

## Legal Effect of 11 U.S.C. § 1325(a): Whether the “Hanging Paragraph” Eliminates a Creditor’s Ability to Assert a Deficiency Claim

### 1. INTRODUCTION

The “hanging paragraph” is implicated for statutory interpretation when a debtor proposes to turn over their vehicle to the secured creditor during a Chapter 13 confirmation hearing, but does not offer to pay any deficient amount owed to the creditor after the vehicle is liquidated. The majority of the cases conclude that the hanging paragraph prevents bifurcation of the secured creditor’s claim upon surrender of collateral pursuant to 11 U.S.C. § 1325(a)(5)(c). On the other hand, the minority of case law hold that the creditor is entitled to assert an unsecured claim for any deficiency claim.

The “cramdown” provision in Chapter 13, states that a debtor can modify the rights of a secured creditor with a purchase money security in a motor vehicle by bifurcating the claim into a secured and unsecured portion based on the value of the vehicle. In Re Morales, 359 B.R. 211 (Bankr. N.D. Ill. 2007). However, in response to debtors abusive ability to bifurcate a creditor’s claim, Congress amended (BAPCPA) § 1325(a)(5) to prohibit abuse when debtors purchase motor vehicles on credit prior to bankruptcy and use the “cramdown” provision to pay a secured creditor a lesser amount than the full claim. In Re Morales at 214.

### 2. APPLICABLE LAW

A. Pursuant to Section 1325(a)(5) of the Bankruptcy Code, as revised by BAPCPA, provides three alternatives for the treatment of allowed secured claims under a Chapter 13 plan: (1) pursuant to § 1325(a)(5)(A) a plan can be confirmed if the secured creditor accepts the plan; (2) pursuant to § 1325(a)(5)(B) a plan can be confirmed over objection of a holder of an allowed secured claim if the debtor retains the creditor's collateral and pays the value of that collateral as a secured claim, with any balance treated as an unsecured claim; and (3) pursuant to § 1325(a)(5)(C) a plan can be confirmed if the debtor surrenders the collateral to the secured creditor.

B. The “hanging paragraph” provides:

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day 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.

- C. Under 11 U.S.C. § 506, a bifurcation of a secured claim is prohibited under the following circumstances: (1) the creditor has a purchase money security interest; (2) in a motor vehicle acquired for the debtor's personal use; and (3) the debt secured by the vehicle was incurred within 910 days of the filing of the petition. If these requirements exist, bifurcation is not permitted of a secured claim described in § 1325(a)(5).

3. **MINORITY VIEWPOINT:** WHEN THE DEBTOR SURRENDERS THE MOTOR VEHICLE, A CREDITOR IS ENTITLED TO ASSERT AN UNSECURED CLAIM FOR ANY DEFICIENCY BALANCE REMAINING AFTER LIQUIDATION OF THE COLLATERAL.

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

**Facts:** On March 7, 2006 plaintiff loaned debtors \$17,331.89 to purchase a 2005 Ford Focus. On February 28, 2006 debtors filed for Chapter 13 Bankruptcy. At the time of filing the balance due on plaintiff's loan was \$14,182.76 and the estimated value of the Ford Focus was \$9,325. Thereafter, the debtors surrendered the vehicle to the plaintiff. The plaintiff argued that a secured claim for full payment of the loan balance is appropriate regardless of value of the vehicle surrendered. However, the debtors asserted that the surrender of the vehicle extinguished plaintiff's entire claim.

**Procedural Posture:** U.S. Bankruptcy Court confirmed the debtor's Chapter 13 plan, and the secured creditor appealed. District Court Reversed.

**Issue:** Whether the debtor's surrender of car extinguished creditor's remaining unsecured claim for deficiency on loan? **No**

**Rationale:** The court reasoned that upon receiving a surrender of its collateral, the secured creditor has received one of three treatments under § 1325(a)(5). The court noted that it does not follow from that premise, that the creditor somehow loses the right to file, and have allowed under § 502 as an unsecured claim the deficiency balance that remains unpaid, and that is otherwise enforceable under nonbankruptcy law, after disposition of the collateral and application of the proceeds to the debt.

Furthermore, the court viewed legislative history for guidance since the "hanging paragraph" is ambiguous. The court noted that the hanging paragraph was added to give secured creditors fair treatment in Chapter 13 and give more protection to creditors with purchase money security interests. Courts have contended that "it seems extremely unlikely, given the purposes expressed in the titles of the amendments, that the intent of the amendment was to eliminate the long existing right

of creditors in bankruptcy to an unsecured deficiency claim.” In re Duke, 345 B.R. 806 (Bankr. W.D. Ky. 2006). Finally, the court mentioned, “that the plain intent of the amendment was to deny the debtor the right to retain the asset while avoiding full contractual payment, but to preserve the status quo if the collateral is surrendered.”

**Rule:** The District court held that debtor’s surrender of car did not extinguish creditor’s remaining unsecured claim for deficiency on loan. Creditor is entitled to its state law (Uniform Commercial Code Sections 9-610 to 9-624) right to liquidate the collateral and retain an unsecured claim for the balance due.

4. **MAJORITY VIEWPOINT:** WHEN THE DEBTOR SURRENDERS THE MOTOR VEHICLE, A CREDITOR IS NOT ENTITLED TO ASSERT AN UNSECURED CLAIM FOR ANY DEFICIENCY BALANCE REMAINING AFTER LIQUIDATION OF THE COLLATERAL.

A. **In re Evans, 349 B.R. 498 (Bankr. E.D. Mich. 2006).**

**Facts:** On December 23, 2004 Ervin Evans, the debtor, entered into an agreement with Ford Motor Credit to finance the purchase of his 2005 Ford Escape. Subsequently, Evans was laid off of work. On January 30, 2006, Evans and his spouse filed for Chapter 13 bankruptcy. On April 28, 2006 Evans filed an amended plan proposing that he would surrender the vehicle in full satisfaction of the debt. However, Ford Motor Credit objected to confirmation of plan and contended that they were owed an unsecured claim for any deficiency balance due after the sale of the vehicle.

**Issue:** Whether the debtor could surrender the vehicle in full satisfaction of creditor’s claim although there was a deficiency balance due after the sale of the vehicle? **Yes**

**Rationale:** The court reasoned that pursuant to “hanging paragraph” provision in statute governing confirmation of Chapter 13 plans, which made Bankruptcy Codes claim bifurcation statute unavailable as to claim of creditor holding purchase money security interest in vehicle acquired for debtor’s personal use within 910-day prepetition period, Chapter 13 debtor could surrender vehicle in full satisfaction of secured creditor’s claim. Additionally, the court noted that if a statute is unambiguous, there is no need for court to inquire beyond the statutes plain language; the meaning of legislation should be conclusive, except in the rare case in which the literal application of a statute will produce a result demonstrably at odds with the intentions of the drafters. In essence, this court relied upon the majority view by finding that the language in the hanging paragraph was unambiguous. Moreover, in Ezell, the court thoroughly reviewed the legislative history on this issue and concluded that the statement of Congressional intent summarily mirrors statutory language. In re Ezell, 338 B.R. 330 (Bankr. E.D. Tenn. 2006).

**Rule:** That the debtor could surrender vehicle in full satisfaction of Ford Motor Credit's claim.

5. **CONCLUSION**

Accordingly, whether or not the court will interpret the "hanging paragraph" as a plain reading will determine if the secured creditor can seek a deficiency claim for the remaining balance of the vehicle. As a result, these two split decisions have significantly divided bankruptcy court circuits.