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DETERMINING THE LIMITS OF POSTPETITION INTEREST UNDER SECTION 506(b) OF THE BANKRUPTCY CODE: IN RE RON PAIR ENTERPRISES

by

Veryl Victoria Miles*

The passage of the Bankruptcy Reform Act of 19781 marked a significant event in Congressional legislation as it provided our legal system with the most comprehensive body of bankruptcy law since the enactment of the Bankruptcy Act of 1898.2 However, as is characteristic of law in general, the shortcomings and imperfections of the Code quickly became apparent, resulting in several major amendments and revisions. The first set of revisions was introduced through the Bankruptcy Amendments and Federal Judgeship Act of 1984,3 which was enacted in response to a Supreme Court holding that the jurisdiction of the bankruptcy courts under the Code was unconstitutional.4 In addition to the jurisdiction and venue questions that the 1984 Amendments sought to resolve, these amendments also included substantive changes to the Code.5 In 1986, another set of

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2 30 Stat. 544 (1898).


4 In Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), the Supreme Court held that the grant of jurisdiction to bankruptcy judges to decide state-based claims arising in or related to cases under the Code was a grant of judicial power that could only be exercised by an Article III court. Because the bankruptcy courts were not Article III courts, the jurisdiction granted under Section 1471 of the Code was in violation of the Constitution. After considerable delay, the Bankruptcy Amendments and Federal Judgeship Act of 1984, supra at note 3, was enacted to respond to this question. Under the 1984 Amendments, the original and exclusive jurisdiction of bankruptcy cases is vested in the Federal district courts, which are empowered to refer any or all bankruptcy cases or proceedings arising in or related to a bankruptcy case to the bankruptcy courts in that district. 28 U.S.C. §§ 1334, 157 (1982 & Supp. IV 1986).

5 These changes were proposed under Title III of the 1984 Amendments and addressed a variety of issues under the Code, including consumer credit agreements, grain storage facility bankruptcies, leasehold management agreements, the nondischargeability of judgments against drunk drivers, and collective bargaining agreements.
amendments was enacted to address the United States Trustee System under the Code, and to make special provisions for family farmer bankruptcies through the addition of Chapter 12.6

This barrage of change, clarification and the making of a more perfect body of bankruptcy law continues. As with the question of the constitutionality of the bankruptcy courts in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,7 the need for clarification of the Code often finds its way to the Supreme Court. This process of legal clarification and resolution has been activated most recently in the Court's granting of certiorari in the case of *In re Ron Pair Enterprises, Inc.* (hereinafter *Ron Pair Enterprises*).8 In this case, the Court will interpret the meaning of Section 506(b) of the Code.9 The language of Section 506(b) is as follows:

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.10

In *Ron Pair Enterprises*, the Sixth Circuit Court of Appeals held that the allowance of postpetition interest to oversecured creditors under Section 506(b) was limited to consensual liens, such that it did not permit postpetition interest on claims secured by nonconsensual liens such as tax liens.11 This is contrary to the Fourth Circuit's holding in *In re Best Repair Company, Inc.* (hereinafter *Best Repair*),12 which held that "Section 506(b) permits an over-secured creditor to recover post-petition interest on nonconsensual claims."13 The majority of the courts that have interpreted Section 506(b) have held that it allows postpetition interest on all over-

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10 Id.
11 828 F.2d at 372-73.
12 789 F.2d 1080 (4th Cir. 1986).
13 Id. at 1082.
secured claims, whether they are consensual or nonconsensual in nature.\textsuperscript{14} This interpretation is based on what these courts see as a reading of the “plain language” of the statute. The courts in the minority have held that postpetition interest under Section 506(b) is limited to consensual liens.\textsuperscript{15} These courts have taken this position because they believe that the language of Section 506(b) is too ambiguous. Because of this “ambiguity” and the lack of any legislative history on the question of postpetition interest under the provision,\textsuperscript{16} these courts have looked to the pre-Code law on postpetition interest to support the view that it was the intent of Congress to codify the “well established” pre-Code law, which permitted postpetition interest only where the claim was over-secured due to a consensual lien.\textsuperscript{17}

This article will consider the merits of both sides of the debate that now engulfs Section 506(b), as presented primarily by the Sixth and Fourth Circuit Courts in \textit{Ron Pair Enterprises} and \textit{Best Repair}, respectively.


\textsuperscript{16} The legislative history concerning Section 506(b) does not make any statement regarding postpetition interest; it only addresses the allowance of “fees, costs and charges”: Subsection (b) codifies current law by entitling a creditor with an over-secured claim to any reasonable fees (including attorney’s fees), costs, or charges provided under the agreement under which the claim arose. These fees, costs, and charges are [sic] secured claims to the extent that the value of the collateral exceeds the amount of the underlying claim.


\textit{See also} H.R. REP. NO. 595, 95th Cong., 2d Sess. 356-57, \textit{reprinted in} 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6312. The same statement is made in the House report with the exception of the parenthetical statement (including attorney’s fees).

