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An Oversecured Creditor's Right to Postpetition Interest on Mortgage Arrearages: The Interplay Between Bankruptcy Code Sections 506(b), 1322(b) and 1325(a)(5)(B)

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COMMENTS

AN OVERSECURED CREDITOR'S RIGHT TO POSTPETITION INTEREST ON MORTGAGE ARREARAGES: THE INTERPLAY BETWEEN BANKRUPTCY CODE SECTIONS 506(b), 1322(b) AND 1325(a)(5)(B)

Wade v. Hannon, 968 F.2d 1036 (10th Cir.), cert. granted sub nom.
Rake v. Wade, 113 S. Ct. 459 (1992)

In *Wade v. Hannon*,¹ the Tenth Circuit concluded that 11 U.S.C. § 506(b)² requires a Chapter 13 debtor³ who cures a default on the mortgage of his principal residence pursuant to 11 U.S.C. § 1322(b)⁴ to pay interest on prepetition arrearages to an oversecured creditor, even if the mortgage instrument is silent on the issue and state law would not mandate such payment.⁵

1. 968 F.2d 1036 (10th Cir.), cert. granted sub nom. *Rake v. Wade*, 113 S. Ct. 459 (1992).

2. Section 506(b) provides:

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

11 U.S.C. § 506(b) (1988). See *infra* notes 15-22 and accompanying text.

3. A Chapter 13 debtor is a person who files for bankruptcy under 11 U.S.C. §§ 1301-30 (1988). See also *infra* note 6.

4. Section 1322(b) provides in part:

[T]he plan may-

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

11 U.S.C. § 1322(b) (1988). See *infra* notes 26-30 and accompanying text.

5. 968 F.2d at 1042. This Case Comment only addresses whether an oversecured creditor is entitled to interest on arrearages when a Chapter 13 debtor cures a default on mortgage payments. This Comment does not address what the appropriate interest rate might be in the event that the court awards interest. For an overview of interest rate possibilities, see Cardinal Fed. Sav. & Loan Ass'n v. Colegrove (*In re Colegrove*), 771 F.2d 119, 123 (6th Cir. 1985); Thomas O. Depperschmidt, *Choosing the Proper Interest Rate in Bankruptcy Proceedings: Resolution of Special Issues in the Sixth, Eighth and Ninth Circuits*, 18 N. Ky. L. REV. 457 (1991).

In addition, the question whether a denial of interest on arrearages constitutes a "taking" in violation of the Fifth Amendment is beyond the scope of this Comment.

In this consolidated case, the debtors filed for bankruptcy protection under Chapter 13 of the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code" or "Code")⁶ in three separate actions.⁷ When they filed, the debtors had defaulted on oversecured mortgages on their principal residences.⁸ The Chapter 13 plans required the debtors to make all future monthly principal and interest payments in accordance with the respective loan documents and to cure the prepetition defaults by making monthly payments to compensate for the missed payments—the arrearages.⁹ Neither the mortgage agreements nor the Chapter 13 plans required the debtors to pay interest on the arrearages, costs, or attorneys' fees.¹⁰

In each case, the mortgagees brought suit seeking interest on the arrearages, attorneys' fees and costs created by the debtors' prepetition defaults.¹¹ The bankruptcy court denied the mortgagees' requests for interest in all three cases.¹² On appeal, the United States District Court for the Northern District of Oklahoma consolidated the cases and affirmed the bankruptcy court's findings.¹³ The Tenth Circuit reversed

6. Pub. L. No. 95-598, 92 Stat. 2549 (1978). In particular, Chapter 13 of the Code undertakes to solve problems which its predecessor caused by misunderstanding and erratic application. The underlying purpose of Chapter 13 is "to permit an individual to pay his debts and avoid bankruptcy by making periodic payments to a trustee under bankruptcy court protection, with the trustee fairly distributing the funds deposited to creditors until all debts have been paid." S. REP. NO. 989, 95th Cong., 2d Sess. 12 (1978).

7. 968 F.2d at 1037.

8. *Id.*

9. *Id.* The plans also required the debtors to reimburse the creditors for attorneys' fees and default penalties owed under the mortgage agreements. Each mortgage instrument also included a five dollar late-payment charge. *Id.*

10. *Id.* The mortgage agreements authorized 10% per annum interest on any amounts the mortgagees had to incur for insurance payments, taxes and assessments because of the mortgagors' defaults. The bankruptcy court awarded this interest to the creditors. The Tenth Circuit assumed that this action was not disputed because neither the district court nor the parties' briefs addressed the debtors' responsibility for this interest payment. *Id.* at 1037 n.4.

