No. 10-1443

In the Supreme Court of the United States

AMERICREDIT FINANCIAL SERVICES, INC.,
Petitioner,

v.

MARLENE A. PENROD,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONER'S REPLY BRIEF

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CORPORATE DISCLOSURE STATEMENT

The corporate disclosure statement included in the petition for writ of certiorari remains accurate.

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AmeriCredit submits the following reply to Penrod's Opposing Brief. ("OB")

I. THERE IS A CONFLICT IN THE CIRCUITS

Penrod's argument that there is no conflict in the circuits is strangely at odds with the Ninth Circuit decision that Penrod supports:

> We decline to adopt the reasoning of our sister circuits. *We acknowledge that our decision creates a circuit split*, and we do not do so lightly. *In re Penrod*, 611 F.3d 1158, 1161 (9th Cir. 2010) (emphasis added).

Prior to Congress' adoption of BAPCPA in 2005, the Chapter 13 plan requirements of Section 1325(a)(5) and the bifurcation rules of Section 506 applied uniformly throughout the country. Penrod argues that the Hanging Paragraph cast aside that uniformity in favor of a rule that would allow each state to determine how a claim in bankruptcy can be bifurcated in a Chapter 13 plan. The predicate for Penrod's argument is that Congress intended the term "purchase money security interest" in the Hanging Paragraph to be defined, not just by reference to Article 9, but instead by reference to how the highest court in each state has interpreted that term in its version of Article 9. OB at 8 *et. seq.* Under this interpretation, in order to confirm a Chapter 13 plan where the Hanging Paragraph applies, each of the 94 bankruptcy courts in the United States would be required to divine how the highest court in each state in which the bankruptcy court sits would interpret the term PMSI in Section 9-103 as applicable in that state.

This, in turn, would mean that application of the Chapter 13 plan requirements would give rise to conflicting outcomes in each state. It is hard to imagine that Congress intended this drastic change in the Bankruptcy Code when it enacted the Hanging Paragraph.

As support for her argument, Penrod cites *Butner v. United States*, 440 U.S. 448 (1979) and its progeny. OB at 10, *et. seq*. These cases do not support Penrod's argument. In *Butner,* this Court held that, where the Bankruptcy Code is silent, state law applies to define property interests and claims asserted in a bankruptcy case. This case does not involve a dispute over a state law property interest or a state law claim. Both parties concede that Penrod has an ownership interest in the vehicle and AmeriCredit has a security interest in the vehicle. The dispute solely concerns the effect of one Bankruptcy Code provision--Section 1325 (a)(*)(the Hanging Paragraph)--on two others--Sections 1325(a)(5) and 506. Thus, no state law property interest or claim is implicated.

AmeriCredit recognizes that it is appropriate for the bankruptcy courts to look to Article 9 to define the term PMSI since the Bankruptcy Code has no definition of this term and it is specifically and uniformly defined in Article 9 of the UCC. In fact, AmeriCredit urged the lower courts to consult Article 9 since it strongly supports AmeriCredit's position. Eight circuit courts, in 9 opinions, and New York's highest court agreed. Petition at 8, n. 2. But, when these courts concluded that the charge for negative equity is a PMSI and is therefore protected from bifurcation by the Hanging Paragraph, they were interpreting and applying federal law, not state law.

United States v. Kimbell Foods, 440 U.S. 715, 727 (1979).

In interpreting a term used in a federal statute, such as the Bankruptcy Code, this Court has frequently referred to state law where the term is not defined in the statute but has an established and uniform meaning under state statutory or common law. But, in borrowing from state law, where no state law property interest is involved, the Court is applying a uniform federal rule of interpretation. For example, in *Citizens Bank v. Strumpf*, 516 U.S. 16 (1995), this Court consulted state law to decide when a "setoff" occurs within the meaning of the automatic stay provisions of Section 362(a)(7) of the Bankruptcy Code but then observed:

> But even if state law were different, the question whether a setoff under §362(a)(7) has occurred is a matter of federal law, and other provisions of the Bankruptcy Code would lead us to embrace the same requirement of an intent permanently to settle accounts. 516 U.S. at 19.

See also Molzof v. United States, 502 U.S. 301 (1992) (applying law dictionaries, prior Supreme Court cases and an accumulated body of common law to define the term "punitive damages" as used in the Federal Tort Claims Act); *Mac's Shell Service, Inc. v. Shell Oil Products Co. LLC*, 130 S. Ct. 1251, 1257-1258 (2010) (relying upon dictionary definitions and state law, including the UCC, to define the terms "terminate" and cancel" as used in the Petroleum Marketing Practices Act).

