Secured Financing's Uneasy Place in Bankruptcy: Claims for Interest in Chapter 11

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Bankruptcy has always been the ultimate measure of a creditor's security. In this era of rising bankruptcy filings, questions sur-

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1. Statistics compiled by Dun & Bradstreet Corporation indicate that there were more than 61,000 business failures in 1987. The Dun & Bradstreet Corp., Business Failure Record 4 (1988). The Administrative Office of the U.S. Courts calculated that there were 62,534 business bankruptcy filings in 1989. R. Mecham, Annual Report of the Director of the Administrative Office of the U.S. Courts 27 (1989). Significantly, business debt "is at a record level in relation to the nation's income." Robinson, America's Not-So-Troubling Debts and Deficits, Harv. Bus. Rev., July-Aug. 1989, at 50, 52. Further, of the more than $300 billion in corporate debt attributable to leveraged takeover struggles, approximately $150 billion is "junk bonds." Id. Studies report that at least 5% or 6% of these high-risk, high-yield investment vehicles are likely defaults. Worthy, The Coming Defaults in Junk Bonds, Fortune, Mar. 16, 1987, at 27; see also Myerson, Business Diary: More Bond Defaults, N.Y. Times, Apr. 15, 1990, § 3, at 2, col. 4 (stating that "[t]he darkest forecasts of corporate bond defaults soon come to seem far too optimistic."). The latest data reveals that personal bankruptcy filings have nearly doubled since 1984, with creditors, such as bankers, searching for ways to "stem the tide that costs them billions of dollars a year." Shoutitz, Halting the Rush to Bankruptcy, Am. Banker, Aug. 24, 1989, at 6; see also Consumers' Debt Rose $5.4 Billion in December, N.Y. Times, Feb. 8, 1989, at D2, col. 5 (tracing sharp rise in consumer debt); Stout, Consumer Debt Jumped Sharply in November, Wall St. J., Jan. 10,
rounding the secured creditor's prospects, if the debtor finds itself in bankruptcy, have assumed increased relevance. At its core, the distributional aim of the secured transaction under state law is to subordinate competing claims in an effort to obtain full satisfaction for prioritized creditors of privately contracted entitlements arising from the promise to pay. This goal stands in stark contrast to federal bankruptcy law's egalitarian norms, with its attendant concerns in the reorganization context, for the debtor's continued financial viability. The inherent potential for conflict between these two systems is compounded by textual ambiguities in the Bankruptcy Reform Act of 1978, and the relative sparsity of empirical exploration of the traditional justifications for bankruptcy's policies as well as secured financing's missions.

Issues relevant to the treatment of the secured creditor's entitlement to interest accruing after the date of filing the bankruptcy petition (postpetition interest) offer a meaningful context in which to explore these themes. In most instances, the parties' security agreement will provide for the debtor's payment of interest on outstanding indebtedness at a fixed rate for the term of the contract. Often, the contract will also entitle the creditor to payment and accrual of an


2. This Article concerns consensual secured claims, which are liens recognized by state law and created by agreement between the debtor and the creditor. These encumbrances include security interests in personalty and real estate mortgages. See, e.g., U.C.C. § 9 (1978) [hereinafter Article 9]; UNIF. LAND SECURITY INTEREST ACT, 7A U.L.A. 141 (1990). The Bankruptcy Reform Act of 1978 includes these consensual liens in its definition of "security interest." See 11 U.S.C. § 101 (1988).

3. See, e.g., White & Summers, Uniform Commercial Code § 24-1, at 1126 (3d ed. 1988) (explaining that "[t]he usual outcome in a priority conflict under the [Uniform Commercial] Code is that the winning party satisfies himself in full out of the collateral before the subordinate party satisfies himself to any extent.").

4. See infra notes 20-24, 66-97 and accompanying text.


6. For a compelling compilation of empirical findings on consumer bankruptcy, see As We Forgive Our Debtors, supra note 1. The results of these findings are discussed in an ensuing article by Professor Boshkoff. See Boshkoff, As We Forgive Our Debtors in the Classroom, 65 IND. L.J. 65 (1989). Pioneering studies of personal bankruptcies can be found in Schuchman, The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States, 88 COM. L.J. 288 (1983); Schuchman, New Jersey Debtors 1982-83: An Empirical Study, 15 SETON HALL L. REV. 541 (1985).

7. See infra notes 51-81, 171-73 and accompanying text.
increased interest rate in the event of the debtor's default. Outside
the bankruptcy context, state law generally renders such "default inter-

8. See Cohen, Marwil & Gerard, Entitlement of Secured Creditors to Default Interest
   Rates Under Bankruptcy Code Sections 506(b) and 1124, 45 Bus. L. 415 (1989).
   
9. See, e.g., N.Y. GEN. OBLIG. LAW § 5-501 (McKinney 1989) (providing that interest
   cannot be usurious); CAL. CIV. CODE § 1670.5 (West 1989) (prohibiting unconscionable inter-
   est rates); Citibank N.A. v. Nyland, 878 F.2d 620, 625 (2d Cir. 1989); In re United
   Merchants & Mfrs., 674 F.2d 134 (2d Cir. 1982).
   
10. For the primary chapter of the Bankruptcy Code pertaining to reorganization, see 11
    U.S.C. §§ 1101-1174 (1988). With few exceptions, it governs business reorganizations, ena-
   bling financially distressed entities to restructure their obligations and operations in order to
    resume healthy functioning. By contrast, Chapter 7 of the Bankruptcy Code is for enterprises
    that are beyond rehabilitation. It prescribes a schema for the liquidation of the beleaguered
    
    
    
13. See infra notes 117-32 and accompanying text.
    
14. See infra notes 114-16 and accompanying text.
    
15. See infra notes 36, 54-56, 169-77 and accompanying text.
    
16. See infra notes 40-43, 177-79 and accompanying text.
    
17. See infra notes 54-57, 169-70 and accompanying text.

   the default rate constitutes
   an impermissible penalty. When default is accompanied by bank-
   ruptcy reorganization proceedings, however, the enforceability of
   creditor claims to postpetition interest at an enhanced interest rate is
   by no means plain.

As a general matter, bankruptcy law disallows postpetition inter-

11. By contrast, when a given claim is oversecured, i.e., whenever the collateral's
   value exceeds the principal obligation, the creditor is entitled to
   postpetition interest to the extent of the security's value. The Bank-
   ruptcy Code, however, does not resolve the important question of the
   allowable rate of interest that the oversecured creditor should be
   awarded. Moreover, it is unclear whether interest on oversecured
   claims must be paid during the pendency of reorganization
   proceedings.

The enforcement in bankruptcy of default interest rates could
be deemed to vindicate the oversecured creditor reliance interests
while preserving cognizable property and contract entitlements. The authenticity of presumed creditor expectations, however, is un-
certain, and ultimately may yield to fact. Further, the labels "prop-
erty” and “contract” do not provide an especially persuasive basis
for distinguishing the entitlements of secured creditors from those of unsecured creditors.  

More fundamentally, the disallowance of default interest rates seems an appropriate vindication of legislative and public policies when courts are presented with the prototypical debtor and creditor that Congress envisioned when it promulgated the Bankruptcy Code's provisions on reorganization. The debtor-protective measures contained in modern bankruptcy law seek to promote the successful rehabilitation of the business debtor who, although in the throes of transient financial difficulties, represents a viable and productive business operation. The classic policy behind reorganization is to give this valuable member of economic society another chance, thereby preserving the jobs, products or services that financial stress have placed in jeopardy. The traditional prototypical debtor, saddled with debts in hard times as a consequence of its providing a legitimate product-line or service, should be shielded from the destructive effects that default penalty provisions are apt to impose. Accordingly, the traditional prototypical oversecured creditor is presumed to be a financially stable entity who typically enjoys superior bargaining power and leverage. This formidable actor should not

