No. 09-3181

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

IN RE AUBREY HOWARD,
*Debtor,*

AUBREY HOWARD,
*Debtor-Appellant*

— v. —

AMERICREDIT FINANCIAL SERVICES, INC
*Creditor-Appellee*

ON DIRECT APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

Bankruptcy Case No. 08-32998

Jacqueline P. Cox, United States Bankruptcy Judge

**AMICI CURIAE BRIEF
OF AMERICAN FINANCIAL SERVICES ASSOCIATION, ILLINOIS FINANCIAL SERVICES ASSOCIATION, AND NATIONAL AUTOMOBILE DEALERS ASSOCIATION SUPPORTING APPELLEE AND AFFIRMATION OF THE JUDGMENT BELOW**

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# CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No.: 09-3181

Short Caption: Aubrey Howard v. Americredit Financial Services, Inc.

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P.26.1.

The Court prefers that the disclosure statement be filed immediately following docketing; but, the disclosure statement must be filed within 21 days of docketing or upon the filing of a motion, response, petition, or answer in this court, whichever occurs first. Attorneys are required to file an amended statement to reflect any material changes in the required information. The text of the statement must also be included in front of the table of contents of the party's main brief. **Counsel is required to complete the entire statement and to use N/A for any information that is not applicable if this form is used.**

**(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must prove the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):**

American Financial Services Association
Illinois Financial Services Association
National Automobile Dealers Association

(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Varga Berger Ledsky Hayes & Casey
James J. White, Esq.

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and
N/A

ii) List any publicly held company that owns 10% of more of the party's or amicus' stock:
N/A

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Attorney's Signature: ______________________ Date: December 3, 2009

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## IDENTITY AND INTEREST OF AMICI CURIAE

### A. Identity of Amici Curiae -- American Financial Services Association, Illinois Financial Services Association and National Automobile Dealers Association

The American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA has a broad membership, ranging from large international financial services firms to single office, independently owned consumer finance companies. The association represents financial services companies that hold a leadership position in their markets and conform to the highest standards of customer service and ethical business practices. AFSA has provided services to its members for more than 90 years. The association's officers, board, and staff are dedicated to continuing this legacy of commitment through the addition of new members and programs, and increasing the quality of existing services.

The Illinois Financial Services Association ("IFSA"), established in 1917, is the largest Illinois trade association for market-funded providers of diversified consumer financial services. IFSA's member lenders, ranging in size from small entrepreneurial entities to large multi-state or multi-national companies, offer a broad array of financial services, including "direct" credit extensions such as personal property secured (e.g. auto) loans, unsecured small loans and residential mortgage/home equity loans. IFSA's members also provide a substantial amount of "indirect" credit extensions via their purchase of motor vehicle retail installment contracts entered into between car buyers and car dealers -- this business known as "sales finance." IFSA's approximate 20 members serve over one million Illinois families and provide over $4 billion in financing.

Founded in 1917, the National Automobile Dealers Association ("NADA") is a non-profit trade organization whose members hold franchises to sell at retail passenger cars and trucks, and related goods and services, as authorized dealers of the various motor-vehicle manufacturers and distributors doing business in the United States. As of November 25, 2009, there were 18,642 franchised motor vehicle dealers in the United States of which 16,671 are members of NADA. Among other services provided, NADA advises members of relevant legal and regulatory issues. NADA closely monitors federal statutes, state statutes, and court rulings interpreting such laws. NADA appears before and submits briefs to courts and other tribunals as an amicus curiae to advocate interpretations of federal and state statutes that will advance the interests of its members as a group.

### B. Interest of AFSA, IFSA and NADA as Amici Curiae

The AFSA, IFSA and NADA membership have a vital interest in the outcome of this case. Members of AFSA and IFSA are sales finance companies significantly engaged in the business of purchasing motor vehicle retail installment sale contracts from motor vehicle dealerships. Members of NADA enter into those motor vehicle retail installment sale contracts with consumer buyers of motor vehicles. Hence the case has broadscale application to an important segment of the U.S. economy -- i.e. the financing of motor vehicle purchases by retail consumers.

