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# SHOULD COURTS HANG ON EVERY WORD OF CONGRESS'S HANGING PARAGRAPH? A SOLUTION TO JUDICIAL CONTROVERSY OVER CHAPTER 13 SURRENDERED VEHICLES

*Netta Grutman\**

## I. INTRODUCTION

As part of the Bankruptcy Abuse Prevention Consumer Protection Act of 2005, Congress added a paragraph to the bankruptcy code governing the confirmation of Chapter 13 plans.<sup>1</sup> This addition has led to the recent confusion about how courts should approach claims secured by vehicles that are surrendered as part of the debtor's Chapter 13 plan.<sup>2</sup> This confusion has led to a nation wide circuit split as well as majority and minority approaches to the controversy.<sup>3</sup> This modern dilemma undoubtedly challenges the law's pursuit of predictability, stability, and logic.

Too often lawyers complicate intuitive and simple concepts with

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1. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005).

2. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*819 (8th Cir. Feb. 5, 2008).

3. *Id.*

complex jargon. The concept discussed in this Note is straightforward as illustrated by the following example. Tommy, age six, gives his ball to Nathan, a fellow-first grader, in exchange for five dollars. Nathan uses the ball during recess and gets it dirty, but does not pay Tommy the five dollars. Tommy takes back his ball, and already having a sophisticated business sense, resells it to Katie for three dollars, the depreciated value of the now dirty ball. Does Tommy have a right to ask Nathan for the two-dollar difference? Intuitively, the answer is yes.

While this example is an oversimplification, the concept of debt and collateral is not complex. This same question in more complicated bankruptcy jargon is whether undersecured creditors have a right to a deficiency claim against debtors who surrender their vehicle as part of their Chapter 13 bankruptcy plan.<sup>4</sup> This question may be daunting at first. However, inserting the characters from the above example into a real case discussing the issue, *Capital One Auto Finance v. Osborn*, provides the following illustration: Tommy is the creditor, or *Capital One Auto Finance* and Nathan is the debtor, or Nathan L. Osborn.<sup>5</sup> Nathan L. Osborn purchased a vehicle, failed to make payments, and then attempted to surrender it as part of his Chapter 13 plan in full repayment of his debt on the vehicle.<sup>6</sup>

Prior to 2005, courts followed the intuitive result that creditors had a claim for the difference between the balance of the debt owed on the vehicle (\$5 in the ball example or \$20,279.80 in *Capital One*) and the resale value of the surrendered vehicle (\$3 in the ball example and \$10,800 in *Capital One*).<sup>7</sup> In 2005, Congress added complicated jargon in the form of a “hanging paragraph”<sup>8</sup> to 11 U.S.C. 1325(a), the statute guiding Chapter 13 plans, in order to solve one problem, but ended up causing another.<sup>9</sup>

This paragraph was added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) in an effort to eliminate “cram down” as part of Chapter 13 plans.<sup>10</sup> Cram down allowed debtors prior to 2005 to retain their vehicle and only repay its present value at the time of filing their petition for bankruptcy over the life of their plans.<sup>11</sup> Thus, if applied to *Capital One*, Osborne would only be expected to pay \$10,800 (the present value of the vehicle at the time he filed for Chapter 13

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4. *Id.* at \*819.

5. *Id.* at \*817.

6. *Id.*

7. *In re Ezell*, 338 B.R. 330, 336 (Bankr. E.D. Tenn. 2006).

8. This is a term of art created by courts to identify a freestanding unnumbered paragraph positioned after 11 U.S.C. 1325(a)(9) (2006).

9. 11 U.S.C. § 1325 (2006).

10. *Capital One*, 2008 WL 304750, at \*820; *see also In re Ezell*, 338 B.R. at 330.

11. *In re Particka*, 355 B.R. 616, 623 (Bankr. E.D. Mich. 2006) (referring to the present or resale value of the vehicle as the cram down value).

bankruptcy) over the life of his Chapter 13 plan to *retain* the vehicle.<sup>12</sup> This is similar to Nathan deciding after he has played with the ball and gotten it dirty that he would like to keep it but only pay \$3, the reduced value of the ball.

Cram down was possible due to bifurcation of claims, or separation of the secured and unsecured value of the claim.<sup>13</sup> The secured value of a claim is backed by the value of the collateral securing that claim, whereas any amount of debt not secured by collateral is considered an unsecured claim.<sup>14</sup> The hanging paragraph eliminates cram down by eliminating the debtor's ability to separate his or her claim into secured and unsecured claims.<sup>15</sup> For example, when Osborn originally financed his vehicle, the lien was secured for \$20,279.80, the value of the new car. But as the car depreciated, the value of the secured claim depreciated as well.<sup>16</sup> If a month after purchasing the vehicle, it was worth \$20,000, then Capital One would have a secured claim for \$20,000 and an unsecured claim for the remaining \$279.80, or the value of debt not backed by collateral.<sup>17</sup>

