DOES NEGATIVE EQUITY NEGATE THE HANGING PARAGRAPH?

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INTRODUCTION

Pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act, the so called "Hanging Paragraph"[1] in section 1325 of the Bankruptcy Code was added to prevent the bifurcation of an auto lender's claim if it arose from a purchase money security interest in a motor vehicle acquired for personal use within 910 days of filing for bankruptcy.[2] A recurring issue that Bankruptcy Courts are currently grappling with is the impact of negative equity financing[3] on purchase

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[1] *See* AmeriCredit Fin. Servs., Inc. v. Long (*In re* Long), 519 F.3d 288, 292 (6th Cir. 2008) (acknowledging "hanging paragraph" or "anti-cramdown paragraph" Congress added to end of section 1325(a)); *see also In re* Vinson, 391 B.R. 754, 758 (Bankr. D.S.C. 2008) (referring to it as "flush" language); Robin Miller, Annotation, *Effect of "Hanging" or "Anti-Cramdown" Paragraph Added to 11 U.S.C.A. § 1325(a) by Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)*, 19 A.L.R. FED. 2d 157 (2007) ("Because of its lack of a formal citation, courts often refer to the paragraph as the 'hanging' or 'anti-cram down' paragraph of § 1325(a).").

[2] In 11 U.S.C. § 1325, the provision states:

> For the 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. § 1325(a) (2006) (emphasis added); *see In re* Padgett, 389 B.R. 203, 206 (Bankr. D. Kan. 2008) ("[L]anguage contained within the hanging paragraph makes the value of the collateral irrelevant in determining the allowed amount of a claim secured by a purchase money security interest . . . ."); *In re* Pinti, 363 B.R. 369, 375 (Bankr. S.D.N.Y. 2007) (acknowledging hanging paragraph's primary function as preventing bifurcation of creditor's lien into secured and unsecured liens if made within 910 days before bankruptcy filing).

[3] *See* GMAC v. Horne, 390 B.R. 191, 194 (E.D. Va. 2008) (describing negative equity as debt owed on trade-in vehicle in excess of trade-in vehicle's value, which seller pays off and includes in contract as fraction of financed purchase price of replacement vehicle); *In re* Lavigne, Nos. 07-30192, 07-31402, 07-31247, 06-32914, 2007 WL 3469454, at *1 n.1 (Bankr. E.D. Va. Nov. 14, 2007) ("Negative equity is the amount by which the outstanding loan balance exceeds the value of the trade-in vehicle."), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re* Tuck, No. 06-10886-DHW, 2007 WL 4365456, at *1 (Bankr. M.D. Ala. Dec. 10, 2007) (defining negative equity as value of debt owed minus trade-in vehicle's value).

money security interests ("PMSI") within the context of the hanging paragraph.[4] This Comment maintains first that negative equity financing secured by a replacement vehicle does not give rise to a PMSI in the new vehicle, and second, absent a clear allocation of monthly payments in a contract, comingling negative equity financing with a purchase money obligation should transform the purchase money status of the entire security interest to non-purchase status.

Courts are split with respect to the purchase money status of negative equity financing. Some courts deem negative equity financing to have purchase money character if it were either integral or necessary to the sale of the replacement vehicle.[5] However, other courts hold that negative equity financing should not be magically crowned with purchase money status by the simple fact that it is obtained in the same transaction as the purchase of the newly secured replacement vehicle.[6]

If it is determined that negative equity financing does not give rise to a PMSI due to its lack of purchase money character, then further analysis is necessary to determine whether the entire loan is affected by the inclusion of negative equity.[7] The courts are split again on this issue. Courts generally resort to the Uniform Commercial Code ("U.C.C.") definition of purchase money security interest and ultimately are divided as to whether the dual status or transformation rule applies in

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[4] *See GMAC*, 390 B.R. at 196–97 (stating focus of appeals to be financing of negative equity and interpreting meaning of purchase money security interest); *see In re* Johnson, 380 B.R. 236, 239 (Bankr. D. Or. 2007) (recognizing "Hanging Paragraph has been the subject of substantial litigation and disputes regarding its interpretation"); *In re* Burt, 378 B.R. 352, 358 (Bankr. D. Utah 2007) (observing no consensus exists on application of negative equity and PMSIs under hanging paragraph) (citation omitted).

[5] *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 258–59 (W.D.N.Y. 2007) (rationalizing if seller and buyer concur on including payoff of debt on trade-in as essential to their transaction for new vehicle, it is difficult to view that as something other than expense incurred) (citation omitted); Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291, at *2 (M.D. Ga. June 26, 2007) (finding negative equity was included in collateral where it was "inextricably intertwined" with transaction), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *In re* Cohrs, 373 B.R. 107, 109–10 (Bankr. E.D. Cal. 2007) (requiring "'close nexus'" between gaining collateral and secured obligation for purchase money character) (citation omitted).

[6] *See In re* Hernandez, 388 B.R. 883, 884–85 (Bankr. C.D. Ill. 2008) (finding majority view of "the negative equity resulting from a trade in of a vehicle is not part of the purchase money security interest" to be "consistent with the plain meaning of the hanging paragraph"); *In re Johnson*, 380 B.R. at 250 ("Financed negative equity is neither part of the 'price of the collateral' being purchased, nor is it 'value given to enable the debtor to acquire rights in or the use of the collateral' being purchased."); *In re* Mitchell, 379 B.R. 131, 138 (Bankr. M.D. Tenn. 2007) (agreeing negative equity financing is not part of creditor's purchase money security interest).

[7] *See In re* Busby, No. 0702717EE, 2008 WL 4104184, at *6 (Bankr. S.D. Miss. Aug. 28, 2008) (observing "[s]ince the Court has found that the negative equity is not protected as part of the PMSI securing the vehicle, the next issue is how should that negative equity be addressesed"); *In re* Brodowski, 391 B.R. 393, 401–02 (Bankr. S.D. Tex. 2008) (concluding after finding negative equity not part of PMSI court should then address treatment of such negative equity under transformation rule or dual-status rule); *In re* Sanders, 377 B.R. 836, 857–58 (Bankr. W.D. Tex. 2007) (indicating after determining negative equity to be outside purchase money security interest, court "next need[ed] to determine how or whether [creditor's] claim fits within the 910-day exception to the general rule that secured claims can be bifurcated in a chapter 13 plan").

these negative equity cases.[8] The dual status rule doles out the non-purchase money portion and treats the remaining as a pure purchase money obligation. On the other hand, the transformation rule re-characterizes the entire obligation into non-purchase money if it is tainted by the comingling of purchase and non-purchase money obligations.[9]

Part I of this Comment will briefly examine the legislative history of the hanging paragraph in section 1325(a) of the Bankruptcy Code and Revised Article 9 section 9-103 of the U.C.C. Part II of this Comment will discuss the purchase money status of negative equity and argue that negative equity is not a PMSI because (1) it is not part of the purchase price of the collateral; (2) it is not value used to enable the consumer to acquire rights in the new vehicle; and (3) there is no close nexus between negative equity financing for a trade-in vehicle and the purchase of a replacement vehicle. Part III of this Comment will discuss the dual status rule and outlines the complexities of tracing that is required when dual status is applied. Part III will conclude that although the dual status rule may arguably be preferable in theory, it is not practical in its application. Part IV of this Comment supports the application of the transformation rule as a default (absent clear allocation provisions in the contract) for negative equity cases based on statutory interpretation and bankruptcy policies and provides a method for preserving creditors' pure PMSIs under the hanging paragraph.

I. BACKGROUND

A. Section 1325 Hanging Paragraph in Bankruptcy Code

The legislative history of the hanging paragraph, titled "Restoring the Foundation for Secured Credit" indicates congressional intent to remedy the cram down effect of section 506 bifurcation of claims in the auto lending industry.[10]

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[8] *See* Pristas v. Landaus of Plymouth, Inc. (*In re* Pristas), 742 F.2d 797, 800–01 (3d Cir. 1984) (acknowledging courts are split regarding whether to apply transformation or dual status rule); *In re Busby*, 2008 WL 4104184, at *6 (noting courts ultimately determine whether to apply transformation rule or dual-status rule); *In re* Mancini, 390 B.R. 796, 806 (Bankr. M.D. Pa. 2008) (noting courts follow either transformation or dual status rule "[w]hen a claim is partly a purchase money security interest and partly a non-purchase money security interest").

[9] *See In re* Munzberg, 388 B.R. 529, 544 (Bankr. D. Vt. 2008) (noting transformation rule "'holds that a security interest that is part purchase-money and part non-purchase money completely loses its purchase-money character and is entirely transformed into a non-purchase-money security interest'") (citation omitted). *See generally* Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 857–60 (B.A.P. 9th Cir. 2008) (defining and discussing application of transformation and dual status rules); *In re* Riach, No. 07-61645-aer13, 2008 WL 474384, at *4 (Bankr. D. Or. Feb. 19, 2008) (explaining generally both transformation and dual status rules).

[10] *See* AmeriCredit Fin. Servs., Inc. v. Long (*In re* Long), 519 F.3d 288, 294 (6th Cir. 2008) (finding drafters of hanging paragraph "'intended only good things for car lenders and other lienholders'" (quoting KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 451.5-1 (3d ed. 2000 & Supp. 2007-1))); Capital One Auto Fin. v. Osborn, 515 F.3d 817, 820 (8th Cir. 2008) (adding of hanging paragraph to Bankruptcy Code served to eliminate "cram down" option for vehicles "purchased less than 910 days before the Chapter 13 bankruptcy"); Wells Fargo Fin. Acceptance v. Rodriguez (*In re* Rodriguez), 375 B.R. 535, 548 (B.A.P. 9th

Section 506 of the Bankruptcy Code bifurcates an under-secured claim, allowing a secured claim limited to the value of the collateral with the remaining portion left as an unsecured claim.[11] This cram down effect forced auto lenders to receive a secured claim equal to the value of the collateral.[12] The fact that motor vehicles drastically decrease in value over time meant that the auto lender's secured claim decreased while the unsecured claim steadily increased. The addition of the

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Cir. 2007) (observing "Congress intended to take away the right of debtors to reduce their secured obligations on retained 910 vehicles to the value of the vehicles"); *Peaslee*, 373 B.R. at 261 ("To the extent that it is possible to glean any Congressional intent behind the hanging paragraph . . . that intent . . . seems to be to protect creditors from the abuse of 'cram-down.'") (citations omitted); *In re* Duke, 345 B.R. 806, 809 (Bankr. W.D. Ky. 2006) ("The history [of the hanging paragraph] does indicate that it was meant to discourage bankruptcy abuse. It is interesting to note that the section of BAPCPA that added the hanging paragraph was entitled, 'Section 306—Giving Secured Creditors Fair Treatment in Chapter 13 . . . Restoring the Foundation for Secured Credit.'") (citation omitted); *In re* Carver, 338 B.R. 521, 523–24 (Bankr. S.D. Ga. 2006) (holding plain language of hanging paragraph indicates cram down "does not apply to 910 claims when determining the treatment of secured claims"); *In re Sanders*, 377 B.R. at 845 (holding hanging paragraph "eliminates bifurcation and the resulting cram down in value with respect to car creditors" under certain circumstances); *see also* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, H.R. REP. NO. 109-31(I), pt. 1, at 17, 72 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 103

> S. 256's protections for secured creditors include a prohibition against bifurcating a secured debt incurred within the 910-day period preceding the filing of a bankruptcy case if the debt is secured by a purchase money security interest in a motor vehicle acquired for the debtor's personal use. Where the collateral consists of any other type of property having value, S. 256 prohibits bifurcation of specified secured debts if incurred during the one-year period preceding the filing of the bankruptcy case. The bill clarifies current law to specify that the value of a claim secured by personal property is the replacement value of such property without deduction for the secured creditor's costs of sale or marketing. In addition, the bill terminates the automatic stay with respect to personal property if the debtor does not timely reaffirm the underlying obligation or redeem the property . . . Section 306(b) adds a new paragraph to section 1325(a) of the Bankruptcy Code specifying that Bankruptcy Code section 506 does not apply to a debt incurred within the two and one-half year period preceding the filing of the bankruptcy case if the debt is secured by a purchase money security interest in a motor vehicle acquired for the personal use of the debtor within 910 days preceding the filing of the petition. Where the collateral consists of any other type of property having value, section 306(b) provides that section 506 of the Bankruptcy Code does not apply if the debt was incurred during the one-year period preceding the filing of the bankruptcy case.

[11] 11 U.S.C. § 506(a)(1) (2006). *See In re* Hayes, 376 B.R. 655, 662 (Bankr. M.D. Tenn. 2007) (stating before BAPCPA, chapter 13 debtors could bifurcate under-secured claims into secured and unsecured portions under section 506(a)); *see also* Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427, 429 (6th Cir. 1982) ("The total claim of the secured creditor which is to be allowed is divided into two parts, the secured portion of the claim and the unsecured portion."); *In re* Johnson, 380 B.R. 236, 239–40 (Bankr. D. Or. 2007) (noting hanging paragraph prevents debtors from cramming down motor vehicle claims).

[12] *See In re* Morales, 359 B.R. 211, 214 (Bankr. N.D. Ill. 2007) (acknowledging Congress's recognition of this "abusive" debtor practice) (citation omitted); *In re* Payne, 347 B.R. 278, 281 (Bankr. S.D. Ohio 2006) ("The Credit Union suggests, not inaccurately, that through the BAPCPA amendments to § 1325(a)(5), Congress was attempting to remedy a perceived abuse by those who buy vehicles on credit on the eve of bankruptcy and then utilize the cramdown provisions of the Bankruptcy Code to pay the secured creditor a lesser amount than its full claim."); *In re* Turner, 349 B.R. 437, 442 (Bankr. D.S.C. 2006) (observing relevant legislative history of hanging paragraph).

hanging paragraph in section 1325 purports to make cram down inapplicable for PMSIs in motor vehicles acquired for personal use within 910 days of filing for bankruptcy.[13] The purpose was to give auto lenders an allowed secured claim for the full amount of the obligation rather than have it bifurcated according to the decreased value of the vehicle at the time of filing.[14]

When auto loans are made to consumers to purchase a new vehicle, the loan can cover all or part of the purchase price of the vehicle as well as negative equity in a trade-in vehicle. Negative equity refers to a trade-in vehicle where the balance owed on the car exceeds its market value.[15] Negative equity financing is the process by which the consumer obtains a new loan to satisfy the antecedent debt still owed on the vehicle, which is usually done when the consumer is also taking out a loan to purchase a new vehicle.[16] Because negative equity is added or "rolled in" to the purchase money loan used to acquire the new vehicle, courts are split as to whether to categorize negative equity as purchase money obligation.[17]

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[13] *See* DaimlerChrysler Fin. Servs. Ams. LLC v. Ballard (*In re* Ballard), 526 F.3d 634, 638 (10th Cir. 2008) (acknowledging hanging paragraph's anti-cram down effect); *In re* Graupner, 356 B.R. 907, 911 (Bankr. M.D. Ga. 2006) (stressing hanging paragraph "has the effect of precluding debtors from bifurcating undersecured claims" under section 506 of Code), *aff'd sub nom.* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *see also In re* Ford, 387 B.R. 827, 829 (Bankr. D. Kan. 2008) (interpreting in broad terms hanging paragraph's preventative nature).

[14] *See In re Hayes*, 376 B.R. at 664 (noting that satisfaction of hanging paragraph's criteria protects from bifurcation); *In re* Sanders, 377 B.R. 836, 845 (Bankr. W.D. Tex. 2007) ("If this special provision applies, then a debtor's plan must treat the entire claim of the creditor as secured, regardless the value of the collateral . . . ."); *In re Turner*, 349 B.R. at 442 (determining "secured creditors subject to the flush language of § 1325(a) are fully secured for the entire amount of their claims"); *see also* KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §451.3 (3d ed. 2000 & Supp. 2007-1) (observing "[a] strong majority of courts have concluded that when a debt falls within the hanging sentence, § 506 is disabled and the debt is treated as if it were fully secured though it can be otherwise modified consistent with § 1322(b)(2)").

[15] *See In re* Burt, 378 B.R. 352, 355 n.5 (Bankr. D. Utah 2007) ("Negative equity results when a debtor trades in a vehicle that is 'under water,' meaning the trade-in vehicle has more debt against it than its value."); *In re* Petrocci, 370 B.R. 489, 502 (Bankr. N.D.N.Y. 2007) (noting negative equity debt occurs when "less than nine hundred and ten day-old vehicle is not worth the outstanding loan balance"); *In re* Wright, 276 B.R. 399, 405 (Bankr. W.D. Pa. 2002) (stating debtors have negative equity when amount owed surpasses vehicle's value).

[16] *See* Miller, *supra* note 1 (defining negative equity, in context of hanging paragraph, as situation in which replacement vehicle is purchased before vehicle being used as trade-in has been paid for so that purchaser is obtaining loan to cover both new purchase and balance still owed for trade-in vehicle); *see also* Kenneth J. Rojc & Thomas K. Juffernbruch, *Negative Equity in Trade-In Vehicles: Regulation Z and State Law Developments*, 55 BUS. LAW. 1295, 1295 (May 2000) (describing negative equity as "aris[ing] when the lien payoff on a trade-in vehicle exceeds the amount of the trade-in allowance"); William F. Savino & David S. Widenor, *Commercial Law*, 58 SYRACUSE L. REV. 779, 817 (2008) (describing question presented in *General Motors Acceptance Corp. v. Peaslee* as "whether the PMSI included the amount of the 'rolled up' debt or negative equity from the trade-in of a prior motor vehicle 'as part of the purchase price of the new vehicle'") (citation omitted).

[17] *Compare* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 48 (D. Kan. 2007) (holding purchase money obligation does not include debt resulting from "'optional transaction where negative equity is refinanced'" but does include remaining obligations) (citations omitted), *and In re* White, 352 B.R. 633, 639 (Bankr. E.D. La. 2006) (describing vehicle's related insurance and warranty purchases as separate contracts and therefore "not a part of the purchase money security interest in the vehicle"), *with* Gen. Motors

The nature of rolled-in negative equity financing and its treatment in evaluating PMSIs has spurred much debate in the courts.[18] A contributing factor to the diverging treatment of negative equity is the lack of direction under the U.C.C. provision (adopted by most states) that leaves it to the courts to determine whether dual status or transformation rules should be applied for consumer goods regarding purchase money status.[19] A few courts hold that the entire obligation is clothed in purchase money character despite the inclusion of negative equity;[20] and therefore, the creditor will have a fully secured claim for the entire amount of the debt under the hanging paragraph.[21] However, most courts hold that the negative equity portion

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Acceptance Corp. v. Peaslee, 373 B.R. 252, 262 (W.D.N.Y. 2007) (holding "claims attributable to the payoff of negative equity" constitute secured claims).

[18] *See Peaslee*, 373 B.R. at 255 (noting "no clear consensus . . . has yet emerged" regarding "the extent to which a creditor holds a purchase money security interest . . . in connection with a . . . sale in which the seller allows the buyer to 'roll in' the 'negative equity' on a trade-in vehicle"); *In re Burt*, 378 B.R. at 358 (noting although many courts have interpreted effect of hanging paragraph, no clear consensus regarding negative equity in motor vehicle financing transactions has emerged); *In re* Wall, 376 B.R. 769, 770 (Bankr. W.D.N.C. 2007) ("The courts that have addressed this issue have reached conclusions falling into three different categories.").

[19] New York's adaptation of U.C.C. section 9-103 states:

> Non-consumer-goods transactions; no inference. The limitation of the rules in subsections (e), (f), and (g) to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

N.Y. U.C.C. LAW § 9-103(h) (McKinney 2008). *See* In re Munzberg, 388 B.R. 529, 547 (Bankr. D. Vt. 2008) ("[T]he Vermont UCC only provides guidance on allocation of payments for non-consumer transactions, allowing courts the discretion, pursuant to 9A V.S.A. § 9-103(h), to fashion their own rules in consumer transactions.") (footnote omitted); *see also* In re Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007) ("Once a transaction is determined to be partially purchase money and partially nonpurchase money, California UCC § 9103(h) leaves to the court's discretion whether to apply the dual status rule or the transformation rule to the treatment of the secured claim.").

[20] *See In re Wall*, 376 B.R. at 771 (deciding "the financing of a motor vehicle that includes negative equity in a trade-in vehicle may constitute a 'purchase money security interest' that is not subject to" changes by chapter 13 plan); *In re* Cohrs, 373 B.R. 107, 110–11 (Bankr. E.D. Cal. 2007) (noting pay off of negative equity was "part of the single transaction . . . for the purpose of acquiring the property securing the new obligation"); *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y. 2007) (noting negative equity to be "inextricably linked" to purchase of new vehicle).

[21] *See Peaslee*, 373 B.R. at 256 (advancing rule "[i]f the provisions of this 'hanging paragraph' are met, the bankruptcy court is precluded from reducing or stripping-down the creditor's *purchase money security interest* on the debt and the entire amount of that indebtedness must be covered in the plan"); *In re* Austin, 381 B.R. 892, 897 (Bankr. D. Utah 2008) (holding "$3,000.00 negative equity financing, and the balance of the financing" is considered "purchase-money obligation" such that hanging paragraph "insulates . . . claim from bifurcation under [section] 506 of the Code"); *In re* Burt, 378 B.R. 352, 354 (Bankr. D. Utah 2007) (holding hanging paragraph of section 1325(a) applies and "Ford Motor Credit's entire claim, including that portion of the claim attributable to negative equity and costs associated with the purchase of the vehicle qualifies as a PMSI"); *In re Cohrs*, 373 B.R. at 110 (reading "section 9103 and Comment 3 to require only a 'close nexus' between the acquisition of the property and the secured obligation" meaning "it must be part of a single transaction and all components of the obligation incurred must have been for the purpose of acquiring the property securing the new obligation"); *In re Petrocci*, 370 B.R. at 502 (asserting "primary purpose of the hanging paragraph of Code § 1325(a)(9) is . . . to take the 'unsecured negative equity debt'

is not "purchase money," and have applied different rules to deal with the mixing of non-purchase money and pure purchase money loans.[22] Courts following the transformation rule hold that the inclusion of this non-purchase money obligation with a purchase money transaction will destroy the entire obligation's purchase money character. This makes the anti-bifurcation protection under the hanging paragraph inapplicable.[23] As a result, the entire debt will be subject to section 506 bifurcation and the claim will only be a secured claim to the extent of the value of the collateral.[24]

Other courts apply the dual status rule and carve out the rolled in negative equity portion of the loan giving only the purchase money portion of the loan protection under the hanging paragraph.[25] The pure purchase money portion will be treated as a fully secured claim, regardless of the value of the collateral.[26]

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which any Chapter 13 debtor has when his or her less than nine hundred and ten day-old vehicle is not worth the outstanding loan balance" and by not applying treatment of section 506, "to 'transform it into secured debt not supported by collateral value, and then require it to be paid in full to the detriment of other unsecured creditors'" (quoting *In re* Peaslee, 358 B.R. 545, 556 (Bankr. W.D.N.Y. 2006), *rev'd sub nom.* Gen. Motor Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007))).