The 2005 amendments to Section 1325(a) added an unenumerated, hanging paragraph at the end of the section that deals with certain claims secured by motor vehicles. The effect of this hanging paragraph has been widely debated by creditors, debtors, counsel and commentators. This case affords the Court an opportunity to address this debate as it pertains to whether a creditor's claim is covered by the hanging paragraph when a portion of the amount financed under a motor vehicle retail installment sale contract includes debt attributable to the payment of negative equity with respect to a trade-in vehicle.

## SUMMARY OF ARGUMENT

The question raised on appeal is whether the Bankruptcy Court erred in finding that the entire security interest on Howard's 2007 Chevrolet Trailblazer for the debt of $34,698.07 constituted a "purchase-money security interest" as that term is used in Section 1325(a) of the

Bankruptcy Code. The Bankruptcy Court found correctly, and, as such, its decision should be affirmed.

This case is a byproduct of the 2005 amendments to the Bankruptcy Code. Those amendments, entitled the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," are known in bankruptcy practices as "BAPCPA." Before BAPCPA, a debtor who owed $15,000 on a car worth only $10,000 could, in a Chapter 13 plan in a procedure inelegantly known as a "cramdown," keep his car by dividing the $15,000 claim into a $5,000 unsecured claim and a $10,000 secured claim. He would then use the Chapter 13 plan to pay $10,000 over time on the secured obligation and treat the $5,000 unsecured claim like all other unsecured claims who generally receive little.

BAPCPA restricted this right to cramdown. For vehicles financed within 910 days of bankruptcy, the debtor was denied the power to divide his debt into secured and unsecured portions. To keep his car, the debtor had to pay the full amount to his creditor even if the value of the collateral (the vehicle) was acknowledged to be less than the remaining balance on the debt.

This inartfully drafted provision of BAPCPA reflects a balancing of the interests of those consumer creditors who specialize in secured credit (automotive creditors) and those who specialize in unsecured credit (credit-card issuers).

The issue in this case and in similar cases elsewhere is whether the entire debt secured by the car is to be treated as a "purchase-money security interest." To the extent that the security interest is not purchase-money, the creditor does not enjoy the protection of the new provision and the debtor may cram down. If the security interest is "purchase-money," cramdown is prohibited. To date, six federal circuit courts have ruled on this issue, as well as one state supreme court, and every one of these rulings favor the position that AmeriCredit has taken. See Appellee's Brief at n. 2. The overwhelming majority of courts, at every level of review, support this result. See Appellee's Brief at 17-21.

So what is so hard about the term "purchase-money security interest?" Quite a bit, it turns out. Like many things in the Bankruptcy Code, and in commercial law generally, there is more than meets the eye. In recent times, it has become commonplace for debtors to pay for their cars over five or even seven years. Typically cars depreciate at a rate faster than the amount financed is paid down. When that happens the debtor is said to have a "negative equity" in his car or to be "upside down"; he owes more on the debt than the car is worth.

The problem, as in this case, comes when the debtor returns for a newer vehicle before he has paid off the debt on the old one. When he buys the new car, he incurs a new debt that includes not only the sticker price on the new vehicle, but also payments for dealer-provided products and services such as license fees, assorted taxes, ***and*** an amount to cover the "negative equity." The "negative equity" is the amount by which his debt against the trade-in exceeds the value of the trade-in, net of any cash down payment or manufacturer's rebate. This secured transaction only works if the price paid to acquire the new vehicle covers the expense incurred to satisfy the negative equity.

The question is whether a security interest that secures both the sticker price on the new car and the remaining balance on the old car is to be regarded as "purchase-money security interest." Howard, of course, says "no;" AmeriCredit says "yes." The Bankruptcy Court below held that the security interest covering Howard's Vehicle was a purchase-money security interest as to the entire amount of its claim, and was therefore not subject to bifurcation and cramdown in the Howard's wage earner plan.

Although it is stuffed with definitions, the Bankruptcy Code does not define "purchase-money security interest." It seems likely that Congress intended the term to have a federal law meaning drawn from the language, from inferences about Congressional intent, from commercial practice, and by analogy to state law and to other federal law. It is also possible that Congress intended to use state-law definitions. Whether one regards the words as federal or state, the outcome is the same. Even if Congress intended a federal definition, that definition would have to lean heavily on state statutes that define the term. If Congress wanted to adopt state-law definitions, those same statutes would be applied directly.

