No. 10-1443

IN THE

Supreme Court of the United States

AMERICREDIT FINANCIAL SERVICES, INC.,

PETITIONER,

—V.—

MARLENE A. PENROD,

RESPONDENT.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITIONER

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INTRODUCTION[1]

This case presents a very common occurrence for an automotive creditor: a consumer seeks to trade-in a vehicle with "negative equity" (*i.e.* where the amount owed by the customer on the vehicle exceeds its trade-in value) in connection with the purchase of another vehicle. An auto dealer faced with this scenario will commonly structure a transaction where the amount necessary to satisfy the customer's "negative equity" on the trade-in vehicle is included as part of the obligation that is secured by the new vehicle.

This common practice, however, can raise issues regarding the ultimate repayment of the full amount of the obligation should the consumer subsequently seek the protection of the Bankruptcy Court. The legal issue at the core of this case is the proper interpretation of a portion of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[2] ("BAPCPA"), 11 U.S.C. § 1325(a)(*). This provision, known among bankruptcy practitioners as the "hanging paragraph" because of the way in which

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[1] Pursuant to Rule 37, counsel of record received timely notice of the intent to file the brief. The parties to this case have consented to the filing of this amicus, and a letter reflecting that consent is on file with the Court. Counsel for the ABA certifies that no counsel for any party authored this brief either in whole or in part, and no person or entity, other than ABA and its members, made a monetary contribution to the preparation or submission of the brief.

[2] Pub. L. No. 109-8, 119 Stat. 80 (2005).

it appears to visually dangle from the other portions of this section on the printed page, was enacted by Congress with the express intention of preserving the purchase money security interest ("PMSI") of creditors who provide consumer financing for the purchase of personal automobiles.

The ABA submits that the Ninth Circuit erred when it concluded that, despite the clear language of section 1325(a)(*), the negative equity portion of Respondent's obligation could be treated as unsecured debt. This result stands apart from the *eight* other United States Courts of Appeal [3] that have correctly interpreted the language of 11 U.S.C. § 1325(a)(*) as protecting a creditor's PMSI in bankruptcy proceedings when the purchase transaction in question includes a debtor's negative equity in a trade-in vehicle. The Court should grant review in order to resolve the split among the Federal Courts of Appeal caused by the Ninth Circuit's decision below.

STATEMENT OF INTEREST OF AMICUS CURIAE

The American Bankers Association ("ABA") is the principal national trade association of the

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[3] *See, e.g., In re Westfall*, 599 F.3d 498 (6th Cir. 2010); *In re Howard,* 597 F.3d 852 (7th Cir. 2010); *In re Peaslee*, 585 F.3d 53 (2d Cir. 2009)(per curiam); *In re Dale*, 582 F.3d 568 (5th Cir. 2009); *In re Mierkowski*, 580 F.3d 740 (8th Cir. 2009); *In re Ford*, 574 F.3d 1279 (10th Cir. 2009); *In re Price*, 562 F.3d 618 (4th Cir. 2009); *In re Graupner*, 537 F.3d 1295 (11th Cir. 2008).

financial services industry. The ABA's headquarters are located in Washington, DC. Its members, located in each of the fifty states, the District of Columbia, and Puerto Rico, include financial institutions of all sizes. ABA members hold a majority of the domestic assets of the banking industry in the United States. The ABA frequently submits *amicus curiae* briefs to state and federal courts in matters that significantly affect its members and the business of banking.

The ABA, on behalf of its members, has a direct interest in the outcome of this case. If allowed to stand, the Ninth Circuit's decision will directly and adversely affect a matter of fundamental importance to the ABA and its members: their ability to recover the secured credit that they extend to their customers. The banking industry is a significant source of credit for consumers who seek to purchase an automobile, and the outcome of this case will have a direct impact upon our members' participation in this particular sector of consumer financing, either as a direct lender or as a purchaser of retail installment sales contracts.

ARGUMENT

The ABA strongly concurs with the arguments articulated by AmeriCredit in support of its Petition. As discussed in Petitioner's Brief (at 14), the "hanging paragraph" presents an important – and highly litigated – portion of BAPCA. By Petitioner's count, since it was enacted in 2005 approximately 96

trial and appellate courts throughout the country have ruled on this issue.[4] Eight federal circuit courts, in nine separate opinions, have ruled that a charge for negative equity is protected from bifurcation and cramdown by the hanging paragraph, while only the Ninth Circuit panel's opinion in this case has reached a contrary result.

