SECURED AUTOMOBILE CLAIMS

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MOTOR VEHICLES UNDER CHAPTER 13 OF THE BANKRUPTCY CODE

The Hanging Paragraph

- Prior to the 2005 amendments (BAPCPA), Bankruptcy Code § § 1325(a)(5) and 506(a)(1) allowed a Chapter 13 debtor to modify the rights of a financer with a PMSI in a motor vehicle by bifurcating the claim into secured and unsecured portions, based on the vehicle's value.

- In BAPCPA, Congress sought to remedy an abuse by consumers who bought vehicles on credit on the eve of bankruptcy and then utilized the cramdown provisions of the Bankruptcy Code to pay the secured vehicle financer a lesser amount than its full claim. To cure this abuse, Congress amended § 1325 to give motor vehicle financers special protection against cramdown.

- The operative language, found in an inelegant "Hanging Paragraph", provides:

> **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 [sic] 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 within the 1-year period preceding that filing.**

- The legislative provenance of the Hanging Paragraph clearly shows that the final result was a trade-off between unsecured creditors (who got big benefits from the "means testing" provisions of BAPCPA that force more consumer debtors from Chapter 7 into Chapter 13) and motor vehicle financers, who would otherwise lose ground as a result of the 2005 amendments.

- Congress chose not to define the key term "purchase money security interest" as used in the amended Bankruptcy Code. The courts have been mightily wrestling with it ever since.

- Intense judicial hostility to the hanging paragraph

Surrender of the Vehicle in Full Satisfaction of the Claim

- The first issue that emerged under the HP was whether a Chapter 13 debtor could surrender a 910-vehicle in full satisfaction of the secured debt, leaving the creditor with no unsecured deficiency claim.

- At first, the bankruptcy courts held almost uniformly that, with respect to 910-vehicles, there is no federal mechanism by which the secured debt can be split into a secured piece and an unsecured piece. Therefore, the right to assert an unsecured claim for the deficiency disappears.

- Then came Chief Judge Easterbrook's decision in In re Wright, 492 F.3d 829 (7th Cir. 2007). The Seventh Circuit held that a 910-debtor who surrendered a vehicle to the secured creditor was still on the hook. After getting the stay lifted, the creditor could proceed, under **state** law, with a UCC foreclosure sale and recover any deficiency as an unsecured claim in the debtor's Chapter 13 bankruptcy. In reaching this conclusion, the court focused on the legislative purpose of the HP:

> If the Wrights had surrendered their car the day before filing for bankruptcy, the creditor would have been entitled to treat any shortfall in the collateral's value as an unsecured debt. It is hard to see why the result should be different if the debtors surrendered the collateral the day after filing for bankruptcy when, given the hanging paragraph, no operative section of the Bankruptcy Code contains any contrary rule. Section 306(b) of the 2005 Act…which enacted the hanging paragraph is captioned "Restoring the Foundation for Secured Credit". This implies replacing a contract-defeating provision such as Section 506 (which allows judges rather than the market to value the collateral and set

> an interest rate, and may prevent creditors from repossessing) with the agreement freely negotiated between debtor and creditor. Debtors do not offer up any argument that "the Foundation for Secured Credit" could be "restored" by making all purchase-money loans non-recourse; they do not argue that non-recourse lending is common in consumer transactions, and it is hard to imagine that Congress took such an indirect means of making non-recourse lending compulsory.

- The Seventh Circuit decision has completely turned around the "surrender in full" issue in the courts. It has been uniformly followed by the five other federal appellate courts that have ruled on the issue. Capital One Auto Finance v. Osborn, 515 F.3d 817 (8th Cir. 2008); In re Long, 519 F.3d 288 (6th Cir. 2008)("Based upon the legislative history, there is little doubt that the 'hanging-sentence architects intended only good things for car lenders and other lienholders.'" (Quoting Judge Keith Lundin's Chapter 13 treatise.); In re Ballard, 526 F.3d 634 (10th Cir. 2008); Tidewater Finance Co. v. Kenney, 531 F.3d 312 (4th Cir. 2008); In re Barrett, 543 F.3d 1239 (11th Cir. 2008).

