying it over the life of a chapter 13 plan. To do so would be to modify the mortgage in violation of § 1322(b)(2).³⁹²

To distinguish *Seidel* from *Entz-White*, Judge Sneed noted that the *Seidel* cure would have been paid over the life of a chapter 13

³⁹⁰ See *Entz-White* 850 F.2d at 1343.

³⁹¹ 752 F.2d 1382, 1383 (9th Cir. 1985).

³⁹² The violation of § 1322(b)(2) by modifying a mortgage has been overruled by the 1994 amendments. See 11 U.S.C. § 1322(c)(1) (1994). *Accord*, *First National Fidelity Bank v. Perry*, 945 F.2d 61, 65, (3d Cir. 1991) (Stapleton, J.).

plan. In *Entz-White*, the cure would be paid in cash.³⁹³ On this basis, Sneed ruled that the *Seidel* situation did not represent a cure. Although in *Seidel* Judge Farris emphasized the absence of reinstatement as the disqualifying factor,³⁹⁴ Judge Sneed reinterpreted *Seidel* to mean that "cure" refers to cash payment—not deferred payment.³⁹⁵ On the reasoning of *Entz-White*, therefore, "cure" under § 1322(b)(5) may be accomplished over a "reasonable time" because Congress modified "cure" with this extra clause. "Cure" *simpliciter* means present cash payment.

The *Entz-White* definition of cure has been extended to absurd lengths in *Casa Blanca Lenders, L.P. v. City Commerce Bank (In re Casa Blanca Lenders, L.P.)*.³⁹⁶ In this case, the debtor did not even propose a reorganization plan. Instead, the debtor sold collateral under § 363(b) and wished to surrender cash proceeds directly to the secured party for payment in full. The secured party insisted on the postdefault interest rate, but Judge Sidney Volinn, on the strength of *Entz-White's* definition of "cure," ruled that the predefault rate could be used.³⁹⁷

Section 1124(2) now indicates that a cure must be accomplished in a plan. Hence, payment *before* the confirmation of a plan could *never* be a cure. Nothing in § 363 authorizes cure.³⁹⁸ Furthermore, though the *Casa Blanca Lenders* opinion is not perfectly clear, it appears as if the secured claim was not fully mature, but rather an accelerated obligation. If so, to pay was to cure, even though the contract itself called for a schedule of future payments. Rather than engage in such interpretive difficulty, Judge Volinn should have ruled that § 506(b) applied, and that § 506(b) implies a market rate as opposed to a contract rate. This would have effectively avoided the unfair postdefault interest rate. Meanwhile, cure should imply

³⁹³ See *Entz-White*, 850 F.2d at 1342.

³⁹⁴ See *Seidel*, 752 F.2d at 1386.

³⁹⁵ See *Entz-White*, 850 F.2d at 1341.

³⁹⁶ 196 B.R. 140 (B.A.P. 9th Cir. 1996) (Volinn, J.).

³⁹⁷ See *id.* at 141.

³⁹⁸ See 11 U.S.C. §§ 1124(2), 363 (1994). Judge Kathleen Lax remarked that, "one cannot, by its absence from the text of section 363, leap to the conclusion that 'cure' and any legal considerations based on the concept of cure have no application to the sale and consequent payment of obligations under section 363." *In re 433 South Beverley Drive*, 117 B.R. 563, 566 (Bankr. C.D. Cal. 1990). Judge Lax noted that § 365 refers to cure, thereby supposedly proving that cure exists outside the context of a chapter 11 plan. See *id.* Section 365, though, is a section limited to executory contracts, not "executed" loan agreements. See 11 U.S.C. § 365 (1994).

that a security agreement has been reinstated with regard to payment of interest and principal going forward.

IV. A COMPENSATORY THEORY OF CURE

The incoherence of case law on cure can be attributed to the failure of the courts to develop a principled concept of what constitutes "cure" of a default. At most, courts offered *examples* of cure. Now, in an effort to clarify the issue, Congress has developed its own contractual theory. Yet this theory runs up against the fact that, where a contract too greedily demands entitlements upon default, the contract institutes a penalty and not a cure.

