1 IN THE SUPREME COURT OF THE UNITED STATES

2 - - - - - - - - - - - - - - - - - - -X

3 LEE M. TILL, ET UX., :

4 Petitioners :

5 v. : No. 02-1016

6 SCS CREDIT CORPORATION. :

7 - - - - - - - - - - - - - - - - - - -X

8 Washington, D.C.

9 Tuesday, December 2, 2003

10 The above-entitled matter came on for oral

11 argument before the Supreme Court of the United States at

12 11:12 a.m.

13 APPEARANCES:

14 REBECCA J. HARPER, ESQ., Marion, Indiana; on behalf of the

15 Petitioners.

16 DAVID B. SALMONS, ESQ., Assistant to the Solicitor

17 General, Department of Justice, Washington, D.C.; on

18 behalf of the United States, as amicus curiae,

19 supporting the Petitioners.

20 G. ERIC BRUNSTAD, JR., ESQ., Hartford, Connecticut; on

21 behalf of the Respondent.

22

23

24

25

1 C O N T E N T S

2 ORAL ARGUMENT OF PAGE
3 REBECCA J. HARPER, ESQ.
4 On behalf of the Petitioners 3
5 DAVID B. SALMONS, ESQ.
6 On behalf of the United States,
7 as amicus curiae, supporting the Petitioners 15
8 G. ERIC BRUNSTAD, JR., ESQ.
9 On behalf of the Respondent 25
10 REBUTTAL ARGUMENT OF
11 REBECCA J. HARPER, ESQ.
12 On behalf of the Petitioners 54
13
14
15
16
17
18
19
20
21
22
23
24
25

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 P R O C E E D I N G S

2 (11:12 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument

4 next in No. 02-1016, Lee Till v. SCS Credit Corporation.

5 Ms. Harper.

6 ORAL ARGUMENT OF REBECCA J. HARPER

7 ON BEHALF OF THE PETITIONERS

8 MS. HARPER: Mr. Chief Justice, and may it

9 please the Court:

10 Deferred payments under section

11 1325(a)(5)(B)(ii) must equal the present value of the

12 collateral. Historically present value has been an

13 objective concept equalling the real interest rate and

14 inflation, which is the time value of money.

15 The Seventh Circuit has redefined this concept

16 in a manner that seriously disrupts two fundamental

17 principles of chapter 13, that being the equal treatment

18 of creditors similarly situated and the debtor's

19 rehabilitation, the debtor's access to chapter 13.

20 QUESTION: When you say traditionally it's been

21 understood to mean real interest rate plus time value of

22 money, it means real interest rate for the particular

23 lender. Isn't -- I mean, the -- the interest rate that is

24 given to different lenders is not always the same.

25 MS. HARPER: Under chapter 13, you're simply

1 trying to value the money. It's not particular to a
2 specific creditor because you're just trying to equate the
3 amount of money over time to a particular amount of the
4 allowed secured claim.
5 QUESTION: Well, that's right, but the interest
6 rate that I have to pay when I buy a house with a very
7 small down payment is much higher than the interest I have
8 to pay if I make a much larger down payment.
9 MS. HARPER: That's --
10 QUESTION: And the interest I have to pay, if I
11 make, you know, over $200,000 a year is less than I would
12 get if I have a lower income. So you can't just speak of
13 a fair interest rate in the abstract as though it's a --
14 it -- it's a platonic number floating out there. It
15 certainly depends upon the solvency and -- and the record
16 of payment of the person paying the interest. Isn't that
17 right? I --
18 MS. HARPER: You're -- you're talking about
19 interest in the open market, though, which is not what
20 we're talking about here. We're -- we're talking more
21 about --
22 QUESTION: I'm surprised to hear you saying this
23 because I thought your brief acknowledged that even after
24 you begin with the -- with a discount rate, you know, the
25 -- the Fed's discount rate -- I thought your briefs

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 acknowledged that the bankruptcy court could add to that a
2 -- a surcharge depending upon the riskiness of the chapter
3 13 debtor.
4 MS. HARPER: That --
5 QUESTION: You didn't acknowledge that? I
6 thought your brief acknowledged that. I'm -- you -- you
7 really want to use the discount rate, period, and nothing
8 -- nothing tagged on top of it.
9 MS. HARPER: I was going to get to that, but in
10 certain circumstances an additional risk factor may be
11 required, but it is our position that there are many other
12 statutory elements under -- provisions under chapter 13
13 that cover the types of risks that would normally be
14 included in a contract, for instance.
15 QUESTION: Well, I -- I think the same thing
16 that's bothering Justice Scalia, or that prompted his
17 question in any event, is -- is troubling me. When I -- I
18 read the briefs, I -- I thought that the coerced loan
19 approach, which you object to, did have certain
20 deficiencies, because you had to have testimony what the
21 interest rate is, you have to conform it to the particular
22 transaction, it's hard to administer. I frankly don't see
23 how yours is much different because you add a premium to
24 the prime rate. What is that premium going to be? Why
25 shouldn't it depend on the transaction? Why shouldn't it

1 depend on the risk of default? Why doesn't your approach
2 have all of the same problems as the coerced loan
3 approach?
4 MS. HARPER: Because you need to limit the
5 purpose of that premium. Most risk elements are
6 encompassed within other sections of chapter 13 because
7 your normal risk of deterioration of the collateral, for
8 instance -- that's adequate protection. So you don't have
9 to add on for that. You don't have -- the risk of default
10 is covered by the fact that there is a wage assignment in
11 effect.
12 I'm saying that in certain instances --
13 QUESTION: Well, but if that was true, you could
14 bring up the same thing when you're cross-examining the
15 expert on the coerced loan approach and say, well, we
16 don't want 21 percent because there's a wage assignment.
17 It's the same answer.
18 MS. HARPER: No. The 21 percent, such as the 21
19 percent that was in this record, there was no support for
20 at all. The creditor did not show any basis for --
21 QUESTION: It showed what the creditor had been
22 getting before, and that, I thought, was the argument,
23 that in -- out of chapter 17 -- 13, in chapter 13 our
24 contract rate was 21 percent, and that represents what it
25 would cost this borrower if he were today to take those

1 funds, get the same funds. It would cost him 21 percent
2 because he's a high-risk borrower. That's -- that's the
3 theory. But you're saying that that is a wrong theory, as
4 Judge Rovner said in her opinion, but it's -- it's not
5 because it's more difficult to apply than some other
6 theory.
7 MS. HARPER: Well --
8 QUESTION: I think you're -- you're saying that
9 that's a wrong approach, and maybe you'll say why.
10 MS. HARPER: Yes. It's the wrong approach
11 because the only thing that the creditor is entitled to
12 protection for under 1325 is the value of the collateral.
13 In that 21 percent contract rate, first of all, on the
14 record in this case the expert couldn't even say what it
15 consisted of. But in your typical contract rate of
16 interest, you're going to have transaction charges.
17 You're going to have the risk of default, which has
18 already occurred here, the risk of bankruptcy default, for
19 instance. That risk has already occurred here. The
20 creditor has already been compensated for that.
21 QUESTION: You think that makes this a better --
22 a better borrower? It -- it makes it a safer loan when
23 you're -- when you're -- you're owed money by somebody who
24 has already been through bankruptcy once? You think
25 you're in better shape?

1 MS. HARPER: In many --

2 QUESTION: Gee, that's -- that's a novel

3 approach.

4 MS. HARPER: In many respects, it is safer

5 because here you're talking about a subprime lender who

6 did enter into a contract where it assumed a great amount

7 of risk, but now the debtor's debt structure, his payment

8 obligations have been modified by the chapter 13.

9 QUESTION: So you think a lender has two

10 different loan candidates in front of him, one he thinks

11 is going to go through bankruptcy and the other he thinks

12 is not, so he's going to give the loan to the first one?

13 MS. HARPER: I think that --

14 QUESTION: That's -- that's very difficult for

15 me to assume.

