No. 08-60037

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re MARLENE A. PENROD,
Debtor.

AMERICREDIT FINANCIAL SERVICES, INC.
Creditor-Appellant

— v. —

MARLENE A. PENROD,
Debtor-Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY PANEL
FOR THE NINTH CIRCUIT – NOS. 07-1360, 07-1368

APPELLEE'S BRIEF

KENNETH N. KLEE
KLEE, TUCHIN, BOGDANOFF & STERN LLP
1999 AVENUE OF THE STARS
THIRTY-NINTH FLOOR
LOS ANGELES, CA 90067-6049
310.407.4000

CRAIG V. WINSLOW
LAW OFFICES OF CRAIG V. WINSLOW
630 N. SAN MATEO DRIVE
SAN MATEO, CA 94401
650.347.5445

March 13, 2009

TABLE OF CONTENTS

TABLE OF CONTENTS i

TABLE OF AUTHORITIES iii

STATEMENT OF RELATED CASES 1

JURISDICTIONAL STATEMENT 1

STATEMENT OF THE ISSUE 1

STATEMENT OF THE CASE 1

STATEMENT OF FACTS 2

SUMMARY OF ARGUMENT 3

ARGUMENT 5

I. STATUTORY FRAMEWORK 5

A. The "Hanging Paragraph" 5

B. In light of longstanding bankruptcy policies, the provisions of the "hanging paragraph" of section 1325(a) should be construed narrowly 6

II. The Bankruptcy Appellate Panel correctly concluded that state law defines the creditor's purchase money security interest. 12

A. Whether funds advanced to pay off negative equity constitute a purchase money obligation is determined by California law 12

B. Creditor has argued for the first time on appeal that the definition of purchase money security interest may be determined without reference to state law. 15

III. Funds advanced to pay off negative equity for a trade-in vehicle do not constitute a purchase money obligation under the California Commercial Code. 16

A. Because the transaction at issue in this case is a credit sale transaction, the only relevant inquiry relates to the "price" of the collateral. 16

B. Neither "price" or "value given to enable" include the payoff of negative equity on a trade-in vehicle. 23

IV. Terms used in consumer protection statutes, such as the federal Truth In Lending Act and the California AFSA, enacted for entirely different purposes than the UCC, should not control the meaning of "purchase money obligation. 29

A. The federal Truth In Lending Act has no bearing on the definition of "purchase money obligation" under the UCC. 29

B. Similarly, the California Automobile Finance Sales Act is a wholly inappropriate standard for defining "purchase money obligations" and "purchase money security interests." 34

C. The Bankruptcy Appellate Panel correctly held that TILA and the California AFSA, which are consumer protection statutes, should not be read in *para materia* with the California Commercial Code. 37

V. The Court's best guess as to legislative intent is insufficient to overcome the plain language of the statute. 39

CONCLUSION 43

TABLE OF AUTHORITIES

Cases

In re Acaya,
369 B.R. 564 (Bankr. N.D. Cal. 2007) 17, 36, 37

Broad v. Sealaska Corp.,
85 F.3d 422 (9th Cir. 1996) 16

In re Brown, 346 B.R. 868
(Bankr. N.D. Fla. 2006) 39

Bryant v. Securities Inv. Co.,
102 So. 2d 701 (Miss. 1958)..35

Butner v. United States,
440 U.S. 48, 120 S. Ct. 1951 (2000) 13, 14

In re Callicott,
396 B.R. 506 (E.D. Mo. 2008) 17, 26, 27

Circuit City Stores v. Adams,
532 U.S. 105, 121 S. Ct. 1302, 149 L.Ed 234 (2001) 42

In re Crawford,
397 B.R. 461 (Bankr. E.D. Wis. 2008)....................................17, 24, 30

In re Ford,
2008 WL 1925153 (Bankr. E.D. Wis. 2008)...6

Garcia v. United States,
469 U.S. 70, 105 S. Ct. 479, 83 L.Ed.2d 474 (1984). 42

In re Graupner,
356 B.R. 907 (Bankr. M.D. Ga. 2006),
aff'd 537 F.3d 1295 (11th Cir. 2008)...17, 42

Graupner v. Nuvell Credit Corp.,
537 F.3d 1295 (11th Cir. 2008) 25

GMAC v. Horne,
390 B.R. 191 (E.D. Va. 2008) 22

In re Hall,
2008 WL 5102274 (Bankr. S.D. W.Va. Dec. 3, 2008) 14

In re Hargrove,
2008 WL 5170399 (Bankr. M.D. Tenn. Dec. 10, 2008) 14

In re Hayes,
376 B.R. 655 (Bankr. M.D. Tenn. 2007)..17

Howard Delivery Serv., Inc. v. Zurich Am. Ins., Co.,
547 U.S. 651, 126 S. Ct. 2105 (2006) 7, 8

Johnson v. County of Fresno,
11 Cal. App. 4th 1087 (Cal. App. 2 Dist. 2005)..18

Juarez v. Arcadis Financial, Ltd,
152 Cal. Rptr.3d 382 (Cal. App. 4 Dist. 2007)..36

Kahrer v. Ameriquest Mortgage Co.,
418 F. Supp. 2d 748 (W.D. Pa. 2006) 26

In re Kaspar,
125 F.3d 1358 (10th Cir. 1997) 8

In re Kenney,
2007 WL 1412921 (Bankr. E.D. Va. May 10, 2007), *rev'd in part by Tidewater Finance Co. v. Kenney*, 531 F.3d 312 (4th Cir. 2008) 39

Kokoszka v. Belford,
417 U.S. 642 (1974)...6

Laubach v. Fidelity Consumer Finance Co.,
686 F. Supp. 504 (E.D. Pa. 1988)..26

In re Look,
383 B.R. 210 (Bankr. D. Me. 2008) 17

In re Long,
519 F.3d 288 (6th Cir. 2008) 40, 42

In re Mancini,
390 B.R. 796 (Bankr. M.D. Pa. 2008)...17

McGowan v. King, Inc.,
569 F.2d 845 (5th Cir. 1978) 31

Medical Bd. of California v. Superior Court,
88 Cal. App. 4th 1001 (2001) 38

In re Miller,
2008 WL 5539811 (Bankr D. Kan. 2008)...17

In re Mitchell,
379 B.R. 131 (Bankr. M.D. Tenn. 2007)..17

In re Muldrew,
396 B.R. 915 (E.D. Mich. 2008) 25

In re Munzberg,
388 B.R. 529 (Bankr. D. Vt. 2008) 17

In re Peaslee, [Peaslee I]
358 B.R. 545 (Bankr. W.D.N.Y. 2006).. 10

In re Peaslee, [Peaslee II]
373 B.R. 252 (W.D.N.Y. 2007).. 10, 22, 40

In re Peaslee, [Peaslee III]
547 F.3d 177 (2d Cir. 2008). 10, 14

In re Penrod,
392 B.R. 835 (B.A.P. 9th Cir. 2008) 14, 17, 18, 25

In re Quick,
371 B.R. 459 (B.A.P. 10th Cir. 2007), *rev'd by In re Ballard*, 526 F.3d 634 (10th Cir. 2008)...40

In re Sanders,
377 B.R. 836 (Bankr. W.D. Tex. 2007) 17, 27

In re Saylor,
108 F.3d 219 (9th Cir. 1997) 8

In re Schwalm,
380 B.R. 630 (Bankr. M.D. Fla. 2008) 12

Thomas v. Knickerbocker Operating Co.,
108 N.Y.S. 2d 234 (N.Y. Sup. Nov. 19, 1951) 35

Travelers Cas. and Sur. Co. of America v. Pacific Gas & Electric Co.,
549 U.S. 443 (2007) 13

Trustees of Amalgamated Ins. Fund v. McFarlin's Inc.,
789 F.2d 98 (2d Cir. 1986) 7

Walker v. Superior Court,
47 Cal.3d 112, 763 P.2d 852 (1988) 38

In re Williams,
2007 WL 2122131 (Bankr. E.D. Va. Jul. 19, 2007) 40

In re Zehrung,
351 B.R. 675 (W.D. Wis. 2006) 40

Statutes

11 U.S.C. §101 12

11 U.S.C. § 506 ....5, 7, 9

11 U.S.C. §§ 1322(a)(3) 6

11 U.S.C. § 1322(a)(4) 9

11 U.S.C. § 1322(b)(2) 6

11 U.S.C. § 1325(a) 1, 3, 5, 7

11 U.S.C. § 1325(a)(5)...9

Consumer Credit Protection Act, Pub. L. No. 90-321 (May 29, 1968)...................30

Cal. Civ. Code. § 2981 ....34, 35

Cal. Com. Code § 9101, Comment 1 38

Cal. Comm. Code § 9103...3, 21

Cal. Comm. Code § 9103(a)(2)...18

Cal. Comm. Code § 9103(b)(2) 28

Cal. Comm. Code § 9103(b)(3) 29

Cal. Comm. Code § 9103 (Comment 3) 23

U.C.C. § 9-103 ....12, 20, 24

U.C.C. § 9-103(b)(2)...28

U.C.C. 9-107 (former)...20, 24

<u>Regulations</u>

12 C.F.R., § 226.4(a)...30

2 C.F.R. § 226.8(c)(8)(ii)(1980) 31

12 C.F.R. § 226.8(c)(8)(ii) 31

12 C.F.R. § 226.18(j) 31, 33

Official Staff Commentary § 226.2(a)(18)-3 (Supp. 1 to Part 26) 32, 33

Legislative History

H.R. Rep. 109-31, Pt. 1, 109th Cong., 1st Sess. (2005). 10, 41

15 California Assembly Interim Committee Reports No. 24 (1960) 35

Cal. Assem. Com. On Judiciary, Analysis of Sen. Bill 1092
(1999-2000 Reg. Sess.)..36, 37

Other Authorities

White & Summers, Uniform Commercial Code, § 33-5 (4th Ed.)...................19, 20

Hawkins & Miller, UCC Series §9-103:1 (Rev. Art. 9) 20, 21

Retail Instalment Sales Legislation, 58 Colum. L. Rev. 854 (1958).......................34

Project: Legislative Regulation of Retail Installment Financing,
7 U.C.L.A. L. Rev. 618, 670 (1960)...36

STATEMENT OF RELATED CASES

Debtor is not aware of any related cases pending in this Court.

JURISDICTIONAL STATEMENT

Appellee concurs with Appellant's Jurisdictional Statement.

STATEMENT OF THE ISSUE

The issue in this appeal is whether the portion of the debtor's obligation under a retail sales installment sales contract that is attributable to advances used to pay a pre-existing debt is entitled to protection under the provisions of the hanging paragraph of 11 U.S.C. § 1325(a).[1]

STATEMENT OF THE CASE

Appellee concurs with Appellant's statement regarding the standard of review.

[1] After concluding that Americredit's claim was part purchase money and part non-purchase money, the Bankruptcy Appellate Panel adopted a "dual status" rule which required the purchase money portion to be paid in full, and the non-purchase money portion paid pro rata with other unsecured creditors. The application of the dual status rule is not an issue on appeal.

STATEMENT OF THE FACTS

The facts are accurately set forth in the opinion of the bankruptcy court. To the extent that Appellant's Statement of Facts reiterate the findings of the bankruptcy court, Appellee accepts those facts.

The Debtor agrees with the statement that the bankruptcy appellate panel concluded that funds advanced for negative equity did not meet the 'purchase money security interest' requirement of the hanging paragraph. However, the Debtor disputes that the BAP "held that all other charges evidenced by the Contract met that requirement." *Americredit Br.* at 5. The issue of whether other charges financed under the contract satisfied the purchase money security interest requirement was not before the BAP and the BAP made no findings as to these other charges. Similarly, the BAP made no finding that the Retail Installment Sales Contract complied "in all respects with the California Automobile Finance Act," an issue that was also not before the court. *Americredit Br.* at 2-3.

SUMMARY OF ARGUMENT

The 2005 amendments created an exception to the general rule under which debtors are permitted to modify the right of creditors. Because this exception runs counter to longstanding bankruptcy policies promoting a fresh start for debtors and ensuring equality of distribution among creditors, it should be narrowly construed. Indeed, the exception created by the "hanging paragraph" at the end of section 1325(a) is carefully limited in time, by type and use of the goods, and by the type of claim protected. Specifically, one requirement is that the creditor must have a purchase money security interest securing the debt that is the subject of the claim. The term "purchase money security interest" is not defined in the Bankruptcy Code. But, the term does have a well-settled meaning under the Uniform Commercial Code (U.C.C.). Accordingly, this Court should look to the U.C.C., codified in California as Cal. Comm. Code § 9103, to define the extent of Americredit's purchase money security interest.

An upside-down car is one in which in which the value of the car is less than the amount owed on it. It is not unusual for owners with longer-term loans, low or no down payments, and/or cars that are depreciating rapidly to be "upside-down." When the owner of an

upside-down car wants to trade-in that car and buy a new car, not only must she pay the purchase price of the new car, the negative equity on the old car must also be paid off. While it is common for debtors to finance the payoff of the negative equity, funds advanced to pay off this unsecured debt to the prior car lender do not constitute a purchase money obligation secured by the new car under the Uniform Commercial Code. Such funds are not part of the "price" of the vehicle, nor are they obligations for expenses incurred in connection with acquiring rights in the collateral. The financing of negative equity may be convenient but it is not necessary to acquire rights in the new collateral.

The Americredit seeks to expand the very narrow exception created by Congress far beyond its intended scope—by converting the unsecured negative equity from a trade-in vehicle into a purchase money obligation that is protected from bifurcation. A ruling in favor of Creditor on this issue paves the way for them to manipulate transactions in ways that would permit the creditor to transform an otherwise unsecured debt into one that could not be modified in bankruptcy, by simply insisting that refinancing the additional unsecured debt is a condition of granting a purchase money loan.

ARGUMENT

I. Statutory Framework

A. The "Hanging Paragraph"

The 2005 amendments to the Bankruptcy Code added language at the end of section 1325(a) that makes section 506 inapplicable to certain claims. Because the language is unenumerated, most courts refer to it as the "hanging paragraph." The paragraph 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 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, or if the collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding the filing.

The claims encompassed by the hanging paragraph are two types of debt secured by purchase money security interests. The first type is a purchase money security interest for a debt incurred within 910 days preceding the filing of the petition, if the collateral for that debt consists of a motor vehicle that was acquired for the personal use of the debtor. The second type of claim encompassed by this new language is a purchase money security interest for a debt incurred within one year preceding the filing of the petition if the collateral

consist of any other thing of value. This case involves the first type of claim. However, because the term "purchase money security interest" is applicable to both types of claims, the impact of this Court's decision will extend far beyond creditors that finance motor vehicle sales. *See In re Ford*, 2008 WL 1925153 (Bankr. E.D. Wis. 2008)("It is relatively well settled that…the creditor must have a purchase money security interest whether the collateral is a '910-day vehicle' or 'any other thing of value'").

