THE BANKRUPTCY ABUSE PREVENTION
AND CONSUMER PROTECTION ACT OF 2005
11 U.S.C. § 1325

ISSUES ARISING UNDER THE "HANGING PARAGRAPH"

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Consumer Bankruptcy Practice Under BAPCPA

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TABLE OF CONTENTS

Relevant Statutes

11 U.S.C. § 1325(a)(5)

(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)(i) the plan provides that--

(I) the holder of such claim retain the lien securing such claim until the earlier of--

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section 1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;

(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; and

(iii) if--

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

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

Hanging Paragraph Appended to 11 U.S.C. § 1325

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 (as defined in section 30102 of title 49) 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;

11 U.S.C. § 506(a)

(a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

"Hanging Paragraph" in 11 U.S.C. § 1325[1]

11 U.S.C. § 1325(a)(5) governs the debtor's treatment of secured claims in chapter 13. If the creditor objects to the treatment proposed by the debtor, the debtor has two options. The debtor may either surrender the collateral securing the claim or pay the creditor the amount of the allowed secured claim.[2]

11 U.S.C. § 506 governs determination of the amount of an allowed secured claim. If the claim exceeds the value of the collateral, § 506 reduces the secured claim to the value of the collateral, leaving the creditor with an unsecured claim for the balance. If the value of the collateral exceeds the claim, the secured claim is not reduced and may include interest and reasonable fees and charges provided under the contract with the debtor. Therefore, § 506 may bifurcate otherwise secured claims into secured and unsecured components.

The *Bankruptcy Abuse Prevention and Consumer Protection Act* of 2005 inserted a paragraph at the end of § 1325 which is neither numbered nor lettered. It does not even relate to the subsection immediately preceding it. Therefore, it has come to be called the "hanging paragraph." The hanging paragraph provides as follows:

> 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 (as defined in section 30102 of title 49) 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.

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[1] The court is grateful to his law clerk, Anna Williams, for her assistance in the preparation of this material.

[2] If specified criteria are met, the payment may be made over time in the form of periodic payments.

In essence, if a creditor has a claim (1) incurred within 910 days preceding the chapter 13 petition (2) secured by a purchase-money security interest in a motor vehicle (3) acquired for the personal use of the debtor, then § 506 does not apply to that claim. Therefore, the hanging paragraph exempts qualifying claims from the operation of § 506. But what effect does this have on the claim?

Majority View – Status of Claim

The overwhelming majority of courts conclude that if § 506 is not applicable, the claim is fully secured. Section 506 allows bifurcation of a secured claim into its secured and unsecured components. Therefore, if § 506 is not applicable, the claim is fully secured irrespective of the value of the collateral. "Unless the amount of the claim is subject to reduction for reasons other than collateral value, the creditor's allowed secured claim is fixed at the amount at which the claim is filed." *Ezell*, 338 B.R. 330, 340 (Bankr. E.D. Tenn. 2006).

Congress was obviously "attempting to remedy a perceived abuse by debtors who purchase vehicles on credit on the eve of filing bankruptcy" and use § 506 to pay less than the full amount of the debt." *See In re Sparks*, 346 B.R. 767 (Bankr. S.D. Ohio 2006). However, the statute reaches back two and one-half years for motor vehicles. In addition, the statute includes collateral other than motor vehicles for debts incurred within one year prior to filing.

Many a debtor has argued that a 910 claim is not secured. The argument goes like this. Section 506 defines secured claims. A "secured claim cannot exist except as defined by § 506." *See In re Brown*, 339 B.R. 818, 821 (Bankr. S.D. Ga. 2006) (restating debtor's argument). If section 506 does not apply, the claim cannot, by definition, be secured. However, the majority of courts have concluded that section 506 is not the sole source of the existence of a secured claim. Different rationales have been offered.

Several courts rely on federal law. The Supreme Court has stated that section 506(a) "'by its terms is not a definitional provision.'" *Brown*, 339 B.R. at 821 (quoting *Dewsnup v. Timm,* 502 U.S. 410, 415 (1992)).

Therefore, section 506 does not create a secured claim;[3] it merely allows bifurcation of an already secured claim. *In re Brooks*, 344 B.R. 417, 420 (Bankr. E.D.N.C. 2006). In addition, "[o]ther Code sections address whether a claim is 'allowed' and 'secured.' 11 U.S.C. § 502 governs whether a claim is deemed allowed," and "11 U.S.C. § 101(37) establishes that a debt is 'secured' by a lien." *Brown*, 339 B.R. at 821. Therefore, "[i]t is neither necessary nor appropriate to contort § 506 into a definitional provision." *Id.*

Some courts look beyond the Bankruptcy Code to state law. "A creditor's rights are initially determined upon state law." *In re Shaw*, 341 B.R. 543, 546 (Bankr. M.D.N.C. 2006) (citing *Butner v. U.S.*, 440 U.S. 48, 55 (1979). A creditor's state law rights "may then be altered by a relevant provision of the Bankruptcy Code." *Id.* By preventing bifurcation, the hanging paragraph prevents alteration of the secured status of a 910 creditor's claim. Therefore, the claim is fully secured. *Id.*

Some courts also look to the legislative history in support. The legislative history states that the bill's "protections for secured creditors include a prohibition against bifurcating a secured debt." *In re Murray*, 346 B.R. 237, 244 (Bankr. M.D. Ga. 2006) (quoting H.R. Rep. No. 109-31(I) at 17 (2005), U.S. Code Cong. & Admin. News 2005, pp. 88, 103)). The implication is that the debt is already secured outside the scope and operation of § 506. In addition, it indicates that "Congress did not intend to disfavor the class of secured creditors" subject to the hanging paragraph. *In re Turner*, 349 B.R. 437, 441 (Bankr. D.S.C. 2006) (treating them as unsecured creditors would punish or disfavor them). Given the purpose of the paragraph to address a "perceived abuse," limiting bifurcation in specified circumstances is not an absurd result. *Sparks*, 346 B.R. at 771.