18. See infra notes 40-43, 177-80 and accompanying text.
19. See infra notes 66-81, 85-95 and accompanying text.
20. See, e.g., United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983) (interpreting the Bankruptcy Code, the Court stated that "[b]y permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners."); infra notes 76-81, 87-97 and accompanying text.
21. See, e.g., S. REP. No. 598, 95th Cong., 2d Sess. 10, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5796 (emphasizing that "fair and equitable reorganization" represents the "last clear chance" to conserve values "that corporate financial stress or insolvency have placed in jeopardy.") At a minimum, this is what Congress had in mind when it promulgated the provisions on reorganization. Whether the legislative vision of bankruptcy as a viable means toward successful debtor rehabilitation comports with present-day realities is now a matter of some debate. See, e.g., Kashner, Majority Clauses and Non-Bankruptcy Corporate Reorganizations - Contractual and Statutory Alternatives, 44 BUS. LAW. 123, 123 (1988) (observing that "[g]enerally accepted financial and legal wisdom now says that a financially troubled corporation that needs to restructure its debt is better off in terms of costs and expenditure of time doing so outside of bankruptcy."); Bankruptcy Can Be a Fate Worse Than Liquidation, N.Y. Times, Feb. 10, 1990, at A24, col. 4 (city ed.).
22. See infra notes 87, 93-95 and accompanying text.
23. See generally White, Efficiency Justifications for Personal Property Security, 37 VAND. L. REV. 473, 475 (1984) (contending that "[s]ecured creditors tend to be well informed, well represented, and powerful. Our traditional notions of fairness and concern for the underdog would suggest that the banks and other secured creditors should not receive better treatment than the general creditors."); S. REP. No. 598, 95th Cong., 2d Sess. 10, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS at 5796 (stating that the vulnerable "debtor in distress" should be shielded in Chapter 11 from the "natural tendency" to pacify large
be hindered unduly by virtue of the denial of an entitlement incidental to repayment of the principal obligation.\textsuperscript{24} Thus, postdefault interest seems theoretically akin to a "windfall" to be reaped at the expense of the goals of reorganization.

When the relevant players comport with these models, the allowance of claims for postpetition interest at an increased rate implicates concerns for the very integrity of the reorganization process and the socially desirable ends that debtor recovery tends to serve.\textsuperscript{26} Permitting certain creditors to reap gains triggered by bankruptcy when there are few resources available to satisfy other claimants\textsuperscript{28} and to revive the debtor frustrates successful reorganization while providing potent disincentives to the troubled entity's even seeking rehabilitation.\textsuperscript{27} If the financially distressed enterprise were obliged to honor post-default entitlements during the Chapter 11 proceeding, the continuing financial burden could force a liquidation. If interest payments were forestalled during reorganization but permitted to accrue unpaid, an onerous burden would be added to the dead weight of claims to be settled under any ultimate plan of recovery.

The statutory gaps that characterize this area have been filled by recent judicial interpretations that boldly attempt to allay some of these concerns.\textsuperscript{28} The decisions, which broadly deny awards of postpetition interest through resort to the Bankruptcy Code's curative provisions, are appropriate as well as prudent in view of their respective facts, when the given debtor and oversecured creditor comport with the congressional prototypes. The rulings are troublesome, however, insofar as they rest on the unstated and untested assumption that all lenders and debtors will fit the traditional models. Recent financing arrangements belie this presumption, and remind us that in certain instances the customary roles of debtor and creditor may well be reversed.\textsuperscript{29} Moreover, newly prominent and intricate

\textsuperscript{24} See generally In re South Village, 25 Bankr. 987 (Bankr. D. Utah 1982) (determining that secured creditor protections must be limited to preserve bankruptcy's essential function; keeping businesses in operation).

\textsuperscript{25} See infra notes 74-81, 85-95 and accompanying text.

\textsuperscript{26} See generally Kennedy, Secured Creditors Under the Bankruptcy Reform Act, 15 Ind. L. Rev. 477, 477 (1982) (asserting that "[t]o the extent a secured creditor obtains protection against the necessity of sharing in the losses suffered by other creditors of an insolvent debtor, he frustrates a fundamental bankruptcy objective.").

\textsuperscript{27} See infra notes 187-93 and accompanying text.

\textsuperscript{28} See infra notes 133-68 and accompanying text.

\textsuperscript{29} Intricate corporate financing arrangements involving significant debt encumbrance find the formidable business conglomerate in the role of debtor, with the relatively small start-
corporate business transactions, such as the leveraged buyout, involve the encumbrance of significant debt by the acquired enterprise in an attempt to amass personal fortunes for the investor group. The company typically is obliged then to shift its focus from the manufacture and marketing of its product or service line to financial up business in the role of creditor, extending a product line or service on credit. For example, Claridge's Chocolates, a small enterprise founded by a sole entrepreneur in 1988, supplied on credit forty percent of its product to department stores acquired by Campeau, Inc. When Campeau, Inc., the debtor, was rendered bankrupt as a consequence of its onerous leveraged buyout undertaking (see infra notes 30-35 and accompanying text), it defaulted on its obligations to its creditor Claridge's Chocolates, causing significant hardship to this new venture. See Adam Smith's Money World: Going Broke: The Infamous Chapter 11, (WNET television broadcast, Feb. 27, 1990) [hereinafter Adam Smith's Money World] (transcript no. 619, at 5, on file at Hofstra Law Review), wherein the founder of Claridge's Chocolates recounts:

We got hurt by the [Campeau bankruptcy]. We did receive bad checks. We did get caught with bad receivables. But the biggest problem for us was the top line. We were not able to ship orders we had in-house. And we had the product produced . . . . We wanted to create a product, and now, with these particular problems, you have Robert Campeau coming in, who in my opinion was hugely irresponsible in what he did . . . . So many people have been hurt.

Id. at 5-6.

30. Leveraged buyouts are defined as “acquisitions in which the purchase price is financed largely with the credit, cash flow and, directly or indirectly, the assets of the acquired company.” Dayan, Leveraged Buy-Outs, in PRACTISING LAW INSTITUTE No. 370, GOING PRIVATE 1981 113, 115 (1981). Leveraged buyouts bring about concentration of a corporation's ownership in the hands of a few stockholders. This permits the stockholders to control the corporation with the incentive to operate it efficiently in order to realize the entire profit for themselves. Such a joinder of control and ownership, however, is produced at great cost to the corporation, which provides most of the funds used to purchase the stock from the selling shareholders.

Queenan, The Collapsed Leveraged Buyout and the Trustee in Bankruptcy, 11 CARDozo L. Rev. 1, 1 (1989) (footnote omitted). The leveraged buyout has attained a prominent place in modern-day financing arrangements. “Between 1979 and 1987 the annual number of LBOs of public companies rose from 16 to 259. During that same time frame, the aggregate price paid in those transactions increased from under $1 billion to over $35.6 billion.” Id. at 3. See Sterngold, Buyout Specialist Bids $20.3 Billion for RJR Nabisco, N.Y. Times, Oct. 25, 1988, at A1, col. 6; Roberts, Macmillan Inc. Agrees to Buy-Out By KKR Valued at $2.36 Billion, Wall St. J., Sept. 13, 1988, at A3, col. 1; Betting the Store: Campeau at Last Gets Federated - Now Can He Make a Go of It?, Wall St. J., Apr. 4, 1988, at A1, col. 6. See generally Bratton, Corporate Debt Relationships: Legal Theory in a Time of Restructuring, 1989 DUKE L.J. 92, 95 (contending that “[r]estructurings have pushed corporate debt-equity ratios to historic highs; levels of indebtedness formerly thought unacceptably risky have become routine.”).

31. Traditionally, a business grows by providing a product or service zealously and efficiently. In contrast, leveraged buyout participants seek to amass personal fortunes through expansion designed to accommodate enormous debt service. See generally Queenan, supra note 30, at 3 (explaining that the leveraged buyout “offers tremendous profit incentives to all involved . . . . Additionally, these transactions generate huge fees for investment bankers, which explains why they have been such a force in initiating as well as financing [leveraged buyouts].”).
measures designed to generate the cash necessary to reduce the debt.\footnote{Einer} When the ravaged entity is left insolvent\footnote{In one era, the major cause of bankruptcy was the level of debt. In the past 10 years, corporate debt has risen from $1.3 trillion to $2.8 trillion, an all-time high. Much of that debt is in the form of high-yield bonds issued to finance takeovers and LBOs in the roaring 80s. Some of the buyers and some of the bond dealers became rich, but not all of that debt will be paid.}{32} as a consequence of its attempt to achieve concentration of its ownership in the hands of the select few investor-stockholders, there is the danger of significant prejudice to the company's non-stockholder constituency, including those creditors whose financing had sustained the now-compromised product or service line.\footnote{In other eras, companies sought the protection of the bankruptcy law because of bad business decisions or turns in business that left them unable to pay their bills. But in the 1990s, the major cause of bankruptcy is likely to be the level of debt. In the past 10 years, corporate debt has risen from $1.3 trillion to $2.8 trillion, an all-time high. Much of that debt is in the form of high-yield, or junk, bonds issued for takeovers and LBOs in the roaring 80s. Some of the buyers and some of the bond dealers became rich, but not all of that debt will be paid.}{33} In such settings, the federal policies that would otherwise condone a pro-debtor bias are noticeably absent, insofar as the debtor's trouble is of its own making due to imprudent overborrowing.\footnote{In other eras, companies sought the protection of the bankruptcy law because of bad business decisions or turns in business that left them unable to pay their bills. But in the 1990s, the major cause of bankruptcy is likely to be the level of debt. In the past 10 years, corporate debt has risen from $1.3 trillion to $2.8 trillion, an all-time high. Much of that debt is in the form of high-yield bonds issued to finance takeovers and LBOs in the roaring 80s. Some of the buyers and some of the bond dealers became rich, but not all of that debt will be paid.}{34} In contrast, then, to the blanket nullification of postpetition awards, equitable balancing would afford the flexibility necessary to accommodate both the traditional corporate debtor and creditor as well as the recent over-leveraged patterns of financing which arguably call into question the policies based on the

acustomed debtor-creditor relationship.

