TRANSCRIPT OF PROCEEDINGS

IN THE SUPREME COURT OF THE UNITED STATES

UNITED SAVINGS ASSOCIATION OF TEXAS	)	
Petitioner,	)	
v.	)	No. 86-1602
TIMBERS OF INWOOD FOREST ASSOCIATES, INC.,	)	
Respondent.	)	

Pages: 1 through 49

Place: Washington, D.C.

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Petitioner,

v. No. 86-1602

TIMBERS OF INWOOD FOREST ASSOCIATES, INC.,

Respondent.

Washington, D.C.

Tuesday, December 1, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:55 p.m.

APPEARANCES:

H. MILES COHN, ESQUIRE, HOUSTON, TEXAS; on behalf of the Petitioner.

LEONARAD H. SIMON, ESQUIRE, HOUSTON, TEXAS; on behalf of the Respondent.

C O N T E N T S

P R O C E E D I N G S

(1:55 p.m.)

CHIEF JUSTICE REHNQUIST: We will hear argument next in Number 86-1602, United Savings Association of Texas versus Timbers of Inwood Forest Associates, Inc.

Mr. Cohn, you may proceed whenever you are ready.

ORAL ARGUMENT OF H. MILES COHN, ESQUIRE

ON BEHALF OF PETITIONER

MR. COHN: Mr. Chief Justice, and may it please the Court:

United Savings is a secured creditor of Timbers of Inwood Forest Associates, a debtor under Chapter 11 of the Bankruptcy Code. As a creditor, United Savings has a claim against this debtor. But as a secured creditor, United Savings has much more.

United has an interest in property of the bankruptcy estate. Specifically, that interest is a first lien deed of trust, or real property mortgage, on property owned by the debtor, that property being an apartment project located in Houston, Texas.

Pursuant to the provisions of that mortgage and under applicable laws of the State of Texas, United Savings has the right to have its security interest foreclosed at such time as the debtor may default, has the right to have the property sold at a foreclosure sale at that time, and then to take the

proceeds of that sale, or the proceeds of its subsequent disposition of the property, and apply those proceeds to its debt, to take that money in effect and put it out in a new investment and to begin earning interest or other income on that new investment, and to take that money also and apply it to the payment of its debt.

QUESTION: Mr. Cohn, were you representing the client in the proceedings below?

MR. COHN: Yes.

QUESTION: And was a petition ever filed with the Bankruptcy Court for relief from the stay under Section 362(d)(2)?

MR. COHN: No, Your Honor. This action was originally brought under 362(d)(1) only.

QUESTION: I just wondered why no petition was filed for relief from the stay.

MR. COHN: Well, it was a petition for relief from the stay, Your Honor. It was filed under 362(d)(1), rather than under 362(d)(2). And I suppose of hindsight were foresight and we were starting this all over again, we might have done it differently. But at this time, particulary in Texas, but I suspect elsewhere across the country, the practice in this sort of case was to focus very early on in the case on the question of whether the secured creditor's interest in property was adequately protected. That was the typical practice, and

therefore, this motion was filed focusing on that issue.

QUESTION: Did the debtor have any equity in the property here?

MR. COHN: No, Your Honor.

QUESTION: No, I didn't think so.

MR. COHN: The debtor does not have equity in the property.

QUESTION: Right.

MR. COHN: And that was one of the findings of the Bankruptcy Court. I think it is important in fact to emphasize what those findings were.

Bankruptcy Code Section 362(a) imposes an automatic stay which stops the exercise of rights and property at such time as a bankruptcy case is commenced. The automatic stay imposes a very real cost on a secured creditor. That cost is measured by the income lost, the income that could have been earned had the creditor been allowed, but for the automatic stay, to exercise its rights and property.

QUESTION: How long can that cost continue to be extracted from the creditor? I mean, under (d)(2) there is a certain amount of time in which this thing has to be brought to an end or else it is not considered an effective reorganization. Isn't that true?

MR. COHN: No, Your Honor, (d)(2) does not set forth any kind of specific standard or time limit.

QUESTION: I'm sure nothing specific. But it can't be considered an effective reorganization if it drags on interminably, can it?

MR. COHN: At some point it has dragged on so long and there is no little hope of any kind of reorganization that the Bankruptcy Court might terminate the stay on other grounds. But that might be two or three years, it might be many months, it might be any period of time that causes injury and damage to the secured creditor.

QUESTION: Do you think it can go on for two years?

MR. COHN: I have seen cases that have, Your Honor.

QUESTION: Should they?

MR. COHN: Normally not, Your Honor, but they should, and I think it is important to focus, in answering the question posed by this case, not on the single asset case. This is a single asset case in which to some extent the issues are blended together, but the same issue arises in multiple asset cases.

You might have a Continental Airlines in which a secured creditor holding a lien on one airplane comes in and says the stay ought to be terminated, and if there is no protection for the interest of that secured creditor in the sense of the time value of money, it is very difficult for that creditor to come in and argue that the proceedings have dragged on too long.

In terms of a very complex case, the proceedings might last justifiably a very long period of time, but that should not take the place of the need to protect the individual secured creditors.

QUESTION: The only point I am making is that there is some outside limit that is introduced elsewhere in the Code upon how long the creditor has to eat the interest, in effect.

MR. COHN: I hate to be difficult, but I think the answer is yes and no. Yes, in that the Bankruptcy Court has discretion at some point to take action under some other provisions, but no, in the sense that there is no principal basis for measuring the damage done to the secured creditor and imposing some kind of protection as time goes on other than adequate protection under 362(d)(1) and 361.

Yes, at some point the Court may conclude that this case has dragged on too long, but even if that is six months past what might be a reasonable limit, the secured creditor has incurred very serious costs.

The seriousness of those costs I think is well illustrated by the facts of this case. The Bankruptcy Court found that but for the automatic stay, United Savings could have foreclosed on the property and liquidated its collateral within six months of the filing of the case, that United could have earned $4.25 million by selling the property, and could have reinvested that money at 12 percent interest per annum.