11. *Id.* at 1037. The mortgagees relied on 11 U.S.C. §§ 506(b) and 1325(a)(5)(B). *Id.* Section 1325(a)(5)(B) provides in pertinent part:

(a) The court shall confirm a plan if—

(5) with respect to each allowed secured claim provided for by the plan—

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim

11 U.S.C. § 1325(a)(5)(B) (1988). See *infra* notes 22-25 and accompanying text.

12. 968 F.2d at 1037.

13. *Id.* The district court held that 11 U.S.C. § 1322(b) prevents the application of 11 U.S.C. §§ 506(b) and 1325(a)(5) to these cases. *Id.* at 1037-38.

and remanded the case, holding that Chapter 13 debtors must pay postpetition interest pursuant to section 506(b) on arrearages and other charges because a cure is simply a statutory modification of an oversecured claim.¹⁴

In order to resolve the interest-on-arrearages issue, courts must consider the interplay between, and the interpretation of, three sections of the Bankruptcy Code. Section 506(b)¹⁵ grants an oversecured creditor the right to postpetition interest in addition to the repetition claim.¹⁶ The United States Supreme Court interpreted this Code section broadly in *United States v. Ron Pair Enterprises, Inc.*¹⁷ In *Ron Pair*, the Court held that section 506(b) grants an oversecured creditor the right to postpetition interest on both nonconsensual¹⁸ and consensual¹⁹ allowed claims.²⁰ Although the Court relied on the "plain meaning" of the statutory language to reach this conclusion,²¹ it specifically noted that neither other sections of the Bankruptcy Code nor the legislative history of section 506 compelled a different result.²²

Similar to section 506(b), 11 U.S.C. § 1325(a)(5)(B)²³ suggests that

14. 968 F.2d at 1040-42. For a more in-depth discussion of the court's reasoning, see *infra* notes 67-87 and accompanying text.

15. See *supra* note 2 for the text of § 506(b).

16. 11 U.S.C. § 103(a) dictates that § 506 applies to Chapter 13 proceedings. Section 103(a) provides: "Except as provided in section 1161 of this title, chapters 1, 3 and 5 of this title apply in a case under chapter 7, 11, 12 or 13. . . ." 11 U.S.C. § 103(a) (1988).

17. 489 U.S. 235 (1989).

18. "Nonconsensual" claims are "involuntary secured claims, such as a judicial or statutory lien which are fixed by operation of law and do not require the consent of the debtor." *Id.* at 240 (citations omitted).

19. "Consensual" claims are "voluntary . . . secured claims, each created by agreement between the debtor and the creditor and called a 'security interest by the Code . . .'" *Id.* (citation omitted).

20. *Id.* at 237. In *Ron Pair*, the United States filed a nonconsensual claim for unpaid withholding and Social Security taxes, penalties and interest. *Id.* Although *Wade*, unlike *Ron Pair*, involved a consensual claim, the *Ron Pair* Court erased any distinction between the two types of claims for the purposes of 11 U.S.C. § 506(b). *Id.* at 243. Moreover, *Ron Pair's* significance to the *Wade* issue lies in its liberal approach towards awarding interest payments.

21. *Id.* at 242.

22. *Id.* at 243. The legislative history offers no indication of whether postpetition interest is allowable. *Id.* at 243 n.6. "Neither the Committee Reports nor the statements by the managers of the legislation" make any mention of postpetition interest. H.R. REP. NO. 595, 95th Cong., 1st Sess. 356 (1977); S. REP. NO. 989, 95th Cong., 2d Sess. 68 (1978); 124 CONG. REC. 32398 (1978) (statement of Rep. Edwards); 124 CONG. REC. 33997 (1978) (statement of Sen. DeConcini). For an in-depth discussion of *Ron Pair*, see Kathryn R. Heidt, *Interest Under Section 506(b) of the Bankruptcy Code: The Right, the Rate and the Relationship to Bankruptcy Policy*, 1991 UTAH L. REV. 361.

23. See *supra* note 11 for text of § 1325(a)(5)(B).

postpetition interest is allowable. This Chapter 13 “cram down”²⁴ provision dictates that plans must protect secured creditors’ liens and pay the full present value of the claim during the life of the plan.²⁵ Numerous courts have concluded that this section requires payment of postpetition interest on secured claims to compensate the creditor for the reduction in the claim’s value over time.²⁶

The third provision of the Code that courts must consider is 11 U.S.C. § 1322(b).²⁷ This section bars a Chapter 13 debtor from “modifying” a claim secured only by an interest in the debtor’s principal residence,²⁸ but permits the debtor to “cure” a default on a long-term²⁹ debt such as a mortgage.³⁰ Generally, debate concerning interest on mortgage arrear-

24. Cram down is a “colloquial expression that describes court confirmation of a bankruptcy plan, notwithstanding creditor opposition.” BLACK’S LAW DICTIONARY 366 (6th ed. 1990).

