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Continuing the Litigation of Collateral Valuation in Bankruptcy: *Associates Commercial Corp. v. Rash*

I. INTRODUCTION

In 1989, Elray Rash purchased a Kenworth tractor truck for $73,700 that he intended to use with his spouse, Jean Rash, in a contract freight-hauling business.[1] After several years of payment on the truck, the Rashes found themselves unable to stay afloat financially and filed for chapter 13 bankruptcy.[2] Under their bankruptcy plan, the Rashes wanted to retain the truck in order to keep income flowing to them from their business.[3] However, Associates Commercial Corporation (ACC), the creditor who owned the lien on the truck, had other plans for the truck.[4] ACC wanted to sell the truck immediately and not be a part of the Rash's bankruptcy.[5] Under the Bankruptcy Code, the Rashes were permitted to keep the truck, provided they pay to ACC the current value of the truck over the time length of the bankruptcy plan.[6] This is commonly referred to as a debtor's "cram down" power where a debtor retains and pays the current value for collateralized property in a bankruptcy plan over the objection of the secured creditor.[7]

The issue before the Fifth Circuit in *Rash* was what standard of valuation should be used to determine the value which the Rashes would pay to ACC over the length of the bankruptcy plan.[8] Until the Supreme Court decided *Associates Commercial Corp. v. Rash*,[9] the circuits had been divided over a replacement value

1. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1882 (1997).
2. *See id.*
3. *See id.* at 1883.
4. *See id.*
5. *See id.*
6. *See id.* at 1882 n.1, 1883 (quoting 11 U.S.C. 1325(a)(5)(B) (1994)).
7. *See id.* at 882-83. *See generally* Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061 (1985) (providing a comprehensive review of issues in valuation contests).
8. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1038 (5th Cir. 1996)(en banc), *rev'd*, 117 S. Ct. 1879 (1997).
9. 117 S. Ct. 1879 (1997).

standard,[10] a foreclosure value standard,[11] and a midpoint value standard.[12] The Supreme Court followed the dissent of the Fifth Circuit in *In re Rash*[13] and other courts[14] by adopting the replacement value standard.[15]

A. *Reasons for Litigating Value*

In bankruptcy reorganization hearings the valuation of secured collateral is a highly debated issue between the debtor and the secured creditor because the debtor retains and uses the secured property during the reorganization over the objection of the secured creditor.[16] Generally, secured creditors prefer to foreclose on their collateral and immediately put their assets to a productive and safe use.[17] Litigation over valuation is fostered by the ambiguous language of the Bankruptcy Code regarding valuation, section 506(a).[18] In pertinent part, section 506(a) states:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. *Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.*[19]

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10. *See* Taffi v. United States (*In re* Taffi), 96 F.3d 1190, 1192 (9th Cir. 1996) (en banc), *cert. denied*, 117 S. Ct. 2478 (1997). The Court labeled their standard "replacement value" standard, however, they also gave that label the Court's own definition. *See Rash*, 117 S. Ct. at 1884 n.2. The replacement value standard is also associated with what others call "retail value." *See In re* Rash, 149 B.R. 430, 432 (Bankr. E.D. Tex. 1993) ("[R]etail value reflects actual replacement cost to a debtor.").

11. *See In re Rash*, 90 F.3d at 1060. "Foreclosure value" is similar to "wholesale value." *See In re Rash*, 149 B.R. at 431-32.

12. *See, e.g.*, General Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 62 (2d Cir. 1997) (holding that courts have discretion to allocate value at the midpoint between replacement value and foreclosure value); *In re* Hoskins, 102 F.3d 311, 316 (7th Cir. 1996) (same).

13. 90 F.3d at 1061-75 (Smith, C.J., dissenting).

14. For cases adopting a variation on the replacement value standard see, e.g., *In re Taffi*, 96 F.3d at 1192-93; Metrobank v. Trimble (*In re* Trimble), 50 F.3d 530, 531-32 (8th Cir. 1995); Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (*In re* Winthrop Old Farm Nurseries, Inc.), 50 F.3d 72, 74-76 (1st Cir. 1995); Huntington Nat'l Bank v. Pees (*In re* McClurkin), 31 F.3d 401, 406 (6th Cir. 1994); and Coker v. Sovran Equity Mortgage Corp. (*In re* Coker), 973 F.2d 258, 260 (4th Cir. 1992).

15. *See Rash*, 117 S. Ct. at 1882.

16. *See id.* at 1882-83.

17. *See id.* at 1885.

18. *See In re Rash*, 90 F.3d at 1043 ("The first sentence [of section 506(a)] clearly envisions a layered analysis"); *In re* Hoskins, 102 F.3d 311, 313 (7th Cir. 1996). "The briefs and arguments of the parties are full of false starts. *Both* sides appeal to the 'plain meaning' of section 506(a) — a bad sign." *Id.* Out of necessity, Chief Judge Posner looked to section 506(a) to try to determine the "plain meaning," but found that "[w]e get little help from the statute." *See id* at 314.

19. 11 U.S.C. § 506(a) (1994) (emphasis added).

The valuation standard has been interpreted differently by the circuit courts because the statutory language does not specify a standard of valuation that should be used.[20] Congress designed section 506(a) broadly enough to encompass the different duties it has in the Bankruptcy Code.[21] Due to the statute's broad language,[22] many different theories and labels of valuation are bandied about in court, such as those confronted in Rash.[23] Other theories and labels addressed out of court include wholesale value, retail value, orderly liquidation value, replacement value, foreclosure or liquidation value, and going concern value or enterprise value.[24] Section 506(a) allows courts to make case-by-case determinations of a creditor's secured interest in the property based on "the type of bankruptcy case, the type of property, and the proposed disposition of the collateral," without the help of a valuation standard provided to them by the code.[25] The differing interpretations of section 506(a) prompted the Supreme Court to accept *Rash* to resolve the issue for the lower courts.[26]

Where the law is uncertain, litigation over the amount a debtor has to pay a creditor in bankruptcy for property retained by a debtor is likely to occur. Many

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20. *See In re Hoskins*, 102 F.3d at 314 ("Wholesale price is one simple rule; retail price another; the midpoint of the two prices is a third. None is enacted or excluded by the statute [section 506(a)]. We must decide which is best.").

21. *See* S. REP. NO. 95-989, at 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854; *see also* John J. Rapisardi, *Valuing Collateral for Cram downs: Circuits Adopt Varying Approaches*, N.Y.L.J., Jan. 28, 1997, at 1, 4.

22. *See* NATIONAL BANKRUPTCY REVIEW COMMISSION, REPORT OF THE BANKRUPTCY REVIEW COMMISSION, § 1.5.2, at 244-45 (1997) [hereinafter BANKRUPTCY COMMISSION].

23. *See supra* notes 10-14 and accompanying text.

24. *See Our Two Cents: Stay Litigation After Rash*, ¶4 (last modified Mar. 16, 1998) <http://www.stinson.inter.net/2cents/*rash*.htm>.

> [r]eplacement cost (the current cost of a similar item); fair market value (what a willing buyer would pay for a like item sold by a willing seller); liquidation value (the estimated amount that could be realized from a forced sale of the property at a public auction after proper advertising); orderly liquidation value (the amount that could be realized from a forced sale of the property in tact with all related equipment not necessarily at an auction); retail value (the price for which an item is sold at retail); wholesale value (the price for which an item is sold at wholesale); and going concern or enterprise value (the value of an enterprise as a going concern, taking into account goodwill).

Id.

25. *See* BANKRUPTCY COMMISSION *supra* note 22, at 244-45 (citing H.R. REP. NO. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6312). "'Value' does not necessarily contemplate forced sale or liquidation value of collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case basis, taking into account the facts of each case and the competing interest in the case." H.R. REP. NO. 95-595, at 356, *reprinted in* 1978 U.S.C.C.A.N. 5787, 6312.

26. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1789, 1884 (1997).

times the collateral is no more than a small truck or other smaller value item.[27] The difference in values asserted in *Rash* was at most $9,125.[28] That small difference could have been enough to force the Rashes into Chapter 7 bankruptcy because Chapter 13 bankruptcy law permits the reorganization plan to spread out any payments to secured creditors for only a limited amount of time.[29] The amount could have increased the Rashes' monthly payments to ACC to a level likely unsustainable under their plan.[30] Thus, parties want the law to be crystal clear to avoid the often expensive litigation of value eating up the difference in valuations offered.[31]

Another reason why a secured creditor would desire to have a higher value is to avoid the harsh results of *United Savings Ass'n v. Timbers of Inwood Forest Associates., Ltd.*[32] The Supreme Court held in *Timbers* that a secured creditor can only receive interest payments in a reorganization bankruptcy when they are over secured.[33] Even then a secured creditor will get interest payments only up to the value of the collateral. Thus, the higher the value, the more interest a secured creditor can receive in the period before the confirmation of the bankruptcy plan.[34] Therefore, a creditor will want to argue for the highest value possible in order to get interest payments pre-confirmation and also to declare themselves eligible post-confirmation for adequate protection in bankruptcy.[35]

B. Summary of Decision

Justice Ginsburg, writing for the majority, rejected a foreclosure value standard in favor of a replacement value standard.[36] The Court found that the Fifth Circuit erred when it interpreted section 506(a) because the language, while not perfectly precise, pointed to a different valuation treatment when the property is

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27. *See In re* Hoskins, 102 F.3d 311, 314 (7th Cir. 1996).

28. *See Rash*, 117 S. Ct. at 1883.

29. *See* 11 U.S.C. § 1322(d) (1994) ("The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.").

30. *See Rash*, 117 S. Ct. at 1883. The Rashes proposed to pay ACC $28,500 over 58 months at a monthly payment of $607.79. *See id.* Had the secured amount been established as $41,171 as ACC desired, the Rashes' payments to ACC would have been at least $875 per month under the same terms. *See id.* A difference of nearly $275 per month in a Chapter 13 individual bankruptcy could easily be a deciding factor as to whether a reorganization will be successful or not. *See* Associates Commercial Corp. v. Rash *(In re* Rash*)*, 90 F.3d 1036, 1055 (5th Cir. 1996) (en banc), *rev'd* 117 S. Ct. 1879 (1997).

31. *See In re Hoskins*, 102 F.3d at 314.

32. 484 U.S. 365 (1988).

33. *See id.* at 372. "Over secured" describes the situation where the amount of a creditor's loan secured by property is less than the current value of the securing property. *See id.* Thus, the debtor has equity in the secured property that can be used to pay the secured creditor interest during the pre-confirmation grace period in which the reorganization plan has not yet been filed. *See id.*

34. *See supra* note 24, at ¶4.

35. *See id.*

36. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1789, 1882 (1997).

retained by the debtor than when the property is returned to the creditor.[37] The phrase from section 506(a) stated that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" led the Court to find that the value of the collateral in question was to be determined from its value in the hands of the debtor in its use as a cash stream instrument.[38] The Court defined replacement value as "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller."[39] Thus, the value to the debtors would be the total present value of the collateral if the debtors were to have to replace the truck.[40]

This note is concerned with presenting the problem the *Rash* Court faced, the administration problems that lower courts may face as a result, and the practical problems litigants may now face. A brief review of the case history leading up to the decision will demonstrate the struggle that was before the lower courts regarding property valuations in bankruptcy under section 506(a). This history includes an examination of the three standards that conflicted the lower courts in cram down valuation of property as well as legislative materials helpful to the courts in making that determination.

Once the historical context is in place, the facts and law that the Court applied to them form the next part of this note. Justice Ginsburg's opinion tackled each differing circuit standard in turn. An analysis of her reasoning and assumptions of law and interpretation of code are very important to the standard to which the Court adhered. A review of Justice Stevens' sole dissent is to be taken up after the majority.

II. HISTORICAL BACKGROUND

A. *Circuit Courts' Differing Standards*

Before the Supreme Court decided *Rash*, the circuits were divided as to how secured property should be valued in a cram down situation.[41] The value given to secured property often determines whether the reorganization plan under a chapter 11 or chapter 13 bankruptcy will succeed.

37. *See id.* at 1884.
38. *See id.* at 1885 (quoting 11 U.S.C. § 506(a)).
39. *Id.* at 1884.
40. *See id.* at 1886.
41. *See id.* at 1882.

1. Replacement Value Standard

The First, Fourth, Sixth, Eighth, and Ninth Circuits each adopted a standard based on the retail or replacement value of property.[42] In *In re Trimble*, the Eighth Circuit held that retail value was the proper valuation standard.[43] The court reasoned that, in order to give the language of section 506(a) full effect, the necessary standard must reflect the debtor's proposed disposition or use of the collateral.[44]

The *Rash* Court cited *In re Taffi* favorably as to its holding that a fair market value is the real estate equivalent of replacement value.[45] *In re Taffi* was a Ninth Circuit decision involving real property in a Chapter 11 bankruptcy.[46] The *Taffi* court held that fair market value was the correct valuation standard from which hypothetical costs of sale should not be deducted.[47]

After the Fifth Circuit decided *Rash* the first time, both the First and Eighth Circuits quoted the decision with approval.[48] However, the subsequent *Rash en banc* ruling turned against these two courts and the initial Fifth Circuit ruling.[49] The first Fifth Circuit decision and the dissent in the subsequent one focused on the second sentence of section 506(a), finding that "when a debtor intends to continue use of creditor's collateral, the debtors are acknowledging the value of the collateral to be greater than if liquidated," thus justifying a different and higher valuation standard.[50] The dissent further argued that a creditor's interest is more than a lien with a right to foreclose, but that the value of the creditor's lien is not based solely on the right to foreclose, but on the right to receive payments secured by the collateral.[51] "The value of the creditor's lien is derived from the stream of payments that the lien secures, rather than the right to foreclose, since no

42. For cases adopting a variation on the replacement value standard, see Taffi v. United States (*In re* Taffi), 96 F.3d 1190, 1192-93 (9th Cir. 1996), *cert. denied*, 117 S. Ct. 2478 (1997); Metrobank v. Trimble (*In re* Trimble), 50 F.3d 530, 531-32 (8th Cir. 1995); Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (*In re* Winthrop Old Farm Nurseries, Inc.), 50 F.3d 72, 74-76 (1st Cir. 1995); Huntington Nat'l Bank v. Pees (*In re* McClurkin), 31 F.3d 401, 406 (6th Cir. 1994); and Coker v. Sovran Equity Mortgage Corp. (*In re* Coker), 973 F.2d 258, 260 (4th Cir. 1992).

43. *See In re Trimble*, 50 F.3d at 531-32.

44. *See id.* at 531.

45. *See Rash*, 117 S. Ct. at 1884, n.2.

46. *See In re Taffi*, 96 F.3d at 1191.

47. *See id.* at 1192.

48. *See In re Trimble*, 50 F.3d at 531-32; Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (*In re* Winthrop Old Farm Nurseries, Inc.), 50 F.3d 72, 74-76 (1st Cir. 1995).

49. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1061 (5th Cir. 1996)(en banc), *rev'd*, 117 S. Ct. 1879 (1997).

50. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 31 F.3d 325, 329 (5th Cir. 1994) (quoting *In re* Penz, 102 B.R. 826, 828 (Bankr. E.D. Okla. 1989)), *rev'd en banc*, 90 F.3d 1036 (5th Cir. 1996), *rev'd*, 117 S. Ct. 1879 (1997).

51. *See In re* Rash, 90 F.3d at 1061-62 (Smith, C.J., dissenting).

liquidation of the collateral is contemplated."[52]

2. Foreclosure Value Standard

The Fifth Circuit, sitting *en banc*, held in *In re Rash* that the foreclosure value was the proper valuation standard in a Chapter 13 cram down situation.[53] The appeal of this case was before the Supreme Court, and its facts and holdings are discussed *infra*.[54]

3. Mid-Point Standard

In re Hoskins[55] and *General Motors Acceptance Corp. v. Valenti (In re* Valenti),[56] two cases recently decided by the Second and Seventh Circuits respectively, opted for a standard that splits the difference between the high value of retail and the low value of foreclosure.[57]

In re Hoskins involved a debtor in chapter 13 bankruptcy where the court was to determine the value of a car the debtor had retained.[58] The debtor demanded a foreclosure value of the car while the bank claimed the retail value.[59] The court held that in chapter 13 bankruptcy cases the valuation standard for assets retained for the production of income is the average of the retail value and the foreclosure value.[60] The court reasoned that a midpoint value standard benefitted both parties in the situation and avoided bestowing a windfall to either side.[61] The court stated that even if the parties found themselves outside of bankruptcy, the bank would likely never take anything less than the wholesale value of the car from the debtor either by stretching out the loan or in forgiveness of debt because that is what the bank could realize at a foreclosure.[62] The *Hoskins* court also found that the debtor would not likely agree to refinance the loan at any amount higher than retail value because the car would not be worth the amount owed.[63] Thus, the court used the midpoint between the two positions, the point at which, if the parties were to spend