The impressive volume of litigation over this issue and the fact that it has arisen in the comparatively short period of time since the enactment of BAPCPA strongly suggests that a final and authoritative resolution of the question of whether a PMSI may include the portion of a secured obligation used to finance the elimination of "negative equity" when a vehicle is traded in as part of a new car purchase is important to both creditors and debtors alike. While there is a strong consensus among the federal appellate courts concerning the proper interpretation of the "hanging paragraph," this case presents the Court with an appropriate opportunity to remove *any* lingering doubt that section 1325(a)(*) protects a creditor's PMSI in a transaction involving negative equity. Granting the Petition would permit the Court to correct an anomalous (and erroneous) ruling in an area where there is an overriding need for national uniformity.

There are also very practical reasons for the Court to grant review in order to bring the Ninth

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[4] Pet. App. 201a-208a.

Circuit's construction of BAPCPA into alignment with its eight sister circuits that have already decided this issue. The Ninth Circuit – which encompasses Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington – represents one of the largest banking markets in the United States. The Ninth Circuit's interpretation of the "hanging paragraph" places creditors in those states at a significant disadvantage in comparison to identically-situated automobile finance creditors that are located in jurisdictions that appropriately protect PMSI from bifurcation and cramdown in a Chapter 13 proceeding. If the panel decision is allowed to stand, the result for banks making or facilitating consumer automobile financing California is likely to be an increased risk of loss connected with this portion of their portfolio, which in turn may ultimately be reflected in a tightening of credit or an increase in the cost of auto credit for consumers in California and other affected jurisdictions. Given the current economic challenges facing the banking industry, the auto industry, and the nation's consumers, the public can ill-afford the price tag that is attached to the Ninth Circuit's failure to implement one of BAPCPA's explicit and most important reforms.

1. The Banking Industry Is A Significant Source Of Credit For Consumers Seeking To Purchase Automobiles.

It should not be a surprise to the Court that the banking industry is a significant source of credit for consumers who seek to purchase an automobile.

The average price of a new automobile is beyond the means of most consumers to purchase outright, meaning that it is usually necessary for a consumer seeking to purchase an automobile to employ some form of financing. For anyone who has shopped for an automobile in the last few years or has paid even the slightest attention to car-related advertising knows that there are many different financing options offered by automobile manufacturers and dealers. One of the most common methods for extending financing for the purchase of an automobile is for the dealer to sell the car to the consumer pursuant to a retail installment sales contract that is then sold by the dealer to a bank or automobile sales finance company.[5]

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[5] While sales finance companies dominate this sector of the industry, a recent study by J.D. Power and Associates shows that more consumers are obtaining financing from non-dealer sources such as banks, credit unions, and online lenders. They report that more than one in five luxury vehicle buyers secure financing without assistance from the dealer. J.D. Power and Associates, "Auto Financing Tips," http://www.jdpower.com/finance/articles/Auto-Financing-Tips/ (accessed June 20, 2011). See also, FDIC, "Supervisory Insights: The Changing Landscape of Indirect Automobile Lending," http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum05/article04_auto_lending.html (2005) (accessed June 21, 2011) (Sales finance companies represented 56 percent of the automobile financing market in 2003, with banks, credit unions, and other finance companies comprising the remaining market).

An overwhelming majority of financial institutions are involved in at least some aspect of providing funding for automobile purchases. Based on data[6] collected by the Federal Deposit Insurance Corporation (FDIC) from all federally insured savings institutions, as of March of 2011:

- Eighty-eight percent of all FDIC-insured banks have outstanding auto loans in their loan portfolio (this includes banks that purchase retail installment sales contracts from dealers);

- The banking industry collectively holds $283 billion in its aggregated auto finance portfolio;

- Auto loans represent nearly a quarter (22 percent) of the industry's consumer finance portfolio.