B. In light of longstanding bankruptcy policies, the provisions of the "hanging paragraph" of section 1325(a) should be construed narrowly.

The two main objectives of the Bankruptcy Code are to provide a fresh start for the debtor and the fair and orderly repayment of creditor to the extent possible. *Kokoszka v. Belford*, 417 U.S. 642, 645 (1974). To foster a debtor's fresh start, the Bankruptcy Code generally permits debtors to modify the rights of secured and unsecured creditors to reflect what they would receive in a liquidation of the debtor's assets. 11 U.S.C. § 1322(b)(2). To ensure the fair repayment of creditors longstanding bankruptcy policy favors equality of distribution among like creditors. *See* 11 U.S.C. §§ 1322(a)(3);

1322(b)(1). *See Howard Delivery Serv., Inc. v. Zurich Am. Ins., Co.*, 547 U.S. 651, 667, 126 S. Ct. 2105, 2116 (2006).

Debtors frequently modify the rights of secured creditors by splitting or "bifurcating" the creditor's claim into two parts: the secured portion which is equal to the value of the collateral and an unsecured portion represented by any amount owed over the value of the collateral. 11 U.S.C. § 506. The 2005 enactment of the "hanging paragraph" at the end of section 1325(a) created an exception to this common method of dealing with secured creditors. The exception at issue in this case, however, is carefully limited 1) in time, 2) by type and use of the goods, and 3) by the type of claim protected. Specifically, for motor vehicles, the debt must have been incurred within 910 days of the filing of the petition, 2) the collateral must be a motor vehicle acquired for personal use of the debtor and 3) the creditor must have a purchase money security interest securing the debt that is the subject of the claim. 11 U.S.C. § 1325(a).

As an exception to the general bankruptcy rules favoring equal treatment of creditors and permitting debtors to modify claims, the elements of the hanging paragraph should be construed narrowly. *Trustees of Amalgamated Ins. Fund v. McFarlin's Inc.*, 789 F.2d 98

(2d Cir. 1986)("Because presumption in bankruptcy is that the debtor's limited resources will be equally distributed among his creditors, statutory priorities are narrowly construed."). The hanging paragraph's preference in favor of a certain class of creditors should be strictly interpreted because granting Creditor protection under the paragraph will reduce funds available to pay unsecured creditors.[2] *See Howard Delivery,* 547 U.S. at 667.

Similarly, exceptions to general bankruptcy rules that limit the debtor's opportunity to obtain a fresh start should also be construed narrowly. *See In re Saylor*, 108 F.3d 219, 221 (9th Cir. 1997)(exceptions to dischargeability are to be narrowly construed); *In re Miller,* 454 F.3d 899 (8th Cir. 2006)("Section 549(c) serves as an exception to the automatic stay imposed when a bankruptcy petition is filed, and as such, it should be construed narrowly"); *In re Kaspar*, 125 F.3d 1358, 1361 (10th Cir. 1997)("[e]xceptions to discharge are to be narrowly construed, and because of the fresh start objectives of bankruptcy, doubt is to be resolved in the debtor's favor). Under chapter 13 of the Bankruptcy Code, holders of allowed secured claims

[2] Distribution of the debtor's assets in bankruptcy is almost always a zero-sum game because the claims against the debtor typically far exceed the value of the estate.

and priority unsecured claims are paid in full.[3] The reclassification of unsecured debt into secured debt that Americredit proposes will create a higher amount of unsecured debt, which in turn may make a chapter 13 infeasible for a debtor. Because the exception provided in the hanging paragraph impedes debtors' fresh start the language should be construed narrowly.

The language of the hanging paragraph, with its clearly defined time frame and specification of covered claims, indicates that Congress was concerned with the rapid initial depreciation of motor vehicles and other personal property securing debts incurred to purchase that property. Congress felt that the purchase money obligations should not be subject to a cramdown shortly after the purchase. Creditor, however, seeks to expand the very narrow exception created by Congress far beyond its intended scope—by converting the unsecured negative equity from a trade-in vehicle into a purchase money obligation that is protected from bifurcation. Despite Creditor's suggestion to the contrary, there is simply no

---

[3] Certain domestic support obligations classified as priority unsecured claims are not required to be paid in full. 11 U.S.C. § 1322(a)(4). Allowed secured claims generally must be paid in full to the extent that they are provided for in the debtors chapter 13 plan. 11 U.S.C. §§ 506, 1325(a)(5). Because the hanging paragraph makes the language of 506 inapplicable, creditors with covered claims have higher "allowed secured claims."

legislative history with respect to the hanging paragraph that supports the position that Creditor should receive a windfall from financing unsecured antecedent debt along with the purchase price of the new vehicle.[4] *See* Section V, *supra.* Indeed, a ruling in favor of the Creditor would "transform knowingly refinanced unsecured negative equity debt into secured debt not supported by collateral value, and then require it to be paid in full to the detriment of other unsecured creditors."[5] It would allow a creditor to manipulate a transaction in a way that would permit the creditor to transform an initially unsecured debt into one that could not be modified in bankruptcy, by simply

---

[4] The legislative history merely mirrors the language of the statute. For example, the House Committee Report concerning the hanging paragraph summarizes the change as follows: Section 306(b) adds a new paragraph to section 1325(a) of the Bankruptcy Code specifying that Bankruptcy Code section 506 does not apply to a debt incurred within the two and one-half year period preceding the filing of the bankruptcy case if the debt is secured by a purchase money security interest in a motor vehicle acquired for the personal use of the debtor within 910 days preceding the filing of the petition. Where the collateral consists of any other type of property having value, section 306(b) provides that section 506 of the Bankruptcy Code does not apply if the debt was incurred during the one-year period preceding the filing of the bankruptcy case. H.R. Rep. 109-31, Pt. 1, at 72, 109th Cong., 1st Sess. (2005).

[5] *In re Peaslee*, 358 B.R. 545, 556 (Bankr. W.D.N.Y. 2006)[Peaslee I], *rev'd by* 373 B.R. 252 (W.D.N.Y. 2007)[Peaslee II]. In *Peaslee III*, the Second Circuit Court of Appeals recently certified the negative equity/purchase money issue to the New York Court of Appeals. *In re Peaslee*, 547 F.3d 177 (2d Cir. 2008).

insisting that refinancing of additional unsecured debt is a condition of granting a purchase money loan.

For example, a borrower owes an obligation to a used car dealer that is outside of the scope of the hanging paragraph. The borrower owes more on the vehicle than the vehicle is worth—the car is "upside-down." The borrower defaults on the loan because of financial difficulty. Rather than repossess the car based on its contractual rights, car creditor urges debtor to consider purchasing another car and rolling over the negative equity into a new loan. According to Americredit's position, the negative equity on the old loan would become a purchase money obligation with respect to the new loan and creditor has greatly improved its position vis-à-vis other creditors and in the event the debtor files for bankruptcy.

Similarly, creditors may coerce debtors into entering other types of transactions that greatly improve their position. A creditor or collection agency seeking to collect a totally unsecured debt could transform it into a "secured debt" impervious to modification in bankruptcy by entering into a payment agreement with the debtor that

required the purchase of a small value item with both the purchase price and the previously unsecured debt secured by that item.[6]

This Court should not open the door to more abusive practices committed by the credit industry upon ordinary consumers.