The 2005 provision apparently eliminates this division of claims.<sup>18</sup> If the claim cannot divide into secured and unsecured, courts have found the entire value of the debt remains fully secured. This includes cases where the value of the collateral depreciates.<sup>19</sup> Thus, if a debtor wishes to retain his or her vehicle, he or she must pay the entire value of the debt, not just the present value of the collateral at the time of petition.<sup>20</sup>

Courts have had difficulty applying the 2005 provision when debtors choose to surrender their vehicle as part of their Chapter 13 plan. Prior to 2005, Courts unanimously ruled that the debtor could surrender the vehicle in full satisfaction of his or her secured claim and creditors still had a claim against the debtor for the unsecured portion.<sup>21</sup> Thus, if Nathan drove the vehicle for a month and then decided to surrender the vehicle as part of his Chapter 13 plan he would owe Capital One \$279.80, the value of depreciation for that month, and Capital One would ideally recover the remaining \$20,000 debt by reselling the car for the present value.<sup>22</sup> The 2005 hanging paragraph however has caused courts to second-guess this

12. *Capital One*, 2008 WL 304750 at \*817.

13. 11 U.S.C. § 506 (2006) (defining bifurcation).

14. *Id.*

15. *Capital One*, 2008 WL 304750 at \*820.

16. *Id.* at \*819.

17. § 506.

18. 11 U.S.C. § 1325 (2006) (stating that § 506 no longer applies to claims secured by vehicles purchased within 910 days of the petition date for personal use).

19. § 506 (providing that the amount of a secured claim is limited by the value of the collateral).

20. *Capital One*, 2008 WL 304750 at \*819 (the entire value of the debt being the secured claim that the debtor must account for as part of her/his Chapter 13 plan).

21. *In re Rodriguez*, 375 B.R. 535, 540 (B.A.P. 9th Cir. 2007).

22. *Id.*

procedure.<sup>23</sup>

Today, courts diverge on how to treat these surrendered vehicle claims. Some courts find that creditors are still responsible for paying the deficiency amount between what they promised to pay on the vehicle and what the creditor can recover on that debt by reselling the vehicle.<sup>24</sup> Other courts have found that since Congress determined that claims could no longer be split into secured and unsecured, the vehicle must be surrendered in full satisfaction of the entire claim. Thus, the debtor owes nothing after surrendering the vehicle.<sup>25</sup> However, the minority approach that debtors are responsible for paying the deficiency value is more logical. This approach is supported by legislative intent and statutory interpretation.

Part I of this Note will review Chapter 13 bankruptcy plans. Part II will examine the statutes that are involved in this controversy, mainly § 1325 of the Bankruptcy Code, which governs confirmations of Chapter 13 plans and § 506 of the Code which governs bifurcations. Part III will review the majority and minority approaches of courts between 2005 to present. Part IV will introduce a legally sound solution to the controversy and propose an amendment to § 1325. By adopting the minority approach courts will approach this issue in a predictable and logical manner. Further, by amending the placement of the hanging paragraph to be exclusively applicable to § 1325(a)(5)(B), or retained vehicles, Congress can avoid any confusion about the purpose of the hanging paragraph.

## II. HISTORY AND LAW OF SURRENDERED VEHICLES

### A. CHAPTER 13 BANKRUPTCY PLANS

Chapter 13 bankruptcy, also known as Wage Earner Bankruptcy, includes a repayment plan between the debtor and trustee later confirmed by the court. Debtors typically complete the plan's payments within three to five years.<sup>26</sup> To qualify for this type of bankruptcy, one must (1) be an individual (2) with a steady income and (3) have debts under a proscribed amount.<sup>27</sup> This option is ideal for debtors who would like to keep their

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23. *Id.* at 541 (noting both the majority and minority of courts have been approaching the issue since 2005).

24. *Id.*

25. *Id.*

26. THE EDITORS OF SOCRATES, BANKRUPTCY, AN ACTION PLAN FOR RENEWAL 93 (Katharine Norman et al. ed., Socrates 2006); *see also* 11 U.S.C. § 1322 (2006) (governs the claims that may be part of the Chapter 13 plan while section 1325 governs the requirements for confirmation of the plan).

27. THE EDITORS OF SOCRATES, *supra* note 26, at 94. As of April 1, 2007 a Chapter 13 debtor may not have more than \$336,900 in unsecured debt or more than \$1,010,650 in secured debt, figures

property rather than lose it through liquidation, as in Chapter 7 bankruptcy.<sup>28</sup>

The debtor can propose modifications of a secured claim as part of his or her Chapter 13 plan.<sup>29</sup> If the modification of a secured claim is acceptable to the creditor, then the court confirms the plan.<sup>30</sup> The debtor may also choose to surrender the property securing the claim so that the creditor will no longer have a secured claim.<sup>31</sup> Each of these modifications is illustrated under 11 U.S.C. § 1325 of the Bankruptcy Code as Chapter 13 plans that must be confirmed by the court.