These cases are particularly applicable here since the term "purchase money security interest," as used in the Hanging Paragraph, is a term of art that has a uniform meaning in every jurisdiction in the United States. This meaning is derived from Sections 9-103(a) and (b) which, in relevant part, have been enacted without change in every state and the District of Columbia. Because Sections 9-103(a) and (b) have been uniformly adopted throughout the country, they are a perfect candidate to give a uniform meaning to the term PMSI as used in the Hanging Paragraph.

The conflict in the circuits is best illustrated by carefully examining the opinions of the 9 circuits in which the issue has been addressed. *See* Petition at 8, n. 2 and *Penrod*, 611 F.3d 1158 (9th Cir. 2010) and 636 F.3d 1175 (9th Cir. 2011) (Bea, J., dissenting). In each of these opinions, the circuit courts interpreted the Hanging Paragraph as a matter of federal law, and applied it to the facts of the cases. Although the courts referred to state law to define the term PMSI, they referred to the uniform version of Sections 9-103(a) and (b) and Comment 3, and not to any particular case or authority in the state in which the transaction took place. This includes the Ninth Circuit in the two *Penrod* decisions. Neither the Ninth Circuit panel nor the dissenting judges on denial of AmeriCredit's Petition for Rehearing En Banc made any effort to parse California law on the PMSI issue. In fact, the panel relied primarily on dissenting opinions from the other circuits. In defining the term PMSI in the Hanging Paragraph, the circuit courts cite each other, and many of them rely heavily upon the intent, purposes, policies and preambles of BAPCPA and the Hanging Paragraph, thus signaling that a uniform federal rule of decision, with guidance from state law,

is being applied. *See e.g., In re Price*, 562 F.3d 618, 628-29 (4th Cir. 2009); *In re Graupner*, 537 F.3d 1295, 1297-98, 1302-03 (11th Cir. 2008); *In re Howard*, 597 F.3d 852, 857-58 (7th Cir. 2010).

II. AMERICREDIT HAS NOT WAIVED ITS RIGHT TO RELY ON THE PLAIN TEXT OF THE HANGING PARAGRAPH

Penrod argues that AmeriCredit has waived the right to argue that the plain text of the Hanging Paragraph prohibits the bifurcation and cramdown of its secured claim. OB at 18-19. Penrod claims that this is a "federal law" argument that was asserted for the first time in the Ninth Circuit. Penrod's argument is specious.

Penrod's waiver argument is predicated on the fact that AmeriCredit argued before the BAP that state law (Article 9) should be consulted in determining the meaning of the term PMSI as used in the Hanging Paragraph. OB at 18-19. Penrod argues that AmeriCredit changed its position in the Ninth Circuit when it argued that the plain text of the Hanging Paragraph shields its claim from bifurcation and cramdown. Penrod has misconstrued and misrepresented AmeriCredit's argument.

AmeriCredit's position has been consistently presented at every stage of this case. State law can be consulted in determining the meaning of the term PMSI as used in the Hanging Paragraph, and AmeriCredit therefore urged the BAP to consider Sections 9-103(a) and (b) of Article 9. That was done by the BAP, which concluded that (i) AmeriCredit has a PMSI in Penrod's vehicle, (ii) all other requirements

of the Hanging Paragraph are satisfied, (iii) the Hanging Paragraph applies to AmeriCredit's claim and (iv) Penrod cannot bifurcate AmeriCredit's claim based on the value of the Vehicle. Petition at 18-19. The Ninth Circuit agreed and affirmed the decision of the BAP. In her Opposing Brief filed in this Court, Penrod also concedes each of the above points. See OB at 3-4.

Given the rulings of the lower courts, AmeriCredit's position in the Ninth Circuit was that Article 9 has done its work, and all that is left is for the Court to apply the Hanging Paragraph to the undisputed facts of the case. Petition at 17-20. Applying the plain text of the Hanging Paragraph to these facts, Section 506 of the Bankruptcy Code does not apply to AmeriCredit's claim. Since Section 506 is the only provision of the Bankruptcy Code that allows for the bifurcation of claims in a Chapter 13 case, Penrod's plan must call for the payment of AmeriCredit's entire secured claim.

In order to avoid this result, Penrod asked the BAP to amend the Chapter 13 plan requirements of Section 1325(a)(5) to permit the bifurcation of AmeriCredit's claim, not based on the value of the vehicle as provided in (the now inapplicable) Section 506, but instead based on a dissection of the indebtedness underlying AmeriCredit's claim. The BAP agreed to this request and the Ninth Circuit affirmed its decision. It is this judicial rewrite of Section 1325 that AmeriCredit objected to in its briefs before the Ninth Circuit. Penrod's waiver argument is an attempt to foreclose this analysis. The attempt should not prevail, and the Ninth Circuit should have addressed this issue.