Cure must therefore have a compensatory soul, in spite of the 1994 amendments to the Bankruptcy Code. In order to develop the Dorian Gray portrait relevant to this area of law, I offer the following principles.

The cure of a loan agreement has as its goal reinstatement of the agreement going forward. Parties to the contract thus obtain the exact benefit of their bargain, as if no default had occurred and no bankruptcy petition had been filed. Cure implies that a debtor should be able to deaccelerate the loan and reestablish the scheduled payments as contemplated in the loan agreement. Of course, defaults *have* occurred. No remedy can retroactively change this historical fact. What remedies can do, however, is to make a creditor objectively *indifferent* to the fact of this history.

A creditor should be entitled to compensation rendering the creditor indifferent to default. Thus, monetary amounts that became due in the ordinary course should now be paid as the price of the cure.³⁹⁹ Since the point of cure is deacceleration, the amounts due and owing must be calculated without regard to acceleration. Otherwise, cure would swallow acceleration whole, leaving no future payment schedule to reinstate.⁴⁰⁰

Because the idea is to render the creditor indifferent to the fact of default, the creditor should receive the interest compensation at market rate between the time of the default and the time the cure price is calculated.⁴⁰¹ It may strike one as strange that market rates

³⁹⁹ See *In re Cureton*, 163 B.R. 494, 495-96 (Bankr. E.D. Mich. 1994) (Spector, J.).

⁴⁰⁰ See *Di Pierro v. Taddeo (In re Taddeo)*, 685 F.2d 24, 27 (2d Cir. 1982) (Lumbard, J.).

⁴⁰¹ See Jonathan S. Fields, Note, *Taking Interest in a Cure: Compensation for Time Value of Chapter 13 Residential Mortgage Arrears*, 13 CARDOZO L. REV. 2119, 2130 (1992). In *Cardinal Feder-*

of interest should be paid as part of cure, when cure is the price for reinstating a *lower* contractual rate of interest.⁴⁰² The paradox, however, is a false one. Reinstatement was premised on placing the secured creditor in precisely the position she would have enjoyed had the contract never been breached. True, a default may be the failure to pay the contract rate of interest at some designated time in the past. But in order to reinstate the secured creditor to her precise economic position, it is necessary to commensurate the past default with present cure by employing a *market* rate of interest. The market rate is justified by the premise that, had the debtor actually paid when she was supposed to, the secured creditor could have reinvested the contractually-set interest payment in a market-rate investment vehicle. Thus, the market rate is totally consistent with reinstatement of the contractual rate of interest.

It is sometimes argued that, when a contract does not call for interest on arrears, awarding such interest as part of cure constitutes a "modification" of the home mortgage agreement and therefore should be blocked by the antimodification rule of § 1322(b)(2).⁴⁰³ The easy answer to this challenge is that cure may be accomplished "notwithstanding" § 1322(b)(2). Hence, the antimodification rule is incompetent to block a compensatory theory of cure.

Loan agreements often impose a higher postdefault rate of interest upon debtors. Again, the spirit of cure and reinstatement is to return the secured creditor to the position that she would have occupied had no defaults been sustained and no bankruptcy petition filed. Hence, cure should ignore any postdefault terms and any liquidated damage clause. Instead, only the ordinary course payments,

al Savings & Loan Ass'n v. Colegrove (In re Colegrove), 771 F.2d 119 (6th Cir. 1985), Judge Harry Wellford ruled that the market rate at the time a secured claim was allowed should be used. See *id.* at 123. But the idea of cure (as presented here) is to make the creditor whole at the time of reaffirmation, so that no losses are felt from past breaches and the contract flows into the future. This suggests that only the prevailing rate at the time of reaffirmation should count.

Although compensation implies market rates of interest to commensurate past monetary defaults and the present price of cure, it does not imply that attorneys' fees should be paid unless the contract or local law makes this part of the state-law remedy. In other words, where state law follows the traditional American rule that each side bears the cost of her own attorney, the rule should apply to the concept of cure as well. See *In re Small*, 65 B.R. 686, 693 (Bankr. E.D. Pa. 1986) (Scholl, J.), *aff'd*, 76 B.R. 390 (E.D. Pa. 1987) (Schapiro, J.).

