

COMMENT

FURTHER FORKS IN THE ROAD AHEAD: CLARITY STILL NEEDED IN CHAPTER 13 BANKRUPTCY “910” CAR CLAIMS*

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“[L]et us all be happy, and live within our means, even if we have to borrr[ow] money to do it with.”¹

“[C]apitalism without bankruptcy is like Christianity without hell.”²

I. INTRODUCTION

Consumer bankruptcy has traveled a long road. The word “bankruptcy” originated from the Latin word *ruptus*, meaning broken.³ During the sixteenth century, the Italian phrase *banca rotta*, meaning “bench broken,” was used to describe a money lender who had gone bust.⁴ The Hebrews forgave debts under Moses’s law once every fifty years—the Jubilee year.⁵ Even Genghis Khan forgave bankrupt debtors twice before killing them.⁶

1. ARTEMUS WARD, *Science and Natural History*, in ARTEMUS WARD IN LONDON 63, 71 (G.W. Carleton & Co. 1867) (1866).

2. Alexander L. Taylor III, *The Growing Bankruptcy Brigade*, TIME, Oct. 18, 1982, at 90 (quoting Frank Borman, former chairman of Eastern Air Lines).

3. THE OXFORD ENGLISH DICTIONARY 934 (2d ed. 1989).

4. See *id.* (“According to Johnson, ‘it is said’ that when an Italian money-changer became insolvent, ‘his bench was broke.’”).

5. See *Leviticus* 25:10 (declaring a jubilee in the fiftieth year and instructing those enslaved for debts be freed in that year); see also *Deuteronomy* 15:1–2 (admonishing creditors to forgive debts every seven years under the “Lord’s release”).

6. See George Vernadsky, *The Scope and Contents of Chingis Khan’s Yasa*, 3 HARV. J. ASIATIC STUD. 337, 358 (1938) (noting how the *Yasa*, Khan’s legal code, as related by the Egyptian historian Makrizi, required a debtor to be sentenced to death only after his third bankruptcy); see also GEORGE LANE, *GENGHIS KHAN AND MONGOL RULE* 37 (2004) (“Execution was the reward for . . . persistent bankruptcy . . .”). But see PAUL RATCHNEVSKY, *GENGHIS KHAN: HIS LIFE AND LEGACY* 187–89 (Thomas Nivison Haining trans. & ed., 1991) (questioning the historical accuracy of Makrizi’s accounts that detail Khan’s treatment of bankrupt merchants under the *Yasa*). Does that make some tenacious creditors who won’t stop calling at dinnertime more fearsome than Khan?

Americans have overspent or found themselves in catastrophic situations requiring bankruptcy relief since before the first federal bankruptcy bill was passed in 1800.⁷ Bankruptcy is so engrained in our culture that it is addressed in the U.S. Constitution.⁸ The recent economic meltdown of 2008 has refocused national attention on bankruptcy, as both organizations and individuals file new petitions seeking relief in record numbers.⁹ Individual consumer bankruptcy frees the overburdened debtor from excessive obligations, offers the promise of a fresh start, and allows reengagement with the market society, which enables the debtor to make capital purchases that drive and benefit the larger economy.¹⁰ The laws governing the bankruptcy process have been refined over time; the current Bankruptcy Code was passed in 1978.¹¹ Media commentators described the passage of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005¹² variously as a “major overhaul,”¹³ a “modest reform,”¹⁴ and a “disaster,”¹⁵ but it must be remembered that BAPCPA merely amended the existing Code.

7. See Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 169 (1991) (chronicling the history of American bankruptcy law and noting that the Bankruptcy Act of 1800 permitted only involuntary commercial bankruptcies). Voluntary consumer bankruptcy was first permitted in 1841. Brett Weiss, “Not Dead Yet”: *Bankruptcy After BAPCPA*, MD. B.J., May–June 2007, at 16, 18.

8. U.S. CONST. art. I, § 8, cl. 4 (granting Congress the power to establish “uniform Laws on the subject of Bankruptcies throughout the United States”).

9. See Tara Siegel Bernard & Jenny Anderson, *Bankruptcies by Consumers Climb Sharply*, N.Y. TIMES, Nov. 16, 2008, at 1 (“[A]n average of 4,936 bankruptcies [were] filed each business day [in October 2008], up nearly 34 percent from October 2007.”); Press Release, The Federal Judiciary, Bankruptcy Filings up in Calendar Year 2008 (Mar. 5, 2009), available at http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsDec2008.cfm (noting that the number of business bankruptcy filings increased 54% from 2007 to 2008).

10. See Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT’L & COMP. L. REV. 1, 28–29 (2005) (observing that the “U.S. personal bankruptcy system . . . strongly encourages persons who have failed financially to get back into the economy and try again,” and noting studies that link generous individual bankruptcy exemptions with high levels of entrepreneurship).

11. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended in scattered sections of 11 U.S.C.); see also THE OXFORD COMPANION TO AMERICAN LAW 54 (Kermit L. Hall et al. eds., 2002) (noting that the current bankruptcy statute was passed in 1978 and has been amended significantly since then).

12. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.). Colloquially, the initials of the Act are pronounced by practitioners as a single word: “bap-CE-puh.”

13. Stephen Labaton, *Bankruptcy Bill Set for Passage; Victory for Bush*, N.Y. TIMES, Mar. 9, 2005, at A1.

14. Editorial, *Bankrupt Opposition*, WALL ST. J., Oct. 25, 2006, at A14.

15. *Id.* (quoting the response of the Consumers Union to the passage of BAPCPA).

The process of drafting BAPCPA varied from previous revisions of the Code. Academics and members of the judiciary who drafted the cohesive 1978 Code¹⁶ were in large measure excluded.¹⁷ Instead, a coalition of consumer creditors worked with legislators over a period of eight years to draft the legislation.¹⁸ This change in contributing parties may have caused some of the confusion that the BAPCPA amendments are now producing.

If BAPCPA was a course correction on the ever-evolving path of bankruptcy, some signposts remain obscured. While the title of the reform act purports *consumer* protection,¹⁹ it is the auto lenders who have emerged as the party whose rights have been most significantly improved.²⁰ But how far do those improvements extend? For eight years, car creditors strove to eliminate “cramdown,” which permits in some circumstances the reduction of a debtor’s secured obligation to a creditor in bankruptcy.²¹ Now it is unclear if the car creditors succeeded or, in some cases, if they may actually wish for the return of cramdown on specified terms. This Comment analyzes the denial of cramdown²² in the context of surrendered vehicles and vehicles financed with negative equity. It advocates consistent, literal application of the bankruptcy amendments to enable vehicle creditors to conduct future business with certainty and reduced litigation. Courts should apply the Code in a way that respects the enhanced position auto lenders gained as a result of BAPCPA

16. See Frank R. Kennedy, *Foreword: A Brief History of the Bankruptcy Reform Act*, 58 N.C. L. REV. 667, 669–674 (1980) (chronicling the “model legislative process” involving the interplay of legislators, the National Conference of Bankruptcy Judges, and the Commission on Bankruptcy Laws, which was comprised of academics and professionals in the field).

17. See Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 486–89 (2005) (noting that most of the members of the National Bankruptcy Review Commission, whose report established the conceptual framework of BAPCPA, were political appointees with “limited experience in consumer bankruptcy law”).

18. See *id.* at 498–99 (describing the impact of the Consumer Bankruptcy Reform Coalition’s efforts in shaping BAPCPA).

19. As one judge stated, “[T]o call the Act a ‘consumer protection’ Act is the grossest of misnomers.” *In re Sosa*, 336 B.R. 113, 114 (Bankr. W.D. Tex. 2005) (Monroe, J.).

20. William C. Whitford, *A History of the Automobile Lender Provisions of BAPCPA*, 2007 U. ILL. L. REV. 143, 160.

21. See *infra* Part II (outlining the implications and applications of cramdown in consumer bankruptcy).

22. The term “cramdown” is used consistently throughout this Comment for clarity, although there are times when the terms “strip down” or “lien stripping” might be more appropriate. For a discussion of the distinction, see *In re Price*, 363 B.R. 734, 738–39 (Bankr. E.D.N.C. 2007), *aff’d in part, rev’d in part*, Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re Price*), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

but avoids abusing that improved position at the expense of general unsecured creditors.

Part II introduces cramdown in consumer bankruptcy as well as the legislative efforts taken in BAPCPA to curtail this perceived abuse. Part III begins by outlining divergent case law after the 2005 amendments in which a debtor surrenders, rather than retains, a vehicle during the course of the bankruptcy and concludes with suggestions for consistent application of the Code in this scenario. Part IV opens by discussing the prevalence of negative equity in auto financing and examines the wide-ranging court treatment of negative equity as purchase money. Part IV closes by endorsing treatment of negative equity as an unsecured obligation and encouraging judicial fairness to less powerful unsecured creditors.

II. CRAMDOWN AND THE HANGING PARAGRAPH OF 11 U.S.C. § 1325(A)(9)

Cramdown is perhaps a phonetically unattractive bankruptcy term of art. Where permitted, a Chapter 13 debtor may submit a reorganization plan that pays secured creditors in full only the fair market value of the collateral as of the date of the bankruptcy filing, thus “cramming down” what the debtor must pay.²³ Oftentimes, collateral securing a claim loses value much more rapidly than the debtor reduces the outstanding debt, such as the immediate devaluation of a new car once driven off the dealer’s lot. Somewhere between the handoff of the keys and the purchaser’s arrival at the first stoplight, that new car loses 13% or more of its value.²⁴ In such a scenario, the creditor may be owed significantly more by the debtor than the debtor’s car is worth. Cramdown permits the Chapter 13 debtor to retain the vehicle and pay the creditor only the value of the car as of the

23. Section 1325(a)(5) permits court approval of a plan employing § 506(a) valuation, known as “cramdown,” of certain secured claims. 11 U.S.C. § 1325(a)(5) (2006). Section 506(a)(1) provides:

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 . . . 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*.

11 U.S.C. § 506(a)(1) (2006) (emphasis added); *see also* 11 U.S.C. § 506(a)(2) (2006) (“If the debtor is an individual in a case under chapter 7 or 13, such value . . . shall be determined as of the date of the filing of the petition . . .”).

24. *See* William C. Wood, *The Cost of Driving a Car off the Dealer’s Lot*, 28 J. CONSUMER AFF. 130, 130–31, 133–34 (1994) (noting that consumers may take up to a 25% net acquisition loss on a new car upon immediate resale and arguing the same phenomenon occurs even if a used car is purchased instead).

date of the bankruptcy petition.²⁵ The difference between the value of the collateral and the larger amount of the creditor's claim is partitioned off—"bifurcated"—from the secured claim.²⁶ The secured claim is paid in full, while the secured creditor's bifurcated amount is treated as an unsecured claim²⁷ and may be paid at significantly less than 100%—all the way down to zero.²⁸ Upon completion of the plan, any remaining unpaid debt to the creditor may be discharged.²⁹

The term cramdown originated because the creditor who received this treatment from a debtor's plan could not object to the loss of funds to which it was previously entitled.³⁰ The creditor was powerless to complain. Congress perceived cramdown as an abuse of the bankruptcy system by debtors and used the 2005 amendments to address this specific issue.³¹ BAPCPA inserted a new provision into the Code denying bifurcation to select motor vehicle purchase loans made within two and a half years before the date of the initial bankruptcy

25. See *In re Westfall*, 365 B.R. 755, 758 (Bankr. N.D. Ohio 2007) ("Prior to the enactment of [BAPCPA], debtors could . . . bifurcate claims . . . based on the value of the collateral. To the extent the claim was undersecured, [the] debtor could pay that portion of the claim as an unsecured claim. This is commonly referred to as the 'cramdown' of a claim.").

26. Robin Miller, Annotation, *Effect of "Hanging" or "Anti-Cramdown" Paragraph Added to 11 U.S.C.A. § 1325(a) by Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)*, 19 A.L.R. FED. 2d 157, 168–69 (2007).

27. See *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 239 (1989) (stating that a claim is secured and paid under § 506(a) "only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured").

28. In the wake of BAPCPA, unsecured claims may receive zero or nominal payment in a debtor's plan and such treatment is confirmable under 11 U.S.C. § 1325(a)(7) if made in good faith. See ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 325 (5th ed. 2006) ("[T]he 2005 Amendments evidently contemplate the confirmation of some plans that will leave nothing for the general unsecured creditors."). This is, in essence, the "strip down" to which note 22, *supra*, alludes.

29. See 11 U.S.C. § 1328 (2006) ("[A]s soon as practicable after completion . . . of all payments under the plan, . . . the court shall grant the debtor a discharge of all debts . . ."); see also 11 U.S.C. § 524(a) (2006) (providing that a discharge operates to enjoin collection activity against debtors on discharged debts).

30. See *1st 2nd Mortgage Co. of N.J., Inc. v. Ferandos (In re Ferandos)*, 402 F.3d 147, 151 (3d Cir. 2005) ("Thus, a claim that is not fully collateralized can be modified, and the creditor said to be 'crammed down' to the value of the collateral."); *In re Pajot*, 371 B.R. 139, 146 & n.9 (Bankr. E.D. Va. 2007) (explaining that 11 U.S.C. § 1325(a)(5) required confirmation of a plan over creditor objection that addressed secured claims in the manner required by 11 U.S.C. § 506(a), and acknowledging that "unsecured claims often receive payments of mere pennies on the dollar").

31. See *In re Sparks*, 346 B.R. 767, 770 (Bankr. S.D. Ohio 2006) (recognizing that the legislative history of BAPCPA reveals congressional intent to "address a perceived abuse of debtors purchasing a vehicle shortly before filing bankruptcy and then cramming down the amount owed to the creditors").

filing.³² Inserted immediately following 11 U.S.C. § 1325(a)(9), this provision appears as an unnumbered, non-indented, and flush-with-the-margin paragraph.³³ It does not refer to the immediately preceding material in § 1325(a)(9),³⁴ but references preceding § 1325(a)(5).³⁵ Because of its awkward placement, it has become known as the unnumbered “hanging paragraph,”³⁶ or sometimes simply as “11 U.S.C. § 1325(a)(*).”³⁷

Congress used the following language in the hanging paragraph to deny debtors the ability to bifurcate selected claims:

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle . . . acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.³⁸

Summarized, the hanging paragraph applies when the debtor’s vehicle meets four criteria: “(1) the creditor has a purchase money security interest; (2) the debt was incurred within 910 days preceding the filing of the debtor’s case; (3) the collateral for the debt consists of the motor vehicle; and (4) the motor vehicle was acquired for the personal use of the debtor.”³⁹ When met,

32. BAPCPA, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005) (codified at 11 U.S.C. § 1325(a)(*)) (2006).

33. 11 U.S.C. § 1325(a)(*)) (2006).

34. Section 1325(a)(9) requires a debtor to file all applicable federal, state, and local tax returns for the previous four years if a plan is to be confirmed. 11 U.S.C. §§ 1308, 1325(a)(9) (2006).

35. 11 U.S.C. § 1325(a)(*)) (“For purposes of paragraph (5), section 506 shall . . .”).

36. See, e.g., *In re Payne*, 347 B.R. 278, 280 (Bankr. S.D. Ohio 2006) (“Given its awkward placement and lacking any identifying number or letter, the sentence has been termed by many as the ‘hanging paragraph.’”); *In re White*, 352 B.R. 633, 638 (Bankr. E.D. La. 2006) (noting the provision is “commonly referred to as the ‘hanging paragraph’”); *In re Pool*, 351 B.R. 747, 749 (Bankr. D. Or. 2006) (same).

37. See, e.g., *In re Sanders*, 377 B.R. 836, 841 n.3 (Bankr. W.D. Tex. 2007) (adopting the (*) convention). But see *In re Trejos*, 352 B.R. 249, 253 n.5 (Bankr. D. Nev. 2006) (disfavoring the (*) designation due to the difficulty it presents in searching electronic databases, where the asterisk is used as a universal search character), *aff’d*, 374 B.R. 210 (B.A.P. 9th Cir. 2007). This Comment will reference the hanging paragraph in footnotes as 11 U.S.C. § 1325(a)(*)) (2006).