AmeriCredit submits that its analysis is consistent with the plain text, purpose and legislative history of the Hanging Paragraph. *See* McMickle, *Trade-In Value and Automobile Loans After Bankruptcy Reform*, The Bankruptcy Strategist, Vol. 27, Nos. 1 and 2 at page 3 et seq. (attached hereto as Appendix "I") and the 3 amici curiae briefs filed in this case.

Even assuming that AmeriCredit can somehow be viewed as changing its position from an emphasis on state law to an emphasis on federal law, that change would not be barred by any waiver doctrine. *Lebron v. National Railroad Passenger Corp*., 513 U.S. 374, 379 (1995).

III. NEGATIVE EQUITY IS A PMSI UNDER ARTICLE 9

A. <u>The Advance to Discharge Negative Equity is Not a Refinancing or a Payment of Antecedent Debt</u>

Penrod argues that, when a dealer advances funds to discharge negative equity related to a purchaser's trade-in vehicle, it is refinancing debt owed to a third party and is therefore paying "antecedent debt." OB at 3, 4, 25, 26, 28, 32, 35. This assertion underpins virtually every argument in Penrod's Opposing Brief. The 8 circuit courts addressed this issue and rejected this argument. Petition at 25-27. Penrod makes no effort to challenge the analysis of these courts or explain how they got this wrong. The debt arising out of the dealer's advance to Penrod cannot be viewed as a refinancing or a payment of antecedent debt since it arises out of a new transaction, creating new indebtedness, owed to a new creditor, evidenced by a

new contract and secured by new collateral. In defining the "New Value" provision of Section 547 of the Code, the courts have consistently held that an advance made by a creditor to pay debts owed by the debtor to third parties, is "new credit," and not the "substitution of one obligation for another." See Petition at 26-27.

The 1898 cases cited by Penrod, OB at 27-28, are easily distinguished since the liens being asserted in those cases secure debt completely unrelated to the collateral. Further, Professor Gilmore's article cited by Penrod, OB at 27, does not support her "antecedent debt" argument--Gilmore does not even use the term "antecedent debt." The article's point, like that made in the cases cited by Penrod, is that an advance that is completely unrelated to the acquisition of the collateral is not purchase-money.[1] Gilmore's article strongly supports AmeriCredit's argument that the term "PMSI" should be broadly construed. As Gilmore stresses, the PMSI has long been a favorite of the law. It enables debtors to acquire new assets that might otherwise be subject to an after-acquired property clause. Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333, 1337-38 (1963).

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[1] Penrod's reliance on 1898 Sixth Circuit cases to support her "antecedent debt" argument is disingenuous because she fails to cite the most recent Sixth Circuit authority, *In re Westfall*, 599 F.3d 498, 504 (6th Cir. 2010) (negative equity on trade-in vehicle is closely related to debtor's acquisition of new vehicle).

B. The "Value Given to Enable" Prong Applies to this Case

Section 9-103 has both a "price" and "value given to enable" prong. Apparently recognizing that the "value given to enable" prong fits this case like a glove, Penrod argues that the value prong does not apply. OB at 24. Although Penrod argues that the value prong applies only to loans, and not to credit sale transactions, her argument that the value prong does not apply is hard to reconcile with her repeated characterization of the transaction in this case as a purchase-money loan. OB at 2-4.

Regardless of whether the transaction is viewed as a credit sale or a loan, the circuit courts are correct in applying **both** prongs since the test for price and value in Comment 3 is identical. Petition at 22. As these courts have held, the charge for negative equity meets that test and is therefore a "purchase-money obligation."

C. The "Other Similar Obligations" Language of Comment 3 Does Not Limit the Reach of Comment 3

Like the *Penrod* panel, Penrod focuses almost exclusively on the "other similar obligations" language at the end of Comment 3. OB at 25. Penrod invokes the *ejusdem generis* rule to argue that a charge for negative equity is not a purchase-money obligation because it is not similar to the other charges listed in Comment 3. This argument has no merit because it ignores the first item in the Comment 3 list, which qualifies as a purchase-money obligation all "expenses incurred in connection with acquiring rights in the

collateral," and is set off from the other listed items by a comma. *See Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241-2 (1989).

The appellate courts have consistently rejected the *ejusdem generis* rule in negative equity cases. *See e.g., In re Dale*, 582 F.3d 568, 574 (5th Cir. 2009); *Westfall*, 599 F.3d at 504; *Reiber v. GMAC*, 13 N.Y.3d 75, 80-81 (N.Y. Ct. App. 2009); *GMAC v. Peaslee*, 373 B.R. 252, 258-58 (W.D.N.Y. 2007).