[22] *See In re Burt*, 378 B.R. at 358 ("One line of cases, which includes the bankruptcy court decisions in *Peaslee I*, *Price*, *Acaya*, *Barnes*, and *Pajot*, holds that negative equity is not part of the purchase price of the collateral, and therefore, does not give rise to a PMSI."); Stacy L. Molison, Note, *A Look at Disparate Approaches to Valuation Under Section 506 and Its Relationship to Section 1325*, 15 AM. BANKR. INST. L. REV. 659, 677 (2007) (stating "majority of courts interpret the peculiar relationship between sections 506 and 1325 to mean that bifurcation of items falling under the hanging paragraph is not allowed") (citation omitted); Andrew P. Moratzka, *Negative Equity for "910-Day" Vehicle Purchase Receiving Positive Treatment for Creditors*, 27 AM. BANKR. INST. J. 20, 20, 65 (Sept. 2008) (stating "[n]ot all courts have agreed with" reasoning set forth in *General Motors Acceptance Corp. v. Peaslee*, which held negative equity is purchase money, and stating "national trend is headed in the direction of including negative equity and other costs in a debtor's purchase money obligations") (citation omitted).

[23] *See In re* Callicott, 386 B.R. 232, 237 (Bankr. E.D. Mo. 2008) (holding "if this Court applied the transformation rule here, this would destroy the intent of the hanging paragraph and make it ineffective in almost half of the vehicle financing transactions it was designed to address") (citation omitted); *see also In re* Johnson, 380 B.R. 236, 247–48 (Bankr. D. Or. 2007) ("Most courts concluding that financed negative equity is not a purchase money obligation" can apply transformation rule, which will "not afford any protection against cramdown of the secured creditor's claim"); *In re* Westfall, 365 B.R. 755, 762 (Bankr. N.D. Ohio 2007) (stating "[u]nder the transformation rule, a mixed transaction results in loss of the purchase money security protection" and hanging paragraph no longer applies), *aff'd in part, rev'd in part*, 376 B.R. 210 (Bankr. N.D. Ohio 2007).

[24] *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 256 (W.D.N.Y. 2007) (describing cramdown as "court cram[ming] down the creditor's throat the substitution of money for the collateral, a situation that creditors usually oppose because the court may underestimate the collateral's market value and the appropriate interest rate," and, also, debtor "may fail to make all promised payments, so that the payment stream falls short of the collateral's full value" (quoting *In re* Wright, 492 F.3d 829, 830 (7th Cir. 2007))); *see also In re Westfall*, 365 B.R. at 764 ("When a transaction is 'mixed' or has both purchase money and nonpurchase money components, the entire transaction is transformed into a nonpurchase money transaction . . . ."); *In re* Price, 363 B.R. 734, 738 (Bankr. E.D.N.C. 2007) ("A stripped down claim is bifurcated into two claims: one that is a secured claim equal to the value of the collateral, and a second claim that is unsecured for the balance."), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[25] *In re Johnson*, 380 B.R. at 248 (stating some courts have found "protection against cramdown under the Hanging Paragraph [is] only for the portion of the secured creditor's claim that is a purchase money obligation"); *In re Burt*, 378 B.R. at 364 (noting "dual status rule 'allows a security interest to have . . . the

B. The U.C.C. Should Be Used to Define PMSIs in Bankruptcy

A holder of a PMSI is given special preferential treatment when it comes to priority and perfection over other security interest holders outside the bankruptcy context.[27] With the passage of the hanging paragraph, auto lenders are given special treatment in bankruptcy if they hold a PMSI in motor vehicles within 910 days of the petition.[28] Therefore it is crucial to define what a PMSI is and how it is created in the bankruptcy context.[29] However, the term of art is undefined in the Bankruptcy Code.[30] When Congress fails to define an essential term in a provision of the Bankruptcy Code, Congress is presumed to be aware of the term of art and its common usage outside of bankruptcy law when it employs the term in an amendment.[31] Therefore, the courts have looked to state law, specifically the Uniform Commercial Code for guidance. The Supreme Court has held that, "[p]roperty interests are created and defined by state law. Unless some federal

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status of a PMSI to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to its purchase'" (quoting *In re Petrocci*, 370 B.R. at 504)); *In re* Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007) ("Under the dual status rule, adopted in *Pristas*, a security interest is a purchase money security interest only to the extent it secures the purchase price of the collateral, even if it secures other items.").

[26] *See In re* Turner, 349 B.R. 437, 440–41 (Bankr. D.S.C. 2006) (adopting view that PMSI be treated as fully secured claim); *In re* Robinson, 338 B.R. 70, 73–74 (Bankr. W.D. Mo. 2006) (noting claim fully secured regardless of value of vehicle); *see also* KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §451.1, at 451.1-7 (3d ed. 2007 & Supp. 2007-1) (positing fairness of some courts allowing creditors to secure large claims against debtors using collateral of small monetary value).

[27] *See* Kunkel v. Sprague Nat'l Bank, 128 F.3d 636, 644 (8th Cir. 1997) (holding PMSI gives creditor priority over party with "earlier perfected interest") (citation omitted); Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 845 (B.A.P. 9th Cir. 2008) (observing PMSI is important because it gives creditor "special rights . . . both in perfection and in priority" over others); *In re* Brookwood Sand & Gravel, Inc., 174 B.R. 309, 313 (Bankr. N.D. Ala. 1994) (affirming PMSI gives creditor priority over another party with "earlier perfected security interest . . . in the same collateral").

[28] *See* 11 U.S.C. § 1325(a) (2006) (stating holders of PMSIs in motor vehicles have secured claim for full amount rather than bifurcated claim with secured claim capped at value of collateral); *In re Penrod*, 392 B.R. at 840 (observing hanging paragraph gave auto lenders secured interest beyond actual value of car); Trejos v. VW Credit, Inc. (*In re* Trejos), 374 B.R. 210, 215–17 (B.A.P. 9th Cir. 2007) (noting auto lender entitled extra protection under hanging paragraph).

[29] *See In re Penrod*, 392 B.R. at 843 (indicating definition of PMSI important "for purposes of the hanging paragraph"); *In re* Munzberg, 388 B.R. 529, 535 (Bankr. D. Vt. 2008) (highlighting importance of defining "scope" of PMSI); *cf. In re* Look, 383 B.R. 210, 216 (Bankr. D. Me. 2008) (observing in light of inconsistencies between courts one court called for "uniform" definition of PMSI), *aff'd sub nom.* Bank of Am. v. Look, No. 08-129-P-H, 2008 U.S. Dist. LEXIS 54695 (D. Me. July 17, 2008).

[30] *See In re Penrod*, 392 B.R. at 843 ("When Congress enacted the hanging paragraph in 2005, it did not include a definition of a PMSI."); *In re* Ford, 387 B.R. 827, 830 (Bankr. D. Kan. 2008) (explaining courts struggle defining PMSI because it was not defined by Bankruptcy Code); *In re Look*, 383 B.R. at 215 (documenting no definition of PMSI provided by Code) (citations omitted).

[31] *In re Look*, 383 B.R. at 217 (inferring Congress intended for term to have same meaning as outside of bankruptcy); *In re* Sanders, 377 B.R. 836, 846 (Bankr. W.D. Tex. 2007) (noting "Congress is deemed to understand the context in which terms of art are used, and to intend the term to take on its ordinary meaning within that context") (citation omitted); *cf. In re Munzberg*, 388 B.R. at 535–36 (finding reasoning of bankruptcy courts using state U.C.C. definition to determine meaning of PMSI to be persuasive).

interest requires a different result . . . [t]he justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests . . . ."[32]

The problem with looking wholly to state law is two-fold. First, some states have multiple statutes that regulate motor vehicle financing, and second, complete deference to only state created law leads to lack of consistency when applied to a uniform federal bankruptcy law. For instance, courts that hold negative equity is part of the purchase price of the replacement vehicle look to other state statutes to supplement the U.C.C. definition.[33] The doctrine of "in pari materia" allows the courts to construe similar statutes similarly, as if they were one law.[34] Therefore, some courts incorporate other state laws to the U.C.C. For instance, courts reference the state Motor Vehicle Sales Financing Act ("MVSFA") to complete the definition of the term "price" in the U.C.C.'s definition of "purchase price of the collateral" that gives rise to a PMSI.[35]

Although the U.C.C. is state law, there is sufficient uniformity to the extent that the U.C.C. is rooted in one uniform code that was intended to be adopted by the states to create uniformity over commercial transactions in the United States. Furthermore, this is not the first instance where the U.C.C. has been the source of assessing the creation and status of a security interest in the bankruptcy context.[36] The validity and priority of liens, as well as the trustee's strong arm powers, reference the U.C.C.[37] Here, the term "purchase money security interest" is given its

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[32] Butner v. United States, 440 U.S. 48, 55 (1979).

[33] *See In re Ford*, 387 B.R. at 831 (using Kansas law to decide "financed negative equity falls within the definition of a purchase money obligation"); *see also In re* Burt, 378 B.R. 352, 361–63 (Bankr. D. Utah 2007) (referring to courts using state versions of U.C.C. to determine negative equity as part of purchase price while reaching same conclusion). *Contra In re Munzberg*, 388 B.R. at 538 (indicating conclusion that negative equity is not part of purchase price is "majority position").

[34] *See* Wachovia Bank, Nat'l Ass'n v. Schmidt, 546 U.S. 303, 305 (2006) (noting, generally, statutes dealing with similar subject matter should often be read as one law) (citation omitted); *see also* Lafferty v. St. Riel, 495 F.3d 72, 81–82 (3d Cir. 2007) (stating *in pari materia* is common in statutory construction); *In re* Mancini, 390 B.R. 796, 801–02 (Bankr. M.D. Pa. 2008) (observing "[i]n pari materia means that similar statutes should be construed similarly").

[35] *See In re* Graupner, 356 B.R. 907, 923 (Bankr. M.D. Ga. 2006) (noting "the term 'price,' as used in Georgia's purchase money security interest statute, must be given the meaning set forth" in MVSFA), *aff'd sub nom*. Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *see also In re* Petrocci, 370 B.R. 489, 500–01 (Bankr. N.D.N.Y. 2007) (noting *In re Graupner* court's determination of "price" must have same meaning as codified in MVSFA) (citation omitted). *Contra In re* Pajot, 371 B.R. 139, 149 (Bankr. E.D. Va. 2007) (noting, contrary to *In re Graupner* court's finding and according to "majority position" of *Price* and *Peaslee* courts, term "'price of the collateral'" is clear in U.C.C and does not need further analysis using additional statutes), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008) (using *in pari materia* reading of other statutes) (citation omitted).

[36] *See In re* Leicht, 222 B.R. 670, 681 n.14 (B.A.P. 1st Cir. 1998) (noting "'[b]ankruptcy is federal law of course, but bankruptcy practice has always involved a complex interplay of state as well as federal law'") (citation omitted); *see also In re* Kirk, 71 B.R. 510, 516 n.1 (C.D. Ill. 1987) (applying U.C.C. perfection of security interest provision in bankruptcy context); *In re* Berry, 189 B.R. 82, 87 (Bankr. D.S.C. 1995) (using U.C.C. definition of "security interest" in chapter 13 bankruptcy case).

[37] *See* Triad Int'l Maint. Corp. v. S. Air Transp., Inc., (*In re* S. Air Transp., Inc.), 511 F.3d 526, 531–32 (6th Cir. 2007) (noting use of U.C.C. to establish priority of liens in cases not preempted by federal law); *In*

ordinary and generally understood meaning in the non-bankruptcy context, which in this case, is defined in the Uniform Commercial Code.[38] The term PMSI did not make its first appearance in the hanging paragraph. The 1978 Code used the term in sections 522(f) and 1110, and even then, courts freely cited to the U.C.C. definition.[39] The fact that PMSI is still undefined with the passage of the BAPCPA amendments infers congressional intent to continue the infusion of the consistent U.C.C. definition to an undefined term of art in the Bankruptcy Code.[40] Therefore, the U.C.C. definition of PMSI must be examined to gain a better understanding of what it should mean under the hanging paragraph in bankruptcy.[41]

Despite the temptation to grasp to the U.C.C. definition, courts note that the Comments caution that the definition is to be used only for a limited purpose such as perfection and priority.[42] However, where Congress is aware that a term is commonly used in a particular context, it should be examined in such context as a starting point.[43]

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re Kirk, 71 B.R. at 512 n.1 (using Illinois commercial code to define bankruptcy trustee's rights); *see also* Lawrence Ponoroff, *Exemption Limitations: A Tale of Two Solutions*, 71 AM. BANKR. L.J. 221, 221–22 (1997) (discussing range of bankruptcy rules, "from the validity and priority of liens" to trustee's strong-arm powers, that reference state law).

[38] *See* U.C.C. § 9-103(b) (2000) (defining purchase money security interest as "security interest in goods . . . to the extent that the goods are purchase-money collateral with respect to that security interest"); *see also In re* Vega, 344 B.R. 616, 622 (Bankr. D. Kan. 2006) (using U.C.C. to define PMSI after finding state law controls definition of PMSI); *In re* Adoptante, 140 B.R. 940, 941–42 (Bankr. D.R.I. 1992) (turning to U.C.C. for PMSI definition after finding Bankruptcy Code does not define it).

[39] *See, e.g.*, *In re* Gayhart, 33 B.R. 699, 699–700, 700 n.1 (Bankr. N.D. Ill. 1983) (using Illinois Commercial Code to define a purchase-money security interest in case involving lien avoidance under section 522). *See* 11 U.S.C. § 522(f) (2006) (using term "nonpurchase-money security interest"); 11 U.S.C. § 1110(d)(2) (2006) ("[T]he term 'security interest' means a purchase-money equipment security interest.");

[40] *See* Dewsnup v. Timm, 502 U.S. 410, 419 (1992) ("[T]his Court has been reluctant to accept arguments that would interpret the Code . . . to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history."); *In re* Kutner, 3 B.R. 422, 425 (Bankr. N.D. Tex. 1980) (noting "in the absence of some clear indication to the contrary, Congress will be deemed to have been aware of the meaning [of a term] supplied by the Courts and to have intended the same words to have the same meaning").

[41] *See In re* Munzberg, 388 B.R. 529, 535–36 (Bankr. D. Vt. 2008) (agreeing with other courts that because Bankruptcy Code does not define PMSI and so "bankruptcy courts should rely upon a state's UCC definition of PMSI" too determine if hanging paragraph is applicable); *In re* Look, 383 B.R. 210, 217 (Bankr. D. Me. 2008) (observing courts "have looked to state law to construe the definition of [PMSI]"), *aff'd sub nom*. Bank of Am. v. Look, No. 08-129-P-H, 2008 U.S. Dist. LEXIS 54695 (D. Me. July 17, 2008); *In re* Sanders, 377 B.R. 836, 846 (Bankr. W.D. Tex. 2007) (noting U.C.C. law needs to be examined to understand "meaning of PMSI within the context of [particular section] of the Bankruptcy Code").

[42] *See In re* Johnson, 380 B.R. 236, 240 (Bankr. D. Or. 2007) (observing U.C.C. official comment explaining U.C.C. definition of term "is not meant to preempt" term definitions in other statutes); *In re* Westfall, 376 B.R. 210, 216–17 (Bankr. N.D. Ohio 2007) ("The intent of the framers of the [U.C.C.] is quite clear: the state law definition of [PMSI] was not meant to apply to bankruptcy law."); *see also* U.C.C. § 9-103 cmt. 8 (2001) (endorsing view PMSI definition "under other law is determined by that law" and positing "Bankruptcy Code does not expressly adopt the state law definition of" PMSI).

[43] *See In re* Sanders, 377 B.R. at 846 (noting "Congress is deemed to understand the context in which terms of art are used, and to intend the term to take on its ordinary meaning within that context" and generally discussing importance of context) (citation omitted); *accord In re* Mitchell, 379 B.R. 131, 136 (Bankr. M.D. Tenn. 2007) (using *Sanders* court statutory interpretation analysis and observation of context to demonstrate

C. Revised Article 9 Section 9-103 of the Uniform Commercial Code

In 2001, Article 9 of the Uniform Commercial Code was revised with respect to the treatment of security interests that comingle both purchase money and non-purchase money obligations. Revised section 9-103 of the U.C.C. states that purchase-money security interests in non-consumer transactions would be treated under the "dual-status" rule where PMSI status would be preserved even if the interest was combined with a non-purchase money obligation secured by the same collateral.[44] However, the same section delegates to the courts the decision whether to apply either the dual status or transformation rule for PMSIs in consumer transactions. This created judicial uncertainty as to whether comingling non-purchase money with purchase money obligations would transform the entire obligation to non-purchase money status resulting in loss of preferential treatment. In the alternative, courts could apply dual status and preserve purchase money status for the pure purchase money portion of the obligation.

The debate between creditors and consumer advocates in enacting Revised Article 9 of the U.C.C. resulted in different treatment of PMSIs in consumer and non-consumer transactions.[45] The creditors pushed for a dual status approach to PMSIs in non-consumer transactions such that the purchase money status of the security interest would still exist if the collateral also secures a non-purchase money obligation.[46] In return, to satisfy the consumer advocates, the dual status approach would not be statutorily required for PMSIs in consumer transactions. Furthermore, a provision was added to inform the courts not to draw any inference from the rule

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"why the financing of negative equity is not included in the 'price of the collateral'"); *In re Vega*, 344 B.R. at 622 (holding debtor's argument was not supported by language of statute).

[44] U.C.C. § 9-103(f) & cmt. 7 (2001) (endorsing dual-status rule for non-consumer transactions, where security interest may be PMSI and non-PMSI "to some extent"). *See In re Munzberg*, 388 B.R. at 545 (noting Official Comment 7 to state's Article 9, which "states that the dual-status rule is only applicable to non-consumer goods transactions"); *In re Johnson*, 380 B.R. at 249 (discussing Oregon's adoption of Revised Article 9 which, in non-consumer transactions, states "PMSI does not lose its status even if the purchase money obligation is renewed, refinanced, consolidated, or restructured") (citations omitted).

[45] *See* Charles W. Mooney, *The Consumer Compromise in Revised U.C.C. Article 9: The Shame of it All*, 68 OHIO. ST. L.J. 215, 222 (2007) (recognizing "trade-off" between creditors and consumer advocates resulted in different definitions for PMSI); *see also* Christopher Harry, Comment, *To Be (Transformed), or Not to Be: The Transformation Versus Dual-Status Rules for Purchase-Money Security Interests Under Kansas' Former and Revised Article 9*, 50 U. KAN. L. REV. 1095, 1115 (2002) (noting revisions would address "scope and treatment of PMSIs" and U.C.C. drafting committee recognized need for compromise between creditors and consumer advocates pertaining to Revised Article 9) (citation omitted); Elaine A. Welle, *An Introduction to Revised Article 9 of the Uniform Commercial Code*, 1 WYO. L. REV. 555, 585 (2001) (suggesting Revised Article 9 drafters "were unable to reach a consensus about many contentious consumer-related issues").

[46] *See* Mooney, *supra* note 45, at 222 (noting Revised Article 9 "embraces the 'dual status' approach, under which PMSI status is not destroyed, for example, if the collateral also secures nonpurchase-money obligations"); *see also* Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 846 (B.A.P. 9th Cir. 2008) (stating "Dual Status Rule allow[s] creditors to retain the benefits of purchase money status . . . ."); *In re* Burt, 378 B.R. 352, 364 (Bankr. D. Utah 2007) (asserting under dual status rule, "purchase money status is not destroyed when collateral secures more than its price").

for non-consumer transactions when determining what approach to follow for consumer transactions.[47] By leaving treatment of PMSIs open for consumer transactions, consumer advocates intended to "preserve arguments in favor of the transformation rule in bankruptcy cases" when both purchase money and non-purchase money obligations are secured by the same collateral.[48] Transformation of the entire security interest to non-purchase money results in significant alteration of the secured creditor's priority rights because PMSIs generally receive preferred treatment under both the U.CC. and the Bankruptcy Code.[49]

Revised section 9-103 defines the terms purchase-money collateral, purchase-money obligation, and PMSI as:

> (a) [Definitions.] In this section:
>
> (1) "purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and
>
> (2) "purchase-money obligation" means 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.
>
> (b) [Purchase-money security interest in goods.] 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 . . . .[50]

The definition of a PMSI under the hanging paragraph turns ultimately on how the phrase "all or part of the price of the collateral" or "value given to enable the debtor to acquire rights in or the use of the collateral" is interpreted in the U.C.C.[51] Comment 3 of section 9-103 provides a list of items that are considered part of the

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[47] *See* Mooney, *supra* note 45, at 222–23 (maintaining "the compromise required a provision that calls on courts not to draw any inference from the statute as to the appropriate rule for consumer transactions"); *see also In re* Riach, No. 07-61645-aer13, 2008 WL 474384, at *4 (Bankr. D. Or. Feb. 19, 2008) (stating no inferences are to be drawn from rules for non-consumer transactions as to rule for consumer transactions); *In re Mitchell*, 379 B.R. at 136 n.6 (discussing applicable Tennessee law and noting limitations in rules "'intended to leave to the court the determination of the proper rules in consumer-goods transactions'") (citation omitted).

[48] Mooney, *supra* note 45, at 223. *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 48 n.81 (D. Kan. 2007) (noting subparagraph (f) of section 9-103 "allows the use of the transformation rule in consumer transactions").

[49] *See* U.C.C. § 9-309 (2001); 11 U.S.C. § 1325 (2006); *see also In re* Lance, No. 05-63498, 2006 WL 1586745, at *3 (W.D. Mo. Mar. 7, 2006) (stating "[t]he UCC provides for the automatic perfection of purchase-money security interests taken in consumer goods").

[50] U.C.C. § 9-103 (2000).