38. 11 U.S.C. § 1325(a)(*)) (2006). In addition to the issues regarding motor vehicles, this statute also raises significant questions about purchases of “other thing[s] of value” when the debt was incurred in the one-year period preceding the filing. Those issues are beyond the scope of this Comment.

39. *In re Graupner*, 356 B.R. 907, 911 (Bankr. M.D. Ga. 2006).

these requirements permit no possibility of bifurcation,⁴⁰ and thus the hanging paragraph creates the legal fiction that a subject “910 vehicle”⁴¹ is always valued at the exact amount of the creditor’s proof of claim.⁴²

The drafting of the hanging paragraph has been roundly criticized.⁴³ The most obvious defect is the absence of any alphanumeric designation; the provision “merely dangles at the end of § 1325(a).”⁴⁴ The omission of the word “period” following “910-day” also draws derision,⁴⁵ leading one court to wonder whether the hanging paragraph applied solely to a car purchased on the 910th day prior to the bankruptcy filing.⁴⁶ Bankruptcy judges have expressed deep frustration with this sort of inconsistent drafting present throughout the BAPCPA amendments, in which words are used inconsistently and, sometimes, incorrectly.⁴⁷

The patent defects of numbering and word omission in the hanging paragraph are the least problematic issues presented by this amendment.⁴⁸ Difficult and more divisive to resolve are

40. *In re Bray*, 356 B.R. 850, 854 (Bankr. W.D. Tenn. 2007) (noting wide approval of this interpretation of the hanging paragraph). Post-BAPCPA, however, bifurcation and cramdown remain valid options for cars not falling within the criteria of the hanging paragraph. *See id.* at 863 (finding that because the creditor did not have a purchase money security interest, “the hanging paragraph . . . does not prevent the debtor from bifurcating the [creditor’s] claim into secured and unsecured portions”).

41. Motor vehicles subject to the hanging paragraph are often called “910 vehicles,” and claims are often called “910 claims” due to the 910-day requirement. *See, e.g., In re Johnson*, 337 B.R. 269, 271 (Bankr. M.D.N.C. 2006) (mem.).

42. *In re Durham*, 361 B.R. 206, 209 (Bankr. D. Utah 2006).

43. *See, e.g., In re Trejos*, 352 B.R. 249, 253–54 (Bankr. D. Nev. 2006) (calling the paragraph “poorly drafted” and asserting that “[m]aking practical sense of this provision . . . requires bankruptcy judges to . . . believe in ‘as many as six impossible things before breakfast’”) (quoting LEWIS CARROLL, *ALICE’S ADVENTURES IN WONDERLAND & THROUGH THE LOOKING GLASS* 157 (Bantam Classic 1981) (1865 & 1871)), *aff’d*, 374 B.R. 210 (B.A.P. 9th Cir. 2007).

44. Dianne C. Kerns, *Cram-a-lot: The Quest Continues*, AM. BANKR. INST. J., Nov. 2005, at 10, 10; *see also* Kevin R. Anderson, *Surrender of 910-Vehicles in Chapter 13: Is What’s Good for the Car Lender’s Goose Good for the Debtor’s Gander?*, 6 NORTON BANKR. L. ADVISER, June 2007, at 5, 6 (“The clumsiness of drafting did not place this provision in one of the existing subsections . . .”).

45. *See, e.g., Kerns, supra* note 44, at 10 (noting that the provision is “missing an operable word” and therefore makes no sense).

46. *In re Carver*, 338 B.R. 521, 523 (Bankr. S.D. Ga. 2006).

47. *See* The Honorable Thomas F. Waldron & Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 AM. BANKR. L.J. 195, 200–02 (2007) (citing incidents in the BAPCPA amendments when “and” means “or,” when “and” means “and,” when a court should ignore the word “allowed,” when a court should give effect to the word “allowed,” and other extensive discrepancies between the written text and its intended application in practice).

48. *See In re Carver*, 338 B.R. at 523 (asserting that these two facial problems “are mere shadows of the larger interpretation difficulties this provision presents”).

problems created when the language of the paragraph is applied to real-life scenarios that occur with significant frequency but do not seem to have been contemplated by the drafters. These issues are: (1) the bankruptcy surrender of a secured vehicle; and (2) the presence of negative equity financed into the purchase loan of a retained vehicle. Emerging case law has produced vastly divergent results for ordinary debtors despite nearly identical factual circumstances.⁴⁹ These outcomes may have little to do with jurisdictional issues or underlying state law; sometimes it comes down to the perspective of the judge hearing the case.⁵⁰ With more people entering bankruptcy in some years than graduating from college,⁵¹ consistent treatment of debtors and creditors is appropriate. With the number of cars on the road continually growing,⁵² clarity is needed to assist courts in applying a more uniform interpretation of the hanging paragraph.

The hanging paragraph aligns the treatment of debtors who retain their cars in a post-BAPCPA Chapter 13 reorganization with the more creditor-friendly treatment of debtors retaining their cars in a pre-BAPCPA Chapter 7 liquidation. In both situations, the debtor must pay the full value of the debt if they wish to retain the vehicle.⁵³ The first reoccurring factual scenario generating hanging paragraph litigation concerns what happens

49. See *infra* notes 260–264 and accompanying text (comparing the differing legal conclusions in several cases based upon identical statutory language and similar facts).

50. See *infra* note 285 and accompanying text (contrasting the divergent holdings of two judges in the Middle District of Tennessee).

51. In a twelve-month period ending June 31, 2001, 1,787,104 individuals entered bankruptcy. Teresa A. Sullivan, Deborah Thorne & Elizabeth Warren, *Young, Old, and In Between: Who Files For Bankruptcy?*, NORTON BANKR. L. ADVISER, Sept. 2001, at 1, 2. In the 2000–2001 school year, 1,244,171 individuals obtained bachelor's degrees. U.S. DEP'T OF EDUC., NAT'L CTR. FOR EDUC. STATISTICS, DEGREES CONFERRED BY DEGREE-GRANTING INSTITUTIONS, BY CONTROL OF INSTITUTION: 1969–70 THROUGH 2003–04 tbl.253 (2005), available at http://nces.ed.gov/programs/digest/d05/tables/dt05_253.asp.

52. See U.S. DEP'T OF TRANSP., BUREAU OF TRANSP. STATISTICS, NUMBER OF U.S. AIRCRAFT, VEHICLES, VESSELS, AND OTHER CONVEYANCES tbl.1-11, available at http://www.bts.gov/publications/national_transportation_statistics/html/table_01_11.html (reporting a total growth of 176 million registered vehicles from 1960 to 2006).

53. See Whitford, *supra* note 20, at 144–45, 150 (noting that post-BAPCPA, treatment of vehicle debt under a Chapter 13 plan parallels Chapter 7 debt reaffirmation because the Chapter 13 debtor “must provide for payment of the entire amount owing”). Chapter 7 debtors who retain vehicles exempt from liquidation can enter a voluntary agreement with the creditor to continue payments in order to avoid repossession of the collateral. *Id.* at 144–45. Because the reaffirmation agreement requires creditor approval, the entire amount of the debt, not just the value of the collateral, traditionally is paid to keep the car, and Chapter 7 debtors “reaffirm[]” full liability on the obligation. *Id.*; see also 11 U.S.C. § 524(c) (2006) (describing the reaffirmation process).

when the debtor chooses the option presumably not contemplated by the hanging paragraph—to surrender of the vehicle.

The hanging paragraph states, “For purposes of paragraph (5), section 506 shall not apply”⁵⁴ Paragraph (5) captures three possible debtor dispositions of a motor vehicle: § 1325(a)(5)(A) permits debtor retention where the creditor agrees (this scenario is unlikely); § 1325(a)(5)(B) provides for retention with payment following the bifurcation procedure of § 506(a); and § 1325(a)(5)(C) allows the debtor to surrender the vehicle.⁵⁵ Because Congress drafted the hanging paragraph to apply to all of paragraph (5) in an effort to prevent bifurcation of *retained* 910 vehicles, the plain language of the statute also captures the § 1325(a)(5)(C) surrender provision. This Comment will first address the confusion in the courts as to whether the hanging paragraph permits or prohibits § 506(a) cramdown of a surrendered vehicle by a creditor seeking a deficiency judgment.⁵⁶

The second issue this Comment will address concerns the treatment of negative equity financed by a debtor into a replacement car loan.⁵⁷ Negative equity is the antecedent debt remaining on a traded-in vehicle, which a creditor may finance alongside monies for a replacement vehicle purchase.⁵⁸ At the time of this writing, four lines of cases have emerged treating negative equity in extremely diverse manners. Due to the prevalence of negative equity financing in modern motor vehicle purchases,⁵⁹ consistency of consumer bankruptcy treatment is strongly needed.

54. 11 U.S.C. § 1325(a)(*) (2006).

55. Section 1325(a)(5) reads:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

. . . .

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has *accepted the plan*;

(B) . . .

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is *not less than the allowed amount* of such claim [determined by § 506(a)];

. . . or

(C) the debtor *surrenders* the property securing such claim to such holder; . . .

11 U.S.C. § 1325(a)(5) (2006) (emphasis added).

56. *See infra* Part III.

57. *See infra* Part IV.

58. *See infra* Part IV.A (examining the concept of negative equity in more depth and explaining the corresponding issues presented by the Code amendments).

59. *See infra* notes 184–186 and accompanying text (describing estimates by different auto industry analysts).

One reason multiple analyses are emerging on both issues is that Congress provided scant legislative history to guide the courts.⁶⁰ The hanging paragraph was first proposed in 1998 by then-Senator Spencer Abraham of Michigan at the behest of the automobile finance industry, which sought to completely abolish cramdown.⁶¹ Subsequent revisions ultimately reduced the complete prohibition on cramdown to the current two and a half year lookback prohibition window.⁶² The final report that accompanied the Senate version of BAPCPA merely described the hanging paragraph without providing any congressional insight for application.⁶³ Perhaps because the text of the provision originated from Senator Abraham, multiple courts have determined that Congress intended the hanging paragraph to benefit auto creditors,⁶⁴ but no such intent is expressed in the legislative history.⁶⁵ Nevertheless, “auto [lenders] would appear to be the commercial creditor group that has most improved its position” post-BAPCPA.⁶⁶

Application of the hanging paragraph is not an easy task because the language is subject to multiple reasonable, but

60. See *DaimlerChrysler Fin. Servs. Ams. LLC v. Quick (In re Quick)*, 371 B.R. 459, 463 (B.A.P. 10th Cir. 2007) (acknowledging the “sparse legislative history” of the hanging paragraph amendment), *rev'd sub nom. In re Ballard*, 526 F.3d 634 (10th Cir. 2008).

61. Whitford, *supra* note 20, at 177 (citing Harry Stoffer, *Lobbyists Push Industry's Problems with 'Cramdown' into the Spotlight*, AUTOMOTIVE NEWS, Oct. 26, 1998, at 28, 28). Precedent to abolish cramdown currently exists in the Code. See 11 U.S.C. § 1322(b)(2) (2006) (prohibiting Chapter 13 debtors from cramming down the value of their principal residence as part of their reorganization plan).

62. See Whitford, *supra* note 20, at 180–84 (describing efforts of pro-debtor senators to scale back the Abraham Amendment and speculating that Senator Abraham's defeat in the 2000 congressional election may have contributed to the reduction of the lookback window).

63. See H.R. REP. NO. 109-31, pt. 1, at 71–72 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 139–40. Under the heading: “Giving Secured Creditors Fair Treatment in Chapter 13,” the report states:

Section 306(b) adds a new paragraph to section 1325(a) of the Bankruptcy Code specifying that Bankruptcy Code section 506 does not apply to a debt incurred within the two and one-half year period preceding the filing of the bankruptcy case if the debt is secured by a purchase money security interest in a motor vehicle acquired for the personal use of the debtor within 910 days preceding the filing of the petition.

Id.

64. See, e.g., *In re Morales*, 359 B.R. 211, 214 (Bankr. N.D. Ill. 2007) (viewing BAPCPA as a remedy because “Congress viewed debtors' ability to bifurcate a creditor's claim as abusive”).

65. The closest suggestion of intent is that the hanging paragraph appears in the section of the BAPCPA entitled: “Restoring the Foundation of Secured Credit.” BAPCPA, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005) (codified at 11 U.S.C. § 1325(a)(*) (2006)).

66. Whitford, *supra* note 20, at 160.

conflicting, interpretations.⁶⁷ Courts struggle “to make sense of the statute to the extent that is possible, and to give it an interpretation consistent at least with its semantic sense, if not consistent with some well-articulated purpose.”⁶⁸ The search for a sensible interpretation of the hanging paragraph begins with bankrupt debtors who surrender their cars.

III. DOES CRAMDOWN STILL EXIST IN THE SURRENDER CONTEXT? FROM *IN RE EZELL* TO *IN RE WRIGHT* AND BEYOND

The hanging paragraph dominates post-BAPCPA litigation concerning vehicles.⁶⁹ Many Chapter 13 debtors are consumers who are primarily seeking protection for their homes and their cars.⁷⁰ The courts have essentially resolved the question of whether the hanging paragraph applies to personal-use vehicles that (1) *the debtor wishes to retain throughout the Chapter 13 plan*; (2) the debtor purchased within 910 days prior to the filing of the petition; and (3) involve a complete purchase money security interest.⁷¹ The debtor’s plan must provide for full payment equal to the value of the outstanding claim due to the creditor on the date of the bankruptcy petition filing.⁷²

Less settled, however, is the proper application of the hanging paragraph to 910 cars that the debtor’s plan proposes *to surrender*.⁷³ As previously discussed, the plain language of the

67. *In re Price*, 363 B.R. 734, 737–38 (Bankr. E.D.N.C. 2007), *aff’d in part, rev’d in part*, Wells Fargo Fin. N.C. 1, Inc. v. *Price (In re Price)*, No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

68. *In re Trejos*, 352 B.R. 249, 259 (Bankr. D. Nev. 2006), *aff’d*, 374 B.R. 210 (B.A.P. 9th Cir. 2007).

69. See Hon. James D. Walker, Jr. & Amber Nickell, *Bankruptcy*, 58 MERCER L. REV. 1145, 1163 (2007) (“Probably no BAPCPA amendment generated more case law in the Eleventh Circuit during 2006 than the unnumbered hanging paragraph tacked on to the end of § 1325(a) . . .”).

70. Cf. Amy Merrick, *More Debtors Use Bankruptcy to Keep Homes*, WALL ST. J., Oct. 23, 2007, at A1 (reporting that many debtors use the three- to five-year plan window in Chapter 13 to “stave[] off foreclosure proceedings while the homeowner works out a plan to pay off mortgage debt and other obligations over time”).

71. See *In re Montoya*, 341 B.R. 41, 44 (Bankr. D. Utah 2006) (“The majority of courts interpreting the hanging paragraph hold that it precludes a Chapter 13 debtor from using § 506 to cram down a 910-day vehicle.”).

72. See 11 U.S.C. § 1325(a) (2006) (providing that the court “shall confirm” a debtor’s plan if it provides full payment); *In re Montoya*, 341 B.R. at 46 (rejecting debtor’s plan for providing less than full payment, even when creditor failed to object). There is no discretion granted to the bankruptcy judge. If a plan does not address the issue, it is not confirmable. See *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447, 462 (6th Cir. 2009) (concluding that compliance with 11 U.S.C. § 1325(a) is mandatory for confirmation and that a “bankruptcy court has no discretion to confirm a plan which does not comply with those requirements”).

73. See 11 U.S.C. § 1325(a)(5)(C) (2006) (“[T]he court shall confirm a plan if . . . with

hanging paragraph requires application to all of § 1325(a)(5), including subsection (a)(5)(C).⁷⁴ Consequently, a split of authority has developed concerning whether a surrendered vehicle satisfies the secured claim in full upon surrender, or whether the creditor may sell the surrendered vehicle at foreclosure value and present an unsecured deficiency claim against the estate.⁷⁵ The deficiency represents the difference between the amount outstanding on the allowed claim and the amount realized upon foreclosure.⁷⁶ The split of authority first began in 2006.