16 MS. HARPER: -- a lender may charge additional

17 interest if -- under State law if the lender has

18 indication that the debtor may go through bankruptcy, but

19 normally in the subprime market, that's all factored in

20 because most subprime candidates are candidates for

21 possible bankruptcy in the future.

22 QUESTION: Is it a fact that most chapter 13

23 bankrupts don't make it to the end of the program?

24 MS. HARPER: Well --

25 QUESTION: In fact, the vast majority fail.

1 MS. HARPER: That's not necessarily true when
2 you talk --
3 QUESTION: I thought we had statistics on that.
4 MS. HARPER: The problem is most of the
5 statistics focus on the default rate just from the filing,
6 the number of filings. They don't focus on the default
7 rate after the chapter 13 has been confirmed because there
8 are many -- the case by that point has been reviewed by
9 the court and it's determined to have been feasible. The
10 debtor by that point has been making payments for a
11 substantial period.
12 QUESTION: Are there statistics on that kind of
13 cases that you're describing now?
14 MS. HARPER: There -- I have found limited
15 statistics. One study that I found said that 63 percent
16 of the chapter 13's completed successfully after they
17 reached the point of confirmation. So there is suggestion
18 that after the point of confirmation, the success rate
19 gets much higher, which only makes sense because a lot of
20 times --
21 QUESTION: It's still not a very good risk. I
22 mean, you --
23 MS. HARPER: Well --
24 QUESTION: -- you lend money to somebody. Your
25 chances of getting it back are 2 out of 3?

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 MS. HARPER: The subprime lender's risk in the
2 open market is not good either. So --
3 QUESTION: Well, I think it's better than 2 out
4 of 3.
5 MS. HARPER: It's five times higher than the
6 prime market.
7 QUESTION: Let -- let me ask you a -- the -- the
8 way I see these two approaches. I'm assuming that -- that
9 you're -- you're willing to allow over the prime rate some
10 addition which the -- the courts that -- that follow your
11 -- your favored approach do allow for risk factor. So
12 under your theory, you take the prime rate, and then it is
13 up to the bankruptcy judge to assess what the risk is,
14 something that I think judges are probably not very well
15 qualified to do.
16 You know when -- when you pick the prime rate,
17 that that's not the market rate. It obviously isn't. So
18 it's well below the market rate. I mean, here you had a
19 21 percent loan and you're going to take what? I don't
20 know. A prime rate of 8 percent at most? You know it's
21 wrong. And then the bankruptcy judge has to make it
22 right. Okay?
23 Under the other approach, you take the market
24 rate, the rate that was actually adopted between these --
25 these two people operating in a free market. Now, it --

1 it may be -- may be high, it may be low. You don't know
2 for sure that it's either one. It's -- it's -- it may be
3 accurate. It is not surely inaccurate the way picking the
4 prime is. And then the adjustment to be made by the
5 bankruptcy judge is much less. If there are some special
6 factors that show a lesser risk now than there was when
7 the loan was originally made, he might take them into
8 account.
9 Now, as I see it, the less discretion that is
10 left to the bankruptcy judge and the more weight that is
11 given to the -- to the real forces of the operating
12 market, the better off we are. I -- I don't think that
13 bankruptcy judges are very good risk calculators.
14 MS. HARPER: That totally eliminates the fact
15 that a chapter 13 has been filed and that there are
16 certain minimal requirements for chapter 13 confirmation.
17 A -- and the problem is that market rate, the way these
18 courts have defined it -- has come to mean anything and
19 everything. We're talking about two different market
20 rates here.
21 QUESTION: I'm talking about using the rate of
22 the loan that was actually made.
23 MS. HARPER: But there is nothing in the statute
24 that requires the creditor to be compensated for all of
25 those items that were included in the pre-petition

1 contract.

2 QUESTION: No, but he has to be given the

3 current value of his security and the current value of his

4 security, which is not going to be received 20 years from

5 now or 5 years from now, depends upon how much of a credit

6 risk there is that that money will actually be paid.

7 MS. HARPER: How could the -- how could you

8 possibly contract in advance for the present value of this

9 particular allowed secured claim, $4,000? That amount

10 wasn't even known when the contract rate was established.

11 The contract rate was based upon particular

12 characteristics of the creditor and the debtor and many --

13 QUESTION: In -- in an open market. And if the

14 debtor could have gotten -- it's a very competitive

15 market, as I understand it. And if the debtor could have

16 gotten a lower rate elsewhere, he presumably would have.

17 MS. HARPER: That's --

18 QUESTION: I'm just saying that that's -- that

19 that's a reasonable starting point. Now, if there has to

20 be an adjustment because market rates have gone down since

21 then, that minor adjustment can be made, but that's going

22 to be much less of an adjustment than you're going to have

23 to leave to the bankruptcy judge if you begin with the

24 prime rate which you know is wrong. You know that nobody

25 would have made this -- this car loan at the prime rate.

1 MS. HARPER: That's not the question. The
2 question is not what someone would make a new loan for
3 because an allowed secured claim in chapter 13 is a claim.
4 It's not a loan. Once the bankruptcy is filed --
5 QUESTION: Let me ask you this -- this piece of
6 it. The -- Justice Scalia said to give this kind of you-
7 pick-it discretion to the bankruptcy judge is a worrisome
8 thing, but all of the cases that take this approach, the
9 Treasury bill approach or the prime, seem to have a rather
10 narrow range for that risk factor. They go from 1 percent
11 to 3 percent, and none of them go over 3 percent. Where
12 did they -- where did that range -- who invented that
13 range that 3 percent would be the ceiling?
14 MS. HARPER: That's a good question. I believe
15 that it just results from the fact that in your typical
16 chapter 13, you don't have a lot of special risk that has
17 to be compensated for because you usually have the fixed
18 asset, there's no hazard -- hazardous use, you've got a
19 wage assignment. You -- substantial risk might result,
20 for instance, in a chapter 13 if you had a balloon
21 payment.
22 QUESTION: A what payment?
23 MS. HARPER: A balloon payment instead of
24 periodic weekly payments, which is usually what you have
25 in a chapter 13.

1 QUESTION: As I understand it, your expert in
2 this case, your economist, testified that the prime rate
3 was 8 percent and that in his view a reasonable risk
4 premium would be 1.5. But he conceded under cross-
5 examination that he was unfamiliar with the relevant rates
6 of default or costs of servicing loans in the subprime
7 market, which --
8 MS. HARPER: That's --
9 QUESTION: -- to my mind is conceding that he
10 has no basis for picking 1.5 percent.
11 MS. HARPER: That 1.5 in that case was actually
12 a local bankruptcy rule. But that same expert also
13 testified that prime already includes 2 percent which
14 could not be accounted for except for risk and transaction
15 fees.
16 QUESTION: The risk -- the risk of a prime
17 borrower, of a fat cat borrower.
18 MS. HARPER: But, again, we're not talking about
19 borrowing on a new loan in a chapter 13. The -- we're
20 talking about modification to an old loan, an existing
21 loan. 1322(b)(2) allows you to modify that contract. So
22 we're not looking at what this debtor would have to pay in
23 the open market were it not for the chapter 13. That's
24 not the proper inquiry.
25 If there are no further questions, I would

1 reserve the remainder of my time.

2 QUESTION: Very well, Ms. Harper.

3 Mr. Salmons, we'll hear from you.

4 ORAL ARGUMENT OF DAVID B. SALMONS

5 ON BEHALF OF THE UNITED STATES,

6 AS AMICUS CURIAE, SUPPORTING THE PETITIONERS

7 MR. SALMONS: Thank you, Mr. Chief Justice, and

8 may it please the Court:

9 The court of appeals here held that the

10 bankruptcy courts are required to presume that the pre-

11 bankruptcy contract rate of interest, which varies from

12 creditor to creditor and could range anywhere from 0 to 40

13 percent or more in some jurisdictions, is the appropriate

14 discount rate to use in calculating the present value of

15 plan payments under section 1325. Now, that approach is

16 mistaken, we submit, for three principal reasons.

