No. 02-1016

IN THE
# Supreme Court of the United States

LEE M. TILL and AMY M. TILL,

*Petitioners*,

*v.*

SCS CREDIT CORPORATION,

*Respondent.*

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT**

## BRIEF FOR THE RESPONDENT

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## QUESTIONS PRESENTED

1. Whether, in cases in which a chapter 13 debtor proposes to pay a secured claim in installments following confirmation of a chapter 13 plan, the rate of interest that the debtor must pay under 11 U.S.C. § 1325(a)(5)(B)(ii) is the prevailing market rate that the particular debtor would pay to a lender on a loan of similar amount, duration, and security?

2. Whether, in the absence of an agreement between the parties or proof of a prevailing market rate, the presumptive rate of interest is the contract rate specified in the debtor's pre-bankruptcy loan agreement with the secured creditor?

## RULE 29.6 STATEMENT AND PARTIES TO THE PROCEEDING

Petitioners are chapter 13 debtors Lee M. Till and Amy M. Till. Respondent is secured creditor SCS Credit Corporation. Respondent has no parent company. Respondent is not a publicly traded company, and no publicly traded company owns 10 percent or more of its stock.

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## BRIEF FOR RESPONDENT

This matter arises out of the joint chapter 13 bankruptcy case of petitioners Lee M. Till and Amy M. Till (the "Tills" or "Petitioners"). Before the Tills filed for bankruptcy, respondent SCS Credit Corporation ("SCS" or "Respondent") financed their purchase of an automobile. In their chapter 13 plan, the Tills proposed to keep the automobile and pay SCS's secured claim in installments over time. The issue is the proper rate of interest that the Tills are required to pay to SCS under section 1325(a)(5)(B)(ii) of the Bankruptcy Code. 11 U.S.C. § 1325(a)(5)(B)(ii).

## STATEMENT

### A. The Underlying Retail Installment Transaction

On October 2, 1998, the Tills purchased a used 1990 Chevrolet S-10 truck (the "Chevy") from Instant Auto Finance ("Instant Auto") for $6,395.00, plus fees and taxes of $330.75. JA 21. The Tills made a down payment of $300 toward their purchase and financed the balance of $6,425.75 on credit, executing a Retail Installment Contract ("Installment Contract") in which they agreed to pay this balance over time in 68 bi-weekly installments. *Id.* The installment payments included interest on the financed debt at the rate of 21%. *Id.*

As security for the debt, the Tills granted Instant Auto a purchase money security interest in the Chevy, JA 21; *see* Ind. Code Ann. § 26-1-9.1-103, vesting Instant Auto with the rights of a secured creditor; *see also* Ind. Code Ann. §§ 26-1-9.1-201, 203. Thus, in the event the Tills defaulted under the Installment Contract (e.g., failed to make any of the installment payments when due), Instant Auto had the right to take immediate possession of the Chevy, sell it, and use the proceeds to satisfy the unpaid portion of the Tills' obligation. *Id.*, §§ 26-1-9.1-609, 610, 615. Instant Auto also enjoyed a priority right to its collateral (the Chevy) ahead of the Tills' other creditors. *Id.*, §§ 26-1-9.1-201, 324(a).

After the Tills purchased the Chevy, Instant Auto assigned the Installment Contract to SCS. As a result, SCS acquired all of Instant Auto's rights as a secured creditor in connection with the Chevy and the Tills made their installment payments to SCS.

**B. The Tills' Chapter 13 Case and SCS's Secured Claim**

On October 25, 1999 — little more than a year after they purchased the Chevy — the Tills filed a joint petition for relief under chapter 13 of the Bankruptcy Code, 11 U.S.C. § 1301 *et seq.*, with the United States Bankruptcy Court for the Southern District of Indiana. By that time, the Tills had missed several payments under the Installment Contract and were in default under the agreement. JA 17 (noting arrearages and other late charges of $994.03). Because of the bankruptcy filing, however, the Tills retained possession of the Chevy and SCS could not exercise its state-law collection rights.

By operation of law, when a debtor files a chapter 13 case, a bankruptcy estate is created consisting of all of the debtor's property, including any automobile that the debtor may own. 11 U.S.C. §§ 103(a), 541(a), 1306(a). Thereafter, the Code authorizes a chapter 13 debtor to remain in possession of all property of the estate. 11 U.S.C. § 1306(b). Thus, when the Tills commenced their bankruptcy case, the Chevy became property of their bankruptcy estate, and the Tills continued to use the vehicle.

A debtor's bankruptcy filing also triggers the "automatic stay," which enjoins debt-collection activity against the debtor or property of the estate during the pendency of the case. 11 U.S.C. § 362(a). The Tills' filing of their bankruptcy case thus prevented SCS from taking action to collect the unpaid balance of their debt. It also prevented SCS from exercising its rights against the Chevy, notwithstanding the Tills' failure to make the agreed payments under the Installment Contract. Instead, SCS acquired a "secured claim" in the Tills' bankruptcy proceeding.

Under the Bankruptcy Code, a debtor's monetary obligations constitute "claims" against the debtor's bankruptcy estate. 11 U.S.C. §§ 101(5), 502(b). Creditors holding pre-petition claims, including secured creditors, are entitled to file a "proof of claim" with the bankruptcy court. 11 U.S.C. §§ 101(10), 501(a), 1305; Fed. R. Bankr. P. 3001, 3002.[1] SCS filed a proof of claim, stating that the Tills owed a debt of $4,894.89 under the Installment Contract as of the date of the commencement of their case. JA 16. The proof of claim stated further that SCS's claim was secured by a lien on the Chevy, and that the Chevy had a value of $4,000. *Id.*, 16-17.

The Bankruptcy Code has special provisions governing the determination and treatment of secured claims. Where, as here, the secured creditor's claim ($4,894.89) exceeds the value ($4,000.00) of the collateral securing the debt, section 506(a) of the Code separates the creditor's claim into two parts. 11 U.S.C. § 506(a). First, the creditor holds a "secured claim" equal to the value of the collateral. *Id.* Second, the creditor holds an unsecured claim for the balance (or "deficiency"). *Id.*; *see Associates Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997); 4 *Collier on Bankruptcy* ("*Collier*"), ¶ 506.03 at 506-9 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2003) (hereinafter, "*Collier*"). It is settled that, in cases such as this one, in which the debtor proposes to retain the collateral, the relevant standard to use in valuing the collateral is "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." *Rash*, 520 U.S. at 960.

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1. The Code defines "creditor" as a person holding a claim that arises before the debtor commences a bankruptcy case. 11 U.S.C. § 101(10). The term "pre-petition" refers to claims or events arising or occurring *before* the debtor files a bankruptcy petition. Conversely, the term "post-petition" refers to claims or events arising or occurring *after* the debtor files.

Applying section 506(a), the Bankruptcy Court set the amount of SCS's "secured claim" at $4,000.00 — a sum equal to the value of the Chevy, but significantly less then the total amount of the Tills' debt ($4,894.89). JA 57. For its deficiency, SCS received an unsecured claim in the amount of $894.89.

### C. The Tills' Chapter 13 Plan and the Proposed Treatment of SCS's Secured Claim

A chapter 13 debtor is required to file a "plan" proposing the payment of claims (including secured claims), either with the filing of the bankruptcy petition or within fifteen days thereafter. 11 U.S.C. § 1321, 1322; Fed R. Bankr. P. 3015. The Tills filed their plan at the time they commenced their bankruptcy case.

The plan must provide for the submission of all or part of the debtor's future earnings to fund the payment of claims for a period of between three and five years. 11 U.S.C. §§ 1322(a), (d). The Tills proposed to devote $1,089.00 of their monthly income for three years toward the payment of claims, including SCS's secured claim. JA 9.

A chapter 13 plan may designate classes of creditors, and, in general, modify the rights of creditors, including those holding secured claims. 11 U.S.C. §§ 1322(b)(1), (2). Under section 1325(a)(5), however, a plan may not be confirmed unless it satisfies one of three alternative tests regarding the treatment of secured claims. First, the secured creditor may consent to its treatment under the plan. 11 U.S.C. § 1325(a)(5)(A). Second, the debtor may surrender the collateral to the secured party. 11 U.S.C. § 1325(a)(5)(C). Third, the debtor may retain the collateral provided that the creditor retains its lien and the debtor pays the creditor the "value" of its secured claim "as of the effective date of the plan." 11 U.S.C. § 1325(a)(5)(B).

The debtor may satisfy the last requirement (paying the creditor the "value" of its secured claim) in one of two ways. The debtor may pay the secured creditor the full amount of its secured claim in one lump sum upon the effective date of the plan. Alternatively, the debtor may force an extension of the loan on modified terms by paying the secured claim in installments. Paying a claim over time, of course, does not have the same "value" as immediate payment — a dollar to be paid in the future is worth less than a dollar today. Thus, if the debtor elects to pay in installments, it is undisputed that the debtor must pay interest to ensure that the future payment has the same present value as immediate payment.

In their plan, the Tills proposed to retain the Chevy and pay SCS's secured claim in 17 monthly installments, with interest. JA 12.[2] The interest rate that the Tills selected, however, was 9.5% — less than half the 21% rate specified in the Installment Contract. *Id.*

The plan also provided that the automatic stay would remain in effect for the three-year repayment period, thus preventing debt-collection activity for the duration of the plan. JA 13; *see* 11 U.S.C. § 362(c)(2). The plan further provided that, upon completion of the scheduled payments, SCS would be obligated to release its lien on the Chevy "and deliver clear title to the Debtor(s)." JA 13. Thus, even though the entire debt owed to SCS ($4,894.89) would not be paid in full, SCS would be required to relinquish its lien on its collateral upon the debtor's completion of the installments specified under the plan ($4,000.00 in principal plus interest at 9.5%). Under the plan, the unsecured portion of SCS's overall claim ($894.89) was included in the class of general unsecured claims.

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2. Although the plan states the value of SCS's collateral at $4,225.00, the Bankruptcy Court set the value at $4,000.00. JA 57.

**D. The Plan's Treatment of Unsecured Claims**

A chapter 13 debtor is not required to provide for the full payment of general unsecured claims. Rather, the debtor is merely obligated to devote his or her projected disposable income to the plan for the duration of the repayment period, 11 U.S.C. § 1325(b), and the debtor's payments must provide unsecured creditors with not less than what they would receive in a chapter 7 liquidation, 11 U.S.C. § 1325(a)(4).[3] In addition, the debtor is required to pay these funds to the chapter 13 trustee, rather than to creditors directly. 11 U.S.C. § 1326(c). The role of the chapter 13 trustee is to supervise the debtor's compliance with the chapter 13 process and to act as the debtor's disbursing agent for the payment of claims. 11 U.S.C. §§ 1302, 1326.

Consistent with these requirements, the Tills proposed that their $1,089.00 monthly contribution would be distributed in the following order: first, to pay the trustee's expenses of administering the plan, JA 10; second, to pay a priority tax claim held by the Internal Revenue Service, *id.*; third, to pay secured claims, including SCS's secured claim, *id.*, 10-12; and fourth, to make distributions to general unsecured creditors to the extent of any remaining funds, *id.*, 12. It is undisputed that, after the payment of administrative, priority, and secured claims, the Tills' contributions would not be sufficient to pay general unsecured claims in full.

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3. The major practical difference between chapter 7 and chapter 13 is that, in a chapter 7 case, the debtor is not obligated to contribute any post-petition earnings toward the payment of claims, but generally cannot retain non-exempt property, which is liquidated for the benefit of creditors. *See* 11 U.S.C. §§ 704(1) (prescribing duties of chapter 7 trustee, including liquidation of property of the estate), 522 (exemptions). In a chapter 13 case, the debtor may retain non-exempt assets, but must devote his or her post-petition earnings toward the payment of pre-petition claims. *See* 11 U.S.C. §§ 1302(b)(1) (prescribing duties of chapter 13 trustee and excluding duty of liquidation under section 704(1)), 1322(a)(1), 1325(b)(2).