52. *In re* Green, 151 B.R. 501, 504 (Bankr. D. Minn. 1993).
53. *See In re* Rash, 90 F.3d at 1060-61.
54. *See infra* Parts III.a.-III.b.
55. 102 F.3d 311 (7th Cir. 1996).
56. 105 F.3d 55 (2d Cir. 1997).
57. *In re Valenti*, 105 F.3d at 62-63; *In re Hoskins*, 102 F.3d at 316.
58. *See In re Hoskins*, 102 F.3d at 313.
59. *See id.*
60. *See id.* at 316.
61. *See id.* at 315-316.
62. *See id.*
63. *See id.*

the time and money to negotiate, they would find themselves.[64] The court thereby formed what it found to be an equitable, inexpensive, and pragmatic solution to the problem by creating a court-mandated median between the retail and wholesale values.[65]

The Second Circuit followed in *In re Valenti* by holding that, in chapter 13 bankruptcy cases involving retention of a vehicle by the debtor, the valuation is determined by the midpoint between the retail and wholesale values.[66] The *Valenti* court found it important that the midpoint used by the lower court reflected the dual considerations found in section 506(a) which include the following: "(1) the purpose of the valuation, and (2) the proposed disposition and use of the collateral."[67]

III. FACTS AND HISTORY OF THE CASE

Rash began when husband and wife, Elray and Jean Rash, filed jointly for Chapter 13 bankruptcy in 1992.[68] In 1989, the Rashes purchased a Kenworth tractor truck Elray used in his freight-hauling business which provided most of the family's income.[69] Associates Commercial Corporation (ACC) held the purchase contract and lien on the truck.[70] In their petition for bankruptcy, the Rashes claimed the value of the truck to be $28,500, the wholesale value of the truck.[71] ACC, in a motion for relief from the automatic stay imposed by the Bankruptcy Code[72] and a motion for proof of claim as to the value of the truck, argued that the retail value of the truck was the amount of its claim against the Rashes: $41,171.01.[73] Thus, had the bankruptcy court agreed with the Rashes' value, the total cram down amount considered unsecured in the reorganization plan by the Rashes would be $12,671.01.[74] However, after a valuation hearing, the court determined, upon evaluating expert witnesses by both sides, that the value of the truck was $31,875. The court arrived at that amount by using the retail blue book

64. *See id.* at 316.
65. *See id.*
66. *See* General Motors Acceptance Corp. v. Valenti (*In re* Valenti), 105 F.3d 55, 62 (2d Cir. 1997).
67. *See id.*
68. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1882 (1997).
69. *See* Associates Commercial Corp. v. Rash (*In re Rash*), 90 F.3d 1036, 1038-39 (5th Cir. 1996)(en banc), *rev'd*, 117 S. Ct. 1879 (1997).
70. *See Rash*, 117 S. Ct. at 1882.
71. *See id.* at 1883.
72. *See* 11 U.S.C. § 362(a) (1994).
73. *See Rash*, 117 S. Ct. at 1882.
74. *See id.* at 1882-83. The Rashes did not dispute that the amount of ACC's claim was $41,171.01. *See id.* Instead they argued that only $28,500 should be considered secured because that was the alleged value of the truck at the time of bankruptcy. *See id.* Therefore, the amount in dispute was $12,671.01, the amount that the Rashes would owe ACC under the plan as *unsecured* and the amount as to which ACC would join other unsecured creditors under the plan (and face only receiving a fraction of that amount as the likely result). *See In re* Rash, 90 F.3d at 1055 n.24.

value of $42,500 less twenty five percent, the percent the Rashes' expert testified was necessary to make a profit on the truck due to reconditioning expenses and sales commissions, making the potential unsecured amount of ACC's claim $9,296.01.[75]

The bankruptcy court found in favor of a foreclosure value established at the valuation hearing.[76] The district court upheld the finding, but the Fifth Circuit reversed the lower courts by holding that a replacement value standard was the proper measurement.[77] The Court of Appeals then granted a rehearing *en banc* to reevaluate the previous decision.[78] *En banc*, the court reversed itself by holding the replacement value standard was incorrect and affirmed the district and bankruptcy courts' adoption of a foreclosure valuation standard.[79]

The Fifth Circuit, *en banc*, held that foreclosure value was the proper valuation standard in a Chapter 13 cram down situation.[80] The court focused their attention on state law governing a foreclosure of collateral outside of bankruptcy, on section 506(a) in the valuation inside of bankruptcy, on an economic analysis of the situation, and on legislative history.[81]

The Uniform Commercial Code as applied in Texas, the local jurisdiction in question, allows two remedies for a secured creditor in the disposition of secured collateral which include the following: (1) sell the property in a "commercially reasonable" manner and apply all proceeds towards the debt, that is, sell it at a liquidation sale, or (2) retain the property in full satisfaction of the debt.[82] The panel explained that ACC would have more of their debt secured under a replacement value standard than it would if the truck were valued under the applicable state law.[83] The court reasoned that section 506(a) must be complied with, and yet, state law in conflict with that statute must be followed except to the extent that the statute through "clear[] textual guidance" required departure from

75. *See Rash*, 117 S. Ct. at 1883.

76. *See In re* Rash, 149 B.R. 430, 433 (Bankr. E.D. Tex. 1993), *rev'd*, 90 F.3d 1036 (5th Cir. 1996) (en banc), *rev'd*, 117 S. Ct. 1879 (1997). The bankruptcy court labeled the standard a "wholesale value standard." *See id.* However, it is roughly equivalent to the Court's definition of "foreclosure value." *See Rash*, 117 S. Ct. at 1883 (referring to the bankruptcy court's standard as foreclosure value).

77. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 31 F.3d 325, 328, 331 (5th Cir. 1994), *modified*, 62 F.3d 685 (5th Cir. 1995), *reh'g granted*, 68 F.3d 113 (5th Cir. 1995) (en banc).

78. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 68 F.3d 113, 114 (5th Cir. 1995) (en banc).

79. *See In re Rash*, 90 F.3d at 1060-61.

80. *See id.* at 1060.

81. *See id.* at 1040-60.

82. *See id.* at 1041-42 (citing Tanenbaum v. Economics Lab., Inc., 628 S.W.2d 769, 771-72 (Tex. 1982)).

83. *See id.* at 1042.

state law.[84] Therefore, because state law required a foreclosure standard of valuation by requiring liquidation, the court found that an interpretation of section 506(a) should also be required to adhere to that standard.[85]

The panel then found that the first sentence of section 506(a) supported a foreclosure value determination because it was intended to point to "the value of the collateral to the creditor."[86] Where a creditor only has a lien on property, thus giving the creditor, inter alia, the right to foreclose and retrieve his money, there is no reason that the value should be any more than what the creditor would receive at foreclosure.[87] The panel explained that this reading of the statute neither compelled departure from state law nor compelled a replacement value standard.[88]

The panel then looked at the second sentence of section 506(a).[89] The court noted that section 506(a) merely required that valuation be made "in light of" two main points, to wit, the following: (1) "the purpose of the valuation," and (2) the "disposition or use" of the property.[90] Section 1325(a)(5) determines the purpose of the valuation sub judice where a debtor has two choices as to a creditor such as ACC who does not accept a reorganization plan or the planned retention of secured property.[91] First, a debtor may surrender the secured property to the creditor.[92] Second, the debtor may keep the property and pay the creditor its present value over the length of the plan.[93] The court interpreted section 1325(a)(5)(B) and (C) in conjunction to mean that the secured creditor should get the same amount whether the debtor chooses to surrender or to keep the property.[94] Thus, the court reasoned that because section 506(a) deferred to "the purpose of the valuation" which was regulated by section 1325(a)(5), there should be no difference to a debtor and secured creditor between choosing to surrender or keep property under that section.[95]

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84. *See id.* (quoting BFP v. Resolution Trust Corp., 511 U.S. 531, 543 (1994).

85. *See id.*

86. *See id.* at 1043-44 (citing *In re* Raylin Dev. Co., 110 B.R. 259, 261 (Bankr. W.D. Tex. 1989); *see also* David Gray Carlson, *Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases*, 13 BANKR. DEV. J. 1, 31-40 (1996) (discussing the first sentence of section 506(a) and its application).

87. *See In re Rash*, 90 F.3d at 1040.

88. *See id.* at 1044-45.

89. *See id.* at 1045.

90. *See id.* at 1046 (citing 11 U.S.C. § 506(a)).

91. *See* 11 U.S.C. § 1325(a)(5)(B) (1994); *In re Rash*, 90 F.3d at 1045-46.

92. *See* 11 U.S.C. § 1325(a)(5)(C).