Banks develop indirect automobile financing programs by establishing relationships with automobile dealers. These institutions define the type of debtor and financing terms that they will accept by providing dealers with underwriting and interest rate guidelines. In most cases, a dealership's finance manager gathers credit information from prospective buyers, completes the credit applications, and forwards the documents to the bank for approval. Historically, auto financing has been

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[6] FDIC, "Statistics On Depository Institutions," http://www2.fdic.gov/sdi/index.asp (accessed June 21, 2011).

perceived as a low-risk form of financing, with risk spread among a large volume of small-balance, collateralized loans. [7]

While automobile financing has been viewed as comparatively low-risk from a safety and soundness standpoint, these portfolios are not immune to the ups and downs of the economy or the behavior of the consumers that they serve. Unfortunately, not all auto financing continues to perform: as of March of 2011, the FDIC reports that slightly more than a quarter of a percent (0.29 percent) of auto credits held by all FDIC insured banks are either 90 days past due or in nonaccrual status. [8] And while industry-wide data is difficult to come by, it is fair to presume that a representative percentage of these non-performing credits represent obligations owed by individuals who have (or will) seek the protection of the bankruptcy courts.

2. The Issue Of "Negative Equity" Affects The Banking Industry.

Because the banking industry has a large presence in the area of automobile finance, the proper recognition by the courts of the protections

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[7] FDIC, "Supervisory Insights: The Changing Landscape of Indirect Automobile Lending," http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum05/article04_auto_lending.html (2005) (accessed June 21, 2011).

[8] FDIC, "Statistics On Depository Institutions," http://www2.fdic.gov/sdi/index.asp (accessed June 21, 2011).

provided to creditors under BAPCPA is important to the ABA and its members. The sheer volume of secured auto finance credits currently held by the industry and the prevalence of finance transactions involving "negative equity" at trade-in combine to make this so.

According to the U.S. Department of Transportation, new automobile sales in the U.S. from 1998 to 2009 have ranged from 5.4 to 8.8 million cars each year.[9] The established pattern among consumers has been to trade in their cars after about three years.[10] This pattern hasn't changed appreciably for decades. What has changed is the length of time that consumers are financing the purchase of an automobile. Thirty years ago a three-year finance period was the norm, and consumers began looking for a new car as soon as they paid off their current vehicle. Today, longer term financing is common as consumers opt to purchase comparatively more expensive automobiles.[11] To compensate for the increased

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[9] *See* Bureau of Transp. Statistics, U.S. Dep't of Transp., National Transportation Statistics 1-12 (2010), *available at* http://www.bts.gov/publications/national_transportation_statistics/html/table_01_12.html.

[10] Welsh, Jonathan, *When a $38,000 Car Costs $44,000*, Wall Street Journal May 22, 2007, at D1 (available at http://online.wsj.com/article/SB117980528602310508.html?mod=todays_us_nonsub_pj).

[11] Welsh, *id.* In 2006, the average price paid for a vehicle was $29,316, compared with $28,942 a year earlier and $19,773 in 1996. Some commentators believe that this trend is

(continued...)

price, many consumers seek to reduce the size of monthly payments by spreading them over longer periods.[12] Today, many people begin to think about new cars just halfway through the financing term.[13]

The advent of consumers opting for longer term financing for automotive purchases has, in turn, amplified the issue of dealing with negative equity on a trade-in when putting together financing for a new car purchase. According to the Wall Street Journal, in 2006 about 29% of car buyers who traded in a vehicle to buy a new one owed more on their old-car obligations than their trade-in vehicle was worth,

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(...continued)
attributable to "an escalation of taste" among consumers. Where people used to be satisfied with safe, reliable transportation, they now regard features like leather upholstery, elaborate stereo systems and heated seats as necessities even on economy cars. Consumers also assess extra-cost options based on how much they add to the monthly payment instead of their total cost, so they have a greater tendency to add luxury features. *Id.*

[12] FDIC, "Supervisory Insights: The Changing Landscape of Indirect Automobile Lending," ("Federal Reserve Bank data show the average new car loan maturity increasing from 53 months to 62.5 months between 1999 and fourth quarter 2003 as more consumers selected a 72-month loan product. An article in the *American Banker* indicates that the terms of automobile loans are increasing, with some banks offering eight-year loans."). *See* "Driven into Making More Used-Car Loans," *American Banker*, April 15, 2005.