\textsuperscript{17} The pre-Code rule on postpetition interest and its judicial history is discussed \textit{infra} at notes 43-83 and accompanying text.
After summarizing the arguments presented and the decision of the court in *Ron Pair Enterprises*, the article will present an analysis of the majority and minority views on the language of Section 506(b) and offer a critical assessment of the pre-Code law on the allowance of postpetition interest on over-secured claims. From this assessment, this article will conclude that Section 506(b) should be interpreted in accordance with the majority view of permitting postpetition interest on all over-secured claims, regardless of the consensual or nonconsensual nature of the lien. In support of this conclusion, the article will show that the language of Section 506(b) is not so ambiguous as to permit a contrary reading, and that to conclude otherwise, as the minority would urge, would serve to continue a strained and artificial reading of the provision. This conclusion will also be based on an analysis and assessment of the judicial evolution and logic put forth in support of the pre-Code law of limiting postpetition interest to consensual liens. This support of pre-Code law is found to be flawed and questionable as a "well established" rule of bankruptcy law.

I. The Case: *In re Ron Pair Enterprises, Inc.*

The secured claimant in *Ron Pair Enterprises* was the United States government, which filed a claim against the estate of the debtor for unpaid withholding and social security taxes, prepetition penalties, and prepetition and postpetition interest against the unpaid taxes. The court in *Ron Pair Enterprises* correctly describes the general rule prohibiting postpetition interest and the first two exceptions to this prohibition as "well established" rules of law. It also stated that, "It was equally well established by at least four courts of appeals that the third exception - allowing the payment of postpetition interest if the claim was over-secured - did not apply to liens which were nonconsensual in nature, such as tax liens . . . ." 828 F.2d at 371 (citations omitted). The court asserted that Congress did not intend to "depart" from the pre-Code rule permitting postpetition interest on over-secured consensual liens, and that Section 506(b) codifies this pre-Code rule. *Id.* at 373.

The court in *In re Gilliland*, 67 Bankr. 410 (Bankr. N.D. Tex. 1986), aptly described the logic behind the third exception to the pre-Code prohibition against post-petition interest "to be flawed." This article will analyze the logic of the third exception, and question the description of this exception as being a pre-Code rule that was as "well established" as the general prohibition against postpetition interest and the first two exceptions to this prohibition. It will also challenge the suggestion that Congress intended to codify the third exception under Section 506(b).

The debtor, *Ron Pair Enterprises*, Inc., filed a petition for a Chapter 11 reorganization under the Code. The reorganization plan provided that the Government would receive payment of prepetition taxes, penalties and interest, but no provision was made for postpetition interest on the outstanding tax debt. The bankruptcy court rejected the Government's objection to the reorganization plan and was subsequently reversed by the district court, which held that the Government was entitled to postpetition interest. 828 F.2d at 368-69. The district court held that the "plain language" of Section 506(b) entitled the Government to postpetition interest. It relied on *Best Repair* and a prior Sixth
held a prepetition tax lien against the debtor's property to secure the
debtor's payment of his tax obligations. In this case, the Sixth Circuit
Court of Appeals reversed a district court decision which allowed the
Government postpetition interest under Section 506(b), holding that "the
language of Section 506(b) does not clearly provide for the payment of
such interest and, in fact, it fails to explicitly overrule the pre-Code judi-
cially created concept disallowing the payment of postpetition interest on
nonconsensual prepetition oversecured claims."\(^2\)

Thus, the debate regarding the meaning of Section 506(b) hinged on
the language of the provision and the pre-Code judicial law on the ques-
tion of the permissibility of postpetition interest. The debtor argued that
postpetition interest under Section 506(b) was limited to consensual liens,
such as mortgages, where a contractual agreement had been executed be-
tween the debtor and the creditor providing specific terms for the payment
of interest, costs and fees that would be allowed under the loan agreement.
This argument was based on the debtor's reading of the language of Sec-
tion 506(b) in such a way that the clause "charges provided for under the
agreement under which such claim arose" modified the words "interest on
such claim" as well as "any reasonable fees, costs, or charges."\(^2\)
The debtor also noted that this reading of the statute was consistent with the
pre-Code law regarding postpetition interest and was a correct reading,
because the legislative history of Section 506(b) did not indicate that the
provision was to be a departure from pre-Code law and the language of
the statute was "too ambiguous to be considered an explicit departure
from a well-established doctrine."\(^2\)

On the other hand, the Government argued that Section 506(b) was
not ambiguous, and it read the allowance of postpetition interest on over-
secured liens to include all liens, regardless of the consensual or noncon-
sensual nature of the lien. It suggested that the clause "charges provided
for under the agreement under which such claim arose" only modified
"any reasonable fees, costs, or charges" and that it did not include "inter-
est on such claim" because it had been separated by the commas and offset
from the other words by "and any," thus indicating that Congress inten-
tended for the interest on claims to be treated differently from "fees, costs,

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\(^2\) Circuit decision, \textit{In re Colegrove}, 771 F.2d 119 (6th Cir. 1985), in which the court looked to Section
506(b) as authority for its conclusion that a mortgagee was entitled to interest on arrearages even
though interest was not provided for in the loan agreement. 828 F.2d at 369.

\(^2\) 828 F.2d at 368.

\(^2\) Id. at 369.

