SECURED DEBTS

Sunday, May 2, 2010

Moderator: James Haller, Esq., NACBA Director (Belleville, IL)
Panelists: William Brewer, Esq., NACBA Vice-President (Raleigh, NC)
Hon. Roger L. Efremsky, U.S. Bankruptcy Court (San Jose, CA)

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REVIEW OF SELECTED ISSUES CONCERNING TREATMENT OF NON-REAL ESTATE SECURED DEBTS IN CHAPTER 13 BANKRUPTCY

NACBA ANNUAL MEETING
San Francisco, California
May 2, 2010

Honorable Roger L. Efