07-3962-bk(L), 07-3952-bk(CON), 07-3964-bk(CON), 07-3981-bk(CON), 07-3986-bk(CON), 07-3990-bk(CON)

United States Court of Appeals
for the
Second Circuit

In re: Faith Ann Peaslee, Jonathan T. Vanmanen, Omayra Martinez; Michael Colombai, Shannon A. Colombai, Pamela D. Jackson

GEORGE M. REIBER,

Defendant-Appellant,

– v. –

GMAC, LLC, FORD MOTOR CREDIT COMPANY, GENERAL MOTORS ACCEPTANCE CORPORATION, AMERICAN SUZUKI FINANCIAL SERVICES CO., LLC, SOVEREIGN BANK, HSBC AUTO FINANCE,

Plaintiffs-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF NEW YORK

BRIEF OF *AMICI CURIAE* AMERICAN FINANCIAL SERVICES ASSOCIATION AND NATIONAL AUTOMOBILE DEALERS ASSOCIATION IN SUPPORT OF PLAINTIFFS-APPELLEES AND SUPPORTING AFFIRMATION OF THE JUDGMENT BELOW

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CERTIFICATE OF INTERESTED PERSONS
AND CORPORATE DISCLOSURE STATEMENT

Amici Curiae adopt the Certificate of Interested Persons and Corporate Disclosure Statement filed by Plaintiff-Appellees. Counsel for Amici Curiae certify, pursuant to Fed. R. App. P. 26.1 and L.R. 26.1-1 and 1.2, that, in addition to the parties identified in Plaintiff-Appellees' Certificate of Interested Persons and Corporate Disclosure Statement, the following parties have an interest in the outcome of this case:

American Financial Services Association (Amicus Curiae)

National Automobile Dealers Association (Amicus Curiae)

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FEDERAL RULE OF APPELLATE PROCEDURE 29(a) STATEMENT

Pursuant to Federal Rule of Appellate Procedure 29(a), all parties consent to the filing of this brief.

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IDENTITY AND INTEREST OF AMICI CURIAE

A. Identity of Amicus Curiae – American Financial Services Association

The American Financial Services Association (AFSA) is the national trade association for the consumer credit industry protecting access to credit and consumer choice. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages.

AFSA has provided services to its members for over ninety years. The Association's officers, board, and staff are dedicated to continuing this legacy of commitment through the addition of new members and programs, and increasing the quality of existing services.

B. Identity of Amicus Curiae – National Automobile Dealers Association

Founded in 1917, the National Automobile Dealers Association ("NADA") is a non-profit trade organization whose members hold franchises to sell at retail passenger cars and trucks and related goods and services as authorized dealers of the various motor vehicle manufacturers and distributors doing business in the United States. As of November 27, 2007, there were 20,899 franchised motor vehicle dealers in the United States. Of those, 19,307 are members of NADA. Among other services provided, NADA advises members of relevant legal and regulatory issues. NADA closely monitors federal statutes, state statutes, and court rulings interpreting such laws. NADA appears before and submits briefs to courts

and other tribunals as *amicus curiae* to advocate interpretations of federal and state statutes that will advance the interests of its members as a group.

C. Interest of AFSA as Amicus Curiae

The AFSA membership has a vital interest in the outcome of this case. AFSA members primarily represent motor vehicles installment sale financers. The 2005 amendments to section 1325(a) added an unenumerated, hanging paragraph at the end of the section that deals with certain claims secured by motor vehicles. The effect of this paragraph has been widely debated by creditors, debtors, counsel and commentators, and there is a split of authority in the Bankruptcy Courts. This case affords the Court an opportunity to address this debate as it pertains to whether a creditor's claim is covered by the hanging paragraph where a portion of the financing is used to payoff negative equity from a trade-in vehicle. To Movant's knowledge, this case will be one of the first appellate decisions on this matter.

D. Interest of NADA as Amicus Curiae

NADA and its members have a substantial interest in this litigation, not only because it will impact franchised motor vehicle dealers in New York, but also because it may impact motor vehicle dealers in other states.

STATEMENT OF THE ISSUES

AFSA and NADA adopt the Statement of the Issues filed by Appellee, GMAC.

SUMMARY OF ARGUMENT

The question raised on appeal is whether the District Court erred in finding that the entire security interest on Peaslee's new Grand Am for the debt of $17,904.95 constituted a "purchase-money security interest" as that term is used in Section 1325(a) of the Bankruptcy Code. The district Court found correctly, and as such its decision should be affirmed.

This case is a byproduct of the 2005 amendments to the Bankruptcy Code. Those amendments are titled the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and are known to bankruptcy disciples as "BAPCPA." This case is one of a handful of similar cases that are bubbling up through the federal court system from many bankruptcy courts[1].