A critical assessment of the relevant case law, in light of pertinent theoretical and historical antecedents, suggests a frame of inquiry relevant whenever bankruptcy's collectivization goals are asked to honor the self-interests of secured creditors seeking to enforce entitlements established before (as well as independently) of bankruptcy. Recent judicial pronouncements accommodate the traditional paradigm described above, which gave rise to congressional debtor-protective policies. However, debt financing typical of the 1980's real estate, retail and other corporate industries calls into question universal application of judicial solutions designed to oblige traditional pro-debtor concerns.

I. THEORETICAL ANTECEDENTS

A. The Functions of Security

The fundamental distinguishing feature of a secured transaction is the creditor's entitlement to rely on identified collateral for satisfaction of all or part of the outstanding indebtedness in the event of the debtor's default. Frequently, secured debt takes the form of a consensual lien on the debtor's personalty, pursuant to Article 9 of the Uniform Commercial Code, or realty, in accordance with applicable state law. These consensual encumbrances often are accompanied by a host of privately bargained-for creditor entitlements in the event of the debtor's default or bankruptcy.

It is well established that secured creditors' contractual and state property rights are protected by the Constitution's due process and just compensation clauses. This recognition, however,
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does not by itself provide a compelling framework for distinguishing the entitlements of secured creditors from those of unsecured creditors.\(^\text{42}\) State debtor-creditor law suggests that unsecured creditors also have legally cognizable property interests in the debtor's assets, although such interests reside in the whole of the debtor's qualifying property, as opposed to any one or more identified bodies of collateral.\(^\text{43}\)

Essentially, theorists and academicians have posited that security functions as a risk-allocating device\(^\text{44}\) as well as an efficient means to decrease the total cost of credit.\(^\text{45}\) Article 9, now enacted in every state,\(^\text{46}\) replaced the bewildering myriad of common law per-

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42. Even more fundamentally, it has been posited as a matter of corporate law theory that "[h]istorically, contract has had an equal, or more often subordinate, position in corporate legal theory - a position closely grounded in and responsive to economic practice." Bratton, *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1473 (1989); see also Bratton, *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. L. REV. 667, 684 (observing, in context of examination of judicial regulation of issuer-bondholder conflicts of interest, that "[c]ourts no longer confine themselves to classical assumptions about contract relations.").

43. See UNIF. FRAUDULENT CONVEYANCE ACT § 1, 7A U.L.A. 430 (1985); Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 554-60 (1977) (explaining that state fraudulent conveyance law proscribes debtor misbehavior vis-a-vis all creditors). For a detailed analysis of secured and unsecured creditors' constitutional rights see Rogers, supra note 41, at 991 (concluding that "[r]eliance on the labels 'property' and 'contract' . . . hardly suffices to explain the supposed distinction between the constitutional rights of secured and unsecured creditors.").


sonal property security devices by streamlining rules for the creation, priority and enforcement of consensual security interests in personality. The official comments to section 9-101 note that “[t]he aim of this Article is to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.”\(^{47}\) Similarly, the Uniform Land Security Interest Act\(^ {48}\) represents a comprehensive scheme to govern all consensual security interests in real estate.\(^ {49}\) The statute endeavors to provide a cohesive framework in which the “variety of financing secured by real estate can go forward with greater certainty and less transaction cost.”\(^ {50}\)

Concerns of efficiency and risk allocation aside, as a general matter security is often perceived as “a hedge against bankruptcy and other manifestations of the debtor’s insolvency.”\(^ {51}\) For instance, the Article 9 priority rules allow a debtor “to make a private contract with one creditor that denoms the claims of other creditors from an initial position of parity to one of subordination.”\(^ {52}\) Indeed, one of the primary reasons for collateralizing in accordance with the statute’s requirements is to protect this creditor against the world of potentially competing claimants in the event of the debtor’s default. “Priority is the purpose of security; and the secured creditor seeks to subordinate, not to share.”\(^ {53}\)

It is unclear, however, whether secured creditors collateralize with the actual expectation that their bargained-for entitlements will, for the most part, be honored when default is accompanied by bankruptcy.\(^ {54}\) While those vested with special non-bankruptcy law entitlements, such as Article 9 claimants, often fare best in the bankruptcy process,\(^ {55}\) it has been aptly observed that “there are no

49. Id. at 141; see R. Powell, supra note 38, at ¶ 435.1.
52. Jackson & Kronman, supra note 44, at 1147; see also B. Clark, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 1.02[3] (2d ed. 1988) (noting that “[t]he position of the secured party with a properly perfected security interest is an exalted one.”).
53. R. Duncan & W. Lyons, supra note 39, at § 4.01[1]; see also White & Summers, supra note 3, § 24-1, at 1126 (stating that a prioritized creditor is entitled to full satisfaction before subordinate party takes).
54. See infra notes 172-80 and accompanying text.
55. See Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain, 91 YALE L.J. 857 (1982). Professor Jackson, noting that the principal concerns of bankruptcy are creditor-distribution questions, observed that “[t]he claimants who fare best in the
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winners in bankruptcy, only survivors. Ultimate, more needs to be learned about the secured creditor's *bona fide* expectations, and empirical exploration of authentic creditor experience (and, attendantly, secured financing's justifiable purposes), is an important and worthwhile source of study. Bankruptcy law's distributional scheme cannot honor expectations or purposes that remain uncharted.

B. The Origins of Bankruptcy Law

In a crucial respect, the aims of modern bankruptcy law differ considerably from those reflected in its Roman and English law antecedents. While contemporary doctrine reveals substantial concern for the debtor, bankruptcy has its origins as a device intended solely to facilitate creditors' collection abilities, without regard for the debtor's future well-being or the societal interests to be served by successful debtor rehabilitation. Initially, for example, discharge was not permitted and debtors remained liable to any creditors not paid in full at the conclusion of the asset distribution process. Indeed, bankrupts were deemed the perpetrators of fraud, and were

bankruptcy process hold special entitlements under applicable non-bankruptcy law." *Id.* at 858. Jackson offers a normative thesis aimed at justifying "the time-honored proposition that non-bankruptcy entitlements, such as security interests, should be recognized in bankruptcy." *Id.* He proposes that bankruptcy be viewed "as a system designed to mirror the agreement one would expect the creditors to form among themselves were they able to negotiate such an agreement . . . ." *Id.* at 860.

57. *See infra* notes 66-78, 87-96, 182-93 and accompanying text.
subject to punitive sanctions including imprisonment. The very term "bankruptcy" (literally translated from the Latin "banca rupta," or "broken bench") is derived from the Roman custom of physically breaking the debtor's workbench once his assets were collected and distributed. This practice served as a punishment as well as a warning to other indebted tradesmen.

Significantly, however, the early bankruptcy laws prescribed an enduring collective remedy for aggrieved creditors.

Although an individual creditor did not lose the right to sue the merchant debtor at some later time (because there was no discharge), each creditor had to share the debtor's existing assets with every other creditor. Essential elements of these early English bankruptcy statutes, then, were the sequestration of the merchant's assets and the imposition of restraint on creditors, to ensure that a creditor did not seek repayment in full at the expense of other creditors.

All creditors would share in the delinquent debtor's assets on a pro rata basis. This collective mode of redress afforded many creditors a means of reaching their debtor's assets, where previously none had existed. Nonetheless, "cases could arise in which an individual creditor fared worse under the bankruptcy statute. A creditor who might have been able to recover in full if left to pursue individual remedies would have to share whatever the debtor had with all the other creditors."