Retention of the Vehicle and Elimination of Cramdown

[Note: the author of these materials represents motor vehicle financers in these cases]

- The fighting issue: Does the existence of "negative equity" (where the amount the debtor owes on the trade-in vehicle exceeds the trade-in allowed, and the dealer finances that difference as part of the package deal) destroy or reduce the dealer's PMSI in the new vehicle? The answer turns on the scope of the term "purchase-money security interest". At the current time, the case law on this contentious issue is huge and is pretty much split down the middle, though the only federal appellate court to decide the issue has concluded that NE is protected as part of a PMSI. Graupner v. Nuvell Credit Corp., 537 F.3d 1295 (11th Cir. 2008). Other leading cases protecting NE include GMAC v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007); GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008) and Nuvell Credit Corp. v. Muldrew, 396 B.R. 915 (E.D. Mich. 2008). The leading cases finding that NE is not protected include In re Penrod, 392 B.R 835 (9th Cir. BAP 2008) and In re Sanders, 377 B.R. 836 (Bankr. W.D. Tex. 2007)(court finds that NE isn't part of a PMSI under the UCC, then invokes a "federal transformation rule" to disqualify the vehicle financer's entire secured claim). In addition to having been decided in the 11th Circuit, the NE issue is currently before seven other federal appellate courts (2d Circuit, 4th Circuit, 5th Circuit, 6th Circuit, 8th Circuit, 9th Circuit and 10th Circuit).

- Does "negative equity" include cash rebates and down payments? The concept of "gross NE" vs. "net NE".

- Who are the opponents of the vehicle financers? Is it debtors or is it unsecured creditors?

Elements of the UCC Analysis

- Most courts hold that, in determining the scope of the critical term PMSI for purposes of the hanging paragraph, they should rely heavily on Article 9 of the UCC, where the term has existed for decades. Under Revised Article 9, a security interest in goods is a purchase-money security interest to the extent that the goods are "purchase-money collateral." In turn the term purchase-money collateral means goods that secure a "purchase-money obligation incurred with respect to that collateral." Finally, the term "purchase-money obligation" means "an obligation of an obligor incurred as all or part of the **price** or **for value given to enable the debtor to acquire rights in or the use of the collateral** if the value is in fact so used." (Emphasis added.)

- Official Comment 3 to Section 9-103 of the UCC elaborates:

> 3. Subsection (a) defines "purchase-money collateral" and "purchase-money obligation." These terms are essential to the description of what constitutes a purchase-money security interest under subsection (b). As used in subsection (a)(2), the definition of "purchase-money obligation" the "price" of the collateral or the "value given to enable" **includes obligations for expenses incurred in connection with acquiring rights in the collateral,** sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.
>
> The concept of "purchase-money security interest" requires a **close nexus between the acquisition of collateral and the secured obligation.** Thus, a

> security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price. (Emphasis added.)

- Do the statutory text and the Official Comment contemplate negative equity as a "purchase-money obligation"? In wrestling with this bottom-line issue, the courts have considered a number of factors:

- The two prongs--(1) price and (2) value given—relate to "sales" transactions and "loan" transactions respectively under the old version of Article 9, but are now conflated. How all of the case law thus far involves the assignment of installment sales contract from a dealer to a vehicler financer like GMAC or Ford Motor Credit. These installment transactions are properly treated as **sales** rather than **loans**, so that the "price" prong is particularly relevant, even though both prongs apply.

- Does the "value to enable" prong protect only value that is essential to the financing?

- The broad term "obligations for expenses incurred in connection with acquiring rights in the collateral." Is it proper to fire the *ejusdem generis* canon of statutory construction? In other words, is the broad introductory phrase limited by the items that follow in the list?

- Historically, the favored status of the PMSI, as explained brilliantly in Gilmore, *The Purchase Money Priority*, 76 Harv. L. Rev. 1333(1963).

- How the term "price", which includes items like finance charges and attorney's fees, is not limited to a layman's understanding of the term. It is a term of art.

- Why was negative equity not included in the list in Comment 3?

- The "close nexus" test and the example of rolling in unrelated credit card debt as part of the financing package.

- Is the obligation for NE an "antecedent debt"? Is it one transaction or two?

- The impact of UCC 1-102, 1-103, which urges courts to construe the UCC to promote its "underlying purposes and policies", and to encourage "the continued expansion of commercial practices through custom, usage and agreement of the parties".