## E. The Confirmation Hearing

Pending the bankruptcy court's confirmation of a plan, the debtor is required within thirty days of filing his or her plan to begin making the payments called for under the plan to be held in escrow by the chapter 13 trustee. 11 U.S.C. § 1326(a). If the court ultimately confirms the plan, these payments are then released to creditors. 11 U.S.C. § 1326(c). As is common in chapter 13 cases, after the Tills filed their plan, the chapter 13 trustee moved to dismiss their case for failure to make initial payments. JA 25. By February 29, 2000, however, the Tills had cured their default, and the trustee withdrew his motion. *Id.*

SCS objected to confirmation of the Tills' initial plan, and the Tills filed an amended plan on January 31, 2000. SCS objected to the amended plan on the sole ground that the 9.5% rate of interest specified in the plan was inadequate under section 1325(a)(5)(B) to provide SCS with the required "value" of its secured claim. JA 22. In response, the Tills sought to "cram down" the plan over SCS's objection, arguing that the rate was adequate.[4] On February 29, 2000, the Bankruptcy Court held a hearing on the Tills' request for confirmation, together with SCS's objection. JA 24.

During the hearing, the Tills explained that they had arrived at the 9.5% rate by taking an unspecified rate of 8% and adding to it an additional 1.5% for risk. JA 37. In support of their proposed rate, the Tills offered the testimony of Steve Russell, an economics professor. JA 40.

At the hearing, Professor Russell reviewed the concepts of a "prime rate" of interest and the basic rate adjustments that

4. The term "cram down" refers to forcing a creditor to accept the terms of a plan involuntarily. As discussed, a secured creditor in a chapter 13 case may be forced to accept a plan over its objection if the plan satisfies one of the three alternative confirmation requirements of section 1325(a)(5) applicable to secured claims.

lenders typically make to reflect the circumstances of particular borrowers. First, he explained that the "prime rate" is the rate that "banks charge on [unsecured] loans to their most credit-worthy corporate customers." JA 41. He then stated that the prime rate incorporates (a) the general rate of inflation (which he estimated at the time to be approximately 2.5%); plus (b) the expected rate of return on the loan if the funds were loaned on a riskless basis, such as to the federal government on a Treasury bond (which return he estimated at the time to be approximately 3.5%); plus (c) an amount reflecting the transaction costs for the lender associated with the loan; plus (d) the risk that the credit-worthy customer would default. JA 41-42. Second, Professor Russell explained that, for loans to less credit-worthy customers, the rate would be adjusted to take into account (a) the increased risk to the lender of not being paid in full; and (b) the lender's transaction costs associated with the loan, including legal costs and overhead. JA 42.

After reviewing these concepts, Professor Russell opined that a 9.5% rate would be reasonable. JA 43. On cross-examination, however, Professor Russell conceded that he was unfamiliar with how any particular lender would assess the risk profile of a particular borrower. JA 44. He also conceded that he was unfamiliar with the "sub-prime" lending market, the relevant default rates associated with sub-prime car loans, and the relevant collection costs. JA 44-45.[5] Professor Russell further acknowledged that lenders would tend to view sub-prime loans as "singularly risky." JA 44.

5. The term "sub-prime" refers to the credit characteristics of borrowers with weak credit histories. *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency & Office of Thrift Supervision, *Expanded Guidance for Subprime Lending Programs*, 2-3 (January 31, 2001), available at *http://www.fsround.org/PDFs/Subprimeguidance.pdf* (hereinafter, "*Interagency Expanded Guidance*") (defining a sub-prime borrower as one with relatively high default probability as evidenced by a low credit bureau risk score or history of foreclosure, repossession or charge-off).

SCS offered two witnesses: Craig Cook, a sales manager for Instant Auto, and Neil Bird, the general manager of SCS. Mr. Cook explained that the factors that Instant Auto considered in making loans to its customers included current employment, longevity of residence, credit history, references, and the ability to make a down-payment. JA 47. Mr. Cook stated that Instant Auto served the "sub-prime" market — making loans to individuals with "poor credit histories" and who were "risky customers." *Id.* Mr. Cook testified that the Tills' credit history and credit characteristics were typical of other sub-prime borrowers, and that the market rate of interest for such borrowers was 21%. JA 47-48. Mr. Cook testified further that the fact that a borrower files a chapter 13 case is a "negative" credit characteristic. JA 48.

Mr. Bird also testified that the Tills' credit profile was typical of the sub-prime market, and that the prevailing market rate for borrowers such as the Tills was 21%. JA 50, 52. Mr. Bird further explained that SCS and other lenders viewed chapter 13 plans negatively because chapter 13 debtors typically fail to make all the payments required under their plans: "usually we don't get paid the full plan for the vehicle." JA 51. In addition, Mr. Bird explained that the chapter 13 process typically involves delay and that, in some cases, SCS receives no distribution at all under the debtor's plan. *Id*.

## F. The Bankruptcy Court's Ruling

On June 27, 2000, the Bankruptcy Court overruled SCS's objection to the plan. (Pet. Cert. App. 40a). The court concluded that the method for calculating an appropriate rate of interest under section 1325(a)(5)(B) is the "prime-plus" formula, determined by taking the prevailing "prime rate" and adding a risk premium, based on the court's assessment of the risks of the debtor's plan. (Pet. Cert. App. 42a-43a). Concluding that 9.5% was an appropriate rate under this approach, the

Bankruptcy Court confirmed the Tills' plan on July 13, 2000. JA 56.[6]

## G. The District Court's Reversal

On appeal, the United States District Court for the Southern District of Indiana reversed and remanded. Pet. Cert. App. 34a. Following the Seventh Circuit's prior decision in *Koopmans v. Farm Credit Servs. of Mid-America*, 102 F.3d 874 (7th Cir. 1996), the court concluded that the appropriate rate was a "market rate" determined by the "coerced loan" method, under which the rate is determined by reference to what the secured lender would receive if it collected the proceeds of its collateral and reinvested them in a new loan of similar duration and risk. Pet. Cert. App. 37a-38a. The court concluded that, based on the unrebutted evidence, SCS would have obtained a 21% rate on a similar loan and so found this rate to be controlling. *Id.*, 38a.

## H. The Seventh Circuit's Ruling

On further appeal, a divided panel of the Seventh Circuit agreed with the District Court's adoption of the "coerced loan" approach, but remanded with instructions to apply the approach in light of the panel's elaboration of its methodology. Pet. Cert. App. 21a-22a. The court determined that, absent agreement among the parties on an appropriate rate, the secured lender's contract rate should serve as the "presumptive rate." *Id.*, 20a-21a. This rate should control unless the secured creditor presented "'persuasive evidence that its current rate is in excess of the contract rate,'" in which event the current rate would

6. As noted, the 9.5% rate is based on a 1.5% risk premium added to an 8% rate. The United States argues erroneously that the 1.5% premium is "undisputed as a factual finding." US Br. at 26. In truth, there is no evidence to support the 1.5% risk premium. The only evidence is that the Tills are high-risk borrowers and that no lender would lend to them at a rate less than 21%. JA 47-48. The 1.5% figure is simply a number that the Tills offered and the bankruptcy court accepted. It has no basis in "fact."

control. *Id.* (quoting *GMAC v. Jones*, 999 F.2d 63, 70-71 (3d Cir. 1993)). Conversely, the debtor might rebut the presumption in favor of a lower rate if the debtor could demonstrate that "'the creditor's current rate is less than the contract rate.'" *Id.*

In reaching its conclusion, the Seventh Circuit found that the purpose of section 1325(a)(5)(B)(ii) is to place the secured creditor in essentially the same position that it would have occupied had it been able to recover its collateral and reinvest the proceeds in a new loan of similar risk and duration. Pet. Cert. App. 12a. The court observed that, by its terms, section 1325(a)(5)(B)(ii) directs that a secured creditor forced to accept delayed payment must be compensated for the delay in a manner sufficient to preserve the "value" of the creditor's present interest in its collateral. *Id.*

Noting that section 1325(a)(5) provides the debtor with three options for resolving the treatment of a secured claim, the Seventh Circuit reasoned that Congress must have intended all three options to provide roughly equivalent value. Pet. Cert. App. 12a.[7] The court concluded that, in order for the cram-down option to provide the secured creditor with the same value as the other two options (i.e., surrendering the collateral or striking a bargain), the debtor would have to pay interest to the secured creditor at a "market rate." *Id.*, 13a. The court further concluded that the relevant market rate would be what the particular lender would currently receive on a loan of similar duration and risk outside of bankruptcy. *Id.*, 20a.

7. As discussed, the three options are (1) the debtor surrenders the collateral to the secured creditor, 11 U.S.C. § 1325(a)(5)(C); (2) the secured creditor and debtor agree to a consensual rate, 11 U.S.C. § 1325(a)(5)(A); or (3) the debtor "crams down" the secured creditor by forcing the creditor to accept the debtor's retention of the collateral in exchange for installment payments of principal plus interest equal to the "value" of the creditor's secured claim. 11 U.S.C. § 1325(a)(5)(B).

In adopting the contract rate specified in the parties' pre-bankruptcy loan agreement as the presumptive measure of an appropriate market rate, the Seventh Circuit conceded that, in doing so, "we are approximating, not necessarily duplicating precisely, the present value of the collateral to the creditor as [section 1325(a)(5)(B)] requires." Pet. Cert. App. 20a. Nevertheless, the court concluded that "we believe that the old contract rate will yield a rate sufficiently reflective of the value of the collateral at the time of the effectiveness of the plan to serve as a presumptive rate." *Id.*

In conducting its analysis, the Seventh Circuit considered and rejected two competing methods. First, the court considered the "cost of funds" approach, under which a bankruptcy court would set the interest rate based on the creditor's hypothetical cost of borrowing the particular funds that the debtor is obligated to pay under the plan. Pet. Cert. App. 13a. Observing that this approach fails to take account of the risks associated with the debtor's plan, the court rejected it as inadequate to provide the creditor with the "value" of its secured claim. *Id.*, 14a-15a.

Second, the court considered the "formula" approach adopted by the bankruptcy court. Pet. Cert. App. 15a. Rejecting this standard, the court explained that, in enacting section 1325(a)(5), Congress intended to protect secured creditors from several types of risks and costs, including the debtor's risk of default and nonpayment, the continued depreciation of the collateral, and the costs associated with continuing to service the loan. *Id.*, 16a. Observing that the formula approach failed to account adequately for these risks and costs in individual cases, the court concluded that the Code requires a more particularized inquiry. *Id.*, 17a.

**SUMMARY OF ARGUMENT**

Congress designed chapter 13 to afford insolvent wage-earners the opportunity to devise a plan for the repayment of their debts from future earnings. At the end of the repayment period, the debtor may obtain a discharge of unsatisfied obligations, provided the debtor has substantially completed the payments required under the plan. 11 U.S.C. § 1328. Because the process is strictly voluntary, a debtor may abandon the plan at any time. 11 U.S.C. §§ 1307(a), (b). In fact, most chapter 13 debtors fail to complete their repayment plans. *See Rash*, 520 U.S. at 963 (the "vast majority of [chapter 13] reorganizations fail . . . leaving creditors with only a fraction of the compensation due them") (citation omitted).

The Bankruptcy Code generally allows a chapter 13 debtor to keep his or her assets. If the debtor elects to keep an asset that secures a debt, however, the debtor must pay the creditor the "value" of its secured claim, either immediately, or over time by compelling an extension of the loan. 11 U.S.C. § 1325(a)(5)(B)(ii). If the debtor elects the latter course, the debtor must pay the creditor interest sufficient to ensure that future payments have the same present value as immediate payment. *Id.* The issue in this case is whether the applicable rate of interest is properly a prevailing market rate that takes into account a market assessment of the risks and costs associated with the debtor's promise of delayed payment or some other rate, based on a judicial officer's discretionary assessment of the risks of the debtor's plan, the riskless Treasury-bill rate, or the creditor's cost of borrowing funds.