A. *The Hanging Paragraph Permits Surrender in Full Satisfaction*

This issue was first argued in *In re Ezell*,⁷⁷ a Chapter 13 case from the Eastern District of Tennessee.⁷⁸ Judge Richard Stair's decision in *Ezell* was the first to assert the proposition that the hanging paragraph prohibits cramdown in the creditor context as well as the debtor context.⁷⁹ Unable to cramdown the value of its own claim and not permitted to refuse the surrender of the collateral,⁸⁰ the creditor in *Ezell* was forced to accept the vehicle

respect to each allowed secured claim provided for by the plan . . . the debtor surrenders the property securing such claim to such holder . . .”).

74. See *supra* notes 54–55 and accompanying text.

75. Compare *In re Liebold*, No. 07-33296, 2008 WL 112101, at *2 (Bankr. E.D. Tenn. Jan. 9, 2008) (finding vehicle surrendered in full satisfaction), with *Capital One Auto Fin. v. Osborn (In re Osborn)*, 515 F.3d 817, 821–23 (8th Cir. 2008) (finding that state law afforded the creditor a right to a deficiency judgment on the debtor's surrendered vehicle). Once the vehicle is surrendered it is no longer a part of the bankruptcy estate. 11 U.S.C. § 541(a) (2006) (defining the estate as “all of the following property, wherever located and by whomever held: . . . all legal or equitable interests of the debtor in property as of the commencement of the case,” which is held until abandoned or disposed of by the trustee).

76. See 11 U.S.C. § 502(a) (2006) (indicating that creditor claims are automatically deemed fully allowed against assets of the estate unless a party in interest objects to the amount or validity).

77. *In re Ezell*, 338 B.R. 330, 342 (Bankr. E.D. Tenn. 2006), *abrogated by In re Long*, 519 F.3d 288 (6th Cir. 2008). Although overruled, *Ezell* represents the viewpoint of bankruptcy courts that adhere to the proposition that the hanging paragraph permits surrender of a 910 vehicle in full satisfaction. See *In re Barrett*, 543 F.3d 1239, 1243 (11th Cir. 2008) (following the “clear majority holding” that surrender fully satisfies the claim); *Tidewater Fin. Co. v. Kenney (In re Kenney)*, 531 F.3d 312, 317–18 (4th Cir. 2008).

78. Tennessee has one of the highest rates of bankruptcy filings in the country. See Pamela A. Maclean, *Bankruptcy Filings Up 30% in Past 12 Months*, NAT'L L.J., June 9, 2008, at 3 (indicating Tennessee had the highest per capita bankruptcy filing in the nation for the 12-month period ending March 31, 2008); Getahn Ward, *Bankruptcy Crackdown*, TENNESSEAN, Jan. 13, 2004, at 1E.

79. See *In re Ezell*, 338 B.R. at 335 (“[T]he allowed secured claim of the class of creditors defined in the [Hanging] Paragraph is fixed at the amount of the creditor's claim, without resorting to the secured/unsecured bifurcation procedure mandated by [§ 506].”).

80. The surrender provision in § 1325(a) is not discretionary to the creditor. The

in full satisfaction of the debt owed.⁸¹ No recourse for an outstanding deficiency could be pursued.⁸² This outcome has colloquially, and perhaps appropriately, come to be known as creditors “eat[ing] steel.”⁸³ Judge Stair’s conclusion as to the effect of the hanging paragraph on surrendered vehicles subsequently became the “majority view among bankruptcy judges.”⁸⁴ The *Ezell* decision relied upon the cornerstone bankruptcy opinion of *United States v. Ron Pair Enterprises*,⁸⁵ which stated that if the language of a statute is plain and unambiguous, “the sole function of the courts is to enforce it according to its terms.”⁸⁶ Courts following the reasoning of *Ezell* have likewise felt compelled to follow the clear directive of *Ron Pair* when interpreting the hanging paragraph.⁸⁷

While acknowledging that the drafting of the provision was poor,⁸⁸ Judge Stair found the language of the hanging paragraph “not particularly ambiguous.”⁸⁹ Accordingly, he held that because the hanging paragraph literally prohibited any application of § 506(a) to 910 car claims the creditor could not bifurcate the claim, and the debtor’s surrender of the vehicle would satisfy the debt in full.⁹⁰ Implicit within this holding was the assumption, explicitly stated in subsequent case law, that § 506(a) was the sole method of bankruptcy claim valuation through bifurcation.⁹¹

plan must be confirmed if the debtor elects surrender as one of the available dispositions of the property. 11 U.S.C. § 1325(a)(5)(C) (2006).

81. *In re Ezell*, 338 B.R. at 342 (“Because application of § 506(a) is entirely removed from the picture, there can be no deficiency balance, either secured or unsecured, and surrender satisfies an allowed secured claim in full.”).

82. *Id.* at 341.

83. Anderson, *supra* note 44, at 6; *see also In re Particka*, 355 B.R. 616, 628 (Bankr. E.D. Mich. 2006) (referring to the practice as “eat[ing] metal”).

84. *In re Wright*, 492 F.3d 829, 830 (7th Cir. 2007) (Easterbrook, J.).

85. *In re Ezell*, 338 B.R. at 341 (citing *United States v. Ron Pair Enters., Inc.* 489 U.S. 235 (1989)).

86. *Ron Pair*, 489 U.S. at 241 (quoting *Caminetti v. United States*, 242 U.S. 470, 485 (1917)).

87. *See, e.g., In re Pinti*, 363 B.R. 369, 377 (Bankr. S.D.N.Y. 2007) (explaining that *Ron Pair* directs a straightforward interpretation of the hanging paragraph unless absurdity results); *In re Evans*, 349 B.R. 498, 500 (Bankr. E.D. Mich. 2006) (same).

88. *See In re Ezell*, 338 B.R. at 340 (“Revised § 1325(a) is, at best, confusing.” (citing Henry E. Hildebrand, III, *Impact of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 on Chapter 13 Trustees*, 79 AM. BANKR. L.J. 373, 386 n.65 (2005))).

89. *Id.*

90. *Id.* at 341.

91. *See In re Steakley*, 360 B.R. 769, 773–74 (Bankr. E.D. Tenn. 2007) (Stair, J.) (“BAPCPA now expressly sets forth the valuation method to be employed in Chapter 7 and Chapter 13 cases . . .”), *abrogated by In re Long*, 519 F.3d 288 (6th Cir. 2008); *see also Capital One Auto Fin. v. Osborn (In re Osborn)*, 363 B.R. 72, 77 (B.A.P. 8th Cir. 2007) (stating that an allowed secured claim comes into being because of the application of § 506(a), not because of state law), *rev’d*, 515 F.3d 817 (8th Cir. 2008) (holding that the

Judge Stair's decision dealt directly with a creditor's argument that § 506(a) did not apply because § 506(a) had never previously applied to the bifurcation of claims in the surrender context.⁹² The creditor argued that because state law governed bifurcation of claims, the hanging paragraph's elimination of the § 506(a) bifurcation process had no effect and the deficiency claim should be permitted.⁹³ The court responded that, historically, federal law had always determined the value of the secured claim "in light of the purpose of the valuation and of the proposed disposition or use of such property."⁹⁴ Surrender was one such permitted disposition;⁹⁵ therefore § 506(a) provided the method of valuation.⁹⁶ Prior to BAPCPA, this provision had set surrender valuation at liquidation value and allowed a deficiency claim against the estate for any amount between the liquidation value and the creditor's claim.⁹⁷

Judge Stair found that although the hanging paragraph removed § 506(a) from the analysis, federal bankruptcy law continued to govern all other aspects (i.e., valuation remained a federal matter).⁹⁸ No state law claim of bifurcation for valuation was applicable because the hanging paragraph now trumped § 506(a) and defined the valuation.⁹⁹ Thus, surrender valuation is the same as retention valuation—neither allowing bifurcation.

In a later case, *In re Steakley*, Judge Stair explained that the removal of § 506 from the equation simply denied any possibility of bifurcation into secured and unsecured portions, "solidif[ying]

application of state law to the contract between the parties supplies the creditor's right to the deficiency and that the hanging paragraph does not affect state law rights). *But see infra* Part III.B (discussing circuit court opinions holding creditors may use state law to obtain an unsecured deficiency after surrender of a vehicle).

92. *In re Ezell*, 338 B.R. at 335.

93. *Id.* at 335, 339–40.

94. *Id.* at 339–40 (citing 11 U.S.C. § 506(a) (2004), the pre-BAPCPA version); *see also* *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 961–62 (1997) (holding that valuation of items is determined by disposition, i.e., that retained consumer items are valued at fair market replacement value; to value such items at a foreclosure standard would render the language of § 506(a) inconsequential). The corollary holding is that foreclosed items should, therefore, be valued at foreclosure value.

95. *See In re Ezell*, 338 B.R. at 336 (describing surrender as one of the debtor's three options under pre-BAPCPA § 1325(a)(5)).

96. *See id.* at 338–40 (contrasting pre-BAPCPA § 506 valuation with the procedure required after the amendments).

97. *Id.* at 339–40; *see Rash*, 520 U.S. at 962 (observing surrender valuation of collateral to be the value realized upon foreclosure pursuant to § 506(a)).

98. *See In re Ezell*, 338 B.R. at 341–42 (concluding that allowing a creditor to obtain deficiency in accordance with state law would be "demonstrably at odds with Revised § 506(a)").

99. *See id.* at 342 ("Because application of § 506(a) is entirely removed from the picture, there can be no deficiency balance . . .").

the creditor's standing as a fully secured creditor."¹⁰⁰ Therefore, a debtor's surrender of the fully secured vehicle completely extinguished the creditor's claim.

Subsequent decisions adopted similar reasoning, finding fairness and balance in the result.¹⁰¹ The Tenth Circuit Bankruptcy Appellate Panel addressed the primary concerns raised subsequent to *Ezell* in *In re Quick*.¹⁰² First, the court held that the hanging paragraph was unambiguous and literal application of its terms would not lead to a result that is "demonstrably at odds with the apparent intentions of its drafters."¹⁰³ The court reasoned that although the amendments generally benefit creditors they need not be interpreted to *only* benefit creditors.¹⁰⁴ Denying a deficiency judgment to creditors could have resulted from "the normal give and take of the legislative process," and, thus, interpretation in favor of the debtor was appropriate.¹⁰⁵ Second, the *Quick* court resoundingly endorsed *Ezell's* interpretation of federal valuation of claims in the surrender context and found no "allowed unsecured claim" for a deficiency could arise without application of § 506(a).¹⁰⁶ The *Quick* decision captures the rationale of the majority line of cases beginning with *Ezell*, which offers a fair result. Fairness, however, is not a guiding principle of the Bankruptcy Code,¹⁰⁷ and

100. *In re Steakley*, 360 B.R. 769, 774 (Bankr. E.D. Tenn. 2007). In *Steakley*, Judge Stair did not cite the wealth of cases advocating his *Ezell* holding and chose to list only two. *Id.* at 772 (citing *In re Brown*, 346 B.R. 868, 876–77 (Bankr. N.D. Fla. 2006); *In re Payne*, 347 B.R. 278, 283 (Bankr. S.D. Ohio 2006)).

101. *See In re Payne*, 347 B.R. at 283 (pointing out that a creditor must take the risk of covering the deficiency in a surrender that any debtor would have to do if retaining the vehicle); *In re Turkowitch*, 355 B.R. 120, 127 (Bankr. E.D. Wis. 2006) ("[T]here is nothing unfair about denying the 910-creditor a deficiency claim that will dilute the distribution to other creditors or increase the debtor's obligations under a plan."); *see also* Anderson, *supra* note 44, at 5–6 (using a 'good for the goose, good for the gander' metaphor in the title of the article interpreting the hanging paragraph).

102. *DaimlerChrysler Fin. Servs. Ams. LLC v. Quick (In re Quick)*, 371 B.R. 459 (B.A.P. 10th Cir. 2007), *rev'd sub nom. In re Ballard*, 526 F.3d 634 (10th Cir. 2008).

103. *Id.* at 463.

104. *Id.* at 463 n.10.

105. *See id.* (declining, however, to endorse such an interpretation of congressional intent because such an analysis is only proper if ambiguity exists).

106. *See id.* at 464 (quoting *Capital One Auto Fin. v. Osborn (In re Osborn)*, 363 B.R. 72, 77 (B.A.P. 8th Cir. 2007)).

107. It is a guiding principle of the Code that similar claims should be treated similarly, but the Code also recognizes and enforces "fair" discrimination among classes of creditors in certain circumstances. *See* Hon. Robert D. Drain, *A Short Summary of Chapter 11 of the United States Bankruptcy Code*, 890 COM. L. & PRAC. COURSE HANDBOOK SERIES 75, 91 (2006); *see also* Editorial, *No Protection for Homeowners*, N.Y. TIMES, Jul. 14, 2007, at A10 ("[D]uring the reform effort, fairness took a back seat to a baser aim—simply, to make it more difficult for consumers to gain a fresh start through bankruptcy.").

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a vocal minority is emerging in several circuits that is arguably the new majority.

B. The Hanging Paragraph Is Inapplicable to the Surrender Context

The conclusion that a debtor may surrender a vehicle in full satisfaction has been endorsed by a majority of bankruptcy courts. However, several circuit courts evaluating the issue have held that “Article 9 of the Uniform Commercial Code [UCC] plus the law of contracts entitle the creditor to an unsecured deficiency judgment after surrender of the collateral.”¹⁰⁸ The *In re Wright* decision, with its estimable author, Chief Judge Frank Easterbrook of the Seventh Circuit Court of Appeals, began to sway the balance toward allowing a deficiency judgment for the creditor left with the surrendered vehicle.¹⁰⁹

The brief *Wright* opinion rejected the conclusion reached by prior courts “that § 506 is the *only* source of authority for a deficiency judgment when the collateral is insufficient” to satisfy the claim.¹¹⁰ Judge Easterbrook pointed to *Butner v. United States*, which held that state law determines rights and obligations when the Code does not supply a federal rule.¹¹¹ Applying the Court’s holding in *Butner*, Judge Easterbrook argued that state law should fill the vacuum left by the hanging paragraph’s removal of the § 506 valuation process.¹¹² *Ezell* and

108. *In re Wright*, 492 F.3d 829, 830–31 (7th Cir. 2007); *see also* Capital One Auto Fin. v. Osborn (*In re Osborn*), 515 F.3d 817, 822 (8th Cir. 2008) (allowing the creditor’s unsecured deficiency claim); AmeriCredit Fin. Servs., Inc. v. Long (*In re Long*), 519 F.3d 288, 291 (6th Cir. 2008) (same); DaimlerChrysler Fin. Servs. Ams. LLC v. Barrett (*In re Barrett*), 543 F.3d 1239, 1243 (11th Cir. 2008) (same); Tidewater Fin. Co. v. Kenney, 531 F.3d 312, 315 (4th Cir. 2008) (same); DaimlerChrysler Fin. Servs. Ams. LLC v. Ballard (*In re Ballard*), 526 F.3d 634, 639 (10th Cir. 2008) (same).

The lead opinion in *Long*, which overruled *Ezell*, did not follow the rationale adopted by the other circuits that have evaluated this issue. It attempted to establish a new consistent federal rule applying the doctrine of “the equity of the statute.” In order to avoid confusion, this Comment will forego analysis of this rationale because it has been rejected not only by the other circuits but also by the concurring judge and the dissenting judge in the *Long* opinion. *See In re Barrett*, 543 F.3d at 1245 (analyzing the *Long* holding).

109. Initially, the opinion had little effect beyond the Seventh Circuit. In *In re Quick*, the 10th Circuit Bankruptcy Appellate Panel rejected *Wright* two days after the opinion was released. *In re Quick*, 371 B.R. 459 (B.A.P. 10th Cir. 2007). It acknowledged but rejected the holding in *Wright*. *Id.* at 463 n.8. Additionally, *Ezell* author Judge Stair held to his position in the wake of *Wright*, issuing subsequent rulings without reference to *Wright*. *See, e.g., In re Sturgeon*, No. 07-33844, 2008 WL 400426, at *1 (Bankr. E.D. Tenn. Feb. 11, 2008).

110. *In re Wright*, 492 F.3d at 832.