Prior to BAPCPA, a debtor who owed $15,000 on a car worth only $10,000 could, in a wage earner's plan under Chapter 13, keep his car by paying only

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[1] See, e.g. *See In re Burt*, 2378 B.R. 352 (Bankr. D. Utah 2007); *In re Wall*, 376 B.R. 769 (Bankr. W.D.N.C. 2007); *In re Weiser*, 2007 WL 4570917 (Bankr. W.D.Mo. 2007), *In re Brown*, 339 B.R. 818 (Bankr. S.D. Ga. 2006); *In re Bufford*, 2006 WL 1677160 (Bankr. N.D. Tex. 2006); *In re Curtis*, 345 B.R. 756 (Bankr. D. Utah 2006); *In re Durham* 361 B.R. 206 (Bankr. D. Utah 2007); *In re Ezell* 338 B.R. 330 (Bankr. E.D.Tenn. 2006); *In re Honeycutt*, Case No. 06-48771 (Bankr. E.D. Mich. 11/2/06); *In re Particka 355* B.R. 616 (Bankr. E.D. Mich. 2006).

$10,000 to his secured creditor. In a procedure inelegantly known as a "cramdown" or "lien stripping," the debtor could divide his creditor's claim into a $5,000 unsecured claim and a $10,000 secured claim. He would then keep the car by paying $10,000 over time to his creditor on the secured obligation and give the creditor little or nothing on the $5,000 unsecured claim.

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

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

The issue in this case and in similar cases elsewhere is whether the entire interest secured by the new car is to be treated as a "purchase-money security interest." To the extent that the security interest is not purchase-money, the creditor does not enjoy the protection of the new provision and the debtor may cramdown. If the entire security interest is "purchase-money," cramdown is prohibited.

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

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

Now there is a problem. Is a security interest that secures both the sticker price on the new car and the remaining balance on the old car regarded as a "purchase-money security interest?" The debtor, of course, says no. The creditor says yes. Relying principally on New York state law for the definition of purchase-money, while citing other statutory authority for the definition of "cash

sale price," the District Court below held that the security interest covering the negative equity was a purchase-money security interest and was entitled to the new protection in BAPCPA against cramdown.

Although it is stuffed with definitions, the Bankruptcy Code has no definition of "purchase-money security interest." It seems likely that Congress intended the term to have a federal law meaning drawn from the language, from inferences about Congressional intent, from commercial practice, and by analogy to state law and to other federal law. It is also possible that Congress intended to use state law definitions. Whether one regards the words as federal or state, the outcome is the same. Even if Congress intended a federal definition, that definition would have to lean heavily on state statutes that define the term. If Congress wanted to adopt state law definitions, those same statutes would be applied directly.

ARGUMENT

I. THE LANGUAGE OF THE STATUTE AND THE CONGRESSIONAL PURPOSE FAVOR GMAC

A. Congress' Purpose

As its name proclaims ("Bankruptcy Abuse Prevention") the 2005 Act was designed both to make it more difficult for consumers to cancel their debt and to move debtors with means to repay their bills. It came at the end of a twenty-year

spurt in bankruptcy filings from 250,000 in 1978 to more than 1,500,000 filings in 2004. All but a small number of these filers are consumer debtors.

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

The opponents in Congress were as persistent and clever in opposition to the Act as the proponents were determined and united in support.

Among the principal creditor advocates for the bill were credit card companies.[2] By 2005 it was claimed that the credit card industry had spent over $100 million in lobbying and other activity to promote the bill. In general, credit card companies make unsecured loans and fare poorly in Chapter 7 consumer liquidations. Many consumer Chapter 7s are "no asset" cases. A "no asset" debtor shields all of his assets by smart use of the exemption law and so makes no distribution to any unsecured creditor. To attempt to get something from some of the Chapter 7 debtors, the credit card companies and other unsecured creditors hoped to force some of those debtors into Chapter 13 where they would be required to give up a part of their wages for 5 years.

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[2] Egan, Timothy "Newly Bankrupt Raking in Piles of Credit Offers." The New York Times, Dec. 11, 2005.

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

The secured creditors, particularly the auto creditors, must have feared that their interests would be injured by a bill that would move many debtors from Chapter 7 (liquidation), into Chapter 13 (wage earner plans). Secured creditors' concern would arise principally because of the probability of a cramdown in Chapter 13. In Chapter 7 by comparison, debtors frequently sign "reaffirmation" agreements under which they are obliged, even after the bankruptcy, to the pay the full amount due on their cars, whatever the car's value. So a large-scale move out of Chapter 7 and into Chapter 13 – of the kind hoped for by the credit card issuers – would favor the credit card companies (by giving them a 5 year share of the

debtor's future wages) and would injure the auto creditors (by substituting low-pay cramdowns for high-pay reaffirmation agreements).