D. The *In Pari Materia* Doctrine Applies

Penrod challenges the application of the *in pari materia* doctrine, claiming that Article 9 and California's Automobile Sales Finance Act ("ASFA") do not share the same precise purpose. OB at 20. This reading of the doctrine is far too narrow. The *in pari materia* doctrine should be applied since both Article 9 and ASFA apply to the same class of persons, relate to the same subject matter and have the same general purpose. *See Isobe v. Unemployment Ins. Appeals Bd.,* 12 Cal. 3d 584, 590 (1974).

At the very least, ASFA's authorization of negative equity charges, and its direction that they be disclosed to automobile purchasers as part of the "price" of the automobile, is powerful evidence that they bear a "close nexus" to the acquisition of automobiles and are part of the "price" of the automobile as those terms are used in Section 9-103 and Comment 3. Petition at 27-29.

IV. THE HANGING PARAGRAPH IS NOT LIMITED TO PROTECTING AUTOMOBILE FINANCIERS AGAINST DEPRECIATION OF THE AUTOMOBILE

Penrod argues that the sole purpose of the Hanging Paragraph is to protect banks and automobile finance companies against the depreciation that occurs shortly after the purchase of an automobile. OB at 32 *et. seq*. The plain language of the Hanging Paragraph, as well as its purpose and legislative history, dictate that its purpose is to require Chapter 13 debtors to pay the full indebtedness evidenced by the automobile sales finance contract if the Hanging Paragraph applies to a secured creditor's claim. *See In re Wright*, 492 F.3d 829, 832 (7th Cir. 2007) (application of the Hanging Paragraph "implies replacing a contract defeating provision such as § 506 … with the agreement freely negotiated between debtor and creditor") (Easterbrook, J.). *Accord Graupner,* 537 F.3d at 1302.

V. THE STATISTICS CITED BY PENROD AS TO NEW CAR SALES ARE INAPPOSITE

Penrod cites statistics showing an increase in new car sales since the *Penrod* decision as proof that banks and automobile finance companies will conduct business as usual even if this Court declines to hear this case. OB at 36 *et. seq.* It is not surprising that there has been an uptick in the new car sales over the last year as the economy begins its slow recovery from the deep recession. However, it is naïve for Penrod to suggest that the automobile sales finance market will not make adjustments if the *Penrod* decision becomes final and the litigation resumes with even greater force. If dealers and automobile financiers are forced

to absorb the loss associated with the financing of negative equity when the purchaser files a Chapter 13 petition and to incur even greater litigation expenses as new challenges are launched, it is certain that they will be forced to adjust by denying or curtailing credit or charging higher rates to offset the risk. In effect, the overwhelming majority of automobile purchasers who do not file bankruptcy will be subsidizing those very few who file for bankruptcy protection.

CONCLUSION

AmeriCredit respectfully requests this Court to grant its Petition for A Writ of Certiorari. In view of the overwhelming authority supporting AmeriCredit's position, the Court may wish to grant Americredit's Petition and reverse the judgment of the lower court pursuant to Rule 16(1).

Respectfully submitted.

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APPENDIX 1

Volume 27, Number 1 • November 2009

Trade-in Value and Auto Loans After Bankruptcy Reform

Part One of a Two-Part Article

By John D. McMickle

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In 2005, when Congress enacted PL 109-8, significant changes were in store for the automobile finance industry. Under the prior law, automobile financiers faced the prospect of cram-down or lien stripping, whereby a portion of the amount due on an automobile sales contract could be bifurcated and then treated as unsecured. The effect of this procedure was

to substantially reduce the likelihood of the auto lender being repaid the full amount due under the sales contract. PL 109-8 was specifically drafted to prevent this from occurring if a vehicle was purchased within two and one-half years (910 days) prior to the bankruptcy filing and the debt resulted from a purchase money security interest.

REAL-WORLD CONSEQUENCES

Four years after the enactment of PL 109-8, there is as yet little literature on the real-world financial consequences of the 910 provision. However, the literature that does exist indicates the 910 provision has lowered borrowing costs in certain states. According to the staff of the Federal Reserve Bank of New York, in states with high bankruptcy exemptions, interest rates for auto loans declined after 2005. According to this study, auto loan interest spreads declined after PL 109-8 in these states specifically due to the prohibition on cram-down.