111. *Id.* (citing *Butner v. United States*, 440 U.S. 48, 54–55 (1979)).

112. *Id.* at 832–33.

its progeny stand for the assertion that the hanging paragraph does not leave a vacuum and, thus, federal law determines the surrender value. In contrast, Judge Easterbrook found that the hanging paragraph simply restored the parties to the positions they would have observed absent the filing—a state law, nonbankruptcy determination of deficiency under whichever UCC deficiency provision¹¹³ the state had adopted.¹¹⁴

The *Wright* court rejected *Ezell*, centering its argument on *Ezell*'s result: the transformation of the secured lien on the surrendered vehicle from recourse to nonrecourse debt.¹¹⁵ Judge Easterbrook argued that because the section of the 2005 amendment encompassing the hanging paragraph was entitled “Restoring the Foundation for Secured Credit,”¹¹⁶ Congress could not have intended to reduce the strength of the creditor’s secured interest in the manner contemplated by the majority line of cases.¹¹⁷ Commentators have noted that Judge Easterbrook failed to find the hanging paragraph ambiguous before he resorted to using the title to aid his interpretation.¹¹⁸ Previously, Judge Easterbrook interpretatively relied on a heading only when ambiguity existed.¹¹⁹

Judge Easterbrook cited *In re Particka*¹²⁰ as an example of a court finding that a deficiency survives the surrender as a state law claim.¹²¹ As in *Wright*, the *Particka* court relied on the proposition of *Butner* that property interests are defined by state law, and a bankruptcy proceeding should not alter the state law analysis unless a federal interest requires a different result.¹²²

113. Several UCC provisions discuss deficiency judgments from recovered secured personal property and serve as the model for state commercial law. U.C.C. §§ 9-610 to -624 (2007). Specifically, § 9-615 indicates that the obligor is liable for any deficiency after creditor disposition of recovered collateral. U.C.C. § 9-615(d)(2) (2007).

114. *In re Wright*, 492 F.3d at 832.

115. *Id.*

116. BAPCPA, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005) (codified at 11 U.S.C. § 1325(a)(*) (2006)).

117. *In re Wright*, 492 F.3d at 832.

118. See Waldron & Berman, *supra* note 47, at 227–28 (possibly chiding Judge Easterbrook for this convenient omission). Subsequent circuit-level courts have all found the hanging paragraph to be unambiguous. See *DaimlerChrysler Fin. Servs. Ams. LLC v. Ballard* (*In re Ballard*), 526 F.3d 634, 638 (10th Cir. 2008) (finding the statutory language clear and, therefore, no need to look beyond it); *Capital One Auto Fin. v. Osborn* (*In re Osborn*), 515 F.3d 817, 821 (8th Cir. 2008) (same); *Tidewater Fin. Co. v. Kenney*, 531 F.3d 312, 318 (4th Cir. 2008) (same).

119. Waldron & Berman, *supra* note 47, at 227 (citing Judge Easterbrook’s opinion in *United States v. BDO Seidman, LLP*, 492 F.3d 806, 823 (7th Cir. 2007), as an example).

120. *In re Particka*, 355 B.R. 616 (Bankr. E.D. Mich. 2006).

121. *In re Wright*, 492 F.3d at 830–32.

122. *In re Particka*, 355 B.R. at 620 (quoting *Butner v. United States*, 440 U.S. 48, 55

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The *Particka* court asserted that, pre-BAPCPA, § 506 had never applied to bifurcation of a secured claim in the surrender context nor did it apply after the amendments.¹²³ Bifurcation upon surrender was always an existing state remedy. The court held that although the hanging paragraph captured the surrender language of § 1325(a)(5)(C), the statute's application to surrender lacked meaning because surrender valuation was a state matter.¹²⁴

Later courts have adopted the *Wright* line of reasoning. The Fourth Circuit, in *Tidewater Financial Co. v. Kenney*, endorsed the Seventh Circuit's assertion in *Wright* that § 506 is not the only source of a deficiency judgment, which could also arise from operation of state law.¹²⁵ Stating that the hanging paragraph's removal of § 506 from the inquiry created a vacuum, the *Kenney* court argued that *Butner* requires state law to fill in the gaps and supply a deficiency remedy.¹²⁶ The court also relied on the Supreme Court's assertion in *Travelers Casualty & Surety Co. v. Pacific Gas & Electric Co.* that "creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, *subject to any qualifying or contrary provisions* of the Bankruptcy Code."¹²⁷ The *Kenney* court shied away from the position in *Particka* that § 506 had never applied in the surrender context but still focused on state law as the legitimate source of a deficiency right.¹²⁸ Previously, § 506 had "merely provided 'a method for the judicial valuation of an allowed secured claim,'" bifurcating the claim into secured and unsecured components.¹²⁹ Absent § 506, the parties' sales contract defined the deficiency valuation of the claim.¹³⁰

The *Particka* decision, on the other hand, asserted that § 506(a)'s bankruptcy valuation of the claim was only appropriate where there was an interest of the estate in the collateral.¹³¹ In

(1979)).

123. *Id.* at 625. This assertion encompasses the creditor's argument that failed in *Ezell*. See *supra* notes 92–95 and accompanying text.

124. *In re Particka*, 355 B.R. at 625–26.

125. *Tidewater Fin. Co. v. Kenney (In re Kenney)*, 531 F.3d 312, 319–20 (4th Cir. 2008).

126. *Id.* at 319 (quoting *In re Wright*, 492 F.3d at 832).

127. *Id.* (quoting *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 444 (2007)) (emphasis added).

128. *In re Kenney*, 531 F.3d at 319–20.

129. *Id.* at 320 (quoting *DaimlerChrysler Fin. Servs. Ams. LLC v. Ballard (In re Ballard)*, 526 F.3d 634, 641 (10th Cir. 2008)) (emphasis added).

130. *Id.* at 319–20.

131. *In re Particka*, 355 B.R. 616, 624 (Bankr. S.D. Mich. 2006) (asserting that the federal bifurcation discussion is irrelevant).

the surrender context, the estate retained no property interest in the collateral that secured the claim and only the unsecured claim remained after liquidation.¹³² Because the collateral could not be subjected to the § 506(a) valuation procedure because it was no longer property of the estate, the state law remedy of foreclosure sale was appropriate to set the valuation of an unsecured deficiency judgment of the collateral.¹³³

The *Particka* court acknowledged the existence of the *Ezell* line of cases, expressed a temptation to follow it, but chose to adopt the reasoning of a sole existing case that shared its interpretation.¹³⁴ This case, *In re Zehrung*, held “[t]he creditor’s rights being unmodified by § 506, it is entitled to its state law right to liquidate the collateral and retain an unsecured claim for the balance due.”¹³⁵ However, like many of the later circuit rulings following its reasoning, the *Zehrung* decision is flawed because it ignores the fact that while the creditor’s *right to a deficiency* in bankruptcy is not modified, the claim’s *valuation* is changed. That valuation is modified by the unambiguous text of the hanging paragraph, which sets the valuation of the surrendered collateral at the amount of the claim, irrespective of any application of § 506.¹³⁶ The hanging paragraph trumps because § 1322 explicitly permits extensive modification of creditor rights and interests in bankruptcy.¹³⁷ In the face of conflicting state law concerning deficiency claims, federal bankruptcy law controls.¹³⁸

132. See *id.* at 625, 628–29 (recognizing that possible confusion could arise from the hanging paragraph’s lack of precise drafting).

133. *Id.* at 624.

134. *Id.* at 625.

135. Dupaco Cmty. Credit Union v. Zehrung (*In re Zehrung*), 351 B.R. 675, 678 (Bankr. W.D. Wis. 2006).

136. See 11 U.S.C. § 1325(a)(*) (2006) (stating that § 506 does not apply when specific elements are present); see also, e.g., *In re Adams*, No. 08-12192, 2009 WL 794503, at *5 (Bankr. E.D. La. Mar. 27, 2009) (rejecting the *Wright* court’s analysis and arguing that state law controls only claim validity and the Bankruptcy Code “determines whether a claim is allowable, entitled to distribution, and in what measure and priority”).

137. See 11 U.S.C. § 1322(b)(2) (2006) (permitting debtors’ plans to modify payment amounts, interest rates, defaults, and schedules for nearly every class of creditor claim). The supremacy of the Constitution’s Bankruptcy Clause allows Congress unlimited power where it has chosen to legislate. *In re Pruitt*, No. 08-30164, 2009 WL 535975, at *3 (Bankr. D. Conn. Feb. 24, 2009) (Dabrowski, C.J.). Therefore, as enacted, the unambiguous language of the hanging paragraph preempts any state law attempting to determine a surrender deficiency valuation. *Id.* at *3, *19.

138. See, e.g., *In re Tompkins*, 391 B.R. 560, 564 (Bankr. S.D.N.Y. 2008) (finding that the hanging paragraph’s valuation of the claim as fully secured qualifies or conflicts with, and by virtue of federal superiority trumps, state valuation); *In re Brown*, 346 B.R. 868, 876 (Bankr. N.D. Fla. 2006) (“[T]here is nothing inappropriate about bankruptcy laws affecting a creditor’s right to recover under state law.”).

Eventually, either the *Particka*-inspired, circuit-level interpretation or the *Ezell*-inspired, trial-level interpretation will dominate the disposition of surrendered vehicles. The trial-level interpretation appears more likely to emerge as controlling when each are placed under close textual scrutiny.

C. Evaluating These Different Interpretations

The analysis employed by Judge Easterbrook's line of cases seems to ignore two primary elements underpinning the majority line of cases. First, the language of the hanging paragraph unambiguously applies to surrender,¹³⁹ and, second, surrender valuation has been and continues to be a federal bankruptcy law determination.¹⁴⁰

Courts, including the *Particka* court, have found the hanging paragraph to be unambiguous.¹⁴¹ As such, the hanging paragraph explicitly applies equally to all parts of § 1325(a)(5), including the subsection (a)(5)(C) surrender context as well as the commonly understood subsection (a)(5)(B) retention context. Any § 506(a) bifurcation of an allowed 910 claim is therefore prohibited by the hanging paragraph.¹⁴² Allowing a creditor to assert a deficiency claim after disposition of the surrendered vehicle under an alternative state law regime would permit the very practice that the hanging paragraph prohibits: bifurcation of the claim.¹⁴³

It is conceivable that bifurcation would be permitted were it not the case that bankruptcy surrender valuation is a determination that has historically been governed by bankruptcy law rather than state law.¹⁴⁴ The Supreme Court addressed the application of § 506 to the surrender of a personal-use item in *Associates Commercial Corp. v. Rash*.¹⁴⁵ The *Rash* decision

139. See *supra* notes 54–55 and accompanying text.

140. See *supra* notes 97–99 and accompanying text.

141. See *In re Particka*, 355 B.R. 616, 623 (Bankr. E.D. Mich. 2006) (concluding that the hanging paragraph “is unambiguous insofar as its reference to § 506 is concerned”). As noted earlier, the *Wright* court fails to address whether the hanging paragraph is ambiguous. See *supra* notes 118–119.

142. See *In re Nicely*, 349 B.R. 600, 603 (Bankr. W.D. Mo. 2006) (asserting that the hanging paragraph prohibits bifurcation)

143. *Id.*

144. See Chris Lenhart, *Toward a Midpoint Valuation Standard in Cram Down: Ointment for the Rash Decision*, 83 CORNELL L. REV. 1821, 1825–26 (1998) (stating that § 506 “governs the valuation of secured claims in reorganizations”); cf. *In re Price*, 366 B.R. 389, 396 (Bankr. M.D. Pa. 2007) (“Further, the minority position that pre BAPCPA § 506 was inapplicable when property was surrendered is simply incorrect.”).

145. *Assoc. Commercial Corp. v. Rash*, 520 U.S. 953, 960 (1997) (holding that valuation of a surrendered item was set at liquidation value); see *In re Price*, 366 B.R. at 396 (explaining that the Supreme Court's discussion of “disposed-use” valuation in *Rash*

indicates that state valuation law does not govern but is instead trumped by the federal bankruptcy statute.¹⁴⁶ Although the § 506 bifurcation valuation is removed by the hanging paragraph, nothing in BAPCPA indicates a federal intent to relinquish the determination of the secured claim's value. Indeed, the hanging paragraph explicitly sets it at the full value of the claim. Section 1322 permits a debtor's confirmed Chapter 13 plan to modify almost any interest of a creditor, secured or otherwise.¹⁴⁷ The hanging paragraph does not, as Judge Easterbrook argues, leave the parties to their prebankruptcy contract by removing § 506 valuation.¹⁴⁸ It supersedes the § 506 valuation and modifies the creditor's rights by producing a valuation under which the 910 vehicle is fully secured.¹⁴⁹

The argument that a deficiency might be calculated under state law ignores the fact that the creditor is seeking allowance of the deficiency as a *bankruptcy* claim. Thus the Bankruptcy Code and not state law determines whether, and to what extent, such a claim will be allowed.¹⁵⁰ Without § 506(a), there is no bankruptcy mechanism for allowing an unsecured claim on a surrendered 910 vehicle.¹⁵¹ Additionally, the argument that the vehicle is no longer property of the estate once it is surrendered and thus subject to a state law deficiency is flawed because if the creditor were to sell the surrendered car at a profit, the estate would maintain an interest in the excess proceeds of the sale.¹⁵² The estate's interest runs both ways and is certainly not extinguished.

Ultimately, the best textual argument against a deficiency is found in the recent *Travelers* opinion.¹⁵³ The Supreme Court stated that “[c]reditors’ entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor’s obligation, *subject to any qualifying or contrary provision*

indicated its belief that § 506 applied in both the retention and surrender contexts).

146. *Rash*, 520 U.S. at 964 (“The Code’s cram down option displaces a secured creditor’s state-law right to obtain immediate foreclosure upon a debtor’s default.”).

147. 11 U.S.C. § 1322(b)(2) (2006) (“[T]he plan may . . . modify the rights of holders of secured claims [except a claim on the debtor’s principal residence] or of holders of unsecured claims . . .”).

148. *See In re Wright*, 492 F.3d 829, 832 (7th Cir. 2007) (“[T]he hanging paragraph leaves the parties to their contractual entitlements.”).

149. *In re Pinti*, 363 B.R. 369, 380–81 (Bankr. S.D.N.Y. 2007).

150. *Id.* at 380. Although any legitimate contractual claim will be permitted under § 502, the valuation is controlled elsewhere in the Code. *See id.* at 383.

151. *Id.* at 380–81.

152. *Id.* at 382–83.

153. *Travelers Cas. & Sur. Co. v. Pac. Gas & Elec. Co.*, 549 U.S. 443 (2007).

of the bankruptcy code.”¹⁵⁴ The hanging paragraph is just such a provision.¹⁵⁵

It is important to recognize that permitting the debtor to surrender a vehicle in full satisfaction often has little impact on a *debtor's* obligation under a Chapter 13 plan. The debtor will probably pay the same amount over the duration of the statutory period.¹⁵⁶ Surrender in full satisfaction has the most impact on the debtor's unsecured creditors. Because all unsecured creditors share pro rata from a pool of the debtor's disposable income paid into the plan, allowing a 910 creditor a deficiency claim generally dilutes the pro rata recovery of every other unsecured creditor.¹⁵⁷ While the hanging paragraph seems intended to weigh hardest on the debtor who buys and retains a new car shortly before filing bankruptcy, enforcing a deficiency judgment upon surrender actually weighs hardest on the debtor's other creditors.

A literal interpretation of the hanging paragraph might become more widely accepted were it not for some courts' sense that the *Ezell* strict interpretation is demonstrably at odds with their own sense of congressional intent. Judge Easterbrook appeared particularly guided by his interpretation of congressional objectives. He rejected *Ezell*, believing that the decision transformed the 910 debt into nonrecourse debt when the car was surrendered because it was in opposition to his understanding of the purpose of the amendments.¹⁵⁸

The Ninth Circuit Bankruptcy Appellate Panel, while choosing to follow *Wright* and denying surrender in full satisfaction, questioned “whether Congress intended that, *in return for protection from cramdown*, 910 creditors who recover surrendered 910 vehicles have lost their right to a deficiency claim.”¹⁵⁹ The court seemed inclined toward this “rough fairness” interpretation because the hanging paragraph granted secured creditors an advantage in recovery over unsecureds by diminishing the pool of funds available to pay them.¹⁶⁰ Ultimately, the court declined, in the absence of clearer

154. *Id.* at 444.