QUESTION: May I ask a question there? That is a higher return than they would have gotten if there had been no default, I take it?

MR. COHN: Yes, Your Honor.

QUESTION: One of the rights you seek to protect is the right to get the benefits out of a foreclosure to which you have a legal entitlement, which may be better than having the debt paid according to its original terms.

If that right is to be protected, should it not also be protected for the oversecured creditor?

MR. COHN: Well, I believe the oversecured creditor is protected, because -- and this is one of the confusing things about the Opinion of the Court below. We have never argued that all undersecured creditors are entitled to periodic cash payments. Creditors, secured creditors are entitled to some protection for the costs of delay. The oversecured creditor is protected because he in a sense has equity in the property and he knows that when he gets to the end of the proceeding there is value to cover the costs of delay.

QUESTION: But he doesn't get the same benefit that the undersecured creditor gets.

MR. COHN: He absolutely does. He gets it at a different point in time. In other words, interest continues to accrue on his debt.

QUESTION: Yes.

MR. COHN: And he is entitled to eventually --

QUESTION: But he doesn't get the 12 percent rate. You are getting 12 percent, if I understand you.

MR. COHN: We get 12 percent but not, if the debtor elects, under Section 1142, to reinstate the debt according to its terms.

In essence, it is like there are two tracks going along. The secured creditors rights might be measured by default, in which case he gets in essence the money he could have earned in the event that there had been a default or he gets what would have happened if the debtor reinstates and lives up to the terms of the contract.

The debtor has that election. The debtor doesn't have to pay 12 percent interest. The debtor can live up to the terms of the contract.

QUESTION: Not if he doesn't have the money.

MR. COHN: Well, if he doesn't have the money, then the debtor's interest and property is not being adequately protected.

QUESTION: So the other track disappears and you get 12.5 percent.

MR. COHN: That is correct, Your Honor, if the debtor can pay it. But there may be no reason to pay it.

QUESTION: Favoring you over the oversecured

creditor, which is Justice Stevens' point.

MR. COHN: It doesn't favor us because at the end of the case, you are eventually going to have the same result. I suppose the oversecured creditor -- let's say in both cases there is ultimately a default. That is, the debtor does not reinstate. The debtor has defaulted. He may default at different points in the proceeding depending on when the Judge forces him to make these payments. If he defaults later in the proceeding, the oversecured creditor will get his property back. In other words, he will at that point be allowed to foreclose and if he is really oversecured, he is going to get back even more than that particular amount of interest. He'll get back the whole property. And that conceivably could be more.

QUESTION: He does not get to keep the overage. He can sell it off and use the proceeds of sale to pay off the debt, but he can't keep a profit.

MR. COHN: At most real property foreclosure sales, and certainly in Texas, the lender bids it in, and it is very difficult to find other buyers, and the lender effectively ends up owning the property.

QUESTION: If the property is substantially oversecured, if the debt is substantially oversecured, presumably the property would sell for more than the obligation.

MR. COHN: If it is substantial enough.

QUESTION: Yes.

MR. COHN: It depends how much the gap is.

QUESTION: And it is true, isn't it, that the oversecured creditor would, at the end of the line, get the contractual interest, not the amount of interest that you say the undersecured creditor might be entitled to get?

MR. COHN: Yes, Your Honor. At the end of the line, the oversecured creditor will get his contractual interest. But, if the debtor elects to keep the contract in force in a plan of reorganization, the debtor also will get the benefit of contractual interest. There is one case on record where a court has attempted to reconcile the sections, and I don't think there is any problem in the context of a plan of reorganization with the Bankruptcy Court saying to the undersecured creditor who has gotten perhaps more interest than he would have under the contract that we are going to rebate or count some payments against you to make up for that difference because the creditor is now going to reinstate.

Also, I might add, this is an issue that almost never comes up. I can't see it really ever coming up. Here, it's 12 percent interest but it is calculated on what in this case higher, in fact, in this case it's lower than the contract amount because contract interest was 14 percent. But if you take as a hypothetical you're getting 12 percent interest when

10 percent was the contracted rate, you are typically getting it, if you are an undersecured creditor on a principal balance that is much less, so that the total you are getting is still less than you would be getting if you got your payments. And that stands to reason because the debtor always has the option of making the regular payments.

I don't think there is any court that wouldn't allow a debtor to make the regular payments of interest called for and retain the property while the case is proceeding.

I think this case involves a situation where a creditor has suffered a very real loss. No payments have been made in this case. And I think it is important to put this issue in the context of what the Bankruptcy Code did to it. If this case had been decided under the Bankruptcy Act there would be no Timbers of Inwood Forest Associates, because an undersecured creditor was almost invariably entitled to relief from the stay.

QUESTION: He just took his security and foreclosed and thumbed his nose at the Bankruptcy Court.

MR. COHN: That is correct, Your Honor, because the cases under the Bankruptcy Act uniformly held that except in certain very limited circumstances where the secured creditor for some other reason was protected, the secured creditor was entitled to take back his property if the debtor had no equity in it.

In other words, if he had no equity, what's the point of the debtor keeping the property?

What the Bankruptcy Code did was to put something really dramatic into the Code. Instead of just saying that the Court must terminate the stay if there is inadequate protection or if some other standard is not met, the Code also allows the Bankruptcy Court to condition the automatic stay. And that allowed the Bankruptcy Court in this case to do something it could not have done under the Bankruptcy Act. Under the Bankruptcy Act the Court would had to have just terminated the stay when we filed our motion under 362(d)(1).

QUESTION: And then the secured creditor would have had whatever value there was in the security and used that money at whatever market rates?

MR. COHN: That is correct, Your Honor. Under the Bankruptcy Act, the stay would have been terminated because the debtor had no equity in the property. We would have taken the property back and would have been out of the bankruptcy case.

Under the Bankruptcy Code, the Court has an additional alternative. The Court can say to the debtor, okay, even though you couldn't have kept this property before, we will let you keep the property. We will keep the stay in effect as long as it is conditioned on something that protects the secured creditor from the costs of delay.

