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Default Rates of Interest and Cure of a Defaulted Debt in a Chapter 11 Plan of Reorganization (Part I): *Entz-White*'s Overlooked Choice of Law Dimension

By Ralph Brubaker

The congeries of confusing Code provisions in Code §§ 365(b)(2)(D), 1124(2)(A), and 1123(d) produces an important and very difficult question: when a debtor's Chapter 11 plan of reorganization proposes to cure a defaulted promissory note and "de-accelerate" and reinstate the original repayment schedule pursuant to Code § 1124(2), what rate of interest must the debtor pay on the debt from the date of default through the date of cure—the contractual rate of interest, a market rate, or some other (e.g., formula) rate? And if the contract rate is to be used, is the appropriate contract rate the nondefault rate of interest or the higher default rate set by the parties' contract?

In the 1983 Ninth Circuit decision of *In re Entz-White Lumber and Supply, Inc.*,[1] the court held that the appropriate rate of interest for the cure payment is the nondefault contract rate of interest. In the subsequent Supreme Court decision of *Rake v. Wade*,[2] though, by holding that the interest necessary to cure defaults is governed by Code § 506(b), the Court decoupled cure interest from the contract rate of interest, given the *Ron Pair* interpretation of § 506(b).[3] But in 1994 Congress enacted Code § 1123(d) to overrule *Rake v. Wade* and mandate that cure amounts be determined in accordance with the parties' contractual agreement and applicable state law.

Last month, in the case of *In re New Investments, Inc.*,[4] the Ninth Circuit held that § 1123(d) has also legislatively overruled *Entz-White* and requires payment of cure interest at the default rate of interest contained in the parties' contract, and the Eleventh Circuit similarly construed the effect of § 1123(d) last year in a nonprecedential opinion in the case of *In re Sagamore Partners, Ltd.* [5] There was a vigorous dissenting opinion in *New Investments*, though. Moreover, both the *New Investments* and *Sagamore Partners* decisions wholly failed to address the implications of Code § 365(b)(2)(D), also enacted in 1994 and incorporated by reference into Code § 1124(2), and there are very credible indications that § 365(b)(2)(D) codified

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the *Entz-White* holding. Given the immense complexity (intensified by perplexing ambiguity) of the Code provisions at issue, as well as the large dollar amounts that can be at stake, we may not have heard the last of *Entz-White*.

This Part I will analyze those courts' decisions that the "plain meaning" of Code § 1123(d) repudiates the *Entz-White* conception of cure. Part II in next month's issue of *Bankruptcy Law Letter* will address the implications of the statutory provision those courts neglected to even mention, Code § 365(b)(2)(D), which not only further undermines the facile conclusion that the 1994 Code amendments legislatively overruled *Entz-White*, but also indicates that, in fact, the 1994 amendments *codified* *Entz-White*.

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Acceleration and Code § 1124(2) "De-acceleration"

Full understanding of the Bankruptcy Code's cure provisions requires some background knowledge of the common-law contract principles of which the Code's cure right is simply a modification and, in some senses, an extension.

A material breach of a contractual obligation not only entitles the other party to the contract to cease further performance, it also gives that injured party the right to sue immediately for a "total" breach: "[a] claim for damages . . . based on all of the injured party's remaining rights to performance."[6] The holder of a promissory note to be repaid in periodic installments, however, has no general right to sue for the entire unpaid balance of the debt upon default in the payment of an individual installment.

> There is an important exception to the general rule that a breach by nonperformance, if sufficiently serious, gives the injured party a claim for damages for total breach. If, at the time of the breach, the injured party has fully performed and the only remaining duty of performance of the party in breach is to pay money in independent installments, the failure to pay one or more installments does not amount to a total breach that will accelerate the time for payment of the balance of the debt. The injured party may maintain successive actions for partial breach as successive installments fall due.[7]

It is in response to this rule that installment notes nearly universally contain acceleration clauses "under which the remaining installments become due, either automatically or at the option of the injured party, on a breach as to one installment, so that such nonperformance gives rise to a claim for damages for total breach."[8]

In a Chapter 11 case, though, a debtor's plan can provide for cure of payment defaults and "de-acceleration" of a note pursuant to Code §§ 1123(a)(5)(G) and 1124(2). Code § 1123(a)(5)(G) provides a general authorization for the "curing or waiving of any default" under a plan of reorganization. Code § 1124(2) specifies the conditions under which a cure and reinstatement leaves a class unimpaired, with the consequence that the unimpaired class, "and each holder of a claim . . . of such class, are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required."[9] Section 1124(2) provides (in relevant part) as follows:

> [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 or of a kind that section 365(b)(2) expressly does not require to be cured;
>
> (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
>
> (E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

Because such a cure and "de-acceleration" under Code § 1124(2) does not impair the noteholder's claim, the debtor's plan can be confirmed even over the dissent of the noteholder, who is entitled to neither (1) the § 1129(b) "cram down" protections afforded only to "each class of claims or interests *that is impaired* under, and has not accepted, the plan," nor (2) the § 1129(a)(7) "best interests" protection reserved for "each *impaired* class of claims or interests."[10] Cure and reinstatement under Code § 1124(2), therefore, is a kind of super-cramdown that is even more powerful than a § 1129(b) cramdown (since impaired creditors crammed down under § 1129(b) are entitled to best-interests protection under § 1129(a)(7)).[11]