The development of bankruptcy law in the United States reflects a significantly greater concern for the debtor's recovery. The Bankruptcy Act of 1898, the first comprehensive statutory compilation, "expanded bankruptcy from a remedy that was imposed by
creditors to one that could be voluntarily sought by debtors." Among other debtor-protective measures, the 1898 Act entitled the debtor to a discharge of outstanding obligations in exchange for the liquidation of the debtor's non-exempt assets. "Thus, at the close of the 19th century, a body of law originally designed to serve creditors took on a significant aspect of debtor protection."

Subsequent amendments, most notably the Chandler Act of 1938, prescribed a comprehensive and accessible framework for debtor reorganization. The Bankruptcy Code continued to liberalize bankruptcy practice and procedure so as to permit equitable balancing of the interests of creditors and debtors, while facilitating the aims of debtor recovery. Most significantly, the provisions on business reorganization prescribe procedures designed to protect creditors while promoting the successful rehabilitation of the financially troubled debtor. Indeed, the principal aim of Chapter 11 is to encourage the cooperative participation of all interested parties in order to rescue those entities which, although fiscally distressed, have a viable future. "[N]o longer should a worthy 'patient' succumb to..."
the cost of the financial rehabilitation operation." To this end, the debtor is to be shielded from postbankruptcy harassment by creditors seeking to enforce special entitlements destined to compromise resort to, as well as attainment of, reorganization goals.

Thus, the Bankruptcy Code, like the 1898 Act, preserves bankruptcy's essential historical function as a collective mechanism aimed at distribution on an egalitarian basis. This egalitarian norm, firmly rooted since the very origins of bankruptcy law, coupled with the Chapter 11 concerns for debtor recovery, portend conflict whenever a secured claimant seeks to carry out self-interested expectations during bankruptcy proceedings.

C. Secured Financing's Uneasy Coexistence with Bankruptcy's Normative Goals

As a general matter, federal bankruptcy law recognizes and permits the enforcement, subject to limitation, of secured liens. In a seminal pronouncement on the impact of the 1898 Act upon secured
creditors' rights, the Supreme Court noted that "the federal bankruptcy court should take whatever steps are necessary to ensure that the [secured creditor] is afforded in federal bankruptcy court the same protections he would have under state law if no bankruptcy had ensued." In the context of deferring to applicable state laws that supported a secured creditor's claims to rents that accrued post-bankruptcy on realty serving as collateral, the Court continued:

Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy."

Similarly, the legislative history of the Bankruptcy Code reveals an intent to attune bankruptcy law to the practices and benefits of a modern credit economy, of which a vital feature is the secured financing arrangement.

Notwithstanding this somewhat vague resolve, modern bankruptcy law remains grounded in the firmly established policies of affording the debtor a financial reprise or fresh start, rehabilitating

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84. Id. at 55 (citation omitted); see Weg, The Secured Creditor's Rights to Rents from Real Property, 17 REAL EST. L.J. 29 (1988).
87. See, e.g., Local Loan Co. v. Hunt, 292 U.S. 234, 244-45 (1934), where the Court noted that bankruptcy law serves primarily to provide honest debtors an avenue to rid themselves of obligations incurred as a consequence of business misfortunes. The Court continued:
the troubled enterprise, and achieving egalitarian distribution among claimants. In reorganization proceedings, the financially distressed entity is restructured "to enable it to operate successfully in the future . . . . By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return for its owners." The rehabilitation process "presupposes dynamic rather than static uses of property and denouement in a plan which accommodates the many, not just the few." Reorganization is intended to afford the debtor a meaningful opportunity to regroup, shielding it from "preferential systems of debt collection with a more equitable and orderly distribution of assets."

To facilitate these ends, bankruptcy endeavors to restrain creditors from advancing their individual interests to the detriment of others. One of the primary purposes of the Bankruptcy Act [of 1898] is to [afford debtors] . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." Id. at 244. See generally Jackson, The Fresh Start Policy in Bankruptcy Law, 98 HARV. L. REV. 1393, 1439-47 (1985) (proposing a normative theory of debtor discharge); Kennedy, Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start, 76 W. VA. L. REV. 427, 428-30 (1974) (reciting the history and applications of the fresh start policy); Note, Protection of a Debtor's "Fresh Start" Under the New Bankruptcy Code, 39 CATH. U.L. REV. 843, 846 (1990) (authored by Richard S. Davis) (exploring the fresh start imperative in the context of Bankruptcy Reform Act of 1978). Confirmation of a plan of reorganization entitles the debtor to a discharge of prior debts. 11 U.S.C. § 1141(d)(1) (1988). "This discharge is effective as against any creditor, regardless of whether or not . . . the creditor has accepted the plan." B. WEINTRAUB & A. RESNICK, BANKRUPTCY LAW MANUAL § 8.24, at 8-119 (1986); see infra note 139 and accompanying text (discussing plan confirmation).

88. See, e.g., S. REP. NO. 598, 95th Cong., 2d Sess. 10, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5796 (discussing the economic importance of reorganization); In re South Village, 25 Bk. 987 (Bankr. D. Utah 1982) (reconfirming bankruptcy's principal objective as keeping businesses in operation); Harris v. Zion's Savings Bank & Trust Co., 317 U.S. 447, 451 (1943) (stating that bankruptcy affords opportunity for debtor rehabilitation while leaving creditors "all for which they may reasonably hope.").

89. See supra note 79 and accompanying text.

90. The policies of debtor rehabilitation, debt discharge and egalitarian distribution are viable in both the reorganization setting as well as in the liquidation context. See supra notes 66-79 and accompanying text. In liquidation proceedings, the Bankruptcy Code seeks to afford the debtor a financial fresh start while prescribing an egalitarian schema for distributing assets among claimants. See T. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 4 (1986); Jackson, supra note 87, at 1396.


93. Id. The court continued: "[reorganization] encourages rehabilitation: debtors may seek its asylum while recovery is possible rather than coasting to the point of no return; creditors, realizing that foreclosure is useless, may rechannel energies toward more therapeutic ends." Id.
other claimants and the debtor's recovery. Indeed, of greatest relevance to the immediate context is the Bankruptcy Code's overriding normative goal of enabling "the owners of assets to use those assets in a way that is most productive to them as a group in the face of incentives by individual owners to maximize their own positions." This objective stands in stark contrast to the aims of state debtor-creditor law, such as Article 9, intended to permit holders of prioritized secured claims to advance their own interests at the expense of subordinate competing claims.

When bankruptcy's collectivization goal is asked to oblige the self-interests and alleged expectations of secured creditors, who may be seeking to enforce entitlements established before bankruptcy, the potential for conflict is manifest. The treatment of secured creditors' claims for postpetition interest presents an important setting in which to examine secured financing's precarious coexistence with bankruptcy imperatives.

II. Specific Applications: Postpetition Interest

A. Statutory and Case Law Underpinnings

The 1898 Act did not address the issue of creditor entitlement to postpetition interest. In an effort to facilitate the aims of reorganization, case law filled the legislative void by denying accrual or payment of postpetition interest on unsecured debt. As the Supreme Court observed, "[t]o allow a secured creditor interest where his security was worth less than the value of his debt was thought to be inequitable to unsecured creditors." The courts permitted application and accrual of interest on secured debt, but only to the extent that the collateral was sufficient to pay such interest. The traditional justification for allowing postpetition interest on over-
secured consensual liens is articulated in United States v. Harrington,\textsuperscript{102} where the Fourth Circuit noted that when the given collateral is intended to secure both the principal of the debt and interest until payment, and when the security is sufficient to do so, the contract between the parties should not be abrogated by bankruptcy.\textsuperscript{103}

The equitable principle applied in assessing prebankruptcy Code claims for postpetition interest is found in Vanston Bondholders Protective Comm. v. Green.\textsuperscript{104} There, the Supreme Court found it "manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor."\textsuperscript{105} Vanston is significant insofar as the case urges that the propriety of postpetition interest be determined, not on rigid adherence to any bright-line rules, but rather on the overall aims of reorganization, as well as the equities presented by the particular controversy.\textsuperscript{106}

Under the Bankruptcy Code, unsecured claims, including the undersecured portion of a partially secured claim, are not entitled to postpetition interest in bankruptcy.\textsuperscript{107} By contrast, the holder of an oversecured claim\textsuperscript{108} may recover postpetition interest to the extent of the excess collateral value.\textsuperscript{109} Specifically, Bankruptcy Code sec-