\(^2\) Id.
or charges". In other words, "fees, costs, or charges" would only be permitted under Section 506(b) if there was an agreement between the debtor and the creditor providing for such claims; whereas, interest on claims would be allowed in any case pursuant to agreement or otherwise. The Government argued that since the language of the statute was unambiguous, the court should not refer to the pre-Code rule concerning postpetition interest.23

In rejecting the Government's suggestion that the pre-Code law not be considered in interpreting Section 506(b), the court explained that, while the language of the statute is the starting point in statutory interpretation, pre-Code law also needs to be considered in order to understand the context in which the statute was drafted, and thus its meaning.24 The court described the pre-Code rule as "a well-established general rule that interest on both secured and unsecured prepetition claims ceased to accrue upon the filing of a bankruptcy petition."25 The court noted that this principle was based on an equitable doctrine that delays in the payment of the claims of creditors, which are necessitated by the bankruptcy process, should not place one creditor (that is, a creditor with high interest bearing obligations) at an advantage over other creditors where the assets of the estate are already insufficient to pay the principal all of the estate's out-

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23 The Government counters by arguing that the language of Section 506(b) is unambiguous in that the emphasized clause above [provided for under the agreement under which such claim arose] only modifies 'any reasonable fees, costs, or charges.' The Government relies on the fact that the phrase 'interest on such claim' is set off by commas and is followed by the words 'and any,' indicating that interest is to be treated differently from fees, costs, or charges. The Government argues that since the language is unambiguous and allows for postpetition interest to be awarded on any allowed secured prepetition claim regardless of whether it is consensual or not, this Court should not refer to pre-Code law to interpret Section 506(b). The Government suggests further that even if this Court is inclined to review pre-Code law, the punctuation, phraseology and grammatical structure of Section 506(b) plainly and unambiguously express Congress' intent to depart from pre-Code law. 828 F.2d at 369.

24 We first reject the Government's contention that pre-Code law should not be relied on in interpreting Section 506(b) since the provision appears to be unambiguous. While the language of a statute is always the starting point when its construction is at issue, it is only the starting point. [P]re-Code law should be reviewed in order to better understand the context in which the provision was drafted and therefore the language itself. In fact, [t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codification. 828 F.2d at 369-370 (citations omitted) (Emphasis added).

25 828 F.2d at 370.
The court proceeded with a discussion of the three exceptions to this general prohibition to postpetition interest. The first exception allows postpetition interest in cases where the debtor is proved to be solvent. The second exception allows postpetition interest in cases where the secured creditor is in possession of securities or other property that produces income during the bankruptcy proceedings. The last exception, which the court relied on in this case, allows postpetition interest in cases where the value of the collateral securing the claim is sufficient to pay both the principal and interest on the debt.

The third exception has been interpreted by five circuit courts to be limited to consensual liens for several reasons: (1) because the security agreement in granting the lien has been voluntarily entered into by the creditor and the debtor and the creditor has bargained for the collateral to secure the principal and interest on the debt, this expectation should not be interfered with; (2) nonconsensual liens such as tax liens are general liens which apply to all of the debtor's property and are not specific liens like consensual liens; and (3) the interest accruing on unpaid taxes is more of an enforcement device against debtors, but works as a penalty on the other creditors of the debtor who will go unpaid as the accruing interest depletes the availability of assets for their claims. On the basis of this interpretation of the third exception to the pre-Code law and its reading of Section 506(b), the court in Ron Pair Enterprises held that Section 506(b) was not intended to change this exception to the pre-Code prohibition against postpetition interest, and thus the Government was not entitled to such interest.

II. THE LANGUAGE OF SECTION 506(b)

As noted above, the court in Ron Pair Enterprises approached its analysis of Section 506(b) by “starting” with the language of the statute. The discussion and analysis of the language of Section 506(b) in Ron Pair Enterprises is rather limited and fails to bring any new dimension to

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26 Id.
27 Id.
28 See In re Boston & Maine Corp., 719 F.2d 493 (1st Cir. 1983); In re Kerber Packing Company, 276 F.2d 245 (7th Cir. 1960); United States v. Mighell, 273 F.2d 682 (10th Cir. 1959); United States v. Bass, 271 F.2d 129 (9th Cir. 1959); United States v. Harrington, 269 F.2d 719 (4th Cir. 1959).
29 828 F.2d at 373.
30 See supra note 10 and accompanying text.
the arguments that the lower courts supporting its view have offered previously. The court essentially looked to Collier on Bankruptcy for support, which is also of the view that Section 506(b) limits the allowance of postpetition interest to over-secured consensual liens in accordance with the pre-Code rule. Collier on Bankruptcy notes that there is a clear split in authority on the interpretation of Section 506(b), and states that this limited view of the provision is “consistent with the position that the phrase ‘provided for under the agreement under which such claim arose’ in 11 U.S.C. Section 506(b) modifies the phrase ‘interest on such claim.’” However, Collier on Bankruptcy also acknowledges that when one considers Section 506(b) from a grammatical perspective, a logical reading of the statute does allow for postpetition interest on all liens, without any distinction as to whether the lien is consensual or nonconsensual.