That something in this case was periodic post

petition payments, but it doesn't have to be. It could be anything. 362(d)(1) is the statute that gives the Bankruptcy Court this authority. It provides that the Court may condition the stay.

QUESTION: Well, the Code, as opposed to the Act, has disadvantaged the secured creditor in one degree, anyway. And we are just arguing over whether it has disadvantaged him further still.

Previously, he didn't have to worry about some judge assuring, in the judge's estimation, that he wasn't being prejudiced by the delay. Now, he does, under the Code. Before, he could take his property and go.

MR. COHN: I think it was a change in methodology. I don't think that Congress intended to disadvantage secured creditors at all in enacting the Bankruptcy Code.

QUESTION: Oh, but it is a disadvantage not to be able to take your property and leave. Even if they can get the judge teo figure out that you're not being prejudiced, you don't consider that a disadvantage?

MR. COHN: Not if you are being compensated for the cost of delay. Because what bankruptcy does is substitute value for in kind treatment. You may not get the property.

QUESTION: Having your property is quite different from having some judge's estimation that you have gotten something as good as your property, isn't it?

MR. COHN: Yes. I agree.

QUESTION: My point is that we all agree that the secured creditor is being disadvantaged by the Code and the question is, in addition to disadvantaging him to this degree, did the Congress, moreover, want to deprive him of the ability to make use of the time value of his money?

MR. COHN: I think very clearly not. In response to that, Your Honor, I would like to point to really two broad things that are set forth in the legislative history. And I might say as an aside that there has been a lot of argument in the lower courts and many articles written on this subject that spends a lot of time on what adequate protection means, what indubitable equivalent means, various terms that may have some meaning in other contexts but aren't really defined in the Bankruptcy Code. And I think in getting mixed into that argument they sometimes miss the two really clear things that are stated in the legislative history.

One is that Congress chose, consciously chose, not to define the meaning of value, and therefore I think it is unfair to latch onto examples in the legislative history or little bits and pieces or words. Congress, in both the House and Senate reports, in more than one place, made very clear that this was a matter to be left to judicial development.

But on the other hand, and this is the second thing that is very important, Congress made very clear that it sought

to protect the full value of the creditor's interest in property.

In both the House and Senate reports, there is language that the full benefit of the creditor's bargain should be protected, and an interesting aside to that is that the House and Senate reports also say that this means something more than what the Constitution requires. The Constitution generally has been interpreted to require that the value of the collateral at least be protected. And the House and Senate Report said that adequate protection means more than that. It means that even though the creditor may not be allowed to foreclose exactly on default or exactly at the time when he might under state law, even though he might not get in kind what he is entitled to under state law, that nevertheless he would be entitled to the value of what he gets under state law.

I think that if you begin with this thing, that Congress wanted to protect the value of the creditor's interest in property, in this case the value of a mortgage, it necessarily follows that the costs of delay must be protected, for several reasons.

First of all, that is the essence of the secured creditor's rights. The secured creditor has a right under his mortgage to foreclose on default. The secured creditor, with all due respect to this apartment project, doesn't want the project. United Savings doesn't want to own this property.

United Savings wants to use the property as a means to recover its loan, and it does that by having it sold at foreclosure sale as soon as it is entitled to under the mortgage, taking that money, putting it out at interest, and the quicker it can do that and the more interest it can earn, the quicker it can recover its debt.

Moreover, and I think this is another very, very crucial thing that as overlooked by the Court below, this value, this time value of money, is something that is protected under non-bankruptcy law.

No one would doubt that a fee simple interest in property is worth more than a future interest in property. I don't think anybody would doubt that.

Surely it follows that a temporary deprivation of an interest in property decreases its value, and in fact, in another context, this Court held recently, in First English Evangelical Lutheran Church, that an owner's interest in property was decreased when, for a period of time, he was temporarily deprived of that interest.

And I don't think there is any reason for treating security interests any differently. If the secured creditor is deprived of his property for a period of time, the value of that security interest is less.

For example --

QUESTION: Mr. Cohn, can I ask you about some of the

structural problems with the other portions of the statute that the interpretation you are putting on this creates?

MR. COHN: Certainly.

QUESTION: Subsection 362(b) provides for -- you are moving under (d)(1).

MR. COHN: Yes.

QUESTION: Which says the automatic stay can be terminated for cause, including the lack of adequate protection of an interest in property. Now, you are saying that there is automatically inadequate protection when a less than fully secured creditor is not given the time value of his money, in effect, right?

MR. COHN: Yes, although the question is phrased a little bit differently.

QUESTION: Nonetheless, you are saying that that comes to the same thing. There is lack of adequate protection unless you are assured, unless the stay is modified to give you the time value of the money.

If that is the case, then why isn't (d)(2) entirely superfluous? That is, with respect to a stay of an act against property under Subsection (a), you can move for modification if two conditions. Number one, the debtor does not have an equity in such property -- but that is always going to be the case when you have an undersecured creditor -- and, two, you need a second condition under (d)(2) -- such property is not necessary

for an effective reorganization.

You wouldn't need that second condition under your theory of the case, because the first condition, the first part of (d)(2) would be the same as (d)(1), and you wouldn't need a second part to (d)(2).

MR. COHN: I think the mistake in that analysis is that adequate protection, the (d)(1) section, is not directed just to this.

It could have been written a lot more specifically to set out, for example, in single asset cases, these are the rules. But instead the Code required adequate protection of an interest in property. And it could have been written differently.

QUESTION: Well, (d)(1) isn't written just for this. But (d)(2) is written just for this.

MR. COHN: (d)(2) is not necessarily limited to a single asset case. It would apply to any. Obviously, you are moving for relief from the stay with respect to a single asset. In (d)(2), one thing that enters into the analysis that I might add is that the second part of the test on (d)(2) which requires that there be a reasonable hope of reorganization, doesn't require rehabilitation because a reorganization can include a liquidating plan.