## B. THE HANGING PARAGRAPH IN 11 U.S.C. § 1325(a)

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) added a hanging paragraph to the end of 11 U.S.C. § 1325(a)(9).<sup>32</sup> The name “hanging paragraph” was coined in response to Congress inserting a freestanding, unnumbered paragraph between 11 U.S.C. § 1325(a)(9) and 1325(b)(1).<sup>33</sup> The purpose of adding the hanging paragraph was to add protection for secured creditors.<sup>34</sup> Congress made this addition in response to cram down, a situation in which a debtor could retain the vehicle securing a debt yet pay only the present value of the collateral to the creditor over the life of the Chapter 13 plan.<sup>35</sup> The remaining balance of the debt would become an unsecured claim.<sup>36</sup> The BAPCPA sought to achieve this goal by adding a provision under § 1325 that eliminates the use of § 506, the bifurcation section, in cases where the debtor has purchased a vehicle for personal use within 910 days of filing for Chapter 13 bankruptcy.<sup>37</sup>

Courts use § 506 of the Bankruptcy Code to determine the value of the debtor’s secured claim.<sup>38</sup> This statute allows courts to cram down the

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that are adjusted over time.

28. STEPHEN ELIAS & ROBIN LEONARD, CHAPTER 13 BANKRUPTCY, REPAY YOUR DEBTS 10 (Lisa Guerin ed., Nolo 2006).

29. DAVID G. EPSTEIN, BANKRUPTCY AND RELATED LAW IN A NUTSHELL 381, (Thomson West 2005).

30. 11 U.S.C. § 1325 (a)(5)(A) (2006).

31. § 1325 (the collateral securing the claim is surrendered in full satisfaction of the secured claim).

32. *Id.*

33. § 1325(a).

34. H.R. REP. No. 109-31(I), 140, *reprinted in* 2005 U.S.C.C.A.N. 88, 103.

35. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*820 (8th Cir. Feb. 5, 2008).

36. *Id.*

37. § 1325(a) (see specifically the hanging paragraph).

38. 11 U.S.C. § 506 (2006).

secured claim to the value of the collateral.<sup>39</sup> The remaining balance of a debt becomes an unsecured claim by the creditor against the debtor.<sup>40</sup> Eliminating the use of § 506 is the equivalent of prohibiting bifurcation on claims that fall under the terms of that statute.<sup>41</sup> Since the secured claim is not split into secured and unsecured, the entire debt remains a secured claim regardless of the diminishing value of the collateral.<sup>42</sup>

Prior to BAPCPA's additional provision, debtors had three options for creating a Chapter 13 plan with respect to vehicles purchased within 910 days of bankruptcy and having the plan confirmed. The options were: (1) obtain the creditor's acceptance of their plan under § 1325(a)(5)(A); (2) retain the vehicle and use § 506 to bifurcate the claim into secured and unsecured portions, and pay the creditor the cram down amount under § 1325(a)(5)(B); or (3) surrender the vehicle in full satisfaction of the secured claim, with the difference in value between the collateral and the loan remaining as an unsecured claim.<sup>43</sup>

The hanging paragraph, also termed by some courts as the "anti-cram down provision,"<sup>44</sup> changes the options available to debtors by preventing the use of § 506 in order to cram down their payment plan to present value of the retained vehicle.<sup>45</sup> By placing the unnumbered hanging paragraph at the end of § 1325(a)(9), Congress gave the impression that it intended for the provision to affect both retained and surrendered vehicles.<sup>46</sup>

The effect of the hanging paragraph on retained vehicles is that it eliminates the debtor's ability to use § 506 to bifurcate his/her claim on vehicles purchased for personal use and within 910 days of the petition date.<sup>47</sup> These debtors are thus left with three similar, yet different options from the pre-BAPCPA days. The options are to (1) obtain the creditor's acceptance of the plan; (2) retain the collateral and make full payment of

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39. *Id.*

40. *Id.*; see also *In re Ezell*, 338 B.R. 330, 338 (Bankr. E.D. Tenn. 2006).

41. § 1325(a) (identifying vehicles purchased within 910 days of the petition date for personal use as no longer being subject to bifurcation of claims under § 506); see also § 506.

42. *In re Ezell*, 338 B.R. at 335 (referring to the creditor's argument that since § 506 does not apply to § 1325 per the addition of the hanging paragraph, the secured claim on the vehicle in question remains secured and must be considered such as part of the debtor's plan); see also *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*822 (8th Cir. Feb. 5, 2008).

43. *In re Particka*, 355 B.R. 616, 622 (Bankr. E.D. Mich. 2006).

44. *In re Ezell*, 338 B.R. at 333-34.

45. "Retained vehicles" will be used frequently throughout to refer to vehicles that are retained per § 1325(a)(5)(B) in the debtor's plan. See *In re Particka*, 355 B.R. at 622.

46. § 1325(a)(9) (the placement of the hanging paragraph is after § 1325(a)(9) and refers to all sections above which includes all sections under 1325(a), 1325(a)(5)(A), 1325(a)(5)(B), and 1325(a)(5)(C). Section 1325(a)(5)(A) is beyond the scope of this Note because if both the creditor and debtor agree to a Chapter 13 plan, there is no question as to bifurcation of the claims). "Surrendered vehicle" will be used throughout the Note to refer to vehicles that are surrendered per § 1325(a)(5)(C) of the debtors plan.