II. The Bankruptcy Appellate Panel correctly concluded that state law defines the creditor's purchase money security interest.

A. Whether funds advanced to pay off negative equity constitute a purchase money obligation is determined by California law.

The Bankruptcy Code does not define the term "purchase money security interest." *See* 11 U.S.C. §101 (definitional section of the Bankruptcy Code). However, it is a well-known term of art under Article 9 of the U.C.C. Consequently, the vast majority of courts considering the question of whether "negative equity" is part of a creditor's purchase money security interest have looked to state law for an answer. *See In re Schwalm*, 380 B.R. 630 (Bankr. M.D. Fla. 2008)("The parties in this case, and all of the reported decisions, are in accord that the analysis must therefore begin with the definition of PMSI in Section 9-103 of the UCC" as codified by state law).

[6] As noted above the "purchase money security interest" requirement applies to both types of claims covered by the hanging paragraph. In this example, financing the purchase of a low value item, such as a toaster oven, and requiring the debtor to roll over an unsecured debt would put creditor in a superior position.

Americredit's assertion that "purchase money security interest" can be defined without reference to state law is contrary to well-settled precedent of the Supreme Court. Most recently, the Supreme Court has stated that:

> "Indeed, we have long recognized that the " 'basic federal rule' in bankruptcy is that state law governs the substance of claims, Congress having 'generally left the determination of property rights in assets of a bankruptcy's estate to state law.'"

Travelers Cas. and Sur. Co. of America v. Pacific Gas & Electric Co., 549 U.S. 443, 450-51 (2007)(citations omitted). The same principles were espoused by the Supreme Court in *Butner v. United States*, 440 U.S. 48, 120 S. Ct. 1951 (2000). In *Butner*, the Court was asked to determine the rights of a second mortgagee to rents collected during the period between the mortgagor's bankruptcy and the foreclosure sale of the property. *Id.* at 49. The circuit courts were split on whether the mortgagee's right pursuant to a security interest were to be determined with reference to state law, or by reference to a "federal law of equity." *Id*. at 52-53. Under the "federal law of equity rule" some courts afforded mortgagees a secured interest in rents even if state law did not recognize any such interest. *Id*. at 53. Americredit's argument is akin to the "federal rule of equity" because it seeks to have its claim recognized as a "purchase money security interest"

without reference to state law, and even if state law would not so characterize its claim.

The Supreme Court rejected the "federal rule of equity" finding that:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of the bankruptcy.' *Lewis v. Manufacturers National Bank*, 364 U.S. 603, 609, 81 S.Ct. 347, 350, 5 L.Ed.2d 323. The justification for application of state law are not limited to ownership interest, they apply with equal force to security interests …"

Butner, 440 U.S. at 55. Noting that historically courts have "freely borrowed from the UCC when interpreting the provisions that contained "purchase money security interest," the bankruptcy appellate panel also concluded that state law should control the definition of "purchase money security interest" within the hanging paragraph. *In re Penrod*, 392 B.R. 835, 843-44 (B.A.P. 9th Cir. 2008)(citations omitted); *accord In re Peaslee*, 547 F.3d 177, 184-85 (2d Cir. 2008)(stating that "state law governs the defintion of PMSI in

the hanging paragraph"). There being no good reasons to depart from the well-settled definition of "purchase money security interest" under California law, this Court should reject Americredit's entreaty to create a federal law definition of the term.

B. Creditor has argued for the first time on appeal that the definition of purchase money security interest may be determined without reference to state law.

For the first time on appeal, Americredit argues that this Court should only look to state law if it finds the language of the hanging paragraph ambiguous. *Americredit Br.* at 7. In essence, Americredit argues for a federal definition of "purchase money security interest" based on the "plain language" and "legislative history" of the hanging paragraph. While Americredit has devoted nearly half of its brief to making this argument, it is an argument that it did not raise at either the bankruptcy court or the bankruptcy appellate panel.

To the contrary, in both lower courts Americredit argued that California state law controlled the question of whether it had a "purchase money security interest." *Americredit BAP Br.* at 8-10 ("Whether a Creditor has a 'Purchase Money Security Interest' is Determined by Reference to State Law Not The Bankruptcy Code"); *Americredit Bankr. Br.* at 5 ("Because the Bankruptcy Code does not

define the phrase "purchase money security interest," the Court may refer to state law to provide a definition").

This Court has repeatedly instructed that it will not hear an issue raised for the first time on appeal. *See, e.g., Broad v. Sealaska Corp*., 85 F.3d 422, 430 (9th Cir. 1996)(refusing to consider due process claim raised for the first time on appeal). Because Americredit argues for the first time in its opening brief to this Court that a federal definition of "purchase money security interest" should apply, this Court should decline to consider the argument.

III. Funds advanced to pay off negative equity for a trade-in vehicle do not constitute a purchase money obligation under the California Commercial Code.

A. Because the transaction at issue in this case is a credit sale transaction, the only relevant inquiry relates to the "price" of the collateral.

The majority of courts considering whether funds advanced to pay off negative equity on a trade-in vehicle constitutes a purchase

money obligation under the U.C.C. have concluded that they do not.[7] The definition of a purchase money security interest is contained in § 9-103 of the Uniform Commercial Code. In California, section 9-103 of the U.C.C. is codified at California Commercial Code § 9103. The starting point for defining a "purchase money security interest" is a "purchase money obligation" which means "an obligation of an obligor incurred as all or part of the price of the collateral or for given value to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." Cal. Comm. Code § 9103 (a)(2), (b). As the Bankruptcy Appellate Panel recognized this definition encompasses two types of purchase money obligations. *In re Penrod*, 392 B.R. 835. 844-45 (B.A.P. 9th Cir. 2008).

---

[7] *See, e.g., In re Penrod,* 392 B.R. 835 (9th Cir. BAP 2008); *In re Callicott*, 396 B.R. 506 (E.D. Mo. 2008); *In re Hargrove*, 2008 WL 5170399 (Bankr. M.D. Tenn. Dec. 10, 2008); *In re Hall*, 2008 WL 5102274 (Bankr. S.D. W.Va. Dec. 3, 2008); *In re Miller*, 2008 WL 5539811 (Bankr D. Kan. 2008); *In re Crawford*, 397 B.R. 461 (Bankr. E.D. Wis. 2008); *In re Mancini,* 390 B.R. 796 (Bankr. M.D. Pa. 2008); *In re Munzberg,* 388 B.R. 529 (Bankr. D. Vt. 2008); *In re Look,* 383 B.R. 210 (Bankr. D. Me. 2008); *In re Mitchell*, 379 B.R. 131 (Bankr. M.D. Tenn. 2007); *In re Hayes*, 376 B.R. 655 (Bankr. M.D. Tenn. 2007); *In re Sanders*, 377 B.R. 836 (Bankr. W.D. Tex. 2007); *In re Acaya*, 369 B.R. 564 (Bankr. N.D. Cal. 2007). Even the *Graupner* bankruptcy court noted the "seemingly obvious conclusion" that Creditor "does not hold a purchase money security interest". *In re Graupner*, 356 B.R. 907, 917 (Bankr. M.D. Ga. 2006), *aff'd* 537 F.3d 1295 (11th Cir. 2008).

