Marc S. Stern
1825 NW 65th St.
Seattle, WA 98117
(206)448-7996
marc@hutzbah.com

Hon. Paul B. Schneider
Chapter 13
Hearing Date:
Hearing Time:
Response Date:

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA

In Re:	)	NO. 03-48796
	)	
	)	BRIEF IN OPPOSITION TO RELIEF
Debtor	)	FROM STAY AND IN SUPPORT OF
	)	REFINANCE AND CURE

FACTS

1. The debtor purchased a piece of ground and commenced construction. She put $400,000 into the construction when she ran out of funds.

2. The instant construction loan, with an 8% interest rate was taken out. At around the time the debtor began to have marital difficulties. She discovered that her husband was drinking to excess, committing legal malpractice and incurring debt about which she knew nothing. She commenced a dissolution proceeding. He was ordered to transfer the property to her but ignored the court order and, after several months filed a Chapter 7 bankruptcy proceeding.

3. During this time the lender started adding interest at the rate of 18% as well as various other charges which are as yet unknown. This has ballooned the original $289,000 loan to something in excess of $400,000 is the lender's pleadings are to be believed.

4. The debtor has made various attempts to refinance the loan, however, each time, the lender has added new charges which made the refinance impossible.

5. The debtor has filed this Chapter proceeding and seeks to refinance and cure the loan. Thereafter, the debtor will market the property and complete the plan.

MARC S. STERN
ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
(206)448-7996

ISSUES PRESENTED

1. Is this creditor entitled to relief from stay on an emergency basis when there is substantial equity in the property, the debtor has recently filed bankruptcy, and the property is necessary for an effective reorganization?

2. Is a creditor entitled to default interest and late fees when the defaults under the note are cured pursuant to an order in a Chapter 11 or Chapter 13 proceeding?

LEGAL ARGUMENT

THERE IS NO BASIS FOR RELIEF FROM STAY WHEN THERE ARE SEVERAL HUNDRED THOUSAND DOLLARS OF ADEQUATE PROTECTION, THE CASE IF RECENTLY FILED, THE PROPERTY IS NECESSARY FOR AN EFFECTIVE REORGANIZATION AND THE DEBTOR HAS PROPOSED A CURE.

Section 362(d) provides that relief from stay may be granted:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest;
> (2) with respect to a stay of an act against property under subsection (a) of this section if–
>
> (A) the debtor does not have an equity in such property; and
>
> (B) such property is not necessary to an effective reorganization; or
>
> (3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period)--
>
> A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

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> (B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.

In this case the overwhelming testimony is that the property is worth several hundred thousand dollars more than the amount claimed by the lender, Venture Bank. Clearly lack of equity is not a basis for relief from stay and certainly not on an emergency basis..

The other basis for relief from stay is "for cause." In this case, no cause is shown. The case is only 2 weeks old. The debtor has filed all of her schedules and has filed a plan of Reorganization which calls for cure of this deed of trust, ongoing payments, and payment of other creditors. Clearly the debtor has not, within the past 2 weeks given any cause for an Emergency order Granting Relief from Stay.

The property is necessary for any effective reorganization. The debtor has recently gotten title to the property. She is in the process of preparing it for sale. The net proceeds from the sale are necessary to her reorganization.

THE DEBTOR IS ENTITLED TO CURE BY PAYING VENTURE BANK THE PRINCIPAL AMOUNT OWING ALONG WITH ITS NON-DEFAULT INTEREST AND A REASONABLE ATTORNEYS' FEE.

In *In Re Entz-White Lumber* 850 F.2d 1338 (9th Cir 1988) the court addressed the question of default interest in bankruptcy when the claim was being cured during the proceedings. The court held:

> [B]y curing the default, Entz-White is entitled to avoid all consequences of the default -- including higher post-default interest rates. This result is consistent with the treatment by other courts of the Bankruptcy Code's cure provisions. While it is true that most cases in this area have involved a default resulting in acceleration, none of which we are aware have treated acceleration as the only

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ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
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> possible consequence of default. *See, e.g., Taddeo,* 685 F.2d at 26 ("A default is an event in the debtor-creditor relationship which triggers certain consequences--here, acceleration."); *Clark,* 738 F.2d at 872 ("Acceleration of a debt is a standard consequence of a default in payments."); *see also In re Forest Hills Assocs*., 40 B.R. 410, 415 (Bankr. S.D.N.Y. 1984) ("just as the debtor need not pay the post-default accelerated debt, he need not pay the post-default interest rate on the accelerated debt"). 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.