- If NE is not a purchase-money obligation, is the vehicle financer's **entire** obligation disqualified from protection under the HP? This is the "transformation rule". UCC 9-626 opts for the "dual-status" rule in commercial transactions, but punts the issue to the courts if the transaction is consumer in nature.

How Revealing is the Legislative History of the Hanging Paragraph?

- Some courts suggest that the HP has no discernible legislative history, but a closer look reveals otherwise. Some courts suggest that it should be construed narrowly, as an exception to the general principle of cramdown.

- The recitals on the legislation, including "Restoring the Foundation for Secured Credit", "Giving Secured Creditors Fair Treatment in Chapter 13 Bankruptcy" and "Preventing Cramdown Abuse", suggest a strong pro-vehicle financer policy.

- The cases have emphasized the anti-bifurcation purpose of the HP. One leading decision, In re Dale, 2008 WL 4287058, S.D. Tex., August 14, 2008 (Civil Action No. H-07-3176. Bankruptcy Case No. H-07-32451.), holds that the language of the HP itself, when viewed against the background of the statute's anti-bifurcation purpose, requires a finding that, if any portion of the claim is PMSI, the whole claim must be protected from cramdown:

> This court agrees the statutory language is clear and unambiguous. A plain reading leaves no question that the hanging paragraph eliminates the federal remedy of bifurcation of claims into secured and unsecured. Further the paragraph fails to distinguish between debtors' options under § 1325(a)(5). Therefore, whether a debtor chooses to return to the creditor or retain a 910 vehicle, no lien stripping is available under federal law….The court declines to parse the statutory language and read into the paragraph's reference to "purchase money security interest" a newly enacted federal bifurcation remedy….because absent § 506's bifurcation mechanism no cramdown is available under federal law, the entire claim, not just the purchase money portion, is secured.

- Though some courts hold that the HP should be construed narrowly because it is an exception to the general rule of cramdown, the "grand compromise" provenance of the HP, coupled with the legislative recitals and captions, suggests that it should be liberally construed to give strong support to vehicle financers.

- Another argument in favor of including NE in a PMSI is the general principle that Congress is presumed to have known about contemporary industry practices and laws governing those practices. Goodyear Atomic Corp. v. Miller, 486 U.S. 174, (U.S. Ohio, May 23, 1988). Congress doesn't legislate in a vacuum. It's clear that the industry practice in 2005 was to include negative equity in a large percentage of new car financing packages. FDIC Supervisory Insights, *The Changing Landscape of Indirect Automobile Lending,* June 23, 5005 ("J.D. Power and Associates estimates that approximately 38 percent of new car buyers have [NE] at trade-in….") Given the prevalence of NE financing, the argument goes, denying it protection as part of a package deal would lead to an absurd result.

- Congress is also deemed to have known about other federal law applicable to vehicle financing when it enacted the HP. In 1999, Truth in Lending was amended to include detailed guidance authorizing vehicle creditors to disclose NE as part of the "Amount Financed" and the "Total Sale Price" under a retail installment contract. This was bank regulatory recognition of the prevalence of the practice.

The Impact of Retail Installment Sales Legislation

- Congress is also deemed to have known that, by 2005, 36 states had enacted retail installment sales acts that expressly authorized NE as part of the "cash price" or the "amount financed". This was a legislative recognition that NE bears a "close nexus" to vehicle financing, just like the financing of accessories, taxes and insurance.

- One of the big issues in the NE litigation around the country is the relevance of RISA legislation to the UCC definition of "purchase-money obligation". Should the two statutes be read *in pari materia* to support the argument that NE should be included as part of the "price" of the new vehicle under UCC 9-103? Do the UCC and the RISAs cover the same general subject matter?

Cases That Protect Negative Equity, Gap Insurance And/Or Service Contracts From Cramdown Under The Hanging Paragraph

1. In re Murray, 346 B.R. 237 (Bankr. M.D. Ga. 2006).

2. In re Johnson, 337 B.R. 269 (Bankr. M.D.N.C. 2/6/06).

3. In re Wible, Case No. 06-40017 (Bankr. M.D.Ga. 6/26/06).

4. In re Honeycutt, Case No. 06-48771 (Bankr. E.D. Mich. 11/2/06).

5. In re Petrocci, 370 B.R. 489 (Bankr. N.D.N.Y. 6/20/07).

6. In re Graupner, 537 F.3d 1295 (11th Cir. 8/6/08), *affirming* Graupner v. Nuvell Credit Corporation, 2007 WL 1858291 (M.D. Ga. 6/26/07); *affirming* In re Graupner, 356 B.R. 907 (Bankr. M.D. Ga., 12/21/06).