155. *In re Tompkins*, 391 B.R. 560, 564 (Bankr. S.D.N.Y. 2008) (opining that the hanging paragraph falls within the category outlined by *Travelers*).

156. *See* *Tidewater Fin. Co. v. Kenney (In re Kenney)*, 531 F.3d 312, 315 n.2 (4th Cir. 2008) (indicating the fixed liability of the debtor's contribution to the plan).

157. *In re Brown*, 346 B.R. 868, 875 (Bankr. N.D. Fla. 2006).

158. *See In re Wright*, 492 F.3d 829, 832 (7th Cir. 2007) (“[I]t is hard to imagine that Congress took such an indirect means of making non-recourse lending *compulsory*.”).

159. *Wells Fargo Fin. Acceptance v. Rodriguez (In re Rodriguez)*, 375 B.R. 535, 548 (B.A.P. 9th Cir. 2007) (emphasis added).

160. *Id.*

indication, to presume this intent.¹⁶¹ However, the Tenth Circuit Bankruptcy Appellate Panel, in *In re Quick*, was not quite so hesitant.¹⁶² The *Quick* court wholly endorsed the reasoning of *Ezell*, stating that permitting surrender in full satisfaction was not “demonstrably at odds with the apparent intentions of its drafters.”¹⁶³ Another court, perhaps anticipating *Wright*, pointed out that the pertinent section of BAPCPA “was not entitled ‘Giving Secured Creditors Improved Treatment in Chapter 13,’ but ‘Giving Secured Creditors *Fair* Treatment in Chapter 13.”¹⁶⁴ The hanging paragraph, while apparently drafted to affect debtors who retain their 910 vehicles, also has a pronounced impact on a debtor’s unsecured creditors. The most reasonable interpretation of the hanging paragraph would deny the secured creditor a deficiency in the surrender context in order to compensate unsecured creditors for the heightened injury they suffer in the more frequent retention context.

While circuit level decisions endorsing *Wright* continue to mount, trial level bankruptcy courts are unimpressed. They continue to endorse the *Ezell* interpretation and openly disagree with the circuit courts’ interpretation of claim valuation and bankruptcy preemption.¹⁶⁵ With so little agreement and so little legislative history, courts on either side of this issue will continue their impassioned advocacy until new legislation brings reform.

D. Legislative Solutions and the Damage They Can Do

Clarity is needed in applying the hanging paragraph to 910 car claims in the surrender context to achieve consistency for Chapter 13 creditors. Solutions require inquiry into the perceived problem. If it were proposed that a secured 910 creditor should be permitted to recover a deficiency judgment from the surrendering Chapter 13 debtor, most courts would agree that a simple fix amending the hanging paragraph to restrict its application to only § 1325(a)(5)(B) would generate the desired result.¹⁶⁶ This treatment would allow § 506(a) to unequivocally reemerge as the

161. *See id.*

162. DaimlerChrysler Fin. Servs. Ams. LLC v. Quick (*In re Quick*), 371 B.R. 459, 465 (B.A.P. 10th Cir. 2007).

163. *Id.* at 463 & n.10.

164. *In re Turkowitch*, 355 B.R. 120, 126 (Bankr. E.D. Wis. 2006).

165. *See, e.g., In re Adams*, No. 08-12192, 2009 WL 794503, at *5 (Bankr. E.D. La. Mar. 27, 2009); *In re Pruitt*, No. 08-30164, 2009 WL 535975, at *3, *19 (Bankr. D. Conn. Feb. 24, 2009) (Dabrowski, C.J.).

166. *See, e.g., Capital One Auto Fin. v. Osborn (In re Osborn)*, 363 B.R. 72, 77 (B.A.P. 8th Cir. 2007) (“Had Congress intended to exclude § 1325(a)(5)(C) from the reach of the hanging paragraph, it would have been simple to do so.”).

provision that determines valuation of secured claims in § 1325(a)(5)(C) surrenders. The dispute as to whether state law or federal law permitted the deficiency would become a distinction without a difference. A permissible deficiency claim could be asserted against the estate either way.

This simple solution, however, is not without problems. In *Rash*, the Supreme Court held that the “proposed use” of the secured property dictates the property’s valuation.¹⁶⁷ *Rash* concerned the cramdown valuation of a retained tractor trailer and held that the valuation of retained property should be the value of similar replacement property.¹⁶⁸ Congress acted in the subsequent BAPCPA amendments to constrain all § 506(a) valuations of personal property held in Chapter 13 cases to the *Rash* Court’s replacement-value valuation.¹⁶⁹ Amending the hanging paragraph to permit 910 car creditors to bifurcate a claim based upon § 506(a)(1) would force those creditors to accept § 506(a)(2)’s replacement-value valuation of the secured portion rather than a foreclosure valuation.¹⁷⁰ This higher replacement valuation would reduce the amount of the deficiency judgment the 910 creditor could then pursue. At this point, the dispute as to whether state or federal bankruptcy law controls would reemerge; creditors would argue for a lower valuation attainable under state law liquidation.

Given the history of the hanging paragraph’s association with Senator Abraham and the auto finance industry in general,¹⁷¹ it is appropriate to assume that this amendment was intended to wholly benefit the 910 creditors over unsecured creditors and debtors. Nevertheless, replacement value now reflected in BAPCPA might be the most equitable solution.¹⁷² This approach would balance the interests of secured and unsecured creditors in a fashion advocated by both the Ninth¹⁷³

167. See *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 965 (1997) (“[U]nder § 506(a), the value of property retained because the debtor has exercised the § 1325(a)(5)(B) ‘cram down’ option is the cost the debtor would incur to obtain a like asset for the same ‘proposed . . . use.’”).

168. *Id.* at 960.

169. WARREN & WESTBROOK, *supra* note 28, at 296.

170. See 11 U.S.C. § 506(a)(2) (2006) (requiring valuation set at the price a retail merchant would charge for like property).

171. See *supra* notes 61–62 and accompanying text.

172. See *Rash*, 520 U.S. at 965 n.6 (“Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented.”).

173. *Wells Fargo Fin. Acceptance v. Rodriguez (In re Rodriguez)*, 375 B.R. 535, 548 (B.A.P. 9th Cir. 2007).

and Tenth¹⁷⁴ Circuit Bankruptcy Appellate Panels. To wit, if the debtor retained the 910 vehicle, more of the debtor's finite pool of funds would be allocated to the secured creditors. If however the debtor surrendered the vehicle, more money would be available for distribution to all unsecured creditors as a result of a higher surrender valuation. Different debtor choices would result in benefits accruing to different creditors.¹⁷⁵ It is likely that debtors would not consistently choose one outcome over the other; therefore, each group would receive some measure of recompense.

On the other hand, if Congress intended to permit a debtor to surrender a 910 car in full satisfaction—denying a 910 creditor a possible deficiency judgment—the legislative fix is equally simple. Amending the hanging paragraph phrase, “For purposes of paragraph (5) . . .” to, “For purposes of paragraph (5)(B) and (C) . . .” would signal Congress's intention to deny § 506(a) bifurcation to creditors in the surrender context as well as to debtors in the retention context. This proposed amendment would require political capital in the face of inevitable resistance from the auto finance industry. Given the long timeframe required to achieve BAPCPA's passage,¹⁷⁶ it seems unlikely that such a change would be simple or quick.

Until Congress chooses to amend the hanging paragraph and resolve the dispute over surrendered 910 vehicles—whether the result is to enable a creditor to pursue a possible deficiency or to unequivocally permit a debtor to surrender in full satisfaction—this issue will continue to provoke litigation, the costs of which already struggling Chapter 13 debtors will be poorly equipped to bear.

In addition to the debtors who seek to resolve their responsibility to auto creditors by surrendering their vehicles, many others enter bankruptcy specifically to avoid repossession of a car that is integral to their financial recovery.¹⁷⁷ These debtors may not have been in the best financial shape when they

174. DaimlerChrysler Fin. Servs. Ams. LLC v. Quick (*In re Quick*), 371 B.R. 459, 463 n.10 (B.A.P. 10th Cir. 2007).

175. See *In re Pinti*, 363 B.R. 369, 387 (Bankr. S.D.N.Y. 2007) (stating that treating the hanging paragraph as permitting a deficiency is to deny the debtor a meaningful choice among the three options of § 1325(a)(5) when crafting a plan).

176. See generally Jensen, *supra* note 17 (recounting nearly a decade of attempts).

177. See Katherine Porter, *Going Broke the Hard Way: The Economics of Rural Failure*, 2005 WIS. L. REV. 969, 1026 (explaining that rural debtors' lack of public transportation can force them into bankruptcy solely to protect a car that is integral to their ability to earn an income and meet future expenses).

originally purchased their car, and the following Part addresses these cases.

IV. NEGATIVE EQUITY AND THE HANGING PARAGRAPH: THE SPECTER OF RISING LITIGATION

A. *Negative Equity, Purchase Money Security Interests, and Incompatible Courts*

A car owner is “upside down” when he owes more on his existing car than it is worth.¹⁷⁸ “Negative equity” refers to the situation in which a new car purchaser, who is upside down on his trade-in vehicle, rolls the antecedent unpaid balance into the new loan for the replacement car.¹⁷⁹ Car dealers frequently offer to finance this difference between the fair market value of the trade-in vehicle and the buyer’s remaining obligation on the trade-in in order to facilitate the subsequent car purchase.¹⁸⁰ Dealers sometimes couch this shifting of debt from one car to the next in terms of “paying off the buyer’s loan for them.”¹⁸¹ No such altruistic actions are actually occurring; the seller is only adding this amount to the buyer’s costs on the next car.¹⁸² Dealers may complain that this situation hurts business, but they still assist buyers in purchasing a new vehicle by financing the difference.¹⁸³

The prevalence of purchasers channeling negative equity into subsequent car purchases is significant and growing. In 2004, Edmunds.com, a leading auto website, estimated that approximately 27% of upside-down car buyers who traded in their existing vehicles financed the outstanding debt into the purchase.¹⁸⁴ In 2007, analysts place this number between 29%¹⁸⁵

178. Stacey L. Bradford, *Avoid Car-Loan Pileup*, FILIFE, Nov. 14, 2004, <http://www.filife.com/stories/avoid-carloan-pileup>.

179. *In re Peaslee*, 547 F.3d 177, 179 (2d Cir. 2008).

180. Elizabeth C. Yen & Timothy P. Meredith, *Truth in Lending Developments in 1999—Preparing for the New Millennium*, 55 BUS. LAW. 1261, 1264 (2000).

181. Stephen A. Plass, *Bargain Avoidance in a Competitive Bargain Market: The Car Sales Conundrum*, 2 WYO. L. REV. 1, 21–22 (2002).

182. *Id.* at 22. The seller is able to generate additional profit through the buyer’s negative equity. *Id.* (“If there is negative equity, the seller will add this sum to the buyer’s costs, and may also raise the selling price of the vehicle to make an additional profit. A [dealer] then sells the traded-in vehicle at a profit.”).

183. See David Kiley, *Lack of Trade-In Value Burns Car Buyers*, USA TODAY, July 7, 2003, at 1A (quoting a Texas dealer who complains that 90% of his new-car customers owe more on their trade-ins than they are worth, oftentimes in amounts up to \$10,000 to \$15,000).

184. Bradford, *supra* note 178.

185. See Jonathan Welsh, *Family Finances*, WALL ST. J., June 3, 2007, at A3 (noting 9% growth over the previous five years to 29% in 2007).

and 40%.¹⁸⁶ Additionally, the dollar amount of negative equity financed by the average buyer in or out of bankruptcy is growing, estimated to have doubled since 2000.¹⁸⁷ One historical study of bankruptcy filers in 1983 showed that 74% had no equity at all in their cars.¹⁸⁸ Little has changed to indicate that this situation has improved, and, based upon broader societal trends, it has probably worsened.¹⁸⁹

Negative equity intersects with the hanging paragraph because the provision applies only to protect creditors who have a “purchase money security interest securing the debt that is the subject of the claim.”¹⁹⁰ The next Section examines the debate that has erupted over whether negative equity constitutes a purchase money obligation. A purchase money security interest (PMSI) is a term of art that appears in the UCC,¹⁹¹ but not in the Bankruptcy Code’s definitional section.¹⁹² Whether a PMSI that secures a debt exists is a matter of state law rather than federal bankruptcy law.¹⁹³

In Texas, as in most other states,¹⁹⁴ the UCC has been adopted concerning PMSIs. Texas law states, “A security interest in goods is a purchase-money security interest . . . to the extent that the goods are purchase-money collateral with respect to that security interest”¹⁹⁵ The term “purchase-money collateral” refers to goods that secure the resulting purchase money

186. See, e.g., *In re Peaslee*, 358 B.R. 545, 554 (Bankr. W.D.N.Y. 2006) (citing creditor GMAC’s brief in which a lender confirmed that between 26% and 38% of buyers have negative equity in the traded-in vehicle, sometimes exceeding \$15,000 due to a series of rolled-in vehicle loans).

187. See Kiley, *supra* note 183, at 1A.

188. See Philip Shuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288, 304 (1983) (“Indeed only 87 of the 339 cases showing a balance (26%) had any equity at all.”).

189. See *supra* notes 183–187.

190. 11 U.S.C. § 1325 (a)(*) (2006).

191. U.C.C. § 9-103 (2000).

192. 11 U.S.C. § 101 provides extensive bankruptcy definitions, but not for terms that are historically associated with state law. See Oleksandra Johnson, *The Bankruptcy Code as Complete Preemption: The Ultimate Trump?*, 81 AM. BANKR. L.J. 31, 63 (2007) (arguing that federal bankruptcy law should not completely preempt state law and noting that the “definitions of some core bankruptcy terms depend on nonbankruptcy law”).

193. *Billings v. Avco Colo. Indus. Bank (In re Billings)*, 838 F.2d 405, 406 (10th Cir. 1988) (observing that courts “uniformly” look to state law to determine whether a PMSI exists).

194. See Richard B. Amandes, *The Uniform Land Transactions Act and the Uniform Simplification of Land Transfers Act Twenty Years Later: Why Have There Been No Adoptions?*, 20 NOVA L. REV. 1033, 1034 (1996) (indicating at least partial UCC adoption in all fifty states).

195. TEX. BUS. & COM. CODE ANN. § 9.103(b)(1) (Vernon 2002) (emphasis added).

obligation, which is “given to enable the debtor to acquire rights” in the collateral.¹⁹⁶

Typically, a secured creditor must satisfy two requirements to establish a PMSI: (1) the money loaned enabled the debtor to obtain the collateral (the enabling requirement); and (2) the debtor actually used those funds to obtain rights in the collateral (the tracing requirement).¹⁹⁷ Because the hanging paragraph only applies when there is a PMSI,¹⁹⁸ litigation concerning whether negative equity is an “enabling” obligation qualifying it for purchase-money status is mushrooming. Clarity is needed concerning the hanging paragraph’s treatment of negative equity.

A “lively dispute in the case law” is underway concerning proper treatment when negative equity appears within a 910 car PMSI.¹⁹⁹ Two primary and two secondary lines of cases have emerged. The cases representing the slight majority hold that a PMSI, as referenced in the hanging paragraph, does not include funds advanced by a lender to retire negative equity resulting from the trade-in of a vehicle.²⁰⁰ Rather, the cases hold that the negative equity has a different status and remains subject to § 506(a) cramdown.²⁰¹ A few courts have gone even further to conclude that the presence of funds advanced to pay off preexisting debt “transforms” all loan funds into nonpurchase money funds, permitting complete cramdown of the debt.²⁰²

196. See TEX. BUS. & COM. CODE ANN. § 9.103(a)(1)–(2) (Vernon 2002).

197. See Keith G. Meyer, *A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code*, 50 U. KAN. L. REV. 143, 152–55 (2001) (broadly tracing essentials of PMSIs); see also *Citifinancial Auto v. Hernandez-Simpson (In re Hernandez-Simpson)*, 369 B.R. 36, 45–46 (D. Kan. 2007) (listing the enabling and tracing requirements for creating a PMSI).