The court in Ron Pair Enterprises concluded that it did not agree with the opinion of the Fourth Circuit Court in Best Repair that the “‘plain meaning’ of Section 506(b) allows for the payment of postpetition interest on all allowed over-secured claims, including nonconsensual

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31 See In re Newbury Cafe, 80 Bankr. 259 (D. Mass. 1987), aff’g 72 Bankr. 478 (Bankr. E.D. Mass. 1987); In re Dan-Ver Enterprises, Inc., 67 Bankr. 951 (W.D. Pa. 1986); In re Churchfield, 62 Bankr. 399 (Bankr. E.D. Mich. 1986); In re Granite Lumber, 63 Bankr. 466 (Bankr. D. Mont. 1986); In re Venable, 48 Bankr. 853 (S.D.N.Y. 1985); In re Stack Steel & Supply Co., 28 Bankr. 151 (Bankr. W.D. Wash. 1983). Most of these cases found the language of Section 506(b) was too ambiguous. This assertion of ambiguity and the lack of legislative history on the question of postpetition interest was advanced by these courts to support their conclusion that Congress intended to codify the pre-Code rule limiting postpetition interest to over-secured consensual liens under Section 506(b).

3 COLLIeR ON BANKRUPTCY § 506.05 at 506-41-42, n.5b (15th ed. 1987).

32 COLLIeR ON BANKRUPTCY concludes that interpreting Section 506(b) as disallowing postpetition interest is more in line with pre-Code precedents and is consistent with the position that the phrase ‘provided for under the agreement under which such claim arose’ in 11 U.S.C. Section 506(b) modifies the phrase ‘interest on such claim’ which . . . is the preferred position. Further, this commentator notes that the legislative history does not evidence an intent to change the pre-Code rule.

828 F.2d at 372 (citations omitted).

3 COLLIeR ON BANKRUPTCY ¶ 506.05 at 506-41-42, n.5b (15th ed. 1987).

35 Inasmuch as this grammatical ambiguity was present in all prior versions of 11 U.S.C. § 506(b) starting with H.R. 6, it cannot be explained as a desire on the part of the drafters to divorce interest from the “reasonable” qualifier which appears only in later versions. But see In re Lovebirdge Mach. & Tool Co., which, based on the assumption that 11 U.S.C. § 506(b) allows postpetition interest on nonconsensual lien claims, explains the grammatical structure as necessary to provide for situations in which there is no agreement. If one accepts that assumption, which constitutes the minority view, that explanation is also.

3 COLLIeR ON BANKRUPTCY, ¶ 506.05 at 506-43, n.10 (15th ed. 1987) (emphasis added).
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liens," or that the limited reading of Section 506(b) "strains" the plain meaning of the provision.\(^3\) It also stated that the position of the Fourth Circuit Court is weakened by its "acknowledgment that Section 506(b) is 'not so clear that [it] would not consider its legislative history to aid [its] interpretation'" and its failure to give a thorough discussion of pre-Code law.\(^3\)

Contrary to the views expressed by the court in *Ron Pair Enterprises*, the acknowledgment by the Fourth Circuit Court in *Best Repair* that the language of Section 506(b) is "not so clear that it would not consider its legislative history" is not a weakness in its opinion. It is the court's recognition of the various arguments about the ambiguity of the language of Section 506(b), which is the crux of the debate between the two differing views. Clearly, there is a real question concerning the ambiguity of the language of this provision. However, it is the extent and/or the degree of the ambiguity that causes such a split in authority. The court in *Best Repair*, and the vast majority of lower courts that have addressed this issue, are of the view that the existence of any ambiguity is not so great as to warrant a reading of the statute other than as it is written.\(^3\) In considering the legislative history of Section 506(b), as opposed to the judicial evolution of pre-Code law on postpetition interest, the court in *Best Repair* concluded that the legislative history of Section 506(b) did not warrant a "depart[ure] from the natural import of the language [of Section 506(b)] itself."\(^6\)

When considering the language of the statute, the argument that it is not ambiguous seems to be most persuasive. First, the provision makes no distinction between consensual or nonconsensual claims.\(^4\) All references to claims and secured claims in Section 506(b) are without any such qualification. In addition to this consideration of the "words" of the provision, the grammatical structure and phrasing of the provision supports the view that the allowance of interest is not limited to consensual liens. The court in *Best Repair* provides a most thorough discussion of the grammatical structure of Section 506(b):

The phrase "interest on such claim" is set off by commas, and the following phrase is introduced by "and any". The effect of this usage is to make

\(^3\) 828 F.2d at 372.
\(^3\) Id. at 372-373.
\(^3\) See generally supra note 14 and accompanying text.
\(^6\) 789 F.2d at 1082.
\(^4\) See generally supra note 14 and accompanying text.
"interest on such claim" a separate and distinct clause to which "provided for under the agreement" does not apply. If Congress had wanted the agreement proviso to limit "interest on such claim" to consensual claims, it could have easily done so by listing seriatim and in parallel form the different items an over-secured creditor can recover subject to an agreement.2 Though Congress could have more clearly separated the interest clause from the agreement clause, we think that the natural meaning of its chosen words is to permit post-petition interest on nonconsensual over-secured claims.3

2.... Congress could have stated: “there shall be allowed to the holder of such claim, interest on such claim and reasonable fees, costs, and charges provided for under the agreement under which such claim arose.” Alternatively, the agreement proviso could be placed first: “there shall be allowed to the holder of such claim, as provided for under the agreement under which such claim arose, interest on such claim and any reasonable fees, costs or charges.”