Such a cure and reinstatement is often an advantageous (from the debtor's perspective) means of dealing with certain secured claims (which typically are each a class unto themselves), particularly those of oversecured creditors and/or those for which the rate of interest necessary to cram down a plan over the secured creditor's dissent[12] greatly exceeds the nondefault contractual rate of interest set in the creditor's note. As the Seventh Circuit explained in an early seminal decision, the entire utility of the Chapter 11 cure and reinstatement provisions lies in "retention of advantageous contract terms," for example, by "allowing the Chapter 11 debtor to reinstate the original terms of an accelerated long-term loan at [a] lower interest rate."[13]

Cure: The Common Law of Contracts and Code § 1124(2)

Although the concept of cure of defaults is employed in various Code provisions, nowhere does the Code illuminate what "cure" of a default is.[14] Indeed, the popular myth of the incurable "historical fact" default[15] starkly demonstrates that "curing" a default is by no means an entirely self-evident self-defining concept. Cure, though, is a concept integral to the background common-law contract principles, against which Code § 1124(2) is a palliative.

Acceleration of a debt is a means by which an individual periodic payment default "gives rise to a claim for damages for total breach" of all remaining payment obligations.[16] Cure is a concept familiar to the common law of contracts and which occupies the space between a default and a consequent termination of the contract giving rise to a claim for damages for a total breach. "Courts . . . encourage the parties to keep the deal together by allowing the injured party to terminate the contract only after an appropriate length of time has passed,"[17] and "the purpose of requiring a period of time before termination is to give the party in breach an opportunity to cure."[18] "[T]he injured party has a claim for damages for total breach if, but only if," the "breach is not cured in time."[19]

Courts will typically give effect to contractual provisions explicitly limiting the time within which defaults can be cured (and thus forestall contract termination and total breach),[20] and, of course, this is from whence comes the general validity of a contractual acceleration of a debt post-default. Code

§ 1124(2), though, essentially extends the otherwise-available nonbankruptcy right to cure payment defaults *beyond* the date specified in the parties' contract (via the acceleration clause), permitting cure of all individual payment defaults predating confirmation of the debtor's plan of reorganization. This bankruptcy cure, then, has the same effect as would a nonbankruptcy cure of payment defaults; it prevents contract termination and the creditor's resulting claim for damages for total breach by undoing the pre-bankruptcy acceleration and "reinstat[ing] the maturity of such claim . . . as such maturity existed before such default."[21]

Payment of Interest as a Component of Cure of Payment Defaults

What, then, is necessary to "cure" pre-confirmation defaults? As a general matter, a "party in breach. . . can 'cure' the breach by correcting the deficiency in performance."[22] On "the question of what is required for cure" (i.e., correcting the deficiency in performance) "[f]or missed payments, the answer is easy—make up the payments."[23] When the default is a debtor's failure to make payments on a debt that is accruing interest, though, failure to repay principal amounts when agreed means that those principal amounts will continue to accrue interest until those principal amounts are actually repaid through a cure payment. Correcting the deficiency in performance, therefore, would seem to require payment of not only (1) the agreed (but missed) periodic amounts called for by the parties' agreement, but also payment of (2) additional accrued interest on the principal portion of that sum for the period that those funds remained delinquent.

Recognizing (a) that agreed periodic payments are often composed of both principal repayment and accrued interest on the entire unpaid principal balance and (b) that the principal amount of the debt will continue to accrue interest until repaid, an alternative way to describe that required cure amount when the debtor has stopped making payments would be payment of (1) the principal portion of all missed payments, plus (2) accrued interest on the entire unpaid principal balance of the debt to the date of cure. Under either formulation, though, interest seems to be an inescapable component of "cure" of defaulted payments on an interest-bearing debt.

The Interest Rate for Curing a Payment Default

If one takes such a "contractual" view of the "cure" required by Code § 1124(2), then the concept of "cure" of a defaulted payment on an interest-bearing debt seems to ineluctably include payment of interest at the rate specified in the parties' contractual agreement. But if the parties' agreement provides that the debt will bear interest at a higher rate after a default (which is common), then what rate is appropriate for calculating the required cure payment—the pre-default contract rate or the higher post-default contract rate?

Entz-White: The Pre-Default Contract Rate of Interest

In *Entz-White*, the most famous decision on this issue, the Ninth Circuit reasoned as follows:

> The Code does not define "cure." In *In re Tadeo*, 685 F.2d 24, 26-27 (2d Cir. 1982), the Second Circuit said, "A default is an event in the debtor-creditor relationship which triggers certain consequences. . . . 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.". . .
>
> * * * *
>
> And, by curing the default, [the debtor] is entitled to avoid all consequences of the default—including higher post-default interest rates. . . . It is clear that the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest.[24]

The Ninth Circuit, therefore, held that any cure payment need only include interest calculated at the nondefault contract rate of interest.