[13] Welsh, *id.*

compared with 20% five years earlier.[14] The percentage of consumers with negative equity on their trade-in has risen and fallen over time and was as high as 39% in 1990.[15] But the amount owed at trade-in has risen steadily in recent years as vehicle prices have increased. Buyers who had negative equity when they traded in their cars in 2006 on average owed $3,062 on their secured obligations, compared with $1,726 in 2000 and $617 in 1990.[16]

For auto dealers and the entities that provide financing for automobile sales, "negative equity" is a well-established fact of life. As the panel recognized, approximately one-third of the car sales in America involve a trade-in vehicle with a negative equity balance. *In re Penrod,* 611 F.3d 1158, 1162 (9th Cir. 2010) (citing *In re Howard,* 597 F.3d at 857-58). Given the prevalence of the issue in terms of the sheer volume of transactions and the litigation that it has spawned, the ABA respectfully submits that the treatment of "negative equity" under BAPCPA as part of a creditor's PMSI is of sufficient importance to warrant this Court's review.

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[14] Welsh, *id.*

[15] Welsh, *id.*

[16] Welsh, *id.*

3. The Ninth Circuit Erred When It Failed To Recognize A PMSI For The Full Amount That Was Financed

Finally, the Court should grant review in this case because the Ninth Circuit erred when it failed to recognize a PMSI for the full amount that was financed – including the "negative equity" portion of Ms. Penrod's trade-in. This error serves to negate the important protections accorded to automobile lenders under BAPCPA that were intended to protect a creditor's PMSI in an automobile loan from bifurcation and cramdown in a Chapter 13 proceeding.

Prior to the enactment of BAPCPA, one of the advantages (from the debtor's perspective) of filing a Chapter 13 bankruptcy was that (pursuant to 11 U.S.C. § 506(a)) a debtor could modify the rights of a financer with a PMSI in a motor vehicle by "bifurcation" of the claim into secured and unsecured portions, based on the vehicle's value. Thus, the creditor would have a secured claim to the extent of the value of the vehicle and an unsecured claim to the extent the creditor's claim exceeds the value of the vehicle. That portion of the creditor's claim allowed as secured would be paid in full with interest, while the unsecured portion would be paid pro-rata with other general unsecured claims. Such a proposal in a Chapter 13 plan is commonly referred to as a "bifurcation and cramdown."

The enactment of BAPCPA in 2005 was intended to reduce this exposure to loss by

restricting the ability of a debtor to rely on bifurcation and cramdown to reduce the amount owed in connection with an automobile financing. The "hanging paragraph" portion of section 1325(a) enacted as part of BAPCPA provides that -

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

11 U.S.C. § 1325(a)(*). As recognized by the 8 other federal circuit courts of appeal that have taken up this issue, BAPCPA provides that an auto creditor's secured claim is not limited to the value of the automobile (as it would under bifurcation and cramdown), but rather extends to the full amount of the secured obligation made to effect the purchase of the car where the creditor has a PMSI as recognized under state law.

As reflected in the lengthy and thoughtful dissent[17] issued by the Ninth Circuit in connection with its denial of Petitioner's request for a rehearing *en banc*, four judges were convinced that (contrary to the result reached in the panel decision) the protection accorded to a valid PMSI not only extends to the purchase price of the vehicle, but also any amount that was financed in order to eliminate the borrower's/debtor's negative equity in their trade-in:

> Keeping the entire loan, including negative equity, as a secured debt appears to be exactly what Congress intended. *11 U.S.C. § 1325(a)(9)* was added as part of BAPCPA. *See* Pub. L. 109-8, § 306(b), 119 Stat. 80 (2005). The title of this section is Giving Secured Creditors Fair Treatment in Chapter 13, and this section specifies its purpose as "Restoring the Foundation for Secured Credit." The plain language of the statute clearly says that "*Section 506* shall not apply" in to these loans. *11 U.S.C. § 1325(a)(9)*. *Section 506* is the only provision that allowed Penrod to bifurcate her loan in the first place. The panel's holding not only disregards the plain language of the statute, it also

[17] *In re Penrod*, 636 F.3d 1175, 2011 U.S. App. LEXIS 3798 (9th Cir. 2011).