The essential purpose of interest, no less than the "value" requirement of section 1325(a)(5)(B)(ii), is to compensate a secured creditor for the risks associated with a debtor's payment proposal. It is axiomatic that a risk-laden promise to make payments in the future is far less valuable than the certain right to obtain full payment from collateral today. *See* Richard A.

Brealey & Stewart C. Meyers, *Principles of Corporate Finance 15* (7th ed. 2003) ("*A safe dollar is worth more than a risky one*."). And a chapter 13 debtor's promise to pay in the future can only be characterized as a very high-risk proposition. A chapter 13 debtor's default is also laden with costs. Although the secured creditor's lien in its (typically depreciating) collateral serves as a partial hedge against ultimate nonpayment, the secured creditor's compensation for the debtor's high risk of default, and the costs associated with any such default, is the interest that the secured creditor is entitled to receive.

An appropriate rate of interest in this context is and ought to be a true market rate — or at least as close to a true market rate as is feasible. This means the rate that the particular debtor would pay to a willing lender in the debtor's geographic area on a loan of similar amount, duration, and security. This is the only reliable way to ensure that the interest rate reflects the true risks of the debtor's proposed future payment stream, and thus, the best way to ensure that the secured creditor receives the full "value" of its secured claim, as the statute requires. Indeed, the very purpose of the lending marketplace is to assess and assign interest rates based on the routine evaluation of such risks.

In most chapter 13 cases, the prevailing market rate will be the same as the rate specified in the parties' pre-petition loan agreement, particularly if the agreement was executed in close proximity to the debtor's bankruptcy filing. Certainly, if the debtor's financial circumstances have not improved, the current rate will not be lower than the old contract rate. For this reason, and as the Seventh Circuit determined, it is appropriate to use the contract rate as the presumptive rate. Either party, however, should be afforded the opportunity to demonstrate that the presumptive rate should not control — e.g., because the market rate available to the debtor is substantially higher or lower than the contract rate. In this case, the unrebutted evidence is that a lender would not lend to the Tills at a rate less than 21% due to their poor credit history and the high prospect of plan default in chapter 13 cases. JA 47-48. This is also the rate specified in the Installment Contract. Hence, in this case, the contract rate and the market rate are one and the same.

Petitioners and their *amici* contend that a judicial officer is best suited to set the rate through application of a formula using the relatively riskless "prime" lending rate, or the riskless Treasury-bill rate, adjusted marginally (by one, two, or three points) according to the judge's sense of the risk of the debtor's plan. Pet. Br. 49; US Br. 8; NACBA Br. 5. Alternatively, they contend that the relevant rate should be the unadjusted, riskless Treasury bill rate. AARP Br. 16-17. A third approach is based on the creditor's cost of funds. Pet. Cert. App. 13a; P Br. 43; T Br. 24. These propositions are unsound.

In no sense is the formula rate a "market rate." Nor does the formula rate, or the riskless Treasury-bill rate, come close to incorporating the true risks associated with the extremely high rate of default of the typical chapter 13 debtor's repayment plan. A rate that consistently overestimates the strength of the debtor's promise of future payment (and correspondingly underestimates the debtor's likelihood of default, together with the associated costs) cannot be faithful to the statutory requirement that any stream of future payments must have a "value" equal to the creditor's secured claim.

The cost-of-funds approach is similarly defective. The rate that a *creditor* must pay to borrow funds in the marketplace will reflect the strength of *its* credit, not that of the debtor. Obviously, the credit-worthiness of the secured party has nothing to do with the risk of the debtor's plan. Accordingly, the cost-of-funds approach is virtually certain to fail the statutory directive that the stream of payments that the *debtor* must make have a "value" equal to the creditor's secured claim.

It is true, of course, that in some (perhaps many) chapter 13 cases there may be *no* lender willing to lend to the particular debtor at any legal rate, owing to the debtor's poor credit history or other factors. But this hardly supports the application of a formula calling for the use of a relatively risk-free rate, with only marginal, discretionary adjustments. Nor does this possibility support application of a riskless Treasury-bill rate or the cost-of-funds approach, which, again, fail to account for the true risks of the debtor's promise of future payments.

Use of a market rate (rather than the alternatives suggested by Petitioners and their *amici*) finds further support in the Bankruptcy Code's treatment of secured claims generally. Although a chapter 13 debtor may modify the rights of secured creditors, the Code's prevailing philosophy is that the secured party is entitled to the full value of its rights. In the context of section 1325(a)(5)(B), the only interest rate that adheres to this philosophy is the market-rate approach.

The history behind the cram-down option of section 1325(a)(5)(B) further supports use of a market rate. The section traces its origin to early reorganization practice, which embraced long ago the principle of "indubitable equivalence" — i.e., that a secured party is entitled to the full value of its rights, not only with regard to the preservation of its collateral position, but also with regard to the interest it is entitled to receive. Only the market-rate approach is consistent with this history.

Use of a market rate is also the most efficient and economical procedure; comports with applicable bankruptcy policy; is equitable; and is warranted to avoid perverse economic incentives. This Court has instructed that, to fix the amount of a creditor's secured claim in any case in which the debtor proposes to retain use of the collateral, the relevant valuation standard is "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." *Rash*, 520 U.S. at 960. The market rate of interest that the debtor must pay in proposing to pay a secured claim over time encompasses nothing more than an extension of this inquiry: the determination of the rate that a willing borrower in the debtor's trade, business, or situation would pay to finance the purchase of the property from a willing lender. For many of the same reasons that the Court adopted the market-based valuation standard in *Rash*, the Court should adopt the market-based interest-rate standard under section 1325(a)(5)(B). Because the Seventh Circuit adopted such an approach, its judgment should be affirmed.

## ARGUMENT

### A. The Rate of Interest Payable Under Section 1325(a)(5)(B)(ii) Is a Market Rate That Accounts for the True Risks and Costs Associated with a Chapter 13 Debtor's Typically Uncertain Promise of Future Payment.

#### 1. Section 1325 of the Code Requires the Payment of Interest at a Market Rate.

In crafting the provisions of the Bankruptcy Code, Congress understood that a debtor's mere promise to repay a secured debt — even one written in a chapter 13 plan — is no guarantee of payment. As compensation for the risks and costs associated with the debtor's potential default, Congress expressly required in section 1325(a)(5)(B) that, if the debtor intends to keep the collateral and compel an involuntary extension of the loan on modified terms by paying the secured creditor over time, the debtor's plan must satisfy two criteria. First, the secured creditor must retain its lien on its collateral to assure payment of its secured claim. 11 U.S.C. § 1325(a)(5)(B)(i). Second, the debtor must promise to pay the secured creditor a stream of payments that have a "value, as of the effective date of the plan" that is "not less than the allowed amount of [the creditor's secured] claim." 11 U.S.C. § 1325(a)(5)(B)(ii); *see Rash*, 520 U.S. at 957 (discussing operation of section 1325(a)(5)(B)).

All agree that, if the debtor proposes to extend the loan by paying the creditor in installments, section 1325(a)(5)(B)(ii) requires the debtor to pay the principal amount of the creditor's secured claim *plus interest*. As a matter of law and logic, the payment of interest is necessary to ensure that the future payments have the same value as immediate payment in full. Because a promise of future payment is inherently more uncertain (and hence less valuable) than full present payment, the payment of interest is necessary to compensate for the difference. *See St. Louis Southwestern R. Co. v. Dickerson*, 470 U.S. 409, 412 (1985) ("It is self-evident that a given sum of money in hand is worth more than the like sum of money payable in the future.") (citations omitted).

As the Court explained in *Rash*, under section 1325(a)(5)(B)(ii), "the debtor is required to provide the creditor with payments, over the life of the plan, that will total the present value of the allowed secured claim, i.e., the present value of the collateral." 520 U.S. at 957. *See also Rake v. Wade*, 508 U.S. 464, 469-70 (1993) ("[Section] 1325(a)(5)(B)(ii) guarantees that property distributed under a plan on account of a claim, including deferred cash payments in satisfaction of the claim, must equal the present dollar value of such claim as of the confirmation date.") (internal citation omitted). As the Court also concluded in *Rake*, section 1325(a)(5)(B)(ii) thus establishes the creditor's entitlement "to interest." *Id.* at 473.[8]

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8. The Code's legislative history similarly recognizes that the term "value," as used in the text of section 1325(a)(5)(B) and similar provisions, means "present value" and requires the payment of interest to reflect the economic reality that the value of any promise of future payment must be "discounted" to reflect the fact that future payments

(Cont'd)

In common commercial parlance, the concepts of "value," "present value" (or "discounting to present value"), and "interest" have well-recognized meanings and are inter-related. The present value of a future payment turns on how much the future payment must be "discounted" to ascertain its current value. In turn, the amount of the discount reflects nothing more than an imputed rate of interest. *See Dickerson*, 470 U.S. at 412 ("the method of calculating present value should take into account . . . the rate of interest"). For example, if the relevant interest rate is 10%, a promise of $10 a year from now has a present value of $9.09:

> The concept of present value is really quite simple and can be easily illustrated. Assume that A wants to borrow money from B, repayable at a future date. B is willing to make the loan, but feels that, considering the risks involved, he is entitled to a 10 percent annual rate of return. This being the case, how much money will he advance to A on A's note

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(Cont'd)
are worth less than the same payments made today. *See* H.R. Rep. No. 95-595 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6364 (discussing the phrase "value, as of the effective date of the plan" and observing that the phrase "indicates that the promised payment under the plan must be discounted to present value as of the effective date of the plan" and that "[t]he discounting should be based only on the unpaid balance of the amount due under the plan, until that amount, including interest, is paid in full"). *Amicus* AARP argues that a reference in the legislative history to the concept of "value" as including the "time value of money" indicates congressional intent to apply a riskless Treasury-bill rate. AARP Br. 16-18; *see also* US Br. at 11. This is unsound. The concept of the "time-value of money" is simply another reference to present value and does not singularly connote use of a riskless Treasury-bill rate. *See John Downes, Dictionary of Finance and Investment Terms*, 303-04, 436 (1985) (characterizing present value as also "called *time value of money*" and defining "time value of money" as including "present value").

> for $10 payable one year hence? The answer is $9.09, because the $10 paid next year provides interest of $.91, which is 10 percent of a $9.09 loan. Thus, $9.09 is the present value of $10 payable one year hence at a discount rate of 10 percent.

Sumner N. Levine, *Financial Analysts' Handbook I*, 140 (1975).

Put another way, the discounting concept reflects what an investor would pay to "purchase" the particular stream of future payments. In the market, an investor simply would not pay $10 today to receive $10 tomorrow. As another text explains:

> The present value of $400,000 [one] year from now must be less than $400,000. After all, *a dollar today is worth more than a dollar tomorrow*, because the dollar today can be invested to start earning interest immediately. Thus, the present value of a delayed payoff may be found by multiplying the payoff by a discount factor. The rate of return . . . is the reward investors demand for accepting delayed payment. . . . [T]he present value . . . is also [the] market price.

Brealey, *supra* at 14. *See also Protective Committee v. Anderson*, 390 U.S. 414, 442 n.20 (1968) ("Value is the present worth of future anticipated earnings.") (citation omitted); 3 *The New Palgrave Dictionary of Money & Finance*, 172 (Peter Newman et al. eds., 1992) (present value means "the summed discounted value of the stream of revenues which [an] asset generates" as to which "[t]he discount factor will be that determined by the interest rate over the relevant period").

In the context of section 1325(a)(5)(B), the value of the secured claim is known (here $4,000). In addition, the proposed term of repayment is known (here 17 months). The sole issue is establishing a rate of interest necessary to ensure that the payments (principal plus interest) to be made over 17 months will have a present value of $4,000. Obviously, if the rate of interest is inadequate, then the stream of payments (principal plus interest) will not have a present value of $4,000, but will be worth some lesser amount.[9] Thus, the future payments can have a "value" equal to the secured creditor's claim only if the plan incorporates the correct rate. As the Court explained in *Rake*:

> [A] creditor receives the "present value" of its claim only if the total amount of the deferred payments includes the amount of the underlying claim plus an appropriate amount of interest to compensate the creditor for the decreased value of the claim caused by the delayed payments. This generally involves a determination of an appropriate discount rate and a discounting of the stream of deferred payments back to the present dollar value of the claim at confirmation.

508 U.S. at 472 n.8.

In sum, the concept of interest is integral to the concepts of "value" and "present value." In turn, the concept of "interest" is dependent on the concept of "risk." As Paul Samuelson has written, in theory, an appropriate interest rate in an ideal (riskless) capital market might be set by simple reference to the supply and demand of capital. Paul A. Samuelson, *Economics* 599 (9th ed. 1973). At the same time,

> [t]hat does not mean that I shall make a small loan at this low an interest rate to an applicant whom I do not know and who has lost three jobs in 6 months'

9. For example, if the prevailing interest rate is 10%, offering the secured creditor 1% on a secured claim of $1,000 means that the present value of the payments (principal and interest) will be less than $1,000.

> time: I may have to charge him as much as 20 per cent per annum to compensate me for having to investigate him, dun him for collection, and cover the risk premium from default and costly litigation.

*Id. See also* Edwin Mansfield, *Economics: Principles*, *Problems*, *Decisions* 563 (1974) ("One of the most important determinants of the rate of interest charged a particular borrower is the *riskiness* of the loan. Naturally, if the lender has doubts about his chances of getting his money back, he will charge a higher interest rate than if he is sure of being repaid."); Daniel B. Suits, *Principles of Economics* 495 (1973); Christine Ammer, *Dictionary of Business and Economics* 236 (1984).

Echoing these concepts, the Court has explained, "as respects 'interest,' the usual import of the term is the amount which one has contracted to pay for the use of borrowed money." *Deputy v. Du Pont*, 308 U.S. 488, 497-98 (1940). *See also Bruning v. United States*, 376 U.S. 358, 360 (1964). The Court has recognized further that, in establishing a particular rate, the risks presented by the debtor's circumstances must ordinarily be taken into account:

> It is common knowledge that interest rates vary not only according to the general use value of money but also according to the hazard of particular classes of loans. Delinquent taxpayers as a class are a poor credit risk; tax default, unless an incident of legitimate tax litigation, is, to the eye sensitive to credit indications, a signal of distress. . . . Another variable is the amount necessary to compensate for the trouble of handling the item.

*Meilink v. Unemployment Reserves Comm'n of California*, 314 U.S. 564, 567 (1942). *See also BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) (in considering value, court must take into account "price-affecting characteristics"); *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 151 (1974) (to determine the "value" of a debt obligation, the court must consider the debtor's "financial condition . . . including both its credit position and its profits prospects").

Moreover, in our economy, interest rates are largely market-driven: "The simplest way to view interest is as a market-determined price charged for the use of money." Lawrence Abbott, *Economics and the Modern World* 640 (1967). Not surprisingly, the riskiest debtors pay the highest rates. As explained in another text:

> Low-risk borrowers such as large corporations pay the prime rate; all other borrowers pay a higher rate. . . . If an individual has a poor credit rating he may not be able to borrow from banks at all, and may have to get a loan from a finance company, whose interest rates range up to 36 percent.

William Albrecht, Jr., *Economics* 597 (1974). *See also* Irving Fisher, *The Theory of Interest* 382 (1930) ("Every lender or borrower knows that the rate of interest varies directly with risk. A bird in the hand is worth two in the bush."); John Lindauer, *Economics* 475-76 (1977); Tomas Sowell, *Basic Economics* 40-41 (2000).

Similarly, the Court has recognized that, in order to fix a true value for a given debt, the relevant standard is typically that of the competitive marketplace, not some artificially determined price: "[I]mplicit in the concept of debt discount is the assumption, and indeed the requirement, that the transaction be subjected to the exigencies of the competitive money market." *National Alfalfa*, 417 U.S. at 151. *See also Koopmans*, 102 F.3d at 876 ("A supplier of capital, no less than a supplier of seeds or combines, is entitled to the market price."). *Cf. Kimball Laundry*

*Co. v. United States*, 338 U.S. 1, 5 (1949) (the value of property as determined in the market place "has an external validity which makes it a fair measure").

The concepts of "value," "present value," and "interest," thus do not contemplate a rate fixed by a judicial officer based on minimal, discretionary adjustments to the prime rate or Treasury-bill rate. On the contrary, such methodologies are the antithesis of common commercial practice and would virtually ensure that the secured creditor will not receive the "value" of its secured claim, as section 1325(a)(5)(B)(ii) requires. For the same reasons, application of an unmodified Treasury-bill rate, or a rate based on the lender's costs of funds, is similarly inappropriate because they bear no relationship to the actual risk of the debtor's default. *See BFP*, 511 U.S. at 540 ("There is another artificially constructed criterion we might look to instead of 'fair market price.' One might judge there to be such a thing as a 'reasonable' or 'fair' forced sale price. . . . The problem is that such judgments represent policy determinations that the Bankruptcy Code gives us no apparent authority to make."); *Green Tree Fin. Serv. Corp. v. Smithwick (In re Smithwick)*, 121 F.3d 211, 215 (5th Cir. 1997). *Cf. United States v. Cartwright*, 411 U.S. 546, 551 (1973) (for tax purposes, property is generally to be determined by its fair market value, measured as the price a willing buyer would pay, and observing that this standard is a longstanding one).

Moreover, Petitioners and their *amici* fail to recognize that Congress crafted the requirements of section 1325(a)(5)(B)(ii) for the protection of *creditors*, not debtors. *Johnson v. Home State Bank*, 501 U.S. 78, 87-88 (1991). Because the whole purpose of the provision is to ensure that the secured party will receive the full value of its claim, the relevant rate must be one that fully compensates the creditor for the actual risks and costs that it faces. The market-rate approach is the only method designed to fulfill this goal. Accordingly, it is the appropriate method to apply in this context.

**2. Chapter 13 Plans Are High-Risk and High-Cost.**

SCS does not challenge the legitimacy of the Tills' chapter 13 filing or the Tills' general ability to modify SCS's rights as a secured creditor. SCS does challenge, however, the Tills' attempt to erode the requirements of section 1325(a)(5)(B)(ii) by promoting an interest-rate approach that vastly understates the risks and costs of the chapter 13 procedure. As this Court has recognized, the unfortunate truth is that the risk of default for chapter 13 cases is exceptionally high, rendering chapter 13 plans extremely risky propositions. *Rash*, 520 U.S. at 963 (the "vast majority of [chapter 13] reorganizations fail . . . leaving creditors with only a fraction of the compensation due them") (citation omitted). More than 60% of chapter 13 debtors fail to complete their plans. *See* Jean M. Lown & Barbara R. Rowe, *A Profile of Utah Consumer Bankruptcy Petitioners*, 5 J.L. & Fam. Stud. 113, 119 (2003) (finding that 74% of chapter 13 cases filed in Utah between 1997 and 2001 were dismissed without completion of the debtors' repayment plans); Scott F. Norberg, *Consumer Bankruptcy's New Clothes*: *An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 Am. Bankr. L. Rev. 415, 439-40 (1999) (finding that approximately two-thirds of chapter 13 filers do not complete their plans and obtain a discharge); William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 68 Am. Bankr. L.J. 397, 410 (1994) (unpublished national survey of 124 chapter 13 trustees finding district-wide plan completion rates as low as 3%).

Corroborating this experience, the unrebutted testimony in the bankruptcy proceeding was that one reason car-loan providers view chapter 13 plans so negatively is that "usually we don't get paid the full plan for the vehicle." JA 51. Indeed, as one author has written, many chapter 13 debtors fail to make even a single payment. *See* Michael W. Dunagan, *Enforcement of Security Interests in Motor Vehicles in Bankruptcy: The Rash* *to Judgment — A Contrarian View from the Creditor's Perspective*, 52 Consumer Fin. L. Q. Rep. 192, 197 (1998) (concluding that the filing of a chapter 13 petition is "the worst thing that can happen to motor vehicle lien holders").

In addition, a failed chapter 13 plan is laden with costs, including the administrative costs associated with monitoring the chapter 13 plan payment process; the costs of delay; and the costs (including attorneys' fees) associated with actual enforcement of the creditor's rights in the event of the debtor's default.

As noted, the automatic stay prevents creditors, including secured creditors, from enforcing their collection rights while the debtor's plan remains in effect. 11 U.S.C. §§ 362(a), 362(c)(2)(C). Thus, when a chapter 13 debtor fails to make scheduled payments under its plan, the secured creditor must return to the bankruptcy court to obtain relief from the stay to enforce its rights. 11 U.S.C. §§ 362(d), 1307(c). At that point, the debtor may (and often will) protest the default, causing further delay and expense. In many instances, the bankruptcy court will give the debtor one or more additional chances to catch up on its payments. At each juncture, the secured creditor is required to shoulder the burden of additional cost — including the cost of paying a filing fee for seeking relief from the bankruptcy court (currently $75.00 for a motion for relief from stay). *See* Fee Schedule for U.S. Bankr. Ct. S.D. Ind., promulgated under 28 U.S.C. § 1930, *available at* http://www.insb.uscourts.gov/. In this case, the fee alone would equal approximately 2% of the collateral value.

Notwithstanding the debtor's default, the debtor will retain possession and use of the collateral until the secured party obtains relief to exercise its rights. In the meantime, the collateral will continue to depreciate, further jeopardizing the creditor's recovery. In addition, defaulting debtors often fail to maintain their vehicles. Thus, even though the secured party may ultimately succeed in obtaining permission to pursue its rights, the value of the collateral may be further impaired. *See Rash*, 520 U.S. at 963 ("where, as here, collateral depreciates rapidly, the secured creditor may receive far less in a failed reorganization than in a prompt foreclosure") (internal quotation marks and citation omitted).

Because of their financial situation, chapter 13 debtors may also allow their insurance to lapse. If an uninsured debtor is involved in an accident, the secured creditor's position will be further impaired. Indeed, if the vehicle is ruined, the debtor may simply abandon it and seek to have the secured creditor's claim recharacterized as unsecured, based on the diminished value of the collateral. Although the secured party may receive notice from the debtor's insurance company of any lapse, because of the automatic stay, the creditor must seek relief in the bankruptcy court before taking action, causing further expense and delay.

In the vast majority of chapter 13 cases, in which the relevant debts are typically small (e.g., car loans of between $5,000 and $15,000), even seemingly minor administrative costs (e.g., five hours of attorneys' fees) assume large economic significance. Indeed, in a significant number of cases, the cost of a single, contested attempt to obtain relief from the automatic stay following the debtor's failure to make payments under its plan may well exceed the value of the collateral.

Given the high risk that a chapter 13 debtor will eventually fail to make the payments called for under its plan, and given the high costs associated with the debtor's likely default, it cannot be presumed that the risks and costs associated with the typical chapter 13 debtor's promise of future payment will be low. On the contrary, the opposite presumption is warranted. Because the risks and costs are typically extremely high, the appropriate rate of interest is a market rate that fully accounts for these factors. *Cf. Rash*, 520 U.S. at 962 (implying that interest rates might properly be higher in bankruptcy cases).

Petitioners complain that the application of a market approach would yield high interest rates in chapter 13 cases and this could not be what Congress intended when it enacted the Bankruptcy Code in 1978, on the theory that sub-prime lending did not exist at the time. Pet. Br. at 14-18. The practice of charging high interest rates for risky borrowers, however, is not a recent phenomenon. In 1941, this Court observed prevailing interest rates as high as 30%, commenting that these reflected the nature of the loans in question. *See Meilink*, 314 U.S. at 568 (interest rate of 2.5% per month). Moreover, there is simply no evidence that Congress intended to limit the concept of "value" in section 1325(a)(5)(B)(ii) to a particular range of rates.