⁴⁰² See *Colegrove*, 771 F.2d at 124 (Celebrezze, J., dissenting) (posing this point as a paradox).

⁴⁰³ See *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 114 B.R. 214, 217-18 (B.A.P. 9th Cir. 1990) (Perris, J.), *aff'd*, 944 F.2d 542 (9th Cir. 1991) (Leavy, J.).

supplemented by market rates of interest, may be included in the ideal cure price.

Many loan agreements require the debtor to pay what § 506(b) calls "fees, costs, or charges" related to enforcement of the loan agreement.⁴⁰⁴ Any such fee, cost, or charge that constitutes an out-of-pocket loss to the creditor should be included in the cure price, to the extent that the contract requires the debtor to reimburse the creditor for such expenses. Interest compensation on these losses should likewise be added to the cure price. In fact, a compensatory theory requires compensation for attorneys' fees and the like *even if* the contract does not so specify, because the idea is to make creditors indifferent to the fact of default as the price of reinstatement. Such fees should be reasonable, of course, under the ordinary mitigation principles that temper the tyranny of damages.

At a time certain, the trustee or debtor will have calculated a single cure price, composed of ordinary course principal and interest payments (whether falling due before or after the bankruptcy petition), out-of-pocket losses for which the debtor is contractually bound to pay, and market rates of interest on the above amounts, to render the creditor indifferent to the fact of default. This lump sum price is what the debtor must pay to exercise the right to reinstate the loan agreement.

As of when must this price be paid? In order to reconcile the above theory of cure with the existing reorganization chapters, I propose that, in chapter 11 cases, the debtor in possession or trustee must pay cash on the effective date of the plan. In chapters 12 and 13, the debtor may pay the cure price over the life of the plan. The rationale for this distinction is that the cure price is a postpetition expenditure made at the option of the trustee or debtor in order to exercise the privilege of reinstatement. In this respect, the cure price represents an administrative expense. Therefore, payment terms should match the terms under which any other administrative expense must be paid.

In chapter 11, administrative claims must be paid in cash on the effective date of the plan.⁴⁰⁵ In chapters 12 and 13, administrative claims may be paid over the life of the plan⁴⁰⁶ (i.e., over three to

⁴⁰⁴ 11 U.S.C. § 506(B) (1994).

⁴⁰⁵ See 11 U.S.C. § 1129(a)(9) (1994).

⁴⁰⁶ See 11 U.S.C. §§ 1222(a)(2), 1322(a)(2) (1994).

five years).⁴⁰⁷ These rules should be borrowed to govern payment of the cure price. Currently, §§ 1222(b)(5) and 1322(b)(5) permit the cure price to be paid over "a reasonable time."⁴⁰⁸ This phrase is opaque and is in any case usually interpreted to mean the cure price is to be paid over the life of the chapter 12 or 13 plan.⁴⁰⁹ The Bankruptcy Code should make explicit what a great many courts are doing anyway.

If the cure price is paid on the above terms, then the loan agreement is reinstated. In chapter 11, the effect of reinstatement ought to be that the secured creditor is deemed unimpaired. As such, the secured creditor is deemed to be an affirmative vote on the plan for cram down purposes. In other words, the secured party is not entitled to bring any cram down objections to confirmation, even if the present value of the cure price and the reinstatement is less than the value of the collateral. This effect of cure and reaffirmation accords with current law.

At this point, it is important to remember that cure is an *adjunct* to reinstatement. Cure is merely the price a debtor must pay for the privilege of reinstatement — it has no independent life. If a loan agreement is already mature according to its terms, there is nothing to reinstate and cure becomes irrelevant. A creditor in such a position is entitled to vote and thereby to trigger cram down protections. Note that this last suggestion does constitute a reversal of at least some case law which interprets "cure" as including the payoff of a claim already due and owing, without regard to acceleration.⁴¹⁰ On the view being offered here, the point of cure would be the performance of some act of deacceleration.

