Toward a Midpoint Valuation Standard in Cram Down: Ointment for the Rash Decision

Chris Lenhart

Follow this and additional works at: http://scholarship.law.cornell.edu/clr

Part of the Law Commons

Recommended Citation
Available at: http://scholarship.law.cornell.edu/clr/vol83/iss6/9
TOWARD A MIDPOINT VALUATION STANDARD IN CRAM DOWN: OINTMENT FOR THE RASH DECISION

Chris Lenhart†

INTRODUCTION .................................................. 1822

I. A PRIMER ON SECURED CLAIMS AND BANKRUPTCY VALUATIONS ............................................. 1823
   A. Bifurcation and Valuation in Bankruptcy ........ 1823
   B. Deciphering the Valuation Terminology ............ 1830

II. FOUR APPROACHES TO VALUING SECURED CLAIMS IN BANKRUPTCY ............................................. 1831
   A. The Wholesale Valuation Standard ................ 1831
      1. Statutory Analysis ................................ 1832
      2. Economic Analysis ................................. 1835
   B. The Replacement Valuation Standard .............. 1839
      1. Statutory Analysis ................................ 1839
      2. Economic Analysis ................................. 1841
   C. The Midpoint Valuation Standard .................. 1845
      1. Statutory Analysis ................................ 1845
      2. Economic Analysis ................................. 1846
   D. Valenti and the Ruleless Approach ............... 1850

III. THE SUPREME COURT’S DECISION IN RASH ......... 1852
   A. Background ........................................ 1852
   B. The Majority’s Adoption of Replacement Value .... 1853
   C. Justice Stevens’s Dissent ........................... 1854

IV. THE TREATMENT OF RASH BY THE COURTS, LEGISLATORS, AND THE BANKRUPTCY SYSTEM: WHY MIDPOINT VALUATION WILL NOT AND SHOULD NOT GO AWAY .................. 1855
   A. Bankruptcy Courts’ Treatment of Rash .......... 1855
      1. Cases Continuing To Use the Midpoint Valuation . . 1856
      2. Cases Claiming To Use Retail Value ............. 1859
         a. Components of Bluebook Wholesale and Retail Values................................ 1859

† The author wishes to thank Professors Lynn M. LoPucki and Jean Braucher for their patient discussions with the author, Jeffrey Brill, Chris Ogiba, Joseph Klapach, Eric Swedenburg, and Daniel E. Wenner for their editing work, and Amy Novak for their patience and support.
b. How Post-Rash Courts Have Applied Retail Valuation .................................. 1863
B. Post-Rash Attempts at Legislative Reform .................. 1865
C. The Role of a Bright-Line Rule for Valuation in the Bankruptcy System ....................... 1868
D. The Role of the Midpoint Valuation Standard in the Bankruptcy System ..................... 1870
CONCLUSION ..................................................... 1875

INTRODUCTION

Children understand the uncertain nature of value at an early age. On any given street corner in America, children sit around and hypothesize: "What would you do for a million dollars?" While the value of the reward is finite—one million dollars—the varying lengths to which each child will go to secure the reward demonstrate that every child on the block values "their" million dollars differently. Despite the initial control that the child has over the valuation, the valuation inevitably becomes more fact specific—"Do I have to eat the whole thing or just one bite?" or "Do I have to kiss her on the cheek or on the lips?" After the children walk away from the game, many will inevitably wonder, "Would I really have done that? Did I value the million dollars correctly?"

Today, bankruptcy judges face many of the same dilemmas regarding valuation. When deciding on the correct value of collateral in bankruptcy, judges do not have the benefit of an actual sale on which to base their decision. Inevitably, these judges must enter a make-believe world in which they hypothesize about the creditor’s potential remedies outside of bankruptcy, the debtor’s potential uses of the collateral, and a number of other factors. Through this process, the bankruptcy judges must take into account the numerous choices that creditors and debtors can make in order to receive their "million dollars." Yet, the serenity of the judge’s hypothetical world will often succumb to fact-specific questions—"Would the creditor in fact liquidate the collateral?" or "Do I need to take into account the debtor’s unique use of the collateral in this case?" As a result of the divergent approaches to valuation that bankruptcy courts have taken, debtors and creditors often have emerged from the court’s valuation wondering, "Would I really have taken those actions? Did the judge value the collateral correctly?"

This Note discusses the three major theories for valuing secured claims in bankruptcy reorganizations and the Supreme Court’s treatment of these theories in Associates Commercial Corp. v. Rash (In re
Prior to the Supreme Court’s decision in Rash, three valuation theories dominated in the courts of appeals: “wholesale valuation,” “replacement valuation,” and “midpoint valuation.” Although the Rash Court prescribed replacement value as the benchmark for Chapter 13 cram down valuations, ambiguity in the Court’s definition of replacement value has prompted some lower courts to continue to use the midpoint value standard. This Note will discuss (1) how the Court’s opinion in Rash has failed to discourage courts from using midpoint valuation, and (2) why the use of midpoint valuation makes sense from a systems analysis standpoint.

Part I outlines the backdrop against which bankruptcy valuations occur and explains the confusing terminology surrounding bankruptcy valuation theories. Part II sets forth the statutory and ideological underpinnings of the three valuation theories, as well as the ruleless approach, operating at the court of appeals level prior to Rash. Part III examines the Supreme Court’s adoption of the replacement value standard in Rash, the reasoning behind the majority’s decision, and Justice Stevens’s dissent. Part IV discusses the lower courts’ and the National Bankruptcy Review Commission’s early treatment of Rash. This Part also analyzes the effect that courts’ choices of valuation standards have on debtors, creditors, and the judiciary within the bankruptcy system. This Note concludes that the Rash decision muddied the valuation waters by failing to clarify the meaning of replacement value and that lower courts are ignoring Rash to the extent that it hinders judicial economy and common sense. This Note argues that courts should instead choose a valuation system that promotes the goals of reducing transaction costs for the parties and minimizing strategic activity.

I
A PRIMER ON SECURED CLAIMS AND BANKRUPTCY VALUATIONS

A. Bifurcation and Valuation in Bankruptcy

A security interest in a petitioning debtor's property entitles secured creditors to two important protections in bankruptcy: (1) “adequate protection” of their interest,7 and (2) payment, by the debtor,
totalling the value of their interest in the collateral. In Chapter 7 liquidations, the secured creditor is entitled to payment of the amount for which the trustee sells the collateral, up to the amount of the secured creditor's claim. Thus, if the debtor owes the secured creditor $100, the secured creditor submits a secured claim for $100, and the trustee sells the collateral for $200, the secured creditor is entitled to $100 of the proceeds from the sale. However, if the trustee only receives $50 for the collateral, the secured creditor is entitled to all of the sale's proceeds and, in addition, may file an unsecured claim for $50. This splitting of the secured creditor's claim is known as bifurcation. Bifurcation simply means that a secured creditor only has a secured claim for the value of the collateral, and the remainder of the debt constitutes an unsecured claim. The treatment of the secured creditor's secured claim in a Chapter 7 liquidation largely parallels the treatment that a secured creditor's claim would receive under state law. Outside of bankruptcy, the creditor has a right to collect from a defaulting debtor's collateral up to the value of the debt by repossessing and selling the debtor's collateral. The secured creditor must pay the debtor any amount that it receives beyond the amount it is owed. If the secured creditor receives less than the amount owed by the debtor, then state law entitles the secured creditor to a deficiency judgment, which allows the secured creditor to collect the remainder of the debt from the debtor. Thus, both the state and the subsequent protection of the secured creditor's collateral. Additionally, the debtor's immediate redemption, reaffirmation, or surrender of the collateral can quickly render the adequate protection issue a moot point. See Elizabeth Warren & Jay Lawrence Westbrook, The Law of Debtors and Creditors 339-40 (3d ed. 1996). Similarly, in Chapter 13, the short or nonexistent time lapse between the initial filing of the petition and the plan offering secured creditors protection greatly reduces the likelihood that adequate protection issues will arise. Thus, the bulk of adequate protection issues should arise in Chapter 11 because the extended period between the time of initial filing and the ultimate confirmation of a plan increases the risk of a loss in value of the collateral.

8 In Chapter 7 cases, the court assigns a local bankruptcy trustee shortly after the filing of the debtor's petition. See 11 U.S.C. §§ 701-702. The trustee bears responsibility for collecting and liquidating the property of the estate. See id. § 704(1).


11 See infra note 43 and accompanying text.


law remedies system and Chapter 7 liquidations attach a value to the secured creditor’s collateral through an actual sale of the collateral, whether by the secured creditor or by the bankruptcy trustee.

Chapter 11 or Chapter 13 reorganizations, however, do not value a secured creditor’s secured claim through an actual sale of the collateral. Instead, the debtor has the first chance to set the collateral’s value, however the secured creditor objects to the debtor’s valuation in a majority of cases, and the bankruptcy court must then set a value on the collateral—often at something less than the total amount that the debtor owes. Valuation of the collateral can occur in a variety of situations, and a court’s valuation in a particular valuation proceeding may not control in different or later valuation proceedings. As in Chapter 7 liquidations, § 506(a) of the Bankruptcy Code gov-

17 The debtor’s plan must be filed within fifteen days of the petition date in a Chapter 13 case. See Fed. R. Bankr. P. 3015(b). The plan contains an initial valuation of the collateral because the plan must specify the time and manner for paying secured claims. See 11 U.S.C. § 1325. Thus, the debtor must value the collateral in order to propose an appropriate repayment schedule. Debtors’ initial valuations often err on the low side, thereby allowing more money to remain in the estate for payment of unsecured claims such as attorneys’ fees. Although some bankruptcy courts have tried to curtail these lowball “estimates” through local rules dictating guidelines for initial valuations, see infra note 166 and accompanying text, secured creditors consistently object to debtors’ initial valuations. See Robert F. Mitsch & Carleton B. Crutchfield, The Rash Decision: A Question of Value in Context, Am. Bankr. Inst. J., July-Aug. 1997, at 18, 18. But see Jean Braucher, Getting It For You Wholesale: Making Sense of Bankruptcy Valuations of Collateral After Rash, 102 Dick. L. Rev. (forthcoming 1998) (manuscript at 4, on file with author) (arguing that Chapter 13 debtors’ attorneys have an incentive to “peg value at a high and thus noncontroversial value” in order to avoid creditor challenges that result in unprofitable litigation for the attorney).

18 A secured creditor may, upon objection to the debtor’s valuation, file a motion for a valuation hearing. See Fed. R. Bankr. P. 3012. This hearing will take place prior to the court’s hearing on confirmation.

19 This undervaluation results from the secured creditor being undersecured, which occurs when the value of the collateral is less than the amount of the total debt. Undersecured loans are common lending practice. See, e.g., Associates Commercial Corp. v. Rash (In re Rash), 90 F.3d 1036, 1053 n.22 (5th Cir. 1996) (“Those who finance cars are typically undersecured. The debt exceeds the car’s retail value.” (quoting Association of Int’l Auto. Mfrs., Inc. Amicus Brief at 5) (citations omitted)), rev’d 117 S. Ct. 1879 (1997).

20 Contexts for application of valuation standards in the bankruptcy setting include: relief from the automatic stay or adequate protection of collateral, see 11 U.S.C. § 362(d) (1994); objection to proof of claim, see id. § 502; cram down and confirmation of debtor’s plan, see id. §§ 1129(b), 1325(a)(5); redemption of collateral in bankruptcy liquidations, see id. § 722; and subordination of secured debt, see id. § 364(d).

21 See Fairchild v. Lebanon Prod. Credit Ass’n (In re Fairchild), 31 B.R. 789, 795 (Bankr. S.D. Ohio 1983) (“A determination of the amount of a secured claim in one aspect of a bankruptcy proceeding is not necessarily res judicata in other aspects of that proceeding.”); Provident Bank v. BBT (In re BBT), 11 B.R. 224, 229 n.10 (Bankr. D. Nev. 1981) (“Of course, the value determined in the light of the purpose of vacating the automatic stay may not be the same as the value for another purpose such as confirmation of a plan.”); see also S. REP. No. 95-989, at 68 (1978) (“[A] valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan.”).
cerns the valuation of secured claims in reorganizations.\textsuperscript{22} Unlike liquidations, however, in which courts value a creditor's secured claim simply based on the trustee's sale,\textsuperscript{23} courts facing valuation proceedings in Chapter 11 or Chapter 13 reorganizations must divine from § 506 a theory for valuing collateral without the benefit of an actual sale.\textsuperscript{24} This section states in relevant part:

An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . 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.\textsuperscript{25}

Although § 506(a) may appear to outline a concrete method for valuation, courts facing valuation proceedings in bankruptcy reorganizations have interpreted this section to support a number of conflicting valuation theories, including "wholesale value, retail value, an average between wholesale and retail value, retail replacement cost, and the 'bid' market price."\textsuperscript{26} One court, commenting on the published cases that have addressed the valuation question, observed that "[t]he only thing more staggering than the sheer number of the decisions is the variance among them."\textsuperscript{27} Three dominant valuation standards—the wholesale value,\textsuperscript{28} replacement value,\textsuperscript{29} and midpoint value\textsuperscript{30}—have emerged from § 506(a) to become the only three valuation theories recognized by the courts of appeals.\textsuperscript{31}

\textsuperscript{22} See 11 U.S.C. § 506(a).
\textsuperscript{23} See supra text accompanying notes 8-12.
\textsuperscript{24} For a case in which a court in a reorganization context preferred the value that an actual sale demonstrated over the trustee's request for a valuation proceeding, see Romley v. Sun Nat'l Bank (In re Two "S" Corp.), 875 F.2d 240, 244 (9th Cir. 1989) (Chapter 11) ("Evidence of other appraised values is also irrelevant, because the sale price is a better indicator of the asset's value than any estimate of value given prior to the sale.").
\textsuperscript{25} 11 U.S.C. § 506(a).
\textsuperscript{27} In re Green, 151 B.R. 501, 502 (Bankr. D. Minn. 1993).
\textsuperscript{28} See infra Part II.A.
\textsuperscript{29} See infra Part II.B.
\textsuperscript{30} See infra Part II.C.
\textsuperscript{31} See infra notes 61, 124, 164. A fourth approach to valuation given in \textit{General Motors Acceptance Corp. v. Valenti} (In re Valenti), 105 F.3d 55 (2d Cir. 1997), involves a "ruleless" approach. \textit{See infra} Part II.D. This approach does not present a fourth theory of valuation, but merely places primacy on a court's flexibility to use any of the three approaches to valuation depending on its merits in a particular case.
Courts most often apply these theories in the context of valuing motor vehicles in Chapter 13 cram downs. The *Rash* decision, and the conflicting circuit court cases cited therein, all arose in the context of valuing vehicles in Chapter 13 cram downs. The debtor’s principal residence is often the most important asset that the debtor owns, and hence should be the subject of most valuation clashes. However, the Supreme Court in *Nobelman v. American Savings Bank* held that 11 U.S.C. § 1322(b)(2) prohibits a § 506(a) bifurcation of a secured creditor’s claim in Chapter 13 when the claim is secured solely by a security interest in the debtor’s principal residence. Because this decision only applies to a debtor’s principal residence, debtors may modify the rights of creditors who have claims secured by motor vehicles without the § 1322(b)(2) restriction. As Elizabeth Warren and Jay Lawrence Westbrook note, “[o]ne of the most common reasons for choosing a Chapter 13 bankruptcy is the debtor’s desire to keep property that is subject to a security interest.” Thus, most valuation cases after *Nobelman* focus on the second most important asset in the debtor’s estate—the debtor’s vehicle. While this Note’s discussion of valuation in Chapter 13 applies to all forms of collateral, in most instances this Note will focus on the valuation of vehicles because it is the subject of the majority of Chapter 13 valuation proceedings.

---

32 Cram down valuations generally arise in the context of Chapter 13 much more often than Chapter 12 or Chapter 11. Chapter 12 applies only to family farmers and is therefore rarely used. Chapter 11 allows a secured creditor to choose to treat the secured creditor’s entire claim as a secured claim for valuation purposes under § 1111(b), which frequently forgoes the need to value a creditor’s secured claim for bifurcation purposes.

33 *Associates Commercial Corp. v. Rash* (*In re Rash*), 117 S. Ct. 1879, 1882 (1997). Note, however, that the vehicle in *Rash* was not the debtor’s car, used for personal reasons and readily available for replacement in a fluid aftermarket, but instead was a Kenworth truck, used for income-producing purposes and available for replacement in a more limited aftermarket. See *id.* at 1882.

34 See *id.* at 1883-84 (citing *General Motors Acceptance Corp. v. Valenti* (*In re Valenti*), 105 F.3d 55 (2d Cir. 1997); *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996); *Taffi v. United States* (*In re Taffi*), 96 F.3d 1190 (9th Cir. 1996); *Winthrop Old Farm Nurseries, Inc. v. New Bedford Institution for Savings* (*In re Winthrop*), 50 F.3d 72 (1st Cir. 1995); *Metrobank v. Trimble* (*In re Trimble*), 50 F.3d 530 (8th Cir. 1995)).


