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Default Rates of Interest and Cure of a Defaulted Debt in a Chapter 11 Plan of Reorganization (Part II): *Entz-White* and the "Penalty Rate" Amendments

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.

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interest contained in the parties' contract, and the Eleventh Circuit similarly construed the effect of § 1123(d) in a nonprecedential opinion in the case of *In re Sagamore Partners, Ltd.*[5] There was a vigorous dissenting opinion in *New Investments*, though.

Part I of this two-part article, in last month's issue of *Bankruptcy Law Letter*, analyzed those courts' decisions that the "plain meaning" of Code § 1123(d) repudiates the *Entz-White* conception of cure.

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Entz-White, though, was a decision regarding the *effects* of a § 1124(2)(A) "cure" of defaults (holding that such a "cure" is *retroactive* in nullifying a default interest rate), and the *effects* of a § 1124(2)(A) "cure" of defaults (as either retroactive or purely prospective) is exclusively an issue of *federal bankruptcy law* that simply *cannot* be determined by looking to "the underlying agreement" of the parties or "applicable nonbankruptcy law" referenced in Code § 1123(d). Indeed, the *New Investmtents* majority fully acknowledged that "§ 1123(d) has *not* altered or attempted to define" the "concept of cure generally" in "returning [a loan] to pre-default conditions, which can include a lower, pre-default interest rate."[6] Nothing in § 1123(d) even purports to tell us whether the nullification of default interest rates effected by "cure" is retroactive or prospective, so § 1123(d) by its terms did *not* (and could *not*) overrule the *Entz-White* holding that a "cure" is retroactive in that regard.

This Part II analyzes an even more curious (and potentially more significant) aspect of the *New Investments* decision. Not only was *New Investments* wrongly decided, it may also have absolutely *no* precedential force, even within the Ninth Circuit. That is because the *New Investments* opinion (both majority and dissent), like the *Sagamore Partners* panel, wholly failed to address another provision in the 1994 amendments, enacted concurrently with § 1123(d), that may well have <u>codified</u> *Entz-White*. This Part II analyzes the implications of Code § 365(b)(2)(D), which is incorporated by explicit statutory reference into (and thus governs the cure required by) § 1124(a)(2)(A).

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*.

The 1994 Enactment of Code § 365(b)(2)(D): Codification of *Entz-White*?

Note that the "cure" required by § 1124(2)(A) in order to "de-accelerate" and reinstate a debt under § 1124(2)(B) is cure of any "default that occurred before or after commencement of the case. . ., *other than a default of a kind specified in section 365(b)(2)*." Code § 365(b)(2) was originally enacted as part of the Code's general invalidation of *ipso facto* default provisions, providing that the cure, compensation, and adequate assurance requisites to assumption of a defaulted executory contract are not required with respect to *ipso facto* defaults.

Of course, default rates and other default fees and charges present similar *ipso facto* concerns.[7] Enforcement of such provisions, triggered by an effective proxy for or predictor of a bankruptcy filing (a default), would enable individual creditors to improve their position in bankruptcy relative to other creditors or to "extort" a windfall distribution from the debtor's going-concern surplus that a

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Chapter 11 proceeding preserves. Thus, Code § 365(b)(2) was subsequently amended in 1994 to add a new sub-subsection 365(b)(2)(D), which itself was amended in the 2005 BAPCPA amendments (adding the italicized language below) to read as follows:

> (2) Paragraph (1) of this subsection [default cure, compensation, and adequate assurance of future performance] does not apply to a default that is a breach of a provision relating to—
>
> * * * *
>
> (D) the satisfaction of any penalty rate or *penalty* provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

The 2005 amendments to § 365(b)(2) (along with a parallel amendment to § 365(b)(1)(A)) was primarily directed at resolving ambiguity regarding the necessity of curing nonmonetary defaults.[8] The pre-2005 version of § 365(b)(2)(D), though, contained another interpretive ambiguity, relevant to the default-interest inquiry at hand,[9] that the 2005 amendment also seems to have clarified: Is the debtor excused from all penalty rates or only those relating to nonmonetary defaults? That interpretive uncertainty is raised by the difficult disjunctive "or" in § 365(b)(2)(D), which can plausibly be read two alternative ways:

> (1) "satisfaction of any [(i)] penalty rate [relating to a default arising from any failure by the debtor to perform nonmonetary obligations] or [(ii)] penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations"; or
>
> (2) "satisfaction of any [(i)] penalty rate or [(ii)] penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations."

Dialing this into the required "cure" under § 1124(2)(A) for "de-acceleration" and reinstatement of a defaulted note under § 1124(2)(B), interpretation (1) excuses a debtor from paying (as part of its cure) only those penalty interest rates triggered by a nonmonetary default, while interpretation (2) excuses a debtor from paying (as part of its cure) all penalty interest rates. Moreover, as applied to the default interest-rate issue, interpretation (2) excusing a debtor from paying (as part of its cure) any penalty interest rate can be seen as simply a codification of the Ninth Circuit holding in *Entz-White*, which reasoned 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."[10] Indeed, Ken Klee made precisely that point in a law review article published shortly after the 1994 amendments.[11] And there are several indications that that is, indeed, the appropriate interpretation of § 365(b)(2)(D).

Interpretive Canons

Canons of statutory construction, in particular series-qualifier canons, suggest that interpretation (2) above, excusing satisfaction of all penalty rates, is the meaning of § 365(b)(2)(D). The general rule regarding a series qualifier, such as the "relating to . . ." clause in § 365(b)(2)(D), is that "[w]hen there is a straightforward, parallel construction that involves all nouns or verbs in a series, a prepositive or postpositive modifier normally applies to the entire series."[12] That general series-qualifier canon, therefore, would point to interpretation (1), excusing from cure only those penalty rates triggered by a nonmonetary default.