[51] U.C.C. § 9-103(a)(2) (2000). *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 258 (W.D.N.Y. 2007) (stating "[w]hether a PMSI exists . . . turns on whether the negative equity . . . constitutes 'part of the price of the collateral'"); *see also In re Burt*, 378 B.R. at 357 (explaining "[i]n order to address the effect of the hanging paragraph," court must determine whether party's security interest is PMSI, and because Code does not define this type of security interest, court must look to U.C.C.).

price of the vehicle and therefore, if it is included in the list, the loan maintains purchase money status.[52] Comment 3 states:

> As used in subsection (a)(2), the definition of "purchase-money obligation," the "*price*" of collateral or the "*value given to enable*" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.
>
> The concept of "purchase-money security interest" requires a *close nexus* between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.[53]

Since revised section 9-103 was modified in some states when adopted,[54] whether a creditor's security interest will be fully secured depends on the state's definition of a PMSI.[55] Some states explicitly include in their version of revised section 9-103 items that the state would recognize as a PMSI. For instance, in Georgia's Uniform Commercial Code, the term purchase-money obligation incorporates the Georgia

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[52] U.C.C. § 9-103 cmt. 3 (2000). *See Peaslee*, 373 B.R. at 258 (acknowledging comment 3 to section 9-103 is "helpful" by defining terms within section by listing certain things that fall within price of collateral, such as sales taxes, interest, and finance charges); *see also In re* White, 352 B.R. 633, 638 (Bankr. E.D. La. 2006) ("Uniform Commercial Code Comment 3 . . . specifies that the price of acquisition includes expenses incurred in connection with acquiring the collateral, including sales taxes, duties, finance charges, interest, freight charges, or other similar obligations.") (citation omitted).

[53] U.C.C. § 9-103 cmt. 3 (2000) (emphasis added).

[54] *See In re* Wear, No. 07-42537, 2008 WL 217172, at *2 (Bankr. W.D. Wash. Jan. 23, 2008) (finding other courts consult state law to determine what constitutes PMSI since Bankruptcy Code does not define term); *see also In re* Johnson, 380 B.R. 236, 240 (Bankr. D. Or. 2007) (holding "term 'purchase money security interest'" is borrowed from U.C.C. "which has been enacted with variations among the states as state code law"); *In re* Price, 363 B.R. 734, 740 (Bankr. E.D.N.C. 2007) (noting bankruptcy courts determining meaning of this term look to U.C.C. as adopted by state) (citation omitted), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price, No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[55] *See In re* Brodowski, 391 B.R. 393, 397–98 (Bankr. S.D. Tex. 2008) (stating bankruptcy courts look to state law to determine whether creditor has PMSI protected from bifurcation under hanging paragraph); *see also In re* Vinson, 391 B.R. 754, 756 (Bankr. D.S.C. 2008) (concluding PMSI definition is provided by state law); *In re* Sanders, 377 B.R. 836, 846 (Bankr. W.D. Tex. 2007) (reasoning when Congress used term PMSI in Bankruptcy Code it "was aware of [its] usage" in Article 9 of U.C.C., so to determine meaning of PMSI court should look to U.C.C.); *In re* Graupner, 356 B.R. 907, 911 (Bankr. M.D. Ga. 2006) ("[W]hether a creditor holds a purchase money security interest is a matter of state law.") (citation omitted), *aff'd sub nom.* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *In re White*, 352 B.R. at 638 (indicating Code has not defined PMSI, so court must consult state law to determine if party's claim is PMSI).

Motor Vehicle Sales Finance Act's definition of cash sale price which includes "any amount paid to the buyer or to a third party on behalf of the buyer to satisfy a lease on or a lien on or a security interest in a motor vehicle used as a trade-in."[56] This statutory definition of "price" led the court in *In re Graupner*[57] to include negative equity of a trade-in vehicle as a component of the cash sale price of the vehicle. As a result, inclusion of negative equity did not affect the purchase money character of the obligation in that state.[58]

Failure to modify U.C.C. section 9-103 has led to inconsistent judicial determinations of whether negative equity has purchase money status when it is included in the financing transaction to purchase a new vehicle.[59] Some courts interpret the term "price" as anything that contributes to the total obligation secured by the purchased collateral, including negative equity, as "purchase money."[60] Other

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[56] GA. CODE ANN., § 10-1-31 (a)(1) (West 2008).

[57] 356 B.R. 907 (Bankr. M.D. Ga. 2006). *See* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1299, 1302 (11th Cir. 2008) (noting district court's affirmation of bankruptcy court's finding of "[t]he trade-in of the vehicle was an integral part of the sales transaction" and therefore included in price of collateral, and confirming this observation).

[58] *See In re Graupner*, 356 B.R. at 923 (finding intent of Georgia General Assembly was "to permit negative equity in a trade-in vehicle to be added to the cash sales price of a new vehicle without precluding the financing creditor or its assignee from taking a purchase money security interest in the new vehicle"); *see also In re Vinson*, 391 B.R. at 757 (noting *Graupner* district court's examination of state law interpretation of PMSI and its ultimate decision) (citation omitted); *In re* Spratling, 377 B.R. 941, 943 (Bankr. M.D. Ga. 2007) (noting it has been established by the court in *In re Graupner* "the financing of negative equity does not preclude the lender from holding a PMSI in the vehicle").

[59] *See In re* Cohrs, 373 B.R. 107, 110–11 (Bankr. E.D. Cal. 2007) (finding lender financing transaction which includes negative equity acquires purchase money security interest); *see also In re* Stevens, 368 B.R. 5, 8 (Bankr. D. Neb. 2007) (applying dual status rule and finding purchase money agreement "may be part purchase-money and part non-purchase-money"). *But see In re* Westfall, 376 B.R. 210, 220 (Bankr. N.D. Ohio 2007) (concluding "the court hereby adopts its previous decision to the extent that it found that negative equity was not part of the value given to enable debtor to acquire rights in the vehicle").

[60] *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 262 (W.D.N.Y. 2007) (finding "portion of the claims attributable to the pay off negative equity" did not affect lenders' secured claims status); *In re* Myers, No. 07-11145-AJM-13, 2008 WL 2445214, at *4 (Bankr. S.D. Ind. June 13, 2008) (holding financing loaned to debtor to pay off of negative equity on trade-in vehicle was part of "'price'" for new vehicle) (citations omitted); *In re* Ford, 387 B.R. 827, 833 (Bankr. D. Kan. 2008) (concluding "debtors' negative equity in a trade-in vehicle, financed by the lender, is a part of the price of the collateral and constitutes value given to enable the debtors to acquire the collateral"); *In re* Austin, 381 B.R. 892, 897 (Bankr. D. Utah 2008) (deciding loan advanced to debtor to pay off negative equity constituted "purchase-money obligation" and therefore fell under "hanging paragraph" protection of section 1325 of the Bankruptcy Code); *In re* Dunlap, 383 B.R. 113, 118 (Bankr. E.D. Wis. 2008) (analyzing "one of BAPCPA's goals was to afford additional protection for secured creditors and, primarily, for automobile lenders"); *In re Vinson*, 391 B.R. at 758 (finding lender had PMSI which was not effected by related loan); *In re* Schwalm, 380 B.R. 630, 634–35 (Bankr. M.D.Fla. 2008) (concluding "'purchase money security interest,' as used in section 1325(a), only makes sense when viewed as applying to those auto financing transactions, lawful and common in industry practice when BAPCPA was adopted, in which negative equity on a trade-in, gap insurance and service contract premiums are financed"); *In re* Weiser, 381 B.R. 263, 270 (Bankr. W.D. Mo. 2007) (deciding "portions of debt" constituted purchase money security interest because "they were expenses incurred in connection with the Debtor's acquiring rights in the [new vehicle]"); *In re* Brei, No. 4:07-BK-01354-JMM, 2007 WL 4104884, *1 (Bankr. D.Ariz. Nov. 14, 2007) (stating even if portion of loan was used to pay off previous lien on vehicle it is still considered "purchase money transaction"); *In re* Burt, 378 B.R. 352, 364–65 (Bankr. D. Utah 2007) (holding "financing of a service contract and other fees" do not

courts find that negative equity does not have purchase money status because it is not part of the actual price of the collateral, nor an expense associated with the new vehicle.[61] The conflicting decisions among the states has led one court to note the necessity of a uniform definition for the term "purchase money security interest" included in the Bankruptcy Code that will preempt the state law U.C.C. definition.[62]

II. PURCHASE MONEY STATUS OF NEGATIVE EQUITY

The treatment of negative equity when evaluating the PMSI is a two-step process.[63] First, the court must determine whether negative equity has purchase

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necessarily "prevent" PMSI) (citations omitted); *In re* Bradlee, No. 07-BK-30527, 2007 Bankr. LEXIS 3863, at *10 (Bankr. W.D. La. Oct. 10, 2007) (concluding Louisiana Motor Vehicle Sales Financing Act includes negative equity in its definition of "'cash price'"); *In re* Watson, No. 07-23632-D-13L, 2007 WL 2873434, at* 1 (Bankr. E.D. Cal. Sept. 27, 2007) (agreeing with *In re Cohrs* decision and analysis that financing negative equity does not "defeat the purchase money secured status for the new loan") (citation omitted); *In re* Wall, 376 B.R. 769, 771 (Bankr. W.D.N.C. 2007) ("This court concludes that the financing of a motor vehicle that includes negative equity in a trade-in vehicle may constitute a [PMSI] that is not subject to modification by the debtors' Chapter 13 Plan."); *In re Cohrs*, 373 B.R. at 110 (noting "when a lender . . . finances the purchase of the new vehicle and" in the same transaction "pays off an outstanding balance owed on the trade-in vehicle, the loan extended is a purchase money obligation of the buyer, the new vehicle is purchase money collateral, and the lender's security interest is a [PMSI]"); *In re* Petrocci, 370 B.R. 489, 498 (Bankr. N.D.N.Y. 2007) (interpreting Official Comment 3 to U.C.C. section 9-103 as "wide-ranging and open-ended attempt to define 'price' . . . [which] explicitly states that the 'price' of the collateral may include much more than . . . 'the actual price of the collateral being acquired'") (citation omitted).

[61] *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 47 (D. Kan. 2007); *In re* Munzberg, 388 B.R. 529, 541 (Bankr. D. Vt. 2008); *In re* Callicott, 386 B.R. 232, 236 (Bankr. E.D. Mo. 2008); *In re* Jernigan, No. 07-04037-8-JRL, 2008 WL 922346, *1 (Bankr. E.D.N.C. Mar. 31, 2008); *In re* Look, 383 B.R. 210, 219 (Bankr. D. Me. 2008); *In re* Wear, No. 07-42537, 2008 WL 217172, *3 (Bankr. W.D. Wash. Jan. 23, 2008); *In re* Johnson, 380 B.R. 236, 245 (Bankr. D. Or. 2007); *In re* Tuck, No. 06-10886-DHW, 2007 WL 4365456, at *2 (Bankr. M.D. Ala. Dec. 10, 2007); *In re* Mitchell, 379 B.R. 131, 136 (Bankr. M.D. Tenn. 2007); *In re* Lavigne, No. 07-30192, 2007 WL 3469454, at *6 (Bankr. E.D. Va. Nov. 14, 2007); *In re* Conyers, 379 B.R. 576, 580 (Bankr. M.D.N.C. 2007); *In re* Hayes, 376 B.R. 655, 670, 676 (Bankr. M.D. Tenn. 2007); *In re* Sanders, 377 B.R. 836, 852 (Bankr. W.D. Tex. 2007); *In re* Blakeslee, 377 B.R. 724, 728–29 (Bankr. M.D. Fla. 2007); *In re* Pajot, 371 B.R. 139, 164–65 (Bankr. E.D. Va. 2007), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re* Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007); *In re* Bray, 365 B.R. 850, 862 (Bankr. W.D. Tenn. 2007); *In re* Price, 363 B.R. 734, 740–42 (Bankr. E.D.N.C. 2007), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007); *In re* Vega, 344 B.R. 616, 621 (Bankr. D. Kan. 2006).

[62] *In re Johnson*, 380 B.R. at 240 (observing comment of *In re Westfall* court, which "suggested that a uniform federal definition or interpretation of 'purchase money security interest' should be developed and applied" (citing *In re* Westfall, 365 B.R. 755, 759 n.4 (Bankr. N.D. Ohio 2007) ("A uniform federal definition for purposes of chapter 13 appears to do no violence to state law."), *aff'd in part, rev'd in part*, 376 B.R. 210 (Bankr. N.D. Ohio 2007))); *see In re Lavigne*, 2007 WL 3469454 at *5 (acknowledging Congress has not defined PMSI in Bankruptcy Code); Trejos v. VW Credit, Inc. (*In re* Trejos), 374 B.R. 210, 215 (B.A.P. 9th Cir. 2007) (determining whether VW Credit holds PMSI requires examination of state law); *In re Pajot*, 371 B.R. at 147 ("Purchase-money security interest is a term undefined in the bankruptcy code.").

[63] *See In re Bray*, 365 B.R. at 860 ("[T]he Court must engage in a two-step process when determining whether or not the Bank has a purchase money security interest in this case."); *cf. Peaslee*, 373 B.R. at 262 n.5 (determining "entire claims, including that portion of the claims attributable to the payoff of negative equity . . . should be treated as secured claims" and thus, not considering whether bankruptcy court "correctly applied the 'transformation rule' rather than the 'dual status rule'"); *In re Petrocci*, 370 B.R. at 504

money status when it is rolled in with a purchase money obligation.[64] If negative equity financing does have purchase money status, then the court need not determine whether to apply the dual status rule or the transformation rule since the entire loan gives the creditor a PMSI.[65] However, if it does not have purchase money status, then further analysis is necessary to determine whether the dual status rule or the transformation rule should apply.

Courts consider three main factors when determining whether negative equity has purchase money status. The court compares negative equity to the list of expenses in revised section 9-103 Comment 3, which include standard fees such as sales tax and finance charges as part of the price of the collateral. In addition, the court evaluates whether negative equity is "value used to enable" the consumer to acquire legal rights in the new vehicle. The court also considers whether there is a close nexus between negative equity and the obligation incurred to purchase the new vehicle.

A. Negative Equity as Part of the Purchase Price of the New Vehicle

In order for a security interest to be characterized as a PMSI, revised section 9-103 requires the obligation be incurred for all or part of the purchase price of the collateral.[66] Negative equity financing and its purchase-money status have been sources of uncertainty for the courts because they are included in the financing package when the consumer purchases a new vehicle.[67] In these negative equity

("This Court finds that the transactions . . . are entirely purchase money obligations pursuant to U.C.C. § 9-103. As such, the issue of whether or not to apply the Dual Status or Transformation rule does not arise, and need not be addressed.").

[64] *See Peaslee*, 373 B.R. at 262 n.5 (determining entire claim, including negative equity, to be treated as secured and so no need to decided whether bankruptcy court "correctly applied" transformation rule instead of dual status rule); *see also In re Petrocci*, 370 B.R. at 504 (stating transactions were not mixed, but rather "entirely purchase money obligations" and therefore "the issue of whether or not to apply the Dual Status or Transformation rule does not arise, and need not be addressed").

[65] *See* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1300 (11th Cir. 2008) (noting line of cases hold negative equity is not purchase money have another issue to deal with: whether dual status or transformation rule should apply); *see also In re Lavigne*, 2007 WL 3469454 at *9 (noting courts are "divided" on issue of whether to apply dual status or transformation rule and noting cases on both sides); *In re* Westfall, 376 B.R. 210, 212–13 (Bankr. N.D. Ohio 2007) (describing judicial split on defintion of PMSI and whether to apply dual status or transformation rule as "maddeningly inconsistent body of decisions").

[66] *See* U.C.C. § 9-103(a)–(b) (2000); Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1301 (11th Cir. 2008) ("The term 'purchase-money obligation' is defined . . . 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.'"); *see also* WILLIAM L. NORTON, JR., 7 NORTON BANKRUPTCY LAW AND PRACTICE 3d, § 151:13 n.20.60 (2008), *available at* Westlaw, NRTN-BLP § 151:13 ("UCC 9-103 . . . defines a purchase money obligation as an obligation that includes all or part of the price of the collateral . . . .").

[67] *Compare In re Graupner*, 537 F.3d at 1300 (pointing out issue of negative equity financing's purchase-money status has been confronted by "dozens of lower courts," and concluding decisions fall into two broad groups: (1) creditor's PMSI includes financing of negative equity; (2) negative equity in trade-in vehicle does not constitute PMSI), *with In re* Wall, 376 B.R. 769, 770–71 (Bankr. W.D.N.C. 2007) (recognizing three different legal views on negative equity: (1) it does not qualify as "'purchase money' obligation", and

cases, the consumer takes out one loan for two purposes secured by the same collateral. One portion is used to satisfy the balance owed on the trade-in vehicle, and the other is used to pay the purchase price of the new vehicle. Since both loans are lumped together on one Retail Installment Sales Contract for the purchase of the new vehicle, some courts hold that negative equity is a PMSI because it appears to be a single transaction.[68] Other courts, such as *In re Price*, recognize that for the convenience of both parties, "there are simply two separate financial transactions memorialized on a single retail installment contract" and the refinance of negative equity should not be given purchase money status just because it is listed in the same contract as the purchase money obligation.[69]

One line of cases holds that negative equity is a purchase money obligation because the list of items in Comment 3 should be construed broadly to include negative equity as part of the purchase price of the vehicle.[70] The District Court in *GMAC v. Peaslee* reasoned that New York U.C.C. provisions should be interpreted liberally to not only encompass the listed items in Comment 3, but also include any item or expense that contributes to the total obligation secured by the new vehicle.[71]

"destroys 'purchase money' status of the entire claim"; (2) it does not qualify as a purchase-money obligation, and destroys purchase-money status "*only to the extent of that negative equity*"; and (3) it *does* qualify as a purchase-money obligation and "protects the creditor's claim from modification") (emphasis added). *See generally* Moratzka, *supra* note 22 (discussing various courts' approaches to assessing negative equity's purchase-money status).

[68] *See In re Graupner*, 537 F.3d at 1302 (noting negative equity in trade-in vehicle and purchase of new vehicle are part of same transaction and therefore "properly regarded as a 'package deal'"); Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 259 (W.D.N.Y. 2007) (noting "[i]f the buyer and seller agree to include the payoff of the outstanding balance on the trade-in as an integral part of their transaction for the sale of the new vehicle, it is in fact difficult to see how that could *not* be viewed as" "'an expense incurred in connection with acquiring rights in' the new vehicle"); *In re* Dunlap, 383 B.R. 113, 118 (Bankr. E.D. Wis. 2008) ("[D]ebtor and Nissan entered into a single transaction for the purchase and sale of a new car, utilizing negative equity financing as the method to accomplish this goal.").

[69] *In re* Price, 363 B.R. 734, 741 (Bankr. E.D.N.C. 2007) ("[T]here are simply two separate financial transactions memorialized on a single retail installment contract document for the convenience of some consumers and to allow the auto industry to sell more vehicles, which is good for both parties."), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. November 14, 2007). *See* Snap-On Tools, Inc. v. Freeman (*In re* Freeman), 956 F.2d 252, 254–55 (11th Cir. 1992) (positing where collateral secures a debt distinguishable from debt required to make purchase, "it is not purchase money") (citation omitted); *see also In re* Horn, 338 B.R. 110, 113–14 (Bankr. M.D. Ala. 2006) (remarking where security interest arises by virtue of multiple transactions securing more than just funds for purchase, security interest "loses its purchase-money character").

[70] *See In re Graupner*, 537 F.3d at 1301 (discussing relevance of Comment 3 to rationale); *In re* Bradlee, No. 07-BK-30527, 2007 Bankr. LEXIS 3863, at *4 (Bankr. W.D. La. Oct. 10, 2007) (indicating both plain language and legislative history suggest Congress intended broad protections from cramdown for financed motor vehicles); *In re Wall*, 376 B.R. at 771 (noting intent of Congress was to protect creditors from cramdown abuse) (citation omitted); *In re* Turner, 349 B.R. 437, 441–43 (Bankr. D.S.C. 2006) (noting deference to legislative intent and history in divining statute's meaning).

[71] *Peaslee*, 373 B.R. at 258–59 (reasoning Comment 3 is helpful because it lists specific items contributing to expense of new vehicle; however, negative equity on trade-in can constitute obligation for expenses in connection with new vehicle). *See In re* Myers, No. 07-11145-AJM-13, 2008 WL 2445214 at *4 (Bankr. S.D. Ind. June 13, 2008) (observing list of examples in Comment 3 is not exclusive because of "'catchall'" phrase, and other similar obligations, at end of comment); *In re* Burt, 378 B.R. 352, 362 (Bankr. D. Utah

U.C.C. section 9-103 Comment 3, which was adopted without modification in New York, states:

> [T]he "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.[72]

The District Court held that if the parties agreed that the loan would cover both the new vehicle and the negative equity of the trade-in, it is difficult to argue that negative equity is not an expense in the sale.[73]

Although the list in Comment 3 is not exhaustive and leaves open the possibility for other expenses related to the acquisition of the vehicle to be included in the "price", the phrase "obligation incurred as all or part of the price of the collateral"[74] should not be construed so liberally as to offend the plain language of the statute. The negative equity of the old vehicle does not constitute an "obligation incurred" since negative equity is wholly unrelated to the price of the collateral and the nature of refinancing negative equity is dissimilar to the expenses listed in Comment 3.[75] The obligation incurred to refinance negative equity is not used to purchase the vehicle, but rather is a loan used to pay off an antecedent debt on another vehicle other than the one purchased.

2007) (determining terms of applicable state UCC defining PMSI should be interpreted broadly so negative equity and other transactional costs would be included in price of collateral).

[72] N.Y. U.C.C. LAW § 9-103 cmt. 3 (McKinney 2008).

[73] *Peaslee*, 373 B.R. at 259 (noting if buyer and seller agree negative equity will be refinanced on trade-in, then it is expense of new vehicle); *see* Savino & Widenor, *supra* note 16, at 818 (noting *Peaslee* court's finding: negative equity of trade-in constitutes expense because it has "requisite nexus" to acquisition of car due to fact that it is "'inextricably intertwined'" with transaction) (citations omitted); *see also In re* Schwalm, 380 B.R. 630, 634 (Bankr. M.D. Fla. 2008) (stating "as a 'packaged' transaction to dispose of the old car, insure the new loan amount, and provide for future maintenance[,] the items included in the amount financed do have a close nexus to the acquisition of the car").