## ARGUMENT

## I. THE LANGUAGE OF THE STATUTE AND THE CONGRESSIONAL PURPOSE FAVOR AMERICREDIT

### A. Congress' Purpose

As its name proclaims, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 was designed both to make it more difficult for consumers to cancel their debt and to require debtors with means to repay their bills. The Act came at the end of a twenty-year spurt in bankruptcy filings from 250,000 in 1978 to more than 1,500,000 filings in 2004. All but a small number of these filers were consumer debtors.

That is not to say that the birth of the Act was easy or quick. The original form of BAPCPA was first introduced in 1998. In the succeeding years it passed the House six times, passed the Senate four times, and cleared both houses of Congress in the same form twice. Once it even reached the President's desk, only to suffer President Clinton's pocket veto.

The opponents in Congress were as persistent and clever in opposing the Act as the proponents were determined and united in support. Among the principal creditor advocates for the bill were credit card companies.[1] By 2005, it was claimed that the credit-card industry had spent over $100 million in lobbying and other activity to promote the bill. In general, credit-card companies make unsecured loans and fare poorly in Chapter 7 consumer liquidations. Many

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[1] Egan, Timothy, *Newly Bankrupt Raking in Piles of Credit Offers*, The New York Times, Dec. 11, 2005 at Section 1.

consumer Chapter 7's are "no asset" cases. A "no asset" debtor shields all of his assets by smart use of the exemption laws and therefore makes no distribution to any unsecured creditor. To attempt to get something from some of the Chapter 7 debtors, the credit-card companies and other unsecured creditors hoped to force some of those debtors into Chapter 13 where they would be required to give up a part of their wages for up to five years.

To the extent that changes in bankruptcy law take assets that the debtor would have kept for himself under the old law, the changes have the potential to benefit all creditors. But to the extent that a change in the law leaves the debtor with the same assets as he would have had under the old law, the change merely improves one creditor's lot at the expense of another creditor. Since, by hypothesis, most debtors in bankruptcy are insolvent, any change in an existing bankruptcy law has the high probability of taking from one creditor and giving to another without any change in the debtor's status. As held by the Court in *In re Long*, 519 F. 3d 288 (6th Cir. 2008), the provision in Section 1325 that is the subject of this case was clearly intended to protect **secured** consumer creditors from the loss that they might otherwise suffer from debtors' migration from Chapter 7 to Chapter 13.

> "the paragraph was only intended to prohibit debtors from cramming down debt when they elect to retain collateral under § 1325(a)(5)(B). See H.R. REP. NO. 109-31, pt. 1, at 17 and 71-72 (2005), reprinted in U.S.C.C.A.N. 88, 103, 140. Based upon the legislative history, there is little doubt that the "hanging-sentence architects intended only good things for car lenders and other lienholders." ; See, e.g., In re Duke, 345 B.R. 806, 809 (Bankr. W.D. Ky. 2006) [Quotation omitted]. *Id. at 294*

The secured creditors, particularly the automotive creditors, must have feared that their interests would be injured by a bill that would move many debtors from Chapter 7 (liquidation), into Chapter 13 (debtor plans). Secured creditors' concerns would arise principally because of the probability of a cramdown in Chapter 13. In Chapter 7, by comparison, debtors frequently sign "reaffirmation" agreements under which they are obliged, even after the bankruptcy, to the pay the full amount due on their cars, whatever their value. Thus, a large-scale move out of Chapter 7 and into Chapter 13 -- of the kind hoped for by the credit-card issuers -- would favor the credit-card companies (by giving them a five-year share of the debtor's future wages) and would injure the automotive creditors (by substituting low-pay cramdowns for high-pay reaffirmation agreements).

When one considers the parties to the Congressional debate (unsecured creditors who would benefit from Chapter 13 growth vs. secured creditors who would suffer), the goals of the principal creditor advocates (credit-card issuers who openly advocated expansion of Chapter 13) and the evolving language of the Act (*see* Section I.B. below), it is unmistakable that Congress intended to protect creditors who finance consumer vehicle purchases from cramdowns in Chapter 13. Congress appears to have been persuaded by the automotive financiers' argument that, unless the anti-cramdown provision was added to the law, the increased costs of cramdown would ultimately be borne by consumers -- including, in particular, some who would be priced out of the market as a result.[2] That Congressional purpose is served by a decision for AmeriCredit.

### B. Congress' Language

The earliest response in the history of BAPCPA to secured creditors' concern is a provision in the 1998 House bill. That provision barred cramdowns, but it was quite narrow. It was not limited to motor vehicles, but it covered only:

> the unpaid principal balance of the purchase price of the personal property acquired [within 180 days of the filing] and the unpaid interest and charges at the contract rate... (Sec 128, H.R.3150, 105th Cong. (1998)).

That provision would not have protected from cramdown much of the debt that is covered by a purchase-money security interest on a car. It would not have protected amounts attributable to title

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2 See Bankruptcy Abuse Prevention and Consumer Protection Act of 2001: Hearings Before the Committee on the Judiciary House of Representatives on H.R. 333, 107th Cong. 371-372 (2001).

and taxes or negative equity on trade-ins, and, of course, it would not have touched any secured transaction that was done more than 6 months before the bankruptcy filing.

Meanwhile an amendment proposed by Senator Abraham of Michigan, inserting a different anti-cramdown provision, was adopted by the Senate Judiciary Committee. This amendment prohibited cramdowns for all security interests of whatever kind and whenever incurred:

> Any "allowed claim [in a Chapter 13 case] that is secured under applicable non-bankruptcy law..." (Sec 302 1998 S. 1301)

Contemporary press reports made the unsurprising claim that Senator Abraham was responding to the interests of the "industry." The language proposed by Senator Abraham was presumably intended to protect the interests of an important group of constituents -- the auto companies and their auto finance arms.

By 1999 the Senate version covered a claim where:

> the debt that is the subject of the claim was incurred within the 5-year period preceding the filing of the petition and the collateral for that debt consists... of a motor vehicle... acquired for the personal use of the debtor... (Sec 306 1999 S. 625)

Note that the 1999 Senate version does not refer to a "purchase-money security interest" and that one infers that the legislation deals with the ***purchase*** of a motor vehicle only from the use of the verb "acquired," but the provision is now limited to motor vehicles bought for personal use.

The purchase-money language appears for the first time in 2000 when the section covers:

> a claim...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 5-year period preceding the filing of the petition, and the collateral for that debt consists of a motor vehicle... acquired for the personal use of the debtor... (emphasis added) (Sec. 306 2000 S. 3186)

As finally enacted, the Abraham amendment is an unnumbered "hanging paragraph" attached to Section 1325(a), sometimes now labeled 1325(a)(*):

> 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 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle... acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the one year period preceding that filing.

### C. Both The Language and Congress' Purpose Support a Reading Favorable to AmeriCredit

There are two notable insights buried within Congress' choice of words and in the progression from the early House language to the words that are now part of Section 1325(a). First, that Congress chose the current language to exclude a certain kind of secured creditor from the Section's protection, and it did not define the term or deal with the scope of "purchase-money." Second, is the breadth of the traditional purchase-money security interest.

#### 1. Excluding Certain Secured Creditors

The drafters chose the purchase-money language to exclude non-purchase-money security interests in vehicles already owned by the debtor. Non- purchase-money security interests in property already owed by consumers are disfavored under the law.[3]

After the original House language, which referred to "purchase-money," was replaced with the 1999 version of the Abraham amendment, a non-purchase-money secured creditor who took a security interest in a car that the debtor had purchased outright within five years of the filing could have claimed the benefit of the provision. The automobile financiers -- purchase-money creditors -- had no interest in enriching non-purchase-money secured creditors who take security interests in property already owned by consumers, nor would the consumer advocates have wished to benefit these creditors. So, it is plausible that the purchase-money language was inserted to deprive these non-purchase-money creditors from using the Section, not to draw any distinction between parts of

[3] See e.g., 16 C.F.R. 444.2(a) (4), where taking a non-purchase-money security in certain household goods is an unfair trade practice; 11 U.S.C. sec. 522(f) (1) (B) of the Bankruptcy Code, avoiding nonpossessory nonpurchase-money security interests against certain consumer goods.

a secured debt incurred in the acquisition of the collateral. If that is the purpose of the language, *i.e.*, to exclude a class of secured creditors, its presence does not justify the omission of negative equity from its protection against cramdown.