There is an exception, however, to the general series-qualifier canon; when a determiner (such as the word "penalty" in § 365(b)(2)(D)) is "repeated before the second element" in the series ("penalty provision" in the § 365(b)(2)(D) series), this "syntax would suggest no carryover modification" to other terms in the series ("penalty rate" in § 365(b)(2)(D)).[13] "With postpositive modifiers, the insertion of a determiner before the second item tends to cut off the modifying phrase so that its backward reach is limited."[14] This particular series-qualifier canon, then, seems to speak directly to the 2005 amendment inserting and repeating the "penalty" determiner before the word "provision" and suggests that the meaning of § 365(b)(2)(D) is that of interpretation (2) above, excusing cure of any and all "penalty rates." Thus, even if interpretation (1) was a reasonable construction of the effect of § 365(b)(2)(D) on a § 1124(2) "cure" before 2005,[15] the 2005 amendment indicates that interpretation (2), excusing satisfaction of any and all "penalty rates," is the meaning of § 365(b)(2)(D).

Legislative History and Statutory Affirmation of the Claremont Acquisition *Decision*

Interpretation (2), excusing satisfaction of any and all "penalty rates," is also supported by the legislative history surrounding the original 1994 enactment of § 365(b)(2)(D), which suggests that codification of *Entz-White* is precisely what Congress intended with the original version of § 365(b)(2)(D), and thus, the 2005 amendment simply clarified that intention. Both the House Report accompanying the originally proposed § 365(b)(2)(D),[16] as well as floor statements accompanying House passage of the legislation ultimately enacted,[17] described the new § 365(b)(2)(D) as providing that cures can be effected "at a nondefault rate (i.e., [the debtor] would not need to pay penalty rates)."[18]

The Ninth Circuit itself, in its *Claremont Acquisition* decision, clearly indicated that this was indeed the meaning of § 365(b)(2)(D) as originally enacted:

> Congress intended subsection (D) to address a single issue: the payment of penalties. . . . The first clause addresses penalty rates which are commonly imposed where a debtor's breach was monetary in nature. The second clause addresses the payment of penalties under liquidated damages provisions where the debtor's breach was nonmonetary in nature.[19]

Inserting and repeating the word "penalty" before the second clause in 2005 leaves little doubt that this is now the meaning of § 365(b)(2)(D); the 2005 amendment to § 365(b)(2)(D) "expressly adopt[s] the Ninth Circuit's *Claremont* decision," as regards its interpretation of § 365(b)(2)(D).[20] And, of course, part-and-parcel of the 2005 affirmation of the *Claremont Acquisition* interpretation of § 365(b)(2)(D) is a more emphatic codification of *Entz-White*: "The first clause [of § 365(b)(2)(D)] addresses penalty rates which are commonly imposed where a debtor's breach was monetary in nature"[21] and excuses "the satisfaction of any [such] penalty rate."[22]

§ 365(b)(2)(D)'s Specific Directive Negating Penalty Rates Trumps § 1123(d)'s General Directive Regarding Contractual Cure Amounts

The leading decision interpreting the effect of *both* of the 1994 "cure" amendments—*both* § 1123(d) *and* § 365(b)(2)(D)—as regards their effect on the continuing validity of *Entz-White* is Bankruptcy Judge Case's opinion in *In re Phoenix Business Park Ltd. Partnership*, holding that the 1994 amendments did *not* overrule and indeed codified *Entz-White*.[23] Judge Case's analysis of the implications of § 365(b)(2)(D), based upon the *Claremont Acquisition* interpretation of § 365(b)(2)(D), is even more compelling now that the 2005 amendment to § 365(b)(2)(D) has explicitly affirmed the *Claremont Acquisition* interpretation of § 365(b)(2)(D).

Both the Ninth Circuit in *New Investments* and the Eleventh Circuit in *Sagamore Partners* reached a contrary conclusion by completely ignoring the implications of § 365(b)(2)(D) and focusing exclusively upon the supposed "plain language" of § 1123(d). As demonstrated in Part I of this article, though, by its terms § 1123(d) says absolutely *nothing* about the *Entz-White* default interest-rate issue. Code § 365(b)(2)(D), therefore, is the *only* statutory provision that explicitly addresses the *Entz-White* default interest issue.

Even if there were a conflict between § 1123(d) and § 365(b)(2)(D) as regards default interest, though,[24] Judge Case rightly pointed out that § 1123(d)'s failure to specifically trump §§ 365(b)(2)(D) and 1124(2)(A), in its introductory "notwithstanding" clause, means that those provisions (which are more specific with respect to the default rate issue[25]) trump any contrary implications in § 1123(d) as regards payment of default interest in curing defaults. If Congress's "intent was to overrule, rather than codify, the *Entz-White* line of cases," then "one would expect the limiting preliminary language of section 1123(d) to include reference to one or both of" sections 365(b)(2)(D) and 1124(2)(A), but "[n]o such reference exists."[26]

> The foregoing analysis compels the conclusion that Congress did not legislatively overrule *Entz-White* [through Code § 1123(d)], that *Entz-White* remains good law [pursuant to Code § 365(b)(2)(D)] and that, therefore, a debtor need pay interest only at the contract rate, and not the default rate, . . . in order to effectuate a cure under section 1124(2).[27]

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Evisceration of the § 1124(2)(A) Cross-Reference to § 365(b)(2)