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[3] *In re Scruggs*, 342 B.R. 571, 574 (Bankr. E.D. Ark. 2006). Section 506(a)(1) merely "defines the extent or amount of a secured claim for purposes of treatment under the Bankruptcy Code." *Id.*

Majority View – Interest

The overwhelming majority conclude that because the claim is secured, it is subject to the requirements of 11 U.S.C. § 1325(a)(5) governing treatment of secured claims.[4] Therefore, if the creditor objects to the plan, the debtor must either surrender the collateral or pay the present value of the claim. Specifically, the statute provides that the court must confirm the plan if "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." 11 U.S.C. § 1325(a)(5)(B)(ii).

What is the appropriate rate of interest to ensure present value of a 910 claim? In May of 2004, the Supreme Court adopted the prime-plus formula approach for calculating the rate of interest which will ensure present value under § 1325(a)(5)(B)(ii). The formula starts with the prime national interest rate and includes an adjustment for risk of nonpayment. *See Till v. SCS Credit Corp.,* 541 U.S. 465, 124 S. Ct. 1951, 158 L. Ed. 2d 787 (2004). The Supreme Court "expressly rejected the use of the contract rate of interest to satisfy the present value requirement in a Chapter 13 plan." *In re Fleming*, 339 B.R. 716, 721 (Bankr. E.D. Mo. 2006). However, the *Till* decision was rendered in a case where the secured claim was "stripped down" or "bifurcated" into its secured and unsecured components. If the secured claim is not bifurcated, does *Till* apply?

The majority of courts answer the question in the affirmative. The hanging paragraph does not abrogate *Till.* In I*n re Wright*, the creditor

[4] Some courts have noted that the grammatical structure of the hanging paragraph "supports the conclusion that § 1325(a)(5) is still applicable" to qualifying claims. *In re Montoya*, 341 B.R. 41, 44 (Bankr. D. Utah 2006). Because the paragraph beings with the phrase, "For purposes of paragraph (5)," "a court must consider § 1325(a)(5) when contemplating confirmation." *Id.* "Initially, then, it would seem that the hanging paragraph anticipates that there will be an allowed secured claim as provided for in the plan, and that the hanging paragraph will operate on that claim." *In re Trejos*, 352 B.R. 249, 259 (Bankr. D. Nev. 2006).

argued that *Till* applied only to "strip down cases." 338 B.R. 917, 919 (Bankr. M.D. Ala. 2006). The court rejected the argument, stating that *Till* applies in "all chapter 13 cases which are being confirmed over the objection of a secured creditor irrespective of the value of its collateral in relation to the amount of its claim." *Id.* In other words, *Till* applies in all "cram down" cases.

The courts have advanced several reasons in support of this conclusion. First, with limited exceptions, 11 U.S.C. § 1322(b)(2) allows a debtor to modify the rights of holders of secured claims. Congress did not amend § 1322 to prevent the modification of 910 claims, and nothing in the hanging paragraph prevents such modification. *Fleming*, 339 B.R. at 721. The hanging paragraph protects a qualifying claim only from bifurcation. It is not a complete safe-harbor against any modification. *Wright*, 338 B.R. at 920. A plan may still modify the term of the loan, the interest rate, the amount and number of payments – even if bifurcation is not allowed.[5] *In re Johnson*, 337 B.R. 269, 273 (Bankr. M.D.N.C. 2006); *In re Parish*, 2006 WL 1679710, at*2 (Bankr. M.D. Fla. Mar. 10, 2006).

Second, BAPCPA does not except 910 claims from the present value requirement of § 1325(a)(5)(B)(ii) applicable to secured claims. *In re Bufford*, 343 B.R. 827, 833 (Bankr. N.D. Tex. 2006). Because 910 claims are classified as secured, the debtor must pay their present value. The Supreme Court has adopted the *Till* formula for determining present value in cram down cases. *Till* was decided about one and one-half years before BAPCPA went into effect. If Congress had wanted to abrogate *Till* with respect to 910 claims, it certainly could have done so. *Fleming*, 339 B.R. at 723. Not only is the hanging paragraph silent on the issue of interest, "there is no mention of interest or of *Till* in any of the legislative history of the amendments to § 1325." *In re Murray*, 352 B.R. 340, 354 (Bankr. M.D. Ga. 2006). BAPCPA "does not make § 1325 or any Code provision, other tha[n] § 506, inapplicable to these claims."

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[5] "[S]tate law determines rights in property only to the extent such rights are not modified by the Bankruptcy Code. Section 1322(b)(2) . . . expressly permits modification of [910 creditor's] rights subject to the limitations set forth in Section 1325 of the Bankruptcy Code." *Fleming*, 339 B.R. at 724.

Bufford, 343 B.R. at 833.

When the contract rate is below the *Till* rate, is the debtor required to pay the higher *Till* rate? Three courts have held that *Till* applies only in cram down situations where a creditor's rights are modified: "Any plan that modifies a secured creditor's rights over the creditor's objection is a cram down that triggers the application of Section 1325(a)(5)(B)(ii) and *Till."*[6] However, if the debtor proposes to pay the claim on an "unmodified basis, in full according to the terms of the contract by direct payments from the debtor to the creditor, [it[is not a cram down. *In re Pryor*, 341 B.R. 648, 651 (Bankr. C.D. Ill. 2006).

Two other courts have applied *Till* to 910 claims where the contract rate of interest was 0%. In *In re Brill*, the court held that "if the plan proposes to pay the secured claim in installments over time, the *Till* rate of interest" applies. 350 B.R. 853 (Bankr. E.D. Wis. 2006). The court did not mention and one could not determine from the recitation of the facts whether the creditor's rights were altered by the plan. The court stated: "Nothing in *Till* suggests that the rule set forth in the case can be used to benefit debtors, but not creditors, when the application of the rule results in an interest rate other than the contract rate." *Id.* at 350. In *In re Scruggs*, the court also applied the *Till* rate of interest instead of the 0% contract rate. 342 B.R. 571 (Bankr. E.D. Ark. 2006). The court stated that the contract rate of interest is irrelevant under 11 U.S.C. § 1325(a)(5)(B)(ii). *Id.* at 575. The facts reflected that the creditor's rights were modified by the plan, though the court did not make an express finding to that effect.