198. See 11 U.S.C. § 1325(a)(*) (2006) (“[S]ection 506 shall not apply . . . if the creditor has a purchase money security interest securing the debt that is the subject of the claim . . .”).

199. *In re Sanders*, 377 B.R. 836, 845 (Bankr. W.D. Tex. 2007).

200. See, e.g., *id.* (citing *In re Pajot*, 371 B.R. 139 (Bankr. E.D. Va. 2007) (finding no PMSI), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191, 201 (E.D. Va. 2008) (mem.)); *In re Westfall*, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007) (same).

201. See *In re Pajot*, 371 B.R. at 157 (separating negative equity for alternative treatment but protecting lender’s PMSI in full). Despite partial reversal, *Pajot* continues to be cited with approval for the proposition of dual status treatment. See, e.g., *Americredit Fin. Servs., Inc. v. Penrod (In re Penrod)*, 392 B.R. 835, 857 (B.A.P. 9th Cir. 2008). This “dual status” of funds is discussed in detail *infra* Part IV.C.

202. See, e.g., *In re Price*, 363 B.R. 734, 746 (Bankr. E.D.N.C. 2007) (adopting the transformation rule and concluding the hanging paragraph did not preclude the debtor’s proposed cramdown of the debt), *aff'd in part, rev'd in part*, *Wells Fargo Fin. N.C. 1, Inc. v. Price (In re Price)*, No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007). The transformation rule is discussed *infra* Part IV.D.

The second primary line of cases holds that, despite negative equity, the creditor remains fully secured.²⁰³ These cases rely on reading in other state laws to reach this conclusion.²⁰⁴

The last group of emerging cases holds that the hanging paragraph is a narrow exception to § 1325(a)(5) and that the presence of negative equity disqualifies the claim and permits cramdown because the hanging paragraph, strictly construed, permits *only* a “purchase money security interest.”²⁰⁵ These courts use different reasoning but ultimately reach the same result as that achieved by the transformation line of cases. No matter the outcome, all the cases first ask: Is there a PMSI?

B. *Is Negative Equity a Purchase Money Obligation?*

The divergent lines of cases differ as to whether they treat negative equity as purchase money or nonpurchase money. Three of the four lines of cases hold that negative equity financed into a subsequent car purchase fails as a purchase money obligation for two principal reasons.²⁰⁶ First, negative equity is not a component of the price of the collateral, and, second, it is not value given to enable the debtor to acquire rights in the collateral.²⁰⁷

Most courts have looked to Official Comment 3 of UCC § 9-103, which has been adopted by various state legislatures, to determine if negative equity is a component of the price paid²⁰⁸ for the collateral.²⁰⁹ Courts have construed add-ons, such as

203. See, e.g., *In re Sanders*, 377 B.R. at 845 (“[T]he ‘purchase money’ in ‘purchase money security interest’ may include funds advanced to pay off the negative equity, so that the claim is not thereby disqualified from inclusion as a 910-day claim.” (citing *In re Graupner*, 356 B.R. 907, 923 (Bankr. M.D. Ga. 2006))); see also *Gen. Motors Acceptance Corp. v. Peaslee*, 373 B.R. 252, 258–59 (W.D.N.Y. 2007) (same). “Negative equity as fully secured” is discussed *infra* Part IV.E.

204. See, e.g., *In re Graupner*, 356 B.R. at 920–21 (reading in provisions of the state Motor Vehicle Sales Financing Act (GA. CODE ANN. § 10-1-31(a) (2000))).

205. See *In re Sanders*, 377 B.R. at 858–59 (basing the ruling wholly on bankruptcy law without resort to variable state interpretations); *In re Mitchell*, 379 B.R. 131, 139–42 (Bankr. M.D. Tenn. 2007) (same). These cases are discussed *infra* Part IV.F.

206. See, e.g., *In re Pajot*, 371 B.R. at 157 (representing dual status line); *In re Price*, 363 B.R. at 746 (representing transformation line); *In re Sanders*, 377 B.R. at 858 (representing federal line).

207. See *infra* notes 219–221 and accompanying text.

208. See U.C.C. § 9-103 cmt. 3 (2007) (stating that, in addition to the price of the collateral, other items such as sales taxes, interest, attorney’s fees, administrative charges, and “*other similar obligations*” are also held to constitute the “price” paid and the “value given to enable” the debtor to acquire rights in the collateral (emphasis added)).

209. See, e.g., *In re Westfall*, 365 B.R. 755, 760 (Bankr. N.D. Ohio 2007) (relying on the Official Comment in both the UCC and the Ohio equivalent). Not every dollar loaned necessarily becomes part of the purchase money obligation. Only funds outlined by individual state statute receive such treatment, and they may be subject to case-by-case scrutiny. *In re Hayes*, 376 B.R. 655, 670 (Bankr. M.D. Tenn. 2007).

extended warranties and service contracts, on the newly purchased vehicle to qualify as “price paid.”²¹⁰ Courts have been reluctant, however, to extend this definition to negative equity held over from a previous vehicle.²¹¹

Creditors seeking to protect negative equity have argued that the term “price of the collateral” is ambiguous.²¹² They argue that the state legislatures intended that financed negative equity should be included in the price, and they further urge courts to “look to other statutes to offer a gloss on the definition of ‘price.’”²¹³ The majority of cases have rejected this argument, finding the term “price” unambiguous and declining to look elsewhere.²¹⁴

Courts considering whether negative equity constitutes a purchase money obligation more often question whether the financing is “value given to enable” the purchase.²¹⁵ Creditors frequently argue that full payment of the outstanding negative equity was necessary to enable the debtor to purchase the new vehicle.²¹⁶ They argue that the UCC requires only a “close nexus between the acquisition of collateral and the secured obligation,”²¹⁷ and, as such, negative equity—closely related to the purchase of the 910 car—should be considered a purchase money obligation.²¹⁸

Most courts remain unconvinced that negative equity has a sufficient nexus to rise to this level. These courts find the negative equity financing to constitute a separate transaction

210. See, e.g., *In re Johnson*, 337 B.R. 269, 272–73 (Bankr. M.D.N.C. 2006) (mem.); *In re Murray*, 346 B.R. 237, 240 (Bankr. M.D. Ga. 2006) (mem.).

211. See *In re Pajot*, 371 B.R. at 149–50 (asserting that the list in the Official Comment “does not contemplate the inclusion of negative equity”).

212. *Id.* at 149 (acknowledging but ultimately rejecting this claim of ambiguity).

213. *Id.*

214. See, e.g., *id.* at 149–50 (finding the term “price” to be clear on its face and thus declining to review other statutes); see also *In re Peaslee*, 358 B.R. 545, 556 (Bankr. W.D.N.Y. 2006) (determining that the “plain meaning . . . does not result in an absurd disposition”); *In re Price*, 363 B.R. 734, 742 (Bankr. E.D.N.C. 2007) (same), *aff’d in part, rev’d in part*, Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re Price*), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007). The majority holds that the remaining debt on the trade-in is an antecedent debt that only becomes “nominally secured” when it is financed into the subsequent car purchase. See *In re Pajot*, 371 B.R. at 149.

215. See *supra* note 196 and accompanying text (defining “value given to enable”).

216. See *In re Price*, 363 B.R. at 741 (rejecting a creditor’s argument that funds loaned to refinance negative equity should be counted as part of the purchase price).

217. U.C.C. § 9-103 cmt. 3 (2007).

218. *In re Pajot*, 371 B.R. at 154. These creditors argue the “close nexus” language is only intended to deny purchase-money status to debtors who roll in all manner of “unrelated” debt, such as student loans or credit card obligations, while protecting financing related to the purchase. *Id.*

apart from the purchase.²¹⁹ For example, the court in *In re Peaslee* characterized the refinancing of negative equity as a “convenient but unnecessary option for a consumer purchasing a replacement vehicle, . . . not value given to ‘enable’ that consumer to acquire rights in or the use of the replacement collateral.”²²⁰ The majority of new car buyers do not need to enter into a negative equity refinancing agreement. Therefore, many courts have rejected the argument that such agreements traditionally “enable” the purchase or share a “close nexus” with it.²²¹

If a court determines that negative equity is not a purchase money obligation, it must then determine how to treat it as a bankruptcy claim. The results have not been uniform.

C. *The Dual Status Rule and Negative Equity*

Presence of nonpurchase money alongside purchase money in a financing transaction is contemplated by the UCC. Section 9-103(f) explicitly indicates there is no loss of purchase-money status to the extent of those purchase-money funds for *nonconsumer* goods when nonpurchase money obligations coexist.²²² For nonconsumer goods, the UCC approves application of the “dual status” rule, which bifurcates the claim into PMSI and non-PMSI components.²²³ Courts following this rule apply the hanging paragraph to protect in full the PMSI component but not the negative equity remainder.²²⁴

The majority of bankruptcy courts prefer the dual status rule because it appeals to their equitable understanding of the

219. See *In re Hayes*, 376 B.R. 655, 673 (Bankr. M.D. Tenn. 2007) (determining that the money advanced to pay off negative equity went to plaintiff-creditor’s competitor and was not actually used to pay for the new vehicle and thus was “not a purchase money obligation”); *In re Brodowski*, 391 B.R. 393, 398 (Bankr. S.D. Tex. 2008) (stating the purchase of the new vehicle and the refinancing of the negative equity from the old vehicle constituted “two separate and distinct transactions”).

220. *In re Peaslee*, 358 B.R. 545, 557 (Bankr. W.D.N.Y. 2006).

221. See *id.* at 558 n.14 (“[N]o matter how neatly you paint stripes on a [negative equity debt] horse, you cannot turn it into a [purchase money security interest] zebra.”).

222. U.C.C. § 9-103(f)(1) (2007). The UCC explicitly endorses the dual status rule in the commercial context, and many states have followed this advice. See U.C.C. § 9-103 cmt. 7a (2007); see also TEX. BUS. & COM. CODE ANN. § 9-103 cmt. 7a (Vernon 2002). Some states go so far as to mandate only the dual status rule in all contexts, consumer and commercial. See, e.g., KAN. STAT. ANN. § 84-9-103(f) (Supp. 2007); see also *In re Vega*, 344 B.R. 616, 622 n.29 (Bankr. D. Kan. 2006) (acknowledging that the dual status rule in Kansas “applies in both commercial and consumer contexts, meaning that a creditor’s purchase money status is not lost” merely because of the presence of nonpurchase money funds).

223. U.C.C. § 9-103 cmt. 7a (2007).

224. See *infra* notes 237–239 and accompanying discussion.

2005 amendments.²²⁵ For example, the *Pajot* court noted that the modern trend, applying the dual status rule, “allows the court to treat the portion that is purchase-money (essentially the purchase price) as purchase-money, whereas the nonpurchase-money portion remains nonpurchase-money and is treated accordingly.”²²⁶

These courts hold that protection of the creditor’s interest in *the vehicle that the creditor financed* is the guiding principle of the hanging paragraph, and the dual status rule best achieves that principle in the negative equity context.²²⁷ The excess trade-in balance, representing negative equity, is simply an “unsecured antecedent debt” that may be disposed of with similarly classified claims in the debtor’s Chapter 13 plan.²²⁸

In support of the view that the dual status rule is the most appropriate resolution when purchase money and nonpurchase money coexist, many courts rely on UCC language. The pertinent provision states that “[a] security interest in goods is a purchase-money security interest *to the extent* that the goods are purchase-money collateral with respect to that security interest.”²²⁹ On policy grounds, the “to the extent” language supports protection of the price of the collateral without extending similar protection for items extraneous to purchase.²³⁰ Courts have commented that, given the creditor-oriented bent of the BAPCPA amendments, dual status interpretation is preferable to a reading that would, in essence, render “knowingly refinanced unsecured negative equity debt into secured debt not supported by collateral

225. See, e.g., *In re Pajot*, 371 B.R. at 157 (basing its decision on “an equitable analysis of BAPCPA’s revisions”).

226. *Id.*

227. See *In re Penrod*, 392 B.R. 835, 859 (B.A.P. 9th Cir. 2008) (“[The Dual Status Rule is] consistent with the apparent purpose of the hanging paragraph. [Therefore,] we are persuaded that the Dual Status Rule should be applied as the federal rule.”); see also *In re Johnson*, 380 B.R. 236, 250 (Bankr. D. Or. 2007) (“[A]pplying the dual purpose rule is more consistent with congressional intent.”); *In re Westfall*, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007) (describing the transformation rule as “too severe” and adopting the dual status rule as more equitable).

228. *CitiFinancial v. Hernandez-Simpson (In re Hernandez-Simpson)*, 369 B.R. 36, 48 (D. Kan. 2007) (affirming negative equity classification as unsecured).

229. U.C.C. § 9-103(b)(1) (2007) (emphasis added); see also *First Nat’l Bank of Boston v. Shugrue (In re Ionosphere Clubs, Inc.)*, 123 B.R. 166, 171–72 (S.D.N.Y. 1991) (relying on Professor McLaughlin’s observation that “the language of § 9-107 . . . suggested that a security interest could have both PMSI and non-PMSI components” (citing Gerald T. McLaughlin, “Add On” Clauses in Equipment Purchase Money Financing, 49 *FORD. L. REV.* 661, 691 (1981))).

230. See *In re Acaya*, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007) (policy of encouraging refinancing by protecting PMSI character); see also *Pristas v. Landaus of Plymouth, Inc. (In re Pristas)*, 742 F.2d 797, 800 (3d Cir. 1984) (policy of modernizing and simplifying commercial lending).

value.”²³¹ Such a conversion would require negative equity to be paid ahead of, and to the detriment of, other unsecured creditors, violating a fundamental tenet of the Code: “equality of distribution among like creditors.”²³²

Bankruptcy courts choosing to apply the dual status rule in negative equity situations recognize it is a fact-intensive determination.²³³ Only in cases where evidence exists permitting a court to clearly define the negative equity valuation will the courts lean towards the dual status rule.²³⁴ Motor vehicle financing agreements in some states are required to identify the negative equity plainly;²³⁵ in other states, statutes permit it to be lumped into the larger price of the car.²³⁶ Nonetheless, courts that strongly advocate the dual status rule have reserved the right to employ other means when creative creditor contracts have “obfuscated” the negative equity amount.²³⁷

The result of applying the dual status rule to a 910 claim is a bifurcation of the creditor’s claim into secured and unsecured components. These courts completely protect the amount of the creditor’s 910 claim as mandated by the hanging paragraph²³⁸ and only bifurcate the negative equity for unsecured treatment.²³⁹ Other courts take a different approach.

231. *In re Petrocci*, 370 B.R. 489, 495–96 (Bankr. N.D.N.Y. 2007) (quoting *In re Peaslee*, 358 B.R. 545, 556 (Bankr. W.D.N.Y. 2006)) (expressing a belief that Congress would protect unsecured creditors).

232. *Id.* at 496 (quoting *In re Peaslee*, 358 B.R. at 556).

233. *In re Pajot*, 371 B.R. 139, 157–58 (Bankr. E.D. Va. 2007).

234. *Id.*

235. *See, e.g., In re Acaya*, 369 B.R. at 571 (noting the applicability of such a statute in California).

236. *See, e.g., In re Graupner*, 356 B.R. 907, 922–23 (Bankr. M.D. Ga. 2006) (holding that “price” may include negative equity, among other items such as warranties, taxes, and other charges, without requiring clear delineation).

237. *In re Pajot*, 371 B.R. at 158 (reserving the right to use transformation, discussed *infra* Part IV.D, where allocation is uncertain). In “creative creditor” cases, transformation avoids the “evidentiary nightmare” of dissecting the contract to find a negative equity value that application of the dual status rule would require. *In re Peaslee*, 358 B.R. 545, 560 (Bankr. W.D.N.Y. 2006).

238. This is both the fair market value of the collateral, as well as the amount the debtor may owe in excess of the value of the collateral minus the negative equity. *In re Pajot*, 371 B.R. at 163.