17 First, it violates the core bankruptcy principle

18 of equality of distribution for similarly situated

19 creditors. Under the court of appeals' approach, two

20 creditors could make car loans to the same debtor that

21 resulted in allowed secured claims of equal value, and yet

22 one would receive thousands more in plan payments solely

23 because the other made its car loan at a time when the

24 debtor's financial troubles had not yet become obvious.

25 QUESTION: Is that right? I just want to be

1 sure I understand the -- the point. I thought if you had
2 that differential before the bankruptcy judge, it's a --
3 the original is a presumptive risk, and the judge could
4 then resolve it by maybe compromising between the two.
5 MR. SALMONS: Your Honor, this is an important
6 point because I think there is some misconception about
7 what the court of appeals held in this case, and I think
8 that's due in part to the fact that respondents, at least
9 as I read their position, are not really defending the
10 approach taken by the court of appeals. The court of
11 appeals did not adopt a presumption in favor of the pre-
12 bankruptcy contract rate because it thought that that
13 represented accurately the relevant market, if you will,
14 for the risks of -- and benefits and protections that
15 exist under the Bankruptcy Code.
16 In fact, under the court of appeals' approach,
17 the risk of nonpayment is really irrelevant. What the
18 court of appeals says is that because the -- the creditor
19 is denied use of funds for the period of the payment plan,
20 that it therefore is entitled to whatever rate it would
21 have gone out and funded a new loan at if it had been
22 allowed to foreclose and reinvest the proceeds. Now --
23 QUESTION: I agree with you, and -- and the
24 respondent is not defending that approach, but rather the
25 approach that you use the rate of the -- of the original

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 loan as the starting point, and then adjust it as
2 necessary.
3 MR. SALMONS: That's correct, and I just want to
4 emphasize, though, that -- that the adjustment that the
5 court of appeals would make is not one I think that
6 anybody before the Court now would defend because the
7 court of appeals would adjust only if you could prove that
8 the -- a particular secured creditor is now making loans
9 at some other rate and there's no reason to think why that
10 has anything to do with what the present value of plan
11 payments would be under 1325. And -- and the problem --
12 QUESTION: So, but you're saying -- but you're
13 saying that under the respondent's view, that -- that the
14 creditors would be treated differently?
15 MR. SALMONS: If respondent's view is that you
16 should have a presumption in favor of the pre-bankruptcy
17 contract rate, then that would be the result. What's not
18 clear to me is whether it's actually respondent's view
19 that you should have a presumption in favor of the
20 subprime contract rate or the highest contract rate
21 allowed by State law because it's important to remember
22 that pre-bankruptcy contract rates are going to vary. You
23 could have a 0 percent lender. You could have a prime
24 lender, and you could have a subprime lender. And there's
25 no reason to think that any one of those necessarily

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 captures the unique mix of risks and benefits and
2 protections that exist under the Bankruptcy Code.
3 QUESTION: Where do you get the principle that
4 all secured creditors have to be treated equally? Where
5 does -- where does that appear?
6 MR. SALMONS: Well, Your Honor, on -- I would
7 refer you to page 19 --
8 QUESTION: I'm sure it's true of all unsecured
9 creditors. I -- I don't know why --
10 QUESTION: Page 19 of what?
11 MR. SALMONS: I'm sorry, Your Honor. I would
12 refer you to page 19 of the Government's brief where we
13 refer to two cases by this Court, Bigeur v. the IRS and --
14 and Union Bank v. Wolas, that stand for the principle that
15 -- that embody the notion that equality of distribution
16 among creditors is a central policy of the Bankruptcy
17 Code. That's this Court's language.
18 QUESTION: Similarly situated creditors.
19 MR. SALMONS: To be sure, Your Honor.
20 QUESTION: Not secured versus unsecured.
21 MR. SALMONS: That's why I gave the example that
22 I did of two creditors that extend car loans and the only
23 difference between them -- they have the exact same
24 allowed value under the code for their claim. The only
25 difference between them is that one made its loan 2 years

1 prior to bankruptcy when the -- when the debtor's credit
2 history was not quite as bad and the other made it 2 weeks
3 before bankruptcy when the only rate the debtor could get
4 is --
5 QUESTION: Well, why isn't that a valid
6 distinction?
7 MR. SALMONS: Because, Your Honor, from the
8 standpoint of section 1325(a)(5), the relevant inquiry is
9 what is the present value of the promised future payments
10 from the debtor. All creditors are now facing the exact
11 same situation, and I think respondent concedes this. And
12 those are the risks of inflation, the time value of money,
13 and the risk that particular payments may not be made
14 under a plan. And there's no reason to think --
15 QUESTION: Well, and the risk --
16 MR. SALMONS: -- that those are different for
17 creditors --
18 QUESTION: The risk of the security will just
19 disappear too, you know, be totally devalued.
20 MR. SALMONS: Your Honor, I don't think that's
21 embodied in section 1325(a)(5). If anything, that's
22 captured in the higher replacement value standard for the
23 valuing of the underlying claim that this Court adopted in
24 Rash. And I would add that -- that one reason to think
25 why the discount rate here doesn't need to go too far in

1 taking risks of nonpayment into account is that this Court
2 in Rash adopted the underlying value here, replacement
3 value, that's typically significantly higher than what
4 the --
5 QUESTION: What has that to do with it? I don't
6 see what that has to do with it at all.
7 MR. SALMONS: Well, Your Honor, what --
8 QUESTION: I mean, the reason I say that is I
9 thought we were following a statute, and what the statute
10 tells us is that the value of what they receive has to
11 equal $4,000. They receive a set of promises to pay so
12 much a month and the right to repossess if those promises
13 are not kept. Now, that's what the statute tells us to
14 do. So let's do it. What do we care how they arrived at
15 the $4,000?
16 MR. SALMONS: Your Honor, my only point is that
17 this Court in Rash noted that the higher replacement --
18 QUESTION: Whatever it said in Rash, reading the
19 statute, unless they actually contradicted that, doesn't
20 the statute say what I just said? So the problem in the
21 case is how do we value the stream of payments plus the
22 repossession value?
23 MR. SALMONS: I think --
24 QUESTION: I would have thought that that kind
25 of thing is something bankruptcy judges are paid to make

1 judgments about all the time.

2 MR. SALMONS: Well, I -- I generally agree with

3 -- with Your Honor's statement. What -- what I would add,

4 though, is that the dispute in this case is not -- I mean,

5 it's undisputed that inflation and the time value of money

6 have to be taken into account under -- under the discount

7 rate. The only question is whether you have to take into

8 account the risks of nonpayment. We submit that there --

9 QUESTION: Of course, you do. Of course, you

10 do. There is a risk of nonpayment and anything that

11 didn't take that into account would not be equating the

12 property with the $4,000.

13 MR. SALMONS: Your Honor, if -- if this Court

14 believes that risks of nonpayment need to be taken into

15 account, then we submit that the best way to do that is to

16 start with a market indicator such as the prime rate that

17 captures the time value of money and the risk of inflation

18 and then -- then allow -- and -- and some risk of

19 nonpayment, and then allow the bankruptcy court, which --

20 which, by the way, has just made a determination under

21 1325(a)(6) about the likelihood that -- that the payments

22 will be made. And it has made --

23 QUESTION: Start with a figure that you know for

24 sure is wrong. You know for sure that this person who got

25 a 21 percent car loan because he was a bad credit risk was

1 never going to get the prime rate of 8 percent.

2 MR. SALMONS: Your Honor --

3 QUESTION: Why begin with -- with something --

4 MR. SALMONS: Your Honor, the answer to your

5 question --

6 QUESTION: -- that you know is going to be

7 abysmally low except for the fact that it will mean less

8 money for the secured creditors and more money for the

9 unsecured creditors, among whom is often numbered the

10 United States?

11 MR. SALMONS: Your Honor -- Your Honor, the

12 answer to your question --

13 (Laughter.)