The first type is a credit sale transaction in which the seller extends credit to the buyer. For example, when an appliance store extends credit to a borrower for the purchase of a washer and dryer that purchase is considered a credit sale transaction. Similarly, when a car dealer extends credit to a borrower to purchase a vehicle the transaction is a credit sale. The transaction will maintain its character as a credit sale transaction even if the original creditor assigns its rights to another entity. *See, e.g., Johnson v. County of Fresno*, 111 Cal. App. 4th 1087, 1096 (Cal. App. 2 Dist. 2005)(assignee stands in the shoes of the assignor).

In credit sales transactions, the seller's purchase money security interest extends to all or part of the "price" of the collateral. By the plain terms of the § 9103(a)(2), a purchase-money obligation in a credit sale can be part of the "price" of the collateral, or it can be the whole "price" of the collateral, but it cannot be an obligation that is greater than the "price" of the collateral.

The second type of purchase money security interest described in section 9103(a)(2) is an enabling loan transaction in which a third-party lender provides funds to a borrower to purchase goods from a seller. *See Penrod*, at 845. The lender's purchase money obligation

includes the value that the lender gave to the borrower, which enabled the borrower to acquire rights in the goods, and which value the borrower, in fact, used to acquire the goods. For example, a credit union may obtain a purchase money security interest by loaning money to a borrower, which the borrower in turn uses to purchase a vehicle from a car dealer.

The two types of transactions are explained by James J. White and Robert S. Summers, leading experts in the field as follows:

> The secured parties described in subsection (a) are familiar: a seller of a refrigerator who retains the security interest for part of the price, a seller of an automobile who retains the security interest for part of the price, a seller who has, in effect, made a loan by selling goods on credit. Although the Code does not define the word "seller," we anticipate no trouble for courts in applying subsection to the buyer under a cross-collateral provision whereby the price of one item is secured, not only by that item, but by other items as well (see Section 4-2). Under 9-107 (a) and under the cases the seller does not have a purchase money interest to the extent his debt is secured by goods other than those he sold.
>
> Subsection (b) of 9-107 describes a less familiar but equally important transaction in which a lender agrees to lend money to a debtor so that he may, for example, buy a new line of merchandise or purchase some new equipment. To insure that the pearly gates leading to a purchase money lender's Valhalla are not open too wide, the Code draftsmen have drafted 9-107 (b) rather narrowly. First, the lender must have given "value" by making advances or incurring an obligation. Comment 2

> tells us that this requirement excludes from the purchase money category "any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt."

White & Summers, Uniform Commercial Code, § 33-5 (4th Ed.).

A comparison of the former section 9-107 and the current section 9-103 reveals that the substance of the law has not changed. The two categories of purchase money obligations were set out in separate subparagraphs of section 9-107 and have now been combined in one subparagraph of section 9-103(a). This combination of subparagraphs (a) and (b) of former section 9-107 into one paragraph in current section 9-103 has not altered the U.C.C.'s recognition of the two types of purchase money obligation identified by White & Summers. Another leading treatise on the U.C.C. states with respect to section 9-103 the following:

> Revised Section 9-103 deals with an important concept for Article 9 purposes, the purchase-money security interest or PMSI in goods. It divides the types of PMSIs into two: those which are direct and those which are enabling. Although the Code's treatment of direct and enabling purchase-money security interests is the same, the drafters, by this division, intended to make clear that they viewed purchase-money financing transactions more broadly than merely those when a person directly related to the transaction (e.g., a seller) extended credit and retained a security interest. Instead, the term includes those types of direct PMSIs, but also those types of PMSIs that are taken by a person who makes advances or incurs

> an obligation to enable the debtor to acquire rights in or the use of collateral.

Hawkins & Miller, UCC Series §9-103:1 (Rev. Art. 9) (footnotes omitted).

In this case the original lender was Hansel Ford, who sold the vehicle to the debtor. Americredit is the assignee of Hansel Ford and assumed its rights. Therefore, under the former section 9-107, Americredit's rights, if any, as a result of a purchase money obligation would have arisen pursuant to section 9-107(a). Under current law, Cal. Comm. Code § 9103, its rights arise under the phrase "obligation of an obligor incurred as all or part of the price of the collateral," and not as a lender who "gave value to enable the obligor to acquire rights in the collateral." Because the transaction at issue in this case is a credit sale transaction, the only relevant inquiry relates to the "price" of the collateral.

Americredit seeks to expand the reach of the purchase money concept by suggesting it has a purchase money security interest if its claim falls into either category when in fact the two type of purchase money security interests are mutually exclusive. That is, Americredit seeks two bites at the proverbial apple, when only one is available under the section 9103.

Specifically, Americredit erroneously states that negative equity should be considered purchase money if it is part of the "price" of the collateral <u>OR</u> if it was value given to enable the debtor to acquire rights in the collateral. *Americredit Br.* at 29 ("The two prongs are alternatives, and Ford Credit prevails if it satisfies either prong."). Here Americredit has failed to grasp a fundamental difference in purchase money security interests derived from credit sales (*i.e.*, seller financed transactions) and those derived from enabling loans (*i.e.*, third-party lender transactions). The excerpt from White & Summers quoted above clearly explains that "value given to enable the debtor to acquire rights in or the use is the collateral" is designed not to *expand* the scope of obligations meeting the definition of a purchase money obligation, but only to *identify* the second type of person that could obtain a purchase money security interest: a third-party lender, who can be a purchase money lender. Similarly, many cases relied on by Americredit fail to understand this important difference. *See GMAC v. Horne*, 390 B.R. 191 (E.D. Va. 2008)(concluding "negative equity may be considered as a component of the 'price' and of the 'value given to enable' even though transaction was credit sale not implicating 'value given to enable'); *In re Peaslee*, 373 B.R. 252

(W.D.N.Y. 2007)(considering "price" and "value given" as alternatives rather than mutually exclusive based on the type of transaction).

Even if this Court were to hold that a credit sale, such as the one in this case, could give rise to both types of purchase money security interest, funds advanced to payoff the negative equity on the debtor's trade in vehicle would not satisfy either prong of the "purchase money obligation" definition.

B. Neither "price" or "value given to enable" include the payoff of negative equity on a trade-in vehicle.

The "price" of the collateral or "value given to enable" for purposes of defining a "purchase money obligation" may include obligations for expenses incurred in connection with acquiring right in the collateral, sales taxes, duties, finance charges, freight charges, costs of storage interest, demurrage, administrative charges, expenses of collection and enforcement, and attorney's fees. Cal. Comm. Code § 9103 (Comment 3). Price may also include other obligations that are similar to those items on the enumerated list. *Id.* The pay off of a pre-existing claim or antecedent debt is not included in this list, nor is it an obligation similar to those provided. *See* cases cited, *supra* note 4. In fact, the U.C.C. excludes the payment of antecedent debt from a

purchase money obligation. Comment 2 to U.C.C. § 9-107 (the precursor to U.C.C. § 9-103) explicitly provided that a purchase money security interest could not secure a pre-existing claim or antecedent debt. *See In re Crawford*, 397 B.R. 461, 466-467 (Bankr. E.D. Wis. 2008), and cases cited. In relevant part, Comment 2 to former section 9-107 (which previously defined purchase money security interest) provided:

> Definitions: "Purchase Money Security Interest" - "When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This Section therefore provides that the purchase money party must be one who gives value 'by making advances or incurring an obligation:' the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt."