3. Thus, Congress might have more clearly stated what we deem already apparent by adding the following bracketed material: “there shall be allowed to the holder of such claim [i] interest on such claim, and [ii] any reasonable fees, costs or charges provided for under the agreement under which such claim arose.” Unlike the alterations in footnote two, however, we think this minor addition comports with the existing meaning of the provision.4

The kind of analysis presented in Best Repair has been adopted by the majority of courts in interpreting the plain language of Section 506(b), and in most of these cases this analysis has concluded the discussion on the meaning of the provision.4 However, the insistence of courts like Ron Pair Enterprises to consider pre-Code law on postpetition interest should not be ignored. Perhaps the most important and compelling reason for considering the pre-Code law on postpetition interest is that it requires a review of the judicial evolution of bankruptcy law on the subject, which in turn provides for a critical analysis of the pre-Code rule that Ron Pair Enterprises asserted was codified under Section 506(b).

III. THE PRE-CODE RULE: JUDICIAL EVOLUTION AND LOGIC

In addition to the analysis of the language of Section 506(b), the Sixth Circuit also looked to the pre-Code law on postpetition interest in

41 789 F.2d at 1082.
42 See generally supra note 14 and accompanying text.
interpreting the provision, which was the fundamental basis of its decision. The court's authority for considering the pre-Code law is found in a rule of statutory construction set forth in *Midlantic National Bank v. New Jersey Department of Environmental Protection.* The Supreme Court granted certiorari in *Midlantic* to interpret the meaning of the abandonment provision of Section 554(a) of the Bankruptcy Code. As in *Ron Pair Enterprises*, there was little legislative history on Section 554 and there had been a pre-Code law on the trustee's powers to abandon property of the estate at bankruptcy. In its decision to apply this pre-Code rule in interpreting Section 554, the Court stated:

[W]hen Congress enacted § 554, there were well-recognized restrictions on a trustee's abandonment power. In codifying the judicially developed rule of abandonment, Congress also presumably included the established corollary that a trustee could not exercise his abandonment power in violation of certain state and federal laws. The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.

In its description of the pre-Code law regarding postpetition interest, the court in *Ron Pair Enterprises* stated that "it was a well-established general rule that interest on both secured and unsecured prepetition . . . ."

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43 "We are of the opinion that the language of Section 506(b), when read in light of the pre-Code judicially created doctrine, codifies the pre-Code law on the issue of allowable postpetition interest." 828 F.2d at 372.

44 474 U.S. 494 (1986).


47 *Id.* at 501 (citing Edmonds v. Compagnie Generale Transatlantique, 443 U.S. 256, 266-267 (1979)(emphasis added)). Justice Rehnquist offered a compelling dissenting opinion which questions the majority's opinion describing the judicially developed pre-Code rules on abandonment as "well established." In his dissenting opinion, Justice Rehnquist also expressed objections to the Court's use of this pre-Code law to support its interpretation of Section 554(a) because of the "scant" legislative history of Section 554(a):

The Court seeks to turn the seemingly unqualified language and the absence of helpful legislative history to its advantage. Adopting the reasoning of the Court of Appeals, the Court argues that in light of Congress' failure to elaborate, Section 554 must have been intended to codify prior "abandonment" case law, and that under prior law a "trustee could not exercise his abandonment power in violation of certain state and federal laws." I disagree. *We have previously expressed our unwillingness to read into unqualified statutory language exceptions or limitations based upon legislative history unless that legislative history demonstrates with extraordinary clairty that this was indeed the intent of Congress.*

474 U.S. at 510 (citations omitted)(emphasis added).
claims ceased to accrue upon the filing of a bankruptcy petition." The court stated that the federal courts created exceptions to this rule, noting the third exception which permits postpetition interest where "the value of the collateral securing the debt is sufficient to pay both the claim and postpetition interest on the claim." The court described its view that this exception was limited to consensual liens as being "equally well established by at least four courts of appeals."

The court's description of its limited view of the third exception as being the "well established" pre-Code rule that was codified by Congress under Section 506(b) is debatable and arguably unsupportable. It was a well established rule in the evolution of the pre-Code law on postpetition interest that once a debtor had sought relief at bankruptcy or through receivership, interest would not accrue against the bankrupt's debts. This rule taken from English law was described by Justice Holmes in Sexton v. Dreyfus:

For more than a century and a half the theory of the English bankrupt [sic] system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission. This rule was applied to mortgages as well as to unsecured debts . . . and notwithstanding occasional doubts it has been so applied with the prevailing assent of the English judges ever since . . . . We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we copied the system. . . . No one doubts that interest on unsecured debts stops.