93. *See* 11 U.S.C. § 1325(a)(5)(B). Section 1325(a)(5)(B) and (C) are as follows:

> (a) Except as provided in subsection (b), the court shall confirm a plan if . . . (5) with respect to each allowed secured claim provided for by the plan . . . (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or (C) the debtor surrenders the property securing such claim to such holder. . . .

Id.

94. *See In re Rash*, 90 F.3d at 1046-47.

95. *See id.* at 1046-47.

The Fifth Circuit further found that the disposition or use "language [of section 506(a)] does not patently lead to the conclusion that, where the debtor proposes to retain and use the collateral, the value of the collateral is equal to what it would cost the debtor to replace it."[96] The court reasoned that the language in section 506(a) was not sufficiently direct to compel reversal of both state law and the first parts of section 506(a) that pointed toward a foreclosure standard.[97] Thus, the panel decided that a bankruptcy court must take into consideration the disposition or use, but that in most cases disposition or use would not be determinative as to the standard of valuation that would apply.[98]

The Fifth Circuit also looked at the legislative history surrounding the enactment of section 506(a) and concluded that the history supported a liquidation value in the context of a cram down.[99] The court reasoned that the legislative history showed that Congress left the valuation of collateral flexible because section 506(a) is applied under the Bankruptcy Code in so many different contexts making flexibility essential to a workable utility code section such as section 506.[100]

Finally, the panel rejected any arguments that the replacement value was the fairest or that a foreclosure value standard would give debtors a windfall at the expense of the creditors.[101] The court first reasoned that a replacement value standard would give the secured creditor a greater secured interest in the value of the property in the possession of the debtor than it would if the creditor were to sell the vehicle.[102] Were the debtor to purchase a substantially similar truck, the hypothetical cost of that truck would include "services provided by a dealer, such as inventory storage, reconditioning, marketing, and warranties of quality."[103] This hypothetical cost was not represented in the truck in the debtor's possession.[104]

96. *See id.*

97. *See id.* at 1048-50.

98. *See id.* at 1050-51; *see also* Isaac M. Pachulski, *The Cram Down and Valuation Under Chapter 11 of the Bankruptcy Code*, 58 N.C. L. REV. 925, 939 (1980) ("It is incongruous to value a business that is being reorganized on the basis of the price its assets could fetch on a piecemeal liquidation when the entire theory of the reorganization is that the debtor is being preserved as a going concern."). *But see The Valuation Debate*, AM. BANKR. INST. J., 1, 41 (Nov. 1996) (complaining that *Rash* focused mainly on the "use or disposition" clause to the detriment of the "proposed disposition" clause of section 506(a)), *available in* WESTLAW, I5-NOV AMBKRIJ 1.

99. *See In re Rash*, 90 F.3d at 1059 (citing *In re* Sherman, 157 B.R. 987, 991 (Bankr. E.D. Tex. 1993) (supporting the court's interpretation of the "disposition or use")).

100. *See id.* at 1058. Section 506 stands as a code section applicable to all chapters of bankruptcy, thus earning the "utility" appellation. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1887 (1997) (Stevens, J., dissenting).

101. *See In re Rash*, 90 F.3d at 1052-55.

102. *See id.* at 1051.

103. See *id.*

104. *See id.*

The court also rejected the argument that a debtor would reap a windfall in a foreclosure valuation.[105] The argument is that a debtor would have property with a greater retail worth than that which they owe and could subsequently sell the property at a gain to the detriment to the secured creditor.[106] The court rejected this argument on the grounds that in reality a debtor needs the property for the reorganization plan and a debtor is in no position to recondition, advertise, and sell the property anyway.[107]

IV. ANALYSIS OF OPINION

The Court, in granting certiorari, did so with the intent to solve a split in the lower courts.[108] With the circuits adhering to three separate standards, the Court necessarily had to evaluate each one. Justice Ginsburg wrote the opinion for the eight to one majority.[109]

A. *Rejection of the Foreclosure Value Standard and the Fifth Circuit's Reading of Section 506(a)*

Justice Ginsburg began the opinion by rejecting the Fifth Circuit's selection of the foreclosure value standard.[110] The Fifth Circuit relied heavily on the first sentence of section 506(a) to guide its decision, finding that the "starting point for valuation [is] what the creditor could realize if it sold the estate's interest in the property according to the security agreement," specifically by "repossess[ing] and sell[ing] the collateral."[111] The Supreme Court majority found the Fifth Circuit's reliance on the first sentence misplaced because it then rendered moot the second sentence that purports to tell how to valuate collateral in bankruptcy.[112] Justice Ginsburg iterated that even when read in isolation, the first sentence of section 506(a) gives no direction as to how to valuate collateral, only a "direction simply to consider the 'value of such creditor's interest.'"[113]

The second sentence of section 506(a), according to the majority, should be

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105. *See id.* at 1054.

106. *See id.* (citing Winthrop Old Farm Nurseries v. New Bedford Inst. For Sav. (*In re* Winthrop Old Farm Nurseries), 50 F.3d 72, 76 (1st Cir. 1995)).

107. *See id. But see* Robert F. Mitsch and Carleton B. Crutchfield, *The Rash Decision: A Question of Value in Context*, AM. BANKR. INST. J. 18, 19 (July/Aug. 1997) (observing that debtors reap a windfall because "it would allow the debtor to have the best of both worlds by keeping the collateral and paying only what a stranger at a foreclosure sale might pay. Thus the debtor indirectly pays to himself the money that might have been expended to execute and liquidate the collateral.").

108. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1882 (1997).

109. *See id.* Justice Stevens was the sole dissenter and Justice Scalia joined the majority in all but footnote 4 of the opinion. *See* id. at 1881-82.

110. *See id.* at 1884.

111. *See In re Rash*, 90 F.3d at 1044.

112. *See Rash*, 117 S. Ct. at 1885.

113. *See id.* at 1884 (quoting 11 U.S.C. § 506(a) (1994).

the focus of collateral valuation because it imparts how "valuation shall be determined."[114] Justice Ginsburg stated that the "disposition or use" of the property provided clearer direction in valuation.[115] This statutory direction leads the debtor to certain choices a debtor must face in a bankruptcy proceeding, each pertaining to the "disposition or use" of collateral which include the following: (1) gain acceptance of the reorganization plan by the secured creditor; (2) surrender the collateral to the secured creditor; or (3) keep the collateral by cram down or acceptance and pay the secured creditor its present value over time.[116] Thus, the "disposition or use" is determined by the debtor, and consequently, the value of the collateral is determined by the choice.[117] If the debtor surrenders the collateral to the creditor, the debtor has chosen to have the collateral sold off at what most likely will be a foreclosure or wholesale price.[118] If the collateral is surrendered the secured creditor is free to sell it and reinvest its money.[119] Where the debtor chooses to keep the collateral and cram down the secured creditor, the creditor is ultimately saying that the collateral is worth as much or more to them than the foreclosure value that they could get if they were to surrender the collateral to the creditor.[120] If the foreclosure value standard were applied to the cram down situation, the debtor's "disposition or use" would be rendered insignificant, whereas the replacement value standard "distinguishes retention from surrender and renders meaningful the key words 'disposition or use.'"[121] According to the Court, neither the creditor, the debtor, nor section 506(a) considers surrender and retention of the collateral to be "equivalent acts", and thus requires separate treatment as to "disposition or use."[122] The risks involved in cram down to secured creditors are much higher than in surrender: a second default is possible as well as further deterioration of the collateral despite claims to "adequate protection" to secured creditors offered by section 361.[123] Thus, the actual use for which the

114. *See* 11 U.S.C. § 506(a); *Rash*, 117 S. Ct. at 1885.

115. *See Rash*, 117 S. Ct. at 1885.

116. *See* 11 U.S.C. § 1325(a)(5) (1994); *Rash*, 117 S. Ct. at 1885.

117. *See Rash*, 117 S. Ct. at 1885. If the debtor gains acceptance for his plan from a creditor, the secured creditor must, for whatever reason, feel comfortable with the valuation of the collateral received under the plan or, as a practical matter, the secured creditor would reject the valuation in favor of a different one. *See* 11 U.S.C. § 1325(a)(5) (stating that a debtor can gain confirmation by acceptance or cram down).

118. *See Rash*, 117 S. Ct. at 1885.

119. *See id.* Note that this is the outcome that ACC sought at the first bankruptcy hearing. *See id.* at 1883.

120. *See In re* Penz, 102 B.R. 826, 828 (Bankr. E.D. Okla. 1989).

121. *See Rash*, 117 S. Ct. at 1885.