There are many circumstances in which a debtor may have no equity in the property, yet, nonetheless believe that

it could successfully reorganize, for example, by capital infusion or by a liquidating plan. There are all kinds of things.

So there are circumstances where you wouldn't be entitled to relief under (d)(2), but you would still be entitled to some kind of relief, not necessarily termination of the stay, but some kind of relief under (d)(1).

QUESTION: Give m an example, specifically.

MR. COHN: I think an example would be -- I can think of more than one. You might have a multiple asset case where the debtor has no equity in property and therefore there is some reason for relief under (d)(1), but nevertheless, it is necessary for an effective reorganization, because the debtor is using that property and cannot easily replace it.

So the creditor may not be entitled to any relief under (d)(2) but may be entitled to relief under (d)(1).

Another circumstance would be, in a single asset case, where the debtor has --

QUESTION: No, I want the opposite. I want when you would be entitled to relief under (d)(2) that you couldn't get under (d)(1).

MR. COHN: It might be a different kind of relief. I'm not sure what you mean.

QUESTION: A case where you would be entitled to relief under (d)(2), you wouldn't be entitled to relief under

(d)(1) anyway.

MR. COHN: It would be the situation, I'll give you an example, where the creditor comes in and says we will offer you adequate protection by giving you a lien on other property or by paying adequate protection payments or doing something that meets the requirements of (d)(1). And the creditor says I don't want to fool around with this bankruptcy case. Even though you are going to offer me something that adequately protects my interest, under (d)(2), if there is no equity in the property and this property is not necessary to an effective reorganization, I get it back.

In other words, (d)(1) allows the debtor to hold onto the property, possibly for a period of time beyond which he might reasonably reorganize, or beyond which there may be some reasonable hope of reorganization. So the debtor may not want to take advantage of it but he may want to, and the creditor may say no.

With the Court's permission, if there are no more questions, I would like to reserve the balance of my time.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Cohn. We will hear now from you, Mr. Simon.

ORAL ARGUMENT OF LEONARD H. SIMON, ESQUIRE

ON BEHALF OF RESPONDENT

MR. SIMON: Mr. Chief Justice, and may it please the Court:

I would just like to briefly respond to two points that have been raised by Petitioner.

First, that the time value of foreclosure rights is protected by state law is a question that I can't answer. But it is a question that the Federal Bankruptcy Code has answered. The Federal Bankruptcy Code in Section 502(b)(2() and in Section 506(a) and (b) has legislated on the issue of interest. This Court, in Butner, specifically stated that in cases where the Legislature has spoken on issues, that Federal law will override the state law.

I would just point out to the Court that that issue has been decided under the Bankruptcy Code.

Secondly, both (d)(1) and (d)(2) were part of a law prior to the enactment of the Bankruptcy Code. It is simply not the case that either one or the other was not the law.

QUESTION: But the dramatic change has been the automatic stay, really.

MR. SIMON: Not so, because there was an automatic stay pursuant to 1144, in prior law.

QUESTION: I had a fair amount of experience representing creditors in bankruptcy under the Act and you just didn't have to put up with all this stuff. You could take your security, and they had to bring a plenary action against you in District Court in order to even question, and the only thing there was to defend that the security was improper.

MR. SIMON: Well, I beg to differ with the Court, but at some point there was a time when in order to get an automatic stay effected, a debtor had to take affirmative action to do so.

Once it was effected, however, then we were under the same rules that we are under right now. But, for more than ten years prior to the enactment of the Bankruptcy Code, we had Bankruptcy Rules of Civil Procedure. And those rules provided for an automatic stay upon the filing of the Bankruptcy case.

Your Honor may be referring to a time prior to that time.

QUESTION: Well, my private practice ceased in 1969 so that perhaps I just missed the Bankruptcy Rules.

MR. SIMON: I think perhaps that may be the case. And to say that --

QUESTION: At least there was an understanding on reorganization.

MR. SIMON: Oh, yes, there was. Very clearly so.

QUESTION: But nevertheless, if a secured creditor was undersecured, what happened?

MR. SIMON: Oh, the case law is very clear from prior tot he enactment of the Bankruptcy Code under a steady stream of cases beginning with Sexton v. Dreyfus and ending with Nicholas, and then from the Second Circuit Court of Appeals, starting with In re Murel, Third Avenue Transit, followed by

Yale Express and Bermec, that the undersecured creditor was entitled to protection against the depreciation in the physical value of the property, not for lost opportunity costs. That was the law and has been the law for a century.

And to say that United, the Petitioner herein, was following the law at the time or the practice at the time and only proceeding under (d)(1) is in my mind an incredible argument.

It was surprising to me that they did not proceed under (d)(2). If they had proceeded under (d)(2) they might have won. But they did not.

Now, I would like to just go into my argument if I may.

This is clearly a statutory construction case. This Court has had many occasions to construe Congressional enactments. We have reviewed many of the cases that have talked about the procedure that the Court follows. Ernst & Ernst v. Hochfelder, Touche Ross v. Reddington, and many others, including the Midlantic Bank v. New Jersey, both the majority and the dissenting Opinions, very well-written Opinions on both sides.

What we glean, although this is not an area that is very clear, what we glean from all of these cases is that the Court goes through the following analysis.

First, it looks to the actual words of the statute to

see if the intent of Congress is clear from the face of the statute -- that is, the plain meaning rule -- and, whether such interpretation is harmonious with the entire statutory scheme.

Second, the analysis goes through the Congressional policy of the underlying statute to see if the proper interpretation is consistent with the Congressional policy underlying the statute.

Third, if, only if the intent of Congress cannot be gleaned from the first two elements, then the Court will go into the legislative history. And as this Court has been divided at times on the types of legislative history used or whether legislative history is appropriate to use, beginning in 1950 with a stream of cases, from that point, this Court has been more willing to look at legislative history because of the availability of the legislative history to both sides.

Prior to 1950, the big argument was, it is not available and it wasn't very clear. Today, I am going to emphasize the first two elements of the analysis because it is my belief that nothing substantial can be added to Judge Randall's scholarly treatment and analysis of the legislative history behind the Bankruptcy Code contained in the Timbers Panel Opinion.