14 MR. SALMONS: The answer to your question is

15 because there is no rate you can find that -- that

16 precisely reflects the unique mix of risks and benefits

17 and protections that are available under the Bankruptcy

18 Code. And so by definition, everyone here is talking

19 about a proxy in some form or another.

20 Now, what the prime rate does do is is it

21 accurately captures the time value of money and inflation.

22 Now, we submit that the bankruptcy court, which has just

23 examined the plan -- it has made a determination. In

24 fact, it has found that the payments -- that the debtor

25 will be able to make the payments under the plan -- that

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 bankruptcy court is in the best position to make a
2 determination about plan-specific risks of nonpayment if
3 those risks are going to be included. And that's a much
4 more efficient system than forcing the bankruptcy court to
5 go out and try and find some -- some elusive market that
6 -- that would serve as a proxy for that determination.
7 QUESTION: Well, you could ask them to just look
8 at the contract rate and, if need be, make some adjustment
9 to that because of the fact that they won't have to --
10 MR. SALMONS: Your Honor --
11 QUESTION: -- go through the collection process.
12 MR. SALMONS: -- the difficulty with the
13 contract rate approach is that it varies from creditor to
14 creditor, and there really is no reason to think that --
15 that either secured creditors, or unsecured creditors for
16 that matter, for purposes of -- of this case, should be
17 treated differently. They all face the exact same risks
18 of nonpayment, the exact same problems of inflation and
19 time value of money. They are similarly situated.
20 QUESTION: In this case, as I understand it,
21 this lender always charged 21 percent. It didn't differ
22 from -- from lender -- borrower to borrower. Every one of
23 them was charged 21 percent. That was the market.
24 MR. SALMONS: And -- and another secured
25 creditor may have made a loan prior to that at a prime

1 rate to the same debtor, and it always charges the prime
2 rate, neither of which is particularly relevant to the
3 question of what's the value of the promised payments
4 under the plan.
5 QUESTION: But if the second one was so stupid
6 as to do that, why should he be protected?
7 MR. SALMONS: Well, Your Honor, it's not a
8 matter of stupidity. It's a matter of the fact that a
9 debtor's position changes over time and that what may be a
10 good rate 2 years out from bankruptcy and that is still
11 owed would not be the rate you'd give immediately before
12 bankruptcy. And it may not be the relevant risks of
13 nonpayment that exist under bankruptcy.
14 The point is that -- is that as -- as this Court
15 understood in Rash, the -- the creditor is entitled to the
16 value of its allowed secured claim, and this Court noted
17 in Rash that already compensates significant risks of
18 nonpayment.
19 Now, I would add, if I may --
20 QUESTION: Because if this had been foreclosure
21 value, then if we were going through this exercise, well,
22 the creditor would -- would then sell the asset and -- and
23 charge a -- a new borrower with the same rate of interest.
24 But the asset would be worth much less than the price --
25 MR. SALMONS: That -- that's correct, and Your

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 Honor, I would add that in fact we think it's possible to
2 read the statute so there's no risk of nonpayment at all
3 because the statute refers to property to be distributed
4 under the plan, and it requires the bankruptcy court to
5 make a finding that the debtor will be able to make
6 payments. And there's no guidance whatsoever that would
7 give bankruptcy courts a way to do anything more, and so
8 we think in fact that an appropriate rate could even be
9 the Treasury bill rate which --
10 QUESTION: Thank you, Mr. Salmons.
11 MR. SALMONS: -- excludes that.
12 Thank you.
13 QUESTION: Mr. Brunstad, we'll hear from you.
14 ORAL ARGUMENT OF G. ERIC BRUNSTAD, JR.
15 ON BEHALF OF THE RESPONDENT
16 MR. BRUNSTAD: Mr. Chief Justice, and may it
17 please the Court:
18 The formula approach is surely inaccurate. It
19 systematically under-values the true risks and costs of a
20 chapter 13 promise of repayment. We know at best
21 statistically that chapter 13 debtors at best have a 40
22 percent rate of -- of payment on the plans.
23 QUESTION: How -- how many default?
24 QUESTION: Your -- your opponent says that the
25 -- that that's -- if you're taking after the thing is

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 confirmed, after -- that it's a 63 percent.

2 MR. BRUNSTAD: Yes, Your Honor. There -- there

3 is one study that suggests that, but I must -- I must add

4 that -- that there are other studies that say that the

5 successful completion rate is as low as 3 percent in some

6 jurisdictions. Some 97 percent of chapter 13 fail.

7 QUESTION: After confirmation.

8 MR. BRUNSTAD: Those are -- that's a total

9 number, Your Honor.

10 QUESTION: Okay. That's the difference between

11 your statistics --

12 QUESTION: Yes.

13 QUESTION: -- and hers.

14 QUESTION: Since -- and since this is an after-

15 confirmation case, why -- why don't we take that

16 percentage?

17 MR. BRUNSTAD: Well, Your Honor, giving them the

18 benefit of the doubt, we -- the best we can say, based

19 upon what we know, is approximately a 63 percent success

20 rate.

21 QUESTION: After --

22 QUESTION: What do you say to Mr. Salmons'

23 argument that in fact the -- the plan is not supposed to

24 be confirmed unless the judge makes a -- a determination

25 that it can be followed, and it therefore isn't legitimate

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 to take this kind of risk into consideration at all?

2 MR. BRUNSTAD: It's what we call the feasibility

3 standard, Your Honor, and it applies in every single one

4 of the reorganization chapters. The bankruptcy court must

5 merely determine that the bankruptcy judge feels that the

6 debtor will successfully complete the plan. We know,

7 however, that given the extremely high rate of default in

8 chapter 13, which far exceeds chapter 11, for example,

9 that the feasibility standard doesn't even come close to

10 ensuring --

11 QUESTION: Well, how do we know how -- how many

12 -- what's the percentage of people in this chapter that

13 default within a year on -- on a payment of about $128 a

14 month I guess, that was a small percentage of what they

15 were paying into the court? What's the figure?

16 MR. BRUNSTAD: Well, there are two sources. The

17 best statistics that I've been able to come up with is

18 that it's about a 60 percent failure rate.

19 QUESTION: 60 percent fail within a year? You

20 said that 40 percent failed overall.

21 MR. BRUNSTAD: 60 percent fail within the 3- to

22 5-year period.

23 QUESTION: No. I asked you how many -- this is

24 -- or let's take it then giving you the benefit of the

25 doubt. The payment plan was for 17 months. What is the

1 percentage of people who fail to make a -- I guess it was
2 about 10 percent or 20 percent of the amount he was paying
3 into court. How many fail to make that kind of payment
4 within 17 months?
5 MR. BRUNSTAD: The statistics are not
6 disaggregated on that basis, Your Honor.
7 QUESTION: Correct. That's what I would think.
8 So what is wrong with us saying just by chance
9 what the statute says? What the statute says is,
10 bankruptcy judge, here's what you do. You create a stream
11 of payments such that that stream of payments plus the
12 value of the repossession equals $4,000. Now, that's your
13 job. Go do it. So I would have thought, if I were the
14 bankruptcy judge, the way I'd do it would be by looking to
15 the prime rate and then asking me -- asking you or others
16 to tell me how much riskier this is than the prime rate,
17 and I'd choose a number. And I can't imagine how we're
18 going to come one whit closer than that general
19 instruction, but you'll tell me why it is possible to come
20 closer.
21 MR. BRUNSTAD: Your Honor, the contract rate is
22 the best evidence, the single best evidence of the market
23 rate.
24 QUESTION: Contract rate -- if there has to be a
25 number that's wrong, it has to be that one.