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\item 102. United States v. Harrington, 269 F.2d 719, 724 (4th Cir. 1959).
\item 103. Id. In Harrington, the court refused to allow post-bankruptcy interest on a nonconsensual tax lien. Id. at 726.
\item 104. 329 U.S. 156 (1946).
\item 105. Id. at 165.
\item 106. Id. at 156; see O'Toole, Adequate Protection and Postpetition Interest in Chapter 11 Proceedings, 56 AM. BANKR. L.J. 251, 259 (1982) (noting that the impact of the Vanston case encourages the examination of "postpetition interest not under the mandates of rigid rules, but in the light of the purposes of bankruptcy reorganization in general and the facts of each case in particular.").
\item 107. 11 U.S.C. § 502(b)(2) (1988). See generally Scharer, The Right of the Undersecured Creditor to Postpetition Interest in Bankruptcy on the Value of Its Collateral: Implications of Recent Cases, 21 U.C.C. L.J. 61 (1988). In United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988), a unanimous Supreme Court ruled that in a Chapter 11 reorganization, an undersecured creditor is not entitled to interest on its collateral as compensation for the delay occasioned by the Bankruptcy Code's automatic stay in foreclosing on collateral. Id. at 382. The Supreme Court in Timbers was not concerned with oversecured creditors, who, as noted, are allowed awards of interest to the extent of the collateral's value. Id. at 372.
\item 108. As noted, an oversecured claim is one in which the collateral's value exceeds the amount of principal indebtedness. See supra note 12 and accompanying text.
\item 109. See 11 U.S.C. § 506(b) (1988). See generally B. WEINTRAUB & A. RESNICK, supra note 87, § 5.11[3], at 5-56 (examining entitlements to postpetition interest and concluding that "[w]henever the value of the collateral, after the deducting of expenses that may be recovered from the property, exceeds the amount of the allowed claim, the claimant is entitled
\end{itemize}
CHAPTER 11


tion 506(b) entitles the secured creditor to interest accruing after the petition date to "the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim."\textsuperscript{110} In no event, however, may the oversecured creditor's claim for interest exceed the excess value of the collateral.\textsuperscript{111} Recently, in United States v. Ron Pair Enterprises, Inc.,\textsuperscript{112} a majority of the Supreme Court determined that section 506(b) entitles a creditor to receive postpetition interest even on a nonconsensual oversecured claim.\textsuperscript{113}

Moreover, interest on oversecured claims may have to be paid currently to the secured creditor who resorts successfully to the "adequate protection" relief afforded by the Bankruptcy Code's automatic stay provisions.\textsuperscript{114} The filing of a bankruptcy petition automatically stays all creditor collection proceedings against the debtor or property of the estate.\textsuperscript{115} However, section 362(d)(1) of the Bankruptcy Code affords relief from the stay "for cause, including the lack of adequate protection of an interest in property." While "adequate protection" is not defined in the legislation, section 361(3) provides that adequate protection, when required, may be provided by granting relief designed to afford a creditor "the indubitable equivalent" of the creditor's interest in property. This standard, read in conjunction with section 506(b), suggests that the oversecured creditor may be entitled to current payment of postpetition interest allowed under the parties' security agreement. Further, even if it is not paid to the secured creditor currently during the reorganization,\textsuperscript{116} secured interest permitted under section 506(b) accrues dur-

\begin{footnotesize}
110. 11 U.S.C § 506(b) (1988). As the Supreme Court has noted, "since this provision permits postpetition interest to be paid only out of the security cushion, the undersecured creditor, who has no such cushion, falls within the general rule disallowing postpetition interest." Timbers, 484 U.S. at 372-73.


113. Id. at 237.


116. Current payments of interest might not be mandatory if the collateral is not diminishing in value during the reorganization. See 11 U.S.C. § 361 (1988); United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 369-70 (1988). Nonetheless, it has become commonplace for enterprises in reorganization to pay interest currently to fully secured creditors, so as to avoid any necessity of paying interest upon unpaid interest to such creditors following reorganization.
\end{footnotesize}
ing the pendency of the proceeding, adding to the weight of claims to be dealt with under the execution of the plan.

It is unclear whether these allowances in bankruptcy represent a particular deference to oversecured creditors' bargained-for entitlements. The legislative history of the relevant Bankruptcy Code provisions is "wholly inconclusive." The absence of statutory history is unfortunate, as the Bankruptcy Code fails to resolve the rather important question of the allowable rate of interest to be awarded the oversecured creditor. More specifically, is an oversecured creditor entitled to postpetition interest at a contracted-for higher default rate?

The Supreme Court has yet to rule on whether section 506 allows default rates of interest. Lower court decisions are by no means uniform, with some cases emphatically permitting postpetition interest at enhanced default rates, and others rejecting such entitlements. Courts allow default interest rates in bankruptcy partly on the basis that privately negotiated entitlements should be honored and, to a greater extent, on the ground that section 506 does not expressly authorize examination of the reasonableness of interest rates charged by the secured creditor. Neither assertion is especially persuasive, insofar as bankruptcy law has long tolerated, if not squarely authorized, the modification or abrogation of privately bargained claims to accommodate the exigencies of insolventy or to facilitate the normative aims of bankruptcy. Moreover, the very ability to allow postpetition interest has its roots in an equitable balancing of fact-specific considerations. Indeed, nothing on the face of section 506 prohibits judicial weighing of the salient and competing interests in view of the purposes to be served by reorganization and the more general policies underlying both bankruptcy and com-


118. See, e.g., In re Skyler Ridge, 80 Bankr. 500 (Bankr. C.D. Cal. 1987) (allowing creditor to collect at enhanced default rates according to an agreed upon predefault contract); In re W.S. Sheppley & Co., 45 Bankr. 473 (Bankr. N.D. Iowa 1984) (recognizing an enhanced default rate as legitimate because a defaulting mortgagor is a substantial risk); see also In re 268 Ltd., 789 F.2d 674 (9th Cir. 1986) (noting in dicta that application of section 506 to claims for interest is not circumscribed by a reasonableness standard).


120. See, e.g., Skyler Ridge, 80 Bankr. at 511 (finding that, absent usury or unconscionability, privately contracted default interest rates should stand).

121. Id.


123. See supra notes 104-06 and accompanying text.
Significantly, resort to such inquiry does not compel the denial of the default interest rate in every case. In fact, the decisions to engage in a balancing of the equities have reached divergent conclusions about the enforceability in bankruptcy of the particular interest entitlement at stake. Equitable balancing affords flexibility, permitting judicial vindication of authentic creditor reliance interests when warranted.

Ultimately, when confronted with the claim for postpetition interest at an enhanced rate, courts should weigh the secured creditor's status and reasonable expectation interests against applicable concerns for the debtor's recovery and the integrity of the reorganization process. These competing considerations are presented, yet not explicitly balanced, in recent judicial pronouncements which deny the application and accrual of postdefault interest under the curative provisions of Bankruptcy Code section 1124.

Bankruptcy Code section 1124(2) provides that a debtor seeking to confirm a plan of reorganization can reverse (or "deaccelerate") a contractual debt acceleration and reinstate the original maturity date by "curing" the default that prompted the acceleration. To

124. See In re Maimone, 41 Bankr. 974, 979 (Bankr. D.N.J. 1984) (stating that the policies of the Bankruptcy Code and commercial law "do not forcefully compel either the contract rate of interest, a market rate, the legal rate, or any other particular interest rate.").

125. See, e.g., In re Planvest Equity Income Partners IV, 94 Bankr. 644, 645 (Bankr. D. Ariz. 1988) (denying default interest rate, but awarding contract rate based on application of standard of reasonableness); In re W.S. Sheppley & Co., 62 Bankr. 271 (Bankr. N.D. Iowa 1986) (disallowing postdefault interest rate upon resort to multi-factored inquiry, including fact that lender was partially responsible for allegedly injurious delay in plan confirmation); Maimone, 41 Bankr. at 974 (allowing postpetition interest at contract rate upon consideration of Bankruptcy Code policies and commercial law's aims); see also In re 360 Inns, Ltd., 76 Bankr. 573 (Bankr. N.D. Tex. 1987) (denying default interest rate even though debtor was solvent, based upon equitable principles).

126. See supra notes 29-35 and accompanying text.

127. See supra notes 19-35 and accompanying text (positing that recent financing arrangements resulting in bankruptcy tend not to comport with the congressional prototype of the economically distressed business debtor seeking reprise).

128. In re Southeast Co., 868 F.2d 335 (9th Cir. 1989); In re Entz-White Lumber & Supply, Inc., 850 F.2d 1338 (9th Cir. 1988). See generally In re Forest Hills Assoc., 40 Bankr. 410 (Bankr. S.D.N.Y. 1984) (holding that estate was required to pay only lower predefault rate where mortgage note provided that in the event of default and acceleration, higher interest would be imposed); In re Manville Forest Prods. Corp., 43 Bankr. 293 (Bankr. S.D.N.Y. 1984), rev'd in part, aff'd in part, 60 Bankr. 403 (S.D.N.Y. 1986) (construing section 1124(2) as completely nullifying claim for default rate of interest on accelerated balance of outstanding indebtedness).