36 Id. at 328.

37 See *Bank One, Chicago, NA v. Flowers* (*In re Flowers*), 183 B.R. 509, 516 (N.D. Ill. 1995) (“Creditor’s claim is secured by Debtor’s car, not Debtor’s principal residence, and § 1322(b)(2) therefore permits Debtor’s Chapter 13 payment plan to modify the ‘rights’ of Creditor’s secured claim.”).

38 *Warren & Westbrook*, supra note 7, at 338.

39 See *General Motors Acceptance Corp. v. Valenti* (*In re Valenti*), 105 F.3d 55 (2d Cir. 1997); *In re Hoskins*, 102 F.3d 311 (7th Cir. 1996); *Metrobank v. Trimble* (*In re Trimble*), 50 F.3d 530 (8th Cir. 1995); see also *Henry J. Sommer, Consumer Bankruptcy Law and Practice* 43 (Supp. 1997) (“Valuation issues arise most frequently . . . with respect to motor vehicles.”).
The cram down provision of Chapter 13 allows a debtor to pay the present value of the secured creditor's claim over the life of the debtor's plan, and thereby receive judicial confirmation of their reorganization plan without the secured creditor's approval. Thus, in a cram down, a debtor seeks to have the collateral valued as low as possible in order to reduce the amount of money that he must pay out to ensure that the secured creditor receives the present value of its claim. A creditor will seek a higher valuation of the collateral in order to salvage as much money as possible from the bankruptcy-induced alteration of the original loan contract.

A brief example will help illustrate the operation of the cram down provision. Debtor purchases a vehicle from Secured Creditor for $17,000, which Debtor obtains through financing 100% from Secured Creditor at an interest rate of 15%. One year later, Debtor defaults on his loan from Secured Creditor and shortly thereafter files for Chapter 13. In the petition, Debtor lists ownership of the vehicle, the $15,000 liability to Secured Creditor, and adds Secured Creditor to the petition's list of creditors.

Secured Creditor then files a claim with the bankruptcy court for $15,000, the amount that Debtor still owes on the vehicle loan. Next, Debtor files a plan in which he values the vehicle at $5,000, and he proposes to pay Secured Creditor $161.34 per month for thirty-six months—an amount that reflects the $5,000, plus an interest rate of 10%. This plan ensures that Debtor pays Secured Creditor the present value of $5,000, as required by the cram down provision. Secured Creditor may then object to Debtor's

41 Alternatively, Debtor could receive the loan from a bank, a credit union, or through an affiliate of the auto dealership. In those cases, these lending institutions would serve as the Secured Creditor in this example.
42 Bankruptcy Rule 1007(a)(1) requires that the debtor's petition contain a list of creditors in addition to a list of assets and liabilities. See Fed. R. Bankr. P. 1007(a)(1).
43 Although secured creditors are not required to file the proof of claim that unsecured creditors must file in order to obligate the debtor to pay the unsecured creditor, see Fed. R. Bankr. Proc. 3002(a), some courts have not allowed secured creditors to participate in Chapter 13 distributions without filing such proof. See, e.g., In re Wells, 125 B.R. 297, 300 (Bankr. D. Colo. 1991). For further discussion regarding the benefits and detriments associated with filing a claim as a secured creditor, see LoPucki, supra note 9, at 846-50.
44 The initial valuation, see supra note 17, often originates from the debtor's schedule of assets and liabilities. In some jurisdictions, local rules govern the initial valuation of a vehicle. See infra note 166 and accompanying text.
45 Bankruptcy courts require a current market rate in order to protect the present value of the payments. For an in-depth discussion on the diverse and conflicting treatment by courts of the interest rate question, see Hon. John K. Pearson et al., Ending the Judicial Snipe Hunt: The Search for the Cramdown Interest Rate, 4 Am. Bankr. Inst. L. Rev. 35 (1996).
46 Section 1325 ensures that "the value, as of the effective date of the plan, of property to be distributed under the plan... is not less than the allowed amount of [the] claim." 11 U.S.C. § 1325(a)(5)(B)(ii) (1994). The Chapter 11 cram down provision, 11 U.S.C. § 1129(b)(2)(A)(i)(II), mirrors this language.
plan, in which case the court must hold a valuation hearing separate from, or in conjunction with, the court’s hearing on the confirmation of Debtor’s plan. At the valuation hearing, the court will determine the value of the vehicle by choosing and applying a valuation standard. The value that the court ascribes to the vehicle will become the amount of Secured Creditor’s secured claim, and the difference between that amount and Secured Creditor’s original $15,000 claim will become her unsecured claim.

As stated earlier, Debtor will seek a low value in order to reduce the amount of money that he must pay Secured Creditor on the basis of her secured claim, while Secured Creditor will seek a high value in order to ensure that most, if not all, of the underlying loan becomes a secured claim. Returning to the above example, assume the court determines that the vehicle has a value of $10,000. The court will then require Debtor to pay Secured Creditor monthly payments that reflect the present value of $10,000. The remaining $5,000 that Debtor owes on the outstanding loan will become an unsecured claim, entitling Secured Creditor to payment of the unsecured claim pro rata with the other unsecured claims. Debtor may pay unsecured claims in full, may pay only a percentage of each unsecured claim, or may not pay unsecured claims at all, depending on the debtors’ ability to pay. Thus, Secured Creditor is only assured of receiving $10,000 of the original $15,000 remaining on the loan. Any further payments

47 See supra note 18.
48 Some courts have chosen to combine the valuation hearing and the confirmation hearing. See, e.g., In re Britt, 199 B.R. 1000, 1001 (Bankr. N.D. Ala. 1996).
49 See supra text accompanying notes 13-14.
50 See supra text accompanying note 40.
51 This pro rata requirement for repaying unsecured creditors, which is subject to the priority system in 11 U.S.C. § 507, is explicitly mandated in Chapter 7 by 11 U.S.C. § 726(a), and is inherent in the good faith requirements of Chapter 11, see 11 U.S.C. § 1129(a) (3), and Chapter 13, see 11 U.S.C. § 1325(a) (3).
52 See TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 36 (1989) (reporting that 36% of debtors submitted a plan paying 100 cents on the dollar to unsecured creditors).
54 See, e.g., In re Fields, 190 B.R. 16 (Bankr. D.N.H. 1995) (confirming the Chapter 13 plan despite zero repayment to unsecured creditors). Prior to the addition of § 1325(b) to the Bankruptcy Code, courts had split on the issue of whether zero-repayment plans violated § 1325(a) (3)’s “good faith” test. Compare, e.g., Downey Sav. & Loan Ass’n v. Metz (In re Metz), 820 F.2d 1495, 1497 (9th Cir. 1987) (finding that zero repayment to unsecured creditors is not bad faith per se) with Tenney v. Terry (In re Terry), 630 F.2d 634, 635 (8th Cir. 1980) (finding that a Chapter 13 plan must provide some repayment to unsecured creditors in order to meet the good faith standard). In 1984 Congress added § 1325(b) to the Bankruptcy Code, which set the minimum repayment, provided that there is an objection to the plan, at all of the debtor’s “disposable income” for a three-year period or until all of the unsecured claims are fully paid. See 11 U.S.C. § 1325(b) (1994).
hinge on Debtor's financial savvy. In order to resolve this valuation battle between debtors and creditors, courts have focused on the differing statutory and economic arguments for the competing theories of valuation. The remainder of this Part discusses the differing justifications, both statutory and economic, that proponents of the three established valuation standards have posited to justify their use.

B. Deciphering the Valuation Terminology

Courts' and commentators' tendency to use interchangeably the various labels that describe theories of valuation necessitates a brief explanation of the terminology that these authorities, and this Note, use.\(^5^5\) This Note uses the terms "wholesale value" and "wholesale valuation standard" in this background discussion to describe the particular value that creditors would realize if permitted to repossess and sell the collateral. These terms are intended also to encompass what courts have called "foreclosure value" or the "foreclosure value standard." Because most Chapter 13 cram down cases involve the valuation of motor vehicles, courts assume that wholesale value, usually determined by reference to a National Automobile Dealers Association's Official Used Car Guide ("Bluebook"),\(^5^6\) represents the price that the creditor would receive for the vehicle in a foreclosure sale.\(^5^7\) Authorities use the terms interchangeably because all of these methods of valuation represent a single statutory interpretation of § 506(a)—an interpretation that focuses primarily on the first sentence of the section.\(^5^8\)

The terms "replacement value" and "replacement valuation standard" refer to the debtor's cost of replacing the collateral. These terms, as used in Parts I and II of this Note, include the "retail value" and the "retail valuation standard" terminology that courts often use. All of these terms are intended to represent another single statutory interpretation of § 506(a)—an interpretation that focuses primarily on the second sentence of the section.\(^5^9\) When discussing these terms

---

\(^5^5\) For a further discussion of the conflation of these terms by courts, see 4 COLLIER ON BANKRUPTCY ¶ 506.03[6][c][iii] (Lawrence P. King et al. eds., 15th ed. 1998).

\(^5^6\) Future references to the "Bluebook" should be understood to indicate those industry price guides that dealers, consumers, and courts use to value vehicles. See, e.g., NATIONAL AUTOMOBILE DEALERS ASS'N, OFFICIAL USED CAR GUIDE (1997).

\(^5^7\) Because most of the litigated cases surround the valuation of automobiles, courts often use the wholesale Bluebook value as the benchmark for foreclosure valuations instead of attempting to predict what the secured creditor would receive through a sale at an auto auction or other foreclosure disposition. See, e.g., In re Maddox, 194 B.R. 756, 767 (Bankr. D.N.J.), aff'd, 200 B.R. 546, 550 (D.N.J. 1996); Ford Motor Credit Co. v. Phillips (In re Phillips), 142 B.R. 15, 17 (Bankr. D.N.H. 1992); In re Cook, 38 B.R. 870, 875 (Bankr. D. Utah 1984).

\(^5^8\) See supra text accompanying note 25.

\(^5^9\) See supra text accompanying note 25.
in light of the *Rash* case, however, it becomes problematic to consolidate them because *Rash* specifically distinguishes retail value, which often contains costs that the debtor would not incur if he retained the vehicle, and replacement value, which does not contain dealer costs.\(^\text{60}\) Thus, this Note must parse the differences between foreclosure value, wholesale value, replacement value, and retail value when discussing the *Rash* opinion and its subsequent treatment by the lower courts.

### II

**FOUR APPROACHES TO VALUING SECURED CLAIMS IN BANKRUPTCY**

#### A. The Wholesale Valuation Standard

Two circuits,\(^\text{61}\) numerous bankruptcy courts,\(^\text{62}\) and several commentators\(^\text{63}\) adopted the wholesale valuation standard in bankruptcy reorganizations prior to *Rash*. Absent specific evidence that the secured creditor will receive the full retail value upon disposition of the collateral, the wholesale valuation standard fixes the collateral’s value at the amount that the secured creditor could realize upon disposition of the collateral in a commercially reasonable foreclosure.\(^\text{64}\) For vehicles, some courts use the wholesale price, given in the Bluebook, as the benchmark for valuation.\(^\text{65}\) These courts choose the wholesale

---

\(^{60}\) *See infra* Part III.B.


\(^{63}\) *See* Owen W. Katz, *Valuation of Secured Claims in a Bankruptcy Reorganization: Eating with the Hounds and Running with the Hares*, 100 COM. L.J. 320, 322 (1995) (“The valuation of a secured claim for purposes of a reorganization plan under a commercially reasonable disposition standard . . . is more consistent with other provisions of the Bankruptcy Code and . . . the more defensible result.”); James F. Queenan, Jr., *Standards for Valuation of Security Interests in Chapter 11*, 92 COM. LJ. 18, 20 (1987) (“[T]he selection of a standard for valuation of security and mortgage interests in Chapter 11 should be based upon an analysis of the rights and obligations of the secured creditor at foreclosure. . . .”).

\(^{64}\) *See* *In re Byington*, 197 B.R. 130, 134 (Bankr. D. Kan. 1996).

\(^{65}\) An interesting question arises when the secured creditor enters into a recourse agreement with the retail dealer who sold it the car. Recourse agreements will often require the dealer to reimburse the secured creditor for the full, unpaid contract price should the secured creditor be required to repossess the vehicle. *See* Michael W. Dunagan, *Repossession Issues, Deficiency Judgments and Bankruptcy Considerations for Sub-Prime Auto Lenders*, 49 CONSUMER FIN. L.Q. REP. 384, 385 (1995). However, the majority of cases have refused to recognize the secured creditor’s recourse remedy as a commercially reasonable “sale”; instead, they have completely ignored the agreement for valuation purposes. *See*, e.g., Grubbs v. National Bank of S.C. (*In re Grubbs*), 114 B.R. 450, 452 (D.S.C. 1990); *In re
price because the secured creditor will usually dispose of the vehicle in a commercially reasonable foreclosure "by selling it to a dealer or by sending it to a vehicle auction." 66 Although the legislative history of § 506 suggests that courts should use neither wholesale nor replacement value standards exclusively, 67 courts have agreed that within the context of valuing secured claims in Chapter 13 cram downs, a single rule of law is necessary. 68 Proponents of wholesale valuation have several compelling statutory and economic arguments for adopting their standard.

1. Statutory Analysis

Champions of wholesale value emphasize the importance of the first sentence of § 506, specifically the phrase "the value of such creditor's interest in the estate's interest in such property." 69 In Associates Commercial Corp. v. Rash (In re Rash), 70 the Fifth Circuit applied a two-step analysis in interpreting this phrase. First, the court determined that this phrase requires judges to examine the estate's interest—the rights that the debtor has in the collateral. 71 If the debtor has only a part ownership interest, or if the interest is a junior or subordinated lien, then the creditor's interest is necessarily limited, for the creditor cannot take a security interest in property in which the debtor initially

Cook, 38 B.R. 870, 875 (Bankr. D. Utah 1984); In re Klein, 20 B.R. 493, 495 (Bankr. N.D. Ill. 1982); In re Beranek, 9 B.R. 864, 865 (Bankr. D. Colo. 1981); Chrysler Credit Corp. v. Van Nort (In re Van Nort), 9 B.R. 218, 221 (Bankr. E.D. Mich. 1981). But see In re Stumbo, 7 B.R. 399, 940 (Bankr. D. Colo. 1981) (valuing the vehicle at the amount that the secured creditor would receive as a result of a recourse agreement with the dealership); cf. Lomas Mortgage USA v. Wiese (In re Wiese), 980 F.2d 1279, 1283 (9th Cir. 1992) (distinguishing another case on the ground that "it did not involve... 'any type of recourse agreement that would guarantee the creditor more than market value" (quoting In re Fischer, 136 B.R. 819, 827 (Bankr. D. Alaska 1992)).

66 Byington, 197 B.R. at 134.
67 The House Report states: "Value' does not necessarily contemplate forced sale or liquidation value of the 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 . . . ." H.R. Rep. No. 95-959, at 356 (1977); see also S. Rep. No. 95-989, at 68 (1978) ("While courts will have to determine value on a case-by-case basis . . . valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property.").
68 See infra text accompanying notes 221-23.
70 Associates Commercial Corp. v. Rash (In re Rash), 90 F.3d 1036, 1043-44 (5th Cir. 1996), rev'd, 117 S. Ct. 1879 (1997). This case is one of two cases decided at the court of appeals level that has approved of foreclosure valuation. This case, heard en banc by the Fifth Circuit and decided by a 9-6 vote, reversed an earlier decision by a panel of Fifth Circuit judges in Associates Commercial Corp. v. Rash (In re Rash), 31 F.3d 325 (5th Cir. 1994), modified, 62 F.3d 685 (5th Cir. 1995). The other case, General Motors Acceptance Corp. v. Mitchell (In re Mitchell), 954 F.2d 557 (9th Cir. 1992), was recently overruled by the Ninth Circuit in Taffi v. United States (In re Taffi), 96 F.3d 1190, 1193 (9th Cir. 1996).
71 See Rash, 90 F.3d at 1043.
had no right. Courts uniformly agree that the initial determination of the debtor's interest in the collateral is the first step in valuing that collateral.

Second, the Fifth Circuit looked to the value of the creditor's interest. According to the court: "[The] valuation . . . must account for the fact that the creditor's interest is in the nature of a security interest, giving the creditor the right to repossess and sell the collateral and nothing more. Therefore, the valuation should start with what the creditor could realize by exercising that right."

Other courts cite the Supreme Court's decision in United Savings Ass'n v. Timbers of Inwood Forest Associates to support using the creditor's interest as the starting point for the second step of the valuation process. In Timbers, the Court (in dicta) defined the value of the creditor's interest as "the value of the collateral." According to this view, courts should value collateral as if it was in the creditor's hands. Because secured creditors typically dispose of collateral on the wholesale market, wholesale value is the logical choice for valuing collateral under this approach.