### 2. "Purchase-money Security Interest" Is Broader Than "Principal Balance"

By using the term "purchase-money security interest" instead of the original House term "unpaid principal balance of the purchase price attributable" to property acquired within 180 days, Congress must have intended to include some parts of the debt that would have been omitted by the original House language. The House language, "unpaid principal balance . . . attributable to the goods purchased," identifies the particular type and frequently a portion of a ***debt*** that is covered, whereas "purchase-money security interest" refers to a type of ***security interest***.

No purchase-money security interest is limited to the principal balance and unpaid interest. At a minimum, fees and taxes owed on the purchase of a motor vehicle would be covered and secured by any "purchase-money security interest," *see e.g.* Comment 3 to Section 9-103. But it would be easy to find that a claim for fees, taxes, and negative equity was not part of the "unpaid principal balance" or "interest." So, the words of the House and Senate versions are different, and the words of the Senate version bar cramdowns on more kinds of debt than the words of the House would bar.

Conceding that the Senate language is broader than the House language, can one infer that the Senate intended to treat negative equity amounts as covered by "purchase-money security interests?" Yes. Representatives of the debtors and creditors certainly knew of the practice of rolling negative equity amounts from trade-ins into debts secured by purchase-money security interests on new cars. By 2005 as many as 38 percent of all new car purchasers rolled some part of the exiting debt on a trade-in into the new debt incurred to buy the new car.[4] This is not an obscure practice; it is commonplace and would have been well known to any informed debtor or creditor representative. By 2004 the practice was specifically permitted in the Motor Vehicle Sales Finance Acts of at least 36 states.

It cannot be said that the cramdown provision on motor vehicles traveled below Congress' radar. The topic was controversial; as we show in Section I B above, the provision was modified several times in different ways.[5] And, while it was one of the continuing points of dispute between the debtor and the creditor interests between 1998 and 2004, ultimately the language adopted reflected a compromise worked out over several years to gain support of the secured creditors.

Most importantly, the language chosen by Congress has a meaning found in practice and in state law (*see* Section III below). That law and practice show that a "purchase-money" interest reaches not only a car's cash price but also other amounts that may be folded into the total purchase price. That this language was chosen in lieu of more restrictive language of the House buttresses the argument for a broad definition of "purchase-money." That Congress was apparently adopting Senator Abraham's approach to help car creditors gives further support for the broad reading as a federal definition.

The above analysis confirms the correctness of the Bankruptcy Court's decision in this case holding that AmeriCredit's claim is not subject to bifurcation and cramdown under the hanging paragraph. The claim arose out of an automobile purchase transaction in which all of the charges encompassed within the contract signed by Howard and the dealer were integrally related to the purchase of the new Vehicle. The charges were part of a package transaction negotiated by the parties. The charge for negative equity was essential to complete the deal because Howard would

[4] *See e.g.*, FDIC Supervisory Insights *The Changing Landscape of Indirect Automobile Lending* June 23, 2005.
[5] *See e.g.*, H.R. Rep. No. 107-617, 147 Cong. Rec. S2234-35.

not have purchased the new Vehicle unless the dealer accepted his used car as a trade in; and the dealer would not have accepted Howard's used car as a trade, and paid off the debt on the used car, unless Howard purchased the new Vehicle.

## II. THE DEFINITIONS IN FEDERAL TRUTH IN LENDING LAW AND REGULATIONS SUPPORT AMERICREDIT

When Congress enacted BAPCPA in 2005, it is presumed to have known about other pertinent federal law governing purchase-money financing of motor vehicles.[6] The federal Truth in Lending Act (TILA) (15 U.S.C. §1600 et seq.) and its implementing regulation, Federal Reserve Board Regulation Z (12 CFR 226), deal generally with the disclosures that are required in both consumer credit card accounts (a type of open ended credit) and closed end credit sales of personal property such as motor vehicle retail installment sales (a purchase money transaction that is a type of closed end credit). Although that law does not give a definition as such of "purchase-money security interest," the law does explain the kind of disclosures that must be made in a closed-end sale transaction (such as a motor vehicle retail installment sale) that generates a purchase-money security interest.