47. *Capital One*, 2008 WL 304750, at \*821-22.

the creditor's allowed secured claim; or (3) surrender the collateral to the creditor.<sup>48</sup>

The difference between the pre-BAPCPA option and the post-BAPCPA options is that the debtors cannot bifurcate their claim using § 506.<sup>49</sup> Thus, to retain the vehicle, the debtor's Chapter 13 plan has to include not only the present value of the vehicle on the petition date but also the difference between that amount and the total debt, which equates to the entire debt.<sup>50</sup>

### C. THE JUDICIAL CONTROVERSY OVER INTERPRETING THE HANGING PARAGRAPH

Controversy arises when courts apply the BAPCPA provision to § 1325(a)(5)(C), or "surrendered vehicles."<sup>51</sup> A majority of courts has found that since § 506 does not allow for bifurcation, the whole claim remains secured.<sup>52</sup> Thus, surrendering the collateral that secures that claim satisfies the claim fully.<sup>53</sup> The minority has found that regardless of the inapplicability of § 506, the creditors have an unsecured claim rooted in non-bankruptcy law.<sup>54</sup> Given this logic, the minority courts find that creditors have an unsecured claim for the difference between the value of the vehicle surrendered and the balance of the debt.<sup>55</sup> This is the same logic followed by courts pre-BAPCPA.

#### 1. Secured Versus Unsecured Claims

The terms "secured" and "unsecured claims" have deep roots that are comparatively biblical in bankruptcy. A secured claim occurs when the debtor borrows money against specific collateral, and in turn, the creditor holds a lien on that property.<sup>56</sup> If the debtor defaults on that debt, the creditor has a right to foreclose on the property and sell it to reimburse itself for the loan.<sup>57</sup> Thus, the creditor has a secured claim up to the value

48. *Id.* at \*818; *see infra* Part I.C.

49. *In re Particka*, 355 B.R. at 622.

50. *Id.*

51. This is a term for claims on surrendered vehicles as part of Chapter 13 plans. *See* § 1325(a)(5)(C).

52. *In re Quick*, 371 B.R. 459, 465 (B.A.P. 10th Cir. 2007)

53. *Id.*

54. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*822-23 (8th Cir. Feb. 5, 2008). (non-bankruptcy law refers to the contract law of the state in which the petition is filed).

55. *Id.*

56. *In re Rodriguez*, 375 B.R. 535, 621 (B.A.P. 9th Cir. 2007).

57. *Till v. SCS Credit Corp.*, 541 U.S. 465, 502 (2004).

of the property.<sup>58</sup>

An unsecured claim is very common in daily commercial uses, such as credit cards, where the creditor holds no interest in the debtor's property as security for payment.<sup>59</sup> In cases where the claim is secured and the value of the collateral diminishes, it no longer secures the creditor for the full amount of the debt owed.<sup>60</sup> That creditor becomes undersecured<sup>61</sup> and its claim becomes both a secured claim for the present value of the collateral and an unsecured claim for the remaining balance of the debt.<sup>62</sup> Such secured claims are recognized in bankruptcy law under Bankruptcy Code § 101(51).<sup>63</sup>

When a debtor promises payment in exchange for the financing company holding a lien upon the vehicle, the debtor and creditor form a legal relationship.<sup>64</sup> The first part of that relationship is that the finance company obtains a right to payment enforceable under state contract law.<sup>65</sup> Second, due to the finance company's lien on the vehicle, it acquires a security interest in the vehicle, as defined by § 101(51).<sup>66</sup>

## 2. Bankruptcy Law and Non-Bankruptcy Law

While § 506 allows for bifurcation of claims, it is § 502 of the Bankruptcy Code that allows claims to be filed in the bankruptcy case in the first place.<sup>67</sup> Unless a party of interest objects, § 502 allows a creditor to bring claims into the bankruptcy proceeding.<sup>68</sup> Once a claim is permitted, § 506, where it applies, determines the extent to which the claim

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58. *Id.* (giving an example of a situation in which a debtor defaults and the creditor repossesses and resells the vehicle). See also *supra* note 19, and accompanying text.

59. 11 U.S.C. § 506 (2006) and accompanying text.

60. *Id.* (creating a secured claim for the value of the collateral and an unsecured claim for any remainder).

61. A creditor is undersecured where the value of the collateral securing the claim falls below the value of the debt leaving an unsecured claim.

62. § 506.

63. 11 U.S.C. § 101(5) (2006) defines a claim as a:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured disputed undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

*Id.*

64. *In re Quick*, 371 B.R. 459, 464-65 (B.A.P. 10th Cir. 2007).

65. *Id.* at 464.

66. *Id.* at 464-65; see also *In re Particka*, 355 B.R. 616, 620 (Bankr. E.D. Mich. 2006); 11 U.S.C. § 101(51) ("The term "security interest" means lien created by an agreement.")

67. 11 U.S.C. § 502 (2006).