Though this comment is not included in the comments to § 9-103, Comment 1 to U.C.C. § 9-101 (codified as Cal. Comm. Code § 9101) states that "Comments to former Article 9 will remain of substantial historical value and interest. They also will remain useful in understanding the background and general conceptual approach of this Article." *See also Crawford*, 397 B.R. at 466-467. Furthermore, nothing in the revision of Article 9 suggests that the drafters intended a dramatic departure from the understanding of § 9-107. *Id.* Despite

Americredit's claim to the contrary, funds advanced to discharge debtor's existing indebtedness cannot be part of the creditor's purchase money obligation. *See Americredit Br.* at 39.

Americredit also claims that the characterization of negative equity as a pre-existing debt is inaccurate. The sole support of Americredit's proposition is a conclusory statement without citation from the court in *In re Muldrew*, 396 B.R. 915, 926 (E.D. Mich. 2008). *Americredit Br.* at 39, n.41. However, Creditor itself acknowledges that sums were advanced to "discharge existing indebtedness on a trade-in vehicle." *Americredit Br.* at 2. Creditor does not explain how the payment of another creditor's unsecured claim is not an antecedent debt. *Americredit Br.* at 39-41; *see In re Penrod*, 392 B.R. 835, 842 (B.A.P. 9th Cir. 2008). Nor does Creditor present any argument that overcomes long-standing bankruptcy policy that disfavors the conversion of unsecured claims into secured claims. *Id., citing Dean v. Davis*, 242 U.S. 438, 37 S.Ct. 130 (1917).

Alternatively, Americredit argues, and the Eleventh Circuit Court of Appeal in *Graupner v. Nuvell Credit Corp*., 537 F.3d 1295, 1302 (11th Cir. 2008), found, that the payment of this antecedent debt fits squarely within the term "expenses" because it is a "package

transaction." This reasoning is flawed. "Finance charges, sales taxes and expenses of collection are all rightfully included in the PMSI because they are things that necessarily accompany the purchase of a new car…Paying off the debt on an old car is different." *In re Callicott*, 396 B.R. 506, 509 (E.D. Mo. 2008). Indeed, paying off negative equity is no more closely related to the purchase price than funds advanced to the borrower to pay off, for example, credit card debts to satisfy a creditor's underwriting requirements. Does the payoff of $10,000 in consumer debt become an "expense incurred in connection with acquiring rights in the collateral" if the creditor both requires the debt to be paid off as a condition of extending financing and offers to give the debtor the funds for that purpose? Of course not. *See, e.g., Kahrer v. Ameriquest Mortgage Co*., 418 F. Supp. 2d 748 (W.D. Pa. 2006)(secured lender impermissibly conditioned financing on the payment from the loan proceeds of prior unsecured creditor who had referred borrower to secured lender); *Laubach v. Fidelity Consumer Finance Co.,* 686 F. Supp. 504 (E.D. Pa. 1988)(describing a car finance transaction in which lender required Mr. Copin, a 75-year old borrower, to pay off home mortgage and liens against home and financed the entire transaction), *rev'd* 898 F.2d

907 (3d Cir. 1990)(reversed on preemption grounds). Similarly, a creditor's acceptance of a trade-in vehicle on the condition that the negative equity be paid off and the creditor's willingness to extend the funds to do so does not make it an "expense incurred" to acquire rights in a new vehicle. Clearly, "[o]ne may borrow money to buy something (e.g., a new vehicle), and also borrow additional money for some other purpose (e.g., to pay off the balance of a loan for the trade-in vehicle). The part used to buy something is purchase money obligation. The part used for some other purpose is not." *In re Sanders*, 377 B.R. 836, 853 (Bankr. W.D. Tex. 2007). The creditor's requirement that the debtor retire an existing obligation and providing the debtor the means to do so, does not change the "price" of the new vehicle debtor seeks to purchase. The financing of negative equity may be convenient but it is not necessary to acquire rights in the new collateral. *See Callicott*, 396 B.R. at 509. ('the close nexus required is missing').

Americredit's hypothetical at page 39-40 is inapposite. In that scenario, the Bank lends money to Borrower to purchase a D9 tractor grader from Seller. In Americredit's hypothetical, the proceeds from the Bank loan are given by the Borrower to Seller and in turn those

proceeds are used, in part, by Seller to pay off *Seller's* lien on the equipment. The Borrower has a $100,000 loan secured by a D9 tractor worth $100,000. In the case at bar, the question more appropriately is directed, not to the payment of Seller's creditors, but rather Borrower's other creditors.

The more apt example is as follows: Bank has an outstanding loan to Debtor for $100,000. The loan was originally used to purchase a tractor. The tractor is now only worth $60,000. Debtor now wants to borrow $100,000 from Friendly Finance to purchase a new D9 Tractor. Debtor also wants to sell the old tractor (for $60,000) and have the remaining $40,000 of old debt to Bank rolled into the new loan. When the loan transaction with Friendly Finance is complete, Debtor will owe $140,000, secured by collateral worth $100,000. The $40,000 of old debt is being financed along with the purchase of $100,000 in new equipment and the $40,000 is not considered part of debtor's purchase money obligation.

This conclusion that funds used to pay off negative equity do not constitute a purchase money obligation is bolstered by U.C.C. § 9-103(b)(2), codified in California as Cal. Comm. Code § 9103(b)(2),

which explicitly extends purchase money security interest to antecedent debts *in the case of inventory*:

> A security interest in goods is a purchase money security interest: ...
> (2) if the security interest is in inventory that is or was purchase money collateral, also to the extent that the security interest secures a purchase-money obligation incurred *with respect to other inventory* in which the secured party holds or *held* a purchase money security interest.[8]

Because inventory is a kind of collateral that turns over continuously, this U.C.C. provision creates a special rule that a security interest is still a PMSI even if it secures a pre-existing obligation for inventory that used to be purchase-money collateral but has now been sold, leaving a balance still owing. If a purchase money security interest in ordinary goods could also encompass prior debts, this special provision for inventory would be entirely redundant.

IV. Terms used in consumer protection statutes, such as the federal Truth In Lending Act and the California AFSA, enacted for entirely different purposes than the UCC, should not control the meaning of "purchase money obligation.

A. The federal Truth In Lending Act has no bearing on the definition of "purchase money obligation" under the UCC.

[8] In addition, UCC § 9-103(b)(3) creates a similar special rule for security interests in software.

In 1968, Congress enacted the Truth In Lending Act ("TILA") as part of the Consumer Credit Protection Act. Pub. L. No. 90-321 (May 29, 1968). TILA is primarily a disclosure statute that compels creditors extending credit to consumers to disclose the cost of the credit using a standardized format and terminology defined by the Act itself and by the Federal Reserve Board. The primary goal of TILA is to promote the informed use of credit and encourage comparison shopping by prescribing a uniform standard for disclosing the true cost of credit. In order to achieve this goal, TILA adopts an expansive view of the cost of credit, which includes negative equity, insurance products, and any other cost associated with borrowing money.[9]

Additionally, the Truth In Lending Act contains no definition of "purchase money security interest," which is the language at issue in this case. *See In re Crawford*, 397 B.R. 461, 466 (Bankr. E.D. Wis. 2008). Nor does the TILA define the term "price." Instead, TILA discloses the cost of credit—i.e., the time-price differential—by using the terms "cash price" and "total sale price."