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[6] *In re Pryor*, 341 B.R. 648, 651 (Bankr. C.D. Ill. 2006) (*Till* applies because debtor is modifying stream of payments). *In re Soards*, 344 B.R. 829 (Bankr. W.D. Ky. 2006) (modifying stream of payments so must pay *Till* rate instead of 2.9% contract rate); *In re Ross*, 2006 WL 3246466 (Bankr. W.D. Tenn. June 23, 2006) (altering creditor's rights so must pay *Till* rate instead of 0% contract rate).

Minority View – Status of Claim and Interest

At least three courts have concluded that 910 claims are not secured. These courts reason that the claims rely solely on § 506 for their secured status. Because § 506 does not apply, the claims cannot be secured. A leading treatise espouses this position, noting that it is possible that the hanging paragraph was intended merely to prohibit the use of section 506 to bifurcate a secured claim into a secured an unsecured component. If so,

> such claims should be treated as fully secured claims regardless of the value of the collateral. But, even if that was the intent, because the new language added to section 1325(a) renders entirely inapplicable for some creditors the only section, section 506(a), that gives those creditors allowed secured claims, it does not to [sic] carry out such intent.

In re Trejos, 352 B.R. 249, 260 (Bankr. D. Nev. 2006) (quoting 8 *Collier on Bankrutpcy* § 1325.06[1][a], at pp. 1325-28 to 1325-29 (Henry Sommer & Alan Resnick, 15th rev. ed. 2006)). But if the claim is not secured, what is it, and how is it to be treated? The courts do not agree.

In *In re Carver*, issued in the Southern District of Georgia, Judge Walker concluded that the claim could not be treated as an unsecured claim because "it is unlikely that Congress singled out the creditor with a 910 claim in order to punish it." 338 B.R. 521, 527 (Bankr. S.D. Ga. 2006). He therefore concluded that Congress created "a special provision solely for 910 claims." *Id.* However, he noted that "nothing in the statute offers guidance for the payment of 910 claims, so the Court is left to extrapolate congressional intent from the information it does have." *Id.*

Judge Walker looked to 11 U.S.C. § 1111(b) for guidance – the provision allowing secured creditors in chapter 11 to elect either full payment without interest or bifurcation into secured and unsecured components. Using that as a guide, he concluded:

> In a chapter 13 plan, a 910 claim must receive the *greater* of (1) the full amount of the claim without interest; or (2) the amount the creditor would receive if the claim were bifurcated and crammed down (i.e., secured portion paid with interest and unsecured portion paid pro rata).

Carver, 338 B.R. at 528. Judge Walker acknowledged that a creditor with a de minimus unsecured claim may receive more money through bifurcation and payment of the secured claim with interest.

The result reached by Judge Walker has been superceded by Judge Dalis in the Southern District of Georgia. *See In re Brown*, 339 B.R. 818 (Bankr. S.D. Ga. 2006). However, Judge Walker issued an opinion in the Middle District of Georgia adopting and reaffirming his opinion in *Carver. See In re Green*, 348 B.R. 601 (Bankr. M.D. Ga. 2006).

One could argue that the absence of any language in the statute providing for treatment of 910 claims may indicate that Congress did not intend to create a new class of claims.[7] One could also argue that the decision in *Carver* actually permits that which the hanging paragraph prohibits – bifurcation of the claim.[8] Though Judge Walker was careful to exclude § 506 for purposes of classifying the claim, did he effectively exclude § 506 for purposes of treatment of the claim? He reached a result consistent in part with § 506 albeit through the back door – chapter 11.

A second court in *In re Wampler* concluded that a 910 claim is

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[7] As one court couched this argument: "Furthermore, the Court will not support a judicially crafted treatment of claims with no basis in the Code. The Court finds it unlikely that Congress would create a new, undefined type of claim, and then furnish no guidance as to how such a claim should be handled." *In re DeSardi*, 340 B.R. 790, 812 (Bankr. S.D. Tex. 2006).

[8] In *Green*, Judge Walker stated that "[i]t is clear that Congress intended to prevent bifurcation of certain claims, as the hanging paragraph states." 348 B.R. 601, 609 (Bankr. M.D. Ga. 2006).

entitled to full payment without interest. 345 B.R. 730 (Bankr. D. Kan. 2006). This court did not offer the 910 creditor the election of bifurcation. The court relied on language by the Supreme Court stating that § 506 "governs the definition and treatment of secured claims." *Wampler*, 345 B.R. at 735 (quoting *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 238-239, 109 S. Ct. 1026 103 L. Ed. 2d 290 (1989)). The court concluded, as did the *Carver* court, that if § 506 does not apply, the 910 claim cannot be secured.

However, it is unclear how this court would categorize a 910 claim. After stating that the claim is not an allowed secured claim, the court added:

> To clarify, it is not this Court's finding that creditors are somehow deprived of their prepetition lien in their collateral. A creditor may have a lien in property without holding an allowed secured claim. The liens held by creditors in property subject to the 910 Language will not be released until payment of their allowed claims.