However, courts that have used the wholesale valuation standard encountered trouble reconciling the second sentence of § 506(a) with the first. The second sentence of § 506(a) focuses on the "proposed disposition or use" of the collateral. In Chapter 13, the debtor retains and continues to use the collateral. Wholesale value thus appears to ignore the debtor's use of the collateral, for debtors likely would have to pay retail value to replace the collateral if they were

72 See id.
73 See, e.g., id.; see also Taffi v. United States (In re Taffi), 96 F.3d 1190, 1192 (9th Cir. 1996) (describing the estate's interest in the collateral before proceeding to value the collateral); In re Gabor, 155 B.R. 391, 393-94 (Bankr. N.D. W. Va. 1993) (finding that the estate had no interest in the collateral because of debtor's prepetition transfer).
74 See Rash, 90 F.3d at 1044.
75 Id.; see also In re Raylin Dev. Co., 110 B.R. 259, 261 (Bankr. W.D. Tex. 1989) ("Valuation must be approached in large part from the point of view of what the collateral would be worth in the hands of the creditor . . ."); In re Boring, 91 B.R. 791, 795 (Bankr. S.D. Ohio 1988) ("[I]t is the creditor's interest in property which should be valued under § 506, not the value, per se, of the property itself.").
77 See Rash, 90 F.3d 1036, 1043 (5th Cir. 1996), rev'd, 117 S. Ct. 1879 (1997); In re Maddox, 194 B.R. 762, 768 (Bankr. D.N.J.), aff'd, 200 B.R. 546 (D.N.J. 1996); General Motors Acceptance Corp. v. Mitchell (In re Mitchell), 954 F.2d 557, 560 (9th Cir. 1992), overruled by Taffi, 96 F.3d at 1193;
78 Timbers, 484 U.S. at 372.
80 As outlined in § 1306(b) of the Bankruptcy Code, the debtor in a Chapter 13 case "shall remain in possession of all property of the estate." 11 U.S.C. § 1306(b). The Bankruptcy Code defines property of the estate in § 541. See 11 U.S.C. § 541. Property, as defined, does include motor vehicles in which the debtor has a "legal or equitable interest." 11 U.S.C. § 541(a)(1).
deprived of its use. In *Rash*, the Fifth Circuit skirted this issue by relying on its prior determination that "such value"—the language found in the second sentence of § 506—refers only to the creditor's interest in the collateral. The majority of courts adopting wholesale valuation have limited the application of the "disposition or use" language to situations in which "the manner of that [use] is so unusual or extreme as to constitute a use that is destructive of the collateral itself in a way unanticipated." Examples of such use include "a proposal to use a combine for custom work" when the debtor previously had used it "seasonally to harvest his [own] crop," and when the debtor uses the collateral twenty-four hours per day and causes rapid depreciation. When the debtor uses the collateral in an unusual or extreme manner, the value of the creditor's security interest changes in ways that the secured creditor did not anticipate. However, when the debtor uses the collateral "for its usual, intended purpose, such retention and use should not ordinarily affect a valuation" because the creditor's interest has not changed appreciably. Thus, proponents of wholesale valuation privilege their already determined valuation of the creditor's interest over the statute's "disposition or use" language.

Courts reconcile the "purpose of the valuation" language in the second sentence of § 506(a) with the wholesale valuation standard by examining the purpose and operation of the cram down provisions. Debtors who wish to retain property encumbered with a security interest in Chapter 13 have three options: (1) propose a system of payment for the collateral, to which the secured creditor must consent in order for the plan to gain approval; (2) pay the creditor the present value of the secured claim, as determined by the bankruptcy court; or (3) surrender the collateral to the secured creditor. Because the cram down provision gives debtors the option of surrendering the collateral when the secured creditor refuses their proposed payment, courts espousing wholesale value state that the application of replacement value would undermine the purpose of a cram down. As the Bankruptcy Court for the District of Kansas explains:

[T]he only purpose to determine the value of a vehicle in a Chapter 13 case "is to establish the amount of the creditor's secured claim in

---

81 *Rash*, 90 F.3d at 1047-48.
82 Id. at 1049 (quoting *In re Claey*, 81 B.R. 985, 992 (Bankr D.N.D. 1987)).
83 *Claey*, 81 B.R. at 992.
84 See *Queenan*, supra note 63, at 37.
85 *Rash*, 90 F.3d at 1050.
88 See id. § 1325(a)(5)(B).
89 See id. § 1325(a)(5)(C).
order to permit a debtor to retain and use the property . . . in accordance with § 1325(a)(5)(B)." Otherwise, the debtor would simply surrender the property to the creditor, § 1325(a)(5)(C) would be satisfied, and any impediment to confirmation of the debtor's Chapter 13 plan . . . would be removed.\textsuperscript{90}

The court in \textit{In re Maddox}\textsuperscript{91} observed that the cram down and surrender options are available "as equivalent methods of protecting the secured creditor's interest."\textsuperscript{92} Consequently, valuations in the cram down context should approximate what the creditor would receive in a commercially reasonable sale—the likely result when the debtor surrenders the collateral.\textsuperscript{93} Thus, in order to preserve the "purpose of the valuation"—the debtor's use of the cram down provision—many courts agree that § 506(a) dictates the adoption of wholesale value.

2. \textit{Economic Analysis}

Proponents of both wholesale and replacement valuations maintain that the application of the opposing standard creates a windfall for an undeserving party. Proponents of wholesale valuation believe that replacement valuation creates a windfall for the secured creditors,\textsuperscript{94} while proponents of replacement valuation argue that wholesale valuation creates a windfall for the unsecured creditors, who take the extra disposable income which has accrued to the debtor.\textsuperscript{95}

The Fifth Circuit in \textit{Rash} argued that § 506 protects the secured creditor in a cram down because it requires payments under the debtor's plan to equal the amount of the secured creditor's allowed secured claim, plus a market rate of interest, which allows the creditor to receive a "value of not less than would be received in an immediate liquidation."\textsuperscript{96} Instead of courts granting secured creditors the substantial additional protection of replacement value—a result the \textit{Rash} court chides as "judicial legislation . . . [in which courts] im-

\textsuperscript{90} \textit{Byington}, 197 B.R. at 136 (quoting \textit{In re Myers}, 178 B.R. 518, 523 (Bankr. W.D. Okla. 1995)).


\textsuperscript{92} Id. at 768.

\textsuperscript{93} See id.

\textsuperscript{94} See, e.g., Valley Nat'l Bank v. Malody (\textit{In re Malody}), 102 B.R. 745, 750 (B.A.P. 9th Cir. 1989) (stating that an award of retail value affords the creditor a premium).

\textsuperscript{95} See, e.g., Winthrop Old Farm Nurseries, Inc. v. New Bedford Inst. for Sav. (\textit{In re Winthrop Old Farm Nurseries, Inc.}), 50 F.3d 72, 76 (1st Cir. 1995) (explaining that foreclosure value "allow[s] a reorganizing debtor to reap a windfall"). For a discussion of how proponents of replacement valuation view the debtor's windfall, see infra text accompanying notes 149-51. For further discussion on how the debtor may manipulate this windfall, see infra text accompanying notes 385-90.

pos[e] their view of appropriate bankruptcy policy upon litigants—
the Fifth Circuit placed the onus of procuring additional protection
on the secured creditors themselves. According to the court,
"'[l]enders and sellers build the risk of . . . bankruptcy into the inter-
est rates they charge, the prices at which they sell, and the transaction
costs that they charge.' Creditors can also protect themselves by re-
quiring a larger down payment or shortening the term of the loan.

The court maintained that awarding replacement value created a
windfall for the secured creditor who otherwise would have to fore-
close under state law provisions. As the majority in Rash recog-
nized, awarding replacement value places the creditor in the same
position as a retail dealer, "even where the creditor is not a dealer and
could not realize such value under any other circumstances."

The secured creditor realizes this windfall at the expense of the
pool of unsecured creditors who, by virtue of the secured creditor's
increased claim, lose the payout on a proportionate amount of their
claims. This result occurs even though a secured creditor, to the
extent that he is undersecured, has in effect made an unsecured loan
and thus arguably should share pro rata with the other unsecured
creditors. Although it may appear that the debtor would be ambiv-
alent about the proportion of money allotted to secured and un-
secured creditors, the Fifth Circuit recognized that this allotment
might determine whether a court will confirm the debtor's plan.
The majority in Rash reasoned that if courts awarded replacement
value, some bankruptcies might not be confirmed because the shift in
assets from unsecured creditors to secured creditors, combined with a
possible lack of adequate funds in the plan to compensate secured

97 Id. (quoting In re Myers, 178 B.R. 518, 523 (Bankr. W.D. Okla. 1995)).
98 See id.
99 Id. (quoting Keith M. Lundin, Chapter 13 Bankruptcy § 5.48, at 5-134 (2d ed.
100 See id. at 1054.
101 Id.; see also In re Byington, 197 B.R. 130, 136 (Bankr. D. Kan. 1996) ("A fundamental
problem with a retail standard is that it implicitly includes a profit for the creditor on the
'sale' of its collateral to the debtor."). However, in Rash the creditor did not present evi-
dence that he was in a position to sell the collateral for a price greater than wholesale.
Most courts using foreclosure value will allow creditors to prove that they could receive a
greater price than the wholesale value at a foreclosure sale. See, e.g., Byington, 197 B.R. at
136 (stating that the presumption of foreclosure value "can be overcome by specific evi-
dence demonstrating a creditor's usual method of selling").
102 This occurs because of the system of priority at work in Chapter 13, in which se-
cured creditors are guaranteed payment of their secured claim by operation of the cram
down provisions, see 11 U.S.C. § 1325(a)(5) (B)(ii) (1994), while unsecured creditors are
entitled only to what they would receive in a Chapter 7 liquidation, see 11 U.S.C.
§ 1325(a)(4).
103 See Rash, 90 F.3d at 1053 n.22.
104 See id. at 1055 n.25.
creditors, could violate the "good faith" requirement of § 1325. In such a case, the court would convert the plan to a Chapter 7 liquidation, and the secured creditor would be forced to foreclose, most likely receiving wholesale value as a result.

The wholesale valuation standard focuses on those actions that the debtor and a secured creditor would have taken in the "real world" outside of bankruptcy, ignoring the role of the unsecured creditor in both the real world and in Chapter 13. Outside of bankruptcy, unsecured creditors would have recourse against the secured creditor's collateral to the extent that the collateral's value exceeded the secured creditor's loan. Thus, allocating the windfall—the difference between the amount the secured creditor would have received in a state law foreclosure and the replacement value of the collateral—to the secured creditor ignores the fact that, outside of bankruptcy, the unsecured creditors may not lose this value because of their ability to force a sale of the collateral when its value exceeds the value the secured creditor would receive upon foreclosure. Furthermore, to the extent that bankruptcy bifurcates the secured creditor's claim into secured and unsecured portions, apportionment of the windfall is not a zero-sum game from the secured creditor's standpoint. The secured creditor will still benefit, albeit not as directly, from an increase in the amount that the unsecured creditors will receive.

Supporters of the wholesale value standard also point to Congress's intent to prevent secured creditors from taking "hostage value"

105 See id. at 1055 n.24. But see supra note 54 and accompanying text. For an outline of the good faith requirement, see 11 U.S.C. § 1325(a)(3).
106 See Rash, 90 F.3d at 1055 n.24.
107 Unsecured creditors may proceed against an oversecured creditor's collateral by winning a judgment against the debtor, obtaining a writ of execution, and obtaining a lien by levying on the debtor's property. See Lynn M. LoPucki & Elizabeth Warren, Secured Credit: A Systems Approach 5-14 (1995) (using Vitale v. Hotel California, Inc., 446 A.2d 880 (N.J. Super. Ct. Law Div. 1982) to describe the process by which unsecured creditors become judgment lien holders). Unsecured creditors can obtain judgment and levy on the debtor's property even when this property is subject to a security interest. See LoPucki & Warren, supra, at 563-87 (describing the priority system between secured creditors and judgment lienors). Although Article 9 allows unsecured creditors to seek repayment in this manner, the realities of debtors' and secured creditors' strategic activity may discourage unsecured creditors from seeking any legal remedy in this situation. See Lynn M. LoPucki, Legal Culture, Legal Strategy, and the Law in Lawyers' Heads, 90 Nw. U. L. Rev. 1498, 1537 (1996).
108 For more on the relevance of unsecured creditors to the valuation picture, see Katz, supra note 63.
109 See supra text accompanying notes 8-14.
110 This result assumes that an increase of money in the estate will be distributed to the general unsecured creditors. The possibility of a zero-percentage payout to general unsecured creditors, see supra note 54, and the priority system among unsecured creditors, see 11 U.S.C. § 507, are two obstacles to this result.
in consumer goods. During the late 1970s, when Congress was contemplating changes to Chapter 13, some secured creditors began taking security interests in all of the debtors' household goods and personal items. Although such items had a negligible resale value, their sentimental and replacement value to the debtor placed great pressure on the debtor to repay the debt. The House Report indicates that Congress intended for § 506 to alleviate this coercive pressure by "requir[ing] the court to value the secured creditor's interest." As one court favoring wholesale value observed, "[a] rule requiring valuations . . . to measure the replacement cost of collateral to the debtors would defeat the design of Congress by giving secured creditors leverage they were not meant to have."

Judge Easterbrook's concurrence in In re Hoskins elaborates on the argument that courts should look to state law when deciding how to treat the secured creditor's claim. Easterbrook maintained that without an explicit congressional mandate for choosing a particular valuation standard, like the kind that the Bankruptcy Code gives for home mortgages in § 1322(b)(2), courts should interpret § 506(a) by looking at what recourse the secured creditor would have under state law outside of bankruptcy. In the case of personal property, the secured creditor's recourse is the amount that it could realize from an Article 9 sale. For example, in the case of a vehicle, the secured creditor would realize wholesale value. Even if the vehicle was worth more to the debtor than its wholesale value, Easterbrook hypothesized that the debtor only would have to pay a negligible amount over wholesale value to procure the car at an auction. He reasons first that no dealer would pay over wholesale because "by hypothesis, dealers can get equivalent cars for [wholesale]." He then notes that the secured creditor would also be unwilling to pay more than wholesale value, for to do so would reduce a possible deficiency

---

111 See, e.g., Rash, 90 F.3d at 1056; Grubbs v. Houston First Am. Sav. Ass'n, 730 F.2d 236, 239 & n.3 (5th Cir. 1984) (en banc); In re Cook, 38 B.R. 870, 874 (Bankr. D. Utah 1984).
113 Id.
114 In re Cook, 38 B.R. at 874.
115 102 F.3d 311, 317 (7th Cir. 1996). For a discussion of the majority opinion in Hoskins, see infra Part II.C.
116 See id. at 318 (Easterbrook, J., concurring).
117 11 U.S.C. § 1322(b)(2) (1994); see also supra text accompanying note 36 (discussing the Nobelman decision).
118 Hoskins, 102 F.3d at 318 (Easterbrook, J., concurring).
119 Id. at 320 (Easterbrook, J., concurring); see also supra text accompanying notes 15-16 (discussing state law foreclosure methods for vehicles).
120 See Hoskins, 102 F.3d at 320 (Easterbrook, J., concurring).
121 Id. (Easterbrook, J., concurring).
judgment without getting any value in return. Thus, according to Easterbrook, charging the debtor for the replacement value of the collateral does not accurately reflect the result that would occur outside of bankruptcy.

B. The Replacement Valuation Standard

Prior to the Supreme Court's Rash decision, most circuits favored replacement valuation, and numerous bankruptcy courts and commentators followed their lead. Replacement value measures the debtor's cost of replacing the collateral, as opposed to the amount the creditor would receive from the sale of the collateral. Proponents of replacement valuation find support for their position in the Bankruptcy Code and in an economic evaluation of the effects of awarding replacement value on debtors and secured creditors. Although secured creditors have lobbied Congress to codify the replacement valuation standard in order to avoid the judicial debate altogether, they have not met with any success thus far.