In *In re Casa Blanca* 196 B.R. 140; (9th Cir BAP 1996) in an opinion by Judge Volinn the court determined that a plan was not necessary. Essentially, the allowance of a claim under §506 of the Code determined whether default interest was appropriate. The court held:

> [T]his case requires the application of bankruptcy rather than state law because the issue before the panel involves payment of the Bank's secured claim, not the debtor's interest in property. *Vanston Bondholders Protect. Comm. v. Green,* [329 U.S. 156, 162, 91 L. Ed. 162, 67 S. Ct. 237 (1946) ("In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits"); *see also United States v. Ron Pair Enterprises, Inc.,* 489 U.S. 235, 242, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989) (language of § 506(b) does not require that interest be applied as provided in the loan agreement).

The court continued:

> The concept of "cure" is not exclusive to Chapter 11 or plans of reorganization. ... [All] references to cure involve a determination of the amount of a creditor's claim which is allowable and ultimately payable in a bankruptcy proceeding, provided that assets prove to be sufficient. That is the same issue presented in the instant case. Absent some compelling reason to the contrary, the construction of "cure" and its application to the allowed amount of a creditor's claim should not differ depending on whether it arises under a plan or in some other context in the Bankruptcy Code. *In re 433 South Beverly Drive, 117 Bankr. at 566-567.*

The *Casa Blanca* court went on to discuss the factors to be used by the court in determining the interest rate. Essentially, it is a balancing of equities. The default interest is to be applied to compensate the creditor for the costs of the default.

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ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
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Judge Volinn concluded:

> As a general rule, the contract rate will apply unless equitable considerations dictate otherwise, see. e.g., *Terry Ltd. Partnership, 27 F.3d at 243*, although most courts take a "hard look" at default interest. See *In re Kalian, 178 Bankr. 308, 314 (Bankr. D.R.I. 1995).* Ultimately, the bankruptcy court must decide whether the default rate compensates the creditor for its losses or is more in the nature of a "disguised penalty." *In re Johnson, 184 Bankr. at 573.*

Here it is clear that the amount claimed is substantially worse than disguised penalty, it is a disguised capital sentence.

This was applied by the court affirming a decision by Judge Overstreet in ***In re Udhus,* 218 B.R. 513; (9th Cir BAP *1998)***. In *Udhus*, as in this case all creditors were paid in full pursuant to a plan. Judge Overstreet refused to allow default interest. The BAP affirmed holding

> The more natural reading of sections 506 and 1124 is that the interest awarded should be at the market rate or at the pre-default rate provided for in the contract. *See In re Southeast Co., 81 B.R. 587, 592 (BAP 9th Cir. 1987)*(holding that reliance damage under § 1124(2)©) "does not comprise contractual penalty interest rates")

The court continued:

> A distinguishing fact between Casa Blanca and the instant case is the form of the cure of the default. In Casa Blanca, the secured creditors' claim was cured by a sale of the real property and payment of the secured creditor's claim under § 506(b) and excluded default interest. In this case, the cure was effectuated under Udhus's chapter 11 plan and § 1123. Casa Blanca does not serve as authority for CityBank's argument. **The bankruptcy court had no discretion to award default interest.** [emphasis supplied]

The court continued:

> In summary, the bankruptcy court correctly followed *In re Entz-White Lumber and Supply, Inc., 850 F.2d 1338 (9th Cir. 1988)*, in denying CityBank's claim for default interest. The default in the CityBank loan was cured under § 1123. The cure returned the status of the parties to the same relationship under the loan that existed prior to the default. Udhus's plan paid all creditors in full including CityBank. CityBank was paid in full by receiving its contract interest at the non-default rate. The bankruptcy court did

MARC S. STERN
ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
(206)448-7996

> not abuse its discretion in finding CityBank's claim for administrative expenses unreasonable.

This question was visited by the BAP in In *In re Hassen Imports Partnership* 256 B.R. 916; (9th Cir BAP 2000) The court continued to follow this line of reversing an award of allowing default interest holding:

> The creditor must demonstrate that the default rate is equivalent to damage by "evidence or proof of a tangible nature." *Id. at 147.* KWP produced no such proof in this case. It argued that the Default Rate is reasonable because it falls within a generally-accepted range, and because the same rate of default was approved for the new note. These arguments do not demonstrate, with the specificity required by *Casa Blanca*, that the Default Rate compensated KWP for actual losses.

This was also the reasoning of the court in In *In re Phoenix Business Park*, 257 B.R. 517; (Brcy Ariz 2001).

> By curing the default, *Entz-White* is entitled to avoid all consequences of [the default--including higher post-default interest rates. This result is consistent with the treatment by other courts of the Bankruptcy Code's cure provisions.

In *Udhus, supra,* the BAP discussed the meaning of cure. The court held:

> The Court of Appeals for the Ninth Circuit rejected this argument, holding a § 1123 cure relates to any default. The court adopted the definition of "cure" formed by the Court of Appeals for the Second Circuit in *In re Taddeo, 685 F.2d 24 (2d Cir. 1982)* that "[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**." *Entz-White, 850 F.2d at 1340* (quoting *Taddeo, 685 F.2d at 26-27).* [emphasis supplied].