Congress intended this prohibition to provide broad protection for automobile lenders. As the precise text of the 910 provision evolved over time, it was modified in ways that make it clear Congress intended the 910-day provision to provide an absolute prohibition on lien stripping within 910 days for debt incurred to purchase an automobile. Thus, the current controversy over whether "negative equity" and other charges associated automobile financing should somehow defeat a portion or all of the protection afforded by the 910-day provision arises from a misreading of, or disregard of, Congressional intent.

Tellingly, even the Congressional opponents of the 910-day provision, who sharply criticized the provision during floor debates, acknowledged that it covered all components of debt incurred to purchase an automobile. The debate in Congress was whether it was wise as a matter of policy to create such an absolute shield. With the enactment of PL 109-8, the debate has shifted from policy to statutory interpretation to implement policy. This article is intended to provide a complete and exhaustive review of the legislative record to assist market actors and courts in this task.

THE AUTOMOBILE FINANCE INDUSTRY

Automobile financing is a crucial part of the American economy. The price for a new car or light truck is typically too high for most consumers to make an outright purchase. The financial system has accordingly developed a variety of different financing options to enable the purchase of a new car or light truck on credit. Many prospective car buyers have a trade-in automobile, the value of which can be part of the down payment for a new car. Rather than attempt to sell it directly, most consumers prefer to trade in a used car or truck to the dealer, who offers an accessible way to dispose of used vehicles.

In many cases, the trade-in vehicle will be subject to an existing lien arising out of a previous financing. In most cases, the debt secured by the existing lien exceeds the value of the vehicle. This difference between value and indebtedness is commonly referred to as "negative equity." *See* Wilson & DiChiara, The Changing Landscape of Indirect Automobile Lending, *FDIC Supervisory Insights*, Summer 2005, at 29. When

the trade-in vehicle is subject to an existing lien, the lien must be satisfied before for the purchase of the new vehicle can occur. The attempted sale of a trade-in vehicle without the approval of the prior lien-holder will permit that creditor to repossess the vehicle and/or sue the borrower and finance company and the trade-in vehicle will have a cloud title.

A typical consumer can either roll the negative equity into the debt for a new car, or borrow money to pay off the negative equity. For most consumers, the most efficient choice in this circumstance is to roll the negative equity into the new car or trade because this arrangement is cheaper and easier than the alternative of borrowing to eliminate the old debt. Thus, the ability to roll negative equity into the price paid for a new automobile is crucial to the efficient functioning of the auto finance market.

EFFECTS OF PL 109-8

Assessing the impact of limiting cram-down in the credit market so soon after enactment is difficult. According to a recent study from the staff of the Federal Reserve Board of New York, auto loan interest rate spreads declined after PL 109-8 in certain states. Thus, based on the research actually available to date, passage of the anti-cramdown provisions in PL 109-8 lowered risk to lenders who have therefore lowered interest rates for borrowers. *See* Morgan et al., Seismic Effects of the Bankruptcy Reform, *FRB Report* No. 358 (Feb. 2009).

OVERVIEW OF SELECTED LEGAL ISSUES

As noted earlier, prior to PL 109-8, the bifurcation of automotive loans was permitted in Chapter 13 Bankruptcy proceedings by virtue of 11 U.S.C. § 506(a). This procedure permitted an obligation to be treated as secured only to the market value of the collateral, while the remainder of the claim would be treated as an unsecured claim that would be extinguished at the completion of a Chapter 13 bankruptcy plan. PL 109-8 sought to end this practice by inserting an unnumbered paragraph to 11 U.S.C. § 1325(a), commonly described in court decisions as the "hanging paragraph." The hanging paragraph generally prohibits debtors from utilizing Section 506 to bifurcate a creditor's claim on certain motor vehicles into secured and unsecured claims.

Specifically, the hanging paragraph exempts claims from Section 506 bifurcation if:

- the creditor has a purchase money security interest ("PMSI") securing the debt;
- the debt was incurred within 910 days preceding the date of the bankruptcy filing; and
- the collateral for that debt consists of a motor vehicle the acquired for the personal use of the debtor.

The scope of the hanging paragraph is the topic of much litigation. One of the most litigated questions concerns whether so-called negative equity (debt on a prior vehicle), rolled into a new auto loan, should be treated as part of the PMSI for purposes of the hanging paragraph. Federal courts are presently split into various schools of thought on this question. In

order to clarify Congressional, intent, this paper exhaustively reviews the legislative history of the anti-modification provision.