One court resisted the implications of § 365(b)(2)(D) by simply refusing to apply § 365(b)(2)(D) to a § 1124(2)(A) "cure" of defaults. In the case of *In re Moody National SHS Houston H, LLC*, the court reasoned as follows:

> Although it is true that § 1124(2)(A) references defaults "of a kind" described in § 365(b)(2), the defaults described in § 365(b)(2) are defaults under leases or executory contracts. A mortgage note is neither a lease nor an executory contract.
>
> It would stretch the language of § 1124(2)(A) far beyond its plain meaning to believe that it refers to any default rate of interest on any type of agreement. . . .
>
> This Court declines to apply the § 365(b)(2) exception that is contained in § 1124(2)(A) to determine whether the holder of a claim secured by a garden variety real estate mortgage is unimpaired.[28]

If accepted, though, this reasoning would render § 1124(2) a nullity. The *only* kinds of debts for which § 1124(2) has any utility at all are debts that are *not* associated with executory contracts and unexpired leases subject to § 365. A debtor does not need § 1124(2) to reinstate a defaulted executory contract or unexpired lease via a plan of reorganization. Code § 365 assumption, in and of itself, authorizes cure and reinstatement of such a defaulted executory contract or unexpired lease, and § 1123(b)(2) expressly provides that "a plan may, subject to section 365 . . ., provide for the assumption . . . of any executory contract or unexpired lease of the debtor." The entire purpose and function of § 1124(2), therefore, is to permit a debtor's plan "to cure and reinstate certain *executed* contracts—loan agreements—in reorganization cases."[29]

Hence, the "of a kind" reference in § 1124(2)(A), if it is to have any meaning at all, must be referring to the particular kind of *contract provisions* set forth in the referenced subsection, § 365(b)(2), rather than the kinds of contracts and leases governed by § 365 generally. Indeed, the language of that cross-reference refers only and specifically to a "*default* of a kind specified in section 365(b)(2)," i.e., an *ipso facto* default.

If § 1124(2)(A) were only excusing cure of *ipso facto* defaults in executory contracts and unexpired leases subject to § 365—since § 1124(2) *only* has utility for debts *not* associated with an executory contract or unexpired lease subject to § 365—then § 1124(2)(A) would *never* excuse cure of *ipso facto* defaults. I.e., a debtor could cure, "de-acclerate," and reinstate a defaulted debt under § 1124(2) *only* by also curing *all* ipso facto defaults, such as financial condition defaults or even a bankruptcy filing default. This, of course, would make it impossible to ever cure, "de-accelerate," and reinstate (through a Chapter 11 plan in a *bankruptcy* case) a defaulted debt contract that contains a bankruptcy default clause. Given that debt contracts invariably *do* contain such a bankruptcy default clause (and inevitably *would* if *Moody National* were good law), the *Moody National* interpretation of the "of a kind" reference in § 1124(2)(A) would render § 1124(2) a dead letter. Consequently, it is hard to accept the *Moody National* interpretation as even a plausible (much less "plain") meaning of the statutory text at issue.[30]

Strictly Construing the Effects of a Bankruptcy "Cure"

The bankruptcy court and district court (affirming) in the case of *In re 139-141 Owners Corp.*[31] refused to follow *Entz-White* via an entirely different chain of logic—one that implicitly and properly recognizes that *Entz-White* is a decision about the federal law *effects* of a § 1124(2)(A) "cure" of defaults. Reasoning from that premise, those courts challenged the notion that a § 1124(2)(A) "cure" has any effects other than the one explicitly specified in § 1124(2)(B)—"de-acceleration" of a defaulted debt. As the bankruptcy court in *139-141 Owners Corp.* reasoned:

> Subsection (2) of Section 1124 is concerned only with a secured creditor's contractual right "to demand or receive accelerated payment . . . after the occurrence of a default." Subsection (2) does no more than permit a debtor to avoid the consequences of an accelerated payment provision if the plan meets all four of the conditions specified in the subdivisions of Subsection (2):
>
> (A) the plan must "cure" any default that occurred before or after commencement of the case;
> (B) the plan must "reinstate[ ] the maturity of such claim" as it existed before the default;

> (C) the plan must compensate the creditor for any damages incurred; and
> (D) the plan must not "otherwise alter the legal, equitable, or contractual rights to which" the creditor is contractually entitled.
>
> Nothing in the statute provides expressly or by implication that a debtor has the power to avoid or vitiate a secured creditor's contractual right to default interest by complying with the four subdivisions of Subsection (2). Subsection (2) on its face is concerned only with a contract provision requiring "accelerated payment" upon a default, and the statute permits the debtor to de-accelerate and reinstate the pre-default maturity of the loan only if the plan (D) "does not otherwise alter" the secured creditor's contractual rights.
>
> * * * *
>
> Denial of a mortgagee's contractual right to interest at a default rate undoubtedly does "alter" the secured creditor's contractual rights within the meaning of subsection (D) of Section 1124(2). Thus, Section 1124(2), dealing as it does solely with the concept of impairment in the context of an acceleration clause, does not provide a statutory basis for judicial nullification of a contract right to default rate interest.[32]

There are two major difficulties with this reasoning, though. First, and like the decisions in *New Investements* and *Sagamore Parnters*, it completely overlooks the implications of § 365(b)(2)(D), which explicitly limits the "cure" required by § 1124(2)(A). If § 365(b)(2)(D) codifies *Entz-White*'s retroactive nullification of default interest rates, then that *is* an additional effect of a § 1124(2)(A) "cure" expressly provided for by statute.