68. *Id.*

will be treated as secured or unsecured.<sup>69</sup> If § 506 does not apply, the only consequence is that the claim will not have to meet the valuation requirement proposed by that section.<sup>70</sup> In other words, there are cases where there are secured claims that are not applicable under § 506. Such claims include liens that are not within the interest of the estate.<sup>71</sup> The validity and enforceability of such a claim would be determined by non-bankruptcy law unless otherwise specified in § 502(b).<sup>72</sup>

When faced with situations such as a debtor defaulting on his/her car payments outside of bankruptcy law, the process is simple.<sup>73</sup> The creditor may foreclose upon its security interest (the car), apply the foreclosure value to its debt, and the debtor remains liable for any deficiency.<sup>74</sup> The deficiency balance becomes the creditor's unsecured claim against the debtor.<sup>75</sup> Under bankruptcy law, however, where the property securing the debt is part of the estate, § 506 is used to determine what part of the claim is secured or unsecured.<sup>76</sup>

### 3. The Majority View

By adding the hanging paragraph and precluding the application of § 506 to secured claims on retained vehicles, Congress created a legal fiction where the collateral securing the claim is worth the exact amount of the total debt on the date of the petition.<sup>77</sup> Considering the rate at which cars depreciate, the value of a vehicle in such a dispute is usually worth substantially less than the original value by the date of the petition.<sup>78</sup> Congress' addition eliminates cram down and forces debtors to incorporate the full value of their debt into their Chapter 13 plans.<sup>79</sup>

A majority of courts have determined that Congress created a fiction as applied to surrendered vehicles as well, by allowing the surrendered vehicle to satisfy fully the creditor's claim regardless of the collateral's

69. *In re Particka*, 355 B.R. at 620.

70. *Id.* at 621.

71. 11 U.S.C. § 506 (2006).

72. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*821-22 (8th Cir. Feb. 5, 2008); *In re Particka*, 355 B.R. at 620.

73. *In re Particka*, 355 B.R. at 621.

74. *Id.*

75. *Id.*

76. § 506.

77. *In re Quick*, 371 B.R. 459, 464 (B.A.P. 10th Cir. 2007).

78. *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 963 (1997) (noting that vehicles depreciate rapidly), *superseded by statute* 11 U.S.C. § 1325(a)(9) (2006); *see also Capital One*, 2008 WL 304750 at \*819.

79. *In re Quick*, 371 B.R. at 464.

depreciation.<sup>80</sup> These courts argue that the hanging paragraph unambiguously leads to this result through a plain language interpretation.<sup>81</sup> The language of the hanging paragraph is as follows:

For purposes of paragraph (5) [of § 1325], § 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 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 § 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.<sup>82</sup>

Paragraph (5) of § 1325(a) dictates whether a court should confirm the Chapter 13 plan with respect to certain secured claims.<sup>83</sup> It describes the different routes that a Chapter 13 debtor may take with his or her vehicle once he or she has filed the petition.<sup>84</sup> Once the hanging paragraph was added at the end of this paragraph, it affected § 1325(a)(5)(B) by making the entire claim by the creditor against the retained vehicle secured.<sup>85</sup> This is undisputed.<sup>86</sup>

If the court decides that § 506 allowed for such bifurcation of the creditors claim pre-BAPCPA, then it logically follows that eliminating the use of § 506 from surrendered vehicles should eliminate the ability to bifurcate the claim.<sup>87</sup> If however, a court determines that the creditor's

80. *Id.*

81. *Id.* at 463-64.

82. § 1325.

83. *See id.*:

(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 non-bankruptcy law; or (bb) discharge under § 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 non-bankruptcy law; of such claim is not less than the allowed amount of such claim; and (iii) if—(I) property to be distributed pursuant to this sub§ 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.

84. *Id.*

85. *In re Kenney*, No. 06-71975-A, 2007 U.S. Bankr. WL 1412921, at \*7 (Bankr. E.D. Va. May 10, 2007).

86. *See In re Quick*, 371 B.R. 459, 462 (B.A.P. 10th Cir. 2007) (noting that the concept that a debtor can no longer cram down a 910 debt, but must account for the entire amount of the debt as a secured claim into his or her Chapter 13 plan is universally accepted).

87. *In re Quick*, 371 B.R. at 463.

deficiency claim was always governed by non-bankruptcy state law, then BAPCPA's prohibition of the use of § 506 on surrendered vehicles should be a moot point, as it was never applicable to the claim.<sup>88</sup> These divergent approaches to the logical implication of the hanging paragraph form the basis of the distinction between the majority and minority views on this issue. The majority of courts find that § 506 was the source of creditors' deficiency claims prior to BAPCPA's hanging paragraph,<sup>89</sup> whereas a minority of courts find that creditors' rights to deficiency claims after the vehicle is surrendered are rooted in state law.<sup>90</sup>

#### 4. The Minority View

The minority base their logic on the language of § 506 to determine that the section does not apply to surrendered vehicles.<sup>91</sup> The minority contends that § 506 by its own language excludes plans in which the debtor chooses to surrender the vehicle from being bifurcated by its terms.<sup>92</sup> The minority points to the fact that once a vehicle is surrendered, the estate no longer has an interest in that vehicle.<sup>93</sup> This supports the theory that the drafters of § 506 did not intend surrendered vehicles to be subject to bifurcation under this section.<sup>94</sup> Rather, the minority argues that the claim is allowed into bankruptcy under § 502 and completely determined by state law which is the governing law unless the Bankruptcy Code interferes.<sup>95</sup> In this case, if the above argument is the chosen one, it appears that § 506 of

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88. *In re Rodriguez*, 375 B.R. 535, 547 (B.A.P. 9th Cir. 2007) (noting that 11 U.S.C. § 506 never applied to cases with surrendered collateral, and thus the law remains as it was before BAPCPA's amendment).