LEGISLATIVE HISTORY

In PL 109-8, Congress prohibited claim bifurcation for certain automobiles by enacting an unnumbered paragraph known as the hanging paragraph. The hanging paragraph provides:

> For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase-money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor …

PL 109-8 was under consideration by Congress for nearly a decade. The evidence from the legislative record clearly and unambiguously leads to the conclusion that Congress intended all debt related to the financing of a new vehicle would be protected from bifurcation if incurred within 910 days. The hanging paragraph simply determines how much of that committed disposable income goes to the secured creditor, that enabled the debtor to purchase the new vehicle shortly before bankruptcy, and how much goes to unsecured creditors, such as credit card companies. *See* Elizabeth Warren, Bankruptcy Reform Then and Now, 12 *Am. Bankr. Inst. L. Rev*. 299, 318-19 (2004). During Congressional consideration, the House and

Senate Judiciary Committees received evidence and testimony on a variety of abuses of the Bankruptcy Code, including the opportunistic use of bifurcation. *See* Whitford, A History of the Automobile Lender Provisions of PL 109-8, 2007 *U. Ill. L. Rev*. 143 (2007); Carlson, Cars and Homes in Chapter 13 After the 2005 Amendments to the Bankruptcy Code, 14 Am. Bankr. Inst. L. Rev. 301 (2006); Jensen, A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 79 Am. Bank. L.J. 485 (2005).

105TH CONGRESS

The earliest response in Congress to secured creditor concerns about abuses in the bifurcation and cram-down process was a provision in H.R. 3150, the first version of bankruptcy reform. Unlike the hanging paragraph, Section 110 of this bill amended Section 506 of the Bankruptcy Code. Section 110 was not limited to motor vehicles but was otherwise narrowly focused as to the types of claims that would be immune from bifurcation:

> 1) [Section 506] subsection (a) shall not apply to an allowed claim to the extent attributable in whole or in part to the purchase price of personal property acquired by the debtor within *180 days of the filing of the petition* … ;
> 2) if such allowed claim attributable to the purchase price is secured only by the personal property so acquired, the value of the personal property and the amount of the allowed secured claim shall be the sum of the unpaid principal balance of *the purchase price* and accrued and unpaid interest and charges at the contract rate … ."

See H.R. 3150, 105th Cong. § 128 (1998) (emphasis added).

Section 110 as drafted would have exempted from bifurcation categories of debt other than purchase money security debt. Also, Section 110 would not have protected any secured transaction that was completed more than six months prior to the filing of the bankruptcy petition. Most importantly, the "to the extent" and "in whole or in part" language would have limited the application of the anti-bifurcation rule to the portion of the claim related only to the purchase price, which is but one element of a purchase money security debt. Section 110 was thus very different than the final proposal enacted in PL 109-8.

The companion Senate legislation in the 105th Congress took a different approach. The original version of S. 1301 contained no provision concerning lien stripping or bifurcation. After conducting a hearing during which Congress was asked to address the issue, the Senate Judiciary Committee amended S. 1301 by changing Section 1325 of the Bankruptcy Code to state that Section 506 would be inapplicable to secured indebtedness of any sort or vintage. *See* S. 1301, 105th Cong. § 302(a) (1998); Hearing on The Consumer Bankruptcy Reform Act, 105th Cong. 40 (2008).

Section 124 of the conference agreement, which passed the House but was filibustered in the Senate, did not contain the text of the hanging paragraph. *See* S. Rep. No. 105-794 (1998). Instead, the conference agreement included a five-year look back that applied to all collateral and which retained the limited language of the House bill. This provision reads:

See Sec. 124. Restraining Abusive Purchases On Secured Credit. Section 506 of title 11, United States Code, is amended by adding at the end of the following: (e) In an individual case under chapters 7, 11, 12, or 13 — (1) subsection (a) shall not apply to an allowed claim to the extent attributable in whole or in part to the purchase price of personal property acquired by the debtor within 5 years of the filing of the petition, except for the purpose of applying paragraph (3) of this subsection;

(2) if such allowed claim attributable to the purchase price is secured only by the personal property so acquired, the value of the personal property and the amount of the allowed secured claim shall be the sum of the unpaid principal balance of the purchase price and accrued and unpaid interest and charges at the contract rate;

(3) if such allowed claim attributable to the purchase price is secured by the personal property so acquired and other property, the value of the security may be determined under subsection (a), but the value of the security and the amount of the allowed secured claim shall be not less than the unpaid principal balance of the purchase price of the personal property acquired and unpaid interest and charges at the contract rate; and

(4) in any subsequent case under this title that is filed by or against the debtor in the 2-year period beginning on the date the petition is filed in the original case, the value of the personal property and the amount of the allowed secured claim shall be deemed to be not less than the amount provided under paragraphs (2) and (3).

The Joint Explanatory Statement indicated only that this outcome was a compromise between the House and Senate. See Rep. No. 105-794, at 122 (1998).