122. *See id.*

123. *See* 11 U.S.C. § 361 (1994) (requiring secured creditors be adequately protected as to their interest in property retained by the debtor); *Rash*, 117 S. Ct. at 1885.

debtor is keeping the collateral is determinative, not the hypothetical foreclosure sale by the secured creditor envisioned by the Fifth Circuit.[124]

1. Rejection of any Reference to Legislative History to Support any Other Reading of Section 506

In footnote four the Court disavowed any authority that legislative history may hold over the decision of the Court on the valuation issue, stating that "[w]e give no weight to the legislative history of § 506(a), noting that it is unedifying, offering snippets that might support either standard of valuation."[125] The Court found that the Senate reports merely restated the code section, the House's use of the term "replacement cost" had a meaning different from that used by the court on this issue, and that a House report was taken from discussions before the second sentence of section 506 was added by the Senate.[126] Thus, the Court dismissed all the legislative history as insignificant and non-binding on the Court's decision in finding for a replacement value standard.[127]

B. Rejection of the Mid-Point Standard

While Justice Ginsburg agreed with the admirable goal of simplicity by providing a rule subject to "predictability and uniformity," she did not agree that an average of the high and low values offered to the court was the proper method.[128] Though this standard seemed equitable in its result of a midpoint between the foreclosure and replacement values, it lacked support in the Bankruptcy Code as written.[129] The Court also found that a midpoint standard was in fact more complex than a replacement value standard because it required two valuations instead of just one.[130]

C. Determination of Valuation Must Be Case-by-Case, Yet the Standard Must Remain the Same

Footnote six hedged the Court's holding for a replacement value standard by providing that "[w]hether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the

124. *See Rash,* 117 S. Ct. at 1885-86; *cf.* Associates Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1050 (5th Cir. 1996)(en banc), *rev'd,* 117 S. Ct. 1879 (1997).
125. *See Rash,* 117 S. Ct. at 1886 n.4.
126. *See id.*
127. *See id.*
128. *See id.* at 1886.
129. *See id.*
130. *See id.*; *cf. In re* Hoskins, 102 F.3d 311, 315-16 (7th Cir. 1996) (noting that both debtors and creditors nearly always have a value they are willing to submit is the value for a given item).

nature of the property."[131] Further, in footnote five, the Court rejected any standard of valuation that is without a rule, "allowing use of different valuation standards based on the facts and circumstances of individual cases."[132] Thus, the Court espoused an approach called the "replacement value standard" that purports to take into account all facts and circumstances and allows courts to determine if "replacement value" is equivalent to retail, wholesale, foreclosure, or whatever value the courts find relevant.[133]

The Court did not define replacement value beyond "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller,"[134] except to give guidelines as to how a valuation might be modified to correctly state the value of the collateral in the hands of the debtor.[135] The Court found that normal retail value reflects certain costs that must necessarily be subtracted in order to fairly represent the value; such costs include inventory storage, reconditioning, warranties, and accessories not covered by the security agreement.[136]

D. Justice Stevens' Dissent

Justice Stevens formulated his dissent based on the majority opinion and followed the lead set by the Fifth Circuit decision.[137] First, Justice Stevens rebutted the majority finding that the focal point of section 506(a) is the "proposed disposition or use" and iterated that the "purpose of the valuation" be the starting point.[138] Therefore, according to Justice Stevens, the "purpose" clause of the second sentence can be read independent of the "disposition or use" clause by finding that the sentence need not be read as necessarily applicable in concert in every situation.[139] Section 506 is a "utility" section such that the "disposition or use" clause can apply in many other situations.[140] Thus the "disposition or use" clause is not rendered "surplusage" by its inapplicability in this limited situation as

131. *See Rash*, 117 S. Ct. at 1886 n.6.
132. *See id.* at 1886 n.5.
133. *See id.* at 1886 n.6.
134. *Id.* at 1884.
135. *See id.* at 1886 n.6.
136. *See id.* The Court basically addressed one of the Fifth Circuit's problems with a replacement value standard by providing guidance as to items and services provided by retailers that should not be counted towards "replacement value." *See* Associates Commerical Corp. v. Rash *(In re* Rash*)*, 90 F.3d 1036, 1051-51 (5th Cir. 1996)(en banc), *rev'd*, 117 S.Ct. 1879 (1997).
137. *See Rash*, 117 S. Ct. at 1887 (Stevens, J., dissenting); *In re Rash*, 90 F.3d at 1038-61.
138. *See Rash*, 117 S. Ct. at 1887 (Stevens, J., dissenting) (quoting 11 U.S.C. § 506(a)).
139. *See id.* (Stevens, J., dissenting).
140. *See id.* (Stevens, J., dissenting). Unfortunately, Justice Stevens did not cite any examples of when one clause could clearly apply in place of the other.

the majority would render it.[141] Therefore, the purpose found by Justice Stevens "is to put the creditor in the same shoes as if he were able to exercise his lien and foreclose."[142]

Justice Stevens also articulated that a standard different than foreclosure value would shift the economic loss from secured creditors to unsecured creditors by allowing secured creditors to obtain an advantage in bankruptcy that they would not enjoy outside of bankruptcy.[143]

E. Analysis of Dissent with Respect to the Majority Opinion

Both the majority and dissent may be correct in the interpretation of the second sentence of section 506(a) because the sentence can be broken into two parts as follows: one requiring that the valuation be directed at the "purpose of the valuation," and the other requiring consideration of the "disposition or use."[144] The whole clause, however, must be taken as two necessary parts that must be considered together because they are joined by the conjunctive "and." Otherwise, depending on the collateral and the type of disposition hearing involved, it can simply be implied that either phrase could be emphasized;[145] thus, "[s]uch value shall be determined in light of the purpose of the valuation *and* of the proposed disposition or use of such property."[146] The dissent, however, focused on the "and," and believed that although either part of the clause can be emphasized or de-emphasized, both must still be presently affective.[147] The and connecting the two clauses ties the two together, and consequently, the phrase must be applied as a whole directive, including both clauses of the phrase whenever in use under the Bankruptcy Code.[148]

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141. *See id.* (Stevens, J., dissenting).

142. *Id.* (Stevens, J., dissenting).

143. *See id.* (Stevens, J., dissenting). The greater a secured creditor's interest in collateral, the less money there is available to pay unsecured creditors under a reorganization plan.

144. *See, e.g., id.* at 1884-85 (showing the Court splitting the phrase into two parts); Associates Commercial Corp. v. Rash *(In re* Rash*)*, 90 F.3d 1036, 1042-52 (5th Cir. 1996) (en banc), *rev'd*, 117 S.Ct. 1879 (1997) (same); *In re* Hoskins, 102 F.3d 311, 313 (7th Cir. 1996) (same).

145. *See Rash*, 117 S. Ct. at 1885.

146. 11 U.S.C. § 506(a) (1995) (emphasis added).

147. *Compare Rash*, 117 S. Ct. at 1885, *with id.* at 1887 (Stevens, J., dissenting) (comparing the majority opinion's failure to distinguish the significance of the word and in the clause versus Justice Stevens' dissenting opinion which specifically elaborates the effect that the word and has on the clause).

148. *See* 11 U.S.C. § 506(a); *Rash*, 117 S. Ct. at 1887 (Stevens, J., dissenting).

V. IMPACT

A. *Problems with the Court's "Replacement Value Standard": Some of the Same Questions Still Exist after* Rash

While footnote six of the decision may provide lower courts insight into replacement value, it also takes courts back to square one in the valuation process because replacement value is dependent upon the purpose of the hearing, the proposed disposition or use of the property, *and* "[w]hether replacement value is the equivalent of retail value, wholesale value, or some other value[] depending on the type of debtor and the nature of the property."[149] This ambiguity has led a number of commentators to question to which situations *Rash* actually applies.[150]

Because the Court included in footnote six a list of costs that should be deducted from an established replacement value, there is a question as to whether any other costs outside of that list exist.[151] A Ninth Circuit panel court in *In re Mulvania* reaffirmed *In re Taffi*[152] by holding that commission costs and hypothetical sales costs should not be deductible from the replacement value because they would not accurately reflect the actual use by the debtor.[153] The *Rash* Court excluded costs "typically associated with blue book retail valuation including: warranties, inventory storage and reconditioning."[154] If the Court used the reasoning that blue books included these costs, then this raises the question of whether or not other costs, such as sales, commissions, and advertising costs,

149. *See Rash,* 117 S. Ct. at 1886 n.6.