Petitioners and their *amici* also downplay unreasonably the risks and costs of chapter 13 plans, arguing that a secured creditor enjoys administrative protections that assure payment. These protections, however, are largely illusory, offering little in the way of mitigating the risks and costs of the chapter 13 procedure. For example, pursuant to section 1325(c) of the Code, the court may enter a "wage order," directing that the wages necessary to fund the plan be paid directly from the debtor's employer to the chapter 13 trustee for distribution under the plan. 11 U.S.C. § 1325(c). A wage order is meaningless, however, if the debtor changes jobs; is fired or laid off; or voluntarily abandons a plan. Because these occurrences are commonplace, a wage order is typically no protection at all.

Petitioners and their *amici* suggest further that the risk of default is mitigated because, in order to confirm the plan, the bankruptcy court must determine that the plan is feasible. Pet. Br. 45; US Br. 10; AARP Br. 21-22. This, too, is an illusory protection, as the alleged benefit of a judicial determination of feasibility is belied by the persistently high rate of default in chapter 13 cases.

In addition, Petitioners and their *amici* suggest that a secured creditor's retention of its lien on its collateral is adequate compensation for the risks of the debtor's potential default. Pet. Br. 46; NACBA Br. 22-23; US Br. 27. In most cases of plan default, however, the secured creditor's collateral often proves inadequate to cover completely the creditor's secured claim, let alone its collection costs. Rapid depreciation, combined with the other factors mentioned above, virtually assure that the secured party will not be paid in full if it is forced to assert its rights against its collateral.

It is certainly true that, in the cram-down context, a secured creditor is not faced with all of the costs of issuing a new loan. Pet. Br. 45; US Br. 23. But these savings are more than offset by the costs of delay and collection associated with the chapter 13 process. *See GMAC v. Jones*, 999 F.2d at 68-69 (making this point). Because the market-rate approach is the only method that approximates the true risks and costs of chapter 13 plans, it should be adopted under section 1325(a)(5)(B).[10]

### 3. The Sub-Prime Lending Market Serves High-Risk Borrowers and a Contract Rate Set in this Market Offers an Appropriate Proxy to Establish a Presumptive Rate in Chapter 13 Cases.

As noted, application of the cram-down option under section 1325(a)(5)(B) effects an involuntary extension of the secured creditor's loan on modified terms. Although Petitioners and their *amici* suggest that the terms of this extension are often more beneficial to the secured lender than those of the original loan

10. In support of their arguments, Petitioners and their *amici* rely on a passage from the Collier treatise, 8 *Collier*, ¶ 1325.06[3][b] at 1325-37. Pet. Br. 36; US Br. 23. Without considering the high default rate of chapter 13 debtors, or the high collection costs associated with such default, the treatise suggests that the secured creditor's risk "need not be large." *Collier*, at 1325-37. For the reasons discussed, this analysis is in error.

(thus justifying a reduced rate), the opposite is plainly true in the vast majority of chapter 13 cases. There is thus no reason to believe that, in most instances, the interest rate payable under section 1325(a)(5)(B)(ii) should be less than the rate that the secured creditor accepted in making the loan in the first place. *Cf. Rash*, 520 U.S. at 962-63 (suggesting that interest rates in bankruptcy should be higher).

Further, although the risks and costs of the chapter 13 procedure are likely to be significantly greater than those the lender originally accepted in making its initial lending decision, the old contract rate (as compared to the formula rate, the prime rate, the Treasury-bill rate, or the creditor's cost of funds) will best approximate the true risks and costs of the proposed involuntary extension of credit. This is particularly so where, as here, the loan was executed relatively contemporaneously with the borrowers' bankruptcy filing. Similarly, where, as here, the contract rate was set on the basis of the debtor's poor credit history, the debtor's circumstances have not improved, and no lender would actually lend on the terms proposed in the debtor's plan, the old contract rate clearly is more probative than the alternatives of an actual market rate. Because most chapter 13 cases fit this description, the contract rate should serve as the presumptive rate unless the debtor or the creditor shows by persuasive evidence that the actual market rate would be higher or lower.

Petitioners and their *amici* argue that the contract rate does not control because the task at hand is to determine the value of the debtor's promise of future payment under the plan, not the payment promised under the original loan. US Br. 16, 18. *See also* Pet. Br. 28-30; AARP Br. 28; NACBA Br. 21. This misses the point. The properly controlling rate is the market rate, and the old contract rate is evidence of at least *some* market rate between the parties. Absent a demonstration that the debtor's circumstances have changed sufficiently to warrant a different market rate, the old contract rate will presumptively serve as the best evidence of a market rate.

Lenders such as SCS are in the business of making loans to "sub-prime" borrowers, such as the Tills, who do not qualify for credit under traditional lending criteria. *See* Press Release, *OCC Addresses Subprime Lending Risk Issues* (April 5, 1999) (quoting Comptroller John D. Hawke, Jr.) (defining the characteristics of a sub-prime borrowers). These borrowers "typically have weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies." *Interagency Expanded Guidance* at 2-3.

Like other borrowers, high-risk debtors often require financing in order to make necessary purchases, including the purchase of an automobile. Although the interest rates that SCS and other sub-prime lenders charge may appear to be high, these rates merely reflect the high-risk nature of the borrowers involved in the lending transactions at issue. *See Risks Associated with Subprime Lending*, FDIC Financial Institution Letter (May 22, 1997), *available at http://www.fdic.gov/news/news/financial/1997/fil9744.html* ("Foremost among the risks is a greater likelihood for defaulted loans and any attendant losses.").

Accordingly, sub-prime lenders such as SCS typically charge interest at rates equal to the maximum legal rate in the jurisdictions in which they do business. In Indiana, where SCS operates, the maximum rate under the Indiana Consumer Credit Code is 21%. Ind. Code Ann. § 24-4.5-3-201. This rate enables SCS to serve many high-risk borrowers, such as the Tills, to whom lenders otherwise would be unwilling to extend credit.

Moreover, the 21% rate allowed under Indiana law is similar to the rates allowed in other states. Although states use different means of prescribing maximum interest rates, including general retail installment sales acts, specific motor vehicle sales acts, and consumer credit codes, the laws fall generally into three groups. The largest group, comprising over twenty states, allows a rate agreed upon by the parties to the transaction.[11] Fifteen states and the District of Columbia set a specific rate that ranges from 18 to 25%.[12] Thirteen states use a class system based on the age of the vehicle being purchased, in which older vehicles are subject to the highest rates.[13]

Despite lending at rates that approach or equal state maximums, sub-prime lenders typically underperform banks that lend at prime rates. For example, sub-prime lenders are "[n]early twice as likely to be unprofitable." John Lane, Assoc. Dir., Division of Supervision, FDIC, *Address at the National Automotive Finance Association Non-Prime Lending Conference* (June 18, 2002). This is due largely to the fact that sub-prime lenders live with delinquency rates on used-car loans that are approximately five times greater than the delinquency rates of new-vehicle loans offered almost exclusively by prime lenders. *See* Ted Craig, *Subprime Loan Business Offers Profits, Peril*, UCH-Headline News (July 1, 2002), *available at* http://eusedcarnews.com; *CBA Automotive Finance Study Show Tighter Approval Standards*, Consumer Bankers Association (May 6, 2003), *available at* http://www.cbanet.org/news. In many of these instances, lenders such as SCS are forced to incur collection costs. Nevertheless, both the rate of default and the associated costs are typically less in non-bankruptcy settings than the rate of plan default and the associated costs in the chapter 13 context.

Under the collection laws of most states, secured lenders enjoy quick and inexpensive rights of collection against their

11. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum B.

12. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum C.

13. These states, and the relevant statutory provisions, are set forth in chart form in the accompanying Addendum D.

collateral, including rights of repossession. *See* Ind. Code Ann. § 26-1-9.1-609; *United States v. Whiting Pools*, 462 U.S. 198, 207 n.14 (1983) (discussing secured creditor's right to take possession of its collateral). Outside the bankruptcy context, sub-prime lenders typically do not have the need to hire counsel to represent them in individual cases. In bankruptcy, the opposite is true, precisely because, as explained, an attorney must request relief from the court on behalf of the lender in order to pursue the creditor's rights.

When Congress enacted the Bankruptcy Code in 1978, it abandoned the prevailing philosophy under the former Bankruptcy Act that judges or administrative officials could properly fix payment entitlements. *Bank of Am. Nat'l Trust & Sav. Assoc. v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 458 n.28 (1999) (stating that, when it enacted the Code, "Congress adopted the view that creditors and equity security holders are very often better judges of the debtor's economic viability and their own economic self-interest than courts, trustees, or the SEC") (internal quotation marks and citation omitted). Secured creditors operating in a competitive market are simply in a better position to evaluate the risks inherent in a particular repayment proposal than is a bankruptcy court. *See In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) ("Judges are neither bankers nor lenders and do not have the expertise to set interest rates."). If negotiation does not yield an agreeable interest rate between the creditor and debtor, then the market — not the discretion of a judicial officer — provides the best alternative as a check on the parties' competing views. Because the old contract rate approximates the market standard, it should control presumptively in the absence of evidence of a higher or lower market rate available to the debtor.

Petitioners and their *amici* suggest unfairly that high-rate car loans are often the product of "predatory lending" and interest-rate "gouging." Pet. Br. 16-17 & n.14**.** The fact, however, that some borrowers outside the bankruptcy context may be eligible for lower interest rates than they agree to pay in financing the purchase of used vehicles does not undermine the reality that, in the bankruptcy context, the typical chapter 13 plan offers only a very risky prospect of repayment. Moreover, under the market-rate standard adopted by the court below, a more creditworthy chapter 13 debtor is free to demonstrate that he or she deserves a lower interest rate (for example, because the value of the collateral vastly exceeds the amount of the debt that it secures, thereby materially lowering the secured creditor's risk). Where, as here, the debtor can make no such showing, and the old contract rate most accurately reflects the debtor's circumstances, the old rate should control.[14]

## B. Section 1325(a)(5)(B) Should Be Construed Consistently with the Code's Other Provisions Designed to Protect the Rights of Secured Creditors.

Like other chapters of the Bankruptcy Code, chapter 13 does not require secured creditors to sacrifice the economic value of their security to subsidize the debtor's reorganization attempt. To be sure, the Code allows the debtor to modify the rights of secured parties. But the Code also prescribes explicit limitations on this power that conform to an overarching principle: although a secured creditor might not receive the literal terms of his bargain, "the secured creditor is entitled to receive in value essentially what he bargained for." H.R. Rep. No. 95-595 (1977),

14. Petitioners and their *amici* suggest that Congress's rejection of a proposal in 1984 to establish the contract rate as the definitive rate under section 1325(a)(5)(B)(ii) demonstrates that the contract rate should never apply. Pet. Br. 35; US Br. 14 n.6; AARP Br. 10. The fact that Congress rejected that particular proposal, however, suggests nothing about what Congress intended when it actually enacted the Code in 1978. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one"). Indeed, it is perfectly plausible that Congress believed the proposal to be unnecessary. It is also perfectly plausible that Congress rejected the proposal because it would harm secured creditors in instances in which the prevailing market rate would be greater than the contract rate.

*reprinted in* 1978 U.S.C.C.A.N. 5963, 6295. *See also* 4 *Collier*, ¶ 506.02 at 506-08 ("the protections afforded secured creditors under the Code generally adhere first to the principle that the secured creditor is entitled to priority payment out of its collateral, and second to the principle that the secured creditor is entitled to receive the equivalent value of its collateral").