7. In re Cohrs, 373 B.R. 107, (Bankr.E.D.Cal. 7/31/07).

8. General Motors Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 8/15/07) (Peaslee II), *reversing* In re Peaslee, 358 B.R. 545 (Bankr. W.D.N.Y. 2007) (Peaslee I). After publishing Peaslee I, but prior to its reversal, Judge Ninfo published six more opinions that contain no new analysis and merely incorporate Peaslee I by attaching a copy of it. Although these decisions were effectively reversed by Peaslee II, they are sometimes still cited. The following are Judge Ninfo's six other opinions: In re Cassidy, 362 B.R. 596 (Bankr. W.D.N.Y. 3/1/07); In re Freeman, 362 B.R. 608 (Bankr. W.D.N.Y. 3/1/07); In re Phillips, 362 B.R. 612 (Bankr. W.D.N.Y. 3/1/07); In re Rodwell, 362 B.R. 616 (Bankr. W.D.N.Y. 3/1/07); In re Vanmanen, 362 B.R. 620 (Bankr. W.D.N.Y. 3/1/07); In re Grant, 359 B.R. 438 (Bankr. W.D.N.Y. 2/8/07). Peaslee II is on appeal to the Second Circuit which has certified it to the New York Court of appeals.

9. In re Wall, 376 B.R. 769 (Bankr. W.D.N.C. 9/17/07).

10. In re Watson, 2007 WL 287343 (Bankr.E.D.Cal. 9/27/07).

11. In re Bradlee, 2007 Bankr. LEXIS 3863 (Bankr. W.D.La. 10/10/07).

12. In re Macon, 376 B.R. 778 (Bankr.D.S.C. 10/19/07).

13. In re Spratling**,** 377 B.R. 941, (Bankr.M.D.Ga. 10/19/07).

14. In re Burt, 378 B.R. 352, (Bankr.D.Utah 10/24/07).

15. In re Gray, 379 B.R. 576 (Bankr. E.D. Tenn. 11/02/07).

16. In re Brei, 2007 WL 4104884, (Bankr. D. Ariz. 11/14/07).

17. In re Weiser, 381 B.R. 263 (Bankr. W.D. Mo. 12/18/07).

18. In re Schwalm, 380 B.R. 630 (Bankr. M.D.Fla. 1/16/08).

19. In re Vinson, 2008 WL 319678 (Bankr. D.S.C. 1/25/08).

20. In re Dunlap, 383 B.R. 113 (Bankr. E.D.Wis. 1/31/08).

21. In re Austin, 381 B.R. 892 (Bankr. D. Utah 2/12/08).

22. In re Townsend**,** 2008 WL 920610 (Bankr. D.Kan. 4/3/08).

23. In re Wilson, Case No. 07-27272-MDM (Bankr. E.D. Wis. 3/11/08).

24. In re Shockley, Case No. 07-15884 (Bankr. S.D. Ohio 4/29/08).

25. In re Ford, 387 B.R. 827 (Bankr. D.Kan. 5/8/08).

26. In re Myers, 393 B.R. 616 (Bankr. S.D. Ind. 6/13/08).

27. In re Hampton, Case No. 07-14990 (Bankr. S.D. Ohio 6/16/08).

28. In re Smith, Case No. 07-30540 (Bankr. S.D.Ill. 6/24/08).

29. GMAC v. Horne, 390 B.R. 191 (E.D.Va. 7/03/08) *reversing in part and remanding* In re Pajot, 371 B.R. 139, (Bankr. E.D. Va. 7/17/07) and In re LaVigne, 2007 WL 3469454 (Bankr. E.D. Va. 11/14/07).