1. Statutory Analysis

Courts and commentators justify the replacement valuation standard by emphasizing the second sentence of § 506(a), which states that "value shall be determined in light of the purpose of the valua-

---

122 See id. at 320 (Easterbrook, J., concurring).
123 See id. (Easterbrook, J., concurring). Easterbrook's hypothesized sale contains many questionable assumptions, not the least of which is the availability and accessibility of a deficiency judgment from the debtor. See LoPucki & Warren, supra note 107, at 83-85 (discussing the proliferation of antideficiency statutes). If Easterbrook truly wanted Chapter 13 cram down valuations to mirror state law entitlements, he should have argued for extinguishing the secured creditor's unsecured claim completely, thus mirroring the effect of state antideficiency statutes.
124 See Metrobank v. Trimble (In re Trimble), 50 F.3d 530, 532 (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, 75 (1st Cir. 1995) (Chapter 11); cf. Huntington Nat'l Bank v. Pees (In re McClurkin), 31 F.3d 401, 405 (6th Cir. 1994) (concluding that hypothetical costs of sale should not be deducted because property is not being disposed); Coker v. Sovran Equity Mortgage Corp. (In re Coker), 973 F.2d 258, 260 (4th Cir. 1992) (same).
127 See infra note 357.
128 See infra Part II.B.1.
129 See infra Part II.B.2.
130 See infra Part IV.B.
tion and of the proposed disposition or use of [the] property."131 Although replacement and wholesale theorists agree that the phrase, "in light of the purpose of the valuation," means that value may differ depending on the valuation setting,132 the two sides differ sharply on the purpose of valuing secured claims in Chapter 13. In the Fifth Circuit's Rash decision, the dissent stated that the purpose of valuing a secured creditor's claim in Chapter 13 "is to determine the value of property retained by a debtor, not sold by a creditor."133 Looking at the "proposed disposition or use" of the property, the dissent opined:

"[S]ince the Debtor's Plan provides for it to retain the Property, the value of Bank's interest in the Debtor's interest in the Property should be determined without regard for the hypothetical costs that may be incurred by Bank if it gets the Property back. Why? Because it is not getting the Property back."134

In contrast to the Rash majority's limited application of "use" to those situations in which the debtor contemplates particularly harmful uses of the collateral,135 the dissent stated "that disposition or use is relevant in every case."136 The dissent criticized the majority's restrictive reading of the first sentence of § 506(a), maintained that the majority's approach rendered the last sentence of § 506(a) surplusage, and stated that the opinion "virtually ignor[es] the debtor's proposed disposition of the collateral and the requirements of the second sentence of § 506(a)."137

Ironically, advocates of both wholesale and replacement valuation have found support for their statutory interpretation in the Supreme Court's Timbers decision.138 Responding to wholesale valuation proponent's isolation of the term "creditor's interest," courts favoring the replacement standard have cited Justice Scalia's opinion in Timbers to support favorably the proposition that the creditor's interest is not merely the equivalent of foreclosure rights.139 Construing

---

134 Id. (Smith, J., dissenting) (quoting In re Spacek, 112 B.R. 162, 164 (Bankr. W.D. Tex. 1990) (alteration in original)).
135 See supra text accompanying notes 82-85.
136 Rash, 90 F.3d at 1067 (Smith, J., dissenting).
137 Id. at 1068 (Smith, J., dissenting) (quoting Brown & Co. Sec. Corp. v. Balbus (In re Balbus), 933 F.2d 246, 251 (4th Cir. 1991)).
the adequate protection requirement of the Bankruptcy Code,\textsuperscript{140} Scalia stated that "[t]he term 'interest in property' certainly summons up such concepts as 'fee ownership,' 'life estate,' 'co-ownership,' and 'security interest' more readily than it does the notion of 'right to immediate foreclosure.'"\textsuperscript{141} While wholesale value theorists derive a narrow and limited definition of "creditor's interest" from the first sentence of § 506(a), courts favoring the replacement standard argue that the purpose of the first sentence is deceptively simple: "[i]n situations involving only one creditor and one debtor, the value of the undersecured creditor's secured claim is simply the value of the underlying collateral."\textsuperscript{142}

Additionally, those Supreme Court decisions that interpret the Bankruptcy Code as protecting secured creditors at the expense of unsecured creditors appear to support the application of the replacement value standard. The Fifth Circuit's dissent in \textit{Rash} looked to two Supreme Court decisions—\textit{Nobelman v. American Savings Bank}\textsuperscript{143} and \textit{United States v. Ron Pair Enterprises, Inc.}\textsuperscript{144}—to support this preference for secured creditors. The \textit{Nobelman} Court interpreted Chapter 13's cram down provision to prevent debtors from bifurcating home mortgages, thereby reducing the value of the mortgagee's collateral in bankruptcy.\textsuperscript{145} In \textit{Ron Pair}, the Court held that § 506(b) entitled oversecured creditors to interest and costs up to the amount of their extra security in addition to the prepetition amount of their claim.\textsuperscript{146} The dissent in \textit{Rash} reasoned that both of these decisions show the Court's desire to protect secured creditors at the expense of not only the unsecured creditors but also, quite often, the debtor.\textsuperscript{147}

2. Economic Analysis

Replacement valuation's proponents identify several economic reasons for adopting this valuation method. In the Fifth Circuit, the \textit{Rash} dissent asserted that under Chapter 13, the "creditor's rights of foreclosure, sale, bidding-in and the like are not being delayed; rather they are being extinguished and replaced forever . . . with lesser

\textsuperscript{141} Timbers, 484 U.S. at 371.
\textsuperscript{142} Sandy Ridge, 881 F.2d at 1349.
\textsuperscript{143} 508 U.S. 324 (1993) (interpreting § 1322(b)(2) to prohibit debtors from using § 506(a) to cram down mortgages on the debtor's principal residence).
\textsuperscript{144} 489 U.S. 235 (1989).
\textsuperscript{145} See supra text accompanying notes 36-37.
\textsuperscript{146} See \textit{Ron Pair}, 489 U.S. at 299-40.
rights.\textsuperscript{148} Thus, the focus should be on the amount the creditor needs to compensate it for the loss of these rights.

Proponents also argue that replacement valuation properly awards the "bonus" that successful reorganization creates—the amount over and above what the secured creditor would have realized either in a Chapter 7 liquidation or under state law remedies—to secured creditors, because the success of the debtor's plan often turns on the debtor's retention of the secured creditor's collateral.\textsuperscript{149} Courts favoring replacement valuation also reason that awarding this windfall from successful reorganization to the secured creditor compensates the creditor for the risk it assumed—the debtor's reorganization could have failed, which could have caused the collateral to depreciate. Such a failure would force the creditor to incur the depreciation costs that it otherwise could have avoided by immediate liquidation in Chapter 7 or under state law.\textsuperscript{150} Proponents of replacement valuation view the other option—giving the windfall to the debtor or to the estate—as creating incentives for debtors to strip the secured creditor's lien and either sell the collateral for its full market value or destroy it for insurance proceeds.\textsuperscript{151}

Replacement valuation advocates also argue that even if the "creditor's interest" is the correct measure of value under § 506(a), courts still may value that interest incorrectly when calculating the amount the secured creditor would realize in a commercially reasonable sale. They feel that proponents of wholesale valuation ignore two major components of value when performing this calculation: (1) the secured creditor's right to bid-in at a foreclosure; and (2) the value of the secured creditor's leverage vis-à-vis the debtor.\textsuperscript{152} Outside of

\textsuperscript{148} Id. at 1074 (Smith, J., dissenting) (quoting In re Freudenheim, 189 B.R. 279, 280 (Bankr. W.D.N.Y. 1995)).

\textsuperscript{149} See id. at 1072 (Smith, J., dissenting). At one point the majority in Rash poked fun at this notion by pointing out that the dissent's desire to compensate the secured creditor for allowing the debtor to retain the collateral would force courts "to calculate the 'surplus' generated by the debtor's retention of a recliner that he sat in after returning home from an eight-hour shift at a factory." Id. at 1052 n.21. The majority thought that such a reward should be reserved for secured lenders in Chapter 11 reorganizations in which the lender has a security interest in the majority of the business, thereby assuming responsibility for the surplus that the estate creates. See id. at 1053 n.23. While this argument may appear convincing on the surface, this reasoning ignores the fact that the collateral usually at issue is the debtor's car, which is often the debtor's means of transportation to work. The car is thus responsible for the subsequent creation of the debtor's wages, which create the surplus in Chapter 13. For instance, in the Rash, the collateral was the debtor's truck used in his work, and it thereby constituted an important income-producing asset. See id. at 1039.

\textsuperscript{150} See id. at 1066 (Smith, J., dissenting); see also Taffi v. United States (In re Taffi), 96 F.3d 1190, 1192-93 (9th Cir. 1996) ("By agreeing to the Plan and allowing the [debtors] to retain their [collateral], the [creditor] runs a risk. It is appropriate that it also benefit from the higher valuation.").

\textsuperscript{151} See Rash, 90 F.3d at 1073 (Smith, J., dissenting).

bankruptcy, secured creditors have the right to bid-in at the foreclosure sale up to the amount of their debt. At such a sale, the secured creditor typically buys the collateral at wholesale value and then resells it to a buyer in the market, thereby yielding an amount close to the retail value of the collateral. Supporters of replacement valuation argue that wholesale valuation fails to compensate secured creditors for the loss of the right to bid-in, and thus, replacement valuation more closely approximates, in most instances, what would happen in the real world. Replacement valuation proponents garner further support from the language of the Supreme Court's decision in Dewsnup v. Timm. In Dewsnup, the Court interpreted § 506(d) and stated: "The creditor's lien stays with the real property[;] ... any increase over the judicially determined valuation ... rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors ... who had nothing to do with the mortgagor-mortgagee bargain." Some courts have construed this language to "lay to rest any contention that the opportunity ... to bid-in ... [is] not [an] element[ ] of value that should command a difference in treatment of a creditor whose collateral ... will be retained and operated by the Debtor." Thus, the proper valuation standard should take into account the value of the secured creditor's bid-in rights.

---

153 See LoPucki & Warren, supra note 107, at 85-87 (discussing credit bidding by secured creditors). Thus, if the creditor forcing the sale is owed $10,000 by the debtor, he may bid on the collateral up to $10,000 without needing to pay any money (in effect, he would have to pay himself the money he is bidding).

Creditor who bid on and win the collateral obtain several advantages. Creditors often feel that they will be unable to collect any deficiency from the debtor, therefore they will bid-in up to the price at which they think they can sell the collateral in an arms-length transaction. See id. at 86. For example, a debtor would normally be responsible for reimbursing any dollar amount that a creditor realizes below the amount of the debtor's debt (in the above example any amount below $10,000). However, most states have antideficiency statutes which prevent creditors from taking further action on the debt. See id. at 83-85. Thus, the creditor obtains an advantage by purchasing the collateral in "credit" because it will make the debtor's right of redemption harder to exercise and will often allow the creditor to acquire the collateral for an amount significantly less than it could later be sold for in a market sale.


155 See, e.g., Freudenheim, 189 B.R. at 281. The Freudenheim decision also suggests that if the debtor and/or trustee chose to offer the property for sale while operating in bankruptcy, § 363 of the Bankruptcy Code would give the secured creditor the right to bid-in. See id. (citing 11 U.S.C. § 363(k) (1994)).


157 See id. at 417.

158 Freudenheim, 189 B.R. at 281.
While Congress, when it rewrote § 506(a), may have discouraged the “hostage value” leverage that secured creditors once used, it did not address the more benign leverage inherent in the repossession-and-sale remedy that a security interest provides. Recognition of this leverage favors replacement valuation because wholesale valuation does not take it into account. The bankruptcy judge in *In re Jones* cogently illustrated this point with the following example:

Assume the debtor owes a creditor $100,000, and that the debt is secured by a mortgage . . . which has a fair market value of $80,000. Assume also that the creditor would incur costs of $10,000 in foreclosing its mortgage. . . .

Those courts which adjust value under § 506(a) based on hypothetical sales costs would conclude that the creditor in this example holds an allowed secured claim of $70,000. But there is a distinct possibility that the creditor could hold out for more . . . in exchange for its forbearance. . . . [I]t is not likely that the debtor would be able to find another home comparable to her present one for much less than $80,000. And if the debtor were forced to relocate, she probably would incur transaction costs of her own. . . . [T]he debtor in this scenario may very well conclude that $80,000 is a reasonable price to pay to keep her home. Thus[, . . . ] liens will often be undervalued if the court disregards the possibility that the creditor could use the debtor’s own transaction costs as leverage in any negotiations between the parties.

While claim bifurcation negates this type of leverage in bankruptcy, proponents of replacement value seize upon the existence of this leverage to make an important point. These proponents note that if wholesale value theorists insist that a court envision how the secured creditor’s security interest would be valued outside of bankruptcy, then the court must also consider the value of the leverage provided by the security interest.

In their debate over the appropriate valuation standard, replacement and wholesale valuation theorists often failed to consider the merits of finding a middle ground. However, as discussed below, prior to the Supreme Court’s *Rash* opinion a few bankruptcy courts and one circuit court concluded that the midpoint standard of valuation, which represents such a middle ground, comports with both the statutory language governing valuation and the economic considera-
tions implicated by the bankruptcy system. The next section will look at those decisions and the rationale supporting a midpoint valuation standard.

C. The Midpoint Valuation Standard

Prior to the Supreme Court's *Rash* decision, the Seventh Circuit\(^\text{164}\) and a minority of bankruptcy courts\(^\text{165}\) had adopted the midpoint valuation standard for valuing secured claims under § 506(a). Additionally, several bankruptcy courts adopted, in the form of local rules, the midpoint valuation standard as the starting point for motor vehicle valuations.\(^\text{166}\) Midpoint valuation is the mean between the adjudged wholesale value and the retail value of the secured creditor's collateral.\(^\text{167}\)

1. Statutory Analysis

Courts adopting the midpoint valuation standard have concluded that § 506(a) does not mandate the use of any particular valuation standard, and consequently, economic arguments are paramount when choosing a valuation standard.\(^\text{168}\) In *In re Hoskins*,\(^\text{169}\) Judge Posner first noted the statute, the legislative history, and precedent all lack definitive authority for any of the valuation standards, and he then proceeded to make his economic argument.\(^\text{170}\) Similarly, the

---

\(^{164}\) See *In re Hoskins*, 102 F.3d 311, 315 (7th Cir. 1996).


\(^{167}\) In the context of motor vehicle valuations, this average comes from the wholesale and retail values that the Bluebook provides. See, e.g., *In re Younger*, 216 B.R. 649, 656-57 (Bankr. W.D. Okla. 1998); *In re Jenkins*, 215 B.R. 689, 692 (Bankr. N.D. Tex. 1997) (describing pre-*Rash* valuation); *In re Franklin*, 213 B.R. 781, 783 (Bankr. N.D. Fla. 1997).

\(^{168}\) See infra Part II.C.2.

\(^{169}\) 102 F.3d 311 (7th Cir. 1996).

\(^{170}\) With respect to the statute itself, Posner stated that it was of "little help" in deciding which valuation standard to choose. *Hoskins*, 102 F.3d at 314. Posner observed that the legislative history of § 506(a) "points both toward and away from equating 'creditor's interest' to wholesale value." *Id.* (citing H.R. Rep. No. 95-595, at 124, 356 (1978)). Posner hinted that precedent from other circuits on this subject might have bound his decision,
court in *In re Stauffer* found that § 506(a) and its legislative history merely require courts to contemplate the benefits and risks that any particular valuation standard imposed to the estate and the creditors. Because proponents of midpoint valuation find little direction from the statute or congressional intent, they focus mainly upon economic arguments.

2. Economic Analysis

Judge Posner’s economic analysis in *Hoskins* of the competing valuation standards reflects the most articulate defense of the midpoint valuation standard. *Hoskins* arose out of a Chapter 13 bankruptcy petition that the debtors, Zandal and Debra Hoskins, filed in November 1994. The debtors’ Chapter 13 plan valued NBD Bank’s (“NBD”) secured claim in the debtors’ automobile at $3,987.50, representing the midpoint between the car’s retail value of $4,650 and its wholesale value of $3,325. NBD objected to this valuation and subsequently filed a proof of secured claim for $4,874.50, which included the retail value of the car plus interest and attorney’s fees.

After identifying “the emerging trend embrac[ing] a retail valuation,” the bankruptcy court found that the debtor’s midpoint valuation was “a fair treatment of the creditor’s claim.” Distinguishing the cited cases favoring replacement valuation on the ground that they addressed real property rather than personal property, the court concluded that the treatment of real property should differ from that of personal property under § 506(a). The court reasoned that the secured creditor likely would dispose of real property to an end user and thereby receive an amount roughly equivalent to the replacement value of the collateral. In contrast, the court noted that the secured creditor would likely dispose of personal property, like the car at issue, in a wholesale market. Thus, valuing consumer goods with a replacement valuation standard created a windfall for the secured creditor.

but that such grounds for decision “drop[,] out when the courts . . . cannot agree on the proper resolution.” *Id.* at 313.

172 See *id.* at 614 (citing H.R. Rep. No. 95-595, at 356 (1978)).
173 *Hoskins*, 183 B.R. at 166.
174 See *id.*
175 See *id.*. Section 1324 allows parties in interest to object to confirmation of the debtor’s plan at the confirmation hearing. See 11 U.S.C. § 1324 (1994).
178 See *id.*
179 See *id.*
180 See *id.*
Instead, the bankruptcy court chose to adopt the debtor's method of valuation, which it described as "the type of pragmatic compromise often utilized . . . in administering large numbers of cases." The midpoint valuation method, in the court's opinion, satisfied the requirements of § 506(a) and was consistent with the Supreme Court's Nobelman decision. The court noted that the Nobelman decision emphasized the importance of recognizing the interplay between different provisions of the Bankruptcy Code when it held that courts must read § 506(a) in light of § 1322(b) (2) in Chapter 13 cases involving home mortgages. Following the Nobelman Court's guidance, the Hoskins court surmised that because § 1325 does not require a debtor to pay replacement value if he utilizes the surrender option, the interplay of § 506(a) and 1325 does not mandate the use of replacement valuation. Additionally, the court reasoned that the interests of unsecured creditors necessarily factor into the "purpose of the valuation." Finding that replacement valuation mirrors the effects of a Chapter 7 reaffirmation, in which the secured creditor obtains the entire amount of its interest at the expense of unsecured creditors, the court was reluctant to import an identical treatment of unsecured creditors into the Chapter 13 reorganization process. Ultimately, the court limited its ruling to (1) Chapter 13 consumer reorganizations involving collateral that is "not income producing," and (2) cases in which the debtor "will not reap a windfall" by using midpoint valuation.