In 1999, the Federal Reserve Board amended its Official Staff Commentary to Regulation Z to clarify how automotive creditors should disclose negative equity in a motor vehicle installment sale transaction.[7] Those amendments direct creditors to incorporate negative equity as a part of the "Total Sale Price" of a new vehicle in a single credit transaction. 64 F.R. 16614-01, 16617 (adopting revisions to § 226.18(j) (3), Official Staff Interpretations). The Official Staff Commentary define the "Total Sale Price" to include negative equity as follows:

*18(j) Total sale price.*

[6] See *Quality Tooling v. United States*, 47 F.3d 1569, 1584 (Fed.Cir.1995) ("When Congress enacts legislation, it is presumed to know the pertinent law.")

[7] The *Official Staff* Commentary is "the vehicle by which the Division of Consumer and Community Affairs of the Federal Reserve Boards issues official staff interpretations of Regulation Z." 12 C.F.R. Pt. 226, Supp. I, Introduction-1, at 451 (2008).

> 3. *Effect of existing liens*. When a credit sale transaction involves property that is being used as a trade-in (an automobile, for example) and that has a lien exceeding the value of the trade-in, the total sale price is affected by the amount of any cash provided. (See comment 2(a) (18)-3.) To illustrate, assume a consumer finances the purchase of an automobile with a cash price of $ 20,000. **Another vehicle used as a trade-in has a value of $ 8,000 but has an existing lien of $ 10,000, leaving a $ 2,000 deficit that the consumer must finance.**
>
> **i. If the consumer pays $ 1,500 in cash, the creditor may apply the cash first to the lien, leaving a $ 500 deficit, and reflect a down payment of $ 0. The total sale price would include the $ 20,000 cash price, an additional $ 500 financed under § 226.18(b) (2), and the amount of the finance charge.** (emphasis added) Alternatively, the creditor may reflect a down payment of $ 1,500 and finance the $ 2,000 deficit. In that case, the total sale price would include the sum of the $ 20,000 cash price, the $ 2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.
>
> ii. If the consumer pays $ 3,000 in cash, the creditor may apply the cash first to extinguish the lien and reflect the remainder as a down payment of $ 1,000. The total sale price would reflect the $ 20,000 cash price and the amount of the finance charge. (The cash payment extinguishes the trade-in deficit and no charges are added under § 226.18(b) (2).) Alternatively, the creditor may elect to reflect a down payment of $ 3,000 and finance the $ 2,000 deficit. In that case, the total sale price would include the sum of the $ 20,000 cash price, the $ 2,000 lien payoff amount as an additional amount financed, and the amount of the finance charge.

The highlighted part of the quoted paragraph shows that the Federal Reserve intended that any negative equity amount be added to the cash price on the new vehicle to be shown as a single amount in the "total sale price" disclosure given in connection with credit sale transactions such as motor vehicle retail installment sales. Elsewhere, the Regulation requires that negative equity amounts be shown as part of the "Amount Financed." 12 C.F.R. § 226.18(b); *see also* 12 C.F.R. Pt. 226, Supp. I, ¶ 18(j)-3, at 548 (2008). The implication to the buyer and to the creditor from this single disclosure of the "total sale price" and "amount financed," (i.e. secured amount) is that the negative equity will have the same status as the cash price of the new vehicle. Since the seller's security interest for the cash price of the new vehicle is indisputably a "purchase-money" security interest, it follows that the Federal Reserve's direction to bundle the negative equity with the cash price in a credit sale transaction is a direction to secure it with a "purchase-money security interest."

## III. STATE LAW, COMMERCIAL PRACTICE AND PUBLIC POLICY AFFIRM AMERICREDIT'S READING

### A. The Uniform Commercial Code

The words "purchase money security interest" in the hanging paragraph of § 1325(a) are not defined by the Bankruptcy Code, but are defined by state law, particularly the Uniform Commercial Code. The Supreme Court has stated often that state law is the source of the property interests that come into bankruptcy cases, including the rights of creditors to payment or claims.

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy." (Internal citation omitted.) The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee in rents earned by mortgaged property. (Footnote omitted).
>
> *Butner v. United States,* 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1979).