1 MR. BRUNSTAD: But it is less --
2 QUESTION: The contract rate by definition was
3 entered into at some significant period of time prior to
4 the present, and the present, by chance in this instance,
5 is 2 years later, and we know that interest rates fell at
6 least 1 or 2 percent during that time.
7 MR. BRUNSTAD: But not for subprime --
8 QUESTION: So -- what?
9 MR. BRUNSTAD: But not for subprime loans.
10 QUESTION: That's impossible. The prime rate --
11 MR. BRUNSTAD: No, Your Honor. This is why.
12 QUESTION: If that's so, then the risk went up.
13 MR. BRUNSTAD: No, that's not correct, Your
14 Honor, and this is why.
15 QUESTION: No. It isn't?
16 MR. BRUNSTAD: Because State law caps the
17 maximum rate that can be paid.
18 QUESTION: Oh, okay. Okay.
19 MR. BRUNSTAD: So it increases the pool --
20 QUESTION: All right. All right.
21 MR. BRUNSTAD: -- of who can be lent to, but not
22 the rate.
23 QUESTION: All right, because it's a usury
24 problem.
25 MR. BRUNSTAD: Correct.

1 QUESTION: So -- so you would be free with your
2 experts to come in and say why it happens to be that the
3 bankruptcy judge is wrong to take the prime rate and add a
4 risk factor, but ordinarily a contract entered into in
5 advance would not be good evidence of what the interest
6 rate is today. Now, where am I wrong in that?
7 MR. BRUNSTAD: Because, again, the contract rate
8 is the best evidence of a market rate between this
9 borrower and this lender with this particular --
10 QUESTION: At a prior time.
11 MR. BRUNSTAD: At a particular time --
12 QUESTION: Yes.
13 MR. BRUNSTAD: -- particularly if it's
14 contemporaneous to the filing. It reflects it and --
15 QUESTION: Oh, yes, of course. I'm -- but I'm
16 -- I'm simply saying isn't it true by definition that a
17 contract entered into at an earlier period of time where
18 interest rates fluctuate is not going to be very good
19 interest -- evidence of what that interest rate is today.
20 MR. BRUNSTAD: Well, Your Honor, the contract
21 rate is not perfect, but it's far superior to the formula
22 approach, and what you see happening -- Justice Ginsburg,
23 the Second Circuit in the Valenti case came up with a 3-
24 point factor, just simply canvassing some lower court
25 decisions and decided prime rate plus 1, 2, or 3 points.

1 It's not based on any evidence. It's just simply based
2 upon what the court felt was an appropriate range.
3 QUESTION: Your --
4 QUESTION: If you take Mr. Salmons' point that
5 now we're in bankruptcy, it's a different world, and we've
6 got one creditor -- let's say $4,000 is the principal for
7 both, but one lent at prime and one lent at subprime.
8 Once we're in the universe of bankruptcy, why shouldn't
9 those two lenders, both with $4,000 principals, be treated
10 the same?
11 MR. BRUNSTAD: If their risks are different,
12 they should be treated differently, Your Honor.
13 QUESTION: But once you're in the bankruptcy,
14 the risk of getting back the $4,000 is the same for both
15 creditors, isn't it?
16 MR. BRUNSTAD: Not necessarily so, Your Honor.
17 You can take a situation. Say you have a hotel, a common
18 asset in bankruptcy. The hotel may have a senior secured
19 creditor and a junior secured creditor. The number one
20 secured creditor's risks are materially less than the
21 junior secured creditor's. They would be separately
22 classified. Because their risks are different, the
23 interest rates are different.
24 In this very case at page 12 of the joint
25 appendix, you can see how the debtor broke down its four

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 secured creditors into four separate categories, and they
2 have different rates. Two secured creditors are offered
3 9.5 percent and two are offered 0 percent interest for the
4 payments the debtor is going to make.
5 The concept of equality of distribution is
6 precisely equality of distribution among similarly
7 situated creditors. Secured creditors are each unique by
8 their own definition of the risks that they take. They
9 have collateral.
10 QUESTION: And your response to Justice Breyer's
11 question, as I understand it, is that 21 percent may not
12 be precisely what the rate is today for a loan made 3
13 years ago, but it's going to be a lot closer to it than 8
14 percent is.
15 MR. BRUNSTAD: That, plus the fact that the 21
16 percent is often going to be actually too low to reflect
17 the actual risk being assumed.
18 QUESTION: Well, that may be. Well, that may
19 be, but what I didn't understand about your answer is when
20 you said that the contract rate must be more accurate than
21 the formula.
22 MR. BRUNSTAD: It seems to be.
23 QUESTION: Since the formula by definition is
24 perfect --
25 MR. BRUNSTAD: No, Your Honor.

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 QUESTION: Since the formula is an instruction
2 to equate the value of the stream of payments plus
3 repossession with $4,000, the formula by definition is
4 perfect. So --
5 MR. BRUNSTAD: No, Your Honor.
6 QUESTION: Well, why isn't it?
7 MR. BRUNSTAD: The formula rate is essentially
8 standardless, and what we have seen how bankruptcy courts
9 apply the --
10 QUESTION: You're saying I take -- you're saying
11 that --
12 QUESTION: But yours is in theory perfect.
13 QUESTION: Wait. No, no. Answer --
14 MR. BRUNSTAD: Imperfect. That's correct.
15 QUESTION: No, no. Yours is in theory perfect
16 just as -- as the formula is in theory perfect. In both
17 of them you -- you begin with a starting point, and then
18 you make whatever adjustments the reality of the risk
19 requires. That brings you theoretically in both cases a
20 perfect answer.
21 The only question is, as a practical matter,
22 which of the two is likely to come closer to the correct
23 answer, starting with 8 percent that you know is way off
24 the mark and then letting the bankruptcy judge figure out
25 how much you add to that, or starting with 21 percent

1 which, you know, is -- is -- it could be high, it could be
2 low. It's much fairer to both parties, but then let the
3 bankruptcy judge adjust that a little bit. That's the
4 question: what -- what the practical consequence is not
5 the -- the theoretical. They're both perfect
6 theoretically.
7 MR. BRUNSTAD: In theory, Your Honor, yes, but
8 we must be faithful to is the statutory command. And here
9 what we see happening is what happens in this case. A
10 bankruptcy judge takes the formula approach, a --
11 basically a low rate, the prime rate, and is supposed to
12 adjust it. And what do they do? Well, there's no
13 evidence to support any adjustment in this particular
14 case. The debtors' expert did not testify that he knew
15 anything about the risks of these particular debtors.
16 There's no basis for the adjustment. The bankruptcy court
17 did what bankruptcy courts do in these cases; it simply
18 picked a number.
19 QUESTION: Well, couldn't the creditor have
20 brought in an expert?
21 MR. BRUNSTAD: The creditor did bring in two
22 witnesses, and the witnesses testified that these
23 particular debtors with their particular credit histories
24 would be charged a 21 percent rate of interest.
25 QUESTION: Well, can you tell me why is it that

1 the petitioners tell us that their standard is so much
2 easier to administer? Is it because the courts aren't
3 administering it in the right way? As I listened to it,
4 it seems to me I have two choices. I can begin with a low
5 rate and add or I can begin with a high rate and -- and
6 subtract. Why -- why is one any more easy to administer
7 than -- than the other?
8 MR. BRUNSTAD: Because --
9 QUESTION: In fact, it -- it would seem to me --
10 and this I suppose helps you -- that if the courts which
11 are using the petitioners' formula are doing it the right
12 way, it might even be harder to administer. They -- they
13 avoid that problem by just accepting some interest factor
14 of 1 to 3 percent out of the blue although I don't know
15 how they do that.
16 MR. BRUNSTAD: Well, Justice Kennedy, what we
17 have is we have three circuits which have adopted the
18 formula approach, and so we have the experience of the
19 courts in those circuits, and we have the balance of the
20 circuits, approximately seven, that have taken more of the
21 market rate approach. And what we see happening is that
22 in those situations where the bankruptcy courts are
23 applying the formula approach, they are systematically
24 giving chapter 13 debtors a rate of interest pretty close
25 to prime. Now, that can't be correct. That gives the