Also, I would like to commend to the Court, for the arguments which I do not have time today to make, the well written briefs of amici Global Marine and National Association

of Credit Managers.

There are two phrases and one word which has been used to attempt to import into Section 361 this time value analysis. They are "indubitable equivalent," "interest in property," and "value."

Petitioner agues that the phrase "indubitable equivalence" was a term of art at the time of the enactment of the Bankruptcy Code, that it was understood to contain a time value element and that therefore its use in Section 361(3) imports a time value analysis into Section 361.

Petitioner cites for authority Case v. Los Angeles Lumber Products Company, 308 U.S. at 115 where the Court stated that where words are employed in an Act which had at the time a well-known meaning in the law, they are used in that sense unless the context requires otherwise. And I would ask the Court to focus on that last phrase, "unless the context requires" to the contrary.

The arguments against importing the time value analysis into 361 through this term or phrase "indubitable equivalent" are fivefold.

First, the words are used in a different context in Section 361. "Indubitable equivalent" was used prior to the enactment of the Bankruptcy Code in the confirmation context, if in fact they were terms of art.

Secondly, the phrase "indubitable equivalent" had

not, when Congress used it in 1978 in the Bankruptcy Code, become a term of art with a well-defined meaning.

Congress took the phrase from In re Murel Holding Corporation, 75 Fed. 2d 941, a Second Circuit Court of Appeals decision in 1935, where Judge Hand specifically used it in the confirmation context, and in 43 years between the date of Morel and the enactment of the Code, the term or phrase "indubitable equivalent" was only used nine times.

Those Opinions did nothing to define "indubitable equivalent" to create a term of art or to suggest that it means protection for time value of a secured creditor's rights, and those cases are cited in the Amicus Brief filed by the National Association of Credit Management at Page 19.

QUESTION: Isn't that the way Hand used it?

MR. SIMON: No, clearly not. Very clearly not, for two reasons.

First, and this is the -- I was just about to get into this. First, the Opinion of Judge Hand in Murel was by its own terms limited to the confirmation context.

QUESTION: I didn't ask whether it was limited to the confirmation process. I asked whether in that context or in any context, it wasn't specifically directed to time value.

MR. SIMON: No, it was not.

QUESTION: It was not?

MR. SIMON: It was not. In re Murel, time value was

referred to in In re Murel by Judge Hand as quote "completely compensatory." "Completely compensatory." That was the phrase that Judge Hand used in In re Murel to talk about the time value of money.

What "indubitable equivalent" was referring to in that case, if the Court will review that case very carefully, it is a very well-written case, a very knowledgeable man wrote that case, because he understood bankruptcy. He understood it very clearly.

What he was talking about was the fact that there was no principal repayment until the end of the ten-year term. The plan specifically provided for the time value of money. It provided for market interest rate on the principal. And the Judge said it is completely compensatory, it has to be completely compensatory. And then he went on to say that interest is the equalizing factor.

What he was really referring to, I think, was feasibility. With "indubitable equivalent," what he was really referring to was the repayment of the principal and the fact that there was no principal repayment during the ten years of the plan, and that it was an interest-only obligation, and that there was big balloon payment ten years down the line. Nobody knew whether the property was going to have sufficient value to pay that balloon payment. There was no amortization. Yet another possibility, he was referring to the fairness of

forcing a creditor to wait for ten years to receive any interest. But very, very clear, and this is a point which one needs to really review that case very carefully to understand, the time value of money was equated to the term "completely compensatory." "Indubitable equivalent" referred to something completely different.

The importation of the time value analysis into Section 361 through "indubitable equivalent" is yet defended again by Judge Hand's Opinion in which he stated that no doubt less would be required during the interim until a plan could be filed and confirmed by the Court. It very clearly distinguished that.

And finally, and perhaps most importantly, Sections 361, 1129(b)(2)(A) are similar in that each have two specific examples filed by general description, all in the disjunctive. One of the two examples in 1129(b)(2)(A) specifically provides for a time value element, in other words, the confirmation cram-down standard. There is a specific time value element in that statute, in that part of the statute that is not tied to "indubitable equivalent." Neither of the two examples in 361 specifically provide for a time value element. Each section of the Bankruptcy Code containing a specific time value element does so without utilizing the words "indubitable equivalent." Section 1129(a)(7)(A)(ii), Section 1129(a)(9)(B), Section 1129(b)(2)(A), Section 1225(A)(4), Section 1225(b)(1)(A) and

Section 1325(b)(1)(A) are the sections in the Bankruptcy Code that utilize a time value element, and none of them used the words "indubitable equivalent." Thus, when Congress utilized a time value concept, it did so explicitly and it did so without utilizing the phrase "indubitable equivalent." Justice Blackmun, speaking for the Court, in Roussileau v. United States, 464 United States at 23, quoted with approval the following elements of statutory construction from the 1972 Fifth Circuit Opinion in United States v. Won Kim Bo, and I quote: "Where Congress includes particular language in one section of a statute but omits it in another section of the same act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion and exclusion."

Thus, if the phrase is not a term of art, and does not have a unique time value element, what is its meaning? And what is the meaning of "indubitable equivalent"? The answer is that the phrase must mean, quote: "...without a doubt, an acceptable or equal substitute." That's what the phrase means. And so now let's apply it in Section 361(3). It would mean, other adequate protection that would be, without a doubt, an acceptable or equal substitute for the examples of adequate protection described in Sections 361(1) and 361(2). And in Section 1129(b)(2)(A)(iii), the phrase would mean, other fair and equitable treatment that would be, without a doubt, an

acceptable or equal substitute for the examples of fair and equitable treatment described in Sections 1129(b)(2)(A)(i) and 1129(b)(2)(A)(ii).

QUESTION: Is United Savings getting any interest payments during the bankruptcy?

MR. SIMON: United Savings is not getting any interest, per se. It is receiving the net operating income from the property. It is not designated as interest.