25. According to the legislative history, Congress enacted 11 U.S.C. § 1325(a)(5)(B) to “protect the secured creditors of Chapter 13 debtors.” Cardinal Fed. Sav. & Loan Ass’n v. Colegrove (*In re Colegrove*), 771 F.2d 119 (5th Cir. 1985) (citing 124 CONG. REC. S17406 (daily ed. October 6, 1978) (statement of Sen. DeConcini), reprinted in 1978 U.S.C.C.A.N. 6505, 6550); 124 CONG. REC. H11089 (daily ed. September 28, 1978) (statement of Rep. Edwards), reprinted in 1978 U.S.C.C.A.N. 6436, 6481).

26. See, e.g., *Memphis Bank & Trust Co. v. Whitman*, 692 F.2d 427, 431 (6th Cir. 1982) (construing § 1325 to require payment of current interest rate on arrearages due under automobile loan agreement); *In re Cassell*, 119 B.R. 89, 93 (Bankr. W.D. Va. 1990) (holding that the market rate of interest is the proper figure for discounting the Chapter 13 debtor’s future payments to satisfy the present value test); *In re Miller*, 13 B.R. 111, 112-13 (Bankr. S.D. Ind. 1981) (relying on the legislative history of the Chapter 11 cramdown provision which emphasizes the “time value of money” as decisive on the issue).

27. See *supra* note 4 for text of § 1322(b).

28. 11 U.S.C. § 1322(b)(2) (1988).

29. Long-term denotes that the last payment is due beyond the life of the plan. 11 U.S.C. § 1322(b)(5) (1988).

30. *Id.* For the history of “cure,” see generally 5 WILLIAM M. COLLIER, COLLIER ON BANKRUPTCY ¶ 1322.09[2] (15th ed. 1986). Collier traces the history of bankruptcy cure provisions to the Bankruptcy Act of 1898, as amended by the Chandler Act in 1938, which created Chapter 13. Originally, plans could not provide for mortgage creditors because the definition of claims did not include claims secured by real property. To alleviate problems for debtors, courts granted injunctions against foreclosures on mortgages during the pendency of Chapter 13 cases where foreclosure would defeat the plan’s purpose. Under the Bankruptcy Rules of 1973, the injunction became automatic upon filing a petition. *Id.* In its proposal to Congress, the Commission on the Bankruptcy Laws of the United States codified this common-law practice of granting injunctions. Because the Commission placed claims secured by real property within its version Chapter 13, the Commission’s bill included specific provisions for cure. *Id.* In explaining the version of 11 U.S.C. § 1322(b) which Congress adopted, Representative Edwards stated:

Section 1322(b)(2) of the House amendment represents a compromise agreement between similar provisions in the House bill and Senate amendment. Under the House amendment, the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor’s principal residence. It is intended

age focuses on whether paying interest pursuant to either section 506 or section 1325 is an impermissible modification under section 1322(b)(2) or simply a statutory aspect of curing a default under section 1322(b)(5).³¹

Currently, the United States Courts of Appeals differ on the appropriate way to apply these Bankruptcy Code sections when determining whether a Chapter 13 debtor must pay postpetition interest on repetition mortgage arrearages.³² In 1985, the Sixth Circuit first discussed the issue in *Cardinal Federal Savings & Loan Association v. Colegrove* (*In re Colegrove*).³³ A divided panel awarded interest payments to the mortgagee.³⁴ First, the court concluded that interest on arrearages is not a "modifica-

that a claim secured by the debtor's principal residence may be treated under Section 1322(b)(5) of the House amendment.

Cardinal Fed. Sav. & Loan Ass'n v. Colegrove (*In re Colegrove*), 771 F.2d 119 (6th Cir. 1985) (citing 124 CONG. REC. H11089 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards), reprinted in 1978 U.S.C.C.A.N. 6436, 6481)). See also *Grubb v. Houston First Am. Sav. Ass'n*, 730 F.2d 236 (5th Cir. 1984) (outlining the legislative process behind the Bankruptcy Code in general and § 1322(b) in particular). But see *In re Hobaica*, 65 B.R. 693, 695 (Bankr. N.D.N.Y. 1986) (legislative history of 11 U.S.C. § 1322(b) is "extreme in its paucity"); *In re Neal*, 10 B.R. 535, 536 (Bankr. S.D. Ohio 1981) (legislative history is "sparse").