[74] N.Y. U.C.C. LAW § 9-103 (McKinney 2008). *See In re Burt*, 378 B.R. at 362 (discussing Comment 3 lists examples of price of collateral, and notes list is not exhaustive and value includes "much more" than actual price of collateral); *In re* Cohrs, 373 B.R. 107, 109 (Bankr. E.D. Cal. 2007) (stating list in Comment 3 gives examples of "value given" in purchase of collateral and "is broad enough to include" negative equity).

[75] *See In re* Johnson, 380 B.R. 236, 243 (Bankr. D. Or. 2007) (discussing "[n]egative equity is not similar in nature or scope to the other 'expenses incurred in connection with acquiring rights in the collateral' contemplated by Official Comment 3" and therefore "'price of the collateral' does not include negative equity"); *see also In re* Pajot, 371 B.R. 139, 149–50 (Bankr. E.D. Va. 2007) (holding list of items in Comment 3 does not "contemplate the inclusion of negative equity"), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re* Price, 363 B.R. 734, 741 (Bankr. E.D.N.C. 2007) (holding negative equity financing is "significantly and qualitatively different from the fees, freight charges, storage costs, taxes and similar expenses that are typically part of an automobile sale"), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

Furthermore, the "all or part of the price"[76] language implies that purchase money status is limited only to loans that are applied to cover the price of the item purchased. A consumer may obtain a loan for an amount equal or less than the price of a vehicle and that entire obligation will be completely protected against bifurcation under the hanging paragraph. However, the opposite is not true. If a consumer obtains a loan for more than the purchase price of the vehicle, the issue is whether the entire loan will be protected against bifurcation since it is clear that the loan is used for purposes other than to pay the purchase price.

The "all or part" language in the statute suggests a limit—that the obligation incurred should not exceed the price of the collateral.[77] If a consumer obtains a loan to cover both the purchase price of the vehicle and to refinance the negative equity on the trade-in vehicle, the resulting obligation will exceed the price of the collateral.[78] To demonstrate, if a consumer obtains a loan to acquire a new car that is on sale for $40,000 and also to satisfy the $10,000 of negative equity in the trade-in vehicle, the amount indicated on the retail installment contract will state $50,000. If negative equity debt is included as part of the obligation, the total obligation incurred exceeds the original sale price of the new vehicle. Inclusion of the loan to refinance negative equity would improperly expand the plain language of the U.C.C. provision to include unrelated obligations to the purchase price of the new vehicle and allow the creditor to list it as a fully secured claim.

Whether negative equity is an integral part of the transaction also affects the court's finding that negative equity has purchase money status. For instance, the court in *Graupner v. Nuvell Credit Corp.* found that the negative equity financing was an integral part of the transaction such that it should be included in the price.[79]

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[76] N.Y. U.C.C. LAW § 9-103(a)(2) (McKinney 2008). *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 261 (W.D.N.Y. 2007) (concluding section 9-103 term "'price'" equivalent to "'cash sales price'" as defined by separate but related statute); *cf. In re* Graupner, 356 B.R. 907, 919–20 (Bankr. M.D. Ga. 2006) (explaining ambiguous term "'price'" could narrowly refer to "'sticker' price" or broadly refer to other purchase-related costs), *aff'd sub nom.* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008).

[77] *See In re* White, 352 B.R. 633, 639 (Bankr. E.D. La. 2006) (determining insurance deficiency and extended warranty contracts not costs of vehicle acquisition and therefore not part of purchase money security interest). *But see In re Cohrs*, 373 B.R. at 110–11 (finding "value given to acquire a vehicle includes negative equity" gives lender PMSI); *In re* Bray, 365 B.R. 850, 856–57 (Bankr. W.D. Tenn. 2007) (noting one court's decision that securing more than price of purchasing collateral does not prevent party from having PMSI (citing *In re* Coomer, 8 B.R. 351, 353–54 (Bankr. E.D. Tenn. 1980))).

[78] *See In re* Ionosphere, 123 B.R. 166, 172 n.2 (S.D.N.Y. 1991) (noting "[t]he Bankruptcy Court's statement that 'the PMESI cannot exceed the price of what is purchased' . . . is correct. Nevertheless, a creditor may very well possess a PMSI in collateral whose value exceeds the amount of the loan made to purchase it" like "when a buyer obtains financing for only a fraction of the purchase price") (citation omitted); *see also In re* Gray, 382 B.R. 438, 443 (Bankr. E.D. Tenn. 2008) (holding car "treated as a purchase money claim" because "secured obligation" did "not include a debt for money lent to" pay negative equity); *In re* Mitchell, 379 B.R. 131, 136–37 (Bankr. M.D. Tenn. 2007) (noting previous holding that ""price of the collateral" does *not* include the amount financed to pay off the negative equity"' (citing *In re* Sanders, 377 B.R. 836, 853 (Bankr. W.D. Tex. 2007))).

[79] No. 4:07-CV-37CDL, 2007 WL 1858291, at *2 (M.D. Ga. 2007). *See In re* Burt, 378 B.R. 352, 362 (Bankr. D. Utah 2007) (determining negative equity and other purchase-related costs should be included in

Negative equity, the court reasoned, affected the price the debtor paid for the new vehicle and therefore negative equity should be recognized as part of the purchase price of the new car.[80] The District Court in *Peaslee* also recognized that regardless of whether it is mandatory, if negative equity financing was integral to the sale of the new vehicle, then it will be considered "part of the price of the collateral."[81] Although rolled in negative equity of a trade-in is not a necessary expense for the sale of the new vehicle, it "does not require a contrary result, if the facts surrounding the particular transaction at issue are such that the negative equity was integral to the sale."[82]

However, other bankruptcy courts have refused to grant purchase money status to fees and expenses that are not mandatory with the purchase or acquisition of a new vehicle. For instance, in *In re Price*,[83] the court held that loans to pay for gap insurance and negative equity are not mandatory nor is it an expense associated with acquiring a new vehicle. Therefore, these loans were not found to fall under the category of purchase money.[84] The court reasoned that the funds used to satisfy the negative equity of the trade-in vehicle are "'not a component of the price of the collateral.'"[85] Similarly, the court in *In re Pajot* held that negative equity is:

> [N]ot . . . a component of the loan agreement, nor a value-enhancing add-on, and is therefore different from the list of expenses included in Comment 3 [of the U.C.C.] . . . the funds did not "enable" the debtors to purchase the vehicle because rolling

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creditor's PMSI); *In re Cohrs*, 373 B.R. at 109 (noting term for value given for purchase money collateral "is broad enough to include" negative equity).

[80] *Graupner*, 2007 WL 1858291, at *2. *Cf. In re* Spratling, 377 B.R. 941, 945–46 (Bank. M.D. Ga. 2007) (applying "close nexus standard" to conclude gap insurance is included in PMSI). *But see In re Sanders*, 377 B.R. at 853 (determining in situation involving financing and sale of motor vehicle to consumer "amount financed to pay off the negative equity" is not included in "'price of the collateral'").

[81] Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 258–59 (W.D.N.Y. 2007). *See In re* Vinson, 391 B.R. 754, 757–58 (Bankr. D.S.C. 2008) (finding price of collateral included negative equity because trade-in was "rolled into" the transaction); *see also In re Burt*, 378 B.R. at 363 (noting where negative equity is "'inextricably intertwined'" with transaction, negative equity becomes part of price of collateral).

[82] *Peaslee*, 373 B.R. at 259. *See In re* Weiser, 381 B.R. 263, 268 (Bankr. W.D. Mo. 2007) (reasoning since sale of vehicle would not occur without negative equity there existed "close nexus"). *In re Burt*, 378 B.R. at 363 (concluding financing transaction "package deal where the negative equity in the trade-in was paid off by the dealer as part of its retail installment sale" is sufficiently close to be part of price of collateral).

[83] *In re* Price, 363 B.R. 734 (Bankr. E.D.N.C. 2007), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[84] *In re Price*, 363 B.R. at 741. *See In re* Munzberg, 388 B.R. 529, 543–44 (Bankr. D. Vt. 2008) (adopting *In re Price* principle that gap insurance "does not come within the scope of the debt secured by a PMSI" because it is not part of price of collateral); *In re* White, 352 B.R. 633, 639 (Bankr. E.D. La. 2006) (adhering to state statute which excluded insurance deficiency contract from definition of PMSI).

[85] *In re Price*, 363 B.R. at 741. *See In re Munzberg*, 388 B.R. at 541 (stating "negative equity is not an expense incurred 'in connection with acquiring rights in the collateral'" and does not have "'close nexus'" to be secured by PMSI); *see In re* Johnson, 380 B.R. 236, 250–51 (Bankr. D. Or. 2007) (declaring negative equity is not part of "'price of the collateral'" and "paying off antecedent debt[] cannot be a PMSI").

> negative equity into a new financing agreement is merely a convenient, but unnecessary, option.[86]

The view that negative equity is a convenient method for the consumer to pay off the balance of the trade-in vehicle and at the same time purchase a new vehicle echoes the concept that the Retail Installment Sales Contract memorializes two separate financial transactions.[87] Although the loan to satisfy the negative equity debt is secured by the new collateral, the money was not used to purchase that collateral and therefore fails by definition to be "purchase money." An extreme case that illustrates this situation is in *In re Horn*,[88] where the debtor's car loan was refinanced multiple times, thereby destroying the purchase money character of the entire debt.[89] Notably, the court reasoned that "the debt comprises money loaned for the purchase of the car together with four separate, subsequent, and additional cash advances."[90] Therefore the debtor's car "secures more than the debt for the money to acquire it" and consequently, the creditor's security interest "loses its purchase-money character."[91]

At least one court has concluded that negative equity is not part of the purchase price of the collateral.[92] The actual price of the vehicle is the amount the debtor would have paid in cash for the new vehicle, which logically does not include negative equity.[93] Furthermore, the court in *In re Pajot* did not recognize the

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[86] *In re* Pajot, 371 B.R. 139, 152 (Bankr. E.D. Va. 2007) (citations omitted), *aff'd in part, rev'd in part sub nom*. GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008). *See In re Price*, 363 B.R. at 741 (noting words of *In re Peaslee* court, restating "'there are simply two separate financial transactions memorialized on a single retail installment contract document for the convenience of some consumers and to allow the auto industry to sell more vehicles, which is good for both parties'") (citation omitted).

[87] *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 48 (D. Kan. 2007) (observing "'two separate financial transactions memorialized on a single retail installment contract document'") (citation omitted); *see also In re* Conyers, 379 B.R. 576, 582 (Bankr. M.D.N.C. 2007) (explaining financing negative equity was merely "a convenience and an accommodation to the Debtor" but did not enable debtor rights in collateral). *But see* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1302 (11th Cir. 2008) (stating negative equity of trade-in vehicle is "'inextricably intertwined with'" sale of new vehicle and must be considered part of price of collateral).

[88] 338 B.R. 110 (Bankr. M.D. Ala. 2006).

[89] *Id*. at 114 (explaining debtor's "car secures more than the debt for the money to acquire it" thus leaving creditor's security interest without "purchase-money character").

[90] *Id*. at 113–14.

[91] *Id*. at 114.

[92] *See In re* Johnson, 380 B.R. 236, 243 (Bankr. D. Or. 2007); *see also In re* Munzberg**,** 388 B.R. 529, 540 (Bankr. D. Vt. 2008) (noting "negative equity is . . . unsecured debt . . . because the debtor no longer owns the collateral . . . from which the negative equity originated") (citation omitted); *In re* Wear, No. 07-42537, 2008 WL 217172, at *4–7 (Bankr. W.D. Wash. Jan. 23, 2008) (holding negative equity is not part of purchase price of collateral according to state U.C.C.).

[93] *In re Johnson*, 380 B.R. at 244 (interpreting "cash sales price" to mean price which debtor would pay to dealer, and "it logically cannot include negative equity"). *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 48 (D. Kan. 2007) ("'The term "enable" refers to what it has always referred to, which is the value given to allow the debtor to pay, in whole or in part, the actual price of a new item of collateral being acquired, in these cases the replacement vehicles themselves . . . .'" (quoting Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 557 (W.D.N.Y. 2007))); *In re* Sanders, 377 B.R. 836, 851 (Bankr. W.D. Tex.

distinction between negative equity and other unsecured debt that could potentially be rolled in with a purchase money obligation.[94] According to the court, there is no difference between rolling in negative equity and rolling in other unsecured debt to the purchase money obligation.[95] As an illustration, the court noted that it would be absurd to conclude that a lender could have agreed to pay a debtor's student loans and then be able to include it as a PMSI in a new vehicle.[96]

B. Negative Equity as Value Used to Enable Debtor to Acquire Rights in the Collateral

Another factor the court considers when evaluating the purchase money status of negative equity is whether it is "value used to enable" the debtor to acquire rights in the collateral.[97] Some courts hold that the loan to pay off negative equity is value given to the debtor to acquire rights in the new vehicle because the refinancing is an essential part of the sale transaction. Without negative equity financing, the debtor would not have been able to acquire the new vehicle.[98] Other courts find that at its core, negative equity financing constitutes the simple paying off of an existing debt, unrelated to the purchase of a new vehicle.[99] This view supports the characterization of negative equity as non-purchase money because the negative equity financing does not "enable" the consumer to purchase the new vehicle.

2007) (determining "'price of the collateral,' [is] roughly equivalent to 'cash price of the motor vehicle,' [and] does not include the amount advanced to pay off negative equity").

[94] 371 B.R. 139, 154 (Bankr. E.D. Va. 2007) (court did not find a difference between "vehicle negative equity" and other forms of debt such as student loans).

[95] *Id*.

[96] *Id*. *See In re* Padgett, 389 B.R. 203, 212 (Bankr. D. Kan. 2008) (finding there was "insufficiently close nexus between retiring the antecedent debt on the trade-in vehicle and acquiring a new vehicle to constitute purchase money"); *see also In re* Callicott, 386 B.R. 232, 236 (Bankr. E.D. Mo. 2008) (holding no evidence existed showing financing negative equity was "essential" to acquiring vehicle).

[97] *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 262 (W.D.N.Y. 2007) (explaining to determine if PMSI exists, it is necessary to determine if negative equity "constitutes 'value given to enable the debtor[s] to acquire rights in or the use of the collateral'"); *In re* Johnson, 380 B.R. 236, 245–47 (Bankr. D. Or. 2007) (explaining courts consider whether debt given to compensate for negative equity is "value used to enable" in determining purchase-money status of such debt); *see also* U.C.C. § 9-103 cmt. 3 (2007) (clarifying various expenses essential to obtaining rights in given collateral are to be considered when determining purchase-money status of debt).

[98] *See In re* Vinson, 391 B.R. 754, 757 (Bankr. D.S.C. 2008) (finding financing of negative equity essential to purchase of new vehicle and also finding PMSI for full debt amount); *In re* Cohrs, 373 B.R. 107, 109–10 (Bankr. E.D. Cal. 2007) (noting "incidental" charges are incurred due to financing negative equity); *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y 2007) ("This negative equity financing is inextricably linked to the financing of the new car. It is clear that one would not take place without the other.").

[99] *See In re Johnson*, 380 B.R. at 243–45 (holding negative equity is not part of the purchase price of new vehicle nor is it "an expense 'incurred in connection with acquiring'" vehicle, but rather is "an antecedent debt"); *In re* Conyers, 379 B.R. 576, 582 (Bankr. M.D.N.C. 2007) (holding loans given to finance negative equity are "accommodation" and not essential to purchase new vehicle, stating "[w]hile paying off the preexisting debt on the old vehicle was value, it was not value given to enable the Debtor to acquire rights in the collateral"); *In re* Sanders, 377 B.R. 836, 857 (Bankr. W.D. Tex. 2007) (concluding financing used to pay negative equity is not part of purchase value of new vehicle but rather paying off old debt as it "enabled the dealership to pay off the balance on the trade-in using the debtors' credit").

The term "value given to enable" has been interpreted differently in the courts. The court in *In re Westfall* interpreted "value given to enable" as indicating whether the payoff of negative equity was required or necessary in order to obtain a legal interest in the new vehicles.[100] If negative equity was not required for the consumer to acquire the new vehicle, then the auto financer did not have a PMSI for the amount advanced to satisfy the pre-existing debt.[101] This interpretation also led the court to hold that the debtor's rights in the new vehicle did not require the pay off of existing debt on the trade-in vehicle.[102]

Another court stated that the term "enable" has always referred to the value given by the debtor to pay the actual price of the new collateral. The court in *In re Price* held that providing a loan to refinance negative equity may be convenient, but is not necessary for a consumer to purchase a replacement vehicle:

> The term "enable" refers to what it has always referred to, which is the value given to allow the debtor to pay, in whole or in part, the actual price of a new item of collateral being acquired, in these cases the replacement vehicles themselves.[103]

The obligation incurred for payment of previous debt is not "'value given to enable the debtor to acquire rights in or use of the collateral'" because the buyer is securing a new loan to pay off existing debt.[104] Consequently, under this rationale, negative

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[100] 365 B.R. 755, 760 (Bankr. N.D. Ohio 2007) ("[T]he payment of the negative equity was not legally required in order for debtors to acquire rights in the collateral."), *aff'd in part, rev'd in part*, 376 B.R. 210 (Bankr. N.D. Ohio 2007). *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 47 (D. Kan. 2007) (stating since buyer was not required to resolve negative equity debt upon purchasing new vehicle, "'value given to enable' . . . did not include the negative equity"); *In re* Vega, 344 B.R. 616, 622 (Bankr. D. Kan. 2006) (holding since only part of loan was required for purchase of new vehicle, only that portion is "value given to enable").

[101] *In re Westfall*, 365 B.R. at 760 ("Thus, the 'value given to enable' debtors to obtain rights in the new vehicles did not include the payoff of debtors obligations on the existing car loans."). *See In re Callicott*, 386 B.R. at 236 (ruling close nexus does not exist between acquisition of vehicle and loan used to pay off trade-in vehicle because "Debtor had the option of paying off the original debt on the [trade-in vehicle] using other means"); *In re* Pajot, 371 B.R. 139, 152 (Bankr. E.D. Va. 2007) (noting "negative equity payoff is not necessary or compelled" and "negative equity is of a different type and magnitude from the other listed items" in Comment 3, and should not be included in definition), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008). *But see In re* Hayes, 376 B.R. 655, 673 (Bankr. M.D. Tenn. 2007) ("Whether a loan to payoff pre-existing debt enables the debtor or has a close nexus to the acquisition of new purchase money collateral turns on the facts of individual transactions.").

[102] *In re Westfall*, 365 B.R. at 760 ("Debtors were not required to pay off the existing loans to gain a legal interest in the vehicles."). *See In re Pajot*, 371 B.R. at 152 (finding, in this case, "negative equity payoff obligation is not necessary to the transaction"); *see also In re Johnson*, 380 B.R. at 246 (analyzing courts' decisions on both sides of proposition).

[103] *In re* Price, 363 B.R. 734, 741 (Bankr. E.D.N.C. 2007) (quoting *In re* Peaslee, 358 B.R. 545, 557 (Bankr W.D.N.Y. 2007)), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[104] *In re Price*, 363 B.R. at 740–41 (finding "funds loaned to satisfy the negative equity" to be "significantly and qualitatively different from the fees, freight charges, storage costs, taxes, and similar expenses that are typically part of an automobile sale" and noting *In re Peaslee* court's analysis finding "'[t]hat portion of the loan provided is in fact used to pay off the lien on the trade-in vehicle'") (citations

equity loans do not have purchase-money status.[105] The court in *In re Sanders* rejected the creditor's argument that the only means for the debtor to acquire the new vehicle was to obtain a loan from the creditor to pay the balance owed on the trade-in.[106] The court reasoned that it would not take long for other extreme examples to "effectively drain 'purchase-money' of any valid meaning."[107] For example, if a creditor agreed to pay off some of a debtor's credit cards in order for the debtor to qualify for a car loan, then that would constitute an item that "enabled" the debtor to acquire the new vehicle.[108]

At the opposite end of the spectrum, the District Court in *Peaslee* held that the detailed, but non-exhaustive list in Comment 3 of section 9-103 describes the items and expenses that would "enable" the debtor to acquire an interest in the new vehicle.[109] This interpretation overlaps with the question of what constitutes part of the purchase price of the collateral. Comment 3 could be interpreted to mean that an item or expense that facilitates the debtor's acquisition of the collateral is considered part of the purchase price of the vehicle.[110] The District Court also noted that the refinancing of negative equity constitutes an expense when the transaction is done with the sale of the new vehicle, especially when the buyer and seller agree that the refinancing is an "integral" part of the sale.[111] The items contained in Comment 3 are simply a list of expenses that are incurred in a motor vehicle sale,

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omitted). *See In re* Mitchell, 379 B.R. 131, 137 (Bankr. M.D. Tenn. 2007) (finding negative equity does not enable debtors to acquire rights).

[105] *See In re Price*, 363 B.R. at 742 (Bankr. E.D.N.C. 2007) (finding negative equity did not result in PMSI); *see also In re Hayes*, 376 B.R. at 672 (noting "a majority of reported decisions conclude that a loan to payoff 'negative equity' is not included in a purchase money security interest in a new car" and including *In re Price* decision in this list).

[106] *In re* Sanders, 377 B.R. 836, 854 (Bankr. W.D. Tex. 2007) ("One needs only a few imaginative moments to think of other examples so far afield that even [the creditor] would have to eventually admit that the formulation would effectively drain 'purchase money' of any valid meaning.").

[107] *Id.*

[108] *Id.* (offering extreme example stretching meaning of purchase money needed to enable purchase). *See In re* Padgett, 389 B.R. 203, 212 (Bankr. D. Kan. 2008) (holding negative equity did not enable debtor to execute purchase of vehicle); *In re Mitchell*, 379 B.R. at 138 (finding negative equity financing does not enable debtor to "acquire rights in or use of the collateral").

[109] Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 258–259 (W.D.N.Y. 2007) (holding list presented in Comment 3 to U.C.C. section 9-103 is guideline to items that may or may not be considered in value to enable purchase). *See* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291, at *2 (M.D. Ga. June 26, 2007) (holding negative equity fell within meaning of purchase money obligation under Georgia U.C.C. since negative equity was "integral part" of sale), *aff'd*, 537 F.3d 1295 (11th Cir. 2008). *See generally* U.C.C. § 9-103 cmt. 3 (2000) (expounding upon purchase money collateral, purchase money obligation, and purchase money security interest under Article 9).