129. 11 U.S.C. § 1124(2) (1988); Cohen, Marwil & Gerard, supra note 8, at 424-25; see infra notes 133-45 and accompanying text.
construe this provision, courts have determined that "[j]ust as the debtor need not pay the postdefault accelerated debt, he need not pay the postdefault interest rate on the accelerated debt." The Ninth Circuit ventures further and, in a bold and recent departure, has ruled that this "deacceleration" provision also permits the nonaccelerated debtor to continue to pay interest at the predefault rate, regardless of a contractual provision entitling the creditor to a higher postdefault interest rate independent of the note's maturity. The court's decisions also declare that even interest accruing postdefault, but prebankruptcy, is disallowed at the higher rate. The propriety and wisdom of this approach will be explored in the materials that follow.

B. Judicial "Cure-all"

Pursuant to a plan of reorganization, the debtor may be afforded the opportunity to "cure" the effects of a given default. "Cure" is not defined in the Bankruptcy Code. However, in the context of passing upon the entitlement of Chapter 13 debtors to "cure defaults," the Second Circuit in In re Taddeo issued an oft-cited pronouncement with respect to the meaning of "cure" as that term is used throughout the Bankruptcy Code:

[T]he power to cure must comprehend the power to 'de-accelerate.' This follows from the concept of 'curing a default.' A default is an event in the debtor-creditor relationship which triggers certain consequences—here, acceleration. Curing a default commonly means taking care of the triggering event and returning to pre-default conditions. The consequences are thus nullified. This is the concept of 'cure' used throughout the Bankruptcy Code.

Later, the court concluded that "'curing a default' in Chapter 11

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130. In re Southeast Co., 81 Bankr. 587, 591 (Bankr. 9th Cir. 1987), aff'd, 868 F.2d 355 (9th Cir. 1989). See generally Cohen, Marwil & Gerard, supra note 8, at 425 (stating that "[t]he impact of this section [1124(2)] is to moot entirely the claim for a default rate of interest on the accelerated balance.").

131. In re Southeast Co., 868 F.2d 335 (9th Cir. 1989); In re Entz-White Lumber & Supply, 850 F.2d 1338 (9th Cir. 1988).

132. Southeast, 868 F.2d at 339; Entz-White, 850 F.2d at 1342.


134. See generally Epling, Contractual Cure in Bankruptcy, 61 AM. BANKR. L.J. 71, 72-73 (1987) (noting that Bankruptcy Code's cure provisions "are vague and general, leaving to the courts the discretion to impose equitable cure on a case-by-case basis.").

135. 685 F.2d 24, 29 (2d Cir. 1982).

136. Id. at 26-27.
means the same thing as it does in Chapters 7 or 13: the event of
default is remedied and the consequences are nullified,137 notwith-
standing any state laws to the contrary.138

In Chapter 11, a plan of reorganization may be confirmed de-
spite the dissent of a given class of creditors, as long as that class is left “unimpaired” pursuant to section 1124.139 Section 1124(2)140

137. Id. at 29.
138. See In re Blackwelder Furniture Co., 31 Bankr. 878, 880 (Bankr. W.D.N.C. 1983) (deciding whether “the bundle of rights possessed or retained by the unimpaired creditor include[s] such rights as he possessed prior to the commencement of the case or only such rights as he possessed at the instant of filing or immediately after the filing of the petition, as such rights had been limited by the operation of § 552(a) and other sections of the Code.”) The court concluded that the creditor’s “original position” referred to his prepetition position, and not the position he might have occupied after the intervention of the “temporary crisis” of
bankruptcy. Id. at 881.
139. 11 U.S.C. § 1126(f) (1988). Section 1124 is the Chapter 11 provision on impair-
ment. A plan of reorganization must specify the classes of claims that are not impaired by the plan. 11 U.S.C. § 1123(a)(2) (1988). As a general matter, the plan may be confirmed without the consent of those classes deemed unimpaired. 11 U.S.C. § 1129(a)(8)(B) (1988). By con-
trast, confirmation of the plan depends on its acceptance by the impaired classes of creditors,
unless the court sanctions the plan notwithstanding rejection by an impaired group. Id. This
alternative method of plan confirmation is commonly denoted the “cram-down” because it
empowers the court to confirm a plan over the objection of an impaired class of creditors.
On satisfying a number of stringent prerequisites, “the plan may be crammed down nonassenting
classes as long as there is at least one assenting class.” B. WEINTRAUB & A. RESNICK, supra
note 87, § 8.23 [1], at 8-102. For a discussion of the history and impact of bankruptcy’s cram-
down powers see Broude, Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement

Pursuant to section 1124(2), deceleration accompanied by cure does not impair the sec-
cured creditor’s rights. Thus, the plan may be confirmed over that creditor’s objections. In In
re Taddeo, 685 F.2d 24 (2d Cir. 1982), the Second Circuit explained: “Having defined impair-
ment in the broadest possible terms, Congress carved out a small exception to impairment in
§ 1124(2) providing that curing a default, even though it inevitably changes a contractual
acceleration clause, does not thereby ‘impair’ a creditor’s claim.” Id. at 28-29. See generally In
re Madison Hotel Assocs., 749 F.2d 410, 418 (7th Cir. 1984) (allowing confirmation of
reorganization plan which cured default despite creditor’s dissent); H. REP. No. 595, 95th
Cong., 2d Sess. 1, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963; Comment,
Impairment, 3 BANKR. DEV. J. 579 (1986) (authored by Joseph M. Gaynor, Jr.).
140. 11 U.S.C. § 1124 (1988). This section provides in pertinent part:

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 pay-
ment of such claim or interest after the occurrence of a default -
(A) cures any such default, other than a default of a kind specified in
section 365(b)(2) of this title, that occurred before or after the com-
mencement of the case under this title;
(B) reinstates the maturity of such claim or interest as such maturity
provides that notwithstanding the given creditor's contractual entitlement to accelerate the debt as a consequence of default, the reorganization plan may restore the original maturity date and obligations.\textsuperscript{141} The creditor will be deemed "unimpaired," provided that the debtor "cures" any default that existed before the commencement of the bankruptcy case.\textsuperscript{142} The deacceleration principle is intended to vindicate the notion that "the advent of the bankruptcy process is not a proper occasion for the assertion of greater (or different) rights than existed against the debtor, under applicable nonbankruptcy law, the moment before bankruptcy."\textsuperscript{143} As the Supreme Court asserted in \textit{Butner v. United States},\textsuperscript{144} one should not reap a windfall "merely by reason of the happenstance of bankruptcy."\textsuperscript{145}

When confronted with section 1124(2), secured creditors who had bargained for higher postdefault interest rates have argued that, as a condition of cure, the debtor must pay interest at the postdefault rate.\textsuperscript{146} Additionally, creditors have asserted that the statute's curative measure pertains only to obligations that had been accelerated as a consequence of default, and not to loans that had matured "naturally."\textsuperscript{147} The Ninth Circuit has rejected both of these contentions.\textsuperscript{148}

In \textit{In re Southeast Co.},\textsuperscript{149} the debtor and creditor entered into a mortgage that permitted, in the event of default, an increased interest rate that would apply independent of any acceleration of the debt.\textsuperscript{150} After default and the filing of a petition for reorganization,
the Ninth Circuit upheld the denial of the higher postdefault rate of interest to the oversecured creditor.\textsuperscript{181} The court ruled that the cure of default can include the avoidance of a default interest rate that is activated even without an acceleration.\textsuperscript{182}

The creditor argued that because the debtor's duty to pay the postdefault interest rate was not a consequence of acceleration, that duty could not be eliminated by a section 1124(2) cure. The court responded:

[T]he consequences of default for purposes of cure are not limited to acceleration. Section 1124(2) of the Bankruptcy Code 'authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest.' Plans to cure defaults under section 1124(2) are not limited to those defaults resulting in acceleration. Nor are such plans limited to nullifying only the acceleration component of a default.\textsuperscript{183}

Thus, in the court's view, reinstatement of the original maturity date under section 1124(2) also permits the debtor to continue to pay interest at the predefault rate, notwithstanding the creditor's contention that it had bargained for a higher postdefault interest rate, independent of the note's maturity. The creditor would not be deemed impaired,\textsuperscript{184} "so long as the reorganization plan returned the creditor to its original position." As the legislative history of section 1124 states:

The intervention of bankruptcy and the defaults represent a temporary crisis which the plan of reorganization is intended to clear away. 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.\textsuperscript{186}

Since this creditor had been restored to its initial position, the court reasoned, it could not complain of the denial of its claim for interest

\textsuperscript{151} Id. at 337.
\textsuperscript{152} Id; see In re Taddeo, 685 F.2d 24 (2d Cir. 1982). In this regard, Taddeo offers some support for the court's ruling. There, in the context of ruling that the Chapter 13 entitlement to cure is coterminous with the Chapter 11 allowance, the Second Circuit seemed to endorse the contention that section 1124(2) "explicitly gave corporate debtors the power to cure defaults without regard to acceleration." Id. at 28.
\textsuperscript{153} Southeast, 868 F.2d at 338 (citation omitted).
\textsuperscript{154} See supra note 139 and accompanying text.
\textsuperscript{155} Southeast, 868 F.2d at 338.
\textsuperscript{156} Id. (citing S. REP. NO. 989, 95th Cong., 2d Sess. 120, \textit{reprinted in} 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5906).
at the postdefault rate.