This conclusion, however, is far from clear. Even if one accepts the premise that the concept of "cure" implies nullifying all of the consequences of the cured default, all that necessarily follows is that *post-cure* the debt should accrue interest at the lower nondefault contract rate of interest (as if the now-cured default had never occurred).[25] However, nothing in the notion of "cure" as nullifying the consequences of default necessarily tells us the rate at which interest should accrue post-default and *pre-cure* (before the consequences of default have been nullified by the cure).

Arguably, when the parties' agreement contains a post-default interest rate, they have tacitly agreed[26] that, until all of the consequences of default are nullified (by payment in full or otherwise), the debt will accrue interest at the higher default rate—implying that the consequences of default can be nullified through "cure" of the default only if the cure amount is calculated at the higher default rate of interest. In other words, part and parcel of the "default" that must be cured is the debtor's failure to pay (as agreed) default-rate interest accruing until the date of cure. As one bankruptcy court put it:

> I agree that a cure must take care of the triggering event and that cure can nullify consequences. . . . One consequence of default may be, as here, an increase in the interest rate. But it seems to me that that consequence must be, under the notes, part of the cure.[27]

Nonetheless, *Entz-White*, as well as an earlier decision from Bankruptcy Judge Lifland,[28] represented the dominant early view that cure under Code § 1124(2)(A) only requires payment of interest at the nondefault contract rate, notwithstanding a higher default rate in the parties' agreement,[29] and the Ninth Circuit's subsequent decisions confirmed *Entz-White*'s conception of "cure" as *retroactively* nullifying the consequences of default as regards a post-default interest rate.[30] So while the concept of "cure" as nullifying all consequences of the default, in and of itself, cannot and does not tell us whether that cure is retroactive or prospective,[31] *Entz-White* clearly held that a bankruptcy "cure" is *retroactive*, at least as concerns the applicable contractual rate of interest.

The Supreme Court's subsequent *Rake v. Wade* decision conceptualized cure interest in an entirely different, non-contractual manner. The 1994 amendments to the Code overruled *Rake v. Wade* and mandated a "contractual" conception of the required cure amount, but the effect of that amendment on the issue of whether payment of post-default contract interest is part of the required cure payment is hardly definitive.

Rake v. Wade: Interest on Cure Amounts Is Governed by Code § 506(b)

Rake v. Wade involved a Chapter 13 debtor whose plan proposed cure and reinstatement of an oversecured home mortgage debt, as authorized by Code § 1322(b)(3) & (5). The Supreme Court's opinion conceptualized the cure payment required for reinstatement of the mortgage debt—i.e., the missed mortgage payments—as simply a subcomponent of the petition-date mortgage "debt" itself (within the meaning of Code § 101(12)), with a corresponding "claim" (under Code § 101(5)(A)) by the mortgage "creditor" (under Code § 101(10)(A)) to be repaid the missed payment amounts. The right to interest as part of the post-petition cure payment, therefore, according to Justice Thomas's opinion for the unanimous *Rake v. Wade* Court, should be determined by the Code's general provisions regarding post-petition interest on pre-petition claims. Since the mortgage creditor in that case was oversecured, then, that oversecured creditor was entitled to receive post-petition interest as part of the required cure payment under Code § 506(b).[32]

The theory of *Rake v. Wade* was a distinct departure from the contractual conception of cure interest (explored above) that is implicit in *both* the *Entz-White* reasoning *and* the reasoning that challenges *Entz-White* as *contrary* to the terms of the parties' contract. Indeed, the Court's prior *Ron Pair* decision had completely decoupled the entitlement to post-petition interest under § 506(b) from the parties' agreement regarding payment of interest.[33] The theory of *Rake v. Wade* was subject to several potential objections, but the one that led to its ultimate demise was the fact that it required payment of interest on interest, even when the note at issue did not provide for payment of such compound interest and, indeed, even if such compound interest would be prohibited by applicable nonbankruptcy state law.

To understand this interest-on-interest objection, recall that many periodic payments on installment obligations contain both (1) a repayment of some portion of the principal amount of the debt, and (2) all accrued interest on the entire unpaid principal balance. For example, consider an oversecured debt bearing 12% simple annual interest (1% per month) that requires monthly payments of $200 of principal plus all accrued interest since the last monthly payment. Debtor does not make the monthly payment owing when the principal balance of the debt is $10,000, which monthly payment is in the amount of $300, comprised of a $200 payment of principal plus $100 of accrued interest (1% of $10,000). Debtor files Chapter 11 on the date that the $300 monthly payment was due, and then proposes to cure and reinstate that defaulted oversecured installment debt under Debtor's Chapter 11 plan that has an effective date of one month after the petition date.

Assuming for the sake of simplification that the required § 506(b) post-petition interest rate is also 12% simple annual interest (1% per month), under the theory of *Rake v. Wade*, the effective-date payment required to cure the $300 missed payment would be the petition-date amount owing (the "debt"/"claim") for that missed payment ($300), *plus* one month of interest on that amount ($3), for a total cure payment of $303. If we were to honor the parties' agreement, though, that unpaid principal bears only simple (noncompounded) interest (i.e., no interest on interest), the required cure interest would be only one month's interest ($2) on the principal portion of the missed payment ($200), for a total cure payment of $302.[34] The *Rake v. Wade* cure payment is larger because it includes interest on the interest component of the missed payment.