[110] *See Peaslee*, 373 B.R. at 259 (stating where negative equity can be paid by means other than trade-in sale, negative equity can still be "integral to the sale"); *In re* Cohrs, 373 B.R. 107, 109–10 (Bankr. E.D. Cal. 2007) (finding when used vehicle is traded in during purchase of new vehicle, value derived from trade-in is part of purchase price and "incurred to 'enable the debtor to acquire rights in' the new vehicle"); *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y. 2007) (stating negative equity financing is essential portion of financing of new vehicle).

[111] *Peaslee*, 373 B.R. at 259 (positing negative equity may be agreed upon by parties as "integral part" of vehicle sale). *See generally* N.Y. PERS. PROP. LAW § 301(6) (McKinney 2008) (providing definition of "cash sale price").

and the list does not exclude the refinancing of negative equity as an expense to enable the consumer to acquire rights in the vehicle.[112] Similarly, in *In re Schwalm* the court held that if the parties agreed that paying off the negative equity in the trade-in vehicle was an integral part of the purchase transaction, then it would be considered an expense in acquiring the new vehicle.[113]

However, this explanation should not be accepted. First, negative equity is not an "expense" because it is simply another loan to refinance an antecedent debt.[114] Refinancing transactions do not have purchase money status because the funds are not used to purchase the collateral. Expenses incurred in connection with acquiring rights in a new vehicle should only include the standard fees that every buyer has to pay in order to acquire ownership of the car.[115] Negative equity is not required nor is it a standard obligation for a consumer who does not trade-in a vehicle.[116] In addition, further inquiry as to whether the negative equity rollover is an "integral

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[112] *Peaslee*, 373 B.R. at 258–59 (arguing Comment 3 covers expenses resulting from acquiring new collateral and no reason why negative equity should not be included in list). *See In re* Myers, No. 07-11145-AJM-13, 2008 WL 2445214, at *4 (Bankr. S.D. Ind. 2008) (holding Comment 3 "does not limit the definition of 'price of the collateral' or 'value given' only to types of minor, direct and incidental expenses" but rather is inclusive of many types of transaction-related expenses beyond those explicitly listed); *see also In re* Burt, 378 B.R. 352, 360–62 (Bankr. D. Utah 2007) (agreeing with *Peaslee* decision which stated "payoff of the negative equity was precisely the type of [expense] . . . contemplated by Comment 3").

[113] *In re* Schwalm, 380 B.R. 630, 633–35 (Bankr. M.D. Fla. 2008) (finding that parties had negotiated to include negative equity as part of transaction, which was permissible under state and federal law).

[114] *See In re* Munzberg, 388 B.R. 529, 539 (Bankr. D. Vt. 2008) (stating "[n]egative equity is antecedent debt, as it represents the amount financed on a debtor's previous car (Car 1) that remained unpaid at the point the debtor was in the process of purchasing a new car (Car 2)" and therefore, "the negative equity, and the collateral to which it was attached, pre-dated the purchase of Car 2"); *In re* Tuck, No. 06-10886-DHW, 2007 WL 4365456, at *3 (Bankr. M.D. Ala. Dec. 10, 2007) (observing "[n]egative equity . . . is not an expense directly related to the purchase of the second vehicle" and "negative equity represents a prior obligation in connection with a prior vehicle"); *In re* Price, 363 B.R. 734, 741 (Bankr. E.D.N.C. 2007) (asserting funds distributed to pay off debt owed on trade-in vehicle were not part of purchase price, price of new collateral, or value given to allow debtor to gain rights in collateral, and were "significantly and qualitatively different" from standard fees such as taxes, storage fees, and freight charges), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[115] *See In re* Callicott, 386 B.R. 232, 236 (Bankr. E.D. Mo 2008) (concluding negative equity was not "integral" part of transaction where it was used to pay off "original debt" on traded-in car where there was no evidence "financing of payoff" off debt was "essential" to acquire new vehicle); *In re* Johnson, 380 B.R. 236, 243 (Bankr. D. Or. 2007) (finding "the liability for negative equity is not an expense 'incurred in connection with acquiring' the Vehicle; it is an antecedent debt"); *In re Price*, 363 B.R. at 741 n.11 (reasoning loan given to "satisfy" negative equity is "qualitatively different" from fees, freight charges, taxes, etc. that are usually part of sale of vehicle)).

[116] *See In re Johnson*, 380 B.R. at 245 (noting decision of *In re Sanders* which found "financed negative equity was not value given to enable debtors to acquire rights in a vehicle because it did not represent an obligation for an expense incurred in acquiring rights in the collateral" (citing *In re* Sanders, 377 B.R. 836, 853–55 (Bankr. W.D. Tex. 2007))); *In re* Conyers, 379 B.R. 576, 582 (Bankr. M.D.N.C. 2007) (asserting financing for negative equity was "a convenience and an accommodation" but did not rise to level of enabling rights in or use of collateral for debtor); *see also In re* Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007) (observing findings of other courts noted including negative equity in "new loan does not 'enable' most vehicle purchases") (citations omitted).

part"[117] of the transaction requires another evidentiary hearing that leaves too much open for the judge to determine in hindsight. The hearing burdens the bankruptcy estate with more legal fees and delays the bankruptcy proceeding for the individual chapter 13 debtor seeking an efficient resolution for a fresh start.[118]

C. Close Nexus Between Negative Equity and Acquiring the Collateral

The third factor the court takes into consideration is the close nexus requirement in Comment 3 in section 9-103 which states that "'[t]he concept of 'purchase money security interest' requires a *close nexus* between the acquisition of collateral and the secured obligation.'"[119] The nexus standard requires a close connection between the secured obligation and the acquisition of the new collateral in order for the secured obligation to be considered "part of the price of the collateral."[120] Some courts reason that because negative equity is a component of the "packaged transaction," there is a close nexus between the negative equity and the acquisition of the new vehicle.[121] Other courts look to the nature of negative

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[117] *See In re Schwalm*, 380 B.R. at 633 (agreeing with prior decision noting if parties agreed payoff of negative equity was "'integral part'" of transaction, then it is viewed as expense in acquiring new vehicle) (citation omitted); *In re Johnson*, 380 B.R. at 242 (observing other courts' analysis of negative equity rollover as "integral part" of transaction). *But see In re* Wear, No. 07-42537, 2008 WL 217172, *3 (Bankr. W.D. Wash. Jan. 23, 2008) (agreeing with holding of *In re Johnson* that "price of the collateral" does not include negative equity) (citation omitted).

[118] *See generally* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 259 (W.D.N.Y. 2007) ("If the buyer and seller agree to include the payoff of the outstanding balance on the trade-in as an integral part of their transaction . . . it is in fact difficult to see how that could *not* be viewed as such an expense."); Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291, at *2 (M.D. Ga. June 26, 2007) (finding "trade-in of the vehicle was an integral part of the sales transaction"), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y 2007) ("This negative equity financing is inextricably linked to the financing of the new car. It is clear that one would not take place without the other.").

[119] *In re* Riach, No. 07-61645-aer13, 2008 WL 474384, at *3 (Bankr. D. Or. Feb. 19, 2008) (citation omitted) (analyzing relevant section of Comment 3 of applicable state U.C.C.). *See* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291, at * 2 (M.D. Ga. June 26, 2007) (finding close nexus between negative equity and "package transaction"); *In re* Johnson, 380 B.R. 236, 242 (Bankr. D. Or. 2007) (noting Comment 3 requires "'close nexus between the acquisition of the collateral and the secured obligation'").

[120] *See In re Johnson*, 380 B.R. at 242 (observing Comment 3 calls for this close nexus for PMSI to exist); *In re* Sanders, 377 B.R. 837, 856 (Bankr. W.D. Tex. 2007) (noting close nexus requirement for purchase money security interest put forth by Comment 3); *In re* Cohrs, 373 B.R. 107, 109 (Bankr. E.D. Cal. 2007) (noting Comment 3 states "'[t]he concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation'") (citation omitted).

[121] *See Graupner*, 2007 WL 1858291 at * 2 (stating "close nexus between the negative equity and this package transaction supports the conclusion that the negative equity must be considered as part of the price of the collateral"); *In re* Schwalm, 380 B.R. 630, 633–34 (Bankr. M.D. Fla. 2008) (finding close nexus between items included in amount of loan and acquisition of car, where "debtors negotiated a packaged financing"); *In re* Johnson, 380 B.R. 236, 242 (Bankr. D. Or. 2007) ("Some courts have found this close nexus in the financing of negative equity because the parties have agreed to a 'package transaction.'"); *In re Cohrs*, 373 B.R. at 110 (noting Comment 3 requires "only a 'close nexus' between the acquisition of the property and the secured obligation"); *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y. 2007) (discussing Comment 3).

equity and find that it is not closely related to the purchase of the new vehicle.[122] These courts find that negative equity is not necessary to acquire the new vehicle, nor is it similar in nature to the items listed in Comment 3, and thus, negative equity financing fails the close nexus requirement.[123]

In *Schwalm*,[124] the debtors obtained a loan to cover the sticker price of the new vehicles, taxes, tag and title, gap insurance, extended warranty coverage and to pay the remaining balance owed on the trade-in vehicles.[125] The court held that the components of the packaged financing agreement, which included the trade-in vehicle, loan to pay off the negative equity, and the future maintenance of the replacement vehicle, all have a close nexus to the acquisition of the new vehicle.[126] The court arrived at the same conclusion in *In re Cohrs*,[127] where the financed negative equity was "part of a single transaction and all components of the obligation incurred [were] for the purpose of acquiring the property securing the new obligation."[128] The court in *In re Petrocci* even went so far as to hold that financing negative equity is so deeply linked to the financing of the new vehicle that one would not have occurred without the other.[129] This sentiment was followed by *Graupner* where the court decided that the negative equity financing was so "inextricably intertwined" with the purchase of a new vehicle that negative equity must be considered as part of the purchase price.[130]

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[122] *See* GMAC v. Horne, 390 B.R. 191, 197 (E.D. Va. 2008) (noting holding of *Pajot* court, which found "negative equity payoff obligation is not necessary to the transaction") (citation omitted); *see also In re* Padgett, 389 B.R. 203, 212 (Bankr. D. Kan. 2008) (holding "negative equity payoff obligation is not necessary to the transaction"); *In re* Price, 363 B.R. 734, 741 (Bankr. E.D.N.C. 2007) (holding loans for negative equity are "significantly" different from other financial components of automobile transaction), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[123] *See In re* Busby, No. 0702717EE, 2008 WL 4104184, at *5 (Bankr. S.D. Miss. Aug. 28, 2008) (rejecting argument of close nexus existing between negative equity and acquisition of new vehicle); *see also In re* Sanders, 377 B.R. 836, 856–57 (Bankr. W.D. Tex. 2007) (finding financing negative equity does not give rise to close nexus between acquisition of collateral and secured obligation as described in Comment 3); *In re* Pajot, 371 B.R. 139, 152 (Bankr. E.D. Va. 2007) ("[T]here is an insufficiently close nexus between the negative equity payoff and acquiring a new vehicle."), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008).

[124] 380 B.R. 630 (Bankr. M.D. Fla. 2008).

[125] *Id*. at 631.

[126] *Id.* at 633–34 (explaining items in amount financed have close nexus to acquisition of automobile, which is in line with explanation of price in Comment 3 of applicable state U.C.C.). *See In re* Vinson, 391 B.R. 754, 756 (Bankr. D.S.C. 2008) ("'[P]urchase-money security interest' requires a close nexus between the acquisition of collateral and the secured obligation."). *But see In re Johnson*, 380 B.R. at 247 (holding financed negative equity "does not create the requisite close nexus between 'value given' and the [debtors'] acquisition of rights in the Vehicle").

[127] 373 B.R. 107 (Bankr. E.D. Cal. 2007).

[128] *Id*. at 110–11.

[129] *In re* Petrocci, 370 B.R. 489, 499 (Bankr. N.D.N.Y 2007) ("[N]egative equity financing is inextricably linked to the financing of the new car. It is clear that one would not take place without the other.").

[130] Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291, at *2 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008).

The second line of cases holds the opposite—the loan must be "closely allied" with the purchase of the collateral.[131] These cases find that the close nexus requirement is a limitation on the auto lender's ability to roll in unrelated debt to the secured claim.[132] For instance, in *In re Pajot*, the court reasoned that negative equity is essentially an unsecured deficiency claim because the debt exceeds the value of the collateral.[133] Once the new auto lender pays the remaining balance to the previous creditor, the new auto lender should not be able to collect it as a secured claim. If this is accepted, then negative equity financing successfully elevates an unsecured deficiency claim to not only a secured claim, but as a preferential purchase-money security interest that is fully protected under the hanging paragraph.[134] This could lead to abuse by the auto lending industry, encouraging rolling in as much negative equity as possible creating a security interest by riding on the coat tails of the loan that was actually used to purchase the replacement vehicle.[135]

In addition, these courts examine the nature of negative equity and compare it to the list of items in Comment 3 and conclude that negative equity is outside the scope of the sale transaction. The court in *In re Pajot* noted that negative equity was unrelated to the purchase of the new vehicle because it is not "of the same type or magnitude" as the items and expenses listed in Comment 3 and therefore failed the close nexus requirement.[136] The court in *In re Johnson* also concluded that

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[131] *See In re* Sanders, 377 B.R. 836, 856 (Bankr. W.D. Tex. 2007) (discussing this line of reasoning as having been described in Gen. Elec. Capital Commercial Auto. Fin., Inc. v. Spartan Motors, Ltd., 675 N.Y.S.2d 626, 631 (N.Y. App. Div. 1998)).

[132] *See In re* Pajot, 371 B.R. 139, 154 (Bankr. E.D. Va. 2007) (stating nexus between negative equity payoff and acquisition of new car is unclear, as "lender could just as easily pay off the debtor's student loans and roll that amount into a secured claim on the second vehicle"), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *see also* Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 857 (B.A.P. 9th Cir. 2008) (noting purpose of hanging paragraph was to protect from abuse by debtors); *In re* Busby, No. 0702717EE, 2008 WL 4104184, at *5–6 (Bankr. S.D. Miss. Aug. 28, 2008) (finding no close nexus between second car and refinancing).

[133] *In re Pajot*, 371 B.R. at 154.

[134] *See In re* Mancini, 390 B.R. 796, 801 (Bankr. M.D. Pa. 2008) (concluding negative equity does not constitute purchase money security interest because it would be "converting unsecured debt into secured debt"); *In re* Steele, No. 08-40282-DML-13, 2008 WL 2486060, at *3 (Bankr. N.D. Tex. June 12, 2008) (noting "effect of the Unnumbered Paragraph is to require full satisfaction of a deficiency claim that, but for [it], would be unsecured"); *In re* Padgett**,** 389 B.R. 203, 211 (Bankr. D. Kan. 2008) ("[T]he 910-day rule . . . magically entitles the second lender's entire loan to be given secured status . . . . Some creditor is getting paid 100% on its debt, notwithstanding that a significant part of that debt is essentially unsecured."); *In re* Hayes, 376 B.R. 655, 672–73 (Bankr. M.D. Tenn. 2007) ("By its nature, negative equity is unsecured debt. The payoff of negative equity as part of a new car purchase means the debtor converted unsecured debt into debt nominally secured by a new item of collateral.").

[135] *See In re Pajot*, 371 B.R. at 164–65 ("If negative equity were to be included as a purchase money security interest, lenders would be rewarded for rolling in as much negative equity as possible. It would enable the creation of a security interest out of what otherwise would have been unsecured out of bankruptcy . . . ."); *see also In re* Munzberg, 388 B.R. 529, 541 (Bankr. D. Vt. 2008) (finding no legislative history to exempt auto lenders from cramdowns "for any loans beyond those made for" purchase of vehicle "within 910 days of a bankruptcy filing"); *In re Acaya*, 369 B.R. at 570 (opining hanging paragraph not applicable because negative equity does not create purchase money security interest).

[136] *In re Pajot*, 371 B.R. at 152.

negative equity is "not similar in nature or in scope" to those listed in Comment 3 because the liability on the trade-in vehicle preceded the purchase of the new vehicle.[137] At the time of sale, there were two separate transactions even though they were simultaneous. The first transaction consisted of the auto lender paying the unsecured deficiency debt on behalf of the debtor and the second transaction was a new loan to pay the purchase price of the replacement vehicle.[138]

Although the purpose of the hanging paragraph is to protect the interests of automobile dealers who provide financing for customers, it should not be interpreted so broadly as to give purchase money status to items that are not part of the purchase price of the collateral.[139] The problem with the broad interpretation of Comment 3 is that it runs counter to one of the fundamental principles of the Bankruptcy Code: to provide a fair and equitable distribution of assets to the creditors.[140] What is most offensive by giving negative equity purchase money status is that an unsecured deficiency claim is transformed and clothed as a PMSI that is fully protected by the Bankruptcy Code. By giving negative equity preferential "purchase money" status, this results in increasing the secured claim for

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[137] *In re* Johnson, 380 B.R. 236, 243 (Bankr. D. Or. 2007).

[138] *See In re Pajot*, 371 B.R. at 154 ("[T]he substance of the transaction, though instantaneous, is that the second creditor is paying off the debtor's unsecured deficiency debt on the first vehicle."); *In re* Lavigne, No. 07-30192, 2007 WL 34693454 at *8 (Bankr. E.D. Va. Nov. 14, 2007) (explaining negative equity liability preceded acquisition of new vehicle and "[t]he pre-existing indebtedness was simply rolled into the new car loan"), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008).

[139] The "hanging paragraph" itself and the above referenced cases clearly indicate the intent was to protect creditors from perceived abuses created by spendthrift debtors prior to petitioning for chapter 13 relief. *See In re Johnson*, 380 B.R. at 244 ("'[T]he text [of a statute] is the best evidence of the legislature's intent.'") (citation omitted); *see also In re Pajot*, 371 B.R at 154 ("If the drafters of the U.C.C. and legislatures enacting it wanted to include negative equity in the definition of purchase-money security interest, it could have been addressed much more explicitly in the statutory text or comments."). *But see* Jean Braucher, Rash *and Ride-Through Redux: The Terms for Holding on to Cars, Homes and Other Collateral Under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 472 (2005) (noting "Congress knows how to say 'payment of the underlying debt'" as "this language appears in section 1325(a)(5)(B)(i)(I)(aa)" which strikes a blow at full debt repayment argument). To be sure, there are other provisions in BAPCPA that streamlined the bankruptcy process and, in some cases, protected debtors but the particular provision at issue here, the so-called "hanging paragraph" of section 1325, was obviously intended to protect the interests of automobile dealers who provide financing for customers. *See In re Lavigne*, 2007 WL 34693454 at *11 (stressing dramatic decrease of value of new car upon leaving dealership); *see also In re* Duke, 345 B.R. 806, 809 (Bankr. W.D. Ky. 2006) (highlighting title of BAPCPA section with hanging paragraph, "'Giving Secured Creditors Fair Treatment in Chapter 13 … Restoring the Foundation for Secured Credit'" indicates legislative intent to protect creditors with PMSI) (citation omitted); *see also* Shaun Mulreed, In re Blair *Misses the Mark: An Alternative Interpretation of the BAPCPA's Homestead Exemption*, 43 SAN DIEGO L. REV. 1071, 1072 (2006) (stressing how commentators see BAPCPA as "anything but pro-debtor").

[140] *See* Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 667 (2006) ("[W]e are guided in reaching our decision by the equal distribution objective underlying the Bankruptcy Code, and the corollary principle that provisions allowing preferences must be tightly construed."); *see also* Total Minatome Corp. v. Jack/Wade Drilling, Inc. (*In re* Jack/Wade Drilling, Inc.), 258 F.3d 385, 387–88 (5th Cir. 2001) ("There is . . . a general presumption in bankruptcy favoring equality in distribution such that 'if one claimant is to be preferred over others, the purpose should be clear from the statute.'" (quoting Nathanson v. NLRB, 344 U. S. 25, 29 (1952))); Drexel Burnham Lambert Group, Inc. v. Galadari, No. 84 Civ. 2602 (CBM), 1987 WL 6164, at *18 (S.D.N.Y. Jan. 29, 1987) ("The guiding premise of our Bankruptcy Code is the equality of distribution of assets among creditors.") (citation omitted).

the vehicle financier while reducing the available funds to pay other unsecured claims.[141]

Negative equity is not a part of the purchase price of the collateral simply because it increases the amount of the loan obtained to purchase the new vehicle.[142] Furthermore, negative equity is not given to enable the debtor to acquire rights in the new vehicle because the funds were not used to pay the actual purchase price of the vehicle.[143] There is no close nexus between negative equity and the acquisition of the collateral because the nature of negative equity is not to purchase the vehicle but to pay off existing debt.[144]

III. THE DUAL STATUS RULE WITH TRACING

U.C.C. section 9-103 expressly left open the treatment of PMSIs in consumer transactions while directing that the dual status rule be applied for non-consumer goods transactions.[145] As a result, some courts apply the dual status rule while

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[141] *In re* Steele, No. 08-40282-DML-13, 2008 WL 2486060, at *4 (Bankr. N.D. Tex. June 12, 2008) ("[T]he increase of secured debt resulting from application of the Unnumbered Paragraph in favor of a deficiency will reduce what is available to pay other unsecured claims."); *see In re Pajot*, 371 B.R at 146 n.9 (illuminating how even before BAPCPA was enacted, most unsecured claim payments amounted to "mere pennies on the dollar"). *But see* DaimlerChrysler Fin. Servs. Ams. LLC v. Ballard (*In re* Ballard), 526 F.3d 634, 640 (10th Cir. 2008) (explaining how unsecured creditors can pursue deficiency claims on basis of state law and contract with debtor).

[142] *See In re* Busby, 0702717EE, 2008 WL 4104184, at *5 (Bankr. S.D. Miss. Aug. 28, 2008) (stating negative equity is unrelated to acquisition of or retention of new vehicle and instead is second transaction); *see also In re* Brodowski, 391 B.R. 393, 398–99 (Bankr. S.D. Tex. 2008) (stating "purchase of the new vehicle and the refinancing of the negative equity in the old vehicle [are] two separate and distinct transactions") (citation omitted). *But see* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1301 (11th Cir. 2008) (holding "negative equity on a trade-in vehicle is 'debt for the money required to make the purchase' of the new vehicle").