In chapters 12 and 13, a reinstated claim should prevent the secured creditor from claiming any cram down protections under § 1222(a) or § 1322(a). Because the premise of cure and reinstatement is the absolute indifference of the creditor to the fact of default and bankruptcy, the creditor should have no standing to object to the confirmation of the plan, so long as the cure price has been correctly calculated and dealt with in the plan. This suggestion sides with the 1994 amendments against *Rake v. Wade*,⁴¹¹ but would ex-

⁴⁰⁷ See 11 U.S.C. §§ 1222(c), 1322(d) (1994).

⁴⁰⁸ See 11 U.S.C. §§ 1222(b)(5), 1322(b)(5) (1994).

⁴⁰⁹ See *supra* notes 344-56 and accompanying text.

⁴¹⁰ See *supra* notes 145-56 and accompanying text.

⁴¹¹ 508 U.S. 464 (1993) (Thomas, J.).

tend these amendments, which now excuse compliance only with § 1222(a)(5) and § 1322(a)(5). These cram down provisions relate only to secured claims. An undersecured creditor holding an unsecured deficit claim should likewise be incapable of asserting any cram down protection under § 1222(a)(4) or § 1322(a)(4), since the undersecured creditor will be rendered indifferent to the fact of plan confirmation.⁴¹²

The option to cure and reinstate must eventually come to an end. Prior to 1994, the case law was fiercely divided on this question. Some courts equated the right to cure with the debtor's continued ownership in the collateral, though such an equation is by no means logically compelled.⁴¹³ Other courts reasoned that, if a judgment had been rendered, the contract merged with the judgment and could no longer be revived.⁴¹⁴ The 1994 amendments declared that cure may be accomplished at least until a foreclosure sale has occurred.⁴¹⁵ This is already being read to mean that cure *after* the foreclosure sale is impossible.⁴¹⁶ A better rule would focus on inconvenience to third parties. Thus, when a foreclosure sale involving a third party buyer has occurred, the trustee or debtor may not cure the contract and deprive the buyer of the collateral. But, where the creditor still owns the collateral as the result of a bid-in sale, cure should still be possible.⁴¹⁷ Merger—a state law concept—should not govern the federal policy of cure and reinstatement. Thus, when a bid-in sale has occurred the same instinct that leads to rejecting the judgment of foreclosure as the deadline also leads to rejecting the sale as the deadline. This is especially so because bid-in sales are so notoriously abusive in consumer contexts. Even bid-in buyers pay cash to some degree—such as when retiring senior liens or reimbursing the sheriff. Debtors or trustees should be required to reimburse the bid-in buyer for these amounts before a contract can be

⁴¹² In this respect, it may be noted that new § 1123(d) indicates that cure is “notwithstanding section 1129(a)(7)”—the “best interest of the creditors” test. 11 U.S.C. § 1123(d) (1994). No such exception exists in the chapter 12 and 13 analogs. Congress should make clear that the “best interest” test is repealed in these chapters whenever a loan agreement is cured and reinstated.

⁴¹³ See *supra* note 164 and accompanying text.

⁴¹⁴ See *supra* note 165 and accompanying text.

⁴¹⁵ See *supra* note 167 and accompanying text.

⁴¹⁶ See *supra* note 169-70 and accompanying text.

⁴¹⁷ See Barry L. Zaretsky, *Some Limits on Mortgagees' Rights in Chapter 13*, 50 BROOK. L. REV. 433, 449-50 (1984) (arguing for this position).

reinstated.

To summarize, the difference between the pure compensatory theory being proposed here and the *Rake v. Wade* theory relying on § 506(b) and § 1325(a)(5) is that the compensatory theory would apply to over- and undersecured creditors alike. Sections 506(b) and 1325(a)(5) apply only to oversecured creditors, leaving no theory of cure for undersecured creditors. The difference between a compensatory theory and the contractual theory adopted in the 1994 amendments is that under the former, courts can ignore default penalties and postdefault interest rates called for in the contract.