Second, and potentially even more significantly, the reasoning of *139-141 Owners Corp.* goes well beyond the *Entz-White* notion of *retroactive* nullification of default interest rates; it also denies that a § 1124(2)(A) "cure" can effect a *prospective*, *post-cure* nullification of default interest rates. Indeed, if § 365(b)(2)(D) codifies *Entz-White*'s retroactive nullification of default interest rates, then the *139-141 Owners Corp.* reasoning would *only* prevent nullification of default interest rates *prospectively* for future *post-cure* payments on the "de-accelerated" debt.

That result is the precise opposite of the *New Investments* holding (that "cure" *does* nullify default interest *prospectively*, but not retroactively), and it is at odds with the longstanding, conventional understanding of the effects of a bankruptcy "cure," which Congress also endorsed in the legislative history for both the original codification of § 1124(2)[33] and the 1994 cure amendments, "that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred."[34] If that is a proper conception of the effect of a bankruptcy "cure" of defaults (and nearly all courts assume that it is, at least prospectively), then the general reasoning of *139-141 Owners Corp.* must be rejected. And if § 365(b)(2)(D) codifies *Entz-White*, then the holding of *139-141 Owners Corp.* (which involved only a *retroactive* nullification of default interest) must also be rejected.

Distinguishing "Penalty" Rates From Compensatory Rates

Another means by which some courts have refused to follow *Entz-White*, even in the face of § 1124(2)(A)'s express incorporation of § 365(b)(2)(D), is by noting that § 365(b)(2)(D) only excuses "the satisfaction of any *penalty* rate," and these courts thus posit that not all *default* rates of interest should be considered "*penalty*" rates.[35] This interpretation of § 365(b)(2)(D), though, is also not free of difficulties. Moreover, properly applied, this interpretation will virtually *never* require payment of default interest.

Initially, it is not at all clear that the "penalty rate" language means anything other than a default rate; i.e., a default rate *is* a "penalty rate" within the meaning of § 365(b)(2)(D). Indeed, *both* the *Entz-White* opinion[36] *and* the legislative history explaining § 365(b)(2)(D)[37] (which was arguably enacted to codify *Entz-White*) expressly assume and state that *all* default rates are and should be considered "penalty" rates.

Moreover, if not all default rates should be considered "penalty" rates, then we need more elucidation of just what a "penalty" rate is, but the case law is unclear as to what is meant by a "penalty" rate. Some cases seem to assume that if a default rate is enforceable under applicable non-bankruptcy law, then it is *not* a "penalty" rate, and thus, § 365(b)(2)(D) does not excuse payment of default interest as part of a cure payment.[38] That,

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however, would make the § 365(b)(2)(D) nullification of a "penalty rate" entirely redundant with § 1123(d), which already expressly requires determination of cure amounts "in accordance with . . . applicable nonbankruptcy law." The surplusage canon, therefore, counsels against interpreting "penalty rate" to mean unenforceable under applicable nonbankuptcy law.[39]

If "penalty rate" means something other than all default rates, it is much more likely that § 365(b)(2)(D) is using the term "penalty" to connote the meaning that term carries under the common law of contracts,[40] where "penalty" refers to an unenforceable liquidated damages provision. Some states do not scrutinize default interest using the penalty/liquidated damages standard of general contract law, but rather provide that default interest is enforceable as long as it is not usurious (i.e., in excess of statutorily prescribed maximum interest rates).[41] This, then, would provide a rationale for imposition of an independent federal bankruptcy prohibition (in § 365(b)(2)(D)) against "penalty rates," that may well be enforceable under applicable nonbankruptcy law, but that nonetheless constitute a "penalty" under the common law understanding of that concept. Indeed, there is a strong tradition that the extent to which bankruptcy courts will allow interest charges "against debtors' estates being administered by them has long been decided by federal law" in accordance with "equitable principles governing bankruptcy distributions."[42] Code § 365(b)(2)(D), therefore, (as incorporated into a § 1124(2)(A) "cure" of defaults) may well simply codify just such an equitable limitation on default interest.

The common law meaning of an unenforceable "penalty" provision is one that "disregard[s] the principle of compensation" by requiring payment of an unreasonably large amount "in light of the anticipated or actual loss caused" by a default "and the difficulties of proof of loss."[43] The Code § 365(b)(2)(D) negation of "penalty" provisions, therefore, operates in tandem with the Code provisions (in both § 365(b)(1) and § 1124(2)) requiring that the debtor, as a condition of reinstatement, not only "cures" defaults but also "compensates" for damages caused thereby.[44] A default interest rate, therefore, should be struck down under § 365(b)(2)(D) (as incorporated into § 1124(2)(A)) as a "penalty rate" if it is not a reasonable approximation of loss caused by the debtor's default.

Thus, the bankruptcy court in the case of *In re Zamani* was on the right track when it held:

> [A]n interest rate providing more than appropriate compensation is a penalty against the debtor and should not be allowed. As a result, it is not enough for a creditor to show that the default rate of interest is within a generally accepted range of interest rates. Rather, the creditor must provide tangible proof of loss; "formulaic or hypothetical" statements are insufficient. If the creditor fails to satisfy this evidentiary burden, the court will only allow the basic contract rate of interest.[45]

Even this approach, though, is incomplete to the extent that it fails to specify what kinds of creditor losses are appropriately compensable. And in that regard, it is particularly noteworthy that the compensation requirement in conjunction with cure and reinstatement of a defaulted debt under Code § 1124(2) is markedly different (and much more limited) than the compensation requirement in conjunction with cure and reinstatement of an executory contract or unexpired lease under Code § 365(b)(1). The counter-party to an assumed executory contract or unexpired lease is entitled to compensation (under § 365(b)(1)(B)) "for any actual pecuniary loss to such party from such [cured] default," which seems to provide full expectation damages consistent with general principles of nonbankruptcy contract law.[46] For defaulted debt reinstated under Code § 1124(2), though, the only compensation required (under § 1124(2)(C)) is "for any damages incurred as a result of any reasonable *reliance* by [the creditor] on such contractual provision or applicable law," which is obviously referring to the "contractual provision or applicable law that entitles the [creditor] to demand or receive accelerated payment . . . after an event of default."[47]