[143] *See In re Brodowski*, 391 B.R. at 398 (holding "refinancing of negative equity . . . is not a legal requirement for the debtor to acquire rights in the collateral and therefore does not 'enable' the acquisition of rights in the new vehicle"); *see also In re* Sanders, 377 B.R. 836, 853–54 (Bankr. W.D. Tex. 2007) (holding funds used to pay off negative equity do not enable debtor to acquire rights in new vehicle). *But see* GMAC v. Horne, 390 B.R. 191, 201–02 (E.D. Va. 2008) (disagreeing with decisions of bankruptcy courts in *In re Pajot* and *In re Lavigne* which reached conclusion that "negative equity is not value given to enable the debtors to acquire rights in or use of the collateral").

[144] *See In re* Johnson, 380 B.R. 236, 247 (Bankr. D. Or. 2007) (holding "financed negative equity is nothing more than a refinance of the pre-existing debt owed on" vehicle traded in and "does not create the requisite close nexus between 'value given' and the [debtor's] acquisition of rights in the [v]ehicle"); *see also In re Sanders*, 377 B.R. at 857 (stating while financing of negative equity was important part of transaction and enabled transaction to occur, it does not create "close nexus between the acquisition of collateral and the secured obligation"). *But see In re* Myers, No. 07-11145-AJM-13, 2008 WL 2445214, at *6 (Bankr. S.D. Ind. June 13, 2008) (determining "financing of the negative equity was an expense that was both part of the 'price of the collateral' and the 'value given' that enabled the Debtor to acquire rights in the Vehicle" therefore satisfying close nexus).

[145] *See* N.Y. U.C.C. LAW § 9-103(h) (McKinney 2003) (stating it is up to courts to determine proper rules in consumer-good transactions); *see also In re* Munzberg, 388 B.R. 529, 545 (Bankr. D. Vt. 2008) (stating, under applicable state U.C.C. law, "dual-status rule is only applicable to non-consumer goods transactions" and it is up to the court to determine proper rules for consumer-goods transactions); Harry, *supra* note 45, at

others apply the transformation rule for consumer goods.[146] Under the dual status rule, the loan is apportioned into a purchase money obligation and a non-purchase money obligation.[147] Only the pure purchase money portion, the amount actually used to satisfy the price of the vehicle, is given full protection under the hanging paragraph such that the actual amount financed secured by the vehicle will be treated as a fully secured claim.[148] The portion that is not purchase money, such as negative equity, would be subject to section 506 bifurcation.[149]

Without the hanging paragraph, lenders would only receive a secured claim up to the value of the collateral, with the remaining obligation remaining unsecured.[150]

1119–20 (discussing role and purpose of U.C.C. section 9-103 in treatment of PMSI in consumer good transactions and non-consumer good transactions).

[146] *See In re Busby*, 2008 WL 4104184 at *6 (applying dual status rule in consumer goods transactions); *In re Munzberg*, 388 B.R. at 545 (discussing ability of courts to choose between transformation rule and dual-status rule and how courts are split on which test to apply); *In re* Vega, 344 B.R. 616, 622–23 n.29 (Bankr. D. Kan. 2006) (noting dual status rule applies to both commercial and consumer transactions in Kansas).

[147] *See In re Johnson*, 380 B.R. at 248 (stating "dual status rule 'allows a security interest to have both the status of a PMSI, to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to the purchase'" (quoting *In re* Petrocci, 370 B.R. 489, 504 (Bankr. N.D.N.Y. 2007))); *In re* Linklater, 48 B.R. 916, 919 (Bankr. D. Nev. 1985) (discussing how under dual status rule court determines "extent to which goods secure their own purchase price" as well as other purchases); *see also* G. Ray Warner, *Consumer Avoidance of Non-purchase-money Security Interests Under Revised Article 9*, 20 AM. BANK. INST. J. 22, 22 (Nov. 2001) (discussing courts following "'dual-status' rule" hold security interest can "be partly purchase-money and partly non-purchase-money").

[148] *See* Citifinancial Auto v. Hernandez-Simpson, 369 B.R. 36, 46 (D. Kan. 2007) (acknowledging purchase-money security interest does not lose its status as PMSI under section 9-103(f) of Kansas U.C.C.); *In re* Lavigne, No. 07-30192, 2007 WL 3469454, at *4 (Bankr. E.D. Va. Nov. 14, 2007) (noting "[i]f a creditor has a [PMSI] in a vehicle purchased for the personal use of the debtor in the 910 days before the debtor filed for bankruptcy," then "the hanging paragraph prohibits the court from confirming a Chapter 13 plan that makes a creditor unsecured to the extent the outstanding loan exceeds the value of the collateral"), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re Petrocci*, 370 B.R. at 504 (noting dual status rule "'allows a security interest to have both the status of a [PMSI], to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to its purchase'") (citation omitted); *see also In re Vega*, 344 B.R. at 622–23 (determining debtor's chapter 13 plan meets provisions of section 1325(a) by "providing full payment of that portion of . . . claim representing its purchase money security interest").

[149] *See In re* Hayes, 376 B.R. 655, 658 (Bankr. M.D. Tenn. 2007) (finding "protection from bifurcation" unavailable where "creditors do not claim purchase money security interests in some items of their collateral"); *see also In re* Burt, 378 B.R. 352, 365 (Bankr. D. Utah 2007) (finding PMSI is not subject to cram down, even if dual status rule were applied); David Gray Carlson, *Cars and Homes in Chapter 13 After the 2005 Amendments to the Bankruptcy Code*, 14 AM. BANKR. INST. L. REV. 301, 350 (2006) ("If, however, there is a surplus following the purchase money security interest, section 506(a) bifurcation could supply a positive secured claim with regard to this second nonpurchase money security interest.").

[150] *See* 11 U.S.C. § 506(a)(1) (2006). Section 506 states:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest 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.

Over time, consumer goods depreciate in value, especially motor vehicles; as soon as they are driven off the lot, which has the consequence of decreasing the lender's secured claim in bankruptcy.[151] At the time of the contract, both parties expect that the vehicle is used to secure the entire loan. After filing the bankruptcy petition, section 506 strips down the amount of secured debt dramatically and lenders lose the benefit of having their entire loan treated as a fully secured claim.[152]

At first glance, the dual status rule seems appropriate because the secured lender will receive accurate protection under the hanging paragraph without negatively affecting the other creditors. The lender will have a secured claim for the actual purchase money obligation, which is what the creditor is entitled to under the hanging paragraph and the remaining non-purchase obligation will be bifurcated under section 506.[153] However, the complexities with tracing and the plain language of the provision do not support application of the dual status rule.

The policy behind the dual status rule is that it encourages "refinancing under circumstances where the creditor has the burden of demonstrating the extent to which a security interest retains its purchase money character, benefitting both buyer and seller by facilitating the sale of consumer goods."[154] Although policy

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see also Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 960–61 (1997) (reading section 506 to provide limit on secured portion of creditor's claim to value of collateral); 4 COLLIER ON BANKRUPTCY, ¶ 506.03, at 506-9 (Alan N. Resnick et al. eds., 15th ed. rev. 2006) (noting "'the secured portion of the claim [is] limited to the value of the collateral'") (citation omitted).

[151] *See In re* Padgett**,** 389 B.R. 203, 211 (Bankr. D. Kan. 2008) (noting, pre-BAPCPA, "rapid deterioration of motor vehicles" led to debtors "only paying a secured claim equal to the depreciated value of the car"); *In re* Callicott, 386 B.R. 232, 237 (Bankr. E.D. Mo. 2008) (discussing legislative intent to prevent creditors' secured claims from being "'reduced by rapid depreciation of collateral'") (citation omitted); *In re* Pajot, 371 B.R. 139, 159 (Bankr. E.D. Va. 2007) (noting in time before BAPCPA, "[d]ue to the rapid depreciation of motor vehicles the moment they leave the dealer's lot, debtors could often reap a benefit by cramming down the debt, only paying a secured claim equal to the depreciated value of the car"), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008).

[152] *See In re* Estrada, 387 B.R. 875, 879 (Bankr. M.D. Fla. 2008) (observing debtors' use of section 506 to "'strip down'" lien to collateral's value) (citation omitted); *In re* Sanders, 377 B.R. 836, 844–45 (Bankr. W.D. Tex. 2007) (noting effect of "'strip down'" on car lenders prior to BAPCPA and remedy enacted by Congress in response to their complaints); *In re* Barnes, 207 B.R. 588, 590 (Bankr. N.D. Ill. 1997) (acknowledging "'stripdown'" of creditor's claim as "possible valuation alternative[]" under section 506).

[153] *See In re* Look, 383 B.R. 210, 219–20 (Bankr. D. Me. 2008) (agreeing with previous decision stating dual status rule is appropriate in "'non-bankruptcy context when deciding . . . whether and to what extent a creditor retains a purchase money security interest when part of the consumer debt is a non-purchase money obligation'") (citation omitted); *In re* Westfall, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007) (finding dual status rule to be preferable, and transactions with "purchase money components" would be secured and "nonpurchase money components . . . [would] be subjected to bifurcation"); *In re Pajot*, 371 B.R. at 162 (noting "[i]n many situations the collateral value is less than the purchase-money debt and there is no collateral value 'left over'; when bifurcated, the entire non-purchase-money portion is unsecured" but "[i]f, however, the collateral value is greater than the purchase-money portion of the claim, . . . there is now collateral 'left over' to secure some of the non-purchase-money portion when that portion is bifurcated in the second step").

[154] *In re* Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007) (citing Borg-Warner Acceptance Corp. v. Tascosa Nat'l Bank, 784 S.W.2d 129, 135 (Tex. App. 1990)). *See In re* Dale, No. 07-32451-H5-13, 2007 WL 5493483, at *6 (Bankr. S.D. Tex. Sept. 17, 2007) (describing dual status rule as "'supportive of a public policy encouraging refinancing'") (citation omitted), *rev'd*, *In re* Dale, No. H-07-32451, 2008 WL 4287058 (S.D. Tex. Aug. 14, 2008); *In re* Linklater, 48 B.R. 916, 919 (Bankr. D. Nev. 1985) (noting dual status rule

encourages application of the dual status rule, whether the rule reflects congressional intent behind the paragraph is debatable.[155] The legislative history of the hanging paragraph, titled "Giving Secured Creditors Fair Treatment in Chapter 13 . . . Restoring the Foundation for Secured Credit,"[156] expresses Congressional intent to protect the vehicle financier's secured claim for the PMSI at the time of the contract without having it stripped down by section 506 bifurcation at the time of filing the bankruptcy petition.[157]

However, at least one court has found that dual status does not carry out legislative intent. The court in *In re Price* held that the hanging paragraph only protects claims that are wholly secured by PMSIs.[158] If the court were to allow portions of the claim to be protected by the hanging paragraph, the court reasoned that it would "essentially write the words 'some portion of the debt' into the statute where they do not now exist."[159] Application of dual status assumes that Congress intended for courts to read into the statute words that are absent and encouraged dissection of claims to determine what portion of the entire claim will be protected under the hanging paragraph.[160] If Congress actually intended to provide protection for claims that are only partially secured by a PMSI, it could have easily done so as it had done in other sections of the Code.[161]

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is used to determine whether perfected PMSI in consumer goods exists, and discussing underlying policy of "facilitat[ing] the sales of consumer goods").

[155] *See In re* Sparks, 346 B.R. 767, 771 (Bankr. S.D. Ohio 2006) (observing "[i]t is not clear, however, why limiting (not eliminating) cram downs by debtors would be an absurd result where it directly addresses the perceived abuse in a proposed amendment captioned 'GIVING SECURED CREDITORS FAIR TREATMENT IN CHAPTER 13 . . . (b) RESTORING THE FOUNDATION FOR SECURED CREDIT'"). *But see* Horr v. Jake Sweeney Smartmart, Inc., No. 1:07-CV-00010, 2007 WL 1989611, at *4 (S.D. Ohio July 6, 2007) (noting debtors in this case conceded "there is very little evidence to reflect what Congress intended by the language it chose to enact in the hanging paragraph").

[156] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8 § 306, 119 Stat. 23, 80.

[157] *See id.*; *see also* AmeriCredit Fin. Servs., Inc. v. Long (*In re* Long), 519 F.3d 288, 293–94 (6th Cir. 2007) (noting hanging paragraph is called "'anti-bifurcation'" paragraph, and referencing "sparse" legislative history supporting conclusion "paragraph was only intended to prohibit debtors from cramming down debt"); Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 261 (W.D.N.Y. 2007) (holding Congressional "intent was to protect creditors from perceived abuses created by spendthrift debtors prior to petitioning for Chapter 13 relief").

[158] *In re* Price, 363 B.R. 734, 742 (Bankr. E.D.N.C. 2007) (agreeing with debtors' reading of hanging paragraph's "strip down" limitation as inapplicable if part of debt is secured by purchase money security interest), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[159] *Id. See* Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 856 (B.A.P. 9th Cir. 2008) ("Congress did not state specifically that the hanging paragraph applied to a claim or debt 'or any part or portion' of either."); *In re* Johnson, 380 B.R. 236, 250 (Bankr. D. Or. 2007) (observing Congress did not "specify that the [h]anging [p]aragraph could be applied only to the 'entire' claim or debt").

[160] *See In re* Busby, No. 0702717EE, 2008 WL 4104184, at *6 (Bankr. S.D. Miss. Aug. 28, 2008) ("Since the Court has adopted the dual-status rule, the Court must now determine which amount is shielded from bifurcation by the hanging paragraph."). *See generally In re Price*, 363 B.R. at 745–46 (applying transformation rule rather than dual status rule because "true purchase price and the amount of the negative equity would be difficult to compute").

[161] *See In re Price*, 363 B.R. at 743 ("If Congress intended the hanging paragraph to provide for the disparate treatment of a claim that is only partially secured by a purchase money security interest, it could

The dual status rule, in its application to PMSIs, is not new and has been applied even before the hanging paragraph was enacted.[162] In 1991, in *Ionosphere Clubs, Inc. v. Shugrue*[163] the court explained:

> This rule has been referred to as the "dual status" rule, because it allows a security interest to have both the status of a PMSI, to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to its purchase.[164]

Although the court adopted the dual status rule over the transformation rule, the court also recognized that some problems may arise:

> Of course, where the obligations are owed to different creditors, there is no problem in allocating payments to each individual loan. The only complexity arises when the debtor takes multiple loans from a single creditor to finance multiple purchases, with each loan secured by security interests in all of the purchased property. In this event, the debtor might make a single periodic payment to the creditor rather than separate payments on each loan. In the event of default, the creditor must be able to determine how much is outstanding on each loan, to determine how much of a PMSI exists in each of the purchased items.[165]

The complexity the court describes, when the debtor takes multiple loans from a single creditor secured by the purchased property, is exactly what the negative equity cases present and therefore the dual status rule should not be adopted or applied to mixed PMSIs under the hanging paragraph.[166] In these negative equity

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easily have done so as it had in other sections of the Code."); *see also* Keene Corp. v. United States, 508 U.S. 200, 208 (1993) (stating where Congress includes certain language in one section of a statute but not in another, it is presumed Congress acted intentionally) (citation omitted). *See generally* Coleman v. Cmty. Trust Bank (*In re* Coleman), 426 F.3d 719, 725–26 (4th Cir. 2005) (arguing presence of certain phrase in part of statute and absence in other part shows Congress' ability to include limitation where desired).

[162] *See* Pristas v. Landaus of Plymouth, Inc. (*In re* Pristas), 742 F.2d 797, 800–01 (3d Cir. 1984) (supporting use of dual status rule and discussing its benefits); *In re* Ionosphere, 123 B.R. 166, 172 (S.D.N.Y. 1991) (referring to dual status rule allowing security interest to be both PMSI and general security interest); *see also In re* Hemingson, 84 B.R. 604, 607 (Bankr. D. Minn. 1988) (accepting dual status rule because it is "'in harmony with'" Bankruptcy Code) (citation omitted).

[163] 123 B.R 166 (S.D.N.Y. 1991).

[164] *Id.* at 172.

[165] *Id.* at 172–73 (footnote omitted).

[166] *Compare In re* Price, 363 B.R. 734, 745–46 (Bankr. E.D.N.C. 2007) (noting previous decision from *In re Peaslee* which stated dual status should not apply for mixed PMSIs and agreeing "generally when negative equity is involved, the appropriate rule is the transformation rule") (citation omitted), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007), *with In re* Munzberg, 388 B.R. 529, 545–46 (Bankr. D. Vt. 2008) (acknowledging split in courts yet adopting dual status rule for mixed PMSIs). *See*

cases, the debtor takes a purchase money loan to purchase the new vehicle and also takes a loan to pay off the existing debt of the old vehicle, both of which are secured by the new vehicle. In reality, the actual purchase price of the replacement vehicle is difficult to determine since the price is affected by the allowance given by the seller for the trade-in vehicle. The complexities of tracing compounded with the difficulty of ascertaining how much of each loan was paid down over time is one of the main reasons why the dual status rule is inappropriate to apply to mixed PMSIs in these negative equity cases. The court in *In re Price*,[167] recognized these difficulties of tracing:

> Not only must the court factor in the value of the vehicle being traded-in and the value of the automobile being sold, it must also ascertain how pre-bankruptcy payments should be allocated to the purchase money and non-purchase money components of the secured debt.[168]

Due to the tracing problem, at least one court has held that the dual status rule will only be applied if there are contractual provisions allocating the debtor's monthly payments between the purchase-money and non-purchase money portions of the debt.[169] The retail installment contracts usually state the total amount the buyer owes to the auto lender without indication of how much negative equity debt was included. Time consuming and costly evidentiary hearings would be necessary to determine exactly how much of the total amount is purchase money that would be protected under the hanging paragraph.[170] In addition, the debtor usually makes one monthly payment to the creditor under the security agreement to pay down the total

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generally In re Brodowski, 391 B.R. 393, 398–99 (Bankr. S.D. Tex. 2008) (discussing second loans on vehicles and their implications on negative equity and PMSIs).

[167] 363 B.R. 734, 745–46 (Bankr. E.D.N.C. 2007) (holding if negative equity involved, transformation rule is more appropriate over dual status); *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007). *See generally* Arkison v. Frontier Asset Mgmt. (*In re* Skagit Pac. Corp.), 316 B.R. 330, 338–339 (B.A.P. 9th Cir. 2004) (discussing tracing pre-petition and application to case involving vehicles), Harris J. Diamond, Note, *Tracing Cash Proceeds in Insolvency Proceedings Under Revised Article 9*, 9 AM. BANKR. INST. L. REV. 385, 407–11 (2001) (reviewing tracing requirement applied under "'reasonable assumptions'" method and "lowest intermediate balance rule" and noting prevalence of LIBR).

[168] *See In re Price*, 363 B.R. at 746.

[169] *See In re* Tuck, No. 06-10886-DHW, 2007 WL 4365456, at *3 (Bankr. M.D. Ala. Dec. 10, 2007) ("An allocation provision is necessary in order to determine when the purchase-money portion is paid resulting in the release of the collateral from the lien."); *see also In re* Riach, No. 07-61645-aer13, 2008 WL 474384, at *4–5 (Bankr. D. Or. Feb. 19, 2008) (noting it would be "most equitable . . . to allocate the monthly payments *pro rata* between the purchase money and non-purchase money components" yet does not cite tracing problem) (citation omitted); Harry, *supra* note 45, at 1113–14 (discussing court's choice to impose "first-in-first-out . . . method for allocating payments on consumer credit obligations . . . after determining there were no contractual provisions to the contrary" in situation involving PMSI) (citation omitted).

[170] *See In re* Peaslee, 358 B.R. 545, 559 (Bankr. W.D.N.Y. 2006) (noting adopting dual status rule might result in "having to conduct numerous and extensive evidentiary hearings" if cases did not settle); *see also In re* Dorsey Trailer Co., No. 04-32662, 2007 WL 4166170, at *4 (Bankr. M.D. Ala. Nov. 20, 2007) (noting carve outs provide avoidance of evidentiary hearings saving time and money).

amount owed. However, when the debtor files for bankruptcy, it must be proven how much each payment was used to pay down the negative equity and how much of the monthly check was used to pay off the purchase money debt.[171] These hearings are extremely time consuming, generate too much uncertainty and drain the funds of the bankruptcy estate.[172] The benefits of having a hearing do not outweigh the financial harm and delay, especially when the chapter 13 individual debtor is seeking a "fresh start" in bankruptcy.[173]

Although ultimately adopting the dual status rule over the transformation rule, the court in *In re Pajot* recognized further complications as a result of the dual status application. The allocation of monthly payments pre-petition to pay down the debt could be treated in three ways:

> [(1) apply] all payments from the time of sale to filing bankruptcy . . . to reduce the purchase-money portion of the claim first, leaving untouched the non-purchase-money portion . . . [(2) apply the payments] first to the non-purchase-money portion of the claim . . . [(3)] pro-rate the pre-bankruptcy payments to both the purchase-money portion and the non-purchase-money portion, reducing each proportionally.[174]

Furthermore, the court in *Ionosphere* focused "on whether the collateral is taken to support a purchase-money obligation, not on whether it may also support other obligations."[175] Although both negative equity and the purchase money obligation are secured by the new vehicle, this is only significant because both debts can be filed as secured claims. The purchase money obligation's connection with the new vehicle is one that is specially protected under the hanging paragraph because it is

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[171] *See In re* Conyers, 379 B.R. 576, 583 (Bankr. M.D.N.C. 2007) (noting three options for pre-bankruptcy payments as all applied to purchase-money, all applied to non-purchase money, or pro-rated); *In re* Blakeslee, 377 B.R. 724, 730 (Bankr. M.D. Fla. 2007) (stating court must allocate "pre-bankruptcy payments to the purchase money and non-purchase money portions of the secured debt") (citation omitted); *In re Price*, 363 B.R. at 746 ("Not only must the court factor in the value of the vehicle being traded-in and the value of the automobile being sold, it must also ascertain how pre-bankruptcy payments should be allocated to the purchase money and non-purchase money components of the secured debt.").

[172] *See* Hakim v. Payco-Gen. Am. Credits, Inc., 272 F.3d 932, 935 (7th Cir. 2001) (noting "'bother, expense, and uncertainty'" of evidentiary hearings (citing Overhauser v. United States, 45 F.3d 1085, 1088 (7th Cir. 1995)); *see also In re* Greenberg, 105 B.R. 691, 697 (Bankr. M.D. Fla. 1989) (requiring evidentiary hearing to establish "designation of allocation of payments on a tax claim").