89. *In re Ezell*, 338 B.R. 330, 339 (Bankr. E.D. Tenn. 2006) (explaining that pre-BAPCPA, § 506 was applied at the very least indirectly to bifurcate the creditor's claim into secured and unsecured).

90. *In re Rodriguez*, 375 B.R. at 547.

91. *In re Particka*, 355 B.R. 616, 624 (Bankr. E.D. Mich. 2006).

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.

11 U.S.C. § 506 (2006).

92. *Id.* (citing § 506 to illustrate that the provision was only meant to apply to claims secured by collateral within the interest of the estate).

93. *Id.*

94. *Id.*

95. *Id.*

the bankruptcy code does not interfere.<sup>96</sup>

Since BAPCPA added this paragraph to the end of § 1325(a) in 2005, courts have been split as to whether to grant a debtor's deficiency claim.<sup>97</sup> This unresolved issue is causing inconsistent rulings, appeals, and instability in this area of the law today.

### III. A LEGISLATIVE SOLUTION TO THE JUDICIAL CONTROVERSY

The minority approach, which has been adopted by the seventh, eighth, and ninth circuits is superior.<sup>98</sup> This approach allows the creditor its deficiency claim after a debtor surrenders a vehicle as part of its Chapter 13 plan.<sup>99</sup> Further, if Congress amends its placement of the hanging paragraph to clarify that it eliminates the use of § 506 only in instances where the vehicle is retained, it would eliminate the confusion that has plagued courts for the last four years.<sup>100</sup>

#### A. CONGRESSIONAL INTENT

The first step that courts must grapple with is whether they find the statutes involved to be ambiguous. If the statutory language is clear and unambiguous then the sole function of the court is to enforce it according to its terms.<sup>101</sup> Only one court faced with the issue has determined that the hanging paragraph was ambiguous.<sup>102</sup> This was most likely due to the conflict between the intentions of Congress in adding the hanging paragraph and the outcome that the majority courts find it has on surrendered vehicles; the Congressional intent being to protect creditors, and the outcome being creditors losing their deficiency claim.<sup>103</sup>

The section of the BAPCPA that added the hanging paragraph is titled "Section 306—Giving Secured Creditors Fair Treatment in Chapter 13,

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96. *Id.*

97. *In re Quick*, 371 B.R. 459, 462 (B.A.P. 10th Cir. 2007).

98. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*819 (8th Cir. Feb. 5, 2008).

99. *Id.*

100. *In re Particka*, 355 B.R. 616, 625 (Bankr. E.D. Mich. 2006) ("[I]t would have made even more sense to have included the hanging paragraph in § 1325(a)(5)(B) instead of appending it to § 1325(a)(9).").

101. *In re Kenney*, No. 06-71975-A, 2007 U.S. Bankr. WL 1412921, at \*5 (Bankr. E.D. Va. May 10, 2007) (citing *In re Osborn*, 363 B.R. 72, 78 (B.A.P. 8th Cir. 2007)).

102. *In re Duke*, 345 B.R. 806, 809 (Bankr. W.D. Ky. 2006).

103. *See generally In re Kenney*, 2007 WL 1412921.

Restoring the Foundation for Secured Credit.”<sup>104</sup> While there is minimal legislative history, and what there is repeats the statutory language, the title conveys that Congress intended to provide added protection to creditors.<sup>105</sup> Thus, it is illogical that Congress’s addition would protect creditors’ against cram down with retained vehicles all the while preventing their deficiency claim with surrendered vehicles.<sup>106</sup> This finding by a majority of courts is a finding that Congress either lacks consistency or is unaware of the effects of its legislation.<sup>107</sup> This inconsistent conclusion is not what Congress intended, and courts finding such have fallen short of accurate legislative interpretation.<sup>108</sup>

Regardless of the lack of legislative history, legislative intent and history are only necessary where the relevant statute is ambiguous.<sup>109</sup> Based on the language in the hanging paragraph, all courts ruling on the issue except for one have found that the language is unambiguous.<sup>110</sup> The language of the hanging paragraph clearly states that § 506 does not apply.<sup>111</sup> The confusion lies in the predicament the majority courts are faced with when they determine that § 506 no longer applies per the hanging paragraph, but recognize that the purpose of hanging paragraph is to help creditors.<sup>112</sup> This inconsistent view supports the minority approach because it explains away inconsistencies of the hanging paragraph as applied to confirmation of both surrendered and retained vehicle plans.<sup>113</sup>

## B. SAFETY IN NUMBERS?

For the majority position to be correct, it must be true that § 506 was

104. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 306(b), 119 Stat. 23, 80 (2005).