1 debtors with the single highest default rate in bankruptcy
2 the lowest rates available in bankruptcy.
3 QUESTION: Would it satisfy you if we said this?
4 Suppose we said we see what we're after here. The
5 objective is to equate the stream of payments plus
6 repossession with $4,000. Now, on the one hand, we know
7 it can't be lower than the prime. On the other hand, if
8 the creditor wants to come in and give a -- present his
9 evidence, the contract, of how risky this person is, then
10 in fact it is evidence absolutely. And the bankruptcy
11 judge will look at it, and he'll try to figure out the
12 pluses and the minuses, what's happened to the interest
13 rate, whether this particular person is a good or bad
14 risk, and he'll choose a number. Don't judges do things
15 like that all the time?
16 MR. BRUNSTAD: And apparently incorrectly
17 systematically in chapter 13 cases.
18 QUESTION: But no. But does what I say satisfy
19 you?
20 MR. BRUNSTAD: No, Your Honor. And here's why.
21 QUESTION: If not -- because?
22 MR. BRUNSTAD: Because the true market rate of
23 interest is almost always going to be at least the
24 contract rate, presumptive contract rate, because the
25 costs in chapter 13 are so much more extraordinarily

1 higher than the costs of collection outside of chapter 13.
2 The automatic stay stays in place for the duration of the
3 plan. If you have a default, the secured party has to
4 come back to the bankruptcy court, hire an attorney, pay a
5 $75 filing fee, argue the case. Bankruptcy judges
6 routinely give the debtor a second chance to cure the
7 default. They have to come back. The costs of collection
8 -- that's even before you get to foreclose on your
9 collateral. The costs of --
10 QUESTION: But don't you get certain advantages?
11 I mean, you do have the wage order. So there's a court
12 supervising that this wage -- every month that this
13 person, this borrower, is going to have to pay.
14 And in the -- in -- in that setting you also
15 have -- going back to Rash, the one thing I don't
16 understand about it because it seems you want to take it
17 the high side both ways. You've already been given the
18 replacement value rather than the foreclosure value.
19 MR. BRUNSTAD: Correct, Your Honor.
20 QUESTION: So if we're going to do it your way
21 and say, well, now, suppose the lender foreclosed on the
22 asset, made a new loan at the 21 percent rate -- but you
23 would have to use not the replacement value, the higher
24 value. You could only use what you could get on
25 foreclosure if we follow your theory about we should make

1 it just like you sold the asset, got money, and made a new
2 loan. But the -- but you -- but the amount that you got
3 would be much less than the replacement value which is
4 what you're getting inside the bankruptcy.
5 MR. BRUNSTAD: Your Honor, the secured creditor
6 in the chapter 13 cramdown context is not trying to make
7 any profit. It's simply trying to mitigate against the
8 enormous losses that it suffers.
9 QUESTION: But isn't that one of the adjustments
10 that would have to be made? You couldn't say adjust 20
11 percent against $4,000. You'd have to say $4,000 minus
12 because your foreclosure price is going to be much lower
13 than the replacement costs that you've got in the
14 bankruptcy.
15 MR. BRUNSTAD: But taking the extremely high
16 risks of default and the costs of actually having to
17 foreclose in the chapter 13 context, the relevant market
18 rate for the value of the stream of payments is always
19 going to be at least the -- the pre-bankruptcy contract
20 rate. In fact, it should --
21 QUESTION: Mr. Brunstad --
22 MR. BRUNSTAD: Yes.
23 QUESTION: -- let me suggest a scary thought.
24 (Laughter.)
25 QUESTION: Is it -- is it possible that the

1 statute does not provide an answer to this question?

2 (Laughter.)

3 QUESTION: That since both of these schemes,

4 your proposal and the other side's proposal, are

5 theoretically perfect, if they are done correctly, the

6 bankruptcy court is free to use either one so long as he

7 comes up with the right answer.

8 MR. BRUNSTAD: No, Your Honor.

9 QUESTION: I mean, the only thing the statute

10 says is what -- what Justice Breyer keeps coming back to.

11 You have to provide him $4,000 in value.

12 MR. BRUNSTAD: No, Your Honor. The -- the

13 bankruptcy statutes sometimes are obscure until we see

14 where they come from, which is why we often look at their

15 history. The master concept of cramdown is indubitable

16 equivalence. It comes from Judge Hand's opinion in the

17 Murel Holdings case. And the example in 1325(a)(5)(B)

18 that we're talking about is simply an example of

19 indubitable equivalence. The secured party must be fully

20 compensated for the risk that it must assume. The concept

21 of indubitable equivalence must be completely

22 compensatory. The secured party is not supposed to take

23 uncompensated risk.

24 QUESTION: Nobody is disagreeing with you about

25 that. That -- what we're -- I think what we're trying to

1 get to -- it's a practical question. I actually think my
2 approach is more perfect than Justice Scalia's perfect
3 approach.
4 (Laughter.)
5 QUESTION: But the reason is it asks the right
6 question.
7 Now, what you're telling me is that by asking
8 the right question, the bankruptcy judges systematically
9 have not done it right. And -- and I see your point. So
10 -- so what we're -- so we're trying to think of a form of
11 words we could say which would lead -- I can't say take
12 the contract rate because I know that must be wrong.
13 MR. BRUNSTAD: No, Your Honor.
14 QUESTION: We could say take the contract rate
15 and go down, and then they'll have the same problem. I --
16 I mean -- all right. But that's what we want them to do,
17 is to honestly equate the value of the payments with the
18 $4,000.
19 MR. BRUNSTAD: Yes, Your Honor.
20 QUESTION: I think everybody wants that, and
21 we're searching -- at least I am -- for a way of how to do
22 that. You keep telling me you take contract rate. I hate
23 to tell you I keep thinking no.
24 MR. BRUNSTAD: As a presumptive rate, Your
25 Honor. And it's important to understand just after this

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 Court's decision in Rash set the valuation standard for
2 setting the principal amount, what you see now is that
3 since we got the standard right, in 99 percent of the
4 cases, the parties come to an agreement as to what the
5 value of the collateral is. Once we get the standard
6 right here, you should expect the same thing. It won't be
7 litigated over and over again.
8 The correct standard is I think to recognize,
9 which I think Your Honor does, that this concept of
10 present value is an economic concept, not an equitable
11 one, and that essentially what we're doing is we're saying
12 there is a stream of payments to be made here and we have
13 to figure out what it's worth. The best test for what
14 it's worth would be what the market says.
15 Now, the problem is, is that in chapter 11 there
16 is a market. People do lend to chapter 11 debtors, and
17 the standard is the same in chapter 11 as 13: value as of
18 the effective date of the plan under 1129. So what we --
19 we have to be very careful about is in chapter 11, the
20 markets do value debtors' promises to pay and they lend
21 money and they charge very high interest rates. Exit
22 lenders or finance lenders charge very high interest
23 rates, 18, 19, 20 percent. It can't be true that in
24 bankruptcy, in chapter 13, who are the riskiest chapter --
25 riskiest debtors with the highest default rate, that we

1 systematically give them a rate which approaches prime.
2 So I think what you need to do, recognizing it's an
3 economic concept, is say what's the best evidence of a
4 market rate.
5 QUESTION: I understand. Tell me an -- a
6 question I don't know the answer to.
7 MR. BRUNSTAD: Yes, Your Honor.
8 QUESTION: When -- when -- if you repossess --
9 if he defaults again -- I mean, the first time he got into
10 bankruptcy. Now, we've got the plan.
11 MR. BRUNSTAD: Yes.
12 QUESTION: And suppose he doesn't make the
13 payments on the truck. Does it then cost you a lot of
14 money to go back even though you say to the judge, judge,
15 this is the second time? We'd like our truck now. It's
16 only worth $2,000 now. And you still have to pay the $75,
17 get your witnesses and everything the second time?
18 MR. BRUNSTAD: What happens the second time,
19 Your Honor, is if the debtor defaults under the plan, the
20 automatic stay is still in effect. Unlike chapter 11
21 cases, where the automatic stay terminates when the plan
22 is confirmed or becomes effective, here the automatic stay
23 stays in place until the end of the repayment period. So
24 if the debtor defaults under the plan, someone has to go
25 back to court and say, I need relief. I need relief from

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 the automatic stay to exercise my collection rights.