[9] The cost of credit under TILA is referred to as the finance charge, and it includes "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction." 12 C.F.R., § 226.4(a).

i. "Total sale price" describes the amount a buyer would pay in exchange for the ability to pay an obligation over time, not the actual price of the item purchased.

The "total sale price" of the Truth In Lending Act is not, and has never been, a term that defines a "purchase money security interest" or "purchase money obligation" under the U.C.C. Rather, it used expansively to advise consumers of the true cost of credit in credit sale transactions. Under the original version of TILA, credit sellers were required to disclose the "deferred payment price" which represented the total amount the borrower would pay in return for the ability to pay the obligation in installments. 12 C.F.R. § 226.8(c)(8)(ii)(1980). *See McGowan v. King, Inc.*, 569 F.2d 845 (5th Cir. 1978)(failure to use term "deferred payment price" violated Old. 12 C.F.R. § 226.8(c)(8)(ii)). The term "deferred payment price" was later changed to "total sale price" but the meaning remains the same. The "total sale price" is defined as the sum of 1) the cash price; 2) amounts that are financed by the creditor and are not included in the finance charge (e.g., title fees, credit insurance premiums); and, 3) the finance charge. 12 C.F.R. § 226.18(j). The definition creates a clear distinction between the "cash price" and the "total sale price." Under the Federal Reserve Board's Official Supplemental Staff Commentary

the financing of negative equity on a trade-in vehicle is included in the "total sale price," (i.e., the true cost of credit), but it is not included in the cash price of the new automobile. *See* Official Staff Commentary § 226.2(a)(18)-3 (Supp. 1 to Part 26)(describing how to calculate the "total sale price" for a vehicle with a "cash price" of $20,000, negative equity from a trade-in of $2,000, a down payment of $1500).

ii. Creditors are permitted to choose the method by which "total sale price" is determined, with one method resulting in a higher "total sale price."

In 1999, the Federal Reserve Board issued Commentary to address situations in which the borrower makes a down payment and trades in a vehicle with negative equity.[10] The Federal Reserve

[10] Official Staff Commentary § 226.2(a)(18)-3 (Supp. 1 to Part 26) provides: *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 downpayment 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. Alternatively, the creditor may reflect a downpayment 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

Board's Supplemental Staff Commentary allows the creditor to use either a "netting" or "non-netting" approach when dealing with negative equity and down payments.[11] The "netting" method results in a lower "total sale price" than if the netting was not performed. Based on the example in the Staff Commentary the netting approach would yield a "total sale price" or $23,500 and the non-netting approach would yield a "total sale price" of $25,000.[12]

Creditor attempts to link the treatment of negative equity in the Commentary to "purchase money obligations" by conveniently omitting critical language from the Commentary. *Americredit Br.* at 26-27, n.16. The omitted language illustrates the two different amount for "total sale price" depending on which method of

---

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 downpayment 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 downpayment 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.

[11] Netting" means that the cash down payment would be applied, or "netted" against the negative equity.

[12] The "total sale price" is the sum of the "cash price" [$20,000] plus other charges [$500 prior lien pay-off in the "netted" approach] or [$2,000 lien payoff in the non-netted approach] plus the finance charge. *See* 12 C.F.R. § 226.18(j).

calculation is chosen by the creditor. When the comment is viewed as a whole, it is clear that the classification of debts as purchase money obligations under the U.C.C. cannot depend on the "total sale price" as used in TILA where the creditor can choose whether the "total sale price" should be higher (non-netting approach) or lower (netting approach) in transactions involving the trade-in of vehicles with negative equity.

B. Similarly, the California Automobile Finance Sales Act is a wholly inappropriate standard for defining "purchase money obligations" and "purchase money security interests."

Like the Truth In Lending Act, the California Automobile Sales Finance Act (AFSA) is a consumer protection statute. Cal. Civ. Code. § 2981, et seq. Across the country during the late 1950s and 1960s, states enacted laws regulating the use of retail sales contracts out of concern for protection of consumers from unconscionable business practices.[13] Historically, general usury statutes applied only to loans,

[13] *See* Retail Instalment Sales Legislation, 58 Colum. L. Rev. 854, 855 (1958)("there have recently been expressions of concern over the rising quantity of consumer credit, deterioration in the qualify of consumer credit, and the oppressive business practices form which consumers need protection").

not to sales of goods on credit.[14] As a result, lenders were avoiding usury restrictions by buying consumer paper at a discount from retailers rather than issuing loans for the purchase of goods. Retail installment statutes addressed this loophole that allowed lenders to exploit unwary consumers. These special usury laws set limits on the charges assessed in credit sale transactions and typically required disclosure of the cost of credit.

In 1961 the Rees-Levering Motor Vehicle Sales and Finance Act, now known as the Automobile Sales Finance Act, was enacted in California. Cal. Civ. Code. § 2981. The purpose of the act was to provide comprehensive protection for the unsophisticated motor vehicle consumer. *See* 15 Assembly Interim Committee Reports No. 24 at 39 (1960)(detailing long list of objectionable car dealer conduct)(Addendum A). When originally enacted the Rees-Levering Act required more than just disclosures. Finding disclosure alone

---

[14] *See, e.g.*, *Thomas v. Knickerbocker Operating Co*., 108 N.Y.S. 2d 234 (N.Y. Sup. Nov. 19, 1951)("mere fact of variation between cash price and time selling price which was greater than 6 per cent did not render transaction usurious"; usury must be founded on loan or forbearance of money; installment agreement did not constitute forbearance of money); *Bryant v. Securities Inv. Co*., 102 So. 2d 701 (Miss. 1958)(fact that time price shown in conditional sales contract for sale of automobile and cash price exceeded percentage of interest permitted by usury laws did not render contract usurious).

inadequate to protect consumers, the Act also contained provisions for maximum allowable finance charges, prohibitions on certain sale contract provisions, and limitations on the repossession and resale of consumer goods.[15] Nearly 50 years later, the AFSA remains first and foremost a "buyer protection act." *See Juarez v. Arcadis Financial, Ltd*, 152 Cal. Rptr.3d 382, 389 (Cal. App. 4 Dist. 2007); *In re Acaya*, 369 B.R. 564 (Bankr. N.D. Cal. 2007). From the enactment of the AFSA until today, no California state court has ever suggested that provisions of the U.C.C. should be interpreted based on the definition of terms used in this consumer protection statute which was enacted to promote disclosure of the true cost of credit and limit abusive conduct by car dealers.

In 1999, California amended its AFSA to expand the definition of "cash price" to include amounts used to pay off negative equity on a trade-in vehicle.[16] This amendment parallels changes in the 1999 Supplemental Staff Commentary to TILA. It permits credit sellers to finance such negative equity and like TILA, instructs that such negative equity should be included in determining the cost of the

[15] Project: Legislative Regulation of Retail Installment Financing, 7 U.C.L.A. L. Rev. 618, 670 (1960).
[16] *See* Cal. Assem. Com. On Judiciary, Analysis of Sen. Bill 1092 (1999-2000 Reg. Sess.), *Americredit Br*. at 49.

credit. The amendment was enacted, not to broaden the definition of purchase money obligation in the commercial code, but rather to reduce consumer confusion. According to the California Assembly Committee analyzing the proposed bill: "[i]t was a common practice for automobile dealers to disclose a negative number on the 'downpayment' line in circumstances involving a negative equity trade in, and then to increase the 'total amount financed' of the newly finance vehicle by a like sum. However, …this practice confused consumers who, when looking over the itemization sheet, believed that a negative number on the downpayment line should reduce the total amount financed rather than increase it." Analysis of Sen Bill. No. 1092, Assembly Comm. on Judiciary (1999-2000 Reg. Sess.), *Americredit's Br*. at 49. As the *Acaya* court noted such a change is "consistent with the AFSA's remedial purpose of protecting consumers from inaccurate and unfair credit practices through full and honest disclosures." *Acaya*, 369 B.R. at 569-70.