31. See *infra* notes 32-88 and accompanying text.

32. Lower courts are similarly divided on the issue. The majority of lower courts hold that a creditor is not entitled to interest. See BAXTER DUNAWAY, THE LAW OF DISTRESSED REAL ESTATE, PART E BANKRUPTCY LAW § 24A.22(f) (1992) (announcing that denial of interest is the majority rule). See, e.g., *In re Thompson*, 127 B.R. 717, 719 (Bankr. D. Conn. 1991) (agreeing with cases denying interest); *In re Murray*, 116 B.R. 307, 308 (Bankr. M.D. Ga. 1990) (interpreting a mortgage contract requiring debtors to pay "interest at the contract rate . . . of this Note on amount so declared due . . ." as not "specific enough" to entitle mortgagee to interest on arrearages); *In re Kooker*, 106 B.R. 233, 235-36 (Bankr. D. Nev. 1989) (proposing that specific and favorable treatment of home mortgage debt provided for by § 1322(b) means that a Chapter 13 plan cannot modify terms, including interest terms, except to cure); *In re Stamper*, 84 B.R. 519, 521 (Bankr. N.D. Ill. 1988) (concluding that § 1325 is inapplicable because a cure is not a modification). But see, e.g., *Resolution Trust Corp. v. Adams*, 142 B.R. 331, 333 (E.D. Mo. 1991) (holding that an interest payment awarded pursuant to § 1325(a)(5)(B) is incidental to cure and not an improper modification); *In re Parker*, 125 B.R. 479, 482-483 (Bankr. W.D. Tex. 1991) (allowing interest pursuant to § 1325(a)(5)(B)(ii) because, if it is not allowed, home mortgage creditors will not receive the same benefits as non-home mortgage creditors); *In re Hall*, 117 B.R. 425, 428 (Bankr. S.D. Ind. 1990) (holding that present value of § 1325(a)(5)(B)(ii) requirement is applicable even in the absence of modification of contractual rights pursuant to § 1322(b)(2)).

The circuit level cases discussed *infra* contained simple fact patterns which, for the most part, resemble the scenario in *Wade*. Basically, each case involved a debtor whose Chapter 13 plan cured repetition defaults on mortgage payments, but did not provide for interest on the arrearages.

33. 771 F.2d 119 (6th Cir. 1985). Aware of its ground-breaking role in clarifying bankruptcy law on this subject, the court expressly commented that it "found little direct precedent on a question which must arise with some frequency in the bankruptcy context." *Id.* at 120.

34. *Id.* at 122. At the time of this early decision, the majority of lower courts awarded interest on mortgage arrearages. *Id.* Allowing interest on arrearages is now the minority position. Furthermore, legal commentators upheld the decision as embodying sound rationale. See, e.g., Comment,

tion” of the loan agreement as prohibited by section 1322(b)(2), but rather a requirement which is “merely incident[al]” to a cure.³⁵ Second, because the court had held previously that an unsecured party would receive interest under section 1325(a),³⁶ it would be “anomalous” to deny this right to a creditor with a security interest in real property.³⁷ In a frequently cited dissent, Judge Celebrezze rejected the majority’s argument and proposed that the loan agreement must specifically provide for interest on arrearages in order for it to constitute part of a cure.³⁸ According to Judge Celebrezze, allowing interest on arrearages clearly modifies the contract in contravention of section 1322(b).³⁹ In addition, Judge Celebrezze argued that sections 506(b) and 1325(a)(5) should not apply to security interests in principal residences because such interests are unique and subject to a completely separate Code provision, section 1322(b)(2).⁴⁰

In *Foster Mortgage Corp. v. Terry* (In re *Terry*),⁴¹ the Eleventh Circuit reached a different conclusion, holding that a creditor with a security interest in the debtor’s principal residence may not collect interest on mortgage arrearages when a Chapter 13 debtor cures a default, unless the mortgage document explicitly provides for it.⁴² The *Terry* court based its decision exclusively on the relationship between sections 1322(b) and

Payment of Interest for Mortgage Arrears Under Chapter 13 Plan Consistent with Bankruptcy Code, 52 LEGAL BULL. 103, 105 (March 1986).

35. 771 F.2d at 122.

36. See *Hardy v. Cinco Fed. Credit Union* (In re *Hardy*), 755 F.2d 75 (6th Cir. 1985) (construing § 1325 as requiring interest on unsecured creditor’s claim).

37. 771 F.2d at 122.

38. *Id.* at 123.

39. *Id.* at 124. Judge Celebrezze noted that Congress could not have intended a mortgagee to profit from the debtor’s bankruptcy. Such a windfall might occur if the market interest rate and the contract interest rate differed. *Id.*

40. *Id.* at 124-125. In addition to quoting floor statements by Rep. Edwards and Sen. DeConcini as support for the premise that home mortgage claims warrant special treatment under the Code, see *supra* note 30 for text of Rep. Edwards’ statement. Judge Celebrezze cited many cases in which other courts asserted that Congress intended to regulate security interests in residences differently from ordinary claims. *Id.* at 125 (citing *Grubbs v. Houston First Am. Sav. Ass’n*, 730 F.2d 236, 245 (5th Cir. 1984) (stating that the primary purpose of § 1322(b)(5) is “to enable a debtor to preserve the equity in his home and to restore and maintain his currency on long-term debt”); *In re Simpkins*, 16 B.R. 956, 963 (Bankr. E.D. Tenn. 1982) (stating that the purpose of § 1322(b) is “to allow debtors to make regular payments on mortgages and to protect long-term lenders”); *United Cos. Fin. Corp. v. Brantley*, 6 B.R. 178, 189 (Bankr. N.D. Fla. 1980) (stating that the purpose of § 1322(b)(2) is “to provide stability in the long-term home financing industry”).