The reasons for this rule against interest are reflective of the basic principles of bankruptcy, that is, to provide the debtor with financial relief, an opportunity for a fresh start, and to treat all creditors fairly and

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48 828 F.2d at 370.
49 Id.
50 Id. at 371.
51 One of the earliest Supreme Court cases to address the issue of postpetition interest was Thomas v. Western Car Company, 149 U.S. 95 (1893). In its opinion, the Court described the pre-Code rule on postpetition interest as follows:

As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of law; it is a necessary incident to the settlement of the estate. We see no reason in departing from this rule in a case like the present, where such a claim would be paid out of moneys [sic] that fall short of paying the mortgage debt.

149 U.S. at 116-117 (citations omitted).
53 Id. at 344 (citations omitted).
equitably in the process. This rule assures the debtor that, upon the commencement of his case at bankruptcy, his obligations would no longer accrue and would be measured at that moment so that the relief sought could be effectuated. The allowance of interest beyond the commencement of the case was looked upon as a "penalty" imposed on creditors subordinate to the claimant of interest. The courts stated that any delay in the settlement of the bankruptcy case was an incident of the bankruptcy proceeding and the allowance of interest, because of such delay, should not benefit one creditor at the expense of others.

The first two exceptions to this general rule prohibiting postpetition interest appear to have been as well established as the rule itself and were recognized by the Supreme Court along with the general prohibition. These two exceptions to the prohibition against postpetition interest were limited to cases where the debtor proved to be solvent, and in cases where the creditor held property of the debtor that produced income or dividends during the bankruptcy proceedings. The equities that warranted these two exceptions were founded on the idea that no other creditor would suffer because of the allowance of postpetition interest. If the debtor was solvent, all of his debts would be paid and "there would be no inequality of distribution and other creditors [would] not suffer by allowing interest on claims after bankruptcy."

With respect to a creditor having an interest in income-producing collateral, the allowance of postpetition interest would not result in a depletion of the estate designated to satisfy the claims of the other creditors.

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67 The first two exceptions to the general prohibition against postpetition interest were derived from English law and recognized by the Supreme Court in City of New York v. Saper. More than forty years ago Mr. Justice Holmes wrote for this Court that the rule stopping interest at bankruptcy had then been followed for more than a century and a half. He said the rule was not a matter of legislative command or statutory construction but, rather, a fundamental principle of the English bankruptcy system which we copied.7
68 In England the practice was well established . . . . Two exceptions were recognized: if the alleged "bankrupt" proved solvent, creditors received post-bankruptcy interest before any surplus reverted to the debtor, and if securities held by a creditor as collateral produced interest or dividends during bankruptcy such amounts were applied to post-bankruptcy interest. These exceptions have been carried over into our system.
336 U.S. 328, 330, 330 n.7 (1948) (citations omitted).
69 Id.
because the assets of the estate available to these creditors would have been identified at the commencement of the case. These two exceptions appear to have evolved simultaneously with the general rule. The third exception appears to have developed later.

The third exception, as it initially evolved in the courts, permitted postpetition interest on a claim after the petition was filed if the value of the collateral securing the creditor's claim exceeded the amount of the principal and the interest due on the claim at the time the petition was filed. On the several occasions that this third exception was recognized by the Supreme Court, the Court was not called upon to consider the applicability of this exception to nonconsensual liens. The exclusion of nonconsensual liens from this exception did not occur until later, when the question was considered in the lower federal courts. Such a limited view of this exception has never been recognized by the Supreme Court.

The evolution and logic of the more restrictive third exception can only be appreciated through an analysis of the four circuit court decisions where the exception evolved in the context of consensual liens. As this analysis will reveal, it is questionable whether the limited view of the third exception can truly be deemed a part of the "well established" pre-Code law on postpetition interest. First, unlike the general pre-Code prohibition against postpetition interest and the first two exceptions, this limited third exception was never recognized by the Supreme Court as one of the exceptions to the general prohibition, let alone as a well established rule. Moreover, the equitable justifications for the limited third exception are not as compelling as in the case of the first two exceptions. Thus, it cannot be relied on with certainty that this limited third excep-

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60 Id.
61 Simple interest on secured claims accruing after the petition was filed was denied unless the security was worth more than the sum of principal and interest due. . . . But where an estate was ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations were invoked to permit payment of this additional interest to the secured creditor rather than to the debtor. Vanston Committee v. Green, 329 U.S. 156, 164 (1946) (citations omitted).
63 See generally cases cited in note 28.
64 In its decision to deny the third exception to a secured tax claimant, the First Circuit in Boston & Maine noted that: "The Supreme Court has never ruled on the applicability of the third exception, granting postpetition interest when there is sufficient secured collateral, to tax liens." 719 F.2d at 497.
65 See infra notes 74-82 and accompanying text.
tion was the well established pre-Code rule codified by Congress under Section 506(b), as suggested by the court in Ron Pair Enterprises.66

It was suggested in the pre-Code circuit court cases that the Supreme Court had prohibited the allowance of any postpetition interest on "all" tax claims in City of New York v. Saper.67 However, these courts appeared to have been reading this decision by the Court out of context. In Saper, the Supreme Court was considering whether tax claims had been classified so as to enjoy a "highly preferred" status over all other debts (under the Bankruptcy Act) that would allow postpetition interest on all tax claims in exception to the general prohibition against postpetition interest on debts. The Court held that, as a result of the 1926 and 1938 amendments to the Act, Congress had "assimilated taxes to other debts for all purposes, including the denial of post-bankruptcy interest."68 Saper did not involve a question concerning whether an over-secured tax claim was entitled to postpetition interest pursuant to the acknowledged exceptions to the general prohibition.69 The Court in Saper was only addressing the question of whether all tax claims, regardless of the secured status of the tax claim, were excepted from the general rule because of a special preferred status under the Bankruptcy Act.