The only losses a creditor is entitled to recover under § 1124(2)(C), therefore, are *reliance* damages incurred in accelerating the debt, which acceleration is being reversed and undone with the cure and reinstatement, as provided for in § 1124(2)(B). "The logic behind § 1124(2)(C) is to protect an accelerating creditor from out-of-pocket losses incurred when a debtor files bankruptcy and undoes the acceleration."[48] Thus, "[t]his section entitles the [creditor] to be compensated for damages incurred in reliance upon [an] acceleration clause and attendant efforts to enforce its rights as a result of such acceleration," "such as legal fees, foreclosure notice fees, court costs, and the like."[49]

Default interest rates do not provide (because they are not designed to provide) a reasonable approximation of such out-of-pocket reliance losses; indeed, compensation for such expenses typically is specifically provided for (separate and apart from, and in addition to, default interest) under most loan agreements. Instead, a commonly advanced justification for default interest is "that charging relatively high default rates of interest provides an incentive for borrowers not to default."[50] Such a provision, though, that produces "an *in terrorem* effect on the other party" in order to "deter breach by compelling performance," is a conspicuous "red flag" sign of a noncompensatory penalty.[51] As the *Zamani* court rightly recognized, then, "[d]efault rates that are meant to be an enforcement mechanism [that coerces performance] go beyond compensation and are unacceptable penalties."[52]

There are compensatory reasons for charging a higher interest rate upon default, as default may provide a creditor more and better information regarding the risk of nonpayment and relevant opportunity cost associated with the unpaid debt. Even if the default rate were a reasonable approximation of the increased risk and opportunity cost, though (which would be a case-by-case evidentiary issue), that is *not* the kind of *reliance* loss compensable under § 1124(2)(C) in connection with a debt reinstated under Code § 1124(2).[53] In the context of a § 1124(2) cure and reinstatement, therefore, it seems reasonable to conclude that default interest rate provisions should routinely (and even presumptively) be considered noncompensatory "penalty" rates that need not be paid as part of a § 1124(2)(A) "cure" of defaults.

The Precedential Force of *New Investments* (or Lack Thereof)

The most perplexing aspect of the *New Investments* decision is its exclusive (and, as explored in Part I, inapt) reliance upon Code § 1123(d), without any mention whatsoever of the implications of Code § 365(b)(2)(D), which explicitly limits the "cure" required by § 1124(2)(A). The most plausible explanation for the court's failure to address the implications of § 365(b)(2)(D) is that the parties did not address § 365(b)(2)(D) in their briefs, and of course, an appellate court has no obligation to address arguments not timely raised by the parties themselves.

The *New Investments* panel, though, was certainly aware of the argument that § 365(b)(2)(D) codifies *Entz-White*, because the court issued an order, in advance of oral argument, instructing counsel to "be prepared at oral argument to discuss the reasoning of the opinions in *In re Pheonix Business Park Ltd. Partnership* and *In re Moody National SHS Houston H, LLC*, particularly as they relate to the relationship between 11 U.S.C. §§ 1123(a)(5)(G), 1123(d), 1124(2)(A), and 365(b)(2)(D)."[54] Yet, in deciding the case, the panel obviously decided not to go beyond the issues and arguments briefed by the parties (which were limited to the effect of Code § 1123(d) upon the required cure payment), as was their prerogative.

The holding of *New Investments*, therefore, speaks *solely* to the implications of § 1123(d) and does *not* address the implications of § 365(b)(2)(D). *New Investments*, therefore, is of extremely limited precedential value, even within the Ninth Circuit. Nothing in *New Investments* prevents any party in any case other than the *New Investments* case itself from raising § 365(b)(2)(D) as excusing payment of default interest as part of a § 1124(2)(A) "cure" of defaults.

We may not have heard the last of *Entz-White*!

Reviving Bankruptcy Courts' Discretion: Cure Without Reinstatement?

The context in which courts seem most receptive to side-stepping *Entz-White* and § 365(b)(2)(D) is when the debtor's estate is solvent and, thus, the nullification of default interest as part of the cure of a defaulted debt inures to the benefit of the debtor's equity holders rather than unsecured creditors.[55] No such distinction (and corresponding

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flexibility), however, appears on the face of the statute itself, nor in the prevailing conception "that a cure pursuant to a plan . . . operate[s] to put the debtor in the same position as if the default had never occurred,"[56] whether or not the debtor's estate is insolvent.

If Code § 365(b)(2)(D) does, indeed, codify *Entz-White*, then it is equally protective of the interests of both unsecured creditors and debtor's equity holders. Indeed, many aspects of the Chapter 11 reorganization process inevitably operate to permit equity holders to preserve an equity interest that would be forfeited or much less valuable were the Chapter 11 process unavailable. The cure and reinstatement provisions of Code § 1124(2), therefore, seem to be yet another indication that "leveling the playing field for the debtor in negotiating a restructuring of secured debt *is* one of the principal functions of Chapter 11 reorganizations,"[57] wholly independent of any benefit for unsecured creditors.

Even if Code § 365(b)(2)(D) codifies *Entz-White*, though, bankruptcy courts nonetheless may be able to reclaim some of the flexibility that super-cramdown via a § 1124(2) cure seems to deny them. That is because another aspect of the *Entz-White* decision may give § 1124(2) cure an exceedingly broad sphere of operation.