41. 780 F.2d 894 (11th Cir. 1986).

42. *Id.* at 895.

1325(a)(5); it did not consider section 506(b). The court concluded that the legislative history of section 1322(b) reveals a congressional intent for the section to form an exception to section 1325(a)(5)(B).⁴³ Moreover, the court held that section 1325(a)(5)(B), which governs creditors whose claims were modified,⁴⁴ does not apply to claims secured by interests in personal residences⁴⁵ because the Code prohibits modification of these claims.⁴⁶ In justifying its holding, the court placed significant weight on a lender's ability to secure interest on arrearages simply by providing for it in the loan agreement.⁴⁷

Following *Terry*, the Third Circuit, in *Appeal of Capps*,⁴⁸ similarly determined that the present value provision of section 1325(a)(5)(B) does not apply when a Chapter 13 debtor cures a mortgage default under section 1322(b). The court held that section 1325(a)(5) did not apply unless the plan modified the mortgage contract.⁴⁹ Moreover, a cure is not a modification, and because section 1322(b)(5) governs the curing of long-term debts, the mortgagee is not automatically entitled to interest on its arrearages.⁵⁰ Although a creditor suffers "incidental adverse effects"

43. *Id.* at 896-97. The court did not refer specifically to any legislative history. Moreover, another court, failing to perceive this legislative intent, noted that the Code nowhere implies that § 1322(b) is a "special exception" to 11 U.S.C. § 1325(a)(5)(B). *In re Small*, 65 B.R. 686, 692 (Bankr. E.D. Pa. 1986).

44. Section 1325, the cram down provision, "allows a debtor to modify the rights of secured creditors by reducing payments." 5 COLLIER ON BANKRUPTCY, *supra* note 30 ¶ 1322.09[4].

45. 11 U.S.C. § 1322(b)(2) (1988).

46. 780 F.2d at 897. The court's opinion regarding modification is inconsistent. First, the court held that "residential mortgages that would otherwise permit the lender to declare the entire debt presently due may be modified by the plan to cure the default and reinstate regular installment payments." *Id.* at 896. Next, the court concluded that mortgage claims are not subject to § 1325 because they cannot be modified. *Id.* at 897.

47. *Id.*

48. 836 F.2d 773 (3d Cir. 1987).

49. *Id.* at 776.

50. *Id.* at 775-77. In an extensive and persuasive analysis of this issue, the *Capps* court relied on multiple sources to reach its conclusion. First, it looked to its recent decision in *In re Roach*, 824 F.2d 1370 (3d Cir. 1987). In *Roach*, the court made several relevant findings in determining that Congress did not envision cure as a modification: (1) Congress placed the modification provision, § 1322(b)(2) separate from the cure provisions, §§ 1322(b)(3) and 1322(b)(5); (2) the Commission on the Bankruptcy Laws of the United States "distinguished the authorization to cure defaults on a home mortgage from the power to modify claimants' rights"; (3) the Senate and House highlighted differences between cure and modification in their debates; and (4) in Chapter 11 counterparts to Chapter 13, the Code differentiated between cure and modification. *Roach*, 824 F.2d at 1375-76.

Next, the *Capps* court cited the Collier treatise, which states in part:

The present value test compensates creditors whose rights have been modified by reductions in payments, interest charges or the total amount due; where a default is cured, however, the creditor's rights are not modified. Since the contract terms remain in force

when a debtor cures,⁵¹ these effects do not embody a complete modification of the agreement.⁵² Absent a contract provision to the contrary, the debtor need not pay interest on prepetition arrearages.⁵³

In *Landmark Financial Services v. Hall*,⁵⁴ the Fourth Circuit continued the trend denying oversecured creditors interest on mortgage arrearages.⁵⁵ Like its predecessors, the court initially distinguished cure pursuant to section 1322(b) from cram down pursuant to section 1325(a)(5).⁵⁶ While cram down assures the secured creditor the present value of his claim during the life of the plan, a cure reinstates the original pre-bankruptcy agreement.⁵⁷ Because cures do not modify creditors' rights, the present value requirement of section 1325 is irrelevant here.⁵⁸ The court acknowledged the Supreme Court's broad interpretation of section 506(b) in *Ron Pair*, but refused to apply it to the cure scenario and thus declined to allow an oversecured mortgagee to collect interest on arrearages.⁵⁹ The court concluded that a cure relies on non-bankruptcy law and agreements, which removes it from provisions such as sections 1325(a)(5) and 506(b), which purport to revalue claims over time pursuant to the Code.⁶⁰ However, the *Landmark* court did concede

(except for the injunction against foreclosure) the time value of money is irrelevant. The creditor receives his interest, charges and costs to which it is entitled under contract and applicable nonbankruptcy law.