In spite of the fact that the Supreme Court had yet to determine whether the over-secured tax claim was entitled to postpetition interest under the third exception, the circuit courts argued that bankruptcy equities justified such an exclusion. In United States v. Harrington,70 the Fourth Circuit began its consideration of the equities justifying the disallowance of postpetition interest on a tax claim by looking at the principles behind the "two clearly established exceptions to the rule that interest on both secured and unsecured claims stops with the filing of the petition in bankruptcy."71 The court noted that with the first two exceptions allowing postpetition interest in cases where the debtor is solvent or where

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66 828 F.2d at 371.
68 336 U.S. at 337.
69 In considering the question of whether the unsecured tax claim was entitled to postpetition interest, the Court in Saper only considered the permissibility of such interest under the first two exceptions of the general rule prohibiting postpetition interest. The Court did not consider whether the third exception, which addressed over-secured claims, applied to a secured tax claim. See In re Ross Nursing Home, 2 Bankr. 496, 499-500 (Bankr. E.D.N.Y. 1980) and Boston & Maine, 719 F.2d at 496, for an accurate discussion of the issues considered by the Court in Saper.
70 269 F.2d 719 (4th Cir. 1959).
71 Id. at 722.
the creditor holds the debtor's income producing property as collateral, the
allowance of postpetition interest would not adversely affect the interests
of other creditors. With the first exception, a "surplus is left after all
claims have been paid" and the creditors claiming interest may look to the
surplus. In the second exception, there would be no depletion of the
bankruptcy estate to the detriment of other creditors because the interest
would not be derived from assets that would have gone to the other credi-
tors, that is, all prepetition assets. Thus, with both exceptions, the
postpetition interest was allowed because it would not be derived from
assets that would normally go to the remaining creditors.

The court noted that the equities warranting the exception to the
general rule in the first two exceptions were not present in the third ex-
ception, allowing postpetition interest on over-secured claims. In such a
case, the court acknowledged that:

If interest is allowed a secured creditor during the bankruptcy proceeding,
even though the security is sufficient, payment must come from assets which
would normally go to the remaining creditors. Delay in the termination of
the bankruptcy proceedings would diminish the shares of general creditors
through no fault of theirs.

However, the court justified the exception in cases of consensual liens
versus nonconsensual liens by noting that the nonconsensual lien is usu-
ally against all of the debtor's assets and not a specific asset, as in the case
of the consensual lien. Accordingly, the allowance of postpetition interest
in the case of nonconsensual liens would be of greater damage to the in-
terest of the remaining creditors in that it could reach the entire estate.

The Fourth Circuit's analysis in Harrington suggests some uncer-
tainty on the part of the court about the status of the third exception to
the general rule as well as the equities that would support the exception.
As noted by the court in its discussion, the first and second exceptions
were "the two clearly established exceptions" to the general prohibition
against postpetition interest. Moreover, the third exception did not pos-
sess the same equitable characteristics that justified these two exceptions.
The allowance of interest under the third exception, unlike the first two

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72 See supra notes 60-68 and accompanying text.
73 Id.
74 269 F.2d at 723.
75 Id.
76 Id. at 723 n.6.
exceptions, would result in a depletion of assets that would have been distributed to the remaining creditors.

Furthermore, the distinction between consensual liens as being "specific" and nonconsensual liens as being "general" is not supportable in all cases. First, consensual liens can be as all encompassing as nonconsensual liens. That is, a creditor can require that a debt be secured by all of the debtor's assets, or the impact of a floating lien against all of a debtor's after-acquired property under a consensual lien could result in a large percentage of the bankruptcy estate being deemed available for the payment of accruing interest, thus diminishing the available assets to the other creditors. Similarly, not all nonconsensual liens are general liens against all of the debtor's property. Some statutory liens are granted against a specific property type such as a typical mechanic's lien. For example, a mechanic's lien or construction lien is usually granted in favor of the creditor who provides labor or supplies for improvements to the debtor's property. These liens are usually limited to the real property or personal property on which the construction project or improvement is made by the laborer or supplier of the materials. Accordingly, this type of nonconsensual lien may be far more specific and less expansive than some consensual liens. Similarly, tax liens do not always cover all of the debtor's assets, they may be limited to the property of the debtor on which the taxes are unpaid, as was the case in *Boston & Maine.*