[173] *In re* Kontrick, 295 F.3d 724, 733 (7th Cir. 2002) (noting "manifest goals of Congress [in bankruptcy are] to resolve the matter of dischargeability promptly and definitively in order to ensure that the debtor receives a fresh start"); Am. Law Ctr. v. Stanley (*In re* Jastrem), 253 F.3d 438, 442 (9th Cir. 2001) (discouraging efforts by creditor to circumvent debtor's fresh start in bankruptcy); *In re* Morgan, 197 B.R. 892, 896 (N.D. Cal. 1996) (noting "'overriding goal of the Bankruptcy Code'" is to provide "'"fresh start"'" for debtor) (citation omitted).

[174] *In re* Pajot, 371 B.R. 139, 161 (Bankr. E.D. Va. 2007), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008).

[175] Harry, *supra* note 45, at 1108–09 (discussing various cases where courts rejected transformation rule and used dual-status rule) (citation omitted).

an obligation whose purpose is to purchase (and to be secured by) the new vehicle.[176] On the other hand, the loan advanced to satisfy negative equity is just another obligation incurred to pay off an existing obligation, secured by collateral that happens to be another vehicle. If the dual status rule is adopted, the opportunity is open for lenders to abuse this rule by redrafting their boilerplate retail installment contracts and increasing the "price" of the vehicle, concealing the fact that rolled-in negative equity is the cause for the marked up "price."[177] The average consumer may not realize the significance of rolling in both loans, giving the false impression that only one purchase money loan exists.

IV. THE TRANSFORMATION RULE

Under the transformation rule, if non-purchase financing is included in the purchase money obligation, the entire debt loses its purchase money character.[178] The transformation rule is the appropriate rule to apply in these negative equity cases because it "prevent[s] overreaching creditors from retaining title to all items covered under a consolidation contract until the last item purchased is paid for."[179] Arguments based on statutory construction[180] and overall efficiency of the bankruptcy system support the transformation rule.

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[176] *See* 11 U.S.C. § 1325(a) (2006). The hanging paragraph states:

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

Id.

[177] *See generally In re* Graupner, 356 B.R. 907, 907 (Bankr. M.D. Ga. 2006) (recognizing term "price" was ambiguous in the state statute because it could mean the "'sticker' price of the collateral" but also "other costs related to and contemporary with the purchase of the collateral"), *aff'd sub nom.* Graupner v. Nuvell Credit Corp., No. 4:07-CV-37CDL, 2007 WL 1858291 (M.D. Ga. June 26, 2007), *aff'd*, 537 F.3d 1295 (11th Cir. 2008); *In re* Carter, 169 B.R. 227, 229 (Bankr. M.D. Ga. 1993) (holding creditor never took PMSI in collateral because original contract was not executed to secure purchase price of collateral, but "was taken to secure the pre-existing balance" of debtor's open account with creditor); Mark Products U.S. v. Interfirst Bank, 737 S.W.2d 389, 394 (Tex. App. 1987) ("Any security interest taken as security for a pre-existing claim or antecedent debt is excluded from the purchase money category.") (citation omitted).

[178] *See In re* Blakeslee, 377 B.R. 724, 730 (Bankr. M.D. Fla. 2007) ("[T]he secured creditor is deemed not to possess a purchase money security interest as the non-purchase money component transforms the entire claim into a non-purchase money security interest.") (citation omitted); *see also In re Pajot*, 371 B.R. at 157; *In re* Acaya, 369 B.R. 564, 570 (Bankr. N.D. Cal. 2007); *In re* Price, 363 B.R. 734, 745 (Bankr. E.D.N.C. 2007), *aff'd in part, rev'd in part sub nom.* Wells Fargo Fin. N.C. 1, Inc. v. Price (*In re* Wells Fargo Fin. N.C. 1, Inc.), No. 5:07-CV-133-BR, 2007 WL 5297071 (E.D.N.C. Nov. 14, 2007).

[179] *See In re Acaya*, 369 B.R. at 570–71 (citing Borg-Warner Acceptance Corp. v. Tascosa Nat'l Bank, 784 S.W.2d 129, 134–35 (Tex. App. 1990)).

[180] *In pari materia*, a canon of statutory interpretation, is not discussed in this note because every state has its own body of law with definitions that could be read together with the U.C.C. terms, such as "price" of the collateral. However it should be noted that courts use this doctrine to determine whether "statutes addressing

First, the new provision, proposed by the auto lending industry, should not give auto lenders more than they are entitled to under a plain language interpretation of the hanging paragraph, especially since the auto financing industry was responsible for its drafting.[181] Secondly, the transformation rule will incentivize auto lenders to carefully draft their contracts with consumers if they want protection under the hanging paragraph. Courts that follow the transformation rule apply it as a default rule when there are no provisions in the retail installment contract indicating the extent to which the loan is actually used to purchase the new vehicle.[182] The transformation rule imposes the burden on the creditor to protect its interests in the contract rather than rely on the courts to interpret statutory provisions and "'distill from a mass of transactions the extent to which a security interest is purchase money.'"[183] Lastly, the application of the transformation rule is beneficial to the entire bankruptcy process.[184] The evidentiary requirement is simpler than the proof requirements of the dual status rule; it is less timely and costly for the debtor and the estate and benefits all the other creditors who are not auto lenders.

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the same subject matter generally should be read 'as if they were one law.'" Lafferty v. St. Riel, 495 F.3d 72, 82 (3d Cir. 2007) (quoting Wachovia Bank v. Schmidt, 546 U.S. 303, 305 (2006)). *See In re* Petrocci, 370 B.R. 489, 501 (Bankr. N.D.N.Y. 2007) (observing under New York case law, where no contrary intent, similar laws are to be construed similarly) (citation omitted). For instance, the term "price" in the U.C.C. is not defined, but many states have adopted its own Motor Vehicle Sales Financing Act ("MVSFA"). Although many courts recognize this doctrine, some courts have been hesitant to rely on other bodies of state law that were enacted with different purposes. *See In re* Mancini, 390 B.R. 796, 802–05 (Bankr. M.D. Pa. 2008) (stating even assuming U.C.C. and MVSFA are to be read *in pari materia*, this reading of two statutes would not provide answer to issue at hand, and MVSFA was "enacted to protect consumers" while the U.C.C. of particular state was adopted to govern creation of security interests; therefore U.C.C. would be considered controlling law as to issue of creating security interests).

[181] *See* William C. Whitford, *A History of the Automobile Lender Provision of BAPCPA*, 2007 U. ILL. L. REV. 143, 176–77 (2007) (introducing "Abraham Amendment," which was later codified as "Hanging Paragraph," on House Floor by Senator Abraham of Michigan, which was done "at the behest" of auto finance industry); *see also* Harry Stoffer, *Lobbyists Push Industry's Problems with 'Cramdown' into the Spotlight*, AUTOMOTIVE NEWS, Oct. 26, 1998, at 28 (noting Senator Abraham's active involvement in hanging paragraph amendment).

[182] *See generally In re Blakeslee*, 377 B.R. at 730 (noting when transformation rule is applicable); *In re Price*, 363 B.R. at 746 (noting application of transformation rule "generally when negative equity is involved").

[183] *In re* Peaslee, 358 B.R. 545, 559 n.18 (Bankr. W.D.N.Y. 2006) (citation omitted). *See* Snap-On Tools v. Freeman (*In re* Freeman), 956 F.2d 252, 255 (11th Cir. 1992) (noting "lender must provide some method 'for determining the extent to which each item of collateral secures its purchase money'") (citation omitted); *In re* Coomer, 8 B.R. 351, 355 (Bankr. E.D. Tenn. 1980) ("When a lender consolidates a purchase money loan with a nonpurchase money loan, it effectively gives up its purchase money status unless there is some method provided for determining the extent to which each item of collateral secures its purchase money.").

[184] *See In re* Pajot, 371 B.R. 139, 158 (Bankr. E.D. Va. 2007) (stating transformation rule is simpler than dual status rule); *see also In re* Lee, 169 B.R. 790, 792 (Bankr. S.D. Ga. 1994) (stating transformation rule holds "'purchase money security interest used to secure the purchase price of goods sold in a particular transaction is "transformed" into a nonpurchase money security interest when antecedent or after-acquired debt is consolidated with the new purchase under one contract'" (quoting *In re* Freeman, 124 B.R. 840, 843 (N.D. Ala. 1991))).

A. The Hanging Paragraph Means What It Says

The legislative history surrounding the hanging paragraph titled, "Restoring the Foundation for Secured Credit," was aimed at combating a particular abuse by chapter 13 debtors in "purchasing a car shortly before a chapter 13 bankruptcy filing and taking advantage of the substantial depreciation that occurs immediately when a new car is driven off the lot to cram down the secured creditor's collateral interest."[185] The "restoring" was meant to convert the remaining unsecured claim, after bifurcation, back to a secured claim thereby giving the auto lender a fully secured claim for the full amount of the loan regardless of the value of the collateral.[186] The legislative intent behind this provision was to ensure that debtors would "not load up on vehicle-secured debt pre-petition only to cram it down to the collateral value in bankruptcy."[187]

Bankruptcy courts have "not hesitated to interpret the provisions of BAPCPA 'as written' even when such an interpretation seemed to be at cross purposes with the intentions of the drafters."[188] Any interpretation that would broadly include loans used for other purposes, such as paying off an antecedent debt should not be protected.[189] If the auto lending industry recognized that paying off negative equity

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[185] *In re* Johnson, 380 B.R. 236, 250 (Bankr. D. Or. 2007). *But see In re* Ford, 387 B.R. 827, 830 (Bankr. D. Kan. 2008) (disagreeing with courts holding "negative equity is not secured by a PMSI"). *See generally In re* Hayes, 376 B.R. 655, 676–84 (Bankr. M.D. Tenn. 2007) (discussing legislative history of hanging paragraph).

[186] *See* H.R. REP. NO. 109-31, pt. 1, at 17 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 103; *see also* AmeriCredit Fin. Servs., Inc. v. Long (*In re* Long), 519 F.3d 288, 294 (6th Cir. 2008) ("[L]egislative history supports the conclusion that the paragraph was only intended to prohibit debtors from cramming down debt when they elect to retain collateral under § 1325(a)(5)(B)."); Wells Fargo Fin. Acceptance v. Rodriguez (*In re* Rodriguez), 375 B.R. 535, 548 (B.A.P. 9th Cir. 2007)) (observing "[i]t is apparent that Congress intended to take away the right of debtors to reduce their secured obligations on retained 910 vehicles to the value of the vehicles" (citing 11 U.S.C. § 1325(a)(5)(B) (2006))).

[187] *In re Johnson*, 380 B.R. at 250 (quoting *In re* Pajot, 371 B.R. 139, 159 (Bankr. E.D. Va. 2007), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008)). *See In re* Lavigne, No. 07-30192, 2007 WL 3469454, at *11 (Bankr. E.D. Va. Nov. 14, 2007) (discussing Congress' intent to prevent abuse by debtors in bifurcating and cramming down creditor's secured claim on motor vehicles) (citations omitted), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re Pajot*, 371 B.R. at 159 (comparing enactment of hanging paragraph to 11 U.S.C. section 1322(b) which similarly protects home mortgages from bifurcation and cramdown (citing *In re* Payne, 347 B.R. 278, 281 (Bankr. S.D. Ohio 2006))).

[188] *In re* Petrocci, 370 B.R. 489, 504 (Bankr. N.D.N.Y. 2007) (agreeing one purpose of BAPCA was for Bankruptcy Courts to enforce provisions "as written" (citing *In re* Rotunda, 349 B.R. 324 (Bankr. N.D.N.Y. 2006))); *see In re Rotunda*, 349 B.R. at 329 (finding Congress meant to eliminate judicial discretion with BAPCPA's '"precise rules-based calculations"' (quoting Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 682 (2005))); *cf. In re Rodriguez*, 375 B.R. at 547–48 (noting result of applying hanging paragraph as one court did could undo congressional intent behind paragraph) (citation omitted).

[189] *See In re* Wear, No. 07-42537, 2008 WL 217172, at *3 (Bankr. W.D. Wash. Jan. 23, 2008) ('"[L]iability for negative equity is not an expense "incurred in connection with acquiring" the Vehicle; it is an antecedent debt."' (quoting *In re Johnson*, 380 B.R. at 243)); *In re Johnson*, 380 B.R. at 247 (noting here, "the financed negative equity is nothing more than a refinance of the pre-existing debt owed on the Trade-in. . . . [I]t does not create the requisite close nexus between 'value given' and the [debtor's] acquisition of rights

on a trade-in vehicle is a common industry practice[190] and sought to protect the entire loan regardless of whether it was purchase money, the provision could have been drafted as "*debt secured by the vehicle acquired* within 910 days preceding the date of bankruptcy" rather than requiring a PMSI.[191] By not giving negative equity financing any effect on the purchase money character of the entire obligation is equivalent to ignoring the term "purchase money" entirely in the provision.[192] In *In re Matthews*[193] the court reasoned:

> The argument that form should not be elevated over substance has merit in some settings, but not here. We are dealing with a statutory scheme that governs the priorities among creditors. *Purchase money security is an exceptional category in the statutory scheme that affords priority to its holder over other creditors, but only if the security is given for the precise purpose as defined in the*

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in the Vehicle"); *In re Lavigne*, 2007 WL 3469454, at *8 ("Negative equity is not a cost incurred in connection with the new acquisition, but rather it is an obligation that pre-existed the transaction.").

[190] *See In re* Munzberg, 388 B.R. 529, 533 (Bankr. D. Vt. 2008) (noting as "standard industry practice" as part of deal for "dealer [to] pay off the lien on the trade-in vehicle as an element of the financing on the new vehicle"); *In re* Schwalm, 380 B.R. 630, 634 (Bankr. M.D. Fla. 2008) ("[I]t was already common industry practice, sanctioned by state motor vehicle finance law, and the federal truth-in-lending law, for automobile dealers to offer buyers packaged financing, which includes the payoff of debt on the trade-in vehicle . . . ."); *In re Johnson*, 380 B.R. at 245–46 ("Given that financing negative equity is increasingly common, it was not an oversight that the legislature did not include negative equity in the list of 'expenses incurred in connection with acquiring rights in the collateral' set forth in Official Comment 3." (citing *In re* Blakeslee, 377 B.R. 724, 728–29 (Bankr. M.D. Fla. 2007))).

[191] *See* 11 U.S.C. § 1325(a) (2006) (noting hanging paragraph states section 506 is inapplicable to claim "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" which was "acquired for the personal use of the debtor"); *see also In re* Stevens, 368 B.R. 5, 8 (Bankr. D. Neb. 2007) (noting debtor cannot use "[section] 506 to 'cram down' the claim of a creditor having a purchase-money security interest securing a debt incurred within 910 days prior to the filing where the collateral consists of a motor vehicle acquired for personal use of the debtor"); *In re* Adams, No. 06-51651, 2007 WL 675958, at *2 (Bankr. M.D. Ga. Mar. 1, 2007) ("[S]ection 506 of the Bankruptcy Code shall not apply to a claim that is secured by a purchase money security interest in a motor vehicle on a debt incurred within the 910 days preceding the bankruptcy filing if the vehicle was acquired for the personal use of the debtor.").

[192] *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 262 (W.D.N.Y. 2007) (concluding "portion of the claims attributable to the payoff of negative equity on the debtors' trade-in vehicles[] should be treated as secured claims"); *see also In re* Myers, No. 07-11145-AJM-13, 2008 WL 2445214, at *2 (Bankr. S.D. Ind. June 13, 2008) (emphasizing some courts hold "financing of negative equity on a trade in as part of the overall car sales transaction does not destroy the purchase money character of the loan and therefore the hanging paragraph applies and the creditor's claim cannot be bifurcated"); *In re Munzberg*, 388 B.R. at 544–45 (describing two traditional approaches under U.C.C.: dual status and transformation rules) (citation omitted).

[193] Matthews v. Transamerica Fin. Servs. (*In re* Matthews), 724 F.2d 798 (9th Cir. 1984). *See In re* Butler, 160 B.R. 155, 158 (Bankr. D. Idaho 1993) ("'The purchase money character of the security interest was extinguished when the proceeds from the first renewal note were used to satisfy the original note.'" (quoting *In re Matthews*, 724 F.2d at 801)); *see also In re* Hagen, No. 86-01874M, 1987 WL 46572, at *2 (Bankr. N.D. Iowa July 9, 1987) (noting conclusion in *In re Matthews* which states "'[t]he argument that form should not be elevated over substance has merit in some settings, but not here'" (quoting *In re Matthews*, 724 F.2d at 801)).

> *statute*. And we should not lose sight of the fact that the lender chooses the form.[194]

The language in the hanging paragraph, when read in addition to other provisions added by the BAPCPA amendments, indicate that a pure PMSI is necessary in order for the creditor to claim the entire debt as protected from bifurcation.[195] It must be presumed that security interests have different meanings if certain adjectives are added or omitted.[196] For instance, the use of the word "if" in the hanging sentence indicates that a creditor either does or does not have a PMSI without further scrutiny of how the security interest can be dissected into purchase-money and non-purchase money: "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 . . . ."[197]

The court in *In re Sanders* emphasized the use of the word "if" as opposed to "to the extent of" in the hanging paragraph to compel application of the transformation rule.[198] The use of language "to the extent of" is used in U.C.C. section 9-103 describing the dual status rule.[199] The lack of this language in the

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[194] *In re Matthews*, 724 F.2d at 801 (emphasis added). *See In re* Johnson, 380 B.R. 236, 247 (Bankr. D. Or. 2007) (noting *In re Matthews* court addressed "harshness of the loss of a PMSI through a refinance"); *see also* Bernard A. Burk, Note, *Preserving the Purchase Money Status of Refinanced or Commingled Purchase Money Debt*, 35 STAN. L. REV. 1133, 1133 (1983) ("The PMSI is a privileged interest in several respects. It can enjoy priority over conflicting security interests taken earlier in time. In addition, it is the only type of nonpossessory security interest that, when taken in certain property, is not avoidable in a consumer bankruptcy.") (citation omitted).

[195] *See* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1295, 1298 (11th Cir. 2008) (highlighting requirements for "anti-bifurcation protection" as described in hanging paragraph); *see also In re* Busby, No. 0702717EE, 2008 WL 4104184, at *4 (Bankr. S.D. Miss. Aug. 28, 2008) (acknowledging "hanging paragraph prohibits the bifurcation of a claim under" 11 U.S.C. section 506 if four requirements in 11 U.S.C. section 1325(a) are met); *In re* Dale, No. H-07-32451, 2008 WL 4287058, at *3 (S.D. Tex. Aug. 14, 2008) ("[S]ince BAPCPA's enactment, courts have disagreed as to the hanging paragraph's effect on a 910 debtor's right, under federal law, to cramdown an indebtedness secured by a 910 vehicle.").

[196] *See In re* Sanders, No. 06-70463, 2006 WL 3386739, at *4 (Bankr. C.D. Ill. Nov. 20, 2006) (positing several courts have "extended the impact of the hanging paragraph by finding that there can also be no bifurcation of a creditor's claim into secured and unsecured components when a debtor proposes to surrender collateral rather than pay for it as part of a Chapter 13 plan"); *see also In re* Curtis, 345 B.R. 756, 760 (Bankr. D. Utah 2006) ("In attempting to construe the hanging paragraph, the Court 'must begin with the language employed by Congress and the assumption that the ordinary meaning of the language accurately expresses the legislative purpose.'") (citation omitted); KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §451.3 (3d ed. 2000 & Supp. 2007-1) (noting "[t]here are interesting issues . . . with respect to the hanging sentence and state law" including "separate analysis of each secured debt to determine whether a PMSI is present").

[197] 11 U.S.C. § 1325(a) (2006) (emphasis added).

[198] *In re* Sanders, 377 B.R. 836, 858–59 (Bankr. W.D. Tex. 2007) (applying plain meaning interpretation of hanging paragraph to find extremely narrow exception to general rule of section 1325(a)(5)).

[199] *See In re Sanders*, 377 B.R. at 846–47 (indicating Congress, by including PMSI in Code, must have intended definition to be guided by state law enactments of U.C.C. from which "term of art" was borrowed); *see also In re* Munzberg, 388 B.R. 529, 544–45 (Bankr. D. Vt. 2008) (discussing how in examining whether to apply dual status or transformation rule courts historically turn to U.C.C.); *In re* Stevens, 368 B.R. 5, 8

hanging paragraph demonstrates congressional intent that in order for a security interest to be protected against bifurcation it must be entirely purchase money.[200] On the other hand, Congress did not specifically assert that the hanging paragraph would only be applied to the "entire" claim or debt, therefore some courts may argue that the hanging paragraph does not require the "entire" claim to be a PMSI.[201] The omission of the phrase "to the extent" which appears in the U.C.C. but not in the hanging paragraph, is critical because without this limitation, the hanging paragraph only applies when the entire obligation has pure purchase money status.[202]

In *In re Sanders*, the court focused on the language in section 1322(b)(2), "a claim secured *only* by a security interest in real property that is the debtor's principle residence."[203] The restrictive word "only" is in the same category as the word "if" which leads to an all or nothing construction of the hanging paragraph.[204] However, the bankruptcy court in *In re Steele* argued against *In re Sanders*' statutory construction. First, the word "only" is much more restrictive than the

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(Bankr. D. Neb. 2007) (following trend of bankruptcy courts to evaluate U.C.C. as enacted under state law to guide definition of PMSI).

[200] *In re Sanders*, 377 B.R. at 860 (finding presence of "to the extent" language elsewhere in Code indicative of Congressional intent to exclude those creditors not plainly indicated in text of hanging paragraph); *see In re* Look, 383 B.R. 210, 220–21 (Bankr. D. Me. 2008) (holding applicable rule that claims with partial PMSI character not subject to hanging paragraph's exception because paragraph uses conditional "if" and does not include "to the extent" language); *In re* Mitchell, 379 B.R. 131, 140–41 (Bankr. M.D. Tenn. 2007) (concluding if any part of claim is not secured as PMSI then entire claim is subject to bifurcation (quoting *In re Sanders*, 377 B.R. at 859–60));

[201] *See In re* Mancini, 390 B.R. 796, 808 (Bankr. M.D. Pa. 2008) (implying Congress did not intent to strip vehicle creditor of PMSI by applying transformation rule simply because claim includes some negative equity of debtor (citing *In re Johnson*, 380 B.R. at 250)); *In re Munzberg*, 388 B.R. at 545–46 (holding protection extends to portion of claim notwithstanding a portion of claim secured by non-PMSI); *In re* Johnson, 380 B.R. 236, 250 (Bankr. D. Or. 2007) (finding language not dispositive, court turned to purpose of hanging paragraph and elects to apply "dual purpose rule").