Pursuant to Code § 1124(2), the provision for cure of defaults is the means to the further end of "de-accelerating" the defaulted debt ("notwithstanding any contractual provision or applicable law" permitting acceleration[58]), "reinstat[ing] the maturity of" the defaulted debt "as such maturity existed before such default,"[59] and otherwise "returning to [the] pre-default conditions" and terms governing the defaulted debt.[60] In *Entz-White*, though, the debtor did not seek to de-accelerate and reinstate pre-default terms and conditions of the defaulted debt. Indeed, the debtor could not de-accelerate the debt at issue because maturity had not been accelerated; rather, the entire debt had become due pursuant to its original terms.[61] Thus, the "cure" the debtor sought to effectuate in *Entz-White* was payment in full of the entire unpaid balance of the debt (*without* payment of post-default interest at the contractual default rate).

If "cure" can include payment in full of the entire debt, then there is no de-acceleration and reinstatement of the original terms and conditions governing the debt because there is no more debt once it is paid in full via "cure." If this is a permissible "cure" of a defaulted debt, then "cure" is an end unto itself rather than a means to reinstatement. The Ninth Circuit, in *Entz-White*, though, held that payment in full of a defaulted debt (without default interest) was a permissible "cure" of that defaulted debt that the debtor could impose on the creditor under § 1124(2)(A).[62]

That conception of "cure" of defaults as an end unto itself is, however, completely at odds with the common law of contracts, from which the Bankrputcy Code's cure provisions are obviously derived (as discussed in Part I). The purpose and function of "cure" of defaults, under the common law of contracts, is to prevent contract termination and the creditor's resulting claim for damages for total breach, i.e., *prevent* the creditor from demanding immediate payment in full of the entire balance of the debt. By holding that "cure" *includes* immediate payment in full of the entire balance of the debt, then, *Entz-White* turns "cure" upside down, emptying it of its reinstatement essence. Other courts, therefore, have disagreed with *Entz-White* and have held that payment in full of the entire balance owing on the debt is not a § 1124(2) "cure" of that debt because "cure require[s] some degree of reinstatement."[63]

Another compelling reason to conclude that immediate payment in full of the entire balance of a debt is not a permissible super-cramdown (via § 1124(2) "cure") is because cramdown via payment in full is fully accommodated by the conventional cramdown provisions of Code § 1129(b). Of course, with respect to cramdown of an oversecured debt (the kind of debt for which § 1124(2) is typically invoked), that payment-in-full cramdown must include post-petition interest under Code § 506(b). And § 506(b) does afford bankruptcy courts the discretion and flexibility to determine whether "the payment of default interest in solvent debtor cases, when considered with other equitable factors, makes the award of default interest appropriate."[64]

It is noteworthy that *New Investments* was also a solvent debtor case involving a "cure" effectuated via payment in full of the entire balance owing on an oversecured debt. In such cases (outside of the Ninth Circuit), creditors have an alternative (and seemingly sounder) means by which to seek payment of post-default interest at the contractual default rate—via § 506(b), on the theory that immediate effective-date payment in full of the entire debt is not a permissible "cure" under Code § 1124(2). Instead, effective-date payment-in-full cramdown must be effectuated under Code § 1129(b).

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]New Investments, 840 F.3d at 1140 (emphasis added).

[7]See David Gray Carlson, Rake's Progress: Cure and Reinstatement of Secured Claims in Bankruptcy Reorganization, 13 Emory Bankr. Dev. J. 273, 324-25 (1997); 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 (Dec. 2004); Charles J. Tabb & Ralph Brubaker, Teacher's Manual for Bankruptcy Law: Principles, Policies, and Practice 479 n.9, 484 (4th ed. 2015). See generally Ralph Brubaker, Option Agreements, the Bargained-For Exchange, and Unenforceable Ipso Facto Provisions, 21 Bankr. L. Letter No. 10, at 1, 1-2, 5 (Oct. 2001).

[8]See generally Brubaker, 24 Bankr. L. Letter No. 12; 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, 101-05 (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 (2005).

[9]See Brubaker, 24 Bankr. L. Letter No. 12, at 2-3.

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

[11]Kenneth N. Klee, Adjusting Chapter 11: Fine Tuning the Plan Process, 69 Am. Bankr. L.J. 551, 558 & n.38 (1995) (stating that "the congressional amendment appears to codify applicable Ninth Circuit precedent that construed the Code as not requiring a default or penalty rate to be paid when a plan reversed the acceleration and reinstated the terms of an obligation," citing *Entz-White*).

[12]Antonin Scalia & Bryan Garner, Reading Law: The Interpretation of Legal Texts 147 (2012).

[13]Scalia & Garner, Reading Law, at 148.

[14]Scalia & Garner, Reading Law, at 149.

[15]That was the pre-2005 interpretation proffered by Grant T. Stein & Ralph S. Wheatly, The Impact of Cure and Reinstatement on Default Interest, 16 Am. Bankr. Inst. J. 7, 8, 33 (Jul.-Aug. 1997).

[16]H.R. Rep. No. 103-835, at 17, 50 (1994).

[17]140 Cong. Rec. H10,758, H10,769 (daily ed. Oct. 4, 1994).

[18]H.R. Rep No. 103-835, at 50; 140 Cong. Rec. H10,769 (daily ed. Oct. 4, 1994).

[19]In re Claremont Acquisition Corp., 113 F.3d 1029, 1034 (9th Cir. 1997). The court also noted that the "legislative history of § 365(b)(2)(D) supports [this] construction of the section and suggests that Congress intended only to relieve debtors of the obligation to pay penalties." Id.