This view comports with the current structure of the Bankruptcy Code's governance of allowed claims. Cure is not a secured claim when the collateral is insufficient to cover both the cure price and principal not yet due under the reinstated agreement. Neither can cure be considered a prepetition unsecured claim under § 502(b), because cure includes both prepetition and postpetition amounts.⁴¹⁸ Finally, a cure cannot be viewed, strictly speaking, as a postpetition administrative claim,⁴¹⁹ since cure includes prepetition defaults. Administrative claims refer to postpetition expenses only.⁴²⁰ To be sure, cure has an administrative odor to it. Cure is the price that a debtor or trustee must pay to reinstate a loan agreement. As such, the trustee or debtor chooses to incur the price postpetition. Cure, in a sense, resembles cross-collateralization terms in postpetition loans, where, as the price for the loan, the trustee agrees to pay prepetition amounts. Increasingly, these loan agreements are being treated as illegitimate, because they straddle the postpetition-prepetition distinction inherent in administrative claims.⁴²¹ Obviously, cure (expressly so in chapter 11)⁴²² is invited to breach this gap. Cure is best viewed as a sui generis charge voluntarily undertaken by a debtor in order to buy the privilege of rein-

⁴¹⁸ Section 502 includes various "late" claims as exceptions to this rule. None is relevant here. See 11 U.S.C. § 502 (1994).

⁴¹⁹ See 11 U.S.C. § 503(b) (1994).

⁴²⁰ Section 503(b)(1)(A) implies this by emphasizing that expenses must be "the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b)(1)(A) (1994). The existence of the estate implies the postpetition time period.

⁴²¹ See *Shapiro v. Saybrook Mfg. Co. (In re Saybrook Mfg. Co.)*, 963 F.2d 1490 (11th Cir. 1992) (Cox, J.); David Gray Carlson, *Postpetition Security Interests Under the Bankruptcy Code*, 48 BUS. LAW. 483, 497-505 (1993); Charles Jordan Tabb, *Requiem for Cross-Collateralization*, 2 J. BANKR. LAW & PRAC. 109, 154-55 (1993).

⁴²² See 11 U.S.C. § 1124(2)(A) (1994).

statement. Cure, therefore, should be accorded the same treatment as are administrative claims.

So ends my catechism on what Congress ought to do.

V. CONCLUSION

Reinstatement of security agreements is an important concept in bankruptcy reorganization. It is particularly important in chapters 11 and 13, where reinstatement is the only means by which a debtor can hold on to her home once she has defaulted on her mortgage.

Reinstatement, however, implies cure of past defaults. Whereas courts had been divided over whether cure was a compensatory (i.e., "tort") concept or a contract concept, the Supreme Court, in *Rake v. Wade*,⁴²³ adopted a third view—that § 506(b) and § 1325(a)(5) governed the cure price. Congress, however, has intervened by shifting bankruptcy jurisprudence back to the contract theory. The 1994 amendments make clear that, for the most part, the contract is to govern the notion of cure.⁴²⁴ This legislative initiative is unfortunate, because many debtors will have a reduced incentive to protect their future unsecured creditors from secured creditor deprecations in a prepetition agreement. It may now be expected that, in the name of cure, secured creditors will load on all sorts of expensive placebos and aroma therapies in order to obtain cure at the highest level of contractual luxury.

A better theory of cure and reinstatement would be to make cure purely compensatory and federally preemptive. Under such a theory, a creditor would be stuck with the bargain actually struck with the debtor, but the creditor would be rendered indifferent to the occurrence of bankruptcy, given the bargain. The means of rendering the creditor indifferent would be to award market rates of interest on all monetary defaults. This interest compensation would start to accrue when the monetary default occurs and would continue until the time the cure price is calculated. If the debtor proposes to pay the cure price over time, market rates must be used again to assure that the present value of payment over time precisely equals the cure price.

⁴²³ 508 U.S. 464 (1993).

⁴²⁴ The only exception is that federal law imposes the deadline of sale on the power to cure. See *supra* notes 161-77 and accompanying text.