Capps, 836 F.2d at 776 (quoting 5 COLLIER ON BANKRUPTCY, *supra* note 30 ¶ 1322.09[4]).

Finally, the *Capps* court surmised that, in essence, cure requires adherence to original contracts for its terms. 836 F.2d at 777. The court supported this premise with a discussion of the pre-Code procedure for cure which occurred outside of the bankruptcy proceedings. *Id.* at 777 n.9. *See supra* note 30.

51. 836 F.2d at 776. For example, the creditor loses his right to foreclose and collect on arrearages after expiration of the contract period for cure. Also, the prolonged period over which the debtor pays the arrearage burdens the creditor because he will not earn interest during this period. *Id.*

52. *Id.*

53. *Id.* at 777. Like the Eleventh Circuit, the Third Circuit did not consider the implications of § 506(b).

54. 918 F.2d 1150 (4th Cir. 1990).

55. *Id.* at 1152.

56. *Id.* at 1154.

57. *Id.*

58. *Id.* The court cited *Capps* as support for the principle that cramdown necessarily involves modification. *See supra* note 50 and accompanying text.

59. 918 F.2d at 1154. This was the first circuit court to address the issue after the Supreme Court's decision in *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235 (1989). *See supra* text accompanying notes 16-22.

60. 918 F.2d at 1154-55. A debtor may be responsible for additional charges when he cures a default. However, the debtor's liability for these charges arises from the original loan agreement, not from the Bankruptcy Code. *Id.*

that any applicable state law requiring interest on mortgage arrearages would control.⁶¹

Finally, in *Shearson Lehman Mortgage Corp. v. Laguna* (In re *Laguna*),⁶² the Ninth Circuit relied substantially on the *Landmark* case and on a well-known bankruptcy treatise⁶³ to conclude that interest on arrearages is not allowable.⁶⁴ Although the court accepted that section 506(b) generally entitles an oversecured creditor to postpetition interest, it noted that sections 1322(b) and 1325(a) qualify this right.⁶⁵ The court then simply cited at length the *Landmark* court's rationale for distinguishing between a cure and a modification.⁶⁶

In *Wade v. Hannon*,⁶⁷ the Tenth Circuit departed from the recent trend in the United States Courts of Appeals by allowing an oversecured mortgagee to collect postpetition interest on mortgage arrearages when a debtor cures prepetition defaults.⁶⁸ The court identified three core elements permeating the other circuits' opinions denying interest on arrearages: (1) cure does not modify the mortgagee's rights under the mortgage contract; (2) cure occurs under the contracts themselves, outside the realm of bankruptcy law; and (3) legislative history indicates that Congress intended to distinguish between mortgages on principal residences and other oversecured creditors' claims.⁶⁹ The *Wade* court dismissed each of these premises and rejected the findings of the other courts that had addressed the issue.

First, the court proposed that a cure under section 1322(b) actually does modify a mortgagee's rights under a contract in at least three ways.⁷⁰ Cure denies the implementation of acceleration clauses by per-

61. *Id.* at 1155. The court found no pertinent Virginia law on the issue. *Id.*

62. 944 F.2d 542 (9th Cir. 1991), *cert. denied*, 112 S. Ct. 1577 (1992).

63. *See id.* at 544-45 (relying on COLLIER ON BANKRUPTCY, *supra* note 30).

64. 944 F.2d at 544-45.

65. *Id.* at 544. As support for this premise, the court cited its earlier holding in *Seidel v. Larson* (In re *Seidel*), 752 F.2d 1382 (9th Cir. 1985) (discussing the relationship between cure and modification and determining that extending the time for payment under a plan beyond the time originally contemplated by the creditor is an impermissible modification).

Other courts also have perceived that more specific Chapter 13 provisions supersede § 506(b). *See Resolution Trust Corp. v. Adams*, 142 B.R. 331, 333 (E.D. Mo. 1991) (holding that more specific provisions relating to Chapter 13 take precedence over more general Code sections).

66. 944 F.2d at 544-45.

67. 968 F.2d 1036 (10th Cir. 1992).