[20]In re 2712 Mission Partners, L.P., 52 Bankr. Ct. Dec. (CRR) 193, 2010 WL 431738, at *3 (Bankr. N.D. Cal. 2010).

[21]Claremont Acquisition, 113 F.3d at 1034

[22]11 U.S.C.A. § 365(b)(2)(D).

[23]In re Phoenix Business Park Ltd. Partnership, 257 B.R. 517, 37 Bankr. Ct. Dec. (CRR) 81 (Bankr. D. Ariz. 2001). Accord Brody v. Geared Equity, LLC, 2014 WL 4090549, at *3 (D. Ariz. 2014), appeal dismissed, (9th Cir. 14-16631) (Jan. 5, 2015); In re DSBC Investments, L.L.C., 2009 WL 2998940, at *2-3 (Bankr. D. Ariz. 2009); In re Zamani, 390 B.R. 680, 685-87, 60 Collier Bankr. Cas. 2d (MB) 117 (Bankr. N.D. Cal. 2008); In re Admiralty RV Resort, LLC, 2002 WL 1285504, at *1 (Bankr. C.D. Cal. 2002).

[24]Such an interpretation is disfavored, however, because "there can be no justification for needlessly

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rendering provisions in conflict if they can be interpreted harmoniously." Scalia & Garner, Reading Law, at 180 (discussing the harmonious-reading canon).

[25]See Scalia & Garner, Reading Law, at 183-89 (discussing the general/specific canon).

[26]Phoenix Business Park, 257 B.R. at 522.

[27]Phoenix Business Park, 257 B.R. at 522.

[28]Moody National, 426 B.R. at 673-74 (citations omitted).

[29]Carlson, 13 Emory Bankr. Dev. J. at 274.

[30]See Scalia & Garner, at 63 (discussing the interpretive "presumption against ineffectiveness," which "ensures that a text's manifest purpose is furthered, not hindered," and which "follows inevitably from the facts that (1) interpretation always depends on context, (2) context always includes evident purpose, and (3) evident purpose always includes effectiveness").

[31]In re 139-141 Owners Corp., 306 B.R. 763, 767-73, 42 Bankr. Ct. Dec. (CRR) 148, 52 Collier Bankr. Cas. 2d (MB) 705 (Bankr. S.D. N.Y. 2004), aff'd in relevant part, 313 B.R. 364, 368-69 (S.D.N.Y. 2004).

[32]139-141 Owners Corp., 306 B.R. at 768.

[33]The Senate Report explained § 1124(2) as follows:

> [A] claim . . . 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. 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 . . . 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. Curing of the default and the *assumption of the debt in accordance with its [original] terms* is an important reorganization technique for dealing with a particular class of claims, especially secured claims.

S. Rep. No. 95-989, at 120 (1978) (emphasis added).

[34]140 Cong. Rec. H10,770 (daily ed. Oct. 4, 1994); H.R. Rep. No. 103-835, at 55 (same).

[35]See, e.g., In re Sweet, 369 B.R. 644, 650, 48 Bankr. Ct. Dec. (CRR) 109, 57 Collier Bankr. Cas. 2d (MB) 155 (Bankr. D. Colo. 2007) ("This language is significant because it suggests that . . . if a default rate is not considered a penalty, default interest may nevertheless be appropriate to effectuate a § 1124(2)(A) cure."); Phoenix Business Park, 257 B.R. at 521 ("Thus, if a default interest rate is a 'penalty rate,' then it does not need to be paid as part of a section 1124(2) cure.").

[36]See Entz-White, 850 F.2d at 1342 ("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*" (emphasis added)).

[37]See 140 Cong. Rec. H10,769 (daily ed. Oct. 4, 1994) ("section 365(b) is clarified to provide that" a default "can be cured at a *nondefault rate* (i.e., [the debtor] would *not* need to pay *penalty rates*) (emphasis added)); H.R. Rep. No. 103-835, at 50 (same).

[38]See, e.g., Sweet, 369 B.R. at 650-51 & n.11.

[39]See Scalia & Garner, Reading Law, at 174-79 (discussing the surplusage canon).

[40]See Brubaker, 24 Bankr. L. Letter No. 12, at 7. See generally Scalia & Garner, Reading Law, at 320-21 (discussing the canon of imputed common-law meaning).

[41]See, e.g., Sweet, 369 B.R. at 650 n.11 (discussing Colorado law).

[42]Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 163, 67 S. Ct. 237, 91 L. Ed. 162 (1946).

[43]Restatement (Second) of Contracts § 356(1) & cmt. a, at 157 (1981) ("The central objective behind the system of contract remedies is compensatory, not punitive.").

[44]See 11 U.S.C.A, §§ 365(b)(1)(A) & (B), 1124(2)(A) & (C). The common law of contracts, similarly, distinguishes between "cure" of defaults and any other damages caused by the default. Cure of a contract breach is not the equivalent of never having breached at all. Thus, a breaching party's subsequent "cure does not wipe out its liability for its breach." E. Allan Farnsworth, Contracts § 8.17, at 589 (4th ed. 2004). "[A] party who has cured a material breach has still committed a breach . . . for which he is liable in damages." Restatement (Second) of Contracts § 242 cmt. a, at 244.

[45]In re Zamani, 390 B.R. 680, 688 (Bankr. N.D. Cal. 2008),

[46]The cure, compensation, and adequate assurance features codified in § 365(b)(1) were first introduced in the 1973 Commission's proposed bankruptcy bill, which indicated that those requirements were borrowed from nonbankruptcy contract law. See Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. I, § 4–602(b)(2) & note 11, at 153, 156-57 (1973). Thus, Code § 365(b)(1)(B) "simply codifies the nondebtor party's nonbankruptcy right to compensation" for breach damages. Brubaker, 24 Bankr. L. Letter No. 12, at 6.