150. *See, e.g., Bankruptcy--Valuation: Rash Decision Gets Bad Marks from Experts at Bankruptcy Conference,* 66 U.S.L.W. 2207, 2208 (1997) [hereinafter *Bankruptcy—Valuation*]; Francis Chu, *Industry Applauds Cram-down Ruling,* REAL EST. FIN. TODAY, June 20, 1997, at 9; John H. Genovese & Paul J. Battista, *'Rash' Ruling Should Not Afflict Ch. 11 Valuations,* NAT'L L.J., Oct. 13, 1997, at B12; Norma Hammes, *Rash: A Retrospective,* (visited Oct. 29, 1997) <http://nacba.com/cases/rash/rashretr.htm>; Marianne Lavelle, *Bankruptcy Ruling Alters Landscape: 'Cram down' Decision May Discourage Liquidations,* NAT'L L.J., June 30, 1997, at B1; Alan R. Ostrowitz, *Valuation of Personal Property in Chapter 13 Cram Downs,* N.Y.L.J., Aug. 12, 1997, at 1; John J. Rapisardi, *Valuing Collateral For Cram Down Purposes,* N.Y.L.J., July 24, 1997, at 5.

151. *See* Gary Klein, Esq., *Opinion Raises More Questions than It Answers,* 16 AM. BANKR. INST. J., July/Aug. 1997, at 18; Hammes, *supra* note 150.

152. Taffi v. United States (*In re* Taffi), 96 F.3d 1190 (9th Cir. 1996) (en banc), *cert. denied,* 117 S. Ct. 2478 (1997).

153. *See* Mulvania v. United States (*In re* Mulvania), 214 B.R. 1, 9-10 (B.A.P. 9th Cir. 1997).

154. Klein, *supra* note 151, at 18.

should be deducted as well.[155]

Another question is raised as to the amount of cost that should be deducted.[156] Costs are hypothetical because the debtor is keeping the collateral.[157] Creditors before and since *Rash* dislike these costs because they are hypothetical, and, thus, subject to much abuse by debtors estimating them extremely high.[158] Even more questions are raised when the debtor has access to the type of collateral in question without having to go to a retail seller.[159] For example, if the debtor had a brother who sells new and used trucks and the debtor could buy vehicles for wholesale prices, then the question is raised whether a court should consider this in valuing the property in a hypothetical replacement value situation.[160] Or, for example, if the debtor could provide sufficient evidence from newspaper ads or other sources that like property was sold for less than the replacement cost initiated by the creditor, then again a question is raised whether a court should also take this into account.[161]

One commentator has suggested another problem: because there is currently no way to valuate used personal property and the market for used personal property is limited, there exists a question as to where one should begin a valuation of such collateral.[162] Presently, there may be inadequate information on items such as the difference in cost of cars sold with a warranty from those without, the cost of reconditioning a used auto prior to resale, the average sales expenses for commission, or the average marketing expenses for any given vehicle on a lot.[163] One commentator, however, is confident that with time the industry and courts will come up with figures and percentages that courts would eventually depend upon as standards.[164]

Where the debtor opts to keep the collateral, creditors face double risks in

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155. *See id.*; *see also In re* Russell, 211 B.R. 12, 13 (Bankr. E.D. N.C. 1997) (discussing that when the National Automobile Dealers Association Guide used to set the replacement value for a car, they did not "include any extra value for items not retained" by the debtor, including neither warranty costs nor reconditioning costs).

156. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1883 (1997) (where experts were required to establish the initial cost of the truck less dealer expenses); BANKRUPTCY COMMISSION, *supra* note 22, at 248.

157. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1051 (5th Cir. 1996) (en banc), *rev'd*, 117 S. Ct. 1879 (1997) ("When hypothetically purchasing a replacement for the collateral from a retail dealer, the debtor would be buying the replacement property and the services provided by a dealer, such as inventory storage, reconditioning, marketing, and warranties of quality.")

158. *See* Mitsch and Crutchfield, *supra* note 107, at 19.

159. *See* Robert M. Lawless & Stephen P. Ferris, *Economics and the Rhetoric of Valuation*, 5 J. BANKR. L. & PRAC. 3, 18 (1995).

160. *See* Bankruptcy—Valuation, *supra* note 150, at 2208.

161. *See id. But see In re* Russell, 211 B.R. 12, 13 (Bankr. E.D. N. C. 1997) (finding a National Automobile Dealers Association Guide was be more accurate as to value than prices found by the debtor in the newspaper).

162. *See Bankruptcy-Valuation*, *supra* note 150, at 2208; Klein, *supra* note 151, at 19.

163. *See* Klein, *supra* note 151, at 18.

164. *See id.*

Chapter 13 bankruptcy because there is the continued risk of loss from default and the likely risk of depreciation due to normal wear and tear.[165] A court would have to take these into consideration when making a replacement value determination and, in addition, determine to what extent to consider them.[166] A court should make the extent of their allowance based on a value determination "in light of [a debtor's] 'disposition or use'"[167] and "the nature of the property."[168] The National Bankruptcy Review Commission, in their analysis of the issue of compensation for risk of loss, found that the courts and parties are better served when the risk of loss such as that described by the Court,[169] is addressed through "adjustment of the amortization rate, adjustment of the interest rate, calculation of adequate protection payments, or changes in other terms of the agreement."[170] The Commission reasoned that the costs of risk of loss compensation are more easily quantified and recognized when out in the open in forms such as those above and not hidden in a high valuation of collateral.[171]

B. *Property's "Use and Disposition"*

While the *Rash* Court deferred to the debtor's use of the retained Kenworth truck, it is possible for a debtor to retain the collateral and yet propose no use.[172] Some would suggest that in situations where the debtor's use cannot be determined, the fallback position must be the creditor's use, which is generally immediate foreclosure and sale.[173] This is a solution that would comport with the requirements set out in *Rash*.[174] Although the disposition or use would guide the court's valuation, it would also strip the creditor of the benefits of the *Rash* ruling by defaulting to foreclosure as the valuation standard.[175] Perhaps a better reading of *Rash* would require more emphasis in this situation upon the nature of the hearing

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165. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1885 (1997) (noting that in a cram down situation, a creditor is "exposed to double risks: The debtor may again default and the property may deteriorate from extended use"); Mitsch & Crutchfield, *supra* note 107, at 19 ("[T]he national statistics show that over 60 percent of the chapter 13s do not reach discharge").

166. *See Rash*, 117 S. Ct. at 1886 n.6 (the best way to ascertain replacement value is left for the trial court to determine).

167. *See id.* at 1886.

168. *See id.* at 1886 n.6.

169. *See supra* note 165 and accompanying text.

170. BANKRUPTCY COMMISSION, *supra* note 22, at 258.

171. *See id.*

172. *See Bankruptcy—Valuation*, *supra* note 150, at 2208.

173. *See id.*

174. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1885-86 (1997).

175. *See Bankruptcy—Valuation*, *supra* note 150, at 2208.

involved.[176] Thus, the use of a debtor wishing to cram down would be retention and the *Rash* replacement value standard would apply.[177] Therefore, the debtor's intention, whether it be stated or unstated, would be irrelevant, and the only relevant factor would be whether the debtor retains or surrenders the property.[178]

C. *Effect on Debtor/Creditor Relations*

It remains to be seen whether the *Rash* decision increases or decreases the amount of litigation generated due to valuation disputes. Litigation may decrease if parties find that there is at least some certainty in the *Rash* decision, and if they can rely on *Rash* to produce a value within a range narrow enough that the difference in dispute is not worth litigating.[179] However, there is also the possibility that parties will decide that the *Rash* decision did not change anything.[180] The perception by parties is that there is as much confusion in the courts as ever.[181] Thus, both parties may avoid litigation because it is either too expensive or too great of a capital risk.[182] Especially in Chapter 13 cases, where the value of collateral is small anyway, parties will tend to avoid litigation because the costs of litigation tend to eat up any money saved by a higher or lower valuation.[183]

There is also the possibility that litigation will increase because the *Rash* case did not really resolve anything, but simply extended the dispute into the foreseeable future.[184] In fact, valuation hearings may even be more unclear and expensive due to all of the costs and issues involved in reaching a replacement value.[185] Not only must experts establish every cost that a debtor would seek to deduct from the value,[186] but, in addition, they must establish the correct starting value, whether it be "retail value, wholesale value, or some other value."[187] Thus, the issue would no longer be what standard to use--the Court made it clear that it should be a

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176. *See id.*

177. *See* Ostrowitz, *supra* note 150, at 6 ("if the debtor is to continue to utilize the property, the property will be valued at its replacement value and not its foreclosure value").

178. *See Rash*, 117 S. Ct. at 1885; Ostrowitz, *supra* note 150, at 1.

179. *See* Klein, *supra* note 151, at 18-19; *see also Bankruptcy—Valuation*, *supra* note 150, at 2208.

180. *See* Rapisardi, *supra* note 150, at 6.