When one considers the parties to the Congressional debate (unsecured creditors who would benefit from Chapter 13 growth v. secured creditors who would suffer), the goals of the principal creditor advocates (credit card issuers who openly advocated expansion of Chapter 13) and the evolving language of the Act (*see* I B below), it is unmistakable that Congress intended to protect creditors who finance consumer vehicle purchases from cramdowns in Chapter 13. Congress appears to have been persuaded by the auto financiers' argument that, unless the anti-cramdown provision was added to the law, the increased costs of cramdown would ultimately be borne by consumers – including, in particular, some who would be priced out of the market as a result. (Bankruptcy: Hearings Before the Committee on the Judiciary House of Representatives on H.R. 333, 107th Cong. 371-372). That congressional purpose is served by a decision for GMAC.

B. Congress' Language

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

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

That provision would not have protected from cramdown much of the debt that is covered by a purchase-money security interest on a car. It would not have protected amounts attributable to title and taxes or negative equity on trade-ins, and, of course, it would not have touched any secured transaction that was done more than 6 months before the bankruptcy filing.

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

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

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

By 1999 the Senate version covered a claim where:

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

Note that the 1999 Senate version does not refer to a "purchase-money security interest" and that one infers that the legislation deals with the **purchase** of a motor

vehicle only from the use of the verb "acquired," but the provision is now limited to motor vehicles bought for personal use.

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

> a claim...if the creditor **has a purchase-money security interest securing the debt that is the subject of the claim**, the debt was incurred within the 5-year period preceding the filing of the petition, and the collateral for that debt consists of a motor vehicle... acquired for the personal use of the debtor... (emphasis added) (Sec. 306 2000 S. 3186)

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

> For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase-money security interest securing the debt that is the subject of the claim, the debt was incurred within 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle... acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the one year period preceding that filing.

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

There are two notable insights buried within Congress' choice of words and in the progression from the early House language to the words that are now part of Section 1325(a). First is the probability that Congress chose the current language to exclude a certain kind of secured creditor from the Section's protection, not to

deal with the scope of “purchase-money.” Second is the breadth of the traditional purchase-money security interest.

1. Excluding Certain Secured Creditors

The drafters may have chosen the purchase-money language to exclude non-purchase-money security interests in vehicles already owned by the debtor. Non-purchase-money security interests in property already owed by consumer debtors are frequently disfavored under the law. (See 16 C.F.R. 444.2(a) (4), where taking a non-purchase-money security in certain household goods is an unfair trade practice, and 522(f) (1) (B) of the Bankruptcy Code, avoiding nonpossessory nonpurchase-money security interests against certain consumer goods.) After the original House language, which referred to “purchase-money,” was replaced with the 1999 version of the Abraham amendment, a non-purchase-money secured creditor who took a security interest in a car that the debtor had purchased outright within five years of the filing could have claimed the benefit of the provision. The automobile financiers – purchase-money creditors all – had no interest in enriching non-purchase-money secured creditors who take security interests in property already owned by a consumer debtor, nor would the consumer advocates have wished to benefit these creditors. So it is plausible that the purchase-money language was inserted only to deprive these non-purchase-money creditors from using the section, not to draw any distinction between parts of a secured debt

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

2. “Purchase-money Security Interest” Is Broader Than “Principal Balance”

By using the generic term “purchase-money security interest” instead of the original House term “unpaid principal balance of the purchase price attributable” to property acquired within 180 days, Congress must have intended to include some parts of the debt that would have been omitted by the original House language. The House language, “unpaid principal balance... attributable to the goods purchased,” identifies the particular type of **debt** that is covered, whereas “purchase-money security interest” refers to a type of **security interest**, not to a type of debt.

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

Conceding that the Senate language is broader than the House language, can one infer that the Senate intended to treat negative equity amounts as covered by "purchase-money security interests?" Yes. Representatives of the debtors and creditors must have known of the practice of rolling negative equity amounts from trade-ins into debts secured by purchase-money security interests on new cars. By 2005 as many as 38 percent of all new car purchasers rolled some part of the exiting debt on a trade-in into the new debt incurred to buy the new car.[3] This is not an obscure practice; it is commonplace and would have been well known to any informed debtor or creditor representative. By 2004 the practice was specifically permitted in the Motor Vehicle Sales Acts of more than 34 states.