QUESTION: And the reason it is not getting any interest is because of the bankruptcy proceedings?

MR. SIMON: The reason why it is not getting any interest at this time is because of the stays that have been entered on the District Court level and then on the Fifth Circuit Court level, staying the effect of the Bankruptcy Court's Order.

QUESTION: Yes, and of course, the Fifth Circuit has reversed the Bankruptcy Court's Order in effect.

MR. SIMON: Yes, that's correct, and so a stay is no longer necessary.

QUESTION: If the Fifth Circuit's view prevailed, United Savings will continue through the proceeding without receiving any interest on its debt.

MR. SIMON: No question about that. I would like to make this point about that, and I was hoping that the Court would raise that.

There is an answer to that question in the Continental decision, and I would like to just refer this to the Court, if I might.

QUESTION: The question I asked was whether United States was receiving interest, and you have answered it by saying no, it isn't receiving interest.

MR. SIMON: It is not receiving interest. I would just like though to refer this to the Court.

I understand that this proceeding has taken quite a long time, and I understand that United has not been receiving interest for a long time, and I understand that a plan of reorganization has not been filed or confirmed. But that is as a result of the fact that the issues that are determined by the Court today have to be decided before something can be done.

And in the Continental case, which is, the full cite of the case is Continental Illinois National Bank and Trust Company v. Chase, at 296 U.S. 648, the Court held that if this long delay were without adequate excuse, the retention of the injunction for the long period which has intervened since it was granted could not be justified, but the delay is obviously due to the many doubts and uncertainties arising from the present litigation.

With those doubts and uncertainties now removed, the proceedings should go forward to completion without further delay. And that will occur.

QUESTION: This case may be an egregious example of extension, because of litigation of important issues, as you suggest.

MR. SIMON: Correct.

QUESTION: But under the rule held by the Fifth Circuit, secured creditors such as United States Savings would not get interest pending the bankruptcy.

MR. SIMON: Correct. The proper remedy for the creditor in that particular instance, if the debtor cannot file a plan of reorganization, in the appropriate period of time, the proper remedy is a motion to dismiss. The Fifth Circuit Court of Appeals decision in the Fifth Circuit is working. This Court needs to know that it is working very well. The Bankruptcy Judges are beginning to follow 1112 more carefully. They are giving greater consideration to extending the exclusive period, and refusing to do so, and they are administering their cases and moving their cases forward. That is the proper remedy for these creditors. That is what, in the en banc decision, Judge Randall said that the Bankruptcy Court should do, and it is incredible, but that is exactly what they are doing. And I don't know any good debtor/bankruptcy lawyer today who is not filing a bankruptcy proceeding, and immediately thereafter pursuing a plan of reorganization with the idea of filing it within the exclusive period, within four months, because the Bankruptcy Courts will not allow a debtor

to stay in bankruptcy indefinitely, any longer. And it is because of the Fifth Circuit. And that is the way that the Code was structured, and that is the way it should work, and, by God, that is the way it is working now, because Judge Randall has basically cleared it up with the Fifth Circuit.

The phrase "interest in property." The phrase "interest in property" as used in Section 361, when read in the context of Sections 362 through 364, clearly refers to the various types of ownership interest or lien interest for which a party may require adequate protection.

For example, an entity may have an ownership interest as a tenant-in-common, a joint tenant or a tenant by the entireties. An entity may be, along with a debtor, a beneficiary in a trust or the holder of a deed of trust covering real or personal property to secure a jointly held note receivable. An entity may be the holder of a pledge. And the list goes on.

While Congress used "interest in property" to describe many different property rights, the phrase refers neither to enforcement powers or remedies to realize the benefit of the "interest in property," nor to creditors' rights for remedies.

Congress' use of the general and broad term "interest in property" therefore should not be read to require protection of state law contractual remedies that are not property rights,

such as the ability to foreclose.

I would like to make one point at this juncture. That is, Justice Scalia, you were absolutely correct. Oversecured creditors would be entitled to not only receive their lost opportunity costs but also to receive their interest in addition to that. Furthermore, it is true that if taken to its logical conclusion, that if the market rate is higher than the contract rate, then they would be getting a benefit over an oversecured creditor. Under Section 506(b) it is very clearly inconsistent. But what is even worse than that is that there is absolutely no reason why undersecured creditors would not be entitled to lost opportunity costs, for, were it not for the imposition of the automatic stay, they would have been entitled to go to judgment, they would have had a judgment lien on their property, and they would have had a right-in-property, a foreclosure right, that would have had measurable value.

QUESTION: The bankruptcy law has always distinguished sharply between secured creditors and undersecured creditors, hasn't it?

MR. SIMON: In certain circumstances, yes, but the Bankruptcy Code has never distinguished secured creditors and undersecured creditors based on the ability to receive lost opportunity costs. Never.

QUESTION: Well, supposing, though, that this bankruptcy is ultimately dismissed. Is United States, or what

is the name of the creditor?

MR. SIMON: United Savings.

QUESTION: United Savings, entitled to get accrued interest out of the security as well as principal?

MR. SIMON: At that time, it becomes moot, because it has the security, it has the collateral. It will have already foreclosed, and so it becomes a moot point at that time.

QUESTION: Unless you're talking about how much it's bid in at.

MR. SIMON: The amount that it will bid in will not be affected by this case or by our interpretation of Section 361. It will bid in the amount of its note or, under Texas law, probably 70 to 80 percent of the amount of the indebtedness, at that time.

QUESTION: It will be a moot point. The fact is, it will be out the interest, during that whole period, right?

MR. SIMON: There is no question that it would be out that interest.

QUESTION: You may consider it moot.

MR. SIMON: There's no question about this.

QUESTION: The good people at United Savings won't.

MR. SIMON: This is a very unusual case.

QUESTION: Pardon?

MR. SIMON: This is a very unusual case, because it has taken so long. It should not have taken so long. Within

six months after the filing of this bankruptcy proceeding, had it not been for this counsel's use of only Section 362(d)(1), and the imposition of the stays and the reluctance of the Bankruptcy Court to do anything pending the Fifth Circuit's determination, this case would have been determined years ago.