See also *Raleigh v. Illinois Dept. of Revenue,* 530 U.S. 15, 20, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000) ("[c]reditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation . . .").

> Indeed, we have long recognized that the " 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination of property rights in the assets of a bankrupt's estate to state law.' " *Ibid.* (quoting *Butner v. United States,* 440 U.S. 48, 57, 54, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979); citation omitted). Accordingly, when the Bankruptcy Code uses the word "claim"-which the Code itself defines as a "right to payment," 11 U.S.C. § 101(5)(A)-it is usually referring to a right to payment recognized under state law. As we stated in *Butner,*"[p]roperty interests are created and defined by state law," and "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." 440 U.S., at 55, 99 S.Ct. 914; accord, *Vanston Bondholders Protective Comm. v. Green,* 329 U.S. 156, 161, 67 S.Ct. 237, 91 L.Ed. 162 (1946) ("What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law").

*Travelers Casualty and Surety Company v. Pacific Gas & Electric,* __ U.S. __, 127 S.Ct. 1199, 1205, 167 L.Ed.2d 178 (2007).

The Supreme Court has made it unmistakably plain for nearly forty years that the policy of uniform treatment, i.e., federal bankruptcy courts treating interests in property and rights to payment uniformly with the treatments they receive in state courts, is so important that it compels federal courts to use in bankruptcy cases the rights and interests in property, which include the right to be paid, that parties have under state law unless federal law otherwise provides. If two parties have competing rights and interests, when one files bankruptcy the nature of those rights and interests does not change unless the Bankruptcy Code specifically says so.

The Bankruptcy Code does not define or otherwise alter the breadth of the "purchase-money" umbrella under Article 9 of the UCC. Article 9 is the law of every state -- tantamount to federal law on this issue. Comment 3 to 9-103 explains that "purchase-money obligation" reaches more than just the listed price of the item purchased:

> As used in subsection (a) (2), the definition of "purchase-money obligation," the "price" of collateral or at the "value given to enable" includes **obligations for expenses incurred in connection with acquiring rights in the collateral**, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.
>
> The concept of **"purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation.** Thus, a security interest does not qualify as a purchase-money security interest if the debtor acquires property on unsecured credit and subsequently creates the security interest to secure the new purchase. (emphasis added)

The current commercial practice, discussed below, recognizes negative equity owed on a trade-in as a routine "expense incurred in connection with acquiring" the new vehicle, and the financing of the remaining debt on the trade-in has more than a "close nexus" to the acquisition of the new vehicle. Since buyers with negative equity on their trade-ins seldom have cash to pay off the amount owed, inevitably that amount must be financed by the creditor on the new vehicle or by some other creditor. So in many cases, the "nexus" is so close that the new car cannot be acquired without financing from the new purchase-money creditor to retire the negative equity.

All six federal circuit courts that have ruled on this issue, as well as the New York Court of Appeal, have relied upon Article 9 to conclude that charges for negative equity are purchase-money obligations under Section 9-103 and Comment 3 and are therefore shielded from bifurcation and cramdown by the hanging paragraph.

### B. The Motor Vehicle Retail Installment Sales Act

The end of World War II saw an explosive growth in consumer credit in the United States. A significant part of that consumer credit was installment sale credit to purchase motor vehicles. To govern that market, many states passed laws called motor vehicle retail installment sales acts.

Although they have similar names, these acts are not uniform (they were not promulgated by the Uniform Law Commissioners), but all of the acts appear to be copied from the same basic template. Because they preceded the federal disclosure law, Truth in Lending, all of them have disclosure requirements similar to those now found in the federal law. For example it is common for these acts to require a specific size of type and to enumerate a list of items that must be expressed in a retail installment sale contract. But the acts went beyond disclosure requirements. They typically establish maximum interest rates, and they often prohibit certain contract terms and outlaw certain creditor behavior. For example the Illinois Motor Vehicle Retail Installment Sales Act ("MVRISA") prohibits any clause that would allow a seller to accelerate the balance on a contract in the absence of the buyer's default 815 ILCS § 375/12 (2001)

It appears that the state legislatures intended these acts comprehensively to deal with sale of automobiles where the seller was to be paid in installments. In many ways these acts have controlled the behavior of automobile sales finance companies and have shaped their contracts in the years since their enactment in the 1950s and 1960s.