68. *Id.* at 1042. The court explicitly noted its reluctance to disagree with 13 out of 15 circuit judges who decided the issue and with the most renowned author on bankruptcy law. *Id.* at 1040.

69. *Id.*

70. *Id.*

mitting cure “within a reasonable time”;⁷¹ it bars the mortgagee’s right to foreclose; and it abridges the customary contract provision that all default payments are immediately due.⁷² In response to the contention that the effects of cure do not amount to a “modification” as contemplated by section 1322(b)(2),⁷³ the *Wade* court concluded that such distinctions improperly treat “modification” as a term of art, instead of the practical term which Congress envisioned.⁷⁴

Next, the *Wade* court rejected the argument that a cure occurs outside of the bankruptcy realm, so that the original contract terms govern.⁷⁵ First, the court observed that cure clearly combines both contract and Code-supplied provisions.⁷⁶ For example, notwithstanding contract provisions to the contrary, the Code protects the mortgagor by allotting a “reasonable” time to repay defaults, by authorizing installments as a method to pay arrearages and by barring foreclosure as a remedy.⁷⁷ If these provisions supersede express contract principles, the court reasoned that it would be unreasonable to rely on the absence of interest provisions in the contract.⁷⁸ Second, the court compared the mortgagee’s claim to other secured claims.⁷⁹ Although the court conceded that an over-secured mortgagee’s claim is distinguishable from claims governed by section 1325(a)(5),⁸⁰ it held the Code’s plain language requires that a

71. 11 U.S.C. § 1322(b)(5) (1988).

72. 968 F.2d at 1040.

73. Such cases include *Terry*, in which the court conceded that the cure provisions modified the contract, but concluded that the changes did not amount to a “modification,” see *supra* note 46; and *Capps*, in which the court noted a cure’s “adverse effects” on mortgage contracts, but again denied that these effects represented a “modification.” See *supra* notes 51-52 and accompanying text.

74. 968 F.2d at 1040.

75. *Id.* at 1041. The Third and Fourth Circuits especially relied on this argument. See *supra* notes 50, 60 and accompanying text.

76. 968 F.2d at 1041.

77. *Id.* Emphasizing the impact of such Code modifications, the court declared that “[i]t seems wholly unreasonable to eviscerate the contract provisions of acceleration and foreclosure and then find binding the absence of a term regarding interest on arrearages.” *Id.*

78. 968 F.2d at 1041.

79. *Id.* While some courts attempt to distinguish a mortgagee’s so-called “security interest” from an ordinary claim, see *supra* note 39 and accompanying text, § 1322(b) itself deems a mortgagee’s interest a “claim.” See *supra* note 4 for text of § 1322(b).

80. 968 F.2d at 1041. The cram down provisions apply to claims which the debtor must pay in full during the term of the plan and which may involve reducing payments, decreasing interest rates or making other changes in the creditor’s claim. *Id.* A mortgage claim differs because it is long-term and its payments and interest rates cannot be reduced. *Id.*

mortgagee's oversecured claim earn interest pursuant to section 506(b).⁸¹

Third, the court rejected other courts' analysis of the legislative history⁸² and determined that Congress intended to treat mortgagees differently from other oversecured creditors because the statutes were not ambiguous.⁸³ The court found that the plain language of the no-modification clause, section 1322(b)(2), means only that the debtor's plan cannot reduce the amount of payments, decrease the interest rate or extend the term of the mortgage.⁸⁴ Conversely, the cure provision relates to the payment of past due amounts.⁸⁵ These provisions do not imply that Congress intended to deny mortgagees the right to interest on arrearages.⁸⁶ Finally, the court found that even assuming that the statute was ambiguous, the legislative history did not reveal a congressional intent to discriminate in any way against home mortgagees.⁸⁷

The *Wade* court's reasoning is faulty. Unfortunately, it generates uncertainty concerning an issue which the circuit courts previously appeared to have settled.⁸⁸ Initially, the *Wade* court failed to appreciate the well-established distinction between cure and modification.⁸⁹ Because cure necessitates some changes in the original loan situation,⁹⁰ the court mistakenly deduced that it is a form of modification.⁹¹ However,

81. *Id.* The court asserted that only a showing of congressional intent to differentiate between home mortgages and other oversecured claims could prevent a conclusion that § 506(b) applied. *Id.*

82. *Id.* The *Terry*, *Capps*, *Landmarks*, and *Laguna* courts all concluded that Congress did contemplate a distinction. See *supra* notes 43, 50, 60, 65 and accompanying text.

83. 968 F.2d at 1041. The basic tenets of statutory construction permit a court to resort to legislative history only when a statute is ambiguous. *Id.* (citing *Toibb v. Radloff*, 111 S. Ct. 2197, 2200 (1991)). According to the court, § 1322(b) is clear on its face. *Id.*

84. 968 F.2d at 1042.