2 A corporation like SCS can't go back to court

3 pro se. It needs a lawyer. You have to hire somebody to

4 go and represent them. You have to pay a filing fee.

5 Oftentimes the bankruptcy judge gives the debtor a second

6 chance to cure the default under the plan. Then the

7 debtor says I'll cure, and then you come back a second

8 time, sometimes a third time, sometimes a fourth time,

9 sometimes a fifth time, incurring costs at each juncture.

10 On loans that typically range between $5 to $15,000,

11 having to go to court even once --

12 QUESTION: Is that compensated for to some

13 extent --

14 MR. BRUNSTAD: No, Your Honor.

15 QUESTION: -- that factor by the fact they're

16 using Blue Book value to value the car rather than what

17 it'd actually be worth in your hands once you repossess

18 it?

19 MR. BRUNSTAD: No, Your Honor. I think that

20 covers the depreciation problem. As we have delay and not

21 payment, we have a rapidly depreciating asset, which the

22 debtor is continuing to possess and drive around. This

23 interest rate compensate for the risk of nonpayment of the

24 promises to pay after confirmation and the costs

25 associated with the debtor's default if the debtor does

1 default under the plan.

2 QUESTION: I -- I don't think it's certainly

3 conclusive of the point, but the initial 21 percent rate,

4 I take it, did take into account the risk of default. So

5 in a sense, the creditor has received up front some

6 compensation for the risk that in fact has occurred.

7 MR. BRUNSTAD: Yes, but at the time the loan is

8 made, Your Honor, we don't know who in the pool of -- of

9 debtors is going to default. Once the default happens --

10 QUESTION: Well, but -- but overall, you account

11 for that.

12 MR. BRUNSTAD: Overall the risks are spread, but

13 if you force the secured party to systematically subsidize

14 interest rates to chapter 13 debtors, who have now

15 demonstrated by their filing they are the riskiest of the

16 risky, what you will eventually have happen is a

17 contraction of the ability to lend.

18 QUESTION: But -- but your original -- you

19 charge 21 percent, and a lot of people are going to

20 successfully pay that and that stream there takes into

21 consideration some account for those who don't pay and go

22 into bankruptcy, doesn't it?

23 MR. BRUNSTAD: Yes, Your Honor, but we shouldn't

24 reward those who file bankruptcy with a rate that is less,

25 since they are the riskiest of the risky, than we would

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 charge the other members of the pool who avoid bankruptcy.

2 QUESTION: Maybe they're not.

3 QUESTION: The -- the Bankruptcy Code, I take

4 it, has solicitude for debtors. Isn't that one of its

5 purposes?

6 MR. BRUNSTAD: Yes, but --

7 QUESTION: Or does that just drop out when we

8 come to the cramdown problem?

9 MR. BRUNSTAD: As this Court indicated in the

10 Johnson case, section 1325(a)(5)(B) is for the protection

11 of creditors. It is a limit on the debtor's ability to

12 adjust or restructure the creditor's rights. It is the

13 creditor's protection. The debtor has options. If the

14 debtor wants to surrender the collateral, it may and

15 discharge the debt. That is the protection for the

16 debtor.

17 QUESTION: But what about then taking this idea?

18 I'm trying to figure out how -- we say, okay, we really

19 mean it. It has to equate those two things. Now, that

20 put -- and -- and then stop and say, you can do it with --

21 I -- I think, you know, prime plus or whatever, maybe the

22 other. But -- but then put the burden back on you to

23 produce some real evidence and statistics about what

24 happens to people we don't know about.

25 Now, who are those people? We agree they've

1 gone into bankruptcy, so they're risky, but they're also
2 trying to get a second chance, and they also want to keep
3 things like the truck because it will help them in their
4 business. And the bankruptcy judge has sat there and
5 looked them in the eye. And you have all those things
6 about it which you don't have about the people you're
7 giving the 21 percent to which is a great mass of
8 undifferentiated people.
9 So then you have the burden of trying to bear it
10 out with statistics and so forth that these people really
11 are risky. And the bankruptcy judge can't just sit there
12 and say, oh, I feel sorry for them. All right? What
13 about something like that?
14 MR. BRUNSTAD: Well, Your Honor, when we get to
15 the chapter 13 confirmation stage, we're in a similar
16 position as when we are at the beginning of making loans
17 to a pool of applicants. We don't know who's going to
18 default and who doesn't. We do know that a large
19 percentage will. We do know that the best evidence of a
20 market rate for these particular class of borrowers is the
21 contract rate. And the question then becomes, do we want
22 to have a system which requires us in each bankruptcy case
23 then to take evidence complicatedly in 471,000 chapter 13
24 cases as to, gee, we need statistics and evidence as to
25 this individualized debtor?

1 QUESTION: No, I mean, you wouldn't have to go
2 that far. Maybe you just have to do it in one or two.
3 But at least we'd get to the stage of people who have
4 trucks and use them for a year and, you know, at least
5 we'd have somewhat better information than just knowing
6 about the default rate in bankruptcy cases in general.
7 And we get a little finer than that. You see, that's what
8 I'm trying to work with. I don't have an answer.
9 MR. BRUNSTAD: I understand.
10 QUESTION: I'm asking.
11 MR. BRUNSTAD: I understand, Your Honor, and I
12 wish I could give you a precise formula. The problem is
13 that these things are normally left to the market to do.
14 Congress has said -- Congress has said basically use an
15 economic market concept here in a context in which the
16 default rate is so high that lenders are just not willing
17 to lend to chapter 13 debtors. Again --
18 QUESTION: But -- but I -- I thought the
19 difficulty of administration charge was the one that the
20 petitioners were making against you. How -- how do I sort
21 that out?
22 MR. BRUNSTAD: And I think -- I think it was
23 Your Honor who also mentioned that -- that our standard is
24 no less cumbersome than theirs. We think it is superior
25 because it will yield the correct result more often.

1 QUESTION: No more cumbersome. Surely, you mean
2 it's no more cumbersome than theirs.
3 MR. BRUNSTAD: Yes, Your Honor. I -- I
4 misspoke. Excuse me.
5 QUESTION: Well, Mr. -- Mr. -- it is to this
6 extent. Most of these debtors are very small debtors.
7 You say take the contract rate as the presumptive rate and
8 then we're going to knock down for all these other things.
9 The high replacement cost that -- is one thing. The
10 interest that they got before bankruptcy is another. The
11 transaction cost that they're saved, another. And so let
12 the debtor come in and show that. But the debtor has no
13 money at all and certainly you don't want the debtor's
14 money eaten up hiring an attorney and further depleting
15 the money that could go to the creditors.
16 So it seems to me wildly unrealistic to expect
17 that if you say the presumptive price is the contract
18 price, you're going to get a debtor who will be able to --
19 I mean, I was surprised, looking at this record, that this
20 debtor got an expert. Who -- who paid the expert? Maybe
21 because the union was involved?
22 MR. BRUNSTAD: I do not know the answer to that,
23 Your Honor.
24 QUESTION: But isn't it typical that these
25 chapter 13 debtors don't have lawyers and don't have

1 experts?

2 MR. BRUNSTAD: No. They often have lawyers,

3 Your Honor.

4 But let me suggest this. If the Court were to

5 set the rate at the presumptive -- the contract rate as

6 the presumptive rate, this is what would happen and this

7 is what has happened in circuits where that is so. The --

8 the contract rate becomes the presumptive rate, and in

9 most cases the debtor will offer that in its plan -- in

10 his or her plan as the appropriate rate. If the debtor

11 doesn't like that, we'll offer less of a rate and then

12 what happens is a negotiation. And the debtor and the

13 secured party get together and they negotiate based upon

14 the debtor's presentation of this is why I think it should

15 be adjusted off of that because my circumstances have

16 improved or there's a lot of equity in this particular

17 collateral, so your risks are less, so you're more

18 protected. And those various reasons can then be given,

19 and then the parties can negotiate.