Wampler, 345 B.R. at 740. Because the claim is not an allowed secured claim, the court concluded that it was not entitled to interest under § 1325(a)(5)(B)(ii).[9] In rejecting the *Wampler* analysis, the court in *Trejos*

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[9] *See In re White* which seemed to adopt a hybrid view. 352 B.R. 633, 644 (Bankr. E.D. La. 2006). After concluding that § 506 provides the definition for an allowed secured claim, the court stated:

> The exclusion of § 506's application is *for purposes of* § 1325(a)(5). Section 506 is therefore otherwise applicable to these claims for all other purposes which would include the right to seek adequate protection pending confirmation and relief from the stay. The wording of the paragraph also indicates that the claim has already qualified as an "allowed secured claim" under both §§ 506 and 1325(a)(5). Otherwise, there would be no need for the hanging paragraph to exclude these claims from the effects of § 506 *for purposes of* § 1325(a)(5).

noted anomalies resulting from a claim being subject to a non-bankruptcy lien but yet not "secured." For instance, is it entitled to adequate protection under § 361?

A third court has declined to classify 910 claims as secured. *In re Taranto*, 344 B.R. 857 (Bankr. N.D. Ohio 2006). The reasoning will sound familiar: "one holds an allowed secured claim only through operation of § 506." *Id.* at 861. If § 506 does not apply, the claim cannot be secured.

The facts were interesting in that case. The creditor held a $28,000 claim secured by a $16,500 vehicle. The contract provided for 0% interest. The plan proposed to pay the claim in full without interest more than three years before the note matured. If the claim were treated as secured, the present value interest on the debt would reduce the amount available to unsecured creditors.

The court held that because the claim was not an allowed secured claim, it was not entitled to present value interest under § 1325(a)(5)(B)(ii). However, the court stated that a 910 claim may be entitled to interest, depending on the "facts of the particular claim." *Id.* at 863. Because the creditor was being paid in full and earlier than required under the contract, the court declined to impose interest on the claim.

From an economic standpoint, the court stated that *Till* was designed to reduce the risk exposure resulting from the strip down of the claim. However, "artificial inflation" of the claim by the hanging paragraph reduces this risk exposure. "To allow both inflation of the allowed amount of the claim and application of interest under *Till* ignores the economic realities of this case and perhaps the vast majority of 910 Claims." *Id.* The court refused to "blindly apply *Till* given this different context where no such risk exposure exists." *Id.*

Id. at 644. Even though the creditor had no allowed secured claim as defined by § 506 for purposes of § 1325(a)(5), the court allowed present value interest on the claim as provided by § 1325.

Surrender in Full Satisfaction of the Claim?

Section 1325(a)(5) prescribes the treatment of allowed secured claims in chapter 13. Under that section, the debtor may (A) treat the claim as agreed with the creditor, (B) pay the amount of the allowed secured claim, usually over time, or (C) surrender the collateral securing the claim. If the creditor objects to the treatment proposed by the debtor, the debtor has only two options – pay the secured claim or surrender the collateral.

Section 506 generally allows the bifurcation of secured claims into their secured and unsecured components. However, if the criteria of the hanging paragraph are met, § 506 does not apply to the claim. Therefore, the secured claim cannot be bifurcated.

The majority of courts agree that if the debtor opts to retain the collateral, the debtor must pay the secured claim in full. But what if the debtor opts to surrender the collateral? What is the effect of the hanging paragraph on the claim?

The seminal case addressing the issue is *In re Ezell*, 338 B.R. 330 (Bankr. E. D. Tenn. 2006). It was the first reported case, and the majority of opinions published since *Ezell* follow the result. The court examined the plain language of the statute which states that § 506 does not apply to a claim described in § 1325(a)(5). Section 506 does not apply to a claim described in § 1325(a)(5)(C) any more than it applies to a claim described in § 1325(a)(5)(B).

Therefore, the court concluded that the hanging paragraph prevents bifurcation of the claim whether the debtor opts to retain the collateral and pay the claim or surrender the collateral securing the claim. If the claim cannot be bifurcated, the creditor has no basis for an unsecured deficiency claim. Therefore, the debtor may surrender collateral securing a “910 claim” in full satisfaction of the debt.

The creditor in that case argued that § 506 did not apply in a liquidation setting even under pre-BAPCPA law. However, the court

looked to prior case law to conclude that 11 U.S.C. § 506 formed the basis for a deficiency claim even under pre-BAPCPA law. The value of a creditor's allowed secured claim was "determined in light of the purpose of the valuation and of the proposed disposition or use of such property." 11 U.S.C. § 506. Upon surrender, "liquidation value was clearly the yardstick by which the allowed secured claim was determined, while for cram down purposes . . . replacement value was the criteria." *Ezell*, 338 B.R. at 339-340 (citing *Associates Comm'l Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879 138 L. Ed. 2d 148 (1997)).

The court concluded that though the language is not "particularly ambiguous," because of its construction, it is "at best, confusing." *Ezell*, 338 B.R. at 340. Examination of the legislative history was not helpful, though it provided no "evidence that the court's determination does not comport with Congressional intent" because it states that the statute "prohibits bifurcation." *Id.* at 341. The court had "no choice" but to interpret the statute as written. *Id.* (citing *United States v. Ron Pair Enters.*, 489 U.S. 235, 109 S. Ct. 1026, 1030, 103 L. Ed. 2d 290 (1989)).

The court noted that the affected creditor was "no more or less disadvantaged" by this result than the debtor. The provision operates against the creditor if the collateral is surrendered but against the debtor if the collateral is retained. The court found the result "fair" and "in harmony with the language" of the hanging paragraph. *Ezell*, 338 B.R. at 342.

As stated, the majority of courts publishing opinions on the issue have followed *Ezell*. In *In re Payne*, the court stated that had "Congress intended to limit application of the statute [to retention scenarios], it could have easily done so," and that "Congress is assumed to know and understand the effect of its legislation." 347 B.R. 278, 283 (Bankr. S.D. Ohio 2006).