> undermines this purpose. (Emphasis per original)[18]

The dissent correctly observes that "[e]very other circuit court to address this precise issue has upheld Congress's clear intent and granted creditors a PMSI in the entire debt incurred in financing a vehicle purchase, including the purchaser's negative equity" and that in doing so "each of these circuits was interpreting a state's law which had adopted the language of U.C.C. Article 9-103 unchanged, as did California Commercial Code § 9103." *In re Penrod*, 636 F. 3d at 1179, citing *In re Howard,* 597 F.3d at 855.

The ABA agrees with the Petitioner (as well as the analysis of the dissenting judges in *Penrod*) that the Ninth Circuit clearly erred when it concluded that a creditor does not have a PMSI in the "negative equity" portion of the secured obligation under California law for purposes of section 1325(a) of the Bankruptcy Code. (Pet. Brief at 21). The ABA agrees – as did the eight other federal circuits and the New York Court of Appeals[19] when they were called upon to construe this issue – that the amount paid by the dealer to obtain good title and eliminate a purchaser's negative equity on the trade-in vehicle qualifies as a PMSI.

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[18] *In re Penrod*, 636 F.3d at 1178.

[19] *In re Peaslee*, 13 N.Y. 3d 75 (N.Y. Ct. App. 2009).

Section 9-103 of Article 9 provides that a security interest in goods is a "purchase money security interest" to the extent that it secures "an obligation … incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." The Official Comments to section 9-103 make it clear that the elements to be included in the "price" of the collateral or the "value given to enable" include a broad range of costs, including "obligations for expenses incurred in connection with acquiring rights in the collateral…" Uniform Commercial Code § 9-103, Comment 3; Cal. Comm. Code § 9103, Comment 3. The Comments to section 9-103 (and the relevant portion of the California Commercial Code) also set forth the applicable test to determine whether expenses, fees or other charges qualify for treatment as a purchase money security interest is that there is "a close nexus between the acquisition of collateral and the secured obligation." *Id.*

The ABA submits that the required "close nexus" exists between the "acquisition of the collateral" and the secured obligation – inclusive of the amount necessary to discharge the debt on the trade-in and eliminate the negative equity – that is necessary to create a PMSI in the scenario presented to the Court. Common sense and the practical realities of this transaction (and millions of other

similar transactions) compel such a conclusion.[20] As noted by the dissent, Ms. Penrod's purchase of a new car – a 2005 Ford Taurus – depended upon and was inextricably intertwined with the terms and conditions under which the dealer would accept her 1999 Ford Explorer in trade. Ms. Penrod

> held only registered, not legal, title to the Explorer. Her lender for the Explorer held legal title until she paid off the remainder of the loan. To get legal title to her Explorer, which she needed to trade it in for the Taurus, Penrod needed the entire debt on the Explorer paid off.[21]

From the dealer's perspective, the total purchase price of the new Taurus necessarily included both the price for the Taurus, and the total amount of negative equity paid off in order to discharge Ms. Penrod's debt on her old Explorer. The "critical" question, as noted by the dissenting Judges in the Ninth Circuit, is

> [w]ould anyone extend this line of credit and pay off the buyer's negative equity

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[20] To illustrate the importance of financing negative equity as an industry practice, Petitioners point out that a majority of states have enacted statutes that expressly authorize the practice and treat negative equity as part of the "amount financed" or the "price" of the new vehicle. *See* Pet. Brief at 12, Appendix O.

[21] *In re: Penrod*, *id.* at 1176.

> in her old car if he could not get a purchase money security interest ("PMSI") in the total amount of debt he assumed? Not if he wanted to stay in business.[22] (footnote omitted)

The ABA respectfully submits that the Petitioner is correct in its conclusion that it retained a PMSI for the full amount of the secured obligation because "[a]s one can see, the amount of money the dealer paid the bank is every bit as much a part of the dealer's cost to sell the Taurus as is the factory invoice."[23]

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[22] *Id.*

[23] *Id.* at 1177.

CONCLUSION

For the foregoing reasons, the ABA urges the Court to grant the Petitioner's request for a writ of certiorari.

Respectfully submitted,

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