30. In re Harless, 2008 WL 3821781 (Bankr.N.D.Ala. 8/13/08).

31. In re Dale, Case No. 4:07-cv-3176 (S.D. Tex. 8/14/08) *reversing* In re Dale, 07-32451-H5-13 (Bankr.S.D.Tex. 2007).

32. Nuvell v. Muldrew, 2008 WL 4458798 (E.D.Mich. 10/03/08).

B. Cases That Do Not Protect Negative Equity But Apply The Dual-Status Rule

1. In re Price, 363 B.R. 734, (Bankr.E.D.N.C., 03/06/07) *affirmed in part by* Wells Fargo North Carolina 1, Inc., v. Price, 2007 WL 5297071, Case No. 5:07-CV-133-BR (W.D.N.C. 2007).

2. In re Bray, 365 B.R. 850 (Bankr.W.D.Tenn. 4/11/07).

3. Citi Financial Auto v. Hernandez-Simpson, 369 B.R. 36 (D.Kan. 5/17/07).

4. In re Acaya, 369 B.R. 564, (Bankr.N.D.Cal. 5/18/07).

5. In re Conyers**,** 379 B.R. 576, Case No. 07-50855 (Bankr. M.D.N.C., 11/02/07), in the District Court the appeal is Case No. 1:08cv00230.

6. In re Hayes, 376 B.R. 655 (Bankr. M.D. Tenn. 11/1/07).

7. In re Johnson, 380 B.R. 236 (Bankr. D.Or. 12/18/07).

8. In re Wear, 2008 WL 217172 (Bankr. W.D. Wash. 1/23/08).

9. In re Riach, 2008 WL 474384 (Bankr. D. Or. 2/19/08).

10. Nuvell Credit Co., v. Callicott, 2008 WL 4878439 (E.D.Mo. 11/12/08) *affirming* In re Callicott, 386 B.R. 232 (Bankr. E.D.Mo. 4/14/08).

11. In re Padgett, 389 B.R. 203, (Bankr. D.Kan 5/27/08).

12. In re Munzberg, 388 B.R. 529, (Bankr.D.Vt. 6/3/08).

13. In re Hernandez, 388 B.R. 883 (Bankr. C.D.Ill. 6/9/08).

14. In re Steele, 2008 WL 2486060 (Bankr.N.D.Tex. 6/12/08).

15. In re Mancini**,** 390 B.R. 796 (Bankr.M.D.Pa., 7/15/08).

16. In re Bandura, 2008 WL 2782851 (Bankr.E.D.Ky. 7/15/08).

17. In re Penrod, 392 B.R. 835 (9th Cir. BAP 7/28/08).

18. In re Busby**,** 393 B.R. 443, (Bankr.S.D.Miss. 8/28/08).

19. In re Brodowski 391 B.R. 393 (Bankr. D.S.Tex. 7/22/08)

20. In re Mierkowski, 2008 WL 4449471 (Bankr. E.D. Mo. 9/29/08).

21. In re White, 352 B.R. 633 (Bankr. E.D. La. 9/29/06).

22. Nuvell Credit Corp., v. Westfall, Case Nos. 1:07CV3322 and 3313 (N.D.Ohio 10/27/08) *affirming* In re Westfall, 365 B.R. 755, (Bankr.N.D.Ohio, 3/30/07), adopted in part by In re Westfall, 376 B.R. 210 (Bankr.N.D.Ohio 9/24/07).

23. In re Crawford 39 7B.R. 461(Bankr. E.D. Wis. 10/28/08).

24. In re McCauley, 398 B.R. 41 (Bankr. D. Colo. 11/20/08).

25. In re Hargrove, 2008 WL 5170399 (Bankr. M.D. Tenn 12/10/2008).

C. Cases that Do Not Protect Negative Equity and Apply the Transformation Rule

1. In re Kellerman, 377 B.R. 302, (Bankr.D.Kan. 8/15/07).

2. In re Sanders, 377 B.R. 836, (Bankr.W.D.Tex. 10/18/07).

3. In re Mitchell, 379 B.R. 131 (Bankr. M.D.Tenn. 11/13/07).

4. In re Hunt, Case No. 07-200627 (Bankr. D. Kan. 8/13/07).

5. Bank of America v. Look, Case No. 2:08-cv-129 (D.Me. 7/17/08) *affirming* In re Look, 383 B.R. 210, Case No. 07-20355 (Bankr. D.Me. 3/6/08).