20 If, however, you set a standard where the

21 bankruptcy court is just simply going to decide based upon

22 the evidence that the parties put in, we're not going to

23 adopt the formula approach, then you'll be back to the

24 problem where we are before, lots of litigation. Again,

25 because the contract rate is the best evidence of a -- of

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 a market rate between these parties, it should be the
2 presumptive rate and we should work from that.
3 QUESTION: Is there any --
4 QUESTION: May I ask you a question that's run
5 through my mind listening to this argument? Going back to
6 the Rash case, was it, that we --
7 QUESTION: Yes.
8 QUESTION: -- we did not there -- the majority
9 did not there. I was in dissent in that case.
10 MR. BRUNSTAD: Yes, Your Honor.
11 QUESTION: -- did not take the case to try and
12 replicate what would have happened if there had been no
13 bankruptcy. They said, we won't -- won't treat it as a --
14 now, you're in effect asking we do treat the case as close
15 as possible to what you would have negotiated in a free
16 market.
17 MR. BRUNSTAD: Not quite, Your Honor. I think
18 actually this is the same analysis as in Rash. What the
19 Court said in Rash that the parties had to do was the
20 debtor had to go out -- the debtor already has the truck
21 -- had the truck in Rash -- is go out and see what it
22 would have cost the debtor to replace that truck. It
23 didn't actually do it, but simply say what would it have
24 cost.
25 The same principle applies here. The debtor

1 should actually go out and see what would someone pay.
2 How much would someone charge to finance this debtor's
3 loan?
4 QUESTION: Yes, but in doing that, they were
5 saying, we're going to do that instead of trying to
6 predict what would happen to -- in the normal course of
7 events between the contracting parties if bankruptcy had
8 not intervened.
9 MR. BRUNSTAD: Well, that's true. In this case,
10 though, that also applies. What would happen if
11 bankruptcy had not intervened is the secured party would
12 have foreclosed, repossessed the collateral, and avoided
13 all the costs.
14 QUESTION: But not at replacement value. You
15 would not have gotten replacement value.
16 MR. BRUNSTAD: That's true, Your Honor, but the
17 reason why you have replacement value is because the
18 debtor is going to keep the -- the collateral and prevents
19 the secured party from exercising its rights and forces
20 the secured party to incur costs that it otherwise would
21 avoid.
22 Now, the whole purpose of the value requirement
23 and the indubitable equivalent concept and the whole
24 cramdown standard is to make sure the secured party
25 doesn't -- isn't shouldered with uncompensated risk.

1 So the question becomes what's best method of
2 compensating the secured party for its risk. And the
3 statute, because of what it requires, value as of the
4 effective date of the plan using an economic concept, says
5 we basically have to value the stream of payments. Nobody
6 really is willing to say I would give this debtor $4,000
7 or take this debtor's promise of payment of $4,000 at --
8 at a prime rate or anything close to a prime rate. Again,
9 the contract date is the best evidence of a market
10 valuation that we have. And so that's what I think we
11 have to work with --
12 QUESTION: Is there any --
13 MR. BRUNSTAD: -- to be faithful to the statute.
14
15 QUESTION: Is there any indication that if we
16 take that, that in fact it will increase the likelihood of
17 default under the plan simply because the higher contract
18 rate will tend to put more pressure on the -- the debtor
19 than the debtor in fact ultimately can -- can satisfy?
20 MR. BRUNSTAD: Well, Your Honor, in the circuits
21 where that already is the standard, that the -- that the
22 presumptive rate is basically the rate that we use.
23 QUESTION: Yes. What is their experience?
24 MR. BRUNSTAD: There -- there is no information
25 to say it's higher default rate. And certainly the fact

1 that most of the circuits have this standard has not
2 stopped chapter 13 from being filed. They keep -- every
3 year the number goes up. So we're now at about 470,000
4 chapter 13 cases a year.
5 QUESTION: But it seems pretty obvious if it's a
6 higher rate, there are going to be more defaults.
7 MR. BRUNSTAD: Well, not necessarily, Your
8 Honor, for this reason. Because the debtor makes -- the
9 -- the debtor does not make payments directly to creditors
10 under the chapter 13 plan. The debtor makes payments to
11 the chapter 13 trustee as a dispersing agent, and the
12 chapter 13 trustee then distributes the money. What
13 you're doing here is you're reallocating in this case a
14 few hundred dollars away from unsecured creditors toward
15 the secured creditor because, again, the statute says the
16 secured creditor is not required to take -- shoulder
17 uncompensated risk for the benefit of anybody else.
18 That's --
19 QUESTION: Why not take the credit card rate?
20 MR. BRUNSTAD: Sorry, Your Honor?
21 QUESTION: Why not take the credit card rate?
22 Why not take his mortgage rate? I mean, you see, those
23 aren't the right rates, are they?
24 MR. BRUNSTAD: Here we have a situation in which
25 the correct rate for auto loans is evidenced by -- I think

Alderson Reporting Company, Inc.
1111 14th Street, N.W. Suite 400 1-800-FOR-DEPO Washington, DC 20005

1 best evidenced by the auto loan contract. It is a loan
2 between this lender and this debtor, decided in the
3 marketplace, with this particular collateral. It is the
4 best evidence of a market rate that we have. It's not
5 perfect, Your Honor. I concede that, but it is the best
6 evidence.
7 QUESTION: It's evidence at a different time
8 before you had all the considerations. I mean, we're
9 going in circles, and I mean, in some respects it's good,
10 in some respects it's bad.
11 QUESTION: Thank you, Mr. Brunstad.
12 Ms. Harper, you have 2 minutes remaining.
13 REBUTTAL ARGUMENT OF REBECCA J. HARPER
14 ON BEHALF OF THE PETITIONERS
15 MS. HARPER: Thank you, Mr. Chief Justice.
16 First of all, we need to get back to the concept
17 of present value. Present value is the time value of
18 money, which is the real rate of interest plus inflation.
19 The record in this case shows that the real rate of
20 interest was 2-and-one-half percent, and inflation was 3-
21 and-one-half percent.
22 Now, in this case, the debtors made all the
23 payments. They actually paid the contract off early, but
24 we need to start with as pure a base as possible and then
25 if there are special circumstances, sure, the bankruptcy

1 court could have discretion to add on if there is
2 particular jeopardy to the property.
3 But we're measuring two different things here.
4 The -- the statute doesn't say contract. The statute
5 doesn't say market rate. This market rate concept has
6 been misabused. And it -- right now under the bankruptcy
7 court's interpretation anything is okay as long as you put
8 this market rate label on it, and that's not a proper
9 standard for chapter 13 confirmation.
10 The other problem is with the respondent's
11 approach, the respondent uses words out of the Bankruptcy
12 Act, pre-Bankruptcy Act, that simply were never enacted
13 under chapter 13. Full compensation, full value of their
14 rights. That's nowhere in chapter 13. It's not a part of
15 the chapter 13 requirements. Indubitable equivalence.
16 That's not a chapter 13 confirmation concept. That's a --
17 that's a concept that was brought in to confuse this
18 issue, but it is not chapter 13.
19 Respondents -- their amicus said that under
20 their interpretation of the statute, basically anything
21 goes. A rate from 100 percent to 300 percent would be
22 just fine with them. Congress has not chosen to protect
23 subprime creditors. This goes against --
24 CHIEF JUSTICE REHNQUIST: Thank you, Ms. Harper.
25 The case is submitted.

1 (Whereupon, at 12:13 p.m., the case in the
2 above-entitled matter was submitted.)
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25