[47]11 U.S.C.A. § 1124(2).

[48]Phoenix Business Park, 257 B.R. at 523.

[49]Phoenix Business Park, 257 B.R. at 522-23.

[50]In re K & J Properties, Inc., 338 B.R. 450, 457 n.6, 44 Bankr. Ct. Dec. (CRR) 208 (Bankr. D. Colo. 2005). See also In re Hassen Imports Partnership, 256 B.R. 916, 918, 45 Collier Bankr. Cas. 2d (MB) 679 (B.A.P. 9th Cir. 2000); Zamani, 390 B.R. at 688.

[51]Farnsworth, Contracts, § 12.18, at 811.

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[52]Zamani, 390 B.R. at 688.

[53]See In re Southeast Co., 81 B.R. 587, 591-92, 18 Collier Bankr. Cas. 2d (MB) 359 (B.A.P. 9th Cir. 1987), decision aff'd, 868 F.2d 335, 18 Bankr. Ct. Dec. (CRR) 1519, 20 Collier Bankr. Cas. 2d (MB) 1348, Bankr. L. Rep. (CCH) P 72698 (9th Cir. 1989); In re Hein, 60 B.R. 769 (Bankr. S.D. Cal. 1986); In re Kizzac Management Corp., 44 B.R. 496, 501, 11 Collier Bankr. Cas. 2d (MB) 1106, Bankr. L. Rep. (CCH) P 70149 (Bankr. S.D. N.Y. 1984); In re Manville Forest Products Corp., 43 B.R. 293, 11 Collier Bankr. Cas. 2d (MB) 735, Bankr. L. Rep. (CCH) P 70062 (Bankr. S.D. N.Y. 1984); 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); Matter of Rainbow Forest Apartments, 33 B.R. 576, 11 Bankr. Ct. Dec. (CRR) 149 (Bankr. N.D. Ga. 1983); In re Masnorth Corp., 28 B.R. 892, 10 Bankr. Ct. Dec. (CRR) 553 (Bankr. N.D. Ga. 1983).

[54]Order, In re New Investments, Inc., No. 13-36194 (9th Cir. Apr. 26, 2016), Docket Entry 33, Doc. ID 9953910 (case citations omitted).

[55]See, for example, Bankruptcy Judge Gropper's frank acknowledgment of the influence of that circumstance on courts' decisions in his *General Growth Properties* opinion. In re General Growth Properties, Inc., 451 B.R. 323, 328-29, 55 Bankr. Ct. Dec. (CRR) 6, 65 Collier Bankr. Cas. 2d (MB) 1351 (Bankr. S.D. N.Y. 2011).

[56]140 Cong. Rec. H10,770 (daily ed. Oct. 4, 1994); H.R. Rep. No. 103-835, at 55 (same).

[57]Ralph Brubaker, Artificial Impairment and the Single-Asset Real Estate Debtor, 33 Bankr. L. Letter No. 4, at 1, 8 (Apr. 2013) (noting that the means by which Chapter 11 does so is, "[i]f the secured creditor will not agree to a restructuring of the [secured] debt, then the debtor may be able to impose a restructuring on the secured creditor through Chapter 11, as long as that restructuring complies with the Code's cramdown provisions," such as the cure and reinstatement super-cramdown provision of § 1124(2)).

[58]11 U.S.C.A. § 1124(2).

[59]11 U.S.C.A. § 1124(2)(B).

[60]New Investments, 840 F.3d at 1141.

[61]"The note was due by its own terms on June 1, 1984. Entz-White did not pay the amount due, and filed a Chapter 11 bankruptcy petition on August 17, 1984." Entz-White, 850 F.2d at 1339.

[62]See Entz-White, 850 F.2d at 1341-42.

[63]Carlson, 13 Emory Bankr. Dev. J. at 347. See, e.g., In re Etienne Estates at Washington LLC, 2016 WL 1254739, at *10 (Bankr. E.D. N.Y. 2016), order corrected, 2016 WL 7377055 (Bankr. E.D. N.Y. 2016); In re General Growth Properties, Inc., 2011 WL 2974305, at *2 (Bankr. S.D. N.Y. 2011); In re Route One West Windsor Ltd. Partnership, 225 B.R. 76, 81-85, 40 Collier Bankr. Cas. 2d (MB) 1069 (Bankr. D. N.J. 1998); In re Liberty Warehouse Associates Ltd. Partnership, 220 B.R. 546, 54-50 (Bankr. S.D. N.Y. 1998); In re Ace-Texas, Inc., 217 B.R. 719, 726-27, 32 Bankr. Ct. Dec. (CRR) 459 (Bankr. D. Del. 1998); In re Chateaugay Corp., 150 B.R. 529, 542-43, 23 Bankr. Ct. Dec. (CRR) 1579, Bankr. L. Rep. (CCH) P 75121 (Bankr. S.D. N.Y. 1993), order aff'd, 170 B.R. 551, Bankr. L. Rep. (CCH) P 76087 (S.D. N.Y. 1994).

[64]In re Dow Corning Corp., 456 F.3d 668, 680, 46 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 80664, 2006 FED App. 0260P (6th Cir. 2006). See generally Christopher W. Frost, A Rare Glimpse at Priority Issues in a Solvent Estate: *In re Dow Corning*, 26 Bankr. L. Letter No.12, at 1 (Dec. 2006).

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