Affirming the decisions of both the bankruptcy judge and the district court that heard NBD's initial appeal, Judge Posner, writing for a unanimous panel, ignored the ad hoc, case-by-case approach to valuing secured claims in Chapter 13—an approach advanced by several bankruptcy courts and arguably grounded in the statute's legisla-

---

181 Id. at 169.
182 See id. at 170.
183 See id. (citing Nobelman v. American Sav. Bank, 113 S. Ct. 2106, 2108 (1993)).
184 See id.
185 Id. at 170.
186 In Chapter 7, debtors can retain the collateral by reaffirming their debt to the secured creditor. See 11 U.S.C. § 524(f). In most cases, this results in the reinstatement of the prepetition debt. In Chapter 13, cram down allows the debtor, in effect, to reaffirm the debt at whatever value the bankruptcy court fixes on the collateral.
188 Id. at 170. Precisely what the court meant by "non-income producing" collateral is unclear. Courts have often argued that debtors can only continue to create the income stream necessary to their plan through the retention of their vehicle. See supra note 149. Indeed, debtors often file Chapter 13 cases as a result of the imminent loss of their vehicle, which would render them unable to get to and from work. Apparently, the Hoskins court had commercial property in mind.
189 Hoskins, 183 B.R. at 170.
190 The district court's affirmation was unreported.
In Posner's opinion, such an ad hoc approach increased the risk that "the costs of bankruptcy litigation [would] eat[ ] up the entire debtor's estate." Posner maintained that while every case presents different facts regarding the nature and condition of the collateral, these different facts do not require that the standard of valuation change. As a result, the court held that the midpoint valuation standard that the Seventh Circuit adopted should apply when valuing any Chapter 13 secured claim.

Posner settled on the midpoint valuation standard by identifying and analyzing the relationship between the debtor and the secured creditor as a "bilateral monopoly." A bilateral monopoly exists when two parties possess the ability to bargain over an item without the influence of competition, such as threatening to sell to a third party. Analyzing the relationship between the Hoskinses and NBD in this paradigm, Posner assessed the market forces driving each of the parties. If the Hoskinses had defaulted on their loan from NBD, the bank would have repossessed the car and likely sold it at wholesale value because the bank was not in the retail automotive business. Assessing the value of the car to the Hoskinses, Posner identified the car as a necessity for a successful reorganization rather than a luxury. He then noted that in order to replace the car, the debtors must pay the retail price from a dealer. Thus, based on this bilateral monopoly analysis the correct value of the car lies somewhere between the wholesale and retail prices.

While Posner admitted that predicting the precise point at which the bargain would be struck within this range is impossible, he posited that the best solution would be to split the difference. Using tenets of

191 See infra Part II.D.
192 Hoskins, 102 F.3d 311, 314 (7th Cir. 1996).
193 See id.
194 See id. at 316. Posner limited the court's holding to Chapter 13 cases, and hinted that for cases involving assets with sentimental value to the debtor, or in the case of real property, the bargaining range may be different than that which the court discussed in Hoskins. See id. at 317. Posner left such valuations to "another day." Id.
195 Id. at 315.
196 For examples of Posner's use of the bilateral monopoly paradigm in other settings, see Walgreen Co. v. Sara Creek Property Co., 966 F.2d 273, 276 (7th Cir. 1992); Milbrew, Inc. v. Commissioner, 710 F.2d 1302, 1306-07 (7th Cir. 1983).
197 See Hoskins, 102 F.3d at 315. Posner did not discuss whether the creditor's ability to sell the car for something greater than wholesale would affect his analysis, but it appears that Posner would likely readjust the value in such a case.
198 See id. Based on his treatment of the car as a necessity, Posner characterized the retail valuation advocates' concerns—that the debtor will sell the car for retail, thereby receiving a windfall to the extent that the court valued the collateral at less than retail—as "a chimera." Id; see also supra text accompanying note 149 (discussing this windfall in the context of replacement valuation). Posner pointed out that the debtor is unlikely to sell the car for retail because he cannot offer a "meaningful warranty." Hoskins, 102 F.3d at 315.
game theory, Posner identified the midpoint as a focal point for bargaining, noting that the midpoint serves as "a natural point to which bargaining parties will gravitate if they don't want to waste a lot of time in bluffing and haggling." According to Posner, fixing the value of the secured creditor's claim at this focal point is superior to either of the other two valuation theories, given "the underlying economics of the situation."

Posner challenged proponents of the foreclosure valuation standard, which purports to value collateral based on what the collateral would garner outside of bankruptcy, by pointing out two inconsistencies in their argument. First, Posner argued that one "commercially reasonable disposition" of the creditor's security interest would be to allow the defaulting debtor to reaffirm the obligation. This reaffirmation, in turn, would allow a creditor, who uses the original security interest as leverage, to realize a greater value than he would otherwise receive through a forced sale. Posner considered it an impossibility to attach a certain value to the bank's lien in a nonbankruptcy world, making the compromise of the midpoint standard even more appealing. Second, Posner was concerned that awarding wholesale value would create a windfall for unsecured creditors. He reasoned that the extra money the unsecured creditors would receive in a Chapter 13 plan, in contrast to a liquidation of the collateral, is available only because the debtor can retain the vehicle and thereby continue to earn a regular income that might allow the unsecured creditors to recover a part of their claims. Addressing the replacement valuation standard, Posner opined that awarding the replacement value of collateral would "reward the bank for its [ability] outside of bankruptcy to threaten to take away the Hoskinses' car and with it perhaps their livelihood."

Lower courts applying the midpoint valuation standard have taken a variety of routes to reach their conclusions. The most well-reasoned bankruptcy court decision favoring midpoint valuation is In re Stauffer. The Stauffer court maintained that awarding wholesale value inadequately compensates the creditor for the risk of failure of

199 Id. at 316 (citing DOUGLAS G. BAIRD ET AL., GAME THEORY AND THE LAW 39 (1994)).
200 Id.
201 Id.
202 See id. Judge Easterbrook took issue with the award of this leverage value in his concurring opinion. See id. at 318-19 (Easterbrook, J., concurring).
203 See id. at 316.
204 See id. at 317. This argument is analogous to that which proponents of retail valuation have made. See supra notes 149-51 and accompanying text.
205 Hoskins, 102 F.3d at 317.
the Chapter 13 plan.  Yet, the court hesitated to award replacement value because it was far in excess of the amount the secured creditor would receive in a repossession sale. The court instead settled upon a midpoint valuation as the “most equitable approach.”

D. Valenti and the Ruleless Approach

The Second Circuit advocated a fourth approach in its General Motors Acceptance Corp. v. Valenti (In re Valenti) decision. Rather than adopting a uniform standard of valuation for every case, the Valenti court held that “no fixed value . . . should be imposed on every bankruptcy court conducting a § 506(a) valuation.” Instead, the court ruled that any standard of valuation may serve as the “starting point the court uses to reach the ultimate value of the claim” so long as the court considers the two criteria that § 506(a) provides: the purpose of the valuation, and the proposed disposition and use of the collateral. Specifically, the court affirmed the bankruptcy court’s decision to value the debtor’s car at the average of the wholesale and retail values in accordance with a local bankruptcy rule that mandated this valuation method.

The Valenti court found the statutory language of § 506(a) “rather amorphous,” stating that although the first sentence implied that the value “should be fixed at the collateral’s liquidation—or wholesale—value,” the “disposition or use” language in the second sentence required courts to “account for the likely replacement cost of the . . . vehicle.” Recognizing the circuit split over the proper

---

207 See id. at 613-14. For further discussion of this risk, see supra text accompanying notes 84-85.
208 See Stauffer, 141 B.R. at 614.
209 Id. Other courts have espoused midpoint value as an equitable solution to the valuation debate. See, e.g., In re Myers, 178 B.R. 518, 524 (Bankr. W.D. Okla. 1995) (stating that midpoint valuation “represents a compromise” that “will provide an equitable result”).
210 105 F.3d 55 (2d Cir. 1997).
211 Id. at 62. The Ninth Circuit’s decision in Taffi v. United States (In re Taffi), 96 F.3d 1190 (9th Cir. 1996), overruling its earlier decision in In re Mitchell, 954 F.2d 557 (9th Cir. 1992), is another example of a court advocating a ruleless approach, insofar as Mitchell advocated a specific valuation method—the foreclosure method. The Taffi court rejected this method, stating that “value is to be determined by the facts presented to the bankruptcy court.” Taffi, 96 F.3d at 1193; see also Johnson v. General Motors Acceptance Corp. (In re Johnson), 165 B.R. 524, 529 (S.D. Ga. 1994) (“A fixed ‘wholesale’ or ‘retail’ standard for . . . valuations is inconsistent with § 506(a)’s aversion to standardized procedure.”); David Gray Carlson, Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases, 15 Bankr. Dev. J. 1, 7 (1996) (“[A]ppellate courts should not even try to legislate a choice. . . . Instead, valuations should be viewed as a question of fact, consigned to the discretion of the fact finder.”).
212 Valenti, 105 F.3d at 62.
213 See id.
214 See id. at 58.
215 Id. at 59.
216 Id. at 61.
valuation standard, the court took issue with awarding "retail value" on the ground that such a valuation "ignores . . . the creditor's interest[, which] . . . must be taken into account."217

The court found support for its ruleless approach in the legislative history of §506(a). The court noted that Congress intended value to be determined on a "'case-by-case basis'" and explained that mandating either wholesale or replacement value would render one of the dual considerations—purpose and disposition—impracticable.218 By allowing a case-by-case determination, the court favored the exercise of discretion by bankruptcy judges.219 The court concluded that this type of fact-sensitive inquiry would prevent creditors from extracting hostage value from the debtor and thereby promote equity between the competing creditors in the case.220

In contrast to the ruleless approach of Valenti, the majority of courts deciding valuation issues apply a rule of law, regardless of which rule they choose.221 For example, Judge Posner stated:

[I]t is one thing to say that a uniform standard of valuation must be applied case by case, since application depends on the facts and they are different from case to case. It is another thing to say that there is no standard. . . . These are tiny cases. The debtor usually has few assets. To prevent the costs of bankruptcy litigation from eating up the entire debtor’s estate, a simple rule of valuation is needed.222

Courts choosing to prescribe valuation standards as a matter of law, however, often maintain that the chosen method is merely a starting point for their determination. The particular valuation standard may be altered to a strictly retail price, a wholesale price, or the midpoint of those two prices, depending on the specific facts of the case.223

---

217 Id. at 62.
219 See id.
220 See id.; see also supra text accompanying notes 111-14, 159-63 (discussing hostage value in the context of the wholesale and replacement value standards).
221 See In re Hoskins, 102 F.3d 311, 314 (7th Cir. 1996); NATIONAL BANKR. REV. COMM’N, supra note 192, at 243–45.
222 Hoskins, 102 F.3d at 314 (citation omitted); see also In re Maddox, 200 B.R. 546, 549 (D.N.J. 1996) (reviewing de novo a bankruptcy court’s interpretation of law).
223 See, e.g., Hobbs v. Gurley Motor Co. (In re Hobbs), 204 B.R. 994, 998-99 (Bankr. D. Ariz. 1997) (finding fair market value to be the appropriate standard, but then requiring specific evidence, i.e. appraisals or experts, to value the particular collateral); Maddox, 194 B.R. at 770 (“Upon appropriate evidentiary showing . . . measurement of value may be adjusted in a particular case.”).
A. Background

The facts of Rash mirror those found in the typical, Chapter 13 vehicle-valuation cases. However, the legal history and procedural posture of the Rash case were decidedly unique. Elray Rash purchased a Kenworth tractor truck in 1989 for use in his freight-hauling business.\(^{224}\) He borrowed a portion of the purchase price from the seller, who then assigned the loan to Associates Commercial Corporation ("ACC").\(^{225}\) In 1992, Rash and his wife filed a petition under Chapter 13.\(^{226}\) At the time of the filing, the Rashes owed $41,171 on the loan.\(^{227}\) The Rashes' Chapter 13 plan proposed to pay ACC, through fifty-eight monthly payments, the present value of the truck, which the petition alleged was $28,500.\(^{228}\) ACC objected to the valuation and countered that their claim was fully secured up to the amount of the loan.\(^{229}\) In a valuation hearing, the Rashes' expert valued the truck at $31,875, estimating that this was the net amount that ACC would receive upon foreclosure.\(^{230}\) ACC's expert maintained that the truck should be valued at $41,000, representing the amount the Rashes would have to pay to purchase a like vehicle.\(^{231}\) The bankruptcy court adopted the Rashes' wholesale valuation, fixed the amount of ACC's secured claim at $31,875, and approved the Rashes' Chapter 13 plan.\(^{232}\) The United States District Court for the Eastern District of Texas affirmed this ruling.\(^{233}\) A panel of the Court of Appeals for the Fifth Circuit reversed the district court's decision and held that replacement value was the correct measure of value.\(^{234}\) However, on a rehearing en banc, the Fifth Circuit reversed its panel decision, finding that the bankruptcy court used the proper method of valuation and correctly fixed the amount of the collateral at its wholesale value.\(^{235}\)


\(^{225}\) See id.

\(^{226}\) See id.

\(^{227}\) See id.

\(^{228}\) See id. at 1883.

\(^{229}\) See id.

\(^{230}\) See id.

\(^{231}\) See id.

\(^{232}\) See id. For the bankruptcy court's decision, see In re Rash, 149 B.R. 430 (Bankr. E.D. Tex. 1993).

\(^{233}\) See Rash 117 S. Ct. at 1883. The district court's decision is unreported.

\(^{234}\) See id. For the Fifth Circuit's panel opinion, see Associates Commercial Corp. v. Rash (In re Rash), 31 F.3d 325 (5th Cir. 1994), modified, 62 F.3d 685 (5th Cir. 1995).

\(^{235}\) See Rash, 117 S. Ct. at 1883 (discussing the Fifth Circuit's majority opinion in Associates Commercial Corp. v. Rash (In re Rash), 90 F.3d 1036 (5th Cir. 1996) (en banc)); see also supra Part II.A (highlighting the Fifth Circuit's rationale in Rash).
B. The Majority's Adoption of Replacement Value

Justice Ginsburg, writing for the eight-member majority, rejected both the foreclosure value and midpoint value standards in favor of what she called the "replacement value" standard: "we hold, the value of the property [in a Chapter 13 cram down] . . . is the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." The majority's short opinion neither contributed new arguments for adopting a replacement value standard nor rebutted the wholesale and midpoint valuation arguments at length. Rather, the Court perfunctorily recapped the traditional arguments for adopting the replacement value standard.

The majority first focused on the language of § 506(a). Like the lower courts that espoused the replacement value standard, the majority found that the first sentence of § 506(a) "imparts no valuation standard." Instead, according to the Rash Court, the sentence merely suggests that partial ownership by the debtor, or the junior or subordinated lien status of the creditor, may complicate a comparison between the creditor's claim and the value of the entire property. In those cases, the first sentence of § 506(a) "tells a court what it must evaluate . . . ; it is not enlightening on how to value collateral." The majority found the "proposed disposition or use" language from the second sentence of § 506(a) "of paramount importance to the valuation question." The Court concluded that applying the foreclosure value standard rendered the second sentence surplusage, whereas use of replacement valuation rendered those words meaningful. The Court chose not to give any weight to the legislative history of § 506(a), noting that the history was "unedifying" and "not enlightening."

The majority also focused on the economic risks that the wholesale value standard poses for creditors. Because use of the Chapter 13 cram down power necessarily involves the debtor's retention and use of the property, the majority noted that the creditor may "obtain[ ] at once neither the property nor its value." Adjustments in the interest rate or adequate protection payments, the majority explained, would not adequately compensate creditors for the risks of subsequent default by the debtor and the concomitant loss of value.