239. In this majority line of cases, the negative equity may only receive the same few pennies on that dollar that any other unsecured claim receives. *See, e.g., In re Conyers*, 379 B.R. 576, 582 (Bankr. M.D.N.C. 2007) (preserving 910 claim per intent of Hanging Paragraph but jettisoning the negative equity to the pool of unsecured claims); *In re Hayes*, 376 B.R. 655, 676 (Bankr. M.D. Tenn. 2007) (same); *In re Acaya*, 369 B.R. at 571 (same); *Citifinancial v. Hernandez-Simpson (In re Hernandez-Simpson)*, 369 B.R. 36, 48 (D. Kan. 2007) (same); *In re Vega*, 344 B.R.616, 623 (Bankr. D. Kan. 2006) (same).

D. The Transformation Rule and Negative Equity

The UCC does not mandate application of the dual status rule in *consumer goods* transactions,²⁴⁰ instead offering courts and legislatures the opportunity to choose the alternate “transformation” rule.²⁴¹ This rule states that a PMSI loses its purchase-money status and is “transformed” into an ordinary security interest when a secured creditor uses the collateral to secure a debt *beyond* the collateral’s price.²⁴² Thus, the presence of negative equity transforms all the funds into nonpurchase money funds;²⁴³ none of the funds qualify for protection by the hanging paragraph. The debtor’s plan may treat the car claim as if it were not a 910 claim, bifurcating for unsecured treatment both (1) the negative equity financed from the preceding vehicle; and (2) the difference between the current value of the car and the amount owing on that purchase.²⁴⁴ The result of application of the transformation rule is as if the BAPCPA amendments never happened. Cramdown is reborn.

The transformation rule is attractive to bankruptcy judges because it does not invite the court to peer into a transaction to discern the parties’ intent. As the Eleventh Circuit has stated, “[T]he court should not be required to distill from a mass of transactions the extent to which a security interest is purchase money.”²⁴⁵ When faced with the choice between applying the dual status rule and the transformation rule to negative equity scenarios, a few courts decline to “unwind[] the manipulations”

240. U.C.C. § 9-103(h) cmts. 4, 8 (2007).

241. U.C.C. § 9-103 cmt. 8 (2007). Where it is used in bankruptcy, the transformation rule appears almost exclusively in the consumer, rather than the commercial, context. *But see* Southtrust Bank of Ala., Nat’l Ass’n v. Borg-Warner Acceptance Corp., 760 F.2d 1240, 1242 (11th Cir. 1985) (“We see no reason to limit [the transformation rule] to consumer bankruptcy cases.”). The dual status rule is mandated for *non-consumer* transactions. *See supra* note 222 (discussing the application of the dual status rule).

242. *See* Geist v. Converse County Bank (*In re Geist*), 79 B.R. 939, 941–43 (D. Wyo. 1987) (discussing the rationale behind the transformation rule).

243. *In re Price*, 363 B.R. 734, 745–46 (Bankr. E.D.N.C. 2007), *aff’d in part, rev’d in part*, Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re Price*), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007); *In re Graupner*, 356 B.R. 907, 914 (Bankr. M.D. Ga. 2006) (“Under the transformation rule, . . . any claimed purchase money security interest is destroyed unless there is some contractual or state law method for determining the extent of the purchase money security interest.”); *cf.* Dominion Bank of the Cumberland, NA v. Nuckolls, 780 F.2d 408 (4th Cir. 1985) (applying the transformation rule under circumstances where purchase money and nonpurchase money are mixed; interim changes in UCC Article 9 now place this decision in question).

244. *In re Price*, 363 B.R. at 746 (determining that a plain reading of the statute permits transformation to apply, leading to complete cramdown to collateral value).

245. *Southtrust Bank of Ala.*, 760 F.2d at 1243 (quoting *In re Coomer*, 8 B.R. 351, 355 (Bankr. E.D. Tenn. 1980)).

of creditors and distinguish between the negative equity and the “mystery” that is the vehicle’s true purchase price.²⁴⁶ These decisions, such as *In re Price*, recognize the difficulty of allocating prebankruptcy contract payments to price or negative equity and hold everything to be nonpurchase-money.²⁴⁷ Some courts adopting the transformation rule acted specifically in response to the difficulties other courts faced in applying the dual status rule.²⁴⁸ For instance, in *Westfall I*, the court preferred transformation in the consumer context because of the “vast difference in the level of sophistication between the parties.”²⁴⁹

Application of the transformation rule, where negative equity exists alongside a PMSI, results in all funds being transformed into nonpurchase money funds.²⁵⁰ Disqualified from the hanging paragraph, the prohibition against bifurcation and cramdown evaporates.²⁵¹ The *Pajot* court noted the transformation rule would “re-enable debtors to cram down the secured claim to the collateral value, meaning the hanging paragraph would be completely ineffective as to almost half of the vehicle financing transactions it was designed to address.”²⁵² The creditor protection Congress sought to provide against debtors incurring significant secured obligations in anticipation of a bankruptcy cramdown would become moot under the

246. *In re Blakeslee*, 377 B.R. 724, 730 (Bankr. M.D. Fla. 2007) (citing *In re Price*, 363 B.R. at 745; *In re Peaslee*, 358 B.R. 545, 560 (Bankr. W.D.N.Y. 2006)).

247. *See In re Price*, 363 B.R. at 746 (pointing out that the court must fix values to both original and replacement cars as well as “ascertain how pre-bankruptcy payments should be allocated to the purchase money and non-purchase money components of the secured debt”). *But see In re Honcoop*, 377 B.R. 719, 724 (Bankr. M.D. Fla. 2007) (foregoing pre-petition allocation and removing entire value of original nonpurchase money from claim).

Other courts that choose to apply the dual status rule resolve this issue by simply prorating the claim. They first determine what percentage of the total amount originally financed qualified as a purchase-money obligation and what amount was negative equity. The courts then apply the percentages to the outstanding claim presented to the court—the resulting negative equity figure is stripped out and treated as unsecured. *See, e.g., In re Brodowski*, 391 B.R. 393, 403 (Bankr. S.D. Tex. 2008) (describing the calculations under the Dual Status rule).

248. *See In re Westfall (Westfall I)*, 365 B.R. 755, 762–63 (Bankr. N.D. Ohio 2007) (noting that transformation was ultimately reconsidered and rejected in favor of the dual status rule during the pendency of this case); *In re Westfall (Westfall II)*, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007) (adopting the dual status rule through the hanging paragraph).

249. *Westfall I*, 365 B.R. at 763. *But cf. In re Pajot*, 371 B.R. 139, 158 (Bankr. E.D. Va. 2007) (finding the transformation rule “laudable for its simplicity, but perhaps is too overbroad”).

250. *In re Blakeslee*, 377 B.R. at 731.

251. *Id.*; *In re Price*, 363 B.R. at 746; *Westfall I*, 365 B.R. at 764.

252. *In re Pajot*, 371 B.R. at 159.

transformation rule.²⁵³ The *Price* court's use of the transformation rule has since been reversed,²⁵⁴ and the few courts following *Price* prior to its reversal have either been reversed²⁵⁵ or have later reconsidered their rulings.²⁵⁶

Defining negative equity as nonpurchase-money has resulted in this disparity of treatment under either the dual status rule or the transformation rule, but not every court disqualifies negative equity from purchase-money status.

E. Negative Equity Qualifies as a Purchase Money Obligation

Another line of cases holds that negative equity is a component of the price given by the debtor to enable her to acquire rights in a 910 vehicle, thus securing the PMSI status required for hanging paragraph creditor protection. In the emerging four-way split of authority, this line of cases appears to draw the second most number of supporters.²⁵⁷ The leading case, *In re Graupner*, extensively discussed the nature of "price" as a component in the determination of a PMSI.²⁵⁸

The *Graupner* court's focus on determining whether negative equity was a component of price started where all previously discussed cases began—the state's adopted version of UCC § 9-103.²⁵⁹ The *Graupner* court, unlike other similarly situated

253. *Id.* at 165.

254. Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re Price*), No. 5:07-CV-133-BR, 2007 WL 5297071, at *4 (E.D.N.C. Nov. 14, 2007).

255. *See, e.g., In re Blakeslee*, 377 B.R. at 724, *rev'd, In re Schwalm*, 380 B.R. 630, 634–35 (Bankr. M.D. Fla. 2008).

256. *Westfall I*, 365 B.R. at 755, *abrogated by In re Westfall (Westfall II)*, 376 B.R. 210, 220–21 (Bankr. N.D. Ohio 2007).

257. *In re Brodowski*, 391 B.R. 393, 395 n.1 (Bankr. S.D. Tex. 2008); *see, e.g., In re Petrocci*, 370 B.R. 489, 505 (Bankr. N.D.N.Y. 2007) (financing greater than purchase price does not destroy PMSI); *In re Cohrs*, 373 B.R. 107, 110–11 (Bankr. E.D. Cal. 2007) (financing greater than price was still "value given"); *In re Graupner*, 356 B.R. 907 (Bankr. M.D. Ga. 2006) (addressing the issue as a matter of first impression).

258. *See In re Graupner*, 356 B.R. at 917–23. The court repeatedly returned to the idea that "a purchase money security interest cannot exceed the *price* of what is purchased in the transaction wherein the security interest is created." *Id.* at 914 (quoting *In re Manuel*, 507 F.2d 990, 993 (5th Cir. 1975)).

259. GA. CODE ANN. § 11-9-103 (2002). The Georgia statutory language, including the adopted comments, was identical to that of Kansas, where *In re Vega*, 344 B.R. 616 (Bankr. D. Kan. 2006), which endorses the dual status rule, was previously decided. *See In re Graupner*, 356 B.R. at 915 (noting that the similar facts of *Vega* were "squarely on point"). The states of Virginia (*Pajot*—dual status), New York (*Peaslee II*—fully secured), North Carolina (*Price*—transformation, *Conyers*—dual status), and Ohio (*Westfall II*—dual status) have adopted essentially the same statutory language yet reached disparate results in application on this point. *In re Pajot*, 371 B.R. at 149 n. 14. Texas has adopted identical language, and Texas bankruptcy courts have applied the dual status rule. *E.g., In re Brodowski*, 391 B.R. at 401–02.

courts, determined that the language of Official Comment 3, concerning items included in the price, was ambiguous.²⁶⁰ Citing the rule of *in pari materia*,²⁶¹ the court then looked elsewhere in Georgia statutes, specifically the recently amended Motor Vehicle Sales Financing Act, which indicates that “cash sale price” may include “any amount paid . . . to satisfy . . . a security interest in a motor vehicle used as a trade-in.”²⁶² The court found that characterizing negative equity as a component of the price was not an unreasonable determination given other pronouncements of the state legislature.²⁶³ The court thus granted the negative equity component purchase-money status and hanging paragraph protection from bifurcation.²⁶⁴

Subsequent courts in other states seized on the *Graupner* rationale and its use of the doctrine of *in pari materia* to hold that negative equity was a component of price, therefore justifying purchase-money status.²⁶⁵ Courts holding that negative equity qualifies for purchase-money status use the hanging paragraph to protect the creditor from any diminishment of their

260. *In re Graupner*, 356 B.R. at 919 (“[T]he exact meaning of the term ‘price,’ as found in [Georgia’s version of the UCC] is not clear from a plain reading of the statute.”).

261. Where ambiguity exists, “all statutes relating to the *same* subject-matter . . . [should] be read, construed, and applied together, and harmonized wherever possible, so as to ascertain the legislative inten[t] and give effect thereto.” *Id.* at 918 (emphasis added).

262. *Id.* (quoting GA. CODE ANN. § 10-1-31(a)(1) (2000)) (emphasis omitted).

263. *Id.* at 923.

264. *Id.*

265. See, e.g., *Gen. Motors Acceptance Corp. v. Peaslee (In re Peaslee)*, 373 B.R. 252, 261 (W.D.N.Y. 2007) (applying the doctrine of *in pari materia* in order to conclude that “the term ‘price,’ as used in U.C.C. § 9-103, should be given the same meaning as [the state law] definition of ‘cash sales price,’ which includes negative equity”); see also *In re Cohrs*, 373 B.R. 107, 110 (Bankr. E.D. Cal. 2007) (reasoning similarly based on CAL. CIV. CODE § 2981(e) (West 2006)). Courts were also willing to conclude that financing of negative equity was “value given to enable the debtor to” make the purchase, creating a nexus sufficient to grant the negative equity purchase-money status. See, e.g., *In re Petrocci*, 370 B.R. 489, 499–500 (Bankr. N.D.N.Y. 2007) (concluding that negative equity financing was “inextricably linked to the financing of the new car” because “one would not take place without the other”); *In re Cohrs*, 373 B.R. at 110.

The Second Circuit recently stayed *Peaslee* and certified the question of whether or not negative equity was a component of price paid to the New York Court of Appeals. *Peaslee v. GMAC, LLC*, 547 F.3d 177, 186–87 (2d Cir. 2008). While the court considered using the doctrine of *in pari materia* as the bankruptcy court had, it ultimately decided to request state guidance on such “exquisitely state law issues.” *Id.* at 186.

Other courts have considered the doctrine of *in pari materia* and, upon reading other state statutes suggested by the creditor, determined the statutes did not address the *same* subject matter as the UCC PMSI provisions. In *Brodowski*, the court found the Texas Motor Vehicle Installment Sales provision to be a consumer protection statute, not a statute regulating security interests. *In re Brodowski*, 391 B.R. 393, 399 (Bankr. S.D. Tex. 2008). Because the statute did not address the same subject matter as the UCC, reading the two together, *in pari materia*, would be improper. *Id.*

910 claim.²⁶⁶ The antecedent debt, originally associated with a vehicle no longer owned by the debtor, receives preferred secured status in Chapter 13 proceedings and must be paid in full by the debtor retaining the vehicle before she exits bankruptcy.²⁶⁷ Because the available pool of funds to pay unsecured creditors is limited to the debtor's discretionary income after paying secured claims, granting the negative equity secured status often has the effect of reducing what can be paid to the remaining unsecured creditors.²⁶⁸

The *Graupner* decision was recently affirmed by the circuit court—the first negative equity case to reach this level.²⁶⁹ Nevertheless, *in pari materia* inquiry into other statutes remains highly state specific; a bankruptcy court in another state in the same circuit has since declined to follow the rationale in *Graupner*.²⁷⁰ Yet another court avoids these inquiries altogether.

F. A Minority of Courts Hold the Hanging Paragraph Is a Narrow Exception

A well-reasoned opinion carefully interpreting the explicit language of the Code in a holistic manner was recently issued by a bankruptcy court in the Western District of Texas.²⁷¹ Judge Leif Clark's decision in *In re Sanders* fully surveyed all the existing case law and essentially treated negative equity in a manner similar to the dual status rule, holding it was not purchase money.²⁷² His analysis diverged from existing case law at this point. Judge Clark read the hanging paragraph as a narrow exception to the otherwise normal treatment of secured claims addressed in Chapter 13.²⁷³ Failure of a creditor's claim to satisfy each and every one of the requirements (motor vehicle,

266. See, e.g., *In re Peaslee*, 373 B.R. at 261 (“[T]he hanging paragraph prohibits the bifurcation of any claim if the debt is secured by a PMSI.”).

267. See *supra* notes 71–72 and accompanying text.

268. Generally, secured creditors are paid in full over the duration of the plan. 11 U.S.C. § 1325(a) (2006). Unsecured creditors may be paid fully, or may only receive a percentage of what is owed them if the debtor is committing all “projected disposable income” to these creditors during the applicable plan period. See 11 U.S.C. § 1325(b)(1) (2006). The remaining unpaid balance is discharged upon the debtor's completion of the plan. See 11 U.S.C. §§ 524, 1325(b)(1), 1328 (2006); see also 11 U.S.C. § 523 (2006) (providing various exceptions to discharge).

269. *In re Graupner*, 537 F.3d 1295, 1296, 1303 (11th Cir. 2008).

270. *In re Busby*, 393 B.R. 443, 451–52 (Bankr. S.D. Miss. 2008).

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

272. *Id.* at 856–57.