The Ninth Circuit’s determination seems motivated in large measure by concerns for the underlying aims of reorganization and, most particularly, the facilitation of successful debtor rehabilitation. Section 1124’s curative provision is properly construed as:

provid[ing] the debtor in distress with the statutory tools necessary to effect a total healing of the scars of contractual default, by placing the parties into the same position they were in immediately before the default occurred. This healing is accomplished by paying the creditor whatever monies he would have received under the contract, had the debtor not defaulted.\textsuperscript{187}

Significantly, the \textit{Southeast Co.} court also rejected the creditor’s contentions that its right to have the default rate applied to accrued postpetition interest is an allowed oversecured claim under section 506(b) and that its right to have the enhanced rate applied to accrued prepetition interest is an allowed claim under section 502(b).\textsuperscript{158} The former contention is governed by another, even bolder, Ninth Circuit ruling, \textit{In re Entz-White Lumber & Supply, Inc.}, where the court applied section 1124(2) to deny an oversecured creditor its entitlement to a postdefault higher interest rate even though the note’s maturity had never accelerated.\textsuperscript{159} In \textit{Entz-White}, the court ruled that section 1124 may be applied retroactively to cure a default arising from a matured prepetition obligation, thereby nullifying all consequences of default, including a postmaturity default rate.\textsuperscript{160}

In determining prepetition interest, the court in \textit{Southeast Co.} held that Bankruptcy Code section 502(b) provides no express mechanism for awarding prepetition interest at the postdefault rate provided for in the security contract.\textsuperscript{161} \textit{Entz-White} would apply by analogy, insofar as there had been a cure under section 1124(2). “To allow prepetition interest at the postdefault rate would eliminate the benefits of cure in this [context],” by precluding nullification of an important result of default.\textsuperscript{162}

In \textit{Entz-White}, the debtor defaulted on a promissory note of ap-
proximately three million dollars owed to the creditor bank. The parties' agreement stipulated that, in the event of default, the governing interest rate would increase to a minimum of eighteen percent per year. The debtor did not pay the outstanding obligation when due and, shortly thereafter, filed a Chapter 11 petition. In accordance with the court-confirmed plan of reorganization, the debtor was entitled to cure the default owed the creditor by paying it the full amount of its principal claim, together with accrued interest at the nondefault rate. The Ninth Circuit affirmed the bankruptcy court's denial of the creditor's claim for default interest, ruling that the curative benefits of section 1124(2) extended beyond those defaults resulting in acceleration. Thus, notwithstanding the fact that the note had matured "naturally," the debtor could cure this default, thereby nullifying all of the default's adverse consequences, including the higher interest rate. By construing section 1124(2) so as to permit a debtor to avoid the payment of default interest on a matured obligation, the Ninth Circuit redefined the bounds of creditor as well as debtor entitlements.

III. IMPLICATIONS FOR CONTINUED VIABILITY OF REORGANIZATION

The Entz-White rationale, as reaffirmed in Southeast Co., surely reveals the extent to which courts will endeavor to defeat default interest when confronted with the paradigmatic debtor and creditor. Moreover, these pronouncements transcend their respective facts. For instance, within the scope of the rulings, demand obligations as well should not be entitled to a default rate of interest so long as the debtor can fully repay the debt in cash at confirmation. At least theoretically, the decisions transform (and not merely postpone) lienholders' contractual rights once bankruptcy is

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163. Entz-White, 850 F.2d at 1339.
164. Id.
165. Id.
166. Id.
167. Id. at 1342. Since the debtor was repaying the creditor's claim in full, it has been posited that the court should have framed the relevant statutory issue as whether section 1124(3) permits awards of default interest. Klausner, Pachulski & Godshall, Chapter 11 - The Bank of Last Resort, 45 Bus. Law. 261, 268 (1989).
168. Entz-White, 850 F.2d at 1342.
169. See supra notes 19-27 and accompanying text (discussing congressional debtor-creditor models sustaining reorganization's debtor-protective policies).
170. Cohen, Marwil & Gerard, supra note 8, at 426.
declared. Hence, for the debtor and general creditors, bankruptcy becomes perhaps a more attractive means of dealing with secured creditors’ claims, an implication which will be explored.

It may be posited that these recent decisions, by defeating the intended impact of default interest clauses, thwart creditors’ expectations. Secured creditors, as such, may collateralize with the expectation, grounded possibly in a host of private property and contract rights,\(^{171}\) that their bargained-for entitlements will, for the most part, be upheld in bankruptcy.\(^{172}\) This contention is less than convincing, however, insofar as doubts about the legitimacy of any averred expectations persist.

At a minimum, secured parties’ reliance interests may not be so firmly rooted as their adherents would assert. As a general matter, bankruptcy law has never treated secured creditors well.\(^{173}\) Ever since Article 9 was promulgated, commentators have predicted the abridgement or displacement of various secured lender entitlements in favor of the debtor’s rights in bankruptcy.\(^{174}\) Indeed, the whole of bankruptcy legislation has been evolving toward greater restrictions

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171. As discussed, the property rights rationale as a basis for affording secured creditors’ special treatment is by no means dispositive. State debtor-creditor law suggests that unsecured creditors also enjoy legally protected interests in the debtor’s assets, residing in the whole of the debtor’s qualifying property. See supra notes 40-43 and accompanying text.

172. See generally T. Jackson, The Logic and Limits of Bankruptcy Law, supra note 90, at 139 (stating that as a general matter, “bankruptcy law should respect the relative value of entitlements fixed before the transition to bankruptcy because the common pool problem is unrelated to the allocation of the original entitlements.”); Jackson, Translating Assets and Liabilities to the Bankruptcy Forum, 14 J. Legal Stud. 73 (1985) (arguing that Bankruptcy’s collectivization goal “can be achieved only if the nonbankruptcy attributes of assets and liabilities that affect ordering among claimants are precisely identified and translated, with minimal dislocations, into the bankruptcy forum.”).

173. See Schwartz, The Continuing Puzzle of Secured Debt, supra note 45, at 1069; see also Carlson, supra note 45, at 578 (claiming that “[b]ankruptcy trustees hate liens and would like to destroy them.”); Koch, Bankruptcy Planning for the Secured Lender, 1982 Banking L.J. 788, 816 (contending that bankruptcy is deemed “traumatic” for secured lenders).

on the secured creditor’s rights against the debtor.\textsuperscript{175} This readily discernible trend is of particular relevancy to postpetition interest, which bankruptcy law has long restricted.\textsuperscript{176}

The well-established judicial and statutory predisposition towards disallowing most claims for postpetition interest, coupled with the cumulative tendency towards curtailing secured creditors’ entitlements in bankruptcy, may render any propounded secured creditor reliance interests somewhat unpersuasive. Moreover, the state “property rights” rationale for affording secured creditors’ favored treatment in bankruptcy is by no means dispositive.\textsuperscript{177} State debtor-creditor law itself suggests that unsecured creditors also have legally cognizable property interests in the debtor’s assets.\textsuperscript{178} Further, pursuant to the bankruptcy power, Congress can and has curtailed state law property entitlements in the debtor-creditor setting, thereby impairing prospectively the rights of secured creditors.\textsuperscript{179}

At bottom, it may well be that postpetition penalty clauses are inserted with little expectation that they will enjoy the force of law. In any event, the contention that the instant rulings frustrate secured creditors’ expectations or secured financing’s aims may ultimately be unavailing if for no other reason than the sorry fact that many of the actual characteristics of security remain unknown.\textsuperscript{180}

Still, the court’s broad construction of section 1124 is somewhat in tension with the meaning typically ascribed to the statute. For instance, Collier\textsuperscript{181} posits that Congress, in enacting section 1124:

\begin{quote}
[Q]uite appropriately concluded that a person that receives the benefits of its original bargain is not impaired even if the plan modifies such person’s rights by preventing such person from using a contractual or legal right of acceleration to terminate a valuable contract of the debtor in circumstances where the debtor is willing to cure past defaults and perform under the original terms of the agreement.\textsuperscript{182}
\end{quote}

\textsuperscript{175} See Jackson, supra note 55, at 901 (positing that bankruptcy law has “consistently moved in the direction of refusing to recognize attempts by a state to elevate the claims of any one type of claimant in bankruptcy through the device of either a state-created priority or a statutory lien effective only in bankruptcy.”).