Post-petition interest on interest is a hot-button issue in bankruptcy jurisprudence. Indeed, in the venerable case of *Vanston Bondholders Protective Committee v. Green*, the Supreme Court held that post-petition interest on interest could *not* be allowed to an oversecured creditor because "an allowance of interest on interest . . . would not be in accord with the equitable principles governing bankruptcy distributions."[35] In legislatively overruling *Rake v. Wade*, then, the House Report accompanying the 1994 amendments explained as follows:

> Section 305. Interest on Interest.
>
> This section will have the effect of overruling the decision of the Supreme Court in *Rake v. Wade*. In that case, the Court held that the Bankruptcy Code required that interest be paid on mortgage arrearages paid by debtors curing defaults on their mortgages. Notwithstanding State law, this case has had the effect of providing a windfall to secured creditors . . . . This had the effect of giving secured creditors interest on interest payments, and interest on late charges and other fees, even where applicable laws prohibit such interest and even when it was something not contemplated by either party in the original transaction.[36]

The 1994 Enactment of Code § 1123(d) and a Contractual Theory of Cure

In overruling *Rake v. Wade*, Congress simply repudiated its theory that cure interest is governed by Code § 506(b). Thus, the 1994 Code amendments enacted a new § 1123(d), applicable to loan agreements entered into after the effective date of the 1994 amendments (October 22, 1994), as follows:

> (d) Notwithstanding . . . 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.[37]

This amendment, therefore, mandates a "contractual" conception of the necessary cure amount, which means that cure interest must be computed at the contract rate. The *New Investments* majority was of the opinion that § 1123(d) also necessarily overrules *Entz-White* and requires cure interest to be computed at the contractual *default* rate:

> § 1123(d) renders void *Entz-White*'s rule that a debtor who proposes to cure a default may avoid a higher, post-default interest rate in a loan agreement. . . . The underlying agreement—here, the promissory note—requires the payment of a higher interest rate upon default. And "applicable nonbankruptcy law"—here, Washington state law—allows for a higher interest rate upon default when provided for in the loan agreement. . . .
>
> The plain language of § 1123(d) compels the holding that a debtor cannot nullify a preexisting obligation in a loan agreement to pay post-default interest solely by proposing a cure. . . .
>
> * * * *
>
> . . . [T]he debtor must cure the default but may

> not "otherwise alter the legal, equitable, or contractual rights" of the creditor, 11 U.S.C. § 1124(2)(E). Here, one of those rights is post-default interest, and New Investments's [sic] cure may not alter that right.
>
> Consistent with § 1124(2), the debtor can return to pre-default conditions, which can include a lower, pre-default interest rate, only by fulfilling the obligations of the underlying loan agreement and applicable state law. 11 U.S.C. § 1123(d). By its terms, § 1123(d) requires that we look to the "underlying agreement," not only to the "pre-default interest provisions" of the underlying agreement.[38]

§ 1123(d) Does Not Specify the Effects of Cure

The reasoning of the Eleventh Circuit panel in *Sagamore Partners* was identical to that of the *New Investments* majority, and the *Sagamore Partners* panel even went so far as to state that § 1123(d) "provide[s] the previously missing definition of 'cure.' "[39] That, however, attributes much more content to § 1123(d) than its "plain language" can carry.

At most, § 1123(d), by its terms, merely specifies a general methodology for determining the "*amount*" that must be paid to cure a *payment default*, and it mandates a "contractual" approach to that payment-amount issue consistent with the "contractual" conception of cure discussed above. Equally (if not more) significant to a complete understanding (i.e., definition) of cure, though, is determining the *effects* of a cure, and § 1123(d), by its terms, says *absolutely nothing* about the *effects* of a cure. Indeed, the *New Investments* majority acknowledged that "§ 1123(d) has *not altered or attempted to define*" the "concept of cure generally" as regards its effects of "put[ting] the debtor in the same position as if the default had never occurred" and "returning to pre-default conditions."[40]

For example, one of the effects of cure, provided for explicitly by § 1124(2)(B), is that cure of defaults permits the plan, in true cram-down fashion (i.e., over the creditor's objection via lack of "impairment" of the creditor's claim), to "reinstate[] the maturity of such claim . . . as such maturity existed before such [cured] default[s]." Nowhere, however, does the Code expressly state that cure of defaults permits the plan (without "impairment" of the creditor's claim) to "provide[] for future [post-cure] interest payments at the pre-default [interest] rate, rather than the post-default [interest] rate."[41] Nonetheless, courts (including the *New Investments* majority in the above-quoted passage) generally assume that such is indeed an effect of "cure" that will *not* "impair" the creditor's claim, by leaning upon the entirely non-statutory "definition" of "cure" set forth in *Entz-White* and that the drafters of the 1994 amendments also endorsed in the House Report explaining § 1123(d): "It is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred."[42]

The Parties' Contract and Applicable Nonbankruptcy Law Cannot Specify the Effects of a Bankruptcy Cure

Code § 1123(d), then, does not speak to the *effects* of cure. Indeed, because § 1123(d) adopts a "contractual" theory of cure, § 1123(d) *cannot* speak to the *effects* of cure, which are purely federal bankruptcy law effects that *contravene* "the underlying agreement" of the parties "and applicable nonbankruptcy law" referenced in § 1123(d).