QUESTION: But they still would have been out six months' interest, wouldn't they?

MR. SIMON: Questionable.

QUESTION: They would have been out the interest for however long the proceeding was in bankruptcy.

MR. SIMON: That assumes they would have taken the property into their REO Department and immediately sold it, which may or may not be the case. There is no evidence in the lower Court to that effect. And in fact, this Court may take judicial notice of the fact that many lenders retain properties in the hopes that they will increase in value over the years and then sell them two and three years dow the line. So it is not an absolute, foregone conclusion that they would have been able to obtain interest. That issue has been decided by this Court many, many times. The undersecured creditor is not entitled to interest under Sexton, Nicholas and many more cases that have been decided by this Court, that the Bankruptcy Code and the power of Congress to legislate bankruptcy laws basically gives the right to Congress to stay the enforcement of lien rights. The Court has continuously said that only the

value of the property is protected against decline, not the loss of interest during the bankruptcy proceedings. That has been very clear precedent.

I am going to go into the next portion of my argument here very quickly. The language of Section 502(b)(2) is clear that a claim for unmatured interest as of the date of bankruptcy is disallowed. There is no question about that. Interest cannot accrue, under Section 502(b)(2). The word "claim" in Section 502(b)(2) is defined in Section 101(4)(a) to include a secured or an unsecured claim.

Section 506(a) defines the secured claim as being equal to the value of the creditor's interest and the estate's interest in the collateral. The question that I would pose to this Court is how could the estate's interest in collateral include foreclosure rights of a third party? If United's interest in the collateral is limited to the estate's interest in the collateral, how could it possibly include lost opportunity costs of a third party?

That is one of the clearest deficiencies in that argument.

There are only two exceptions to 502(b)(2) and that is 506(b) which allows interest in the case where the collateral is in excess of the value of the debt and also 726(a)(5) which provides that if the liquidation estate has enough assets to pay its allowed priority secured and unsecured

claims, then it can also pay interest.

QUESTION: May I ask you one question?

MR. SIMON: Yes, sir.

QUESTION: I hesitate to interrupt. But I want to be sure about your position.

One of the Amicus Briefs filed by a Professor Nimmer from Michigan concludes that, urges that there is neither a requirement of post-petition interest, which your opponent asks for, nor its absolute preclusion is warranted under the terms. Do you take the position that it is absolutely precluded?

MR. SIMON: Yes, sir.

QUESTION: You do. And there is no middle ground. So you disagree, I think you disagree with Judge Clark then in the Fifth Circuit.

MR. SIMON: No. Judge Clark, I believe you are talking about the concurring decision in the en banc?

QUESTION: Yes.

MR. SIMON: I don't believe that the concurring opinion adopted the idea that in some cases it was allowable and in some cases it was not.

QUESTION: I thought it did. I will read it again. But I thought he did.

MR. SIMON: I don't think that was the case that --

QUESTION: I don't' think it is entirely clear in the

majority Opinion whether they agree completely with your view either. But your view is it is absolutely prohibited?

MR. SIMON: Right. The majority Opinion in the Tim case clearly adopts that approach. There is a case, called Briggs Transportation, and that is the case, and I believe that Briggs Transportation is out of the Eighth Circuit, that was decided after American Mariner, which basically says that yes, sometimes it is allowable and sometimes it is not.

The problem with that case is that this is clearly a statutory construction case. I don't have time to go into all of that, but it is clearly a statutory construction case, and it is either permitted or it is not permitted.

QUESTION: Well, it took the Eighth Circuit and it also took Chief Judge Clark.

MR. SIMON: I am not certain that Chief Judge Clark, in his -- I would have to read that concurring opinion again. But I do not believe that Judge Clark was adopting the Briggs Transportation ruling, that in some cases it would be and in some cases it would not. I'd have to read that again, but I do not believe that that is what Judge Clark was saying.

QUESTION: Well, I thought otherwise, and like Justice Stevens, I will have to read it again.

MR. SIMON: Finally, I would like to point out two things out of the legislative history that are amusing, if not interesting. There were two Amicus Briefs filed in this case,

one by the National Commercial Finance Conference. In the legislative proceedings that preceded the enactment of the Code, the party speaking for National Commercial Finance Conference, during those Committee hearings, stated that the secured creditor should receive periodic payments during the pendency of the stay to cover depreciation of property or wear and tear.

It is very interesting that they are now adopting a different approach, when in the Committee hearings they clearly adopted the approach that has been adopted by the Fifth Circuit.

Secondly, the other amicus that has filed in this case, American Bankers Association, also stated that the automatic stay should remain in effect if it is clear that the value of the secured creditor's claim against the collateral will be preserved, and further said that the suggested standards set forth in the Commission's notes should be included in the statute. And the Commission's notes basically said that conditions which may be imposed by the Court when appropriate include, one, requiring other security of an equivalent or two, if there is no equity, or the equity is marginal, requiring additional security to the extent of the anticipated decrease in the value of collateral as a result of its use.

I find that very interesting, that they are now

jumping on the bandwagon and taking the position that this is what the law was at the time that the Code was enacted.

I would also point out to the Court that there was only one comment in all of the legislative history that ended up with the Bankruptcy Code, that even talked about this issue, and it was a part of a law journal article from Mr. Murphy. The law journal article was 63 California Law Review 1483, and the cite was, if the interim --

CHIEF JUSTICE REHNQUIST: Mr. Simon, your time has expired.

MR. SIMON: Thank you.

CHIEF JUSTICE REHNQUIST: Mr. Cohn, you have seven minutes remaining.