And it cannot be said that the cramdown provision on motor vehicles traveled below the Congress' radar. The topic was controversial; as we show in Section I B above, the provision was modified several times in different ways.[4] And, while it was one of the continuing points of dispute between the debtor and the creditor interests between 1998 and 2004, ultimately the language adopted reflected a compromise worked out over several years to gain the secured lenders' support.

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[3] *See e.g.*, FDIC Supervisory Insights *The Changing Landscape of Indirect Automobile Lending* June 23, 2005.

[4] *See e.g.*, H.R. Rep. No. 107-617, 147 Cong. Rec. S2234-35.

Most importantly, the language chosen by Congress has a meaning found in practice and in state law (*see* Section III below). That law and practice show that a "purchase-money" interest reaches not only a car's cash price but also other amounts that may be folded into the total purchase price. That this language was chosen in lieu of more restrictive language of the House buttresses the argument for a broad definition of "purchase-money." That Congress was apparently adopting Senator Abraham's approach to help car creditors gives further support for the broad reading as a federal definition. In the Federal District Court, Judge Larimer held that "by its terms, the hanging paragraph prohibits the bifurcation of *any* claim if the debt is secured by a PMSI. To adopt the Trustee's position would in effect undo [BAPCPA]." *GMAC v. Peaslee*, 373 B.R. 252, 261 (W.D.N.Y. 2007). The Federal District Court found particularly persuasive the fact that Comment 3 to § 9-103 of the UCC's description of the price of collateral listed "obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations." Since Comment 3 did not preface the "sales taxes, duties, et al." list with the words "including" or "such as" or a functionally equivalent phrase, the court determined that the Comment's reference to obligations is a general one, distinct from those expenses which

followed. This further reinforces the District Court's decision, which found the intertwining of the negative equity with the sales financing to be persuasive in determining the negative equity's purchase-money status.

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

When Congress enacted BAPCPA in 2005, it is presumed to have known about other pertinent federal law governing purchase-money financing of motor vehicles.[5] The Truth in Lending Act (TILA) (15 U.S.C. §1600 et seq.) and the Act's regulation, Regulation Z (12 CFR 226), deal generally with the disclosures that are required in both consumer credit card debt (open ended credit) and purchase-money debt for items of personal property (closed end credit). Although that law does not give a definition as such of "purchase-money security interest," the law does explain the kind of disclosures that must be made in a purchase-money transaction that generates a purchase-money security interest.

In 1999, the Federal Reserve Board amended the Official Staff Interpretations of Regulation Z to clarify how purchase-money vehicle financers should disclose negative equity. Those amendments direct creditors to incorporate negative equity as a part of the "total sale price" of a new vehicle in a single financing transaction. 64 F.R. 16614-01, 16617 (adopting revisions to § 226.18(j)

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

(3), Official Staff Interpretations). The Staff Interpretations define the Total Sale Price to include negative equity as follows:

18(j) Total sale price.

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

The highlighted part of the quoted paragraph shows that the Federal Reserve intended that any negative equity amount be added to the cash price on the new vehicle to be shown as a single amount in the "total sale price" disclosure.

Elsewhere the Regulation (12 C.F.R. 226.18(b)) requires that negative equity amounts be shown as part of the "Amount Financed." The implication to the buyer and to the creditor from this single disclosure of the "total price" and "amount financed," (i.e. amount secured) is that the negative equity will have the same status as the cash price of the new vehicle. Since the seller's security interest for the cash price of the new vehicle is indisputably a "purchase-money" security interest, it follows that the Federal Reserve's direction to bundle the negative equity with the cash price is a direction to secure it with a "purchase-money security interest."

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

A. The Uniform Commercial Code

Whether Congress intended a federal definition or a state definition, the state law is a rich source of help.

First consider the breadth of the "purchase-money" umbrella under Article 9 of the UCC. Article 9 is the law of every state – tantamount to federal law on this issue. Comment 3 to 9-103 explains that "purchase-money obligation" reaches more than just the listed price of the item purchased:

> As used in subsection (a) (2), the definition of "purchase-money obligation," the "price" of collateral or at the "value given to enable" includes **obligations for expenses incurred in connection with acquiring rights in the collateral**, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit,

> demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.
>
> The concept of **"purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation.** Thus, a security interest does not qualify as a purchase-money security interest if the debtor acquires property on unsecured credit and subsequently creates the security interest to secure the new purchase. (emphasis added)

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

B. The Motor Vehicle Sales Finance Acts

The end of World War II saw an explosive growth in consumer credit in the United States. A significant part of that consumer credit was installment credit to purchase motor vehicles. To govern that market, many states passed laws called Motor Vehicle Sales Finance Acts. Michigan adopted such an act in 1951; New York adopted its act in 1956.