For example, the § 1124(2)(B) "de-acceleration" of a defaulted note after a § 1124(2)(A) cure of defaults is manifestly in contravention of any prebankruptcy acceleration of the indebtedness provided for "in accordance with the underlying agreement," which acceleration is fully enforceable under "applicable nonbankruptcy law."[43] Moreover, the same is true of all other *effects* of a bankruptcy "cure" of defaults, such as reinstating the nondefault rate of interest for all *future*, *post-cure* debt payments: all such *effects* of a bankruptcy cure are *necessarily* a matter of federal bankruptcy law that simply *cannot* be determined by looking to "the underlying agreement and applicable nonbankruptcy law" referenced in § 1123(d). As the Tenth Circuit stated in construing the contours of a bankruptcy "cure" and the rights afforded thereby, "this issue is as much one of federal law . . . as is the determination that [a bankruptcy "cure"] gives the debtor the right to reverse contractual acceleration of a mortgage in default."[44]

Because the *effects* of a "cure," de-acceleration, and reinstatement in bankruptcy necessarily *con-*

travene the terms of the parties' agreement and otherwise applicable state law, we simply cannot (and thus should not even try to) derive those *effects* by looking to the parties' agreement and applicable state law.

The *Entz-White* Decision Was a Holding Regarding the Retroactive Effect of a Bankruptcy Cure

As discussed above, in mandating a contractual conception of required cure amounts, Code § 1123(d) overturned the *Rake v. Wade* non-contractual (§ 506(b)) theory of cure interest. *Entz-White*, though, is *not* inconsistent with a contractual conception of required cure amounts. Indeed, as discussed above, both *Entz-White* and cases rejecting *Entz-White* reason from a contractual theory of cure.

The issue to which *Entz-White* was directed was solely one of the *effects* of a bankruptcy cure in nullifying a particular consequence of default (the default rate of interest): *is the nullification of the default rate of interest prospective only or retroactive* (such that cure interest is also paid at the nondefault rate of interest specified in the parties' contract)? As with all other questions regarding the *effects* of a bankruptcy cure, *necessarily* that is purely a question of federal bankruptcy law that *cannot* be determined "in accordance with the underlying agreement and applicable nonbankruptcy law" referenced in § 1123(d).

This is what Judge Berzon was getting at in her dissent in *New Investments*. Code § 1123(d) tells us that cure interest must be computed at a contract rate of interest "in accordance with the underlying agreement" (as long as that interest rate is enforceable under "applicable nonbankruptcy law"), but it tells us nothing about whether the nondefault or default rate of interest is the appropriate contract rate[45] because § 1123(d) does not tell us whether cure is prospective or retroactive in nullifying the default rate of interest. Merely adopting a contractual theory of the required "cure" amount (as mandated in § 1123(d)), in and of itself, cannot and does not resolve the question of whether that cure is prospective or retroactive.

Indeed, there is *nothing* in the terms of the Code itself and (as discussed above) *nothing* in the general (non-statututory) concept of "cure" as nullifying the consequences of default that resolves the question of whether that nullifying of consequences is prospective or retroactive.[46] The *New Investments* majority simply *assumed* that a bankruptcy "cure" must operate purely *prospectively*. That is certainly a plausible construction and application of the concept of "cure" as nullifying the consequences of default, if the *New Investments* court were considering the matter as one of first impression, writing on a clean slate. The *New Investments* court, however, was *not* writing on a clean slate; *Entz-White* clearly held that a bankruptcy "cure" is *retroactive* as concerns the applicable contractual rate of interest.[47]

Judge Berzon, in dissent, thus was absolutely correct that the *New Investments* panel was bound by the existing Ninth Circuit precedent of *Entz-White* as regards the retroactive effect of "cure" in nullifying default rates of interest. "The majority's conclusion that § 1123(d) overruled *Entz-White* has no basis in the text of the statute,"[48] particularly given the majority's admission that "§ 1123(d) has *not* altered or attempted to define" the "concept of cure generally" in "returning [a loan] to pre-default conditions."[49]

The Washington Deed of Trust Statute Cannot Determine the Effects of a Bankruptcy Cure

Understanding that the *effects* of a bankruptcy "cure" of defaults can *only* be determined by federal bankruptcy law also helps us see why the *New Investments* majority's reliance on the Washington deed of trust statute was badly misguided. That state statue permits a debtor to halt a nonjudicial foreclosure sale by making a statutorily specified cure of payment defaults, and that statue seems to require that the interest component of the cure payment required to halt the foreclosure be computed using any contractual default rate of interest.[50] The effect of that state statute, however, is to halt a foreclosure sale (which is utterly immaterial for purposes of a bankruptcy "cure"), and that state statute obviously cannot determine the effects of a bankruptcy "cure" of defaults as retroactive or prospective.