Section 1325(a)(5) is one of several provisions that collectively enforce this principle in chapter 13 cases. There is no reason to conclude that Congress intended to erode this basic concept in the post-confirmation context, or otherwise require a secured party to accept less than an interest rate that reflects the true risk of the debtor's payment promise under its plan. Because the governing statutory text requires the payment of full value, and because the payment of a market rate of interest is necessary to ensure that the secured creditor receives economically the full value of a secured claim, that is the appropriate standard here.

As the Court has instructed repeatedly, the provisions of the Bankruptcy Code must be construed "holistically," taking into account the relationship between various provisions as well as their collective object and policy. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369-71 (1988) (construing sections 361, 362 and 506 of the Code and observing that "[s]tatutory construction is a holistic endeavor"); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.") (citations and internal quotation marks omitted); *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 218 (1936) ("To fix the meaning of these provisions [of the Bankruptcy Act] there is need to keep in view the background of their history. There is need to keep in view also the structure of the statute, and the relation, physical and logical, between its several parts.").

In a series of provisions, the Bankruptcy Code prescribes special rights and protections for the holders of "secured claims." Collectively, these provisions demonstrate Congress's effort to strike a balance between affording debtors the opportunity to modify the rights of secured parties to facilitate bankruptcy plans and preserving for secured creditors the full economic value of their rights. Because the market-rate approach best assures that a secured creditor will receive the full value of its rights under section 1325(a)(5)(B), it is the only approach that is fully consistent with these provisions.

First, during the pendency of a bankruptcy case, and before confirmation of any plan, a secured party may be entitled to "adequate protection" in the form of payments or other relief if the debtor's continued use of the collateral threatens to cause a decline in the value of the collateral to the detriment of the secured party while the secured party is prevented from taking possession on account of the automatic stay. 11 U.S.C. §§ 361, 363(e); *Whiting Pools*, 462 U.S. at 204 ("At the secured creditor's insistence, the bankruptcy court must place such limits or conditions on the [debtor's] power to sell, use, or lease property as are necessary to protect the creditor."). For example, if the collateral is depreciating as a result of the debtor's continued use pending approval of a chapter 13 plan, the debtor may be required to make periodic payments to the secured creditor in an amount equal to at least the rate of depreciation, so that the secured party's collateral position is maintained. *See* 4 *Collier*, ¶ 506.03[7][a] at 506-53 through 506-59 (illustrating concepts and providing examples).[15]

15. Similarly, although the automatic stay generally enjoins debt-collection activity during the case, the Bankruptcy Code also provides that, under certain circumstances, a secured creditor may be entitled to stay relief to enforce its non-bankruptcy rights. 11 U.S.C. § 362(d). Under the statute, a creditor is entitled to relief to enforce its rights if the debtor cannot provide "adequate protection" to the secured party to protect its collateral position, or if the debtor has no equity in the collateral and the property is not necessary for reorganization. *Id.*; *see Timbers*, 484 U.S. at 375-76; 4 *Collier*, ¶ 506.03[7][b] at 506-62 through 506-68.

The concept of adequate protection under sections 361 and 363(e) shelters the secured party from the beginning of the bankruptcy case through confirmation of the debtor's chapter 13 plan. At that point, the requirements of section 1325(a)(5)(B) take over. There is no reason to believe that, having preserved the secured party's position up to the point of confirmation, Congress thereafter intended to force the secured party to subsidize the debtor's retention of collateral through imposition of a substandard interest rate. On the contrary, as this Court has explained, "[t]he reorganized debtor is supposed to stand on his own two feet." *Timbers*, 484 U.S. at 378.

Second, as a general rule, creditors are not entitled to accrue interest on claims during a debtor's bankruptcy case between the date the debtor commences its case and the confirmation of any plan. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946) ("The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings.").

Section 506(b) of the Code, however, prescribes an exception for "oversecured" claims. Specifically, a secured creditor is entitled to accrue interest during the case to the extent that the value of its collateral exceeds the amount of its secured claim. 11 U.S.C. § 506(b); *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 239-40 (1989). For oversecured claims, the relevant rate of interest is the contract rate. *See Bradford v. Crozier (In re Laymon)*, 958 F.2d 72, 75 (5th Cir. 1992); *Ruskin v. Griffiths*, 269 F.2d 827, 831-32 (2d Cir. 1959); 3 *Collier*, ¶ 506.04 at 506-109.

Like the concept of adequate protection under sections 363(e) and 361, the interest rule of 506(b) applicable to oversecured claims carries the secured party from the beginning of the bankruptcy case through the confirmation of the debtor's plan. At that point, the interest rate is subject to adjustment, based on prevailing market conditions, in order to ensure that, if the debtor proposes to compel the secured creditor to extend its loan on modified terms, the secured creditor will receive the true value of its secured claim. Because in some cases this may require a rate of interest higher (or lower) than the old contract rate, section 1325(a)(5)(B)(ii) does not require payment of the old contract rate.

Like 506(b), section 1325(a)(5)(B) operates to preserve for the secured creditor the value of its economic bargain. Because the context (confirmation) is different, however, the statute operates in a different way. Specifically, section 1325 offers the debtor flexibility in adjusting the terms of repayment by forcing an extension of the loan on modified terms. Nevertheless, by its terms, section 1325 also aims to preserve for the secured creditor the full economic value of its bargain — to have the benefit of the full value of its collateral.

Third, in chapter 7 liquidation cases, section 725 directs that a trustee shall dispose of a secured party's collateral. 11 U.S.C. § 725. As the legislative history explains, "[t]he purpose of this section is to give the court appropriate authority to ensure that the collateral or its proceeds is returned to the proper secured party." H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6338. In substance, section 1325(a)(5)(B) requires essentially the same thing by directing that the secured creditor receive the full "value" of its secured claim. Again, the difference is that, under section 1325, the debtor is afforded flexibility in modifying the payment terms. Nevertheless, the underlying principle of protecting the secured creditor's economic return from its collateral remains the same.

In an effort to undermine the protection that section 1325(b)(5)(B)(ii) requires, Petitioners and their *amici* refer to other sections of the Code and suggest that these provisions demonstrate an intent to reduce the value of the secured creditor's interest in its collateral. Pet. Br. 19; US Br. 13; AARP Br. 11-15. The fact that the debtor may generally modify the rights of secured parties under section 1322(b)(2), however, is qualified by section 1325(a)(5)(B)(ii), and there is no basis to conclude that the former overrides the latter. On the contrary, the two must be construed together, and section 1325(a)(5)(B)(ii) must be given effect. *E.g.*, *Kelly*, 479 U.S. at 43.

Similarly, the fact that section 362(d)(3)(B) specifically provides for the payment of interest at a "fair market rate" as a means of providing adequate protection, whereas section 1325(a)(5)(B)(ii) uses the term "value," does not preclude the term "value" from requiring the payment of a market rate of interest. Unlike section 362(d)(3)(B), the function of section 1325(a)(5)(B)(ii) is to provide a standard to measure the present value of a proposed future stream of payments. Not surprisingly, the terminology used in the different provisions is distinct.[16]

Finally, contrary to the argument of *amicus* AARP, there is no clash between the use of the term "value" in section 1325(a)(5)(B)(ii) and section 1325(a)(4). Section 1325(a)(4) requires that, in order for the debtor's plan to be confirmed, the debtor's proposed future payments to unsecured creditors must not be less than the immediate distribution that unsecured creditors would receive from the liquidation of the debtor's property in a chapter 7 case. In conducting this comparison, the analysis under sections 1325(a)(5)(B)(ii) and 1325(a)(4), however, is the same: the court must discount the stream of proposed payments under the debtor's chapter 13 plan using an appropriate interest rate in order to determine the stream's present value. The court then compares the present value to the likely value of any distribution that unsecured creditors would receive in a chapter 7 case. So long as the present value of the chapter 13 payments is greater, section 1325(a)(4) is satisfied. In determining an appropriate interest rate, the court need simply select the market rate for unsecured loans available to the debtor.

16. For the same reason, the fact that section 506(b) expressly requires the payment of interest on oversecured claims at the rate set forth in the creditor's contract also is inapposite.

Moreover, because general unsecured creditors share *pro rata* from distributions available to them as a class, the court need only select one rate for the class.

The discounting procedure under section 1325(a)(4), however, is rarely (if ever) employed, for the simple reason that the overwhelming majority of debtors who file for chapter 13 relief would not provide any distribution to general unsecured creditors in a chapter 7 case because they have no unencumbered, non-exempt assets. Thus, by merely making a single distribution to unsecured under a chapter 13 plan, most debtors will satisfy the test of section 1325(a)(4). *Cf. Timbers*, 484 U.S. at 379 (dismissing anomalous result as so exceedingly rare as to be most likely "the product of inadvertence").

### C. The History of Section 1325 Supports a Market-Based Cram-Down Rate.

This Court has recognized that, "[w]hen Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (quoting *Emil v. Hanley*, 318 U.S. 515, 521 (1943)). The Court has further acknowledged the importance of the history and development of bankruptcy jurisprudence by presuming that provisions of the Bankruptcy Code will carry the same meaning as their predecessors unless Congress clearly intended a change. *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) ("We . . . 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure. . . .'") (quoting *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 563 (1990)); *United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 221 (1996) ("Congress could, of course, have intended a different interpretive method for reading terms used in the Bankruptcy Code it created in 1978. But if it had so intended we would expect some statutory indication. . . .").

Chapter 13 derives from former provisions of chapter XIII of the Bankruptcy Act of 1898. Under old chapter XIII, rights of secured creditors could not be altered without the secured creditor's consent. *See General Fin. Corp. v. Garner (In re Garner)*, 556 F.2d 772, 779 (5th Cir. 1977); *In re Moran*, 121 B.R. 879, 882 (Bankr. E.D. Okla. 1991) ("Chapter XIII under the Bankruptcy Act also prohibited the treatment of claims secured by personal property unless the consent of the secured creditor was obtained by the debtor."); *In re Hernandez*, 175 B.R. 962, 965 (N.D. Ill. 1994). *See also* Hon. Roger M. Whelan et al., *Consumer Bankruptcy Reform: Balancing the Equities in Chapter 13*, 2 Am. Bankr. Inst. L. Rev. 165, 191 n.8 (1994). When Congress enacted the provisions of chapter 13, it modified the governing scheme by incorporating a cram-down provision borrowed from the corporate reorganization context. *See* 11 U.S.C. § 1129(b).

The cram-down provisions of the Code appearing in both sections 1129 and 1325 derive from the former cram-down provision of chapter X, which, in turn, derives from the former cram-down provision of section 77B applicable to corporate reorganization. Under section 77B(b)(5), a debtor could confirm a plan of reorganization in which the debtor retained a secured party's collateral over the objection of the secured party, so long as the plan provided "adequate protection for the realization . . . [by secured parties] of the value of their interests, claims, or liens." Bankruptcy Act of 1934, ch. 424, § 77B(b)(5), 48 Stat. 911, 914 (1934) (superseded by the Chandler Act of 1938).

The leading case interpreting this provision is Judge Learned Hand's decision in *Metropolitan Life Ins. Co. v. Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), in which the court held that, in order to be adequately compensated under this provision, the payments offered to the secured party "must be completely compensatory." 75 F.2d at 942. In reaching this conclusion, the court observed that "the payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference. . . ." *Id.* The court also noted that the terms of the repayment had to compensate the secured party for its risk, and that the cram-down provision was not intended to force the secured party to shoulder uncompensated risk for the benefit of others. *Id.* ("We see no reason to suppose that [section 77B of the Bankruptcy Act] was intended to deprive [a creditor of principal plus interest or simply the property] in the interest of junior holders, unless by a substitute of the most indubitable equivalence."). Requiring a secured party to accept less than a market-based interest rate would violate this "indubitable equivalent" standard precisely because it would require the secured party to shoulder uncompensated risk for the benefit of others.