181. *See Bankruptcy—Valuation*, *supra* note 150, at 2208.

182. *See* Rapisardi, *supra* note 150, at 5.

183. *See In re Hoskins*, 102 F.3d 311, 314 (7th Cir. 1996) (stating that the problem for debtors and creditors was that "[r]eplacement value cannot be looked up. It must be litigated; and in the process the value of the asset will be paid out to the lawyers rather than to the creditors"); *cf. In re* Russell, 211 B.R. 12, 12-13 (Bankr. E.D.N.C. 1997) (discussing a debtor and creditor litigating a valuation issue over a difference of only $300).

184. *See* Rapisardi, *supra* note 150, at 6.

185. *See id.*; Genovese & Battista, *supra* note 150, at B12; *Stay Litigation after Rash*, *supra* note 24, at ¶20 ("Undoubtedly, *Rash* will raise more questions than it answered.").

186. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1886, n.6 (1997). Following the Court's directive in footnote 6 of the majority opinion, trial courts should look for ways to find a true replacement value that reflects the actual property the debtor is retaining.

187. *See id.*

replacement value standard--but rather the application of that standard.

Other commentators have expressed that the *Rash* holding will "pressure debtors to reorganize and run their business as an ongoing concern rather than to liquidate."[188] Going concern value is more like replacement value because it values a business as the sum of its parts rather than by its value if each part were sold off separately.[189] Replacement value then gives "secured parties a bonus--some extra going concern value[.]"[190] Debtors lose leverage in negotiations because they cannot count on a judge finding a low-ball value of the property under the plan.[191] One commentator described *Rash* as a step towards "level[ing] the playing field with bankrupt debtors."[192] Thus, debtors will have a harder time cramming down secured creditors due to the higher foreseeable collateral values that must be met in reorganization plans. Furthermore, negotiation on other items such as interest rate, adequate protection, agreement terms, and amortization rate will have to be at the forefront of a debtor's bankruptcy strategy.[193]

D. *Effect on Real Estate Industry*

Rash will affect real estate collateral to the extent that a jurisdiction must determine real estate values starting from a market-based value as a replacement value instead of starting with a foreclosure value.[194] The *Rash* decision, following the Court's instructions to limit valuation discussion to the actual use by the debtor and not hypothetical disposition by creditors, will also limit the extent to which a debtor could convince a court to lower the value of a given property for hypothetical sales costs and foreclosure.[195] Thus, creditors who are secured by real property will benefit the most from *Rash*, while the debtors and unsecured creditors will suffer the most through failed plan confirmation proposals and less money available, respectively.[196]

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188. Lavelle, *supra* note 150, at B1.

189. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1053 n.23 (5th Cir. 1996)(en banc), *rev'd*, 117 S.Ct. 1879 (1997).

190. *See Bankruptcy—Valuation*, *supra* note 150, at 2207.

191. *See In re* Hoskins, 102 F.3d 311, 316 (7th Cir. 1996) (finding that a midpoint Range Rule is the most fair and simply "split[ing] the difference").

192. Ostrowitz, *supra* note 150, at 1.

193. *See* BANKRUPTCY COMMISSION, *supra* note 22, at 258; Ostrowitz, *supra* note 150, at 1.

194. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1885-86 (1997).

195. *See id.*; Chu, *supra* note 150, at 9. *But see* Hammes, *supra* note 150 ("I believe that a valid argument could be made that brokers fees should be deducted from real property valuation.").

196. *See Rash*, 117 S. Ct. at 1887 (Stevens, J., dissenting).

E. To Which Chapters of Bankruptcy Does Rash *Apply?*

Section 506(a) is a "utility" section of the Bankruptcy Code, meaning that it applies to all bankruptcy chapters.[197] *Rash* will apply not only to Chapter 13 but to Chapters 7, 11, and 12 as well.[198] For example, the Supreme Court in *Rash* cited favorably to *In re Taffi*, a Chapter 11 Ninth Circuit case dealing with valuation standards.[199] This notation lends credence to the idea that the Court intended *Rash* to extend beyond Chapter 13 and to other bankruptcy chapters.[200] Thus, where any valuations call on section 506(a) to provide guidance in the valuation of collateral, then *Rash* will likely apply.

F. Differing Standards for Differing Uses, Hearings, and Collateral

Although *Rash* calls for value to be determined by the use or disposition of collateral, there is confusion as to whether value will fluctuate in each situation.[201] Despite the fact that many have declared *Rash* a victory for creditors or that *Rash* is "pro-creditor,"[202] the fact remains that section 506 applies to many different situations under the Bankruptcy Code. In each circumstance, debtors and creditors take opposite stances as to valuation and often flip-flop as to whether they want a high or a low value.[203] For example, a secured creditor's first line of action, where a debtor in bankruptcy is holding collateral which secures the creditor's debt, is to file a motion to lift the automatic stay under section 362(d)(1).[204] In such a situation, the creditor will want the court to find a low collateral value in order to show that the debtor either has no equity in the property or, alternately, that the property is diminishing in value and the debtor cannot adequately protect the creditor's interest. If the creditor can show either no equity and the property is not

197. *See id.*; Rapisardi, *supra* note 150, at 5 ("the precedential effect of this decision cannot be limited to Chapter 13 cases").

198. *See* Rapisardi, *supra* note 150, at 5 ("[the *Rash*] interpretation of the first two sentences of Bankruptcy Code § 506(a)—a provision that applies to Chapters 7, 11, 12, and 13").

199. *See Rash*, 117 S. Ct. at 1883-84, 1884 n.2 (citing *In re Taffi*, 96 F.3d 1190, 1192 (9th Cir. 1996)).

200. *See* Baxter Dunaway, *When the Debtor Retains Property, Is Fair Market or Liquidation Value Used in a Reorganization Plan?*, 6 J. BANKR. L. & PRAC. 617, 624 (Sept./Oct. 1997).

201. *See* Inter-City Beverage Corp. v. General Motors Acceptance Corp. (*In re* Inter-City Beverage Co., Inc.), 209 B.R. 931, 933 (Bankr. W.D. Mo. 1997) (determining the value of collateral using replacement value where the purpose and disposition was a distressed sale); *Stay Litigation After Rash*, *supra* note 24 (asserting that courts have been confused since *Rash*).

202. *See, e.g.*, Ostrowitz, *supra* note 150, at 1.

203. *See Stay Litigation after Rash*, *supra* note 24, at ¶15 ("[I]t sure seems arguable to us that in a motion to lift the stay, the last clause of § 506(a) dictates a different type of valuation in stay litigation than in plan confirmation litigation"). *See generally*, J. Queenan, Jr., *Standards For Valuation of Security Interests in Chapter 11*, 92 COMM. L.J. 18 (1987) (discussing litigant strategies in bankruptcy).

204. *See* Fortgang & Mayer, *supra* note 7, at 1070.

required for a successful reorganization or that there is a lack of adequate protection of the creditor's interest, then the creditor may have the stay lifted as to that property and can foreclose. If the creditor loses this battle, then the next line of action is for the debtor to defend against a cram down by arguing that the value of the property is high--at least higher than the debt. However, parties run the risk of quickly losing favor with a court if they try to flip from low to high value as it seems to suit them.[205] Yet section 506 and *Rash* seem to advocate just such a scenario, where a property is valued depending on the use and/or the purpose of the valuation.[206]

G. Confusion in the Courts as to Rash

Several courts have interpreted *Rash* to mean either more or less than what seems to be its plain meaning. In *In re Inter-City Beverage Co., Inc.*,[207] the bankruptcy court misapplied *Rash* in a Chapter 11 case involving a bulk distressed sale of the collateral before the court.[208] The *Inter-City Beverage* court held that the creditor, GMAC, was allowed a secured claim of the replacement value of their collateral that had been sold at a distressed sale.[209] The court simply reasoned that *Rash* applied even though this was not a cram down situation.[210] This outcome seems clearly contrary to *Rash,* where the Supreme Court envisioned the retention of other valuation standards in situations other than where the debtor retains the collateral and attempts to cram down the secured claimant.[211] The *Inter-City Beverage* court failed to apply the test required by *Rash*.[212] GMAC should have been limited to the liquidation value of the collateral that the distressed sale brought, because the purpose of the valuation and the "disposition or use" by the parties was the liquidation of assets in order to pay off creditors like GMAC.[213]

In *In re Gates*,[214] the debtor kept a car under a Chapter 13 reorganization plan and attempted to cram down her secured creditor.[215] The debtor first claimed that the proper starting value should be taken from a price guide which listed the trade-