105. *In re Duke*, 345 B.R. at 809; *In re Kenney*, 2007 WL 1412921 at \*7.

106. *In re Rodriguez*, 375 B.R. 535, 543 (B.A.P. 9th Cir. 2007).

107. *In re Particka*, 355 B.R. 616, 622 (Bankr. E.D. Mich. 2006) (citing the creditor’s argument that the majority’s logic of extinguishing the creditor’s deficiency claim is inconsistent with the purpose of the hanging paragraph); *In re Payne*, 347 B.R. 278, 283 (Bankr. S.D. Oh. 2006).

108. See generally H.R. REP. No. 109-31(I), 140, reprinted in 2005 U.S.C.C.A.N. 88, 103.

109. *Id.*

110. *In re Kenney*, No. 06-71975-A, 2007 U.S. Bankr. WL 1412921, at \*6 (Bankr. E.D. Va. May 10, 2007).

111. *Id.*; 11 U.S.C. § 1325 (2006).

112. *In re Quick*, 371 B.R. 459, 463 (B.A.P. 10th Cir. 2007) (“[I]t may well be that elimination of deficiency claims was intended to offset, on behalf of 910 debtors, the benefit conferred upon secured 910 creditors by eliminating the cram down option. However, our determination of unambiguity eliminates the necessity of elucidating such an intent.”).

113. *In re Rodriguez*, 375 B.R. 535, 547 (B.A.P. 9th Cir. 2007) (noting that the court in *In re Particka* recognized the majority of courts proceeded from an incorrect assumption that deficiency claims are only created under bankruptcy law).

used to bifurcate the claims prior to 2005.<sup>114</sup> This is not the case.<sup>115</sup> The majority has incorrectly concluded that § 506 establishes the right to assert a deficiency claim.<sup>116</sup> In fact, it is state law that determines whether the creditor has a right to an unsecured deficiency claim.<sup>117</sup>

It is not § 506 that determines whether a bankruptcy claim is allowed: that is the function of § 502.<sup>118</sup> Section 502 of the Bankruptcy Code governs the allowance of claims or interests into the bankruptcy case.<sup>119</sup> To reject a claim, a court must find that it is prohibited under § 502.<sup>120</sup> Claims under state law are allowed into the bankruptcy case by way of § 502.<sup>121</sup> In these cases, the creditors have an unsecured claim based in state contract law and allowed into the bankruptcy case under § 502, not § 506.<sup>122</sup> Once the claim is part of the bankruptcy case, only then can § 506 apply, assuming the claim is part of the estate.

When a debtor surrenders his or her vehicle as part of his or her Chapter 13 plan, three events occur simultaneously.<sup>123</sup> The first is that the plan must be confirmed under 1325(a)(5)(C); secondly, the vehicle is surrendered in full repayment of the *secured* value of the debt, and third, the vehicle is no longer part of the estate, and thus the bankruptcy sections that apply to properties of the estate no longer apply.<sup>124</sup> Section 506, which by its terms only applies to property of the estate, cannot be used to bifurcate claims on vehicles that have been surrendered.<sup>125</sup> Thus, pre- and post-BAPCPA creditors have used state contract law in order to collect their remaining deficiency claim on surrendered vehicles.<sup>126</sup>

The only case in which bankruptcy does not recognize a state law claim is where a provision of the Bankruptcy Code disallows the claim.<sup>127</sup>

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114. *In re Ezell*, 338 B.R. 330, 339 (Bankr. E.D. Tenn. 2006) (citing the argument that if § 506 was not used to bifurcate claim on surrendered vehicles pre-BAPCPA then the addition of the hanging paragraph makes no difference to the ability to bifurcate).

115. *In re Particka*, 355 B.R. 616, 624 (Bankr. E.D. Mich. 2006) (“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.”).

116. *In re Rodriguez*, 375 B.R. at 542 (“The majority position holds that section 506 (and only section 506) creates defines and governs deficiency claim.”).

117. *Id.* at 543.

118. 11 U.S.C. § 502 (2006) (“A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under Chapter 7 of this title, objects.”).

119. *Id.*

120. *In re Rodriguez*, 375 B.R. at 545 (citing *Travelers Cas. & Sur. Co. of America v. Pacific Gas & Elec. Co.*, 127 S. Ct. 1199, 1206 (2007)).

121. *In re Rodriguez*, 375 B.R. at 546

122. *Id.* (indicating that creditors’ security interests rest on the Uniform Commercial Code).

123. *Id.* at 543-44.

124. *Id.* at 544.

125. *Id.*

126. *Id.*

127. *Id.* at 545.