Most recently in *In re Sylmar Plaza*, 314 F.3d 1070 (9th Cir. 2002) the court addressed a case in which the bankruptcy proceeding was filed solely to relieve a solvent debtor of the default interest and late charges found in the note. In responding to a motion to dismiss on the basis that the plan is not filed in good faith, the court held:

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> A plan is proposed in good faith where it achieves a result consistent with the objectives and purposes of the Code. *Ryan v. Loui (In re Corey)*, 892 F.2d 829, 835 (9th Cir.1989); see also, Madison Hotel, 749 F.2d at 425 ("[F]or purposes of determining good faith under section 1129(a)(3) ... the important point of inquiry is the plan itself and whether such plan will fairly achieve a result consistent with the objectives and purposes of the Bankruptcy Code."). The requisite good faith determination is based on the totality of the circumstances. *Stolrow v. Stolrow's, Inc. (In re Stolrow's, Inc.)*, 84 B.R. 167, 172 (9th Cir.BAP 1988).

The Court continued found that a cure, as used in the Bankruptcy Code could be used to nullify the consequences of default, including default interest. It held:

> Our decision in *Great W. Bank & Trust v. Entz-White Lumber and Supply, Inc. (In re Entz-White Lumber and Supply, Inc.*), 850 F.2d 1338 (9th Cir.1988), lays to rest Platinum's argument that a plan intended to nullify the consequences of a default (thereby avoiding the higher post-default interest rate) does not meet the purposes of the Bankruptcy Code. As the court put it, "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.*" *Id.* at 1342 (emphasis added). Given the specific power to cure default, it makes no sense to treat a plan invoking that power as lacking good faith. *See also, Citybank v. Udhus (In re Udhus)*, 218 B.R. 513, 516 (9th Cir. BAP 1998).

The same reasoning can be applied to late charges. The nullification of the consequences of default can only mean that late charges are nullified as well. Any other meaning of the of the term cure is not sanctioned by statute or case law. The *Uhdus* court continued:

> While an oversecured creditor's damages should be properly compensated, cure plus actual loss, if any, provides such compensation. Anything beyond this would constitute a penalty on the debtor. Equitable considerations do not countenance such a result.

It is conceivable that the secured lender may argue that a cure is not permissible in a Chapter 13 proceeding and that the rights are different than a Chapter 11 cure[1]. The case law does not support this position. In *In re Hurt*, 158 BR 154 (9th Cir 1994) the court said:

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[1]If this court is of such a mind, the debtor is prepared to convert this case to a Chapter 11.

MARC S. STERN
ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
(206)448-7996

Although the Ninth Circuit has not specifically addressed which test is appropriate, it is apparent that the circuit would adopt an expansive definition of "cure" as opposed to a restrictive definition. The court in *In re Seidel,* stated that " 'the plain meaning of "cure," as used in §§ 1322(b)(3) and (5), is to remedy or rectify the default and restore matters to the *status quo ante*.' " *In re Seidel,* 752 F.2d 1382, 1386 (9th Cir.1985) (quoting *Clark,* 738 F.2d at 872; *Taddeo,* 685 F.2d at 26-27). *Black's Law Dictionary* defines *status* ****160** quo* as: "the existing state at any given date. *Status quo ante bellum*, the state of things before the war." *Black's Law Dictionary* 1264 (5th ed. 1979). Accordingly, it is apparent that the Ninth Circuit provides for a cure under §1322(b)(5) to restore the debtor's mortgage to its original state before the default regardless of what action the mortgagee has taken.

Two subsequent Ninth Circuit cases support this proposition. In *In re Metz,* the court stated that:

> while modification of the debt is prohibited, Metz's Chapter 13 plan is a permissible "**cure**" of a claim because it simply reinstates the original debt after correcting the arrearage. *See, In re Seidel,* 752 F.2d 1382, 1386 (9th Cir.1985) **(cure** results in reinstatement of the original payment terms of the debt). *In re Metz,* 820 F.2d 1495, 1497 (9th Cir.1987).

CONCLUSION

Relief from stay is not appropriate. There is significant equity in the property and it is necessary to an effective reorganization. The debtor is permitted pursuant to the Bankruptcy Code to cure this obligation by paying the principal, non-default interest, and reasonable attorneys fees. The court should so rule and authorize a refinance and cure.

Dated this September 2, 2003

/s/ Marc S. Stern
Marc S. Stern
WSBA 8194
Attorney for Debtor

MARC S. STERN
ATTORNEY AT LAW
1825 NW 65TH STREET
SEATTLE, WA 98117
(206)448-7996