ELEVENTH CIRCUIT HOLDS THAT "NEGATIVE EQUITY" IS A PURCHASE-MONEY OBLIGATION

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For more than two years, no issue in consumer bankruptcy has been litigated more heavily than "negative equity". When a dealer finances acquisition of a consumer's new car, and rolls into the financing the amount by which the unpaid balance on a trade-in vehicle exceeds the trade-in allowance, does that negative number qualify for purchase-money treatment? That's a crucial question because only "purchase-money security interests" are protected from cramdown under the "hanging paragraph" of the Bankruptcy Code.

The litigation on this issue has been proceeding furiously apace, with the bankruptcy courts pretty much split down the middle. Finally, we now have a federal court of appeals decision, and the court rules squarely in favor of the auto financer. Graupner v. Nuvell Credit Corp., 537 F.3d 1295 (11th Cir. 8/6/08). Let's take a look.

The Graupner case. On June 23, 2005, Stephen Graupner purchased a 2005 Chevy Silverado pick-up truck from a dealer in Georgia. The vehicle was for his personal use and had a "cash price" of $32,919. The dealer agreed to finance the sale via a retail installment contract, with the seller retaining a security interest in the vehicle to secure the unpaid balance of the total sales price. As part of the transaction, Graupner traded in a 2002 Chevy Silverado truck. That vehicle had "negative equity" because Graupner owed $6,347 more on the vehicle than its then-market value. There was nothing in the record indicating to the court that the $6,347 negative equity number was not bona fide and reasonable in amount. The total sales price of the new vehicle included the negative equity, "which had the effect of increasing the purchase price." The total amount financed was $36,384. The dealer subsequently assigned the retail installment contract to Nuvell Credit Corporation, which perfected its security interest by getting its lien noted on the title to the new vehicle. Of course the dealer paid off the lien on the trade-in vehicle.

Less than a year later, on April 19, 2006, Graupner filed Chapter 13 bankruptcy. Nuvell filed its secured proof of claim, showing an amount due on the contract of $33,670. Graupner retained the vehicle and listed it on his schedules as being valued at $23,375. Graupner then proposed a Chapter 13 plan that sought to modify Nuvell's secured claim by bifurcating its into secured and unsecured portions based on the retail value of the vehicle. Nuvell objected to confirmation of the proposed plan, contending that its secured claim couldn't be modified through "cramdown" because it was protected by the hanging paragraph as a "purchase-money security interest". Graupner argued that the negative equity piece of the debt didn't qualify.

Eleventh Circuit: The hanging paragraph is highly protective of secured vehicle financers. The Eleventh Circuit began its opinion by explaining how the legislative history of the hanging paragraph "leaves little doubt that its 'architects intended only good things for car lenders and other lienholders.'" On this point, it cited a recent Sixth Circuit decision, In re Long, 519 F.3d 288 (6th Cir. 2008). The court also cited a leading New York decision, where the federal district court said: "To the extent it is possible to glean any Congressional intent behind the hanging paragraph…that intent…seems to be to protect creditors from the abuse of cramdown.'" GMAC v. Peaslee, 373 B.R. 252, 261 (W.D.N.Y. 2007).

The Eleventh Circuit also cited titles and captions of the legislation enacting the hanging paragraph, such as "Giving Secured Creditors Fair Treatment in Chapter 13" and "Restoring the Foundation for Secured Credit". The court concluded that, by these titles and captions, "Congress intended to take away the right of debtors to reduce their secured obligations on retained 910 vehicles to the value of the vehicles." In other words, Congress concluded that secured retail installment contracts on motor vehicles should be enforced in Chapter 13 as they are written, rather than being replaced by valuation of the vehicle at the time of bankruptcy. Only in this way can the "foundation for secured credit" be "restored". Chief Judge Easterbook makes the same point in a case dealing with a somewhat different issue ("surrender in full satisfaction"). In re Wright, 492 F.3d 829 (7th Cir. 2007).

The UCC broadly defines "purchase money security interest" to include negative equity. The court then turned to Article 9 of the UCC, which defines the term "purchase-money obligation" as "an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." UCC 9-103. This definition contains two prongs: (1) the price of the collateral and (2) value given to enable the debtor to buy the collateral. The vehicle financer only needs to satisfy one of the prongs to prevail. The court also turned to Official Comment 3, which explains:

> [T]he definition of "purchase-money obligation", the "price" of the collateral or the "value" given to enable" includes obligations for expenses incurred in connection with acquiring the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees and other similar obligations.