CONCLUSION

Part Two of this article discusses additional legislation and provides an overview of what it means to the bankruptcy practitioner.

Trade-In Value and Automobile Loans After Bankruptcy Reform

Part Two of a Two-Part Article

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Last month, we discussed that when, in 2005, Congress enacted PL 109-8, significant changes were in store for the automobile finance industry. Four years after the enactment of PL 109-8, there is as yet little literature on the real-world financial consequences of the 910 provision. Based on a comprehensive review of the legislative history of 11 USC § 1325(a)(*), there can be little doubt that the 910 day provision covers all portions of a debt incurred for the purpose of financing an automobile, including negative equity and insurance charges. But there is heavy debate in Congress; we presented an overview

of selected legal issues to prove our point. The conclusion herein continues the discussion.

OVERVIEW OF SELECTED LEGAL ISSUES

106th Congress

In the 106th Congress, the House and Senate passed legislation that was presented to President Clinton, but was then pocket-vetoed. *See* H.R. 2415, 106th Cong. (2000). This legislation was identical to H.R. 3150 in many respects. However, the final version of legislation presented to President Clinton had been modified to contain a compromise; this version prohibited bifurcation for automobiles purchased within five years if there was a purchase money secured interest, with a shorter, one year look-back period for other types of collateral. *See* S. 3186, 106th Cong. § 306(b).

The procedural history of H.R. 2415 is complex. H.R. 2415 as originally passed by both the House and Senate related to security at State Department facilities overseas. However, the substance of both versions of H.R. 2415 was stricken and replaced by the text of S. 3186. The text of S. 3186, in turn, represented a bi-cameral compromise between competing versions of bankruptcy reform-H.R. 833 and S. 625. S. 3186, therefore, contained the operative text that was vetoed by President Clinton; its provisions closely resembled the final version of the hanging paragraph.

During the 106th Congress, when the House of Representatives held a hearing to consider HR 833, its version of bankruptcy reform that contained text

identical to H.R. 3150, the Acting Assistant Attorney General for Legislative Affairs of the Department of Justice (DOJ) submitted a views letter dated March 24, 1999. This letter criticizes the five-year look back as too long, and suggested instead a 180-day look back. *See* Letter to the Honorable George Gekas, March 24, 1999, page 11.

When the Senate considered the conference report for H.R. 2415, Senator Grassley inserted into the Congressional Record a detailed history and explanation of the bill in lieu of a formal legislative history. In relevant part, this history reads as follows:

> *Section 306. Giving Secured Creditors Fair Treatment in Chapter 13*. Second, the extent to which claims secured by purchase money security interests in personal property are subject to cramdown to fair market value is limited. It is intended that cramdown not apply to any collateral described in this provision during the periods of time specified, and that *the amount of the claim which must be paid under the plan be the full amount of the claim allowed under section 502 without application of section 506.* Thus, if the debt was incurred within 5 years prior to filing and the collateral consists of a motor vehicle acquired for the personal use of the debtor, the value of the collateral cannot be reduced to the current fair market value and therefore the amount the plan must pay under section 1325(5)(B)(ii) over the duration of the plan must be the amount of the allowed secured claim under section 506. A similar result applies for any other personal

> property if the debt was incurred during the one year period preceding the filing.

See 1216 Cong. Rec. S11709 (daily ed. Dec. 7, 2000) (emphasis added).

From this record, it is clear that as of 2000, the anti-bifurcation amendment expanded its protection of secured creditors. This penultimate version of the hanging paragraph extended its reach to cover all charges encompassed within a purchase-money security interest and removed the limitations associated with the "to the extent" and "in whole or in part" language.

CLAIMS MADE BY OPPONENTS IN 2000

The claims made by opponents of the legislation in 2000 are also instructive. The Committee Report that accompanied the legislation that ultimately became S. 3186 contains the dissenting views of Sen. Herb Kohl (D-WI) of the Senate Judiciary Committee, who based his opposition on the fact that, under the bill, debtors in Chapter 13 cases would be required to pay the full value of the loan in automobile finance transactions. *See* S. Rep. No. 106-49 at 7 (1999).

One of the most telling and incisive descriptions of this near-final version of the hanging paragraph, which clearly demonstrates the breadth of the anti-bifurcation provision, comes from Sen. Dianne Feinstein, D-CA:

> Here is another sort of Orwellian title. Section 306 is called "Giving Secured Creditors Fair Treatment Under Chapter 13." It ought to be

called "Giving Certain Secured Creditors Preferred Treatment Under Chapter 13" because *it favors those who make car loans over other secured creditors and over unsecured creditors.*

Here is how it works. There is, of course, a concept in bankruptcy law currently called cramdown or strip down. It recognizes the fact that the collateral for some kinds of loans can lose value over time so it may be worth significantly less than the debt owed. Remember that in a bankruptcy proceeding, secured creditors get paid first, but the cramdown concept says to those creditors that they only get paid first up to the amount of the value of the collateral for the loan. After that, if they are still owed money, they have to get in line with the other unsecured creditors.