The legislative history indicates that Congress specifically intended to incorporate the concepts of *Murel* in enacting the cram-down provisions of the Code. H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6475 ("[Section 1129(b)(2)(A)(iii)] requires the Court to confirm the plan notwithstanding the dissent of the electing secured class if the plan provides for the realization by the secured class of the indubitable equivalence of the secured claims. The standard of "indubitable equivalence," as set forth in 28 U.S.C. § 1129(b)(2)(A)(iii), is taken from *In re Murel Holdings Corp.*, 75 F.2d 941 (2d Cir. 1935). *See also Timbers*, 484 U.S. at 378 ("Of course *Murel*, like [the cram-down provisions of chapter 11], proceeds from the premise that in the confirmation context the secured creditor is entitled to present value."). Consistent with the historical underpinnings of the cram-down provision, the debtors' plan in this case, in order to be "completely compensatory," must provide SCS with a true market rate of interest. Absent a rate of interest set by the market, SCS would be compelled improperly to shoulder uncompensated risk for the benefit of the debtors and other creditors because SCS would not be receiving the full "value" of its secured claim.

Petitioners and the United States argue that *Murel* is inapplicable in the context of a cramdown in chapter 13. Pet. Br. 37-38; US Br. 18 n.9. Specifically, Petitioners contend that "the precedential value [of] *Murel* was dispelled by this Court in *Timbers*," which referenced only the importance of 'indubitable equivalence' with regard to the principal of the loan and not with reference to interest." Pet. Br. 37. The Court's holding on this point, however, was limited to situations in which the bankruptcy court is charged with preserving the value of the creditor's collateral from diminution during the period prior to confirmation of the debtor's plan. 484 U.S. at 377. In those situations, a creditor is not entitled under the Code to the immediate payment of the principal of its collateral, during which the status quo is simply preserved. *Id.* The Court noted, however, that interest payments *are necessary* when a creditor's interest is assessed in the debtor's plan. "Under this formulation, even though the undersecured creditor's 'interest' is regarded (properly) as solely the value of the collateral, he must be rendered payments that assure him that value as of the effective date of the plan." *Id.* Thus, the Court did not dispel *Murel* in the confirmation context, which is not the context in *Timbers* but is the context here.

**D. The Policies of the Code Require that SCS Receive the Full Value of its Secured Claim.**

As noted, the Bankruptcy Code embraces the policy of protecting the rights of secured creditors by ensuring that they receive the full "equivalent value" of their rights, and that they receive treatment that is "completely compensatory" in exchange for the deprivation of their non-bankruptcy collection entitlements. Allowing a debtor to keep a secured party's collateral, yet pay interest on a less-than-market rate basis, would violate these policies by effectively requiring the creditor to subsidize the debtor's retention of its collateral. *See In re Roso*, 76 F.3d 179, 181 (8th Cir. 1996) ("By definition, a subsidized rate of interest is not a market rate of interest. It is a rate of interest *below* the market rate."). This would supply nothing less than a proscribed windfall for the debtor by allowing the debtor to reap the benefits of property without paying the market value for it. *See Butner v. United States*, 440 U.S. 48, 55 (1979) (a longstanding policy of bankruptcy law is to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy") (citing *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961)); *Dewsnup*, 502 U.S. at 417-19 (bankruptcy law does not permit the gratuitous transfer of the value of a valid lien to the debtor); *Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (In re Winthrop Old Farm Nurseries, Inc.)*, 50 F.3d 72, 76 (1st Cir. 1995) (a court cannot permit lien stripping that would create a windfall for the debtor); 4 *Collier*, ¶ 506.03[4][a][iii].

In this instance, if the Tills wished to rid themselves of their payment obligation to SCS, they could have surrendered the Chevy and discharged their indebtedness. 11 U.S.C. § 1325(a)(5)(c). Because they elected to keep the collateral, however, they must pay the market value for it, including the market rate of interest that reflects the true risk of forcing SCS to continue on as the Tills' secured lender. *See* Matthew Y. Harris, *Chapter 13 Cramdown Interest Rates: Another Day, Another Dollar — A Cry For Help In Ending The Quest For The Appropriate Interest Rate*, 67 Miss. L.J. 567, 580 (Winter 1997). In this context, forcing SCS to subsidize the debtors' interest rate would give the Tills a proscribed "head start," not a "fresh start." *See Taylor v. AGE Fed. Credit Union (In re Taylor)*, 3 F.3d 1512, 1516 (11th Cir. 1993) (a debtor is entitled to a fresh start, not a head start, and thus must provide for post-petition secured obligations); *In re Kokoszka*, 479 F.2d 990, 995 (2d Cir. 1973), *aff'd sub nom. Kokoszka v. Belford*, 417 U.S. 642 (1974); *Heller v. Foulston (In re Heller)*, 160 B.R. 655, 658

(D. Kan. 1993); 130 Cong. Rec. S8891 (daily ed. June 29, 1984), *reprinted in* 1984 U.S.C.C.A.N. 590, 598 (statement of Sen. Orrin G. Hatch) (indicating that numerous provisions were added to the Bankruptcy Code to ensure that the Code's "fresh start" does not become a "head start"). *See also Boston University v. Mehta (In re Mehta)*, 310 F.3d 308, 311 (3d Cir. 2002) (there are situations "where giving the debtor a fresh start in life is not the paramount concern and protection of the creditor becomes more important"); *In re Scott*, 294 B.R. 620, 628 (Bankr. W.D. Pa. 2003); *In re Coonce*, 213 B.R. 344, 349 (S.D. Ill. 1997).

Contrary to the arguments of Petitioners and their *amici*, the Code's policy of equality of distribution is not at stake. *See Young v. Higbee*, 324 U.S. 204, 210 (1945) ("historically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets"). As explained in Collier, "[c]onceivably, Congress might have adopted a bankruptcy system that abolished distinctions between secured and unsecured debt, leaving all creditors to receive essentially the same treatment on more or less of a pro rata basis. . . . Congress, however, has not chosen such a system." 4 *Collier*, ¶ 506.02 at 506-8. Instead, "[a]s stated in the legislative history to section 361: 'Secured creditors should not be deprived of the benefit of their bargain.'" *Id.* (quoting H.R. Rep. No. 95-595 at U.S.C.C.A.N. 6295). Moreover, there is no basis for attempting to elevate the policy of equality of distribution applicable to unsecured claims to erode the protections afforded secured parties under section 1325(a)(5)(B). *See In re Greystone III Joint Venture*, 995 F.2d 1274, 1280 (5th Cir. 1992) ("'Policy' considerations do not justify preferring one section of the Code, must less elevating its implicit 'policies' over other sections, where the statutory language draws no such distinctions.").

**E. Application of a Market-Rate Standard Is Economically Efficient.**

Like other sub-prime lenders, SCS holds a portfolio of loans, and the risks and costs of any particular borrower are spread among the total number of borrowers in its portfolio. Because lenders such as SCS have numerous loans, they may accept some applicants that are riskier than average, and the risks associated with these applicants are offset by the lower risks of other members of the pool. Notwithstanding its ability to spread risks and costs, however, lenders such as SCS do not approve all applicants. Some applicants are simply too risky to include in the lending pool, particularly given the cap on interest rates imposed by the laws of many states (here 21%), and the fact that lenders such as SCS do not themselves have access to unlimited, cost-free funds.

Petitioners and their *amici* argue that chapter 13 debtors should pay rates of interest lower than non-bankrupt sub-prime borrowers because the risks and costs of default are already built into the interest rates that the lender charged initially. But this ignores the fact that, because of the debtor's bankruptcy, the lender's collection of its contract rate of interest from the particular debtor has been interrupted. Hence, the particular debtor has *not* already "paid for" its potential default. Indeed, the opposite is true. Because SCS will never collect the Tills' debt in full (e.g., because SCS is an undersecured creditor, nearly $1,000 of its claim was stripped off and placed in the unsecured class and will not be paid in full), SCS will, at best, sustain a significant loss on the account.

Moreover, it makes no economic sense that chapter 13 debtors should be rewarded with interest rates that are lower than other high-risk members of the sub-prime lending pool who manage to avoid bankruptcy. As a matter of economic reality, the costs of default associated with chapter 13 cases must be absorbed somewhere. Because interest rates for the lending pool are typically capped at a maximum rate, the inevitable result of mandating lower interest rates for chapter 13 debtors is that fewer sub-prime borrowers will be able to obtain financing. *See* Richard M. Haynes, *Optimal Bankruptcy in a Non-Optimal World*, 44 B.C. L. Rev. 1, 18 (2002) ("Because lending markets are highly competitive and money can be readily invested outside the consumer lending market, debtors are more likely to bear most if not all of the cost of bankruptcy protection in the form of higher interest rates or reduced access to credit."); Reint Gropp et al., *Personal Bankruptcy and Credit Supply and Demand*, 112 Q.J. Econ. 217, 245 (1997) (empirical study finding correlation between generous state bankruptcy exemptions and lack of credit available to low-asset households).

This is so because, in order to maintain any profit margin, the lender will be forced to be more selective in its lending decisions to the extent the lending pool is forced to subsidize interest rates to chapter 13 debtors. *See In re Thompson*, 867 F.2d 416, 419 (7th Cir. 1989); *In re Patterson*, 825 F.2d 1140, 1142 (7th Cir. 1987); *cf. Official Comm. of Unsecured Creditors of LTV Steel Co., Inc. v. Valley Fidelity Bank & Trust Co. (In re Chateaugay Corp.)*, 961 F.2d 378, 382 (2d Cir. 1992). Moreover, forcing secured lenders to subsidize interest rates in bankruptcy would only encourage bankruptcy filings for those who simply wish to reduce their interest rates, thus exacerbating the problem. *See Lewis*, 364 U.S. at 608; *In re Carlton*, 211 B.R. 468, 475 (Bankr. W.D.N.Y. 1997) (noting that "fewer and fewer individual consumer debtors have been forced into bankruptcy because of a recent catastrophic event" and that "more and more [chapter 13 debtors] appear to have filed because it is the only way that they can . . . cram down personal property liens, such as on their vehicles"). Thus, mandating artificially low interest rates would only ensure "that even less [financing] will be supplied." Sowell, *supra* at 41.

Thus, while the interest rates that sub-prime lenders charge may appear high, this merely reflects the risks that they assume in servicing the sub-prime market. *See* Haynes, *supra*, at 18. As one commentator has explained, "[p]eople shocked by . . . the much higher interest rates charged by pawnbrokers and the small finance companies that [serve certain borrowers], as compared to the interest rates charged by banks, have been quick to blame greed or exploitation on the part of the people who run such businesses." Sowell, *supra*, at 40. "Yet studies show that profit rates are no higher [for these businesses] than elsewhere . . ." *Id.*

### F. Use of a Market-Rate Standard Is the Most Practical Approach.

The market-based approach to the interest-rate determination is also the most practical of the alternatives, as it is merely an extension of the procedure mandated by this Court in *Rash*, 520 U.S. at 964, for determining the replacement value of a secured creditor's collateral in chapter 13 cram-down cases. Under *Rash*, if a debtor proposes to retain collateral securing a claim, the bankruptcy court is required to determine the replacement value of the collateral in order to determine the principal amount of the creditor's secured claim. In the absence of an agreement among the parties, the court must take evidence on "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." *Rash*, 520 U.S. at 960.

When they purchase vehicles, most borrowers finance at least a portion of the purchase price. In the chapter 13 context, if the debtor proposes to retain collateral securing a claim, and likewise proposes to pay the principal amount of the creditor's secured claim over time, the bankruptcy court may fix the appropriate rate of interest merely by determining the rate that a willing borrower in the debtor's trade, business, or situation would pay to obtain financing from a willing lender. In this case, the unrebutted evidence is that a lender would charge the Tills not less than 21%. JA 47-48. In the absence of such evidence, the old contract rate may presumptively control.