C. The Bankruptcy Appellate Panel correctly held that TILA and the California AFSA, which are consumer protection statutes, should not be read in *para materia* with the California Commercial Code.

As discussed above, TILA and the California AFSA are consumer protection statutes designed to curb unfair credit practices.

By contrast, Article 9 of the California Commercial Code "provides a comprehensive scheme for the regulation of security interests in personal property and fixtures." Cal. Com. Code § 9101, Comment 1.

Under California law, a statute that is modeled on another statute and shares the same legislative purpose is in *para materia* with the other, and should be interpreted consistently to effectuate legislative intent. *See Medical Bd. of California v. Superior Court*, 88 Cal. App. 4th 1001 (2001). The "[c]haracterization of the object or purpose is more important than characterization of subject matter in determining whether different statutes are closely enough related to justify interpreting one in light of the other. It has been held that where the same subject is treated in several acts having different objects the statutes are not in *para materia*. 'The adventitious occurrence of …similar subject matter, in laws enacted for wholly different ends will normally not justify applying the rule.'" *Walker v. Superior Court*, 47 Cal.3d 112, 124, 763 P.2d 852, 859 n.4 (1988), citing 2A Sutherland, Statutory Construction (4th rev. ed. 1984) § 51.03, p. 467. Thus, while it is true that the subject matter of AFSA, TILA and the California Commercial Code includes, but is not limited to, automobile financing, the fundamental disparity in purpose precludes

the AFSA and TILA from being considered in *para materia* with the California Commercial Code.

V. The court's best guess as to legislative intent is insufficient to overcome the plain language of the statute.

Despite the dearth of legislative history on the hanging paragraph, creditors have routinely argued in hanging paragraph cases that Congressional intent in enacting the provision was solely to benefit creditors. *See Americredit Br.* at 17-24; *In re Kenney*, 2007 WL 1412921 (Bankr. E.D. Va. May 10, 2007)("Creditors argue that the hanging paragraph should always be read to provide heightened protection to 910 secured creditors, as that was the intent of Congress"), *rev'd in part by Tidewater Finance Co. v. Kenney*, 531 F.3d 312 (4th Cir. 2008); *In re Brown*, 346 B.R. 868 (Bankr. N.D. Fla. 2006)("Wells Fargo contends that the absurdity of the result originates from the fact that the changes in the Code wrought by BAPCPA were enacted to enhance the rights of secured creditors in bankruptcy"). One court summarized the creditor's argument on the hanging paragraph as follows:

> The crux of Ford Motor Credit's argument is that § 1325 was amended to protect the interests of the 910 creditor and thus the statute should be interpreted to give the interests of the secured 910

> creditor increased protection. Ford Motor Credit is in essence requesting this Court to find that the statute on its face is contrary to the intent of the drafters.

In re Williams, 2007 WL 2122131 (Bankr. E.D. Va. Jul. 19, 2007). Several courts have adopted the Creditor's argument despite the absence of supporting legislative history. Even the Sixth Circuit Court of Appeals, in *dicta*, has erroneously given weight to what it ***perceived*** as Congress' intent. *See In re Long*, 519 F.3d 288, 294 (6th Cir. 2008). Similarly, the District Court, in *Peaslee II*, without any citation, stated that "the so-called 'hanging paragraph' of § 1325, was obviously intended to protect the interests of automobile dealers who provide financing for customers." *Peaslee II*, 373 B.R. at 261; *see also In re Zehrung*, 351 B.R. 675, 678 (W.D. Wis. 2006)(basing its decision on what it found to be the "likely" and "extremely unlikely" intent of Congress). But what makes this intent "obvious"? Certainly, the legislative history reflects no such intent. *See In re Quick*, 371 B.R. 459, 463 n.10 (B.A.P. 10th Cir. 2007)(" Specifically, we do not agree that BAPCPA amendments that appear to benefit creditors must be interpreted in such a way as to benefit only creditors. In fact, many of the supposedly "pro-creditor" amendments

appear reflective of the normal give and take of the legislative process."), *rev'd by In re Ballard*, 526 F.3d 634 (10th Cir. 2008). Rather the House Report as it pertains to the hanging paragraph merely contains a synopsis of the final statutory language. *See* H.R. Rep. 109-31, Pt. 1, at 71-72, 109th Cong., 1st Sess. (2005). This Court should reject arguments by Americredit and its *amici* that are based on what Americredit has "gleaned" from the legislative history, *Americredit Br.* at 23, based on what its *amici* believe secured creditors "must have feared," *NADA Brief* at 9, and based on reasons why that Congress "may have chosen" the particular language enacted, *NADA Brief* at 13. Americredit's guesses regarding Congressional intent and overreaching generalities are notably uncited and are unsupported by empirical proof or other evidence in the statute or the legislative history. The Court must look beyond the rhetoric of Americredit and its *amici* and instead focus on the language of the statute.

To the extent Creditors and amicis' beliefs are based on the role of private groups advocating for the legislation, the Supreme Court has specifically counseled against inferring any such intent. Courts should not attribute to Congress an official purpose based on the

motives of particular groups that lobbied for or against certain provisions. *See Circuit City Stores v. Adams*, 532 U.S. 105, 120, 121 S. Ct. 1302, 149 L.Ed 234 (2001)(private interest groups' roles in lobbying for or against legislation provide a dubious basis from which to infer intent); *see also Garcia v. United States*, 469 U.S. 70, 76, 105 S. Ct. 479, 83 L.Ed.2d 474 (1984)(courts should look only to Committee Reports that "represent[] the considered and collective understanding of those [legislators] involved in drafting and studying the proposed legislation."). This Court should reject the dicta in *In re Long* and *In re Graupner*, which would lead to the unsupportable conclusion that creditors should always win in cases related to the 2005 amendments simply because creditors lobbied for the passage of the bill.

The language of the hanging paragraph should not be "interpreted" to match a court's determination of what Congress "meant" to say. Rather the plain language of the statute should be conclusive, except in rare cases in which the literal application will produce a result *demonstrably* at odds with the intentions of the drafters.

CONCLUSION

For all the foregoing reasons, Debtor respectfully requests that this Court affirm the decision of the bankruptcy appellate panel.

/s/ Craig V. Winslow

____

CRAIG V. WINSLOW
LAW OFFICES OF CRAIG V. WINSLOW
630 N. SAN MATEO DRIVE
SAN MATEO, CA 94401
650.347.5445

CERTIFICATE OF COMPLIANCE

This brief, exclusive of the certifications, tables of contents and authorities and the identity of counsel at the end of the brief, is 9432 words in text and footnotes as counted by Microsoft Word, the word processing system used to prepare this brief. This brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman 14-point font.

I certify under penalty of perjury that the foregoing is

true and correct.

/s/ Craig V. Winslow

CRAIG V. WINSLOW
LAW OFFICES OF CRAIG V. WINSLOW
630 N. SAN MATEO DRIVE
SAN MATEO, CA 94401
650.347.5445