For example, nothing in that Washington statute purports to nullify default rates of interest *at all*, either retroactively or prospectively.[51] Yet, the Ninth Circuit has squarely held[52] and the *New Investments* majority reaffirmed that a bankruptcy "cure" of defaults *does prospectively* "return[a loan] to pre-default conditions, which can include returning to a lower, pre-default interest rate."[53] That is because the *prospective* nullification of a default interest rate through a bankruptcy "cure" of defaults necessarily is a question of federal bankruptcy law that cannot be determined by the Washington deed of trust statute. Likewise, whether the nullification of default interest through a bankruptcy "cure" is *retroactive* is also exclusively a question of federal bankruptcy law that cannot be determined by the Washington deed of trust statute.

Entz-White, as a matter of the *federal bankruptcy law* effects of a § 1124(2)(A) "cure" of defaults, clearly held that such a cure is *retroactive* in nullifying a default rate of interest, and Washington state law cannot somehow "preempt" that decision. The *New Investments* majority's conclusion to the contrary turns the Supremacy Clause on its head.

Not only did the *New Investments* majority err in concluding that Code § 1123(d) legislatively overruled *Entz-White*, the majority opinion also wholly failed to address another provision in the 1994 amendments, enacted concurrently with § 1123(d), that may well have *codified* *Entz-White*. Part II of this article, in next month's *Bankruptcy Law Letter* will address the implications of Code § 365(b)(2)(D), which are incorporated by explicit statutory reference into (and thus govern the cure required by) § 1124(2)(A).

ENDNOTES:

[1]In re Entz-White Lumber and Supply, Inc., 850 F.2d 1338, 18 Bankr. Ct. Dec. (CRR) 83, Bankr. L. Rep. (CCH) P 72380, 98 A.L.R. Fed. 831 (9th Cir. 1988).

[2]Rake v. Wade, 508 U.S. 464, 113 S. Ct. 2187, 124 L. Ed. 2d 424, 24 Bankr. Ct. Dec. (CRR) 533, 28 Collier Bankr. Cas. 2d (MB) 983, Bankr. L. Rep. (CCH) P 75275 (1993).

[3]U.S. v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S. Ct. 1026, 103 L. Ed. 2d 290, 18 Bankr. Ct. Dec. (CRR) 1150, Bankr. L. Rep. (CCH) P 72575, 89-1 U.S. Tax Cas. (CCH) P 9179, 63 A.F.T.R.2d 89-652 (1989).

[4]In re New Investments, Inc, 840 F.3d 1137, 63 Bankr. Ct. Dec. (CRR) 97, Bankr. L. Rep. (CCH) P 83029 (9th Cir. 2016).

[5]In re Sagamore Partners, Ltd., 620 Fed. Appx. 864, 868-69 (11th Cir. 2015).

[6]Restatement (Second) of Contracts § 236(1) (1981).

[7]E. Allan Farnsworth, Contracts § 8.18, at 575 (4th ed. 2004) (footnotes omitted). See Restatement (Second) of Contracts § 243(3).

[8]Restatement (Second) of Contracts § 243 comment d.

[9]11 U.S.C.A. § 1126(f).

[10]11 U.S.C.A. § 1129(b)(1) & (a)(7).

[11]The repeated emphasis of the court in the *Moody National* case, therefore, to the effect that § 1124(2) is "merely definitional" and thus provides no "basis for the granting of substantive relief" is not only extremely curious, but more importantly, is simply incorrect. In re Moody Nat. SHS Houston H, LLC, 426 B.R. 667, 672, 52 Bankr. Ct. Dec. (CRR) 262 (Bankr. S.D. Tex. 2010). "A major purpose of reinstatement in Chapter 11 is for the [terms of loan] agreements to stand as an alternative to cram down rights under § 1129(b)." David Gray Carlson, Rake's Progress: Cure and Reinstatement of Secured Claims in Bankruptcy Reorganization, 13 Emory Bankr. Dev. J. 273, 286 (1997).

[12]Just what that rate is or should be is still subject to considerable uncertainty and debate. See generally Ralph Brubaker, Cramdown Interest Rates: Disarray Dominates Till . . . ?, 24 Bankr. L. Letter No. 8, at 1 (Aug. 2004); Anthony J. Casey, Bankruptcy's Endowment Effect, 33 Emory Bankr. Dev. J. 141 (2016); Bruce A. Markell, Fair Equivalents and Market Prices: Bankruptcy Cramdown Interest Rates, 33 Emory Bankr. Dev. J. 91 (2016); Bruce A. Markell, To Market, To Market: Momentive and Secured Creditor Cram Down Interest Rates, 36 Bankr. L. Letter No. 2, at 1 (Feb. 2016).

[13]Matter of Madison Hotel Associates, 749 F.2d 410, 419-20, 12 Bankr. Ct. Dec. (CRR) 616, 11 Collier Bankr. Cas. 2d (MB) 771 (7th Cir. 1984).

[14]"The Code does not define 'cure.' " Entz-White, 850 F.2d at 1340.