---

236 Rash, 117 S. Ct. at 1884.
237 See id. at 1884-86.
238 Id. at 1884.
239 See id. at 1884-85.
240 Id. at 1885.
241 Id.
242 See id.
243 Id. at 1886 n.4. Justice Scalia chose not to join footnote 4 of the majority opinion.
244 Id. at 1885.
through rapid depreciation of the vehicle.245 Adoption of the replacement value standard would be the only means of providing adequate compensation.246

The Supreme Court dismissed the Fifth Circuit’s argument that the replacement value standard does not adequately reflect the recourse available to the creditor under state law and noted that the operation of the cram down provision, as well as the operation of the Bankruptcy Code as a whole, has already displaced the rights of secured creditors vis-à-vis state law.247 As the Court pointed out, adoption of the replacement value standard “disrupts” state law “no more” than the operation of the Bankruptcy Code as a whole.248

The majority also dismissed the midpoint valuation standard, as well as the ruleless approach of the Valenti court, stating that there was “no warrant for it” within the statutory language of § 506(a).249 The Court rejected Judge Posner’s conclusion that the language of § 506(a) “suggests no particular valuation method” and read § 506(a) to “suppl[y] a governing instruction less complex” than Posner’s midpoint value standard.250

C. Justice Stevens’s Dissent

Justice Stevens’s one-page dissent in Rash offers a different interpretation of the statutory language and draws upon the economic analysis set forth by Judge Easterbrook in his concurring opinion in Hoskins.251 Stevens stated that the first sentence of § 506(a) “suggests that the value should be determined from the creditor’s perspective,”252 which mirrors the statutory interpretation arguments of lower courts espousing the foreclosure value standard.253 Stevens then focused on the “purpose of the valuation” language in the second sentence and maintained that a cram down merely directs the debtor to pay the present value of the creditor’s secured claim, which the first sentence already has established as the creditor’s interest.254 Therefore, as Stevens stated, “[t]he ‘purpose’ . . . of the valuation under § 506(a), is to put the creditor in the same shoes as if he were able to exercise his lien and foreclose.”255

245 See id.
246 See id.
247 See id. at 1886.
248 Id.
249 Id.
250 Id. (discussing In re Hoskins, 102 F.3d 311, 315 (7th Cir. 1996)).
251 See id. (Stevens, J., dissenting).
252 Id. (Stevens, J., dissenting).
253 See supra Part II.A.1.
254 See Rash, 117 S. Ct. at 1887 (Stevens, J., dissenting).
255 Id. (Stevens, J., dissenting).
Stevens then built on Judge Easterbrook’s concurrence in *Hoskins* and stated that awarding more than foreclosure value would grant a windfall to the undersecured creditors at the expense of the unsecured creditors.\(^{256}\) Foreclosure value, in contrast, “is . . . consistent with the larger statutory scheme by keeping the respective recoveries of secured and unsecured creditors the same throughout the various bankruptcy chapters.”\(^{257}\)  

Finally, Stevens argued that, contrary to the majority’s assertion that “surrender and retention are not equivalent acts,” the present value requirement in §1325(a)(5)(B)(ii) does protect creditors because the interest rate will fluctuate with the amount of risk that the debtor presents.\(^{258}\) Additionally, §361’s adequate protection provision addresses the Court’s concern about rapid depreciation.\(^{259}\) Stevens asserted that these protections put the creditor who is forced to allow the debtor to retain the collateral in essentially the same position that he would have been in had surrender occurred.\(^{260}\)

### IV

**The Treatment of Rash by the Courts, Legislators, and the Bankruptcy System: Why Midpoint Valuation Will Not and Should Not Go Away**

#### A. Bankruptcy Courts’ Treatment of Rash

Bankruptcy courts’ treatment of *Rash* confirms commentators’ fears that *Rash* would provide little help in establishing a consistent valuation standard for Chapter 13 cram downs.\(^{261}\) In cases decided the first year following *Rash*, courts have valued collateral at retail value\(^{262}\) and midpoint value,\(^{263}\) or they have used a fact-specific, ruleless approach.\(^{264}\) Contrary to the prediction of the National Bankruptcy Review Commission that “[c]aselaw will in short order coalesce

---

\(^{256}\) See id. (Stevens, J., dissenting).

\(^{257}\) Id. (Stevens, J., dissenting).

\(^{258}\) See id. at 1887 n.* (Stevens, J., dissenting); see also Carlson, supra note 211, at 15 (discussing the risk component of the cram down interest rate).

\(^{259}\) See *Rash*, 117 S. Ct. at 1887 n.* (Stevens, J., dissenting).

\(^{260}\) See id. (Stevens, J., dissenting).

\(^{261}\) See, e.g., Laurie B. Williams, *The Rash Decision: Is “Replacement Value” a Terminal Case of Poison Ivy or a Mild Case of Eczema?*, NORTON BANKR. L. ADVISER, June 1997, at 9, 11 (“*Rash* does little to promote certainty or simplicity . . . although the court does recognize the important interests of predictability and uniformity.”).


around replacement value measures that are not as widely different as the pre-\textit{Rash} cacophony of standards,” it appears that \textit{Rash} has changed only the rhetoric, and not the realities, of bankruptcy courts’ cram down valuation opinions. The remainder of this section will examine the post-\textit{Rash} valuation cases and dissect the divergent analyses and approaches to interpreting the Court’s tangled opinion.

1. \textbf{Cases Continuing To Use the Midpoint Valuation}

Despite \textit{Rash}’s explicit rejection of the \textit{Hoskins} and \textit{Valenti} decisions, some lower courts have continued to use the midpoint valuation standard as the starting point for cram down valuations. These courts have focused on footnote six in \textit{Rash} for the proposition that replacement value does not preclude using the average between wholesale and retail value as a starting point for valuation. Furthermore, the discretion that the Court apparently handed bankruptcy judges in footnote six resembles the same discretion that the Second Circuit praised in \textit{Valenti}. Footnote six of the \textit{Rash} opinion reads:

\begin{quote}
[T]he replacement-value standard . . . leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented. Whether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the nature of the property. . . . [R]eplacement value . . . should not include . . . portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle . . . .
\end{quote}

Four bankruptcy court decisions—\textit{In re Oglesby}, \textit{In re Younger}, \textit{In re Franklin}, and \textit{In re Glueck}—addressing the post-\textit{Rash} valuation of vehicles in cram down have seized on footnote six as grounds for continuing to use midpoint valuation.

In \textit{Franklin}, the court identified the Supreme Court’s misstatement of the \textit{Hoskins} rule and used this misstatement, in conjunction with footnote six of \textit{Rash}, to conclude that midpoint valuation survived \textit{Rash}. In \textit{Rash}, the Court claimed to reject the midpoint valua-
tion that Posner embraced in Hoskins, describing Posner’s approach as “pick[ing] the midpoint between foreclosure and replacement values.” However, in the Hoskins opinion, Posner approved a midpoint standard that valued collateral at “the average of the retail and the wholesale value.” This misstatement of Hoskins’s holding, in light of the definition of replacement value as either “retail value” or “wholesale value” in footnote six of Rash, led the Franklin court to conclude that “the decision in Rash [does not] dictate[ ] any change in methodology [from the midpoint value method].” The court thus sidestepped Rash’s explicit rejection of Hoskins’s split-the-difference method by stating that the midpoint rule serves merely as a starting point, not as an absolute value. The Franklin court concluded that “the Supreme Court has allowed bankruptcy courts to move the appropriate measure of replacement value back to some point between wholesale and retail values.”

The court in Younger engaged in a similar analysis of Rash and held that “arbitrarily fixing the average of the retail and wholesale . . . values as the starting point for valuation . . . [does not] violate the dictates of Rash.” First, the court stated that retail value, as provided by the Bluebook, “include[s] at least two of the items which Rash specifically stated should not be included in determining replacement value: inventory storage and reconditioning.” Because the prices that dealers charge consumers take into account these items of value, and are thereby included in the Bluebook’s valuation, a vehicle’s replacement value will always be less than its retail value. Second, because Rash requires courts to determine the price “a willing buyer in the debtor’s . . . situation would pay . . . to obtain” the vehicle, a debtor would not, barring extraordinary circumstances, replace the vehicle in the wholesale market. The court held that these two factors “lead[ ] to the conclusion that replacement value as described in Rash . . . is in virtually every case going to be some value between . . . wholesale and retail.” Thus, the court emphasized that footnote six in Rash gives bankruptcy courts “a license . . . to determine valuation in a manner very close to . . . Valenti, and that the

---

274 Rash, 117 S. Ct. at 1886 (emphasis added).
275 In re Hoskins, 102 F.3d 311, 316 (7th Cir. 1996) (emphasis added).
276 Franklin, 213 B.R. at 783.
277 See id. Using the midpoint merely as a starting point would seem to contradict Rash’s rejection of Valenti’s case-by-case methodology. See Rash, 117 S. Ct. at 1886 n.5.
278 Franklin, 213 B.R. at 783.
280 Id. at 656.
281 See id.
282 Rash, 117 S. Ct. at 1884.
283 See Younger, 216 B.R. at 652 (citing Rash).
284 Id. at 656.
[valuation] result . . . may be virtually indistinguishable from that which would have been obtained under Hoskins.\textsuperscript{285}

In Oglesby, the third post-Rash case to find that the midpoint between wholesale and retail value is the appropriate starting point for valuing collateral in Chapter 13, the Court cites Franklin and Younger approvingly,\textsuperscript{286} and the analysis in Oglesby mirrors the Younger court’s analysis. The Oglesby court, like its post-Rash predecessors, shunned valuing the collateral at its retail value because Rash insists on omitting items included in the retail price that the debtor does not receive upon retaining the collateral.\textsuperscript{287} Similarly, the Oglesby court found that valuing the collateral at wholesale value would not accurately represent the market in which the debtor would be replacing the collateral.\textsuperscript{288} Given these two facts, the court found that affixing a midpoint value to the collateral represented the most well-reasoned reading of Rash.\textsuperscript{289}

The most recent bankruptcy court decision, In re Glueck,\textsuperscript{290} also held that midpoint valuation is the correct post-Rash valuation standard for vehicles. Glueck focused on the market in which a debtor would purchase a needed vehicle.\textsuperscript{291} Citing its own experience with vehicle purchases by a debtor, the court recognized that debtors often purchased vehicles from “numerous other sources” at prices below retail, thereby “avoiding the overhead costs” included in prices at retail dealerships.\textsuperscript{292} While the court acknowledged that setting the standard at retail value would be easier for it to manage, the court insisted that the replacement value market that Rash adopted was “clearly broader than a purely retail market.”\textsuperscript{293} That fact, combined with Rash’s footnote six requirement of omitting warranties, storage, and other items, mandated a “discount from retail value.”\textsuperscript{294} However, the court also identified the debtor’s “inability to regularly access the wholesale market” as requiring some upward adjustment from wholesale value.\textsuperscript{295} Thus, the Glueck court, citing with approval the decisions in Franklin, Younger, and Oglesby, adopted the midpoint between retail and wholesale value as the starting point for Chapter 13 valuations.\textsuperscript{296} By adopting midpoint valuation as the standard for bank-

\begin{thebibliography}{99}
\bibitem{285} Id. at 653.
\bibitem{286} See In re Oglesby, 221 B.R. 515, 519 (Bankr. D. Colo. 1998).
\bibitem{287} See id.
\bibitem{288} See id.
\bibitem{289} See id.
\bibitem{291} See id. at *5.
\bibitem{292} Id.
\bibitem{293} Id.
\bibitem{294} Id.
\bibitem{295} Id.
\bibitem{296} See id.
\end{thebibliography}
Bankruptcy valuations, these four courts furthered the bankruptcy system’s
goals of promoting judicial economy, reducing parties’ transaction
costs, and limiting the potential for debtors’ and creditors’ strategic
activity in the bankruptcy system. 297

2. Cases Claiming To Use Retail Value

Three post-Rash cases have used the Bluebook retail value of the
debtor’s vehicle as the benchmark for valuation, 298 despite the Rash
Court’s instruction to omit portions of the retail price “that reflect the
value of items the debtor does not receive” such as inventory storage
costs, reconditioning costs, and warranties. 299 These courts arrived at
their conclusions through varied interpretations of Rash, the compo-
nents of the Bluebook price guide, and the structure of the valuation
process. Before discussing these cases, a detour into the makeup of
Bluebook retail and wholesale values is necessary to understand how
to apply Rash’s footnote six adjustment of value to the frequently used
Bluebook.

a. Components of Bluebook Wholesale and Retail Values

The Bluebook, more formally known as the N.A.D.A. Official Used
Car Guide, lists both a “retail” and a “trade-in or wholesale” price for
used vehicles. 300 Although the Bluebook neither reveals the entirety
of the components going into each value nor delineates the specific
differences between retail and wholesale value, some guidance may be
gleaned from a publisher’s note printed on the inside cover. First, the
Bluebook states that its values are based upon “many sources of infor-
mation, including reports of actual transactions.” 301 Thus, some com-
ponent of its retail value appears to reflect a seller’s asking price, 302
rather than the price at which a willing buyer and a willing seller actu-

297 See infra Part III.C-D.
298 See In re Jenkins, 215 B.R. 689, 692 (Bankr. N.D. Tex. 1997); In re Gates, 214 B.R.
300 N.A.D.A. OFFICIAL USED CAR GUIDE, EASTERN EDITION (June 1998) [hereinafter
1998 N.A.D.A. GUIDE]. The Guide is published monthly and has several different editions
for different regions of the country, reflecting changes in price, which depend on the
strength or weakness of the regional markets.
301 Id. publisher’s note.
302 Whether discrepancies exist between wholesale asking prices and actual sales is
more uncertain. While a potential discrepancy between the asking prices and actual sales
prices in retail transactions may be identified easily due to the traditional haggling be-
tween buyer and seller, the discrepancy between buyer and seller in wholesale transac-
tions is harder to identify, at least insofar as wholesale prices reflect the most common transac-
tions in the wholesale market, dealer auctions, and sales between dealers.
ally completed the transaction.\textsuperscript{303} Operating on this assumption, some portion of the retail value should be deducted to reflect the difference between a seller's asking price and the consummated transaction. Second, the Bluebook assumes that a vehicle is "clean" and that "appropriate deductions should be made for reconditioning costs incurred to put the vehicle in salable condition."\textsuperscript{304} Thus, in the likely event that the debtor's vehicle is not "clean,"\textsuperscript{305} the Bluebook value, whether retail or wholesale, will overstate the value that the \textit{Rash} Court mandates because it does not deduct reconditioning costs.\textsuperscript{306} Third, the Bluebook's retail value includes the possibility of "a limited warranty or guarantee and possibly a current safety and/or emission inspection."\textsuperscript{307} However, such warranties comprise another element of value that the \textit{Rash} Court expressly excluded from replacement value in footnote six.\textsuperscript{308} Thus, to the extent that the retail value reflects such warranties, however limited, courts should exclude them from their valuation. Deducting these three elements from the retail value makes sense because a willing seller would not attempt to charge a willing buyer for items that were not included with the vehicle.

After deducting these elements of retail price, the dealer's marketing costs, and in some instances its inventory storage costs, still remain important elements that separate retail and wholesale value.\textsuperscript{309} The Bluebook likely includes at least some element of these costs in its retail value because this value appears to reflect a component of the seller's asking price,\textsuperscript{310} which naturally will account for all of the seller's costs. The \textit{Rash} Court, however, provides conflicting guidance concerning both of these costs. First, the Court's footnote six does not specifically target marketing costs for exclusion from retail value.\textsuperscript{311} But following the \textit{three} elements that the Court does target for exclusion, it cites a portion of the Fifth Circuit's \textit{Rash} opinion that

\begin{itemize}
  \item Cf. Braucher, supra note 17 (manuscript at 21 n.93) (discussing an interview with the managing editor of the Bluebook in which the editor stated that the guide "strives" to approximate actual sales prices by retail dealers).
  \item 1998 N.A.D.A., supra note 300, publisher's note.
  \item Some examples might include: the vehicle has extensive wear and tear, needs bodywork or other mechanical work, or needs new tires or interior work. \textit{See About the N.A.D.A. Official Used Car Guide} (visited July 10, 1998) <http://www.nada.com/public/ConsumerGuide.htm>.
  \item \textit{See} Associates Commercial Corp. v. Rash (\textit{In re Rash}), 117 S. Ct. 1879, 1886 n.6 (1997).
  \item \textit{About the N.A.D.A. Official Used Car Guide}, supra note 305; \textit{see also} Braucher, supra note 17 (manuscript at 23) (explaining that the Bluebook retail values reflect informal dealer warranties, such as allowing exchanges).
  \item \textit{See Rash}, 117 S. Ct. at 1886 n.6.
  \item \textit{See supra} note 302 and accompanying text.
  \item \textit{See Rash}, 117 S. Ct. at 1886 n.6.
\end{itemize}
ments four elements of value: inventory storage, reconditioning, warranties, and marketing costs.\footnote{312}{See id. (citing Rash, 90 F.3d at 1051-52).} Thus, the Court may have intended to omit marketing costs from retail value. Second, despite the Court's explicit guidance as to inventory storage costs and implicit guidance as to marketing costs, it is difficult to reconcile the Court's "willing buyer/willing seller" language\footnote{313}{See Rash, 117 S. Ct. at 1884.} with the deduction of either of these costs from retail value. The existence of a willing buyer and a willing seller implies an element of seller profit, which in turn implies that the seller recoups all of its costs. Therefore, this language seems to indicate that replacement value, in some instances, should include both the seller's marketing and inventory storage costs.