To give a more tangible example, if someone owes $10,000 on a car loan, but the car which is collateral for that loan is worth only $7,000 now, then only $7,000 of that loan is considered secured in a bankruptcy. That makes perfect sense since the maker of that loan has the right to repossess the car, but if it does that, it can only get $7,000 when it sells the car.

What the bill does is eliminate the cramdown for any car that is purchased within five years of bankruptcy. That means that even though the vehicle that secures the loan has lost much of its value, the entire amount of the debt must be repaid in a Chapter 13 plan. This gives special treatment to the lender and, more importantly, it will make it much more difficult for a Chapter 13 plan to work, and that will

hurt people who want to pay off their debts in an organized fashion under Chapter 13.

See 146 Cong. Rec. S11636 (daily ed. Dec. 6. 2000). (Emphasis added.)

While Congress would later reduce the five-year period to 910 days, the wording of the hanging paragraph would remain otherwise identical.

Based on this review of the legislative history, the only reasonable conclusion is that Congress intended the hanging paragraph to protect far more than mere purchase price and associated interest from bifurcation. In fact, some Congressional opponents of the legislation citied the breadth of the protection afforded by the hanging paragraph as a basis for their opposition. *See* Rep. No. 107-617, at 58.

107TH CONGRESS

In the 107th Congress, the House version of bankruptcy reform continued the five-year look back, while the Senate version contained a three-year look back. *Compare* H.R. 333, 107th Cong. (2001). (Introduced) with H.R. 333, 107th Cong. (2001). (Engrossed Senate Amendment); *see also* S. 220, 107th Cong. (2001). When the House and Senate reconciled these competing legislative proposals, the bodies agreed to the 910-day limitation in the current hanging paragraph but otherwise left the text of the hanging paragraph as it was when pocket vetoed.

The evolution of the hanging paragraph was now complete. Significantly, when settling on the final version of the hanging paragraph, Congress had

changed its focus away from the nature of the debt to the type of transaction that gave rise to the protection against bifurcation: it must be a purchase-money transaction, and not merely principal and interest.

109TH CONGRESS

In the 109th Congress, President Bush signed PL 109-8 into law, creating the text of 11 USC § 1325 (b) (*) as it currently exists. *See* S. 256, 109th Cong. (2005). The text of the hanging paragraph was not modified from the 107th Congress. While the Senate passed its version of the legislation that would become PL 109-8 without filing a report to detail legislative history, the House of Representatives filed a committee report that further supports and reinforces the conclusion that Congress intended the hanging paragraph. Once again, much can be gleaned from the criticisms of the opponents of PL 109-8. In Dissenting Views filed with the report, a number of Congressmen who voted against PL 109-9 specifically cited as a reason for opposition that the 910-day provision would "eliminate" the possibility of bifurcation for "any loan" incurred to purchase an automobile. Thus, it is once again clear that, on the eve of enactment, even the critics of the hanging paragraph understood the breadth of the protection it would afforded the automobile finance industry. *See* Rep. No.109-31, at 72.

CONCLUSION

A careful review of the various proposals to limit or prohibit claim bifurcation in Chapter 13 reveals that Congress specifically intended to prohibit claims bifurcation for all debt incurred to acquire a new

automobile. Congress initially considered a more limited anti-modification proposal that did not differentiate among types of collateral. Eventually, by the early part of this decade, Congress settled on a two-tiered approach: two and one-half years of protection for automobile financings, and one year of protection for other forms of collateral. The evidence is clear, from both proponents and opponents, that the scope of the anti-modification proposal was broad and covered all portions of debt acquired for the purpose of purchasing an automobile.

The policy purpose of the 910-day provision was to provide certainty to auto lenders, which would otherwise face losses in Chapter 13. The literature available at this time indicates that this policy has been successful as interest rates have declined in states with high bankruptcy exemptions. In this regard, court decisions that limit the protection against bifurcation where negative equity is rolled into a vehicle loan are troubling. To the extent these decisions substantially erode the protections Congress clearly intended to provide auto finance companies, it is reasonable to assume that market acts will respond by increasing borrowing costs as a hedge against increased risk. As the interpretive issues under litigation become more settled, it is reasonable to assume that borrowing costs will be effected by scope of protection afforded by the hanging paragraph.