[15]See generally Ralph Brubaker, Cure of Nonmonetary Defaults as a Prerequisite to Assumption of Executory Contracts and Unexpired Leases: A Lesson in the Nature and Function of the Cure Requirement, 24 Bankr. L. Letter No.12, at 1, 7-8 (Dec. 2004); Ward Benson, Nonmonetary "Historical" Defaults Should Not Always Prevent Assumption of Executory Contracts: State Contract Law as the Standard for the Cure Requirement in § 365(b) of the Bankruptcy Code, 23 J. Bankr. L. & Prac.

No. 4, at 413 (Aug. 2014); Andrea Coles-Bjerre, Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy, 40 N.M. L. Rev. 77, 101 & n.101 (2010); David G. Epstein & Lisa Normand, "Real World" and "Academic" Questions About "Nonmonetary Obligations" Under the 2005 Version of 365(b), 13 Am. Bankr. Inst. L. Rev. 617, 623 & n.25 (2005).

[16]Restatement (Second) of Contracts § 243 comment d.

[17]Farnsworth, Contracts § 8.15, at 562.

[18]Farnsworth, Contracts § 8.18, at 572.

[19]Restatement (Second) of Contracts § 243 comment a.

[20]See Farnsworth, Contracts § 8.18, at 572-74.

[21]11 U.S.C.A. § 1124(2)(B). If the debtor had not defaulted on the debt pre-petition, the bankruptcy filing itself operates to accelerate the debt, by virtue of Code § 502(b)'s provisions (1) that the amount of a creditor's claim is to be allowed "as of the date of the filing of the petition" and (2) disallowing any "claim for unmatured interest." 11 U.S.C.A. § 502(b) & (b)(2). "Section 502(b) thus contains t[he] principle[]" that "bankruptcy operates as the acceleration of the principal amount of all claims against the debtor." S. Rep. No. 95-989, at 63 (1978); H.R. Rep. No. 95-595, at 353 (1977).

In such a case, if there were also no defaults on the debt post-petition, that debt could be reinstated without impairment thereof, under Code § 1124(1), if the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim." More likely in such a case, though, is the scenario under which post-petition payments on that debt are not made during the pendency of the automatic stay, and thus, cure of those post-petition payment defaults would be necessary to reinstate the debt without impairment thereof, under Code § 1124(2).

[22]Farnsworth, Contracts § 8.17, at 569.

[23]In re Garcia, 276 B.R. 627, 639 (Bankr. D. Ariz. 2002).

[24]Entz-White, 850 F.2d at 1340, 1342.

[25]That is the holding of In re Southeast Co., 868 F.2d 335, 337-38, 18 Bankr. Ct. Dec. (CRR) 1519, 20 Collier Bankr. Cas. 2d (MB) 1348, Bankr. L. Rep. (CCH) P 72698 (9th Cir. 1989).

[26]The Southeast Co. case provides a rarer example where this agreement was explicit. The note in that case provided that acceleration (at the creditor's option upon default) was independent of and cumulative to default interest (triggered automatically upon default). The debtor could "cure" any payment default before (and thus prevent) acceleration, and "[p]ayment of any interest that had accrued at the default rate was required by the note's terms as a condition precedent to curing default." 868 F.2d at 336.

[27]In re Johnston, 2004 WL 3019472, at *7 (Bankr. N.D. Iowa 2004). See also Carlson, 13 Emory Bankr. Dev. J. at 333 (characterizing the *Entz-White* reasoning as "[p]retending the contract is not in default (when it is) and thereby invoking the predefault rate in violation of the contract"). Cf. In re Countrywood Inv. Group, Ltd., 117 B.R. 338 (Bankr. M.D. Tenn. 1990) (plan provided for interest at default rate as part of cure payment; court holds that payment of that cure amount reinstates pre-default contract rate of interest).

[28]In re Forest Hills Associates, 40 B.R. 410, 11 Bankr. Ct. Dec. (CRR) 1145, Bankr. L. Rep. (CCH) P 69876 (Bankr. S.D. N.Y. 1984).

[29]See also In re Udhus, 218 B.R. 513, 32 Bankr. Ct. Dec. (CRR) 376, 39 Collier Bankr. Cas. 2d (MB) 1139 (B.A.P. 9th Cir. 1998); In re Johnson, 184 B.R. 570, 27 Bankr. Ct. Dec. (CRR) 723, 34 Collier Bankr. Cas. 2d (MB) 72 (Bankr. D. Minn. 1995); In re PCH Associates, 122 B.R. 181 (Bankr. S.D. N.Y. 1990); In re Singer Island Hotel, Ltd., 95 B.R. 845, 20 Collier Bankr. Cas. 2d (MB) 436 (Bankr. S.D. Fla. 1989).

[30]See, e.g., In re Sylmar Plaza, L.P., 314 F.3d 1070, 40 Bankr. Ct. Dec. (CRR) 172, 49 Collier Bankr. Cas. 2d (MB) 1413, Bankr. L. Rep. (CCH) P 78768 (9th Cir. 2002).