The court emphasized that the items in the list of "purchase money expenses" are merely examples of the "price" of the collateral" or the "value given" to the debtor. The court could "see no persuasive reason why traditional transaction costs **and** the refinance of reasonable, bona fide negative equity in connection with the purchase of the new vehicle should not qualify as "expenses" within the meaning of the comment. Based on this broad language, the Eleventh Circuit found that the cost of negative equity was part of Graupner's overall purchase-money obligation.

The court then noted that Comment 3 to 9-103 requires a "close nexus" between acquisition of the collateral and the secured obligation:

> We believe there is such a "close nexus" between the negative equity in the Debtor's trade-in vehicle and the purchase of his new vehicle. The financing was part of the same transaction and may be properly regarded as a "package deal." Payment of the trade-in debt was tantamount to a prerequisite to consummating the sales transaction, and utilizing the negative equity financing was a necessary means to accomplish the purchase of the new vehicle. As the district court held in affirming the bankruptcy court, the

> negative equity was an "integral part of, and "inextricably intertwined with," the sales transaction. To hold otherwise would not be a fair reading of the UCC.

The court also determined that the term "price" as used in UCC 9-103 could be read in conjunction with the 1999 amendments to the Georgia Motor Vehicle Sales Finance Act, which specifically define "cash sale price" to include "any amount paid to the buyer…to satisfy…a lien on or a security interest in a motor vehicle used as a trade-in on the motor vehicle which is the subject of a retail installment transaction [under the Georgia MVSFA]." Reading the 1999 amendment to the Georgia MVSFA and the UCC *in pari materia*, the Eleventh Circuit concluded that the Georgia legislature "intended….to permit negative equity in a trade-in vehicle to be added to the cash sales price of a new vehicle without precluding the financing creditor or its assignee from taking a purchase money security interest in the new vehicle." The Eleventh Circuit also agreed with the district court's conclusion that "[t]he value of that trade-in along with its accompanying debt affected the ultimate price that was paid for the new pick-up truck. The negative equity is inextricably intertwined with the sale transaction and the financing of the purchase."

Public policy considerations. Finally, the court found that precluding purchase-money treatment for negative equity would lead to "absurd results":

> If Congress did not intend for the hanging paragraph to apply to a trade-in's negative equity, as the Debtor ultimately contends, it would have the effect of excluding a substantial number of lawful auto finance transactions that were industry practice when BAPCPA was enacted (a practice that Congress is presumed to have known about). This would be an absurd result given that it is recognized that the "architects of the hanging paragraph intended only good things for car lenders and other lienholders"….It would be particularly absurd because a strong argument can be made that "the primary purpose of the hanging paragraph of Code §1325(a)(9) is, in fact, precisely to take the unsecured negative equity debt which any Chapter 13 debtor has when his or her…vehicle is not worth the outstanding loan balance and, by refusing [to bifurcate it under §506], to transform it into secured debt not supported by collateral value, and then require it to be paid in full to the detriment of other unsecured creditors." (Citing In re Petrocci, 370 B.R. 489, 502 (Bankr. N.D.N.Y. 2007).

So the Eleventh Circuit prohibited cramdown of any portion of Nuvell's secured claim.

Some thoughts about the case.

*****We think the Eleventh Circuit decision is correct. One of the editors of this newsletter, Barkley Clark, represented Nuvell in the appeal.

*The Eleventh Circuit opinion contains an exhaustive citation of decisions from around the country.

*At the end of the opinion, the court penned the following footnote: "We again emphasize that the facts of this case involve reasonable, bona fide negative equity in the trade-in vehicle. Because we have dealt here only with a legitimate purchase transaction, we leave for another day what the result might be if there is evidence of subterfuge relating to an unrelated antecedent debt." This caveat would appear to disqualify something like a vehicle dealer's payoff of the consumer's bank credit card as part of the overall vehicle financing transaction.

*In another very recent negative equity decision, a Texas federal district court ruled in favor of the vehicle financer based solely on the language of the hanging paragraph. The court concluded that "the statutory language is clear and unambiguous. A plain reading leaves no question that the hanging paragraph eliminates the federal remedy of bifurcation of claims into secured and unsecured." In re Dale, No. H-07-3176 (S.D. Tex. August 14, 2008)

*Can Graupner be distinguished based on the language of the Georgia retail installment sales law?