[202] *See In re Look*, 383 B.R. at 220–21 (acknowledging Congress could have chosen to include "to the extent" language and in failing to do so clearly indicates intent hanging paragraph meant to exempt from bifurcation only those claims of pure purchase money status); *In re Sanders*, 377 B.R. at 859–60 (finding choice not to include "to the extent" language conclusive that mixed PMSI claims are not protected from bifurcation). *But see In re* Hayes 376 B.R. 655, 675–76 (Bankr. M.D. Tenn. 2007) (highlighting logic of "all or nothing" argument and discussing support provided by legislative history for such rule, but ultimately deciding against such rule in absence of clear policy choice by Congress).

[203] 11 U.S.C. § 1322(b)(2) (2006) (emphasis added) (providing debtor's chapter 13 plan, subject to conditions set forth in (a) and (c) of section 1322, may either alter or leave untouched rights of holders of both secured or unsecured claims, except those holders of claims whose interests are secured entirely by real property that is debtor's residence may not have their rights modified). *See In re* Maloney, 36 B.R. 876, 877 (Bankr. D.N.H. 1984) (stating 1978 Code specifically prohibits chapter 13 debtor from using plan to modify rights of holder of claim secured by debtor's principal residence); 8 COLLIER ON BANKRUPTCY, ¶ 1322.06, at 1322-23 (Alan N. Resnick et al. eds., 15th ed. rev. 2006) (explaining generally option of chapter 13 debtor to modify rights of holders of both secured claims).

[204] *See In re Sanders*, 377 B.R. at 861 (noting courts' application of "all-or-nothing" approached based on "straightforward review of the language of the statute itself"); United States v. White, 340 B.R. 761, 766 (E.D.N.C. 2006) (noting previous court's support of "all-or-nothing" approach to section 1325(a)) (citation omitted); *see also In re Look*, 383 B.R. at 221 (stating plain language of hanging paragraph requires "'all-or-nothing rule'") (citation omitted).

word "if" such that the hanging paragraph is not as strict as the language in section 1322(b)(2).[205] Secondly, the word "if" applies to the conditions in the hanging paragraph that must be satisfied in order for the claim to be fully protected against bifurcation.[206] Finally, section 1322(b)(2) is linked to cram down under section 1325(a)(5) while the hanging paragraph does not limit cram down; it precludes lien stripping under section 506(a)(1).[207] Regardless of whether Congress used the words "if" or "only," the fact that a qualifier was used at all evidences the intent to limit the applicability of the hanging paragraph.

Congress could have easily drafted the hanging paragraph to protect auto lenders by adding:

> For the 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* [***in whole or in part***] *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 the debt consists of any other thing of value, if that debt was incurred during the 1-year period preceding that filing.[208]

Sections 521(a)(6) and 1326(a)(4) also include language that impose limitations on the debtor if the price is "secured in whole or in part" by the collateral.[209] Since the language in the hanging paragraph does not leave open the possibility for protection of debt that is purchase money "in whole or in part," then the entire debt must be

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[205] *In re* Steele, No. 08-40282-DML-13, 2008 WL 2486060, at *5 (Bankr. N.D. Tex. June 12, 2008). *See In re* Brodowski, 391 B.R. 393, 402 (Bankr. S.D. Tex. 2008) (noting *In re Steele* analysis of the word "only"). *But see* Scarborough v. Chase Manhattan Mortgage Corp. (*In re* Scarborough), 461 F.3d 406, 411 (3d Cir. 2006) (interpreting meaning of "is" as meaning "only").

[206] *In re Steele*, 2008 WL 2486060, at *5. *See* Graupner v. Nuvell Credit Corp. (*In re* Graupner), 537 F.3d 1298 (11th Cir. 2008) (noting all requirements under hanging paragraph must be met to prevent bifurcation); *see also In re* Busby, No. 0702717EE, 2008 WL 4104184, at *4 (Bankr. S.D. Miss. Aug. 28, 2008) (observing bifurcation cannot occur if four requirements are satisfied).

[207] *In re Steele*, 2008 WL 2386060, at *5. *See* Drive Fin. Servs. L.P. v. Jordan, 521 F.3d 343, 347 n.9 (5th Cir. 2008) (indicating hanging paragraph prohibits section 506 lien stripping, but does not mention cram down); *see also In re* Turkowitch, 355 B.R. 120, 129 (Bankr. E.D. Wis. 2006) (noting hanging paragraph stops lien stripping).

[208] *See* 11 U.S.C. § 1325(a) (2006) (emphasis added); *see also In re Hayes*, 376 B.R. at 675 & n.28 (reporting Congress has used restrictive phrases such as "in whole or in part" in other Bankruptcy Code sections).

[209] *See* 11 U.S.C. § 521(a)(6) (2006) (noting debtor shall "not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless" certain actions occur); 11 U.S.C. § 1326(a)(4) (2006) (noting "a debtor retaining possession of personal property subject to a lease or securing a claim attributable in whole or in part to the purchase price of such property" must provide certain things to certain parties); *see also* KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY, § 451.3-3 (3d ed. 2000 & Supp. 2007-1) (showing language of sections 521(a)(6) and 1326(a)(4) and language of hanging paragraph lead to different applications).

PMSI in order to avoid bifurcation.[210] The existence of this type of language, "in whole or in part" in other BAPCPA amendments, is precisely why the transformation rule should be adopted. If Congress knew to specify the language in those provisions and left it out under the hanging paragraph, then we must presume that Congress intended to leave it out here.[211] The fact that negative equity is so common and is excluded from the list in Comment 3 of "expenses incurred in connection with acquiring rights in the collateral" should not be overlooked.[212]

The addition of simple language, "in whole or in part," which was added in other BAPCPA amendments with respect to secured claims, would solve the issues courts are presented with in the aftermath of the enactment of this provision. Whether negative equity is a purchase money obligation would no longer be an issue since the entire debt would be protected. Furthermore, there would be no need to determine whether to apply the dual status rule or the transformation rule to the entire debt since all that is required is that only a portion of the debt be purchase money. The addition of this language would create uniformity in its application since differences in state law categorizing negative equity would be irrelevant.[213] This suggested alteration to the provision would also prevent the courts from using their discretion by applying either the dual status or transformation rule.[214]

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[210] *See In re* Look, 383 B.R. 210, 220–21 (Bankr. D. Me. 2008) ("Congress included no language to signal its intent that the hanging paragraph encompass debt that is only partially secured by a [purchase money security interest]."); *In re* Sanders, 377 B.R. 836, 859–60 (Bankr. W.D. Tex. 2007) (arguing Congress chose not to protect debt "to the extent that" debt consists of PMSI, which would result in protection of debt from bifurcation to the extent to which it consists of PMSI but would exclude non-PMSI portions); KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY, § 451.3-3 (3d ed. 2000 & Supp. 2007-1) (contrasting language of hanging paragraph to other sections of Bankruptcy Code which include "in whole or in part" language).

[211] *See* City of Chi. v. Envtl. Def. Fund, 511 U.S. 328, 338 (1994) ("'It is generally presumed that Congress acts intentionally and purposely' when 'it includes particular language in one section of the statuto [sic] but omits it in another . . . .'" (quoting Keene Corp. v. United States, 508 U.S. 200, 208 (1993))); *see also* Kibbe v. Sumski (*In re* Kibbe), 361 B.R. 302, 313 (B.A.P. 1st Cir. 2007) (stating "[i]t is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another" (quoting Lopez-Soto v. Hawayek, 175 F.3d 170, 173 (1st Cir. 1999))); Carlson, *supra* note 149, at 349–50 (discussing arguments for transformation using "'Congress knew how to'" arguments).

[212] *See* Americredit Fin. Servs., Inc. v. Penrod (*In re* Penrod), 392 B.R. 835, 848 (B.A.P. 9th Cir. 2008) ("Given that financing negative equity is increasingly common, it was likely not an oversight that the reporters for Article 9 did not include negative equity in Comment 3's list of 'expenses incurred in connection with acquiring rights in the collateral.'") (citation omitted); *In re* Johnson, 380 B.R. 236, 245–46 (Bankr. D. Or. 2007) (suggesting it was not accidental legislature did not include negative equity on list of "expenses incurred in connection with acquiring rights in the collateral" provided in Comment 3) (citation omitted); *In re* Blakeslee, 377 B.R. 724, 728–29 (Bankr. M.D. Fla. 2007) ("[T]he legislature's failure to include negative equity in the text of the U.C.C. or in the official comments thereto despite the increasingly common financing of negative equity is not an oversight . . . .").

[213] *See In re Johnson*, 380 B.R. at 247–48 (noting courts concluding negative equity is not purchase money obligation applied transformation rule or dual status rule based on state law); *In re* Burt, 378 B.R. 352, 357 (Bankr. D. Utah 2007) (observing courts look to state law to determine how negative equity affects whether creditor's security interest qualifies as PMSI as used in hanging paragraph); *In re* Acaya, 369 B.R. 564, 567 (Bankr. N.D. Cal. 2007) (noting use of California law to determine what constitutes PMSI because Bankruptcy Code does not provide a definition).

[214] *See In re Johnson*, 380 B.R. at 249 ("Whether to apply the dual status rule in consumer transactions is left to the discretion of the courts . . . ."); *In re* Pajot, 371 B.R. 139, 158 (Bankr. E.D. Va. 2007) ("Although the court follows the dual status rule on these facts, it reserves the discretion to apply the transformation rule

The hanging paragraph is an exception to the general rule that under-secured claims are bifurcated under section 506 and therefore should be construed narrowly.[215] If the hanging paragraph requires debt that is purchase money, it should be interpreted without giving purchase money status to debt simply because it is added to a PMSI and is secured by the same vehicle.[216]

B. Transformation Rule as Default Rule

The transformation rule would not render the entire provision 'inoperative' as some courts believe. For instance, in *In re Schwalm* the court held that it would not interpret the hanging paragraph in such a restrictive manner that the hanging paragraph would be rendered inoperative.[217] Instead, the hanging paragraph should operate, according to the court, in all cases where the lenders had a true PMSI and the debtor did not have negative equity in the trade-in vehicle.

Some cases suggest that the transformation rule will only be applied if there are no contractual provisions that outline the designation of the loan and the allocation of the monthly payments, ultimately placing the burden on the creditor to include such provisions in the retail installment contract.[218] For instance, the court in *In re*

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in cases where the negative equity amount has been obfuscated by creditors' methods of accounting for vehicle trade-ins."), *aff'd in part, rev'd in part sub nom.* GMAC v. Horne, 390 B.R. 191 (E.D. Va. 2008); *In re Acaya*, 369 B.R. at 570 (stating once transaction is determined to contain both purchase money and non-purchase money obligations, court, in its discretion, can elect to apply either dual status or transformation rule).

[215] *See In re* Steele, No. 08-40282-DML-13, 2008 WL 2486060, at *3 (Bankr. N.D. Tex. June 12, 2008) (explaining hanging paragraph, as "exception to the general rule . . . must be construed narrowly"); *In re* Mitchell, 379 B.R. 131, 140 (Bankr. M.D. Tenn. 2007) (arguing hanging paragraph is exception to general rule and therefore must be construed narrowly) (citation omitted); *In re Sanders*, 377 B.R. at 859 (stating hanging paragraph "self-describes its provisions as an exception to the general rule" and "[e]xceptions to general rules are construed narrowly") (citation omitted).

[216] *See In re* Look, 383 B.R. 210, 221 (Bankr. D. Me. 2008) (holding "[b]ecause not all of the debt in question is secured by a [PMSI], § 1325(a) does not apply"), *aff'd sub nom*. Bank of Am. v. Look, No. 08-129-P-H, 2008 U.S. Dist. LEXIS 54695 (D. Me. July 17, 2008); *In re Sanders*, 377 B.R. at 864 (noting because "claim contains non-purchase money debt, [the] claim does not qualify for the exception in section 1325(a)[], and so is subject to the general provisions for secured creditors in section 1325(a)(5)"). *But see, e.g.*, *In re* Wall, 376 B.R. 769, 771 (Bankr. W.D.N.C. 2007) (holding entire debt, including negative equity, was PMSI).

[217] *In re* Schwalm, 380 B.R. 630, 634–35 (Bankr. M.D. Fla. 2008) (holding "that 'purchase money security interest,' as used in Section 1325(a), only makes sense when viewed as applying to those auto financing transactions, lawful and common in industry practice when BAPCPA was adopted, in which negative equity on a trade-in, gap insurance and service contract premiums are financed"). *See* Gen. Motors Acceptance Corp. v. Peaslee, 373 B.R. 252, 259–60 (W.D.N.Y. 2007) (holding "unpaid balance on a trade-in vehicle can and should be considered part of a purchase price on the new vehicle and, therefore, entitled to a purchase money security interest"); *In re* Cohrs, 373 B.R. 107, 110 (Bankr. E.D. Cal. 2007) (recognizing "when a lender . . . finances the purchase of the new vehicle and, as part of the transaction also pays off an outstanding balance owed on the trade-in vehicle, the loan extended is a purchase money obligation of the buyer, the new vehicle is purchase money collateral, and" lender has PMSI).

[218] *See In re* Weiser, 381 B.R. 263, 269 (Bankr. W.D. Mo. 2007) (observing it seems, under Missouri law, dual status approach applies "only if the dual status aspect of the transaction is properly documented, including how payments are to be allocated"); *In re* Matthews, 378 B.R. 481, 487 n.3 (Bankr. D.S.C. 2007) (noting "dual status rule has been found to be applicable in instances where there is an allocation of the

Matthews found that the retail installment contracts specifically divided the debtor's accounts and clearly stated the method for allocating the monthly payments to each loan and therefore found it appropriate to apply the dual status rule.[219] Without these contractual provisions, the court in *In re Blakeslee* found the transformation rule to be appropriate where it would be burdened with "the task of 'unwind[ing] the manipulations' which would be foisted upon it were it to apply the dual status rule to the financing of negative equity in retail installment contracts."[220]

Because the transformation rule is not a per se rule that must be applied in every negative equity case, the burden ultimately falls on the auto lender to carefully draft its contracts to reflect (1) the division of the loan into purchase money and non-purchase money and (2) a certain method of payment allocation.[221] If this is the case, then the transformation rule is no longer a threat to the creditor's entire claim. In these negative equity and vehicle purchasing transactions, the creditor stands in the position of power to protect his interests in the contract and therefore has the power to keep the transformation rule from being applied to his security interest.

If the retail installment contract does not include these provisions, the transformation rule will not completely divest the creditor's interest or claim, and the claim reverts back to what the creditor was entitled to before the hanging paragraph was enacted.[222] The lender will have a secured claim for the value of the motor vehicle on the date of filing the petition and an unsecured claim for the remainder of the obligation. The lender will most likely be paid on a portion of the unsecured claim since the hanging paragraph only applies in a chapter 13 case where the debtor will contribute a portion of future earnings to repay the unsecured creditors as opposed to chapter 7 where usually an unsecured claim will receive very little, if anything, by the end of the case.

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payments, by contract or statute, that enables the court to determine how much of debt is purchase money and where there is a release of the [PMSI] following the payment of such debt").

[219] *In re Matthews*, 378 B.R. at 487–88 (positing clear delineation of accounts and payment methods allow courts to "readily determine the remaining debt Debtor incurred to purchase each vehicle and thereby identify the same as a purchase money obligation under the U.C.C.").

[220] *In re Blakeslee*, 377 B.R. at 730 (quoting *In re* Peaslee, 358 B.R. 545, 560 n.18 (Bankr. W.D.N.Y. 2006)). *But see In re* Callicott, 386 B.R. 232, 237 (Bankr. E.D. Mo. 2008) (observing benefits of using dual status rule where "negative equity amount is clearly delineated within the financial transaction"); *In re* Westfall, 376 B.R. 210, 219 (Bankr. N.D. Ohio 2007) (noting "application of the transformation rule is too severe" in cases dealing with partial purchase money security interests).

[221] *See* Roberts Furniture Co. v. Pierce (*In re* Manuel), 507 F.2d 990, 993 (5th Cir. 1975) (noting court below found lender failed to satisfy burden of proof where security agreement failed to indicate which items were purchase money and non-purchase money collateral and did not indicate "any rule of first-bought, first paid for"); *In re* Norrell, 426 F. Supp. 435, 436 (M.D. Ga. 1977) (denying PMSI status where security agreement provided "so long as *any* indebtedness is outstanding property stands as collateral not only for its price but also for the price of property subsequently acquired on credit"). *But see, e.g.*, *In re* Staley, 426 F. Supp. 437, 438 (M.D. Ga. 1977) (holding PMSI valid where "collateral . . . secured only debt representing its price" according to agreement)

[222] *See In re* Tuck, No. 06-10886-DHW, 2007 WL 4365456, at *4 (Bankr. M.D. Ala. Dec. 10, 2007) (concluding if hanging paragraph did not apply, claim could "be bifurcated into secured and unsecured components"); *see also In re Wright*, 338 B.R. 917, 919 (Bankr. M.D. Ala. 2006) (discussing hanging paragraph and noting effect of this "new provision"); *In re* Johnson, 337 B.R. 269, 270 (Bankr. M.D.N.C. 2006) (highlighting historically claim is bifurcated into secured and unsecured claim).

C. Application of the Transformation Rule is Beneficial to the Bankruptcy Process

One of the benefits of the transformation rule is that the burden of proof is easily satisfied thereby eliminating the need for extensive time consuming hearings that further delay the bankruptcy case.[223] All that needs to be shown is that a portion of the loan obtained by the debtor was not used to purchase the vehicle, but to pay off the preexisting debt in the trade-in vehicle. The evidentiary proof under the dual status rule is much more difficult because the exact amount of negative equity must be traced to split the obligation into purchase money and non-purchase money obligations.[224] Because the transformation rule is straightforward to apply, it benefits all parties involved.[225] The court will not be burdened with "unwinding" transactions between the debtor and the auto lender. The trustee will only need to prove nominal negative equity in the transaction, freeing up time to focus on other matters in the estate. The estate will not waste funds to litigate this issue, which would ultimately result in the debtor contributing less from future earnings to pay off the debt. Even the other creditors will benefit since the auto lender's security interest will not be fully secured, leaving more to be distributed to pay off other claims. To avoid this cram down, the auto lender will be responsible for what is stated in the retail installment contract. If the auto lender clearly divides the loan and provides for a method of allocation from the monthly payments, the auto lender should be protected to the extent the loan is a PMSI under the hanging paragraph.

Whether purchase money status should be given to negative equity financing should be addressed by the legislature, especially if the auto industry believes that the payoff of negative equity of a trade-in vehicle is common practice and a common issue in bankruptcy. Broad interpretation would allow this exception to the general rule to favor overreaching creditors seeking to increase their secured claim to the detriment of the other unsecured creditors.[226] A more narrow interpretation places the burden on the creditor to clearly lay out the components of

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[223] *See In re* Padgett, 389 B.R. 203, 207 (Bankr. D. Kan. 2008) (describing burden of proof); *see also* Juliet M. Moringiello, *A Tale of Two Codes: Examining § 522(F) of the Bankruptcy Code, § 9-103 of the Uniform Commercial Code and the Proper Role of State Law in Bankruptcy*, 79 WASH. U. L.Q. 863, 869 (2001) (noting transformation rule to be "more debtor-friendly" than dual status rule).

[224] *Cf. In re* Acaya, 369 B.R. 564, 571 (Bankr. N.D. Cal. 2008) (noting difficulty of allocating secured claim under dual status rule); Keith G. Meyer, *A Primer on Purchase Money Security Interests Under Revised Article 9 of the Uniform Commercial Code*, 50 U. KAN. L. REV. 143, 155 (2001) ("The 'dual status' doctrine holds that the mere presence of a non-PMSI does not destroy the purchase-money aspect of the original transaction."). *But see In re Westfall*, 376 B.R. at 219 (stating "application of the transformation rule is too severe").

[225] *But see In re Westfall*, 376 B.R. at 220 (concluding dual status rule is beneficial to all parties).

[226] *See* Harry, *supra* note 45, at 1104 (highlighting Bankruptcy Code does not define requirements for achieving and retaining purchase money status) (citation omitted); *cf.* Billings v. AVCO Colo. Indus. Bank (*In re* Billings), 838 F.2d 405, 406 (10th Cir. 1988) (noting for definition of PMSI, "the courts have uniformly looked to the law of the state in which the security interest is created"); *In re* Sanders, 377 B.R. 836, 843 (Bankr. W.D. Tex. 2007) (highlighting Ford Motor Company's argument that state law favors treating entire debt as purchase money).

the loan in the retail installment contracts by explicitly allocating how monthly payments are used to pay down each loan. If the creditor does not make the effort to make the conditions clear, he should not be rewarded with a fully secured claim worth more than the sale price of the collateral.

CONCLUSION

This Comment advocates the view that negative equity should not be given purchase money status simply because it is rolled-in with a purchase money obligation to acquire a new vehicle. In addition, the rolling in of negative equity to a PMSI should strip the purchase money status of the entire security interest. Using the transformation rule as a default rule will motivate lenders to carefully draft sale contracts. If auto lenders seek to protect their interests, they will be required to specifically carve out the non-purchase money portion of the loan and delegate how monthly payments will be allocated. This method is not only fair to all parties involved, it also removes judicial uncertainty of whether to apply the dual status or transformation rule for PMSIs under the hanging paragraph.

The practice of rolling in negative equity of a trade-in vehicle to the purchase of the new vehicle is common in the auto industry, and ultimately a common issue in bankruptcy regarding its status as "purchase money." It is ultimately the responsibility of the legislature to outline how PMSIs should be treated in consumer transactions, especially since there is already a procedure for non-consumer transactions specifically set in place. Without any clear direction from the legislature, the bankruptcy courts are left to reconcile the characterization of negative equity in relation to PMSIs under state law provisions that may counter the intent of the hanging paragraph in the Federal Bankruptcy Code. Bankruptcy courts across the country are still very much divided as to whether to apply the dual status rule or the transformation rule in its interpretation of "purchase money security interest" when negative equity is involved.