MVRISA includes charges for negative equity as part of the "amount financed" related to the motor vehicle, 815 ILCS § 375/2.8 (2001). The amount financed is added to the cash price of the vehicle and finance charges to determine the "deferred payment price" of the vehicle, 815 ILCS § 375/2.10 (2001). This mirrors the term "price" in Comment 3 to Section 9-103 of the UCC, which also references the deferred payment price or total sales price of the collateral. Reading Article 9 and MVRISA *in pari materia*, the Bankruptcy Court correctly held that these charges are purchase-money obligations under Section 9-103. The overwhelming majority of courts have reached the same result. See cases cited in the Appellee's Brief at n. 49.

### C. Commercial Practice and Public Policy

Since all decisions interpreting commercial law have the capacity to facilitate or impair commercial activity, courts should be sensitive to commercial practice when they are interpreting federal and state statutes. The commercial practice in this case supports the proposition that financing negative equity in an installment sale contract creates a purchase-money security interest. So far as one can tell from reading the cases, the law review literature, and the contracts, the consumer and creditor parties to these transactions treat this charge in exactly the same as every other part of the debt. They regard it as secured by the newly-sold vehicle in exactly the same way as every other part of the debt. Presumably Howard chose this mode of financing his debt over other alternatives because it was more convenient than if he borrowed the money on an unsecured basis from a bank or a loan finance company.

In evaluating the commercial practice that underlies these cramdown cases, one should remember that these debtors are always employed (otherwise they would not be in Chapter 13), and they are always the owners of vehicles. These cases do not involve powerless consumers who must accept anything that a creditor offers. Here the dealer's installment sale financing offer was knowingly, and quite understandably, accepted by Howard.

Howard traded in his old vehicle when he purchased the new 2007 Chevrolet Trailblazer from the dealer less than 910 days before he filed his Chapter 13 case. The dealer's willingness to finance the negative equity in the amount of $8,048.68 enabled Howard to complete the deal as he chose. It may have enabled him to borrow the $8,048.68 at a better annual percentage rate, or on better terms, than he could have obtained elsewhere. In any case, it facilitated his purchase of a vehicle that he was under no obligation to purchase.

It is a basic principle of American commercial law -- learned from Karl Llewellyn, father of the Uniform Commercial Code -- that the law should follow practice, not the other way around. This principle is particularly powerful where the practice appears to have been freely chosen by parties who had other alternatives.

## IV. CONCLUSION

The words, the statutory history, the Congressional intent, the analogies to the federal Truth in Lending law and, not least, the Illinois Article 9 and Motor Vehicle Retail Installment Sales Act's explicit recognition of the common, convenient, and practical inclusion of the negative equity on a trade-in as part of the price of the new vehicle directs this Court to affirm the Bankruptcy Court's decision.

This the __ day of December , 2009.

Respectfully submitted,

**AMERICAN FINANCIAL SERVICES ASSOCIATION**

**ILLINOIS FINANCIAL SERVICES ASSOCIATION,**

**and**

**NATIONAL AUTOMOBILE DEALERS ASSOCIATION,**

**Amici Curiae.**

By:________________________________________
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**CERTIFICATE OF COMPLIANCE**

In accordance with Fed. R. App. P. 32 (a)(7)(C), I certify that the foregoing brief complies with the type-volume limitation provided by Fed. R. App. P. 40(b), Fed R. App. P. 32(a)(7)(B)(ii), and Fed. R. App. P. 29(d). This brief contains 6,287 words beginning with the words "**Identity and Interest of Amici Curiae**" and ending with the word "**decision**" at the end of the "CONCLUSION" section, as recorded by the word-count of the Microsoft Word 97 SR-2 word-processing system used to prepare the brief.

________________________________

Craig A. Varga

## CERTIFICATE OF SERVICE

Craig A. Varga, an attorney, hereby certifies that 2 copies of the foregoing, **Amici Curiae Brief of American Financial Services Association, Illinois Financial Services Association and National Automobile Dealers Association Supporting Appellee and Affirmation of the Judgment Below**, were served upon:

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