It makes little practical sense, and would lead only to confusion, for courts to apply a market-based standard for determining the replacement value of a creditor's collateral, as required by *Rash*, and a different standard for determining the amount of interest accruing on that collateral. Moreover, the market-rate approach is consistent with the overarching rationale of *Rash*, that "a simple rule of valuation is needed to serve the interests of uniformity and predictability." 520 U.S. at 965 (internal citations omitted).

In contrast, the alternative approaches that Petitioners and their *amici* advocate are both impractical and arbitrary. Here, the Tills simply offered a 9.5% rate at the confirmation hearing, with no apparent justification other than that the rate suited them. Because the court is required to hold a confirmation hearing regardless of the approach, the procedure should be one defined by a clear standard, which the market-rate approach offers. Not only is this simpler to apply, it also will foster negotiation and agreement over the relevant rate, short of litigation.

Petitioners and their *amici* suggest that the market-rate approach is impractical because it may require the establishment of different interest rates among different secured creditors. Pet. Br. 21-22; US Br. 19; AARP Br. 24; NACBA Br. 23. But that is no different than what the debtors actually proposed in this case: two secured creditors to receive 9.5%, and two to receive 0%. JA 12. Moreover, depending on such factors as whether the particular creditor's collateral vastly exceeds the amount of its debt, different secured creditors may be entitled to different rates because their risks are different. The market approach provides a logical and practical standard that can be used to make these distinctions, and thus, is preferable.

### G. The Failure to Apply a Market Rate Would Be Inequitable.

It is not inequitable for a secured creditor to receive the full equivalent value of its bargain as the holder of a secured claim. *See Chemical Bank N.Y. Trust Co. v. Kheel*, 369 F.2d 845, 848 (2d Cir. 1966) ("Equality among creditors who have lawfully bargained for different treatment is not equity but its opposite . . .") (Friendly, J., concurring). Underlying the "equity" arguments of the Petitioners and their *amici* is a thinly veiled antagonism towards the rights of secured creditors in the bankruptcy context. But it is not for the bankruptcy courts to rewrite the protections that Congress has provided. *See Grupo Mexicano de Desarrollo v. Alliance Bond Fund*, 527 U.S. 308, 332-33 (1999) (the measure of the law is not the chancellor's foot). Similarly, bankruptcy courts simply do not possess the authority to set artificially "just" or "fair" prices. *See BFP*, 511 U.S. at 540 (bankruptcy courts do not have authority to ignore market price in favor of a "fair" price); *City of New York v. Sage*, 239 U.S. 57, 61 (1915) (market price is not "what a tribunal at a later date may think a purchaser would have been wise to give").

Moreover, there is simply nothing unfair or inequitable about requiring a chapter 13 debtor to pay the same market rate for financing that non-debtors must pay. Indeed, it is the opposite proposition that would be unfair.

The Tills have alternatives if they do not wish to be burdened with the obligation of paying SCS's secured claim at a market rate of interest: they can surrender the collateral and discharge any debt that they may owe. If they wish to retain the Chevy, however, they are not entitled to a subsidy. There is no injustice in this result.

## CONCLUSION

For the foregoing reasons, the judgment of the United States Court of Appeals for the Seventh Circuit should be affirmed.

Respectfully submitted,

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## ADDENDUM A

## RELEVANT STATUTORY PROVISIONS

**11 U.S.C. § 361** provides in relevant part:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by –

> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

**11 U.S.C. § 362** provides in relevant part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of —

> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
>
> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
>
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
>
> (4) any act to create, perfect, or enforce any lien against property of the estate;
>
> (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

(c) Except as provided in subsections (d), (e), and (f) of this section—

(1) the stay of an act against property of the estate under subsection (a) of this section continues until such property is no longer property of the estate; and

(2) the stay of any other act under subsection (a) of this section continues until the earliest of —

(A) the time the case is closed;

(B) the time the case is dismissed; or

(C) if the case is a case under chapter 7 of this title concerning an individual or a case under chapter 9, 11, 12, or 13 of this title, the time a discharge is granted or denied.

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay —

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if —

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization; or

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) —

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

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

**11 U.S.C. § 363(e)** provides:

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

**11 U.S.C. § 506(b)** provides:

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

**11 U.S.C. § 725** provides in relevant part:

After the commencement of a case under this chapter, but before final distribution of property of the estate under section 726 of this title, the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.

**11 U.S.C. § 1129** provides in relevant part:

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims —

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests —

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

**11 U.S.C. § 1307** provides in relevant part:

(a) The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.

(b) On request of the debtor at any time, if the case has not been converted under section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable.

**11 U.S.C. § 1322** provides in relevant part:

(a) The plan shall —

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim; and

(3) if the plan classifies claims, provide the same treatment for each claim within a particular class.

(b) Subject to subsections (a) and (c) of this section, the plan may —

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class

so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) provide for the payment of all or any part of any claim allowed under section 1305 of this title;

(7) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(8) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(9) provide for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity; and

(10) include any other appropriate provision not inconsistent with this title.

(d) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

**11 U.S.C. § 1325** provides in relevant part:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title;

(2) any fee, charge, or amount required under chapter 123 of title 28, or by the plan, to be paid before confirmation, has been paid;

(3) the plan has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan —

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder; and

(6) the debtor will be able to make all payments under the plan and to comply with the plan.

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan —

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended —

(A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and

(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

## ADDENDUM B

## MAXIMUM RATE SET BY CONTRACT

| State Statute | Maximum Rate |
|---|---|
| ALA. CODE § 8-8-5 (2002) | rate set by contract for loans of $2,000 or more |
| ARIZ. REV. STAT. ANN. § 44-291 (West 2003) | rate set by contract |
| CO. REV. STAT. ANN. § 5-12-103 (2002) | rate set by contract, but not to exceed 45% per year |
| DEL. CODE ANN. Tit. 5, § 2908 (2002) | rate set by contract |
| HAW. REV. STAT. ANN. § 478-2 (Michie 2000) | rate set by contract |
| IDAHO CODE § 28-42-201 (Michie 1999 & Supp. 2003) | rate set by contract |
| 815 ILL. COMP. STAT. ANN. 375/21 (West Supp. 2003) | no limit |
| KAN. STAT. ANN. § 16-201 (West 1995 & Supp. 2002) | rate set by contract |
| MO. ANN. STAT. § 365.120 (1997 & Supp. 2003) | rate set by contract |
| MONT. CODE ANN. § 31-1-241 (2001) | rate set by contract |
| NEV. REV. STAT. 97.195 (Michie 2001) | rate set by contract |
| N.H. REV. STAT. ANN. § 361-A:8 (Supp. 2002) | rate set by contract |
| N.J. STAT. ANN. §§ 17:16C-40.1, 41 (West 1996) | rate set by contract for loans up to $10,000, but may not increase more than 6% over life of loan or more than 3% in any 12-month period |

| | |
|---|---|
| N.M. STAT. ANN. § 56-8-3 (Michie Supp. 2003) | rate set by contract |
| N.Y. PERS. PROP. LAW § 303 (McKinney Supp. 2003) | rate set by contract |
| N.D. CENT. CODE § 51-13-03 (1999) | rate set by contract |
| OR. REV. STAT. § 83.565 (2001) | rate set by contract |
| S.D. CODIFIED LAWS § 54-3A-3 (Michie 2001) | rate set by contract |
| UTAH CODE ANN. § 70C-2-101 (2001) | rate set by contract |
| VA. CODE ANN. § 6.1-330.60 (Michie Supp. 2003) | rate set by contract |
| WASH. REV. CODE ANN. § 63.14.130 (West Supp. 2003) | rate or dollar amount set by contract |
| WISC. STAT. ANN. § 422.201 (West Supp. 2002) | no limit |

## ADDENDUM C

## SPECIFIC RATE SET

| State Statute | Maximum Rate |
|---|---|
| ARK. CONST. OF 1874, ART. XIX, § 13(B) | 17% |
| D.C. CODE ANN. § 28-3602 (Supp. 2001) | 21% |
| FLA. STAT. ANN. § 520.08 (West 2002) | 21% |
| MD. CODE. ANN., COM. LAW I § 12-609 (2000) | 18% |
| MICH. COMP. LAWS ANN. § 445.1854 (West 2002) | 21% |
| MINN. STAT. ANN. § 168.72 (West Supp. 2003) | 25% |
| NEV. REV. STAT. 97.195 (Michie 2001) | 18% |
| N.D. CENT. CODE § 51-13-03 (1999) | 18% for loans of $3,000 or more |
| OKLA. STAT. ANN. tit. 14A, § 3-508A (West 1996 & Supp. 2003) | 25% |
| OR. REV. STAT. § 83.565 (2001) | 21% |
| S.C. CODE ANN. § 37-2-201 (Law. Co-op. 2002) | 21% |
| S.D. CODIFIED LAWS § 54-3A-3 (Michie 2001) | 18% |
| TEX. FIN. CODE ANN. § 348.104 (Vernon 1998 & Supp. 2003) | 17.5% |
| VA. CODE ANN. § 6.1- | 18% |

| | |
|---|---|
| 330.60 (Michie Supp. 2003) | |
| WISC. STAT. ANN. § 422.201 (West Supp. 2002) | 18% |
| WYO. STAT. ANN. § 40-14-212 (Michie 2003) | 21% |

## ADDENDUM D

## RATE BASED ON CLASS OR OTHER

| Statute | Maximum Rate |
|---|---|
| ALASKA STAT. § 45.45.010 (Michie 2002) | for loans under $25,000, no more than 5% above the rate charged member banks by 12th Fed. Reserve Dist. |
| CAL. CIVIL CODE § 2982 (West Supp. 2003) | rate varies based on how interest is computed; e.g., for loans over $2,000, $25 per month if precomputed or $75 per month if simple interest |
| CONN. GEN. STAT. ANN. § 36a -772 (West Supp. 2003) | 15% for new motor vehicles; 17% for used vehicles less than 2 years old; 19% for other used vehicles |
| FLA. STAT. ANN. § 520.08 (West 2002) | cl. 1 - $10 per $100; cl. 2 - $11 per $100; cl. 3 - $15 per $100; cl. 4 - $17 per $100 |
| GA. CODE ANN. § 10-1-33 (2000) | cl. 1 - $10 per $100; cl. 2 - $13 per $100; cl. 3 - $15 per $100; cl. 4 - $17 per $100 |
| IOWA CODE ANN. § 322.19 (West 1997 & Supp. 2003) | cl. 1 - 1.75% per month simple interest; cl. 2 - 2%; cl. 3 - 2.25% |
| KY. REV. STAT. ANN. § 190.110 (Michie 1997 & Supp. 2002) | cl. 1 - $11 per $100 ; cl. 2 - $13 per $100; cl. 3 - $15 per $100 |
| LA. REV. STAT. ANN. § 6:969.10 (West Supp. 2003) | cl. 1 - 18%; cl. 2 - 24%; cl. 3 - 27%; cl. 4 - 33% |
| MD. CODE. ANN., COM. LAW I § 12-609 (2000) | cl. 1 - 16.5%; cl. 2 - 22%; cl. 3 - 27% |

| | |
|---|---|
| MINN. STAT. ANN. § 168.72 (West Supp. 2003) | cl. 1 - 18%; cl. 2 - 19.75%; cl. 3 – 23.25% |
| MISS. CODE ANN. § 63-19-43 (West 1996 & Supp. 2000) | cl. 1 - 18%; cl. 2 - 21%; cl. 3 - 26.75%; cl. 4 - 28.75% |
| 69 PA. CONS. STAT. ANN. § 619 (West Supp. 2003) | cl. 1 - 18%; cl. 2 - 18%; cl. 3 - 21%; cl. 4 - 7.5%; cl. 5 (mobile homes) - set by FHA; cl. 6 - 10% |
| TEX. FIN. CODE ANN. § 348.104 (Vernon 1998 & Supp. 2003) | the larger of $25 or cl. 1- $7.50 per $100; cl. 2 - $10 per $100; cl. 3 - $12.50 per $100; cl. 4 - $18 per $100 |