The hanging paragraph does not disallow the remaining deficiency claim for two reasons. The first is that it does not prohibit bifurcation, but specifically disallows the use of § 506.<sup>128</sup> Secondly, § 506 never applied to surrendered vehicles as that section is only applied to collateral that is part of the estate.<sup>129</sup> Thus, § 506, which requires that the collateral be part of the estate in order to use that section to bifurcate the claim, is not applicable to surrendered vehicles.<sup>130</sup> Prior to 2005, deficiency claims were consistently allowed under state law, not § 506.<sup>131</sup> Thus, the hanging paragraph should not change the court's approach to such plans, especially when Congress only intended for the paragraph to affect retained vehicles.<sup>132</sup>

### C. HANGING QUESTIONS

The question that Congress leaves courts guessing is why it did not place the hanging paragraph at the end of the retained vehicle section of the Code.<sup>133</sup> The purpose of the addition was to eliminate cram down, a situation that prior to 2005 only occurred as part of retained vehicle plans.<sup>134</sup> The placement of the hanging paragraph in a way that is inclusive of surrendered vehicle claims is what has undoubtedly led a majority of courts to comfortably, yet wrongly, determine that § 506 actually had affected surrendered vehicles in the past.<sup>135</sup> Their reasoning being that Congress would not clarify that § 506 no longer applies to a section that never applied § 506 in the first place.<sup>136</sup>

Unfortunately, legislative history provides no definitive answer to this question. However, there are hints as to what Congress had in mind when it determined the placement of the hanging paragraph. Courts faced with this question have guessed the reasoning behind Congress's placement.<sup>137</sup>

One of the courts agreeing with the minority view, *In re Rodriguez*, determined that Congress applied the hanging paragraph to surrendered vehicles as well because § 506(b) speaks to valuation, a concept that is

128. 11 U.S.C. § 1325 (2006).

129. *In re Rodriguez*, 375 B.R. at 546; 11 U.S.C. § 506 (2006).

130. *In re Rodriguez*, 375 B.R. at 546.

131. *Id.* at 543-44.

132. *Id.* at 544.

133. *In re Particka*, 355 B.R. 616, 625 (Bankr. E.D. Mich. 2006) (noting that the only section of 1325(a) that is affected by the addition of the hanging paragraph is the retained vehicle section, § 1325(a)(5)(A)).

134. *In re Ezell*, 338 B.R. 330, 334 (Bankr. E.D. Tenn. 2006).

135. *In re Quick*, 371 B.R. 459, 463 (B.A.P. 10th Cir. 2007).

136. *Id.*

137. *In re Rodriguez*, 375 B.R. at 544.

applicable to both retained and surrendered vehicles.<sup>138</sup> By prohibiting the application of § 506 to surrendered vehicles Congress forces debtors to consider the total amount realized upon liquidation rather than the replacement value when determining the remaining claim to be part of their plan.<sup>139</sup> In many cases, this will result in the creditor having a larger deficiency claim.<sup>140</sup> This seems to explain the reason Congress prohibited § 506 application to surrendered vehicles and is consistent with its intent to help creditors. Congress left courts hanging as to the logical placement of the hanging paragraph.<sup>141</sup>

#### D. PROPOSED AMENDMENT TO 11 U.S.C. § 1325(a)

In order to avoid confusion Congress should amend § 1325 by moving the hanging paragraph so that it is physically located under 1325(a)(5)(B).<sup>142</sup> The section with the suggested changes would read as follows:

(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; (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; and (iv) For purposes this subsection, section 506 shall not apply to a claim if the creditor has a

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138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *In re Particka*, 355 B.R. 616, 625 (Bankr. E.D. Mich. 2006).

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; or (C) the debtor surrenders the property securing such claim to such holder[.]

This way the hanging paragraph will eliminate cram down by prohibiting bifurcation of a claim against a retained vehicle to achieve Congressional intent.<sup>143</sup> Since § 506 was never used to bifurcate claims under 1325(a)(5)(A), as those claims were agreed upon by the creditor and debtor, or 1325(a)(5)(C), as that property is no longer part of the estate, it is not necessary for Congress to prohibit § 506's application to those sections.<sup>144</sup> Further, Congress does not need to eliminate the application of 506(b) to surrendered vehicles.<sup>145</sup> As mentioned, state contract law creates the creditors' deficiency claim, so that any amount not recovered through resale will become an unsecured claim per the sales agreement.<sup>146</sup>

#### IV. CONCLUSION

With the proposed approach and amendments to § 1325, Courts would consistently find as was found in *Capital One* that people like Nathan L. Osborne are liable for a deficiency claim regardless of his surrendering the vehicle in full satisfaction of the secured portion.<sup>147</sup> Thus, as illustrated by the ball hypothetical, once Nathan decides to surrender the ball (or collateral) to Tommy in fully satisfaction of the secured claim, Tommy still has a claim for the depreciated value, or unsecured portion. Once Tommy resells the ball for its present value of three dollars to Katie, Nathan will owe Tommy the two-dollar difference. Tommy, the creditor retains his deficiency claim.

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143. *Id.*

144. *Id.*

145. *Id.*

146. *In re Rodriguez*, 375 B.R. 535, 546 (B.A.P. 9th Cir. 2007).

147. *Capital One Auto Finance v. Osborn*, No. 07-1726, 2008 WL 304750 at \*819 (8th Cir. Feb. 5, 2008).

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