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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re	Case No. 96-53896-MM
	Chapter 11
DOHRMAN ENTERPRISES,	MEMORANDUM DECISION
Debtor.	

I. INTRODUCTION

Before the court is the legal issue whether Stanislaus County may claim the statutory rate of interest set forth in California Revenue and Taxation Code §4103(a) for delinquent real property taxes or whether it is limited to a market rate of interest.

II. STATEMENT OF FACTS

Dohrman Enterprises purchased property in 1993, subject to the existing tax claim of Stanislaus County. In 1997, the Modesto Redevelopment Agency paid \$662,000 to the debtor as just compensation for the property. Dohrman Enterprises used these funds to pay creditors 100% plus interest pursuant to its plan of reorganization. The County's tax claim was paid in full by Dohrman on August 1, 1997, with the debtor reserving its objection to the claim.

III. ANALYSIS

1 The allowance of postpetition interest is governed by 11 U.S.C. §506(b), which provides that
2 “[t]o the extent that an allowed secured claim is secured by property the value of which . . . is greater
3 than the amount of such claim, there shall be allowed to the holder of such claim, interest on such
4 claim. . . . “ It is undisputed that a nonconsensual, statutory, oversecured creditors is entitled to
5 recover postpetition interest under §506(b). *See United States v. Ron Pair Enterprises, Inc.*, 489
6 U.S. 235 (1989). However, there is no controlling authority determining the appropriate rate of
7 interest to be paid on a lien created by statute. The Ninth Circuit has not addressed this issue. In
8 other jurisdictions, courts have adopted three approaches to determine the appropriate rate of
9 postpetition interest where a lien is created by statute. *See In re Marfin Ready Mix Corp*, 220 B.R.
10 148 (Bankr. E.D.N.Y. 1998). Some courts have held that the rate of interest is always the rate set
11 forth in the statute that created the lien. *See e.g. In re Isley*, 104 B.R. 673 (Bankr. D.N.J. 1989)
12 (18% interest allowed at statutory rate to county taxing authority). Other courts have used a
13 balancing test weighing the equities against the particular facts of the case. *See e.g. In re Wasserman*,
14 151 B.R. 4, 5 (D. Mass. 1993).

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18 The great majority of courts, however, have concluded that, while the bankruptcy court is not
19 bound by the statutory rate, it should only deviate in limited circumstances. *See In re Liuzzo*, 204
20 B.R. 235, 239 (Bankr. N.D. Fla. 1996) (holding that the statutory rate of interest applies unless the
21 debtor presents evidence that “the statutory interest rate is a penalty or the application of the
22 statutory rate would lead to an inequitable or unconscionable result.”). The expressed reasoning is
23 that the interest paid on unpaid taxes is different from that paid on consensual mortgagees because
24 there is no negotiation process. The *Marfin* court noted that:

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26 The interest rate paid to a mortgagee is but one variable in the equation

1 constituting the mortgage transaction. Others exist All are open to
2 negotiation, and the assignment of a value to one variable during the bargaining
3 process will invariably affect the values assigned to the others. Yet the taxing
authority has control over nothing but the interest rate.

4 *In re Marfin*, 220 B.R. at 156.

5 One court recently suggested that the factors to establish an inequitable or unconscionable result
6 would arise where there has been misconduct by the creditor, where application of the statutory
7 interest rate would cause direct harm to unsecured creditors, where the statutory interest rate is a
8 penalty, or where its application would prevent the debtor's fresh start. *See In re P.G. Realty Co.*,
9 220 B.R. 773, 778 (Bankr. E.D.N.Y. 1998).

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11 In *In re P.G. Realty Co.*, the chapter 11 debtor sought a determination of its tax liability to the
12 city and the assessment of the postpetition interest on its oversecured claim. The bankruptcy court
13 followed the majority of cases and held that the court may modify rights created by state law but that
14 absent a compelling interest to the contrary, it would allow interest at the rate set forth in a state's
15 legislative scheme. *In re P.G. Realty Co.*, 220 B.R. at 789. The court explained that "adoption of a
16 'market rate' approach would leave an unresolved fact issue in every bankruptcy case, which would
17 require litigation for every new day's market." *Id.* Further, the court stated that "a legislative tax
18 scheme designated to raise revenue to pay the costs of government is unlike a commercial
19 transaction, where the parties have bargained for their rights."

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22 The debtor has not provided any compelling reason to deviate from the default interest rate.
23 The debtor has not provided any evidence of misconduct by the taxing authority. The statutory rate
24 will not cause direct harm to unsecured creditors. There is no evidence that the statutory rate would
25 prevent the debtor's fresh start.
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1 The remaining issue to be determined is whether the interest provided for in the California
2 Revenue and Taxation Code is a penalty. A penalty is that portion of a tax obligation which is
3 punitive, not compensatory in nature. See *In re Hovan, Inc.*, 96 F.3d 1254, 1259 (9th Cir. 1996).
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5 Courts that have considered this issue have examined the purpose of the statutory rate and its
6 legislative history. See *In re Liuzzo*, 204 B.R. 235, 240 (Bankr. N.D. Fla. 1996); *Galveston Indep.*
7 *School District v. Heartland Fed. Savings & Loan*, 159 B.R. 198, 204 (S.D. Tex. 1993); *In re*
8 *Davison*, 106 B.R. 1021, 1022 (Bankr. D. Neb. 1989). The debtor has not presented any evidence in
9 support of its position that the statutory rate of interest of 18% is penal.
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11 In fact, Revenue and Taxation Code §4103(b) provides the opposite, expressly stating that:

12 [f]or purposes of an administrative hearing or any claim in a bankruptcy
13 proceeding pertaining to the property being redeemed, the assessment of penalties
14 determined pursuant to subdivision (a) with respect to the redemption of that
property constitutes the assessment of interest.

15 IV. CONCLUSION

16 Dohrman's objection to the County's claim is overruled. The amount of interest on the
17 County's tax claim is to be calculated at the statutory rate.
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21 Dated:

22 UNITED STATES BANKRUPTCY JUDGE
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