\textsuperscript{176} As noted, only oversecured creditors are allowed to claim such interest. See supra note 12 and accompanying text.

\textsuperscript{177} See supra notes 40-43 and accompanying text.

\textsuperscript{178} Id.

\textsuperscript{179} See Jackson, supra note 94, at 736 n.29.

\textsuperscript{180} See supra notes 54-56 and accompanying text.

\textsuperscript{181} 5 COLLINER ON BANKRUPTCY ¶ 1124.01 (L. King 15th ed. 1989).

\textsuperscript{182} Id. at ¶ 1124.03[2] (emphasis added).
The Ninth Circuit disregards the references to “accelerated payment” in the statute and in its legislative history.\textsuperscript{183}

While grounded in strained, if not inventive, statutory interpretation, it may be that \textit{Entz-White}, as bolstered by \textit{Southeast Co.}, simply carries the Bankruptcy Code’s cure principle to its logical end. When the consequences of default to be contended with pertain to the allowability of default penalties such as higher interest, it seems vital to the integrity of the reorganization process that the opportunity to cure be permitted, no matter that the given obligation had reached maturity absent actual acceleration. At a minimum, then, section 1124 should be construed so as to permit the debtor the opportunity to cure, independent of whether the default resulted in acceleration.\textsuperscript{184}

Moreover, as concerns the prototypical debtor and creditor,\textsuperscript{185} it may well be that the power to cure under the Bankruptcy Code should permit a plan to nullify all consequences of default, including postpetition interest. Certainly, in the traditional reorganizational setting, the Ninth Circuit’s interpretation facilitates several compelling policies. As the Supreme Court has acknowledged, “the payment of postpetition interest is arguably somewhat in tension with the desirability of paying all creditors as uniformly as practicable.”\textsuperscript{186} Enforcing default interest rates in bankruptcy, thereby permitting the oversecured creditor to reap more than its predefault rate of interest, is especially difficult to justify when there are few resources available to repay all creditors and reorganize the debtor.\textsuperscript{187} Significantly, the courts’ rulings should help to prevent the scope of secured creditor default penalty provisions from widening, thereby discouraging creditor windfalls to be reaped at the expense of the integrity of the reorganization process.

The Ninth Circuit’s pronouncements promote bankruptcy’s vital function in providing an arena for determining collective rights and

\textsuperscript{183} See, e.g., S. REP. No. 989, 95th Cong., 2d Sess. 120, \textit{reprinted in} 1978 U.S. CODE CONG. & ADMIN. NEWS 5789, 5906 (explaining section 1124: “a claim or interest is unimpaired by curing the effect of a default and reinstating the original terms of an obligation when maturity was brought on or accelerated by the default.”).

\textsuperscript{184} The relevant legislative history reveals that the Senate drafters of section 1124 were concerned with defaults resulting in acceleration. Id. However, the House Report ascribes a broader interpretation to the statute. See H. REP. No. 595, 95th Cong., 2d Sess. 408, \textit{reprinted in} 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6364 (noting that “[r]einstatement consists of curing any default.”).

\textsuperscript{185} See supra notes 19-27 and accompanying text.


\textsuperscript{187} Cohen, Marwil & Gerard, \textit{supra} note 8, at 427.
liabilities - a function that is justifiable because it affords "protection against the destructive effects of an individual remedies system when there are not enough assets to go around."

At bottom, "[a] fair and equitable reorganization, as provided in [chapter 11], is literally the last clear chance to conserve for [unsecured creditors and/or equity interests] values that corporate financial stress or insolvency have placed in jeopardy."

Ultimately, allowing default interest rate provisions could undermine resort to, as well as the overall effectiveness of, Chapter 11 proceedings. The importance and potential benefits of successful reorganization are manifest. In contrast to liquidation, reorganization presents an opportunity for the continued productive use of the debtor's business, to the benefit of potentially countless workers and the economy. The financially distressed enterprise should be encouraged to seek the asylum offered by Chapter 11 while recovery is possible, "rather than coasting to the point of no return." Creditors, in turn, realizing that foreclosure would be unavailing, might "rechannel energies toward more therapeutic ends."

Significantly, the debtor's incentives and abilities to rehabilitate could be destroyed if, in bankruptcy and beyond, creditors were permitted to fully exercise collection rights established before, as well as

188. T. Jackson, supra note 90, at 20.
190. See generally Mallory & Phelan, To Impair or Not to Impair - That is the Question in Chapter 11 Reorganization, 17 St. Mary's L.J. 869 (1986) (claiming that "[f]or a business debtor in the throes of financial difficulties, the most important statutory mechanism for rehabilitation is found in Chapter 11 of the Bankruptcy Code."). But see supra note 21 and accompanying text (noting recent challenges to the congressional vision of bankruptcy as the fundamental means toward debtor recovery).
191. See Blum, supra note 98, at 432 n.10; see also In re South Village, Inc., 25 Bankr. 987 (Bankr. D. Utah 1982) (perceiving aim of bankruptcy law as keeping businesses in operation); Anderson, Classification of Claims and Interests in Reorganization Cases Under the New Bankruptcy Code, 58 Am. Bankr. L.J. 99 (1984); Trost, Business Reorganizations Under Chapter 11 of the New Bankruptcy Code, 34 Bus. Law. 1310 (1979); Coogan, Broude & Glatt, Comments on Some Reorganization Provisions of the Pending Bankruptcy Bills, 30 Bus. Law. 1149 (1975); Note, supra note 86, at 315. As noted, there is some debate with respect to whether this theoretical characterization comports with the realities of today's bankruptcy reorganization proceedings. See supra note 21 and accompanying text.
192. See Schwartz, The Continuing Puzzle of Secured Debt, supra note 45, at 1069 (setting forth the view that "reorganizations are thought to be desirable largely because they save jobs and sometimes salvage something for small equity investors.").
194. Id.
independently of, bankruptcy. Moreover, enforcing secured creditors' entitlements to postdefault interest at increased rates would drain the pool of assets to the detriment of lower priority claimants, thereby dampening their incentives to participate supportively in the reorganization and its aftermath. By contrast, the Ninth Circuit's rulings tend to enhance the preferability of Chapter 11 proceedings for most creditors, who are apt to perceive the possibility of an increase in the obtainable bundle of assets.

IV. CONCLUSION

To the extent that the Ninth Circuit's determinations enhance resort to a governmentally-monitored system of redistribution while facilitating the equitable aims of that system, the decisions are justifiable. The potency of averred secured creditor reliance interests to effect a contrary result is diluted in part by concerns as to the authenticity of the creditors' expectations and, ultimately, by the absence of compelling empirical data as to the precise nature of those interests.

While sound in view of their respective facts, however, the cases' insistence that postpetition interest be denied as a matter of legislative imperative is neither plain from the statute nor appropriate in every setting. For instance, recent systems of debt encumbrance suggest that there may well be circumstances in which the given equities favor awards of postpetition interest to oversecured creditors. Resort to equitable balancing, then, in the attempt to discern what cure ought to mean in the given proceeding, should afford courts the flexibility necessary to accommodate emerging, untraditional contingencies while vindicating fundamental fairness.

195. See generally Rogers, supra note 41, at 1005 n.123 (contending that "[s]addled with debts, deprived of assets necessary for minimal comfort, and knowing that the fruits of his endeavors will be taken by creditors, the debtor may simply forgo productive activity, and economic society will lose a potentially productive member."),

196. As noted, the bankruptcy court is, of course, empowered in certain carefully delineated settings to confirm a given plan of reorganization over the objections of an impaired class of creditors. See supra note 139 and accompanying text.

197. See Jackson, supra note 55, at 864-65.

198. See supra notes 29-35 and accompanying text.