Personal Use

- The hanging paragraph applies only to vehicles "acquired for the personal use of the debtor." 11 U.S.C.A. § 1325(*). The statute does not define "personal use."

- Personal use of a vehicle does not include exclusive use by a non-debtor who is not a spouse of the debtor. See In re Lewis, 347 B.R. 769 (Bankr. D. Kan. 2006).

- Personal use of a vehicle does not include use exclusively for business purposes. See In re Lowder, 2006 WL 1794737 (Bankr. D. Kan. 2006).

- Courts have reached different conclusions in deciding whether use of a vehicle by a debtor's "family and household" constitutes "personal use."

  In re Jackson, 338 B.R. 923 (Bankr. M.D. Ga. 2006), found that a vehicle is for the "use of" the person who is the primary driver. Since the vehicle in question was used almost exclusively by the debtor's wife, it was not a 910 Vehicle. The court further concluded that debtor's statement in the retail sales agreement that the vehicle was purchased for "personal, family, or household use" was unavailing to the creditor. The court determined that since Congress used the phrase "personal, family, or household use" in other parts of the statute but only used "personal use" in § 1325, it must have intended to exclude family or household use from the § 1325 test. See also In re Smith, No. 05-16055 (Bankr. M.D. Tenn. 2006); In re Horn, 338 B.R. 110 (Bankr. M.D. Ala. 2006).

  In re Press, 2006 WL 2734335 (Bankr. S.D. Fla. 2006) holds that a debtor-spouse who purchases a car with the intent that the other spouse use it has not purchased the car for his or her personal use, regardless of how much the spouses may share the use of the car, regardless of whether the vehicle is used for family or household use, even if the vehicle is the sole vehicle for the family, and even if the "using" spouse is a joint debtor in the bankruptcy case. This case holds that "debtor" refers to the person who signed the retail vehicle purchase agreement, not the person who signed the bankruptcy petition. The case also agrees with Jackson that Congress intended to exclude vehicles that were used for family or household purposes.

In re Vagi, 351 B.R. 881 (Bankr. N.D. Ohio 2006), reaches a contrary conclusion. Vagi had not signed the retail purchase agreement but she had signed and had filed the bankruptcy petition with her husband. The court held that "use of the debtor" should be read "use of the debtors" under these circumstances

In re Hill, 352 B.R. 69 (Bankr. W.D. La. 2006), holds that the bankruptcy court must look to the "totality of the circumstances." The court held that statute required the purchaser's intent to be determined by looking at the date of acquisition, not the date of the bankruptcy petition (or any other event).

- The court in In re Solis, 356 B.R. 398 (Bankr. S.D. Tex. 2006), analyzed the preceding cases in depth and, based on that analysis and its own construction of the statutory text, developed the following "totality of the circumstances test" to determine whether a vehicle was acquired for the personal use of the debtor:

> [A]t the time of the acquisition the acquirer intended that a significant, material portion of the use of the vehicle would be (a) for the benefit of the debtor(s) in the bankruptcy case, (b) for non-business purposes, and (c) for satisfaction of debtor(s)' wants, needs, or obligations. In determining what is significant and material, the Court must take into consideration all of the facts and circumstances of the case. Id. at 411.

- In re Bethoney, 384 B.R. 24 (Bankr. D. Mass. 2008), acknowledges and recites the interpretations of the "personal use" set forth in various cases. This case states that the court's analysis must start by looking at the debtor's intentions at the date of the vehicle's acquisition. Id. at 29. The court noted the "almost universal agreement that 'personal' implies 'non-business.'" Id. at 29. (Footnotes 17 & 18 of this opinion contain excellent summaries of cases addressing this issue.) The court agreed with the Solis analysis, describing that analysis as follows:

> I conclude In re Solis is the best reasoned decision and the first of a developing majority. Adopting a totality of the circumstances test in which the "personal use" requirement, defined as encompassing both "family" and "household" uses, is satisfied when the debtor's use is "significant and material" balances Congress' clear intent that the debtor's use be "non-business" with the practical realities that face Chapter 13 debtors. As the Solis court suggests, the lines between such categories are often illusory at best.