Similarly, in *In re Brown*, the court enforced the plain language of the statute, stating that there is "nothing absurd about the result." 346 B.R. 868, 875 (Bankr. N.D. Fla. 2006). It is "completely logical" that if a claim is fully secured for one purpose, it is fully secured for another. *Id.* *See In re Osborn*, 348 B.R. 500, 505 (Bankr. W.D. Mo. 2006). The court

rejected the creditor's argument that the ruling resulted in a windfall to the debtor. The court stated that "any benefit would inure largely to the unsecured creditors and not the debtor." *Brown*, 346 B.R. at 875.

Courts have also rejected the creditor's argument that its right to a deficiency claim emanates not from § 506 but from state law. While agreeing that "state law defines creditors' rights, including the right to a deficiency claim," those rights are subject to modification by the Bankruptcy Code. *Osborn*, 348 B.R. at 506. Indeed, § 1322 expressly permits the modification of secured claims in most instances. The hanging paragraph modifies the affected creditor's state law right to a deficiency claim when 910 collateral is surrendered. *Id.*

Courts have also rejected the creditor's argument that this result is at odds with Congressional intent "to enhance the rights of secured creditors in bankruptcy." *Brown*, 346 B.R. at 875. They reason that Congress may have made some changes for the benefit of unsecured creditors. "Both secured and unsecured creditors' lobbies were represented during the drafting and enactment of BAPCPA." *Id.* Limiting the recovery of a 910 creditor to the value of the collateral may result in a "greater dividend for the unsecured creditors." *Id.*

Both Judge Jack Caddell and this author have issued opinions adopting the majority position that a debtor may surrender 910 collateral in full satisfaction of the debt. *See In re Moon,* Case No. 06-81896 (Bankr. N.D. Ala. Jan. 26, 2007) and *In re Reeves*, Case No. 06-30952 (Bankr. M.D. Ala. Dec. 13, 2006). One Bankruptcy Judge has cleverly stated: "While this new language may not operate to hoist the 910-creditor by his own petard, surely the creditor may be said to hang by his own paragraph." *In re Turkowitch*, 2006 WL 3346156, at *5 n.2 (Bankr. E.D. Wis. November 16, 2006). For a good discussion of the issues arising under this paragraph, see *In re Gentry*, 2006 WL 3392947 (Bankr. E.D. Tenn. Nov. 22, 2006).[10]

[10] For additional cases, see the following: *In re Pool*, 351 B.R. 747 (Bankr. D. Or. 2006); *In re Maggett*, 2006 WL 3478991 (Bankr. D. Neb. Oct. 19, 2006); *In re Feddersen*, 2006 WL 3347919 (Bankr. S.D. Ill. Nov. 15, 2006); *In re Sparks*, 346 B.R. 767 (Bankr. S.D. Ohio 2006); In *re Evans,* 349 B.R. 498

However, not all courts hold that a debtor may surrender 910 collateral in full satisfaction of the claim.[11] Instead, the creditor remains entitled to assert a deficiency claim under state law. These courts proffer various arguments in support of this conclusion. The following arguments are not exhaustive.

First, state law controls property rights unless otherwise modified in bankruptcy. Because § 506 does not apply, the creditor's state law rights are not modified by § 506, and the creditor is entitled to pursue a deficiency claim. *In re Duke*, 345 B.R. 806, 809 (Bankr. W.D. Ky. 2006).

Second, § 506 "has application only when the estate retains an interest in the collateral." *Dupaco Community Credit Union v. Zehrung (In re Zehrung)*, 351 B.R. 675, 678 (W.D. Wis. 2006). When collateral is surrendered, the estate does not retain an interest, and the creditor's deficiency claim is determined not by § 506 but by state law. Section 506 did not apply pre-BAPCPA to the surrender of collateral. Therefore, the new language making § 506 inapplicable to the surrender of 910 collateral does not effect a change in the law, and the creditor remains entitled to assert a deficiency claim.[12]

(Bankr. E.D. Mich. 2006); *In re Nicely*, 349 B.R. 600 (Bankr. W.D. Mo. 2006);

[11] *See In re Duke*, 345 B.R. 806 (Bankr. W.D. Ky. 2006); *Dupaco Community Credit Union v. Zehrung (In re Zehrung)*, 351 B.R. 675 (W.D. Wis. 2006); *In re Particka*, 2006 WL 3350198 (Bankr. E.D. Mich. Nov. 17, 2006); *In re Hoffman*, 2006 WL 3813775 (Bankr. E.D. Mich. Dec. 28, 2006); *In re Morales*, 2007 WL 92414 (Bankr. N.D. Ill. Jan. 11, 2007).

[12] *See In re Particka*, 2006 WL 3350198, at *8 (Bankr. E.D. Mich. Nov. 17, 2006):

> In other words, the bifurcation process of § 506 does not, and never did, apply to determine a secured and unsecured portion of a secured creditor's allowed claim where the estate does not have an interest in the property securing such claim. Once a debtor surrenders property to a secured creditor, there is no longer any reason to apply § 506(a) to determine the allowed amount of such creditor's secured claim because the estate no longer holds an

Third, if Congress had intended to abrogate the creditor's state law remedies, "it would have made its intentions very clear in the statute." *Duke*, 345 B.R. at 809. The release of the creditor's deficiency claim "is far beyond what a plain reading of the statute permits." *Id.* "Absent clear legislative intent on the face of the statute," the creditor retains its right to a deficiency claim. *Id.*

Fourth, the legislative history indicates that "Congress intended to provide *more* protection to creditors with purchase money security interests." *Id.* (emphasis added). There "is not the slightest suggestion in the legislative history to the hanging paragraph that it was intended to somehow convert recourse claims of 910 creditors into non-recourse claims upon surrender." *In re Particka,* 2006 WL 3350198, at *10 (Bankr. E.D. Mich. Nov. 17, 2006). "It seems even more unlikely that Congress intended to significantly expand the rights of secured creditors in § 1325(a)(5)(B) and simultaneously reduce them in § 1325(a)(5)(C)." *Zehrung*, 351 B.R. at 678.