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205. *See Stay Litigation after Rash*, *supra* note 24.
206. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1885-86 (1997).
207. Inter-City Beverage Corp. v. Gen. Motors Acceptance Corp. (*In re* Inter-City Beverage Corp.), 209 B.R. 931 (Bankr. W.D. Mo. 1997).
208. *See id.* at 933.
209. *See id.*
210. *See id.*
211. *See Rash*, 117 S. Ct. at 1885.
212. *See id.*; *see also* Genovese & Battista, *supra* note 150, at B12.
213. *See Rash*, 117 S. Ct. at 1885.
214. 214 B.R. 467 (Bankr. D. Md. 1997).
215. *See id.* at 468-69.

in or wholesale price of vehicles.[216] The debtor claimed that where the creditor only offered a retail value, based on a National Automobile Dealers Association Official Used Car Guide (N.A.D.A. Guide),[217] without removing the cost items required to be subtracted by *Rash* in footnote six, then the appropriate value should be determined using the trade-in or wholesale value.[218] In a memorandum opinion, the bankruptcy court held that in the case of personal consumer use of collateral, retail value was the appropriate starting value and, furthermore, it was incumbent upon the debtor to provide proof of items of reduction to that value.[219] The *Rash* decision indicated that certain items should not be included in replacement value.[220] However, the *Gates* decision appears to be in harmony with *Rash* where the "bankruptcy courts, as triers of fact," are to identify "the best way of ascertaining replacement value on the basis of the evidence presented."[221] Thus, the *Gates* court found who wanted the costs deducted was the same party who needed to present the evidence of costs.[222]

In re Russell[223] is a good case to exemplify what the Supreme Court seemed to have intended to be a result of the *Rash* decision. The facts of *Russell* are similar to *Rash*: a Chapter 13 debtor tried to cram down his secured creditor on a car that he was keeping under his reorganization plan.[224] The secured creditor provided evidence from a N.A.D.A. Guide establishing the car's value, whereas the debtor provided evidence from a newspaper showing that the car was selling for $300 less than the guide.[225] The court held that the N.A.D.A. Guide provided a better starting valuation than the newspaper ad, where the debtor could provide no evidence that the vehicle in the ad was "of like age and condition"[226] to the debtor's car.[227] The court agreed with the debtor, though, that the costs specified by footnote six of the *Rash* opinion should be deducted from the N.A.D.A. Guide, had the guide included them.[228] However, the court specifically rejected the debtor's argument for deducting retail costs as "inconsistent with the specific holding in *Rash*," that replacement value reflect "the *cost the debtor would incur* to obtain a like asset for the same 'proposed . . . use.'"[229] The court also reasoned that deducting retail costs was further inconsistent with *Rash*'s adherence to the

216. *See id.* at 469.
217. *See id.*
218. *See id.* at 469-70.
219. *See id.* at 471.
220. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1886 n.6 (1997).
221. *See In re Gates*, 214 B.R. at 471.
222. *See id.* at 472.
223. 211 B.R. 12 (Bankr. E.D.N.C 1997).
224. *See id.* at 12.
225. *See id.*
226. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1884 n.2 (1997).
227. *See In re Russell*, 211 B.R. at 13.
228. *See id.* (citing *Rash*, 117 S. Ct. at 1886 n.6).
229. *See id.* at 14 (quoting *Rash*, 117 S. Ct. at 1886).

Seventh Circuit's desire that "a simple rule of valuation [was] needed."[230] Finally, the court rejected the debtor's argument against *Rash*'s favorable citation to *In re Taffi*,[231] which held that hypothetical sales costs should not be deducted from the collateral's value.[232]

H. Wholesale Value as Possible Solutions as Suggested by the National Bankruptcy Review Commission to Congress

Shortly after the Supreme Court handed down *Rash*, the National Bankruptcy Review Commission reviewed the *Rash* opinion and gave its own evaluation and solution of the valuation problem to Congress.[233]

The Commission proposed wholesale value as a compromise between the often high values represented by retail and the low values obtained at foreclosure or liquidation.[234] The Commission believed that this valuation standard could produce a cheaper, more efficient standard for courts to rely on than the replacement value standard offered by the *Rash* court or even than the equitable split-the-difference value standard.[235]

Wholesale value is the value set by a guide, such as the N.A.D.A. Guide for motor vehicles or the value that dealers or markets in the goods puts on the property, depending on whether the good is used or new.[236] In Chapter 13 bankruptcies, most goods are personal and used and should be priced as such without reference to new goods' prices containing warranties and sales costs.[237] Wholesale value portends to be simple, requiring only one valuation, unlike an average which requires at least two.[238]

230. *See id.* at 14 n.3 (quoting *Rash*, 117 S. Ct. at 1886).

231. *See Rash*, 117 S. Ct. at 1883-84, 1884 n.2.

232. *See In re Russell*, 211 B.R. at 14 (citing *Rash*, 117 S. Ct. at 1884 n.2); *see also* Hammes, *supra* note 150 ("the profit associated with a vehicle's 'retail value' [sh]ould also be disallowed").

233. *See* BANKRUPTCY COMMISSION, *supra* note 22, at 243.

234. *See id.* at 250.

235. *See id.*

236. *See id.* at 251; *see also In re Russell*, 211 B.R. at 14 ("[T]he starting point for [] evaluation will be N.A.D.A. retail value."). Judge Easterbrook noted, in referring to N.A.D.A. Guides, that "[w]holesale and retail values can be looked up in tables. They are simple to administer and satisfy my test or a good rule." *In re* Hoskins, 102 F.3d 311, 320 (7th Cir. 1996) (Easterbrook, J., concurring).

237. *See* BANKRUPTCY COMMISSION, *supra* note 22, at 251.

238. *See id.* at 253.

I. Midpoint Value as Valid Alternative

The *Rash* Court easily dismissed any midpoint standard as unsupported by section 506(a).[239] However, a midpoint standard would provide a compromise position that could be easily established despite requiring at least two valuations.[240] Parties who dispute the value of property in bankruptcy inevitably have at least two values already or there would not be a dispute.[241] Parties in negotiation tend to shift to a middle ground somewhere between what each claims to be the proper value of the collateral.[242]

While a midpoint standard still requires two valuations to be made and submitted, it does provide a clear point for parties to rely on in negotiations outside of court.[243] A midpoint value standard would also help to eliminate litigation on the issue of value because any discrepancies on either end of the spectrum (retail vs. foreclosure) would only marginally affect the midpoint.[244] This manner of valuation also encourages negotiation between the parties to work out the midpoint without having to go to the trouble of having expensive valuations performed and testified to by professional experts, only to have them averaged by the court.[245] Parties are encouraged to find a middle ground on their own. However, the Court specifically rejected this standard of valuation, thus making it inaccessible to all but Congress.[246]

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239. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1886 (1997).
240. *See In re Hoskins*, 102 F.3d at 316.
241. *See id.*
242. *See id.* at 315.
243. *See id.* at 316.
244. *See id.* For example, if there is $1,000 in dispute between the parties' valuation figures, then the midpoint would settle for the middle. Under a midpoint standard the parties have nothing to litigate except maybe the veracity of the values they allege. Yet, even that issue is weakened because the most the parties can gain is half of whatever difference in value between the actual replacement/foreclosure value and the asserted one. However, if either the foreclosure or replacement standard is the accepted standard, then the parties are litigating the full difference between foreclosure and replacement value. Taking the above example, if X were to allege $100 more (or Y were to allege $100 less) value than what is in actuality, then the amount in dispute would raise to $1,100. Under a midpoint value standard, the raised amount at issue is only $50 more, not $100, thus less reason to litigate. Whereas under any other sort of valuation, the difference is the full $550. Not only that, but one side or the other tends to lose more due to a valuation standard to one extreme or the other, thus parties would be more apt to litigate a higher value issue.
245. *See In re Hoskins*, 102 F.3d at 315.
246. *See* Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1886 (1997).

VI. CONCLUSION

In *Rash*, the Supreme Court gave clear direction that the valuation standard is the replacement value standard and that the purpose of the valuation and the proposed disposition or use are the focal point in deciding what valuation is appropriate.[247] However, courts must still struggle with the valuation question due to the number of different purposes,[248] directives in *Rash*,[249] and uses of property in bankruptcy no matter how one looks at the *Rash* decision.[250] Where parties cannot or will not negotiate a compromise valuation of the collateral, the bankruptcy courts will determine the value based on these criteria, whether it be to the benefit of the secured creditor, the unsecured creditor, or the debtor.

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247. *See id.*
248. *See Stay Litigation after Rash, supra* note 24.
249. *See Rash,* 117 S. CT. at 1886 n.6.
250. *See Bankruptcy--Valuation, supra* note 150, at 2207.