[31]As Professor Carlson nicely illustrated, the logical exercise of reasoning from a purely counterfactual subjunctive ("what if") scenario is entirely indeterminate:

> Indeed, subjunctive work of this sort (reimagining the world "as if" the contract were never breached) [could even] 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 attorney's fees. If we unleash subjunctive imagination, there is no limit, save that which imagination chooses to impose upon itself, in reordering the contractual rights of the parties.

Carlson, 13 Emory Bankr. Dev. J. at 333-34.

[32]And since Code § 1322(b)(5) authorizes payment of cure amounts over "a reasonable time" post-confirmation, that secured creditor would also be entitled to received post-confirmation interest on the confirmation-date cure amount (including all post-petition interest that had accrued under § 506(b)) pursuant to Code § 1325(a)(5).

Unlike Chapter 13, Chapter 11 seems to contemplate immediate effective-date payment of cure amounts under § 1124(2), thus mooting any inquiry regarding post-confirmation interest. See Moody National, 426 B.R. at 671 & n.4; Carlson, 13 Emory Bankr. Dev. J. at 339-40.

[33]*Ron Pair* held that even a nonconsensual oversecured creditor, who thus has no agreement with the debtor regarding payment of interest on the debt, is entitled to post-petition interest under

Code § 506(b).

[34]Under either approach, the debtor would also make the regular monthly periodic payment due on the effective date of the plan in the amount set under the parties' original payment schedule (i.e., as if the $300 monthly payment had been made when due). If you want to check your math, that payment would be in the amount of $298.

[35]Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 163, 67 S. Ct. 237, 91 L. Ed. 162 (1946). As regards interest on interest, then, the *Rake v. Wade* holding was, therefore, precisely the opposite of the *Vanston* holding. *Vanston* assumed that interest on interest *was* to be paid under the terms of the parties' agreement and applicable state law, but nonetheless held that it could *not* be allowed to an oversecured creditor post-petition. *Rake* assumed that interest on arrearages (including interest on interest) was *not* permissible under the terms of the parties' agreement or applicable state law, but nonetheless held that such interest (including interest on interest) *must* be allowed to the oversecured creditor post-petition.

[36]H.R. Rep. No. 103-835, at 55 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3364 (citation omitted). See also 140 Cong. Rec. H10,770 (daily ed. Oct. 4, 1994) (same).

[37]Substantially identical provisions were also added to Chapters 12 and 13, in §§ 1222(d) and 1322(e), respectively.

[38]New Investments, 840 F.3d at 1140-42. Accord In re 1 Ashbury Court Partners, L.L.C., 2011 WL 4712010, at *4-5 (Bankr. D. Kan. 2011); Moody National, 426 B.R. at 672-73, 674-76; In re K & J Properties, Inc., 338 B.R. 450, 461, 44 Bankr. Ct. Dec. (CRR) 208 (Bankr. D. Colo. 2005); Johnston, 2004 WL 3019472, at *7.

[39]Sagamore Partners, 620 Fed. Appx. at 869.

[40]New Investments, 840 F.3d at 1141 (emphasis added).

[41]Southeast Co., 868 F.2d at 337.

[42]H.R. Rep. No. 103-835, at 55, reprinted in 1994 U.S.C.C.A.N. at 3364. Accord 140 Cong. Rec. H10,770 (daily ed. Oct. 4, 1994) (same).

[43]11 U.S.C.A. § 1123(d).

[44]In re Thompson, 894 F.2d 1227, 1230, 20 Bankr. Ct. Dec. (CRR) 213, 22 Collier Bankr. Cas. 2d (MB) 250, Bankr. L. Rep. (CCH) P 73225 (10th Cir. 1990).

[45]As Judge Berzon put it: "In short, the text of § 1123(d) makes clear that New Investments' cure will be based on the terms of the promissory note, but offers no guidance on which of the note's provisions governs here." New Investments, 840 F.3d at 1144 (Berzon, C.J., dissenting).

[46]Again, Judge Berzon was absolutely correct: "Neither § 1123(d) nor any other provision of the Bankruptcy Code explains *where* in the underlying agreement to look for the provisions that apply in the event of a cure." New Investments, 840 F.3d at 1144 (Berzon, C.J., dissenting).

[47]As Judge Berzon put it, "the text of § 1123(d) makes clear that New Investments' cure will be based on the terms of the promissory note, but offers no guidance on which of the note's provisions governs here. *Entz-White* provides that guidance," though. New Investments, 840 F.3d at 1144 (Berzon, C.J., dissenting).

[48]New Investments, 840 F.3d at 1144 (Berzon, C.J., dissenting).

[49]New Investments, 840 F.3d at 1141 (emphasis added).

[50]See Wash. Rev. Code Ann. § 61.24.090(1)(a).

[51]See Meyers Way Development Ltd. Partnership v. University Sav. Bank, 80 Wash. App. 655, 910 P.2d 1308, 1317 (Div. 1 1996) (nothing in the statute nullifies default interest provisions); Wash. Code Ann. § 61.24.090(3) (providing that upon cure of defaults, "the deed of trust shall be reinstated and the obligation shall remain as though no *acceleration* had taken place," *not* as though no *default* had taken place (emphasis added)).

[52]See Southeast Co., 868 F.2d at 337-38.

[53]New Investments, 840 F.3d at 1142.

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