One court pointed out an "anomaly" created by surrender of collateral in full satisfaction of the claim. If the debtor surrenders 910 collateral at any time prior to bankruptcy, the creditor retains its right to a deficiency claim. However, if the debtor surrenders the same collateral as part of a chapter 13 plan, the creditor has no right to a deficiency claim. *Zehrung,* 351 B.R. at 678.

"Acquired for the Personal Use of the Debtor"

To fall under the operation of the hanging paragraph, the motor vehicle must have been "acquired for the personal use of the debtor." What does that mean? The statute does not define the phrase, and the legislative history provides no insight into Congressional intent. Courts have not been unanimous in their interpretation and application of the phrase.

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interest in the property.

Basically, the phrase requires the answer to two questions: (1) for whom was the vehicle acquired? and (2) for what purpose? Notice the questions not included: (1) who purchased the vehicle? (2) who owns the vehicle? (3) who else signed the note? These questions may or may not be relevant to the ultimate questions: (1) for whom was the vehicle acquired? and (2) for what purpose? Keeping these two questions in mind will aid in proper application of the phrase to the various fact patterns which arise.

Vehicle Purchased for Nondebtor Adult

The courts have addressed several fact patterns where the debtor purchased the vehicle for the exclusive use of a nondebtor adult. These are among the least problematic because the statute clearly requires the vehicle to have been "acquired for the personal use of the debtor."

In one of the earliest reported cases, the debtor had purchased the vehicle for the use of his wife, a nondebtor. She was the primary driver of the car. The debtor had another vehicle, and drove his wife's car only occasionally. *See In re Jackson*, 338 B.R. 923 (Bankr. M.D. Ga. 2006). The creditor argued that "personal use of the debtor" may include family or household use, *e.g.,* use by the nondebtor spouse.

The court looked to the American Heritage Dictionary for guidance. "Personal" is defined as "[o]f or relating to a particular person; private." *Id.* at 926. The court also noted the absence of the words "family and household" from the section despite the coupling of the words in other sections of the Bankruptcy Code. For instance, the Code defines "consumer debt" as one incurred primarily for a "personal, family or household purpose." 11 U.S.C. § 101(8). The court concluded that the omission of "family and household" from the hanging paragraph "demonstrates that Congress intended "personal use" standing alone to have a different meaning." *Jackson*, 338 B.R. at 926. The court held that the vehicle, which was purchased primarily for the debtor's wife, was not purchased for the "personal use of the debtor."

In a case before the Middle District of Alabama, the court found the phrase "personal use" to be subject to another construction. *See In re*

Morris, Case. No. 06-10251 (Bankr. M.D. Ala. Aug. 15, 2006). The court defined "personal" as not commercial, contrasting personal use from business use. However, this "noncommercial" use must be by the debtor.[13] Because the vehicle was purchased for the personal use of the nondebtor spouse, the hanging paragraph did not apply.

In a similar case before the Middle District of Alabama, the nondebtor spouse used the vehicle to produce income on which the debtor relied. The creditor argued that this reliance constituted an indirect use of the vehicle by the debtor. *See In re Davis*, 2006 WL 3613319 (Bankr. M.D. Ala. Dec. 8, 2006). The court rejected the argument based on the plain language of the Code.[14]

A clearer pattern involves the purchase of the vehicle for the business use of the nondebtor spouse. The debtor in *In re Finnegan* produced evidence that the vehicle was used almost exclusively by her husband in his graphic design business. 2006 WL 3883847 (Bankr. M.D. Pa. Nov. 30, 2006). He stored business materials in the vehicle and claimed the vehicle and related expenses as business deductions for federal income tax purposes. The court held that the vehicle was not acquired for the personal use of the debtor.

Another pattern involves the purchase of the vehicle for the use of an adult son or daughter. In *In re Lewis*, the daughter did not live with the debtors and was not a dependent, but she could not get the loan in her own name. 347 B.R. 769 (Bankr. D. Kan. 2006). The debtors proposed to pay for the vehicle through the plan even though the daughter had made the payments prior to bankruptcy. The court held that the vehicle was not purchased for the personal use of the debtor. In addition, the court held that the plan proposing to pay for this

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[13] Therefore, the *Jackson* court definition may render the statutory language redundant.

[14] The court noted in both *Morris* and *Davis* that the creditor would nevertheless be entitled to relief from the co-debtor stay imposed by 11 U.S.C. § 1301 to the extent that the plan did not fully pay the debt. Therefore, the decisions may have had little practical effect.

unnecessary vehicle was not proposed in good faith and lifted the automatic stay.[15]

The court noted that it might not follow cases excluding the application of the hanging paragraph to a vehicle purchased for a nondebtor spouse. *See In re Solis*, 2006 WL 3298351, at *6 (Bankr. S.D. Tex. Nov. 14, 2006) stating the same in dicta: "[I]f the 'other person' is the debtor's spouse, then the question is more problematic since . . . debtor's spouse may use the vehicle for the benefit of the debtor, debtor's family, and debtor's household. This latter use might, depending on all the facts and circumstances, be 'use of' the debtor."

Vehicle Purchased for Joint Debtor

A more difficult pattern involves the debtor's purchase of a vehicle for a joint debtor spouse. In *Vagi*, the debtor purchased a minivan for the personal use of his wife, a joint debtor and stay-at-home mom. 351 B.R. 881 (Bankr. N.D. Ohio 2006). She used the minivan both for herself and their three small children. The debtor had a separate car and did not drive the minivan, though he rode in the minivan on family outings.

The court looked to the rule of construction found in 11 U.S.C. § 102(7) which states that "the singular includes the plural." Therefore the hanging paragraph may also read, "acquired for the personal use of the debtors." Because the minivan was acquired for the personal use of the joint debtor, the court held that the hanging paragraph applied.