As one commentator has noted, the facts of the Rash case provide a perfect example of the problem with deducting marketing and inventory storage costs from the collateral's value.\footnote{314}{See David G. Epstein et al., Collateral Valuation Arguments After Associates Commercial Corporation v. Rash, 7 J. BAKR. L. & PRAC. 205, 211 (1998).} The debtor in Rash sought to replace a tractor-truck.\footnote{315}{See Rash, 117 S. Ct. at 1882.} The debtor likely will not find a willing seller through an advertisement in the local paper, but instead will need to contact a retail dealer. Thus, courts that apply the willing buyer/willing seller language under these circumstances should focus on the retail seller-to-private buyer market. In this type of market the dealer would recoup his costs of marketing and storage from the buyer through an increased price, and it therefore seems appropriate to include both costs in the collateral's retail valuation despite footnote six's prescription. Alternatively, if the collateral is something that more often is subject to purchase in the private seller-to-private buyer market (e.g., a car), it may be more appropriate for a court to exclude at least inventory storage costs. Under these circumstances the seller most likely does not factor inventory storage costs into his asking price, and the Court's instructions to deduct these costs now seem to reconcile with its willing buyer/willing seller language. In sum, the Rash Court appears to acknowledge that marketing and inventory storage costs should not always be deducted from the retail price.

Returning to the Bluebook's retail value, it becomes apparent why, under Rash, some portions of this value—warranties and reconditioning—should be deducted and other portions—marketing and inventory storage—should not. Deducting the value of warranties and reconditioning while allowing the inclusion of marketing and storage costs would cause the vehicle's value to fall somewhere between the Bluebook's retail and wholesale prices. Although not the only argu-
ment for adopting a midpoint valuation standard, this interpretation of *Rash*, as applied to the Bluebook, would favor such a standard.

One post-*Rash* commentator, Professor Jean Braucher, has advocated the use of wholesale value, as given in the Bluebook, as the proper method of vehicle valuation. Braucher argues that *Rash* directs courts toward the private seller-to-private buyer market as the proper basis for determining replacement value. Because the *Rash* Court held that items the debtor does not receive should be deducted from replacement value, Braucher finds the private seller-to-private buyer market, more specifically a sale “initiated as a classified advertisement or putting a sign in the window of a car to be sold,” the market that would most closely approximate sales at this discounted value. Braucher also concludes that “the inclusion of the example ‘inventory storage’ shows that the Court wants bankruptcy courts to subtract from retail value the costs of retail selling.” Braucher identifies Bluebook wholesale value as the best choice for a simple rule. Even though Bluebook wholesale value derives from a wholesale dealer-to-retail dealer market, Braucher argues that pressures on a private consumer seller, such as a lack of information and a desire to sell quickly, will force a private consumer seller to take a price approximating Bluebook wholesale value.

Several arguments challenge Braucher’s choices of market and of valuation standard. First, even assuming that the private sale is the correct paradigm from which to view vehicle valuation, Braucher fails to consider important characteristics of the private seller. A private seller may easily overcome informational deficiencies by consulting a valuation guide. Further, even if Braucher chooses to omit the private seller’s “inventory storage” costs from retail value, the seller likely would seek to recover his costs of advertising the sale of the vehicle. Second, the Court’s willing buyer/willing seller language cuts in favor of looking to the breakdown of actual sales in the market—by retail dealer and private seller alike—rather than using the value of a single type of market transaction. To the extent that the market includes retail seller-to-private buyer transactions, the retail seller should be allowed to recoup its costs of marketing and inventory storage.

316 See infra Part IV.C-D.
317 See Braucher, supra note 17 (manuscript at 4).
318 See id. at 25.
319 Id. at 15.
320 Id. at 14.
321 See id. at 25-26.
b. How Post-Rash Courts Have Applied Retail Valuation

In the first of the post-Rash cases advocating the use of Bluebook retail value, *In re Russell*, the court held that Bluebook retail value was the appropriate measure for valuing the debtor's vehicle because it did not include the value of any warranties or reconditioning, costs which *Rash* stated should be deducted in vehicle valuations. A downward adjustment of the Bluebook retail price became unnecessary. Furthermore, the court stated that any deduction from Bluebook retail value would be inconsistent with *Rash*'s willing buyer/willing seller language, presumably because the court assumed that the debtor would only find a willing seller at the retail price given by the Bluebook. However, the *Russell* court erred in finding that Bluebook retail value does not include reconditioning costs and warranties—Bluebook retail value does include these elements. The debtor, therefore, likely could find a willing seller who would not charge for these elements of value if they were not included with the car. Thus, the *Russell* court's holding adds little to the valuation debate.

A second case espousing retail value, *In re Gates*, began the valuation process by determining retail value, "as that is the price a consumer would have to pay to replace the vehicle in the consumer market." Next, the court deducted the "value of items, if any, which were included in the retail value but which were not received by a debtor who retains her vehicle." However, instead of applying these two "rules" for valuation as a matter of law, the *Gates* court placed the burden of proof on the debtor to show which items included in the retail value she did not receive. In this case, the debtor's argument that wholesale value was the proper value, at least without more evidence than the wholesale price as given in the Bluebook, did not provide sufficient proof that she did not receive those items. It appears that the *Gates* court hoped to force debtors to prove, through convincing evidence of private sales, that they had a market other than the retail market available to them. However, this approach to valuation ignores the fact that the debtor will not always receive the value of warranties or, if the car is not "clean," the value of

---

325 See id. at 14 (citing *Rash*, 117 S. Ct. at 1884 n.2).
326 See supra text accompanying notes 304-07.
328 Id. at 471.
329 Id.
330 See id. at 472.
331 See id. at 472-73.
requiring the debtor to prove the omission of these elements of value in every case would be duplicative, and requiring the debtor to prove the existence of a private sale market would be unnecessarily time-consuming. 333

The court in In re Jenkins 334 suggested the following valuation standard in lieu of its prior midpoint valuation standard:

Determine the [Bluebook] 'retail' value. . . . Determine the seller's cost to obtain the vehicle. Add to that cost the reconditioning costs, if any, to put the vehicle in saleable condition. Compare the two figures. If they result in a reasonable spread, use the [Bluebook] retail price. If they do not . . . negotiate an agreed value. 335

In so ordering, the court intended to allow the seller to recoup his cost of marketing as represented by the spread between the cost to obtain and the reconditioning costs. The court expressly noted the Supreme Court's intimation that "commissions and other costs of sales . . . be considered" when making a valuation. 336 Additionally, the court found that, despite Rash's prescription to deduct reconditioning costs, "repairs must be made to put the vehicle in saleable condition. [Since t]he seller must incur these costs[,] . . . reducing the price by the amount of the repair costs . . . would result in no profit, and hence, no willing seller." 337 The Jenkins court's literal construction of the hypothetical sale prompted it to add in elements of value, specifically reconditioning and warranties, that the debtor did not receive. However, the court's formula is only useful insofar as it provides a tool for judges to determine the reasonableness of a seller's costs of marketing. To arrive at a more accurate value, the formula should require, after a finding of reasonable costs of marketing, the deduction of reconditioning costs as well as any costs of warranty built into the Bluebook retail price.

A final case interpreting Rash, In re Goodyear, 338 does not specifically address the proper method of vehicle valuation but instead focuses on the proper interest rate to be imposed on that valuation. However, it does lend some insight into those elements of value that may be considered by future courts. In Goodyear, the court calculated the interest rate payable by a debtor on a secured creditor's Chapter
12 secured claim. Citing the *Rash* Court's statement about the inadequacy of interest rate adjustments and adequate protection as means of protecting the secured creditor's interest, the *Goodyear* court found that *Rash* requires "that the risk premium be considered in connection with the valuation of collateral." Thus, the creditor was not entitled to a default premium when calculating the interest rate because such a premium should have been included in the court's valuation of collateral. In this way, *Goodyear* signals that pro-debtor courts may deprive creditors of the value of any increase that *Rash*’s new valuation standard may give them in the future by preventing creditors from receiving a default premium in the interest rate.

B. Post- *Rash* Attempts at Legislative Reform

Shortly after the *Rash* decision, the National Bankruptcy Review Commission ("Commission") published its final report identifying those areas in bankruptcy law in need of reform and proposing possible changes. The Commission criticized *Rash* for failing to resolve the ambiguities in § 506(a) and for not adopting a baseline standard that renders bankruptcy courts' fact-intensive analysis unnecessary. The Commission opposed the adoption of replacement valuation, explaining that the "numerous practical difficulties" in determining the value would inevitably lead to a "protracted 'battle of the experts,'" which can dissipate assets that otherwise would be available for distribution." The Commission challenged the assumption, commonly made by courts interpreting § 506(a), that this section allows for different valuation standards in different contexts. Additionally, the Commission found no good argument for applying different stan-

---

339 Valuation and interest rate questions in Chapter 12 are handled identically to those questions in a Chapter 13 case.
341 See id.
342 See NATIONAL BANKR. REV. COMM’N, supra note 132. The report reflects the final work of the Commission, which Congress created in 1994 to comprehensively examine the need for reform in the bankruptcy system. The report contains over 170 recommendations. In addition, the report contains several vigorous dissents, both with regard to the substance and the procedure involved in compiling the report.
343 See id. at 243-55. The section of the Commission’s report on consumer bankruptcy, including the discussion of *Rash*, reflects the views of a five-member majority of the Commission. The other four members of the Commission dissented from many of the recommendations in the consumer bankruptcy section, including the proposal to adopt wholesale value as the standard of valuation. See id. at 44-47 (containing a dissent in Chapter 5 titled *Recommendations for Reform of Consumer Bankruptcy Law by Four Dissenting Commissioners*). The dissenters instead chose to support "replacement value" as the proper standard of valuation. See id. at 45.
344 Id. at 248.
345 See supra text accompanying notes 20-21.
ceedings of valuation in different chapters of the Bankruptcy Code. In lieu of the standard that the Rash Court adopted, the Commission recommended that a single, uniform standard of valuation apply throughout the bankruptcy chapters and suggested that “[a] creditor’s secured claim in personal property should be determined by the property’s wholesale price.”

The Commission cited several economic and strategic reasons for adopting the wholesale standard: the ease of calculation; the promotion of the spirit of compromise; the correlation with state law entitlements; and the advancement of economic efficiency. First, the Commission lauded wholesale price as an easily calculable standard, requiring simply that the court identify the proper market in used goods from which to derive value. Use of such a “bright-line rule” also “avoids transaction costs in bankruptcy” and promotes judicial efficiency. Second, the Commission identified wholesale price as a midpoint between foreclosure and retail price, thereby promoting a spirit of “compromise.” Notably, the Commission’s contention that using wholesale value constitutes a source of compromise angered the Commission’s dissenters, who pointed out that prior cases have never “employed a below-wholesale standard.” Third, the Commission asserted that adoption of a wholesale value standard would ensure that creditors received no less than they would have otherwise received under state law, pointing out that a lower valuation would give debtors a windfall in light of their retention of the property. Lastly, the Commission restated Judge Easterbrook’s contention in Hoskins that using wholesale value would ensure that the highest valuing user receives the collateral. Any value that the debtor pays beyond the amount that the secured creditor would have received in foreclosure

347 Id. at 243. The Commission was not constrained by the current statutory language of § 506(a) in adopting its recommendation, a luxury that the Rash Court did not share.
348 See id. at 250-55.
349 See id. at 250. For instance, when valuing a vehicle, the wholesale price given in an industry price guide is appropriate. See id. For less common consumer goods, reference to the “want ads” or a flea market will yield a correct valuation. See id. at 250-51.
350 Id. at 250. The dissenters sought to reduce transaction costs as well, but felt that “[c]aselaw will in short order coalesce around replacement value measures that are not as widely different as the pre-Rash cacophony of standards.” Id. at 46 post.
351 See id. at 251. The Commission also identified the midpoint value standard, as the Hoskins court adopted, as a standard that promotes compromise. See id. at 252.
352 Id. at 46 n.76 post.
353 See id. at 254.
354 See id. at 254 n.293 (citing In re Hoskins, 102 F.3d 311, 320 (7th Cir. 1996) (Easterbrook, J., concurring)).
merely reflects the debtor's willingness to pay the most for the collateral.\textsuperscript{355}

In mid-1998, Congress addressed the issue of bankruptcy reform by introducing several bills in the House and Senate that sought to clarify the valuation standard of § 506(a).\textsuperscript{356} Although the secured creditor lobby has tried several times in the past to convince Congress to enact a more favorable valuation standard in Chapter 13,\textsuperscript{357} the 1998 legislation, passed by the House and pending in the Senate, may be the creditor lobby's strongest chance yet to overturn \textit{Rash} and the preceding valuation cases. Section 129 of House Bill 3150, as passed by the House, would amend § 506(a) by adding the following language:

In the case of an individual debtor under chapters 7 and 13, such value with respect to property securing an allowed claim shall be determined based on the replacement value of such property as of the date of filing the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purpose, replacement value shall mean the price a

\textsuperscript{355} See \textit{id.} at 254. Although the Commission's recommendation for bright-line rules in valuations promotes the bankruptcy system's goals of judicial economy and reduction of transaction costs, adoption of either the majority's wholesale value approach or the dissent's replacement value approach would encourage the kind of detrimental strategic activity that \textit{Hoskins}'s midpoint standard would minimize. See \textit{infra} Part IV.C-D.

\textsuperscript{356} See, e.g., H.R. 3150, 105th Cong. § 128 (1998); H.R. 3146, 105th Cong. § 1(d) (1998) (seeking to codify "liquidation value" as the standard); H.R. 2500, 105th Cong. § 111 (1998) (containing provisions similar to House Bill 3150).

\textsuperscript{357} In the past, the secured creditor lobby has failed to convince Congress to adopt the following amendment to § 506(a): "[t]he value of consumer goods which the debtor seeks . . . to be retained pursuant to § 1325(a)(5)(B)(ii) of this title shall be presumed to be the established resale market price, if such market exists, as may be determined from the recognized trade publications or comparable means." S. 2000, 97th Cong., 2nd Sess. § 6 (1982); see also S. 445, 95th Cong., 1st Sess. § 206 (1983) (same).


However, other courts have calculated replacement value using a different approach that looks at the replacement cost to the debtor. This approach shuns the retail value of the collateral in favor of what these courts deem to be a more appropriate calculation of replacement value, whether that value be retail price, less dealer overhead, commissions, and profit, see \textit{McQuinn v. Dial Fin. Co. (In re McQuinn)}, 6 BR 890, 899 (Bankr. D. Neb. 1980), the "bid" market price, see \textit{In re Klein}, 10 B.R. 657, 662 (Bankr. E.D.N.Y. 1981), or some other determination of what constitutes "fair market value," see \textit{Taffi v. United States (In re Taffi)}, 96 F.3d 1190, 1192 (9th Cir. 1996) (en banc). Indeed, it appears that the Supreme Court in \textit{Rash} intended to avoid the conflation of replacement value and retail value. \textit{Associates Commercial Corp. v. Rash (In re Rash)}, 117 S. Ct. 1879, 1886 n.6 (1997).
retail merchant would charge for property of that kind considering
the age and condition of the property at the time value is
determined.\footnote{358} Although the bill invokes the “replacement value” language of
\textit{Rash},\footnote{359} it clearly intends to supplant \textit{Rash}’s deduction of “items the
debtor does not receive” upon retention.\footnote{360} By including the costs of
sale and marketing in the valuation, in addition to specifying the retail
market as the relevant market for valuation purposes, House Bill 3150
would replace \textit{Rash} and its divergent progeny with a retail price stan-
dard as a new bright-line rule for valuation.\footnote{361} Although passage of
House Bill 3150 may please secured creditors and those who rightly
sound the need for a bright-line rule of valuation, a closer look at the
strategic effects of adopting a strictly retail approach militate against
passage of this proposed retail valuation standard.\footnote{362}

C. The Role of a Bright-Line Rule for Valuation in the
Bankruptcy System

Adopting a system of valuation that forgoes fact-intensive inquir-
ies, which impose considerable transaction costs on debtors, creditors,
and the judicial system, will promote the larger bankruptcy system
goals of reducing litigation and maximizing the value in the bank-
ruptcy estate.\footnote{363} Use of a bright-line rule of valuation will result in
lower attorneys’ fees for both debtors and creditors, whether the rule
employs the retail or wholesale value the Bluebook gives, the mid-
point of these values, or some other easily applicable standard. Con-
sequently, a bright-line rule would free up money, which the debtor
otherwise would have to pay his lawyer to litigate the valuation pro-
cedings, for the benefit of the unsecured creditors,\footnote{364} who would re-
ceive money from the increase in the debtor’s estate. The debtor
would enjoy indirect benefits as well because the increased estate may
make the debtor’s plan more feasible.\footnote{365} Secured creditors also would

\footnote{359} \textit{Rash}, 117 S. Ct. at 1886 n.6.
\footnote{360} \textit{Id},
\footnote{361} In cases in which the debtor financed a purchase of personal property by giving a
security interest in that property less than 180 days prior to filing, House Bill 3150 man-
dates valuing the collateral at the contract price, both in the original bankruptcy and in
any bankruptcy filed less than two years after the original filing. \textit{See} H.R. 3150, 105th
\footnote{362} \textit{See infra} Part IV.D.
\footnote{363} \textit{See National Bankr. Rev. Comm’n, supra} note 132, at 244, 248; \textit{Bankruptcy Reform Study, supra} note 165 (“[j]udges were generally critical of valuation hearings as a waste of
resources . . . .”); \textit{supra} text accompanying notes 221-23.
\footnote{364} \textit{See National Bankr. Rev. Comm’n, supra} note 132, at 244.
\footnote{365} The benefits would be direct in the case of a reorganization plan that contem-
plated a 100% payout to the unsecured creditors, even prior to the valuation, because the
debtor would receive any amount in excess of full payment to unsecured creditors.
benefit as a result of less litigation. Although the secured creditor can recover attorneys’ fees from the debtor when the contract allows such recovery, an undersecured creditor’s claim for attorneys’ fees is merely added to the portion of its claim that the claim-bifurcation process renders unsecured. Thus, secured creditors who incur attorneys’ fees in valuation proceedings often pay the bulk—if not all—of those fees. Adoption of a bright-line standard will benefit all parties to the bankruptcy by increasing the estate and by reducing attorneys’ fees for the secured creditor. In addition, the reduction in valuation litigation will reduce judicial costs, both in dollars and in the time lost to the parties in trying to divine the appropriate valuation standard from the divergent approaches of the courts.

Unfortunately, Rash did little to quash the valuation standard debate. Despite the majority’s insistence that “a simple rule of valuation is needed” to serve the interests of predictability and uniformity,” commentators have recognized that the fact-intensive inquiry that footnote six requires undermines the majority’s “simple rule.” Lower courts applying Rash, for the most part, have chosen to adopt a bright-line rule, at least as a definitive starting point for negotiation and litigation. As one court alertly has pointed out, the

367 See, e.g., In re Byrd, 192 B.R. 917, 919 (Bankr. E.D. Tenn. 1996) (explaining that the undersecured creditor has an unsecured claim for postpetition attorneys’ fees provided for in a prepetition promissory note, and that the court can estimate the amount of this claim); see also supra text accompanying notes 11-13 (describing claim bifurcation).
368 However, in the small number of cases in which high percentage payouts to unsecured creditors occur, secured creditors have little to risk in pursuing aggressive litigation strategies to ensure a higher valuation. If the secured creditors win, then they retain more of the lien and protect the present value of their claim. If they lose, they lose only that percentage of their unsecured claim that the debtor is not paying.
369 For example, Judge Easterbrook, commenting on Rash, noted that “[r]epossession 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.” NATIONAL BANKR. REV. COM’N, supra note 132, at 248 n.271 (quoting Hon. Frank H. Easterbrook, Bankruptcy Reform, Luncheon Address to the National Bankruptcy Review Commission Chicago Regional Hearing 4 (July 17, 1997)).
370 Associates Commercial Corp. v. Rash (In re Rash), 117 S. Ct. 1879, 1886 (1997) (quoting In re Hoskins, 102 F.3d 311, 314 (7th Cir. 1996)).
371 Id. at 1886 n.6. Footnote six “leaves to [the individual bankruptcy] courts, as triers of fact, identification of the best way of ascertaining replacement value.” Id.
372 See Williams, supra note 261. Two of the four lower court cases decided after Rash have emphasized the need to fashion a bright-line rule out of Rash’s language. See In re Younger, 216 B.R. 649, 655 (Bankr. W.D. Okla. 1998) (“[T]he volume of cases in which the issue [of cram down valuation] exists ... cries out for the establishment of a starting point ... .”); In re Russell, 211 B.R. 12, 14 n.3 (Bankr. E.D.N.C. 1997) (“This court hears thousands of chapter 13 cases each year ... and an easily applicable standard is essential.”). But see In re McElroy, 210 B.R. 833, 835-37 (Bankr. D. Or. 1997) (determining the value based upon experts’ testimony and actual sales prices).
373 See, e.g., Younger, 216 B.R. at 656; In re Franklin, 213 B.R. 781, 783 (Bankr. N.D. Fla. 1997).
majority of valuation disputes involve differences of less than $3,000, and thus a proper valuation standard should offer a fair starting point for negotiation.\footnote{374} Thus, while this section recommends that courts adopt a single, bright-line rule to reduce costs for debtors, creditors, and the judiciary, the task remains to decide which valuation standard to adopt.

D. The Role of the Midpoint Valuation Standard in the Bankruptcy System

In order to understand why the courts should adopt the midpoint between the replacement value and the wholesale value as the correct standard of valuation, one must first identify the goals of the cram down valuation process and the strategic results that each valuation standard creates.\footnote{375} The two most obvious goals of the cram down valuation process are (1) to enable the debtor to reorganize effectively,\footnote{376} while (2) allowing future consumers to continue to contract with creditors to receive consumer goods in the market.\footnote{377} However, if these were the only goals of the valuation process, their apparently contradictory nature would mandate conflicting solutions. If the system desires to promote effective reorganizations, the best outcome for the debtor would be to receive the collateral at no cost, thereby freeing assets to cover payments to other creditors and increasing the chances of a successful plan. Yet if the system wants to protect future debtors who wish to contract for the purchase of consumer goods, it would make sense to require that the debtor pay the entire value of

\footnote{374} See Younger, 216 B.R. at 655. By contrast, the Rash case involved an unusually large disparity between the parties regarding the collateral's valuation. See supra text accompanying notes 227-31.

\footnote{375} This section posits a rudimentary form of systems analysis. It is based on a paradigm scholars have developed to analyze the workings of a particular system by first studying the goals of the system, the players within the system, and what strategic activity a particular solution will encourage among the many players within and without the system. For more on how systems analysis applies to legal systems, see Lynn M. LoPucki, The Systems Approach to Law, 82 CORNELL L. REV. 479 (1997).


the loan—not just the value of the collateral.\textsuperscript{378} Therefore, given the conflicting nature of these initial goals, the system must define the goals of valuations more narrowly: The purpose of a cram down valuation is to (1) fix a value and (2) ensure that the fixed value minimizes the type of strategic activity that wastes the resources of the debtor, the creditor, and the judicial system.

Courts can minimize strategic activity by adopting a valuation standard that falls somewhere between the wholesale and replacement value. If creditors receive what they believe to be the wholesale value of the collateral or more, they will have received at least the amount that they would have received outside of bankruptcy.\textsuperscript{379} This valuation would not give the creditors an incentive to change their strategy because the value realized would be equal to or greater than that which the creditors contracted for in the event of default. Thus, a valuation between wholesale and replacement minimizes the secured creditors' strategic activity.\textsuperscript{380} Furthermore, if debtors can pay what they believe to be the replacement value of the collateral or less, debtors will not be forced to file Chapter 7 liquidations instead of Chapter 13 reorganizations.\textsuperscript{381} Debtors will also avoid the transaction costs necessary to replace collateral vital to the reorganization, which they could not afford if a court overvalued it.\textsuperscript{382}

However, when a court places a value on collateral that is either higher than replacement value or lower than wholesale value, strategic activity ensues because of the perceived loss of value from either the debtor's or the creditor's perspective. When a court sets a value higher than the replacement value of the collateral, one of two results occurs: (1) the debtor overpays for retention of the collateral, causing a loss to the debtor in relation to what he could have saved by securing the collateral from a cheaper source;\textsuperscript{383} or (2) the debtor must

\textsuperscript{378} While Congress expressly has prevented secured creditors from requiring repayment of the entire loan through the combined process of claim bifurcation, see supra text accompanying notes 11-13, and cram down, courts trying to promote the goal of encouraging future lending may choose a standard that would value the collateral at retail value or higher.

\textsuperscript{379} This outcome assumes the collateral is a vehicle that may easily be sold through a wholesale market in vehicles, and that the creditor has access to this market. See In re Hoskins, 102 F.3d 311, 318 (7th Cir. 1996) (Easterbrook, J., concurring) (describing the operation of the interdealer wholesale market for used cars).

\textsuperscript{380} Creditors will inevitably adjust their interest rates to reflect expected returns in the event of bankruptcy, should courts choose to change the method of valuation. This Note assumes that today’s interest rates on consumer goods lending reflect, in part, the valuation method courts use in the venue where the creditor believes it may be involved in a bankruptcy case.

\textsuperscript{381} See supra text accompanying notes 104-06.

\textsuperscript{382} See supra text accompanying notes 90-93, 184 (discussing surrender and its effects).

\textsuperscript{383} For instance, the debtor could have surrendered the collateral to the secured creditor, see supra text accompanying notes 90-93, and purchased identical collateral in the open market for its replacement price.
surrender the collateral to the creditor, requiring the debtor to incur transaction costs to replace the collateral and depriving him the use of the collateral during the period that he is trying to replace it.\textsuperscript{384} Both of these outcomes negatively affect the goal of minimizing strategic activity as well as the larger goal of promoting effective reorganizations. When a court instead sets the value lower than the wholesale value of the collateral, the court, in effect, offers the collateral to the debtor at an amount less than what the creditor expects to receive in the event of the debtor’s default.

The degree of strategic activity that can occur when a court sets the collateral’s value too low warrants further discussion. Setting the value below wholesale value results in an increase in the debtor’s disposable income, which then serves to transfer this value from the secured creditor to the unsecured creditors.\textsuperscript{385} The debtor likely will keep the collateral because it will be necessary for an effective reorganization, and the secured creditor, in turn, must engage in strategic activity to prevent future losses for which he did not contract, even in the event of default. The debtor also may choose to keep collateral valued at or below wholesale value because he perceives himself as getting “a good deal”; even though some authorities argue that value transferred away from secured creditors will necessarily accrue to unsecured creditors.\textsuperscript{386} Furthermore, the debtor may (1) anticipate future bankruptcy filings, in which the wholesale valuation can strip the old lien,\textsuperscript{387} (2) shorten the reorganization plan and thereby take the income from the unsecured creditors,\textsuperscript{388} or (3) think that he can protect the added income as “reasonably necessary” for his “maintenance or support.”\textsuperscript{389} Strategic solutions for the creditor who has lost the anticipated default value of the loan include increasing interest rates on loans for consumer goods, dropping out of an unprofitable lending market altogether, or initiating other strategies somewhere between the lawmaking and lending stages.\textsuperscript{390} Thus, a proper valuation standard must minimize the risk that bankruptcy courts will value col-

\begin{footnotesize}
\begin{enumerate}
\item See supra text accompanying notes 90-93, 184 (discussing costs of surrender).
\item However, if the debtor’s plan pays 100\% to unsecured creditors, which is not an uncommon occurrence, see supra note 53, then the value transfers from the secured creditor directly to the debtor because any money left in the estate after paying the unsecured creditors in full accrues to the debtor. See 11 U.S.C. § 1325 (1994) (discussing the system of priority in bankruptcy).
\item See supra notes 109-05 and accompanying text.
\item See LoPucki, supra note 9, at 853-54 (describing methods by which a debtor can avoid paying the unsecured portion of an undersecured creditor’s lien).
\item See Carlson, supra note 211, at 11.
\item 11 U.S.C. § 1325(b)(2) (allowing debtor to retain income that is “reasonably necessary” for these purposes).
\item For an example of the lawmaking strategy of the secured creditor lobby, see supra text accompanying notes 356-62.
\end{enumerate}
\end{footnotesize}
lateral above its replacement value or below its wholesale value in order to prevent strategic activity and to help the system achieve its larger goals.

Thus far, proponents of both wholesale and replacement valuation likely remain quite unconvinced of the benefits of a midpoint standard. They respond to arguments in favor of the midpoint value by reasoning that neither wholesale valuation nor replacement valuation requires courts to value collateral any lower than wholesale value or any greater than replacement value, so the aforementioned problem of encouraging strategic activity does not arise. This response assumes, however, that valuing collateral in a bankruptcy court is an exact science. In reality, courts that choose, for example, to value vehicles based on one of the Bluebook’s values will fail to account for differences between the hypothetical vehicle valued in the Bluebook and the actual vehicle valued by the bankruptcy court. If the courts attempt to use a more fact-specific inquiry into the vehicle’s value, then the valuation will necessitate the consideration of conflicting expert testimony,\textsuperscript{391} the creditor’s and debtor’s own observations,\textsuperscript{392} and the judge’s own biases and perceptions about the correct value. As one commentator has pointed out, “it is probably more appropriate to view the varying bases and manners of valuation as establishing a range of possible values as opposed to a finite set of alternatives.”\textsuperscript{393}

Adoption of either wholesale valuation or replacement valuation will cause a greater number of valuation decisions to fall either above these parameters, when using replacement value, or below these parameters, when using wholesale value. Both of those situations will result in strategic activity that skews the purposes and goals of the valuation system. By adopting a standard that looks at the midpoint of these two values, courts will be less likely to value the collateral at a point above replacement value or below wholesale value, thereby minimizing the likelihood that valuation will create strategic activity by debtors and creditors.

Given that valuations should avoid fact-specific examinations,\textsuperscript{394} and that courts should use a valuation standard that sets the value at the midpoint of wholesale and replacement value,\textsuperscript{395} the final inquiry concerns whether courts can effectuate these two goals when valuing


\textsuperscript{393} 3 COLIER ON BANKRUPTCY, supra note 26, § 506:04, at 506-30.

\textsuperscript{394} See supra Part IV.C.

\textsuperscript{395} See supra Part IV.B.2.
collateral in Chapter 13. When valuing vehicles, some post-*Rash* courts have chosen to set the value at the midpoint of the retail and wholesale values, as given in the Bluebook. These courts have recognized that the Bluebook's retail value includes items that the *Rash* Court specifically stated, in footnote six, should not be included in determining replacement value, such as inventory storage and reconditioning costs. The *Rash* Court maintained that it does not "suggest that a creditor is entitled to recover what it would cost the debtor to purchase the collateral brand new." On the other hand, the *Rash* Court's willing buyer/willing seller language intimates that the collateral's value should account for some of the seller's costs and profit, which will result in a price above the Bluebook's wholesale value. Thus, the midpoint of the Bluebook's wholesale and retail values will yield a value that *Rash* contemplated. Moreover, using this method to value the collateral will facilitate an easy calculation, and will minimize the need for costly valuation hearings because it represents a compromise upon which parties will often agree.

Courts should adopt the midpoint of retail value and wholesale value in the Bluebook as the correct method of vehicle valuation in Chapter 13 cram downs. Adopting this bright-line rule will reduce transaction costs to debtors and creditors, will save the courts' time for other disputes, and will provide an amenable starting point for negotiation. Further this rule will accomplish all of these benefits while adhering to the language of the *Rash* opinion. Adopting a retail value standard would ignore *Rash*’s admonitions to avoid conflation of retail and replacement value and would risk the debtor's ability to effectively reorganize. Adopting a wholesale value standard would ignore the *Rash* Court's emphasis on looking at the situation from the perspective of a willing buyer and willing seller. In addition, such a valuation would encourage strategic behavior by those secured creditors that could increase either the debtor’s costs, by trying to recover attorneys’ fees, or the future consumers' costs, by increasing lending costs or decreasing lending competitiveness. Thus, future courts deciding the proper interpretation of the language of *Rash* and the appropriate method of valuation in bankruptcy reorganizations should follow the lead of the *Franklin* and *Younger* courts and adopt the midpoint of retail and wholesale value as the correct valuation standard.

---

397 See, e.g., *Younger*, 216 B.R. at 656.
399 See supra text accompanying notes 309-16.
400 See *Rash*, 117 S. Ct. at 1884 n.2.
401 See supra text accompanying notes 383-84.
402 See *Rash*, 117 S. Ct. at 1884.
Conclusion

Proponents of wholesale, midpoint, and replacement value standards disagree over the proper reading of § 506(a). However, these different schools of thought appear to have forgotten the overall goals of the system and the incentives that each particular method of valuation creates. Most courts agree that deciding on a single method of valuation in cram down situations will solve the problem of voluminous litigation. Nevertheless, demonstrating that the Supreme Court's opinion in Rash does little to promote the process values of certainty, uniformity, and simplicity, courts after Rash have continued to adopt divergent methods of valuation.

Because courts should seek a standard that will reduce strategic activity, which results from valuations above the collateral's actual replacement value or below the collateral's actual wholesale value, the optimal valuation standard for Chapter 13 cram downs is the midpoint of replacement and wholesale values. However, the difficulty of calculating the replacement value without a costly fact-specific inquiry into the makeup of the market available to the debtor requires courts to adopt a measurement for replacement value that is easily identifiable. For vehicle valuations, the best available proxy is the Bluebook values of the vehicle. Thus, courts should fix the value of vehicles in Chapter 13 cram downs at the midpoint between the Bluebook wholesale and retail values.