273. *Id.* at 859 (noting the hanging paragraph describes itself as an exception).

purchased in 910-day period, PMSI, for personal use) disqualified the claim from the hanging paragraph's narrow exception.²⁷⁴

Judge Clark's opinion focused on the larger hanging paragraph phrase "purchase money security interest *securing the debt that is the subject of the claim.*"²⁷⁵ Relying on this language, he held that the debt on the retained motor vehicle may *only* be the PMSI, stating that the hanging paragraph "thus requires 'the debt' to be secured by a PMSI—not 'a part of the debt or 'any portion of the debt or 'that portion of the debt, all phrases that would deliver very different outcomes."²⁷⁶ Arguing that exceptions are to be construed narrowly and must be read within the plain meaning of the language Congress used to create them,²⁷⁷ Judge Clark found that the hanging paragraph was unambiguous in requiring the 910 debt subject to the claim to only be a PMSI debt.²⁷⁸ If the debt also contained negative equity funds, the claim failed to satisfy every requirement for the narrow exception and would thus revert to the standard § 506(a) bifurcation treatment.²⁷⁹

The opinion recognized that the resulting treatment of the negative equity claim by this reasoning was the same as if the transformation rule had applied instead—the claim may be bifurcated and only the fair market value of the collateral would be paid in full.²⁸⁰ Judge Clark argued that the strength in the distinction he made was that his decision rested solely on the language of the Bankruptcy Code and did not require interpretation of the UCC transformation or dual status rules, which might vary state by state.²⁸¹ He was not bothered that this "all-or-nothing" interpretation returned many parties to the position they occupied before the BAPCPA amendments. Believing the hanging paragraph to be the exception—not the

274. *See id.* (relying on the conditional word "if" preceding the hanging paragraph's list of requirements to support this rationale).

275. 11 U.S.C. § 1325(a)(*) (2006) (emphasis added).

276. *In re Sanders*, 377 B.R. at 859–60 (arguing congressional word choice of the broad "if" precludes any "to the extent" dual status argument).

277. *Id.* at 859 (citing *Scarborough v. Chase Manhattan Mortgage Corp. (In re Scarborough)*, 461 F.3d 406, 411 (3d Cir. 2006)).

278. *Id.* at 860. The court indicated a PMSI was to be given the normal plain meaning from state law, but subsequently, the application analysis returned to federal bankruptcy law. *Id.*

279. *Id.* (determining that the creditor is not protected because "not all of the debt is secured by a PMSI" and that the claim is "not the type of claim protected by the hanging paragraph").

280. *Id.* at 860 n. 21 (recognizing his was a "subtle distinction").

281. *Id.* (citing the narrow cramdown prohibition of a home mortgage on a principal residence found in 11 U.S.C. § 1322(b)(2) (2006) as such an example).

rule—he pointed out another instance in which Congress created a similarly limited exception.²⁸²

Whether this opinion will draw adherents is uncertain. To date, only a few cases have followed the opinion.²⁸³ *In re Hayes* acknowledged the decision but declined to follow it in favor of the dual status rule.²⁸⁴ *In re Mitchell* first acknowledged the *Hayes* opinion but found Judge Clark's opinion in *Sanders* more persuasive.²⁸⁵ Extensively citing the analysis of *Sanders*, Chief Judge Paine held that the hanging paragraph was an unambiguous, narrow exception, and the presence of negative equity meant the creditor's claim was disqualified from bifurcation protection.²⁸⁶

G. The State of State Solutions: Some Absurd Results, a Few Punished Creditors, and a Glimmer of Reason

The diverse interpretations and approaches courts have adopted to address the negative equity problem in 910 claims make the surrender issues discussed in Part III seem tame by comparison. The transformation rule cases and the *Sanders* case essentially reject hanging paragraph application to perhaps 50% of claims to which it might apply.²⁸⁷ Yet it is hard to imagine that Congress would spend eight years crafting BAPCPA to protect car creditors but wholly fail to protect the half of these transactions that include negative equity. Certainly, if excepting half of the transactions was Congress's intent, such a sweeping action would have merited some small mention in the admittedly slim legislative history of BAPCPA.

282. *Id.* at 861–62 (citing the narrow cramdown prohibition of a home mortgage on a principal residence found in 11 U.S.C. § 1322(b)(2) (2006) as such an example).

283. *In re Look*, 383 B.R. 210, 220–21 (Bankr. D. Me. 2008); *In re Mitchell*, 379 B.R. 131, 138 (Bankr. M.D. Tenn. 2007). Far more courts have evaluated the decision and praised its scholarship, though ultimately declining to follow it. *See, e.g., In re Graupner*, 537 F.3d 1295, 1300–01 (11th Cir. 2008); *In re Penrod*, 392 B.R. 835, 847, 858 (B.A.P. 9th Cir. 2008); *In re Steele*, No. 08-40282-DML-13, 2008 WL 2486060, at *4 (Bankr. N.D. Tex., Jun. 12, 2008) (“While Judge Clark’s analysis is persuasive, logically defensible and, indeed, represents a *tour de force* of statutory construction, this court respectfully disagrees with the result he reaches.”).

284. *In re Hayes*, 376 B.R. 655, 676 n.30 (Bankr. M.D. Tenn. 2007).

285. *In re Mitchell*, 379 B.R. at 138–39. Both *Hayes* and *Mitchell* originated in the same courthouse in the Middle District of Tennessee, albeit from different judges who share the docket.

286. *Id.* at 142; *see also* The Honorable Nancy C. Dreher, *BAPCPA in the Courts*, BANKR. SERV. CURRENT AWARENESS ALERT, Oct. 2008 (“The [*Mitchell*] court found the language of the hanging paragraph unambiguous in this regard and further said that, if it is in any way ambiguous as a matter of legislative construction, ambiguities favor a more narrow construction.”).

287. *Supra* notes 252, 280–282 and accompanying text.

Bankruptcy judges such as Clark and Paine may simply be frustrated with attempting to divine what Congress intended with the sloppily drafted hanging paragraph and chose to give Congress what it said, rather than what it meant.²⁸⁸ Despite the great logic underpinning these decisions, given the appearance of the hanging paragraph in a section of the amendments entitled “Restoring the Foundation of Secured Credit,”²⁸⁹ a *Sanders* result permitting § 506(a) bifurcation fails to restore any such foundation and may rightly be described as absurd.

The need for clarity on the negative equity situation is becoming urgent as various interpretations mushroom. One of the primary reasons debtors enter Chapter 13 is to protect and retain their secured property, such as a car.²⁹⁰ With the 26% to 38% prevalence of negative equity financing in car notes that creditor GMAC mentioned in *In re Peaslee*,²⁹¹ this issue extensively affects bankruptcy debtors and creditors alike. The emerging schisms cannot adequately be described as resting on the differences of state PMSI laws when two courts operating in the same building can treat negative equity in such opposing manners.²⁹²

The most rational solution is the consistent application of the dual status rule to negative equity claims. This would provide clarity and reliability to all parties. The dual status rule would most clearly enact the hanging paragraph directive to protect a creditor from cramdown of the *value of the vehicle* securing the loan. UCC endorsement of the dual status rule for commercial transactions and some states’ subsequent extension of the rule to consumer transactions indicate that application of the rule is well understood. While the creditor may argue that negative equity is a component of the new car purchased, the debt is inextricably related to a vehicle that the debtor no longer possesses.²⁹³ To treat it otherwise is a conceit. The dual status rule would protect funds borrowed for the car described by the hanging paragraph, but no more.

The dual status rule also recognizes the extensive role that state law plays in property rights. Under state law, a debtor

288. *In re Sanders*, 377 B.R. 836, 864 (Bankr. W.D. Tex. 2007) (strict construction “comports best with accepted canons of statutory construction”).

289. BAPCPA, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005) (codified at 11 U.S.C. § 1325(a)(*) (2006)).

290. See Porter, *supra* note 177, at 1025–26.

291. See *supra* note 186 (discussing creditor brief).

292. See discussion *supra* note 285.

293. *Supra* notes 219–220 and accompanying text.

whose car was repossessed or surrendered outside bankruptcy could have an *unsecured* deficiency judgment entered against him for the amount of the negative equity.²⁹⁴ Application of the dual status rule to bifurcate the claim into PMSI and negative equity components inside bankruptcy would result in the negative equity receiving the same unsecured creditor treatment that the claim would receive outside of bankruptcy. This consistent treatment of claims best respects the state law origins of property rights.

The dual status rule most clearly supports one of the guiding principles of the Bankruptcy Code: equality among like creditors.²⁹⁵ Decisions such as *Graupner* and *Petrocci* have injured unsecured creditors by reasoning that negative equity is a component of the secured obligation.²⁹⁶ The courts that converted this debt to secured status by holding it to be a part of the purchase price improperly placed this unsecured debt ahead of other similar unsecured debt. 910 car creditors already enjoy a significant preference because the hanging paragraph requires that their claims be paid fully when the debtor retains the vehicle, beyond the present value of the collateral securing the claim.²⁹⁷ By permitting these creditors to be repaid additional unsecured monies they advanced to debtors in order to promote their own interest in selling cars, the courts sanction stealing from the ever-shrinking pool of funds available to pay unsecured creditors. The *Pajot* court rejected this conversion of unsecured negative equity to secured status, stating, in dicta, that it permits the lenders to greatly improve their positions in an inappropriate measure.²⁹⁸ These unsecured creditors often do not have a benefit the car creditors enjoy—a strong lobby to protect their interests in Congress.²⁹⁹ Application of the dual status rule avoids this result.

Consistent application of the dual status rule would also result in discouraging vehicle lenders from rolling in ever-larger amounts of negative equity into car loans. Credit is a boon to our

294. See *supra* notes 75–76 (pursuing deficiency after foreclosure).

295. See discussion *supra* note 107.

296. *In re Graupner*, 537 F.3d 1295, 1303 (11th Cir. 2008); *In re Petrocci*, 370 B.R. 489, 504–05 (Bankr. N.D.N.Y. 2007).

297. See *supra* notes 71–72 (retention of vehicle context).

298. *In re Pajot*, 371 B.R. 139, 159–60 (Bankr. E.D. Va. 2007) (“If vehicle financiers were able to secure additional amounts of negative equity rolled into a transaction . . . , this would improve such a lender’s position greatly, arguably above . . . [other] lenders. The court does not believe Congress intended vehicle financiers to reap such a windfall.”).

299. Whitford, *supra* note 20, at 178–182 (discussing industry influence on BAPCPA).

capital society, allowing debtors to purchase and contribute to the growth of the economy.³⁰⁰ However, advance knowledge that negative equity could be bifurcated as an unsecured debt in a later bankruptcy filing would presumably deter a lender from being excessively “generous” with negative equity credit where marginally credit-worthy individuals are involved.³⁰¹

Other courts that fully secure the negative equity argue that creditors would be deterred from over-extending credit by the threat that a debtor might surrender the car in full satisfaction.³⁰² While this would be a powerful disincentive against predatory lending by car creditors, it also relies heavily on the eventual dominance of the *Ezell-Quick* analysis³⁰³ if it is to be effective. That dominance is far from certain.

Bankruptcy courts are courts of equity,³⁰⁴ and equity sometimes requires compromise. The dual status rule succeeds against all other options because it “is a compromise between the two extremes of either ‘rendering the hanging paragraph almost meaningless through the transformation rule or equipping the hanging paragraph with power beyond its intent by finding negative equity included in the definition of purchase-money security interest.’”³⁰⁵ Bankruptcy’s traditional debtor focus was shifted by BAPCPA to reflect greater creditor interests.³⁰⁶ Application of the dual status rule in negative equity financing

300. Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT’L & COMP. L. REV. 1, 8–10 (2005) (chronicling the evolution of the U.S. free market system in relation to bankruptcy law and stating that “credit was in large part what defined capitalism”).

301. See *In re Pajot*, 371 B.R. at 164 (reasoning that protection of negative equity from cramdown incentivizes predatory and unscrupulous creditors). At the end of 2008, the average amount financed on car loans had climbed to 99%, meaning many consumers are financing sums much greater than the value of their vehicles. Jim Quinn, *Has America Jumped the Shark?*, NOLAN CHART, Dec. 9, 2008, <http://www.nolanchart.com/article5622.html>. The economic downturn of 2008–2009 portends soaring losses on auto loans that have been packaged and securitized, much like the toxic mortgage debt that precipitated the current crisis. *Id.* Court actions that permit auto lenders to confer secured status on unsecured debt like negative equity further incentivize excessive, unhealthy consumer debt and injure unsecured creditors at a time when some of them are facing a doubling of their losses to \$96 billion as write-offs in 2009. *Id.*

302. *In re Petrocci*, 370 B.R. 489, 505 (Bankr. N.D.N.Y. 2007).

303. See *supra* Part III (outlining the *Ezell* and *Wright* approaches).

304. *Young v. United States*, 535 U.S. 43, 50 (2002).

305. *In re Conyers*, 379 B.R. 576, 582 (Bankr. M.D.N.C. 2007) (quoting *In re Pajot*, 371 B.R. at 160).

306. See Daren Schlecter, *Before and After the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 Examined Under Recent Case Law: A Curse in Disguise for Consumers?*, 27 WHITTIER L. REV. 787, 788–90 (2006) (arguing that the strongest concern of Congress in enacting BAPCPA was prevention of fraud perpetrated on creditors by debtors).

would respect Congress's intent but also maintain a balance between secured creditors and similarly situated unsecured creditors who deserve an equal pro rata distribution of available funds.

V. CONCLUSION

Uncertainty about vehicle creditor treatment flourishes in the wake of the hanging paragraph. And, while parties may want some consistency, a *desire* for uniformity of federal law does not prove its *need*.³⁰⁷ Various approaches to surrendered vehicles could coexist from district to district. State-oriented solutions to the problem of negative equity could continue to thrive. Like treatment of creditors is only a principle.³⁰⁸

But federal need is different than creditor and debtor need. Creditors today are primarily large, interstate organizations operating in hundreds of judicial districts. Uniformity of application of the hanging paragraph would permit debtors and creditors to arrange their affairs with the reduced costs and uncertainty that attend litigation. Clarity is needed by these parties as to how to structure their dealings under the hanging paragraph.

Concerning surrendered vehicles: permitting Chapter 13 debtors to surrender 910 vehicles in full satisfaction, as the shrinking majority holds, somewhat balances the interests of secured creditors—who are fully paid if the car is retained—with the interests of the unsecured creditors—who get paid from a greater pool of funds if the car is surrendered.³⁰⁹ Surrender in full satisfaction is in keeping with the unambiguous language of the hanging paragraph³¹⁰ and does not require courts to intuit a legislative intent when Congress was silent.³¹¹

Concerning negative equity and retained vehicles: treatment of negative equity as a dual status unsecured claim also has the benefit of balancing the interests of secured and unsecured creditors and adhering to the explicit language of the hanging

307. *Atherton v. FDIC*, 519 U.S. 213, 219–20 (1997) (“To invoke the concept of ‘uniformity,’ however, is not to prove its need.”).

308. *See supra* note 107 (discussing fairness principles).

309. *See supra* notes 173–174 and accompanying text (discussing balancing of interests).

310. *See supra* notes 54–55 and accompanying text.

311. Courts attempting to infer auto lender bias of the hanging paragraph might well heed the cautionary words of Judge Preston in *In re Payne*: “Silence in the legislative history cannot be utilized to create an ambiguity in the statutory language.” *In re Payne*, 347 B.R. 278, 282 (Bankr. S.D. Ohio 2006).

paragraph.³¹² Secured creditors already have extensive protection in bankruptcy; permitting them to pick and choose unsecured debt for better treatment is inappropriate and improperly injures all unsecured creditors, whether they are a large credit card issuer or a local painting company.

It is doubtful that Congress can marshal interest to revise the Bankruptcy Code again so soon on the heels of BAPCPA, although the historic 2008 economic meltdown and subsequent Democratic electoral sweep might prove to be sufficient impetus. In the meantime, appellate courts may have to serve as the conduits of uniformity and should carefully consider the thoughtful and reasoned conclusions the slim majority of trial courts have reached. These decisions rely on the explicit language of the Code and the practical wisdom of bankruptcy judges crafting solutions on a daily basis.

J. Mark Deaton

312. See *supra* notes 295–299 and accompanying text.