The other justification offered by the court in *Harrington,* and by the other courts that followed it, was that in the case of a consensual lien the creditor has extended credit in reliance that a particular security was given as collateral to secure both the principal and the interest of the debt until payment, and that the contract should not be abrogated by bankruptcy. It had also been noted that with tax claims the payment of interest is not contemplated in the payment of taxes at the beginning of a tax year, and the imposition of interest on taxes is an enforcement device and penalty that works against the remaining creditors rather than the debtor. These types of distinctions do not seem to be significant enough to justify the allowance of postpetition interest on consensual liens and not.
on nonconsensual liens. Although they are distinctions between the two classes of liens, consensual versus nonconsensual, they do not have any bearing on the equitable concerns of the first two exceptions; that is whether the allowance of postpetition interest in favor of one creditor is granted at the expense of others. As noted above, the allowance of postpetition interest to any over-secured creditor, whether consensual or nonconsensual in nature, will always deplete the assets of the estate at the expense of the remaining creditors. The fact that interest payments are contemplated in a consensual lien does not lessen the impact of the accrual of postpetition interest in favor of one creditor against the other creditors. In either case, the allowance of postpetition interest will deplete assets that could have gone to the remaining creditors.

The third exception also runs afoul of the basic foundations of bankruptcy law in that it absolutely excludes all over-secured nonconsensual claims from accruing postpetition interest without any consideration of the equities in a case. It is more in the spirit of bankruptcy to consider the permissibility of postpetition interest on all over-secured claims on a case-by-case basis. In considering the limitations of postpetition interest, the First Circuit Court of Appeals in In re Boston and Maine Corporation stated that:

These exceptions are not rigid doctrinal categories. Rather, they are flexible guidelines which have been developed by the courts in the exercise of their equitable powers in insolvency proceedings. The reorganization court must consider whether to grant postpetition interest, not as an abstract matter, but in light of the nature of each claim and the equities of the case before it. At all times the reorganization court must be guided by the basic equitable principle announced in Vanston:

It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor.81

Based on the foregoing, it can be argued that the pre-Code rule limiting postpetition interest to over-secured consensual liens was not a "well established" pre-Code law on postpetition interest. This conclusion is based on the fact that the logic supporting the distinctions between consensual and nonconsensual liens was flawed and very disputable. The rule

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81 Id. at 496 (citations omitted).
did not embody the equitable principles of the first two exceptions to the
general pre-Code rule prohibiting postpetition interest; exceptions that
were as "well established" as the general pre-Code prohibition against
postpetition interest and were recognized by the Supreme Court. More-
over, the Code is designed to encourage a more equitable approach to
bankruptcy. Section 502(j) of the Code provides that if a claim has been
allowed or disallowed it may be reconsidered for cause and allowed or
disallowed based on the equities of the case.

IV. Conclusion

The objective of this article has been to analyze the current debate
over the interpretation of Section 506(b) of the Code. That is, does the
allowance of postpetition interest to over-secured creditors under Section
506(b) include all over-secured claims or only those that are consensual in
nature? The Sixth Circuit, in Ron Pair Enterprises, has held that be-
cause the language of this provision is ambiguous, and there is nothing in
the legislative history which specifically addresses the question of postpeti-
tion interest, Congress must have intended to codify the pre-Code rule
that limited the allowance of postpetition interest to over-secured liens
that were "consensual in nature." The Fourth Circuit, in Best Repair,
found the language of Section 506(b) not to be so ambiguous that it could
not be read to allow postpetition interest on all claims, secured by consen-
sual liens or nonconsensual liens.

The better interpretation of Section 506(b) is that it permits postpet-
tion interest on all over-secured claims. This conclusion is based on sev-
eral of the points discussed above, including the fact that the plain lan-
guage of the provision does not specifically limit the allowance of
postpetition interest to consensual liens. In addition, the grammatical
structure of the provision supports the view that the allowance of postpet-
tion interest under Section 506(b) is unqualified. Moreover, the lack of
legislative history on the question of postpetition interest should not be
used as an excuse to ignore the plain language of the statute, and to find
meaning outside of Section 506(b), in a pre-Code rule that is logically
flawed. When the Sixth Circuit relied on the pre-Code law to interpret

82 A claim for postpetition interest may be objected to by the trustee or the debtor-in-possession.
has been made, the court has to determine whether to allow or disallow the claim based on the
Section 506(b) in *Ron Pair Enterprises*, it was looking to a rule that was based on a weak distinction between consensual and nonconsensual liens that did not justify an absolute prohibition against the allowance of postpetition interest on nonconsensual liens. This distinction is particularly true in cases where nonconsensual liens are not all encompassing and are limited to liens against specific property of the debtor, such as mechanic’s and artisan liens, as well as tax liens that are limited to property on which a tax obligation is outstanding.

To interpret Section 506(b) as absolutely prohibiting postpetition interest on nonconsensual liens, without any opportunity to consider the facts in a given case, is contrary to the equitable principles of bankruptcy law. Bankruptcy law provides for the consideration of each claim on its merits and for a balancing of equities between the debtor and the debtor’s many creditors. Accordingly, Section 506(b) should simply be interpreted as it was written by Congress. That is, consideration should be given to postpetition interest on all over-secured claims, and the equities of a case should determine what is fair in bankruptcy.