However, contrast *In re Press*, 2006 WL 2734335 (Bankr. S.D. Fla. July 26, 2006) where the court rejected the same rule of construction. The court held that because only the husband was a "debtor" on the vehicle and because the bankruptcy estates had not been consolidated, the word "debtor" could not be construed to include his joint debtor wife. Also impacting the decision was the court's conclusion that "personal use" means something different than "personal, family, or household

[15] See also *In re Solis* for a similar result where the debtor purchased the vehicle for the exclusive use of her adult son and his family. 2006 WL 3298351 (Bankr. S.D. Tex. Nov. 14, 2006).

use."

The creditor argued that the vehicle was in fact used by the husband because it was only vehicle the family owned. The court held that because the vehicle was "acquired" for the personal use of the wife, "incidental or even frequent use" by the husband "is not a consideration under the plain meaning of the statute."[16] *Id.* at 3.

Vehicle Purchased for Household

In *Bolze*, the debtor husband purchased a Mazda MPV for the purpose of transporting the entire family in one car when the fourth child was born. 2006 Bankr. LEXIS 2027 (Bankr. D. Kan. Aug. 31, 2006). The husband had a separate car, but he sometimes drove the Mazda on family outings. The debtors argued that if a vehicle is used for household or family use, "it cannot, by definition" be "personal use." The debtors argued that the terms are mutually exclusive.

The court rejected the argument, holding that the terms overlap in meaning. "An automobile can, and usually will, be used for personal, household and family use in most situations. Nothing in the hanging paragraph requires the personal use to be the exclusive use of the

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[16] In *In re Solis*, the court noted:

> The statutory language clearly points to the intention of the acquirer at the date of acquisition. . . . Although the jurisprudence sometimes discusses how the vehicle "is used" rather than discussing the "purpose for which it was acquired", the loose language in many cases can be attributed to lax evidentiary presentations, to the fact that in most cases there is probably no difference between intended use and subsequent actual use, and to the fact that the courts are judging credibility of testimony about "intended use" by observing "actual use." Therefore, the Court concludes that the appropriate test is the intention of the purchaser at the time that the vehicle was acquired.

2006 WL 3298351, at *6 (Bankr. S.D. Tex. Nov. 14, 2006).

property." *Id.* However, the use of a vehicle for business purposes would not qualify as personal use. The court held that the vehicle was acquired for personal use.

Vehicle Purchased for Multiple Users/Uses

In *In re Solis*, the debtor and her nondebtor husband purchased one vehicle to serve as transportation for both of them. 2006 WL 3298351 (Bankr. S.D. Tex. Nov. 14, 2006). The debtor used the vehicle to drive to work and for family and household purposes. The husband used the vehicle for part-time self-employment income. The court stated:

> But, just as there is no bright or gray line for the Court to use when comparing proportionate use by a debtor and use by a nondebtor, there is no guidance in the statute concerning what percentage of business use (less than 100%) would disqualify the vehicle as a 910 Vehicle. The words "solely", "exclusively", "mostly", "primarily", "partially" or any other type of quantitative requirement do not appear in the hanging paragraph in this context, either. Having no guidance from the statute, the Court will adopt its best estimate of a reasonable conclusion. The Court will determine that the "personal use" requirement of the statute is satisfied if the personal use of the debtor is *significant and material*, regardless of whether there is also some business use.

Id. at 6 (emphasis added). The court looked at the totality of the circumstances and concluded that the debtor and her husband anticipated that the debtor's personal use of the vehicle would be "significant and material." Therefore the hanging paragraph was applicable.

In reaching this conclusion, the court held that "in almost all circumstances," a debtor's use of the vehicle to drive to and from work constitutes personal use because "there is almost always an alternative." *Id.* at 7. The court also held that "debtor" in the hanging paragraph refers to the person who filed the bankruptcy case – not the person who is liable on the promissory note for the vehicle.

The court in *In re Wilson* adopted the *Solis* "significant and material" test to resolve another dual use question. 2006 WL 3512921 (Bankr. D. Kan. Dec. 5, 2006). In *Wilson*, the debtors purchased two vehicles for both personal and business purposes. The court found that when they acquired the vehicles, the debtors "intended that a significant and material portion . . . be for the personal use and benefit of both debtors." *Id.* at *4. Therefore, the hanging paragraph applied.

Not all courts agree that driving to work constitutes personal use. In *In re Johnson*, the vehicle was purchased for the primary purpose of enabling one of the debtors to drive to and from work. 350 B.R. 712 (Bankr. W.D. La. 2006). The court adopted a "totality of the circumstances" test and held that a substantial factor is "whether the acquisition of the vehicle enabled the debtor to make a significant contribution to the gross income of the family unit." The court concluded that the vehicle was not acquired for the personal use of the debtor.

However, in *In re Lowder,* the court noted that the debtor's employer did not require her to have the automobile, the employer did not pay for its costs or expenses to operate, and the debtor did not use it within the scope of her employment. 2006 WL 1794737, at *4 (Bankr. D. Kan. June 28, 2006). Therefore, merely using the vehicle to drive to and from work did not constitute business use of the vehicle.

Purchase-Money Security Interest

In addition, to fall under the operation of the hanging paragraph, the creditor must have a purchase-money security interest in the motor vehicle (or other collateral, if the debt was incurred during the 1-year period preceding the petition).

Alabama law defines a purchase-money security interest. The statute provides: "A security interest in goods is a purchase-money security interest: (1) to the extent that the goods are purchase-money collateral with respect to that security interest . . . . *Ala. Code* § 7-9A-103(b) (1975).

The statute defines "purchase-money collateral" as "goods or

software that secures a purchase-money obligation incurred with respect to that collateral." *Ala. Code* § 7-9A-103(a)(1) (1975).

The statute defines "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." *Ala. Code* § 7-9A-103(a)(2) (1975).