85. *Id.*

86. *Id.*

87. *Id.* The court only cited *Ron Pair* as holding that "legislative history of [the] Bankruptcy Code does not shed light on [the] question of postpetition interest." *Id.* Perhaps the court completed a more extensive search before making such a broad conclusion; however, it did not document any such research.

88. While one should not disregard completely the minority position in *Colegrove*, it contained a strong dissent, it is severely criticized in the premier treatise on bankruptcy, and it must be considered in its context as the first in a long line of circuit cases which rejected its findings. See *supra* notes 33-40 and accompanying text.

89. See *supra* notes 50-52, 56-58, 64 and accompanying text. See also *In re Clark*, 738 F.2d 869, 872 (7th Cir. 1984) ("It is clear that Congress intended 'cure' to mean something different from 'modify'; otherwise, in light of [§ 1322](b)(2), [§ 1322](b)(3) [and arguably [§ 1322](b)(5)] would be superfluous."); *In re Taddeo*, 685 F.2d 24, 27 (2d Cir. 1982) ("curing defaults and maintaining payments under [§ 1322](b)(5)] is not a modification").

90. See *supra* notes 70-72 and accompanying text.

91. See *supra* notes 70-74 and accompanying text.

Congress would not have coined different terms and enacted separate provisions to govern cure and modification if it viewed cure as merely an offshoot of modification.⁹²

More importantly, the *Wade* court incorrectly assumed that nothing in the Code or its legislative history suggests that section 506(b) should not apply to home mortgage claims. It is clear from both the plain language of section 1322(b)(2) and its legislative history that Congress intended to treat security interests on principal residences differently from other claims.⁹³ Simply by formulating section 1322(b)(2) to regulate these claims, Congress affords them special treatment.

The *Wade* court's decision also contravenes canons of statutory construction. These rules state that provisions specifically relating to a specific subject prevail over more general provisions.⁹⁴ Although section 506 generally provides oversecured creditors with interest, section 1322(b)(2) specifically mandates that *mortgage* claims may not be modified.⁹⁵ Awarding interest pursuant to section 506(b) obviously modifies the claim.⁹⁶ In light of this conflict, the court should have held that section 1322(b)(2) precludes any application of section 506(b) to interest arrearages.

Finally, in the context of policy, the *Wade* decision unfairly favors the creditor who already occupies a position far superior to that of the debtor. The Code itself purposefully protects the mortgagee⁹⁷ at the expense of the mortgagor by barring typical modifications such as reducing payment and extending time frames.⁹⁸ In addition, the professional lender easily can protect itself from the possibility that it might lose interest on arrearages.⁹⁹ The *Wade* court refused to confer a slight burden

92. Aware of this reasoning, the court later attempted to reconcile the existence of two provisions with its holding that cure modifies a claim by arbitrarily determining that a cure relates to paying the amount past due, while modification relates to reducing payments, decreasing interest rates or extending the period of the note. The court cited no authority for this proposition. 968 F.2d at 1042.

93. See *supra* notes 30, 40, 43 and accompanying text.

94. See *supra* note 65.

95. See *supra* notes 27-28, 42 and accompanying text.

96. See *supra* note 39 and accompanying text. Nothing in the Code or its history indicates that interest on arrearages is incidental to cure.

97. See *supra* note 40 and accompanying text. See generally Regina L. Nassen, Note, *Bankruptcy Code Section 1322(b)(2)'s No-Modification Clause: Who Does It Protect?*, 33 ARIZ. L. REV. 979 (1991).

98. See *supra* note 80.

99. See *supra* note 47 and accompanying text.

on the lender by accepting that it simply should insert a provision for interest on arrearages in the original loan document to avoid this issue altogether.¹⁰⁰ It is reasonable to expect professional lenders to provide for loan default and subsequent bankruptcy filing, a relatively common occurrence in American businesses.

In summary, the Tenth Circuit, holding that section 506(b) requires a Chapter 13 debtor to pay postpetition interest on prepetition mortgage arrearages upon cure, brought the federal circuit courts back in a full circle on the interest on arrearages issue.¹⁰¹ By somewhat evening the split between the circuits and reasserting what appeared to be an outdated conclusion, the Tenth Circuit substantially improved the powerful mortgagee's position in Chapter 13 bankruptcy proceedings and placed a greater burden on the individual mortgagor.

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100. 968 F.2d at 1042.

101. Although the Tenth Circuit reached the same conclusion as the Sixth Circuit, it asserted a different rationale. The Sixth Circuit determined that paying interest is not a modification of the claim, but an incidental aspect of cure. In contrast, the Tenth Circuit held that paying interest is a statutory modification required by § 506(b). *See supra* notes 33-37, 67-86 and accompanying text.

