

1                   IN THE SUPREME COURT OF THE UNITED STATES

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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.

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7	as amicus curiae, supporting the Petitioners	15
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P R O C E E D I N G S

(11:12 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument  
next in No. 02-1016, Lee Till v. SCS Credit Corporation.

Ms. Harper.

ORAL ARGUMENT OF REBECCA J. HARPER  
ON BEHALF OF THE PETITIONERS

MS. HARPER: Mr. Chief Justice, and may it  
please the Court:

Deferred payments under section  
1325(a)(5)(B)(ii) must equal the present value of the  
collateral. Historically present value has been an  
objective concept equalling the real interest rate and  
inflation, which is the time value of money..

The Seventh Circuit has redefined this concept  
in a manner that seriously disrupts two fundamental  
principles of chapter 13, that being the equal treatment  
of creditors similarly situated and the debtor's  
rehabilitation, the debtor's access to chapter 13.

QUESTION: When you say traditionally it's been  
understood to mean real interest rate plus time value of  
money, it means real interest rate for the particular  
lender. Isn't -- I mean, the -- the interest rate that is  
given to different lenders is not always the same.

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

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?

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



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

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, *Bigear 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 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

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



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

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

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

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.



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



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

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

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

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

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.)  
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