In *In re Horn*, the court held that a purchase-money security interest had lost its purchase-money status where the original debt had been refinanced four times, each time with cash advances to the debtor. 338 B.R. 110 (Bankr. M.D. Ala. 2006). With the addition of the cash advances, the vehicle secured "more than the debt for the money to acquire it." *Id.* at 113. Therefore, the debtor "did not incur the entire debt as all or part of the purchase price of the vehicle."[17] *Id.* Let's call this the "multiple transaction" or "refinancing" scenario.

Another is the "negative equity" scenario. In *In re Peaslee*, the debtor had purchased a 2004 Pontiac Grand Am within 910 days before bankruptcy. 2006 WL 3759476 (Bankr. W.D.N.Y. Dec. 22, 2006). In connection with the purchase, the debtor traded in a 1999 Chevrolet Blazer. At that time, the debtor owed more on the Blazer than it was worth. In other words, it had substantial "negative equity." The debt on the Blazer was "rolled-in" and refinanced as part of the purchase of the Grand Am. The entire amount financed was over $5,000 beyond the manufacturer's suggested retail price for the Grand Am. Therefore, some of the debt included a non-purchase money obligation.

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[17] The court relied on *Snap-On Tools, Inc. v. Freeman (In re Freeman)*, 956 F.2d 252 (11th Cir. 1992) which states: "'Without some guidelines, legislative or contractual, the court should not be required to distill from a mass of transactions the extent to which a security interest is purchase money.' (quoting *In re Coomer*, 8 B.R. 351, 355 (Bankr. E.D. Tenn. 1980)). Unless the lender contractually provides some method for determining the extent to which each item of collateral secures its purchase money, it effectively gives up its purchase money status." *Freeman*, 956 F.2d at 255.

Applying New York law, the court held that its version of the Uniform Commercial Code did not "mandate a dual status rule for consumer transactions where the transaction includes both purchase money and non-purchase money obligations." The court was free to apply either a dual status or transformation rule. Under the dual status rule, the court would bifurcate the claim into purchase money and non-purchase money components. Under the transformation rule, the entire debt would be treated as non-purchase money. The court adopted the transformation rule because "it would be impossible . . . to determine the actual amount of the negative equity and the purchase money obligation . . . in large part because the trade-in vehicle would in most cases not be available for inspection and valuation. Therefore, the court held that the creditor did not have a purchase money security interest in the vehicle, and the hanging paragraph was not applicable to the creditor's claim.[18]

The court in *In re Graupner*, applying Georgia law, did not reach the dual status/transformation problem because it found that "the antecedent debt in the form of negative equity in a trade-in vehicle can be considered part of the "price" of collateral for purposes of the Georgia purchase money security interest statute." 2006 WL 3759457, at *12 (Bankr. M.D. Ga. Dec. 21, 2006). The court reached this result by reading Georgia's version of the Uniform Commercial Code and *in pari materia* with Georgia's Motor Vehicle Sales Finance Act ("MVSFA"). The MVSFA expressly defined cash sale "price" to include "'any amount paid . . . to satisfy a . . . security interest in a motor vehicle used as a trade-in . . .'" *Id.* at *8. Therefore, the court held that the entire obligation, though it included the negative equity, was a purchase-money obligation.

The court in *Peaslee* expressly rejected the argument that the counterpart statutes in New York should be read *in pari materia*, stating that the Motor Vehicle Retail Installment Sales Act was not "enacted in order to define or expand upon the definition of 'purchase money

[18] *See In re Vega*, 344 B.R. 616 (Bankr. D. Kan. 2006) applying the dual status rule as mandated by the Kansas legislature in both commercial and consumer contexts. Therefore, the hanging paragraph applied only to a portion of the creditor's claim, and the debtor could not strip down that portion of the purchase money claim.

obligation' under the Uniform Commercial Code." *Peaslee*, 2006 WL 3759476, at *8.

Another scenario was addressed in *In re Murray*, where the debtor, in conjunction with the purchase of the vehicle, had purchased an extended service contract and paid documentary and governmental certificate of title fees. 352 B.R. 340 (Bankr. M.D. Ga. 2006). The debtor argued that the additional items were not part of the "price" of the vehicle. The court considered the Official Comment to Georgia's version of § 9-103 of the Uniform Commercial Code which expands the "price" of collateral to embrace

> 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, expense of collection and enforcement, attorney's fees, and other similar obligations.

Id. at 347 (quoting the Official Comment). The same comment is included in Alabama's version of the U.C.C. The court concluded that the documentary and governmental certificate of title fees are clearly "expenses incurred in connection with acquiring rights in the collateral" and "easily labeled as finance or administrative charges." *Id.* at 347. The court concluded that "because of the nature of the additional items purchased and the relationship between those items and the collateral, which were purchased at the same time and in the same transaction as the collateral," their costs are to be considered part of the purchase price of the vehicle. *Id.* at 349. Therefore, the court held that the extended service contract did not destroy the creditor's purchase money security interest. *See Johnson*, 337 B.R. at 269 (extended service contract does not destroy purchase money security interest in vehicle). *But see In re White*, 352 B.R. 633, 639 (Bankr. E.D. La. 2006) (The "costs of the Insurance Deficiency and the Extended Warranty contracts are not costs of acquiring the vehicle.").

In *In re Trejos*, 352 B.R. 249 (Bankr. D. Nev. 2006), the court held that the assignment of the note from the automobile dealer to a credit

agency did not destroy the purchase money character of the obligation:

> Presumably to make it clear that PMSIs could be assigned, the Code drafters defined purchase money security interests in terms of the manner in which the interest was created rather than in terms of the person or entity in favor of whom the interest was created.

Id. at 266 (quoting 9A William D. Hawkland, *Hawkland UCC Series* § 9-103:1 [Rev.] (Frederick H. Miller, ed., 2006]).

In *In re Curtis*, 345 B.R. 756 (Bankr. D. Utah), the court held that in order for "any other thing of value" to fall under the operation of the hanging paragraph, the creditor must hold a purchase-money security interest in the collateral. In that case, the court concluded that creditor held a purchase-money security interest in two semi-truck tractors.