Although they have similar names, these acts are not uniform (they were not promulgated by the Uniform Law Commissioners), but all of the acts appear to be copied from the same basic template. Because they preceded the federal disclosure law, Truth in Lending, all of them have disclosure requirements similar to those now found in the federal law. For example it is common for these acts to require a specific size of type and to enumerate a list of items that must be expressed in a retail installment sales contract.[6] But the acts went beyond disclosure requirements. They typically establish maximum interest rates, and they often prohibit certain contract terms and outlaw certain creditor behavior. For example the Michigan statute prohibits any clause that would allow a seller to accelerate the balance on a contract because the seller "deems himself to be insecure." (M.C.L. §492.114(b)).

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

With the advent of negative equity financing in the 1990s, many states amended their acts to deal with that practice. New York is a good example. In

[6] *See, e.g.*, M.C.L. § 492.112(e), Cal. Civ. Code §2981.9, 69 P.S. § 613.D.

1994 the New York Legislature added the following language to the definition of "cash sale price" in N.Y. Pers. Prop. Law § 301(6) (McKinney Supp. 2006):

> It also may include the unpaid balance of any amount financed under an outstanding motor vehicle loan agreement or motor vehicle retail instalment contract or the unpaid portion of the early termination obligation under an outstanding motor vehicle retail lease agreement.

The quoted language deals explicitly with negative equity and lease obligations owed on cars that are traded in. It includes the negative equity amount in the "cash sale price" and so treats it exactly like the sales price of the newly purchased car.

Now consider the various parts of the law to see how the New York Legislature would treat the security interest that results in a transaction in which negative equity on a trade-in has been added to the price of a new car. The definition of "cash sale price" also states that it is the price stated "in a retail installment contract" N.Y. Pers. Prop. Law § 301(6) (McKinney Supp. 2006).

The New York law so states a syllogism that leads to the conclusion that negative equity amounts rolled into new contracts are to be treated as covered by a "purchase-money security interest." It proceeds as follows: 1) negative equity amounts are part of the "cash sale price;" 2) the "cash sale price" is the price stated in a "retail installment contract;" 3) a "retail installment contract" is one that creates a "purchase-money security interest," THEREFORE the negative equity is secured by a purchase-money security interest. If one pays attention to New York

law either directly or by analogy, he cannot escape the conclusion that negative equity, included in a new contract, is covered by a purchase-money security interest. In this case that law commands a decision for GMAC, either directly or by analogy.

C. Commercial Practice and Public Policy

Since all decisions interpreting commercial law have the capacity to facilitate or impair commercial activity, courts should be sensitive to commercial practice when they are interpreting federal and state statutes. The commercial practice in this case supports the proposition that including negative equity into a new contract creates a purchase-money security interest. So far as one can tell from reading the cases, the law review literature, and the contracts, the consumer and creditor parties to these transactions treat the negative equity portion of the new debt in exactly the same as every other part of the debt. They regard it as secured by the newly sold vehicle in exactly the same way as every other part of the debt. Presumably the debtor chooses this mode of financing his debt over other alternatives because it is less expensive or more convenient than those alternatives.

In evaluating the commercial practice that underlies these cramdown cases, one should remember that these debtors are always employed (otherwise they would not be in Chapter 13), and they are always the owners of vehicles. These

cases do not involve powerless consumers who must accept anything that a creditor offers. Here the creditor's offer is knowingly accepted by the debtor.

Ms. Peaslee traded her 1999 Chevy Blazer on a 2004 Pontiac Grand Am worth about $23,000; she bought the new Grand Am less than two years before she filed in Chapter 13. The dealer's willingness to finance the negative equity of $5,980 on her old Blazer enabled Ms. Peaslee to complete the deal as she chose. It may have enabled Ms. Peaslee to borrow the $5,980 at a better annual percentage rate than she could have had elsewhere. In any case, it facilitated her purchase of a vehicle that she was under no compulsion to purchase.

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

IV. CONCLUSION

The words, the statutory history, the Congressional intent, the analogies to the federal Truth in Lending law and, not least, the explicit statement of the New York legislature in its Motor Vehicle Retail Instalment Sales Act, direct this Court to affirm Judge Larimer's decision for GMAC.

This the 14th day of January, 2008.

Respectfully submitted,

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I certify that this brief complies with the type-volume limitation set forth in Federal Rules of Appellate Procedure 32(a)(7)(B)(i) and 29(d), it contains less then 7,000 words. According to the word count feature in Microsoft Word, the brief contains 5,668 words.

/s/ James J. White
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