ORAL ARGUMENT OF H. MILES COHN, ESQUIRE

ON BEHALF OF PETITIONER - REBUTTAL

MR. COHN: I would like to begin by responding to Justice Stevens' question and just make clear what our position is on the Briggs issue, also. First of all, United's position is that a secured creditor, as well as others with interest in property of the estate -- that may be a co-owner, or a spouse with interest in community property, anyone with interest in property of the estate -- is entitled to protection for the costs of delay imposed by the automatic stay. That does not necessarily require and it is not our position that that would necessarily require periodic post-petition payments. Adequate

protection may take the form of an equity cushion in the property, it may take the form of an alternative lien, it may take the form of a reorganization proposal or rehabilitation that is going to increase the value of the property such as the completion of goods in process where a lender has a security interest in manufacturing goods. So that is going to depend on the facts of the case. Our position is that some protection ought to be required.

Secondly, we agree with the Respondent that Briggs is not a very good response to this problem. I think what Briggs does is tell each individual Bankruptcy Court to answer a legal question. That legal question being whether the time value of the secured creditor's rights are entitled to protection. I think that is a legal question and it ought to be answered by the Appellate Courts.

QUESTION: Mr. Cohn, do you agree with your opposition as to the status of the secured creditor before the Code was adopted? Did the undersecured creditor in a reorganization ever get the time value of his interest in the property?

MR. COHN: No, I don't agree with the way he sees it. In fact, we may be looking at two different things. I think he is looking at cases that deal with reorganizations. I'm dealing with cases, and the briefs set forth the cases that have to do with motions for relief from stay.

QUESTION: I know. But this is a reorganization case.

MR. COHN: Yes. But the automatic stay --

QUESTION: For which you made the motion.

MR. COHN: There are two different periods of time. The automatic stay won't take effect until a plan of reorganization is confirmed.

QUESTION: Right.

MR. COHN: And there may be different standards or different rules of law involved at such point as the Plaintiff's reorganization is confirmed.

QUESTION: Before the Code, would your client have been entitled to recognition of the time value of his interest in the property?

MR. COHN: Yes.

QUESTION: In this very case, in a case exactly like this?

MR. COHN: Yes. But I have to answer it by saying that it's not a yes or no question. There would not have been an order conditioning the stay on periodic payments or something else to protect time value.

QUESTION: There wouldn't have been, no, because there was no provision like that.

MR. COHN: No, but I believed there would be protection for time value because the Court would have

terminated the stay and given the creditor his property back.

QUESTION: With no equity?

MR. COHN: Yes, if the debtor had no equity in property.

QUESTION: It didn't have to.

MR. COHN: Yes, as I read the cases which are cited in the briefs, where the debtor had no equity in property.

QUESTION: In a reorganization?

MR. COHN: In a reorganization case. That is correct. In any kind of case where the debtor had no equity in the property and there is nothing to be saved for the estate, almost invariably the stay was terminated. And that is why this precise issue, payment of lost opportunity costs didn't really arise under the Bankruptcy Act.

QUESTION: So you just say the cases that he cites to the contrary, he just mis-cites them, or they didn't hold that, or what?

MR. COHN: I think they are inapposite. I think that they are read out of context. There is really a different issue. Under the Bankruptcy Code you have an ability to condition the stay and that raises the whole issue of what periodic payments or what other protection should be fashioned. Under the Bankruptcy Act, protection for the cost of delay was provided in a different way by simply terminating the stay.

I would like to return finally to the language of the

statute, to again make clear our position. The Petitioner does not rely so heavily on the phrases "adequate protection" and "indubitable equivalent" as the Respondent suggests. I do think that an analysis of those words supports our position and those arguments are set forth in the brief. But I think a better argument and one that perhaps goes more to the heart of the issue is found by looking at the wording of Sections 361(1) and (2) which describe the objects of adequate protection.

Those sections are directed to decreases in the value of an interest in property -- in this case a mortgage -- so they are directed to decreases in the value of the mortgage that result from the automatic stay. I think there is no serious question in this case that the automatic stay and the delay that is caused by the automatic stay, does result in a decrease in the value of a mortgage. The Bankruptcy Court made specific findings as to what that damage was and how that value was decreased. Those findings have never been questioned by the Respondent and were not questioned by the Court below. It is clear that the value of that mortgage decreased as a result of the automatic stay. It is also clear that that value is protected under state law under analogous causes of actions that might be filed under state law.

Now, if Congress sought to protect the full value of creditors' interest in property, to protect the benefit of their bargain, how could it be that this important element of

value that is recognized by state courts is somehow omitted? That is not suggested in the legislative history and I think it is clear that that element of value should be protected. Otherwise, we're left in a very odd position, which is that a Congress, which has directed in the legislative history that the full value of rights and property should be protected, will somehow have enacted a statute that leaves secured creditors worse off than they were under the Bankruptcy Act.

QUESTION: Assume we come to the conclusion, erroneous, I'm sure you think, that the secured creditor, prior to the adoption of the Code, would not have had the time value of his money and would have been deprived of it. Do you think that nevertheless, the Code, the way it is worded, should give him something that he wasn't entitled to before?

MR. COHN: Absolutely. Absolutely. The only reason that I go into what the law was before enactment of the Code is to put in context some of the examples that were used in the legislative history.

QUESTION: So what the law was before doesn't govern what the law is now?

MR. COHN: No, absolutely not. I think it helps put in context some of the arguments that are made against our position, but the statute as written directs and defines the object of adequate protection as the value of the creditor's interest in property, the value of the mortgage, in particular

directs that the secured creditor be protected to the extent that that value is decreased by the automatic stay. And I think it is clear, as the Bankruptcy Court found, that if the automatic stay keeps the creditor from foreclosing for a period of time, then the value of that mortgage is decreased. And that is what ought to be protected.

If the Court has no further questions, I will conclude.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Cohn. The case is submitted.

(Whereupon, at 2:48 p.m., the case in the above-entitled matter was submitted.)

REPORTER'S CERTIFICATE

DOCKET NUMBER: 86-1602

CASE TITLE: United Savings Association of Texas v. Timbers of Inwood Forest Associates, Inc.

HEARING DATE: December 1, 1987

LOCATION: Supreme Court, Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the United States Supreme Court and that this is a true and accurate transcript of the case.

Date: 12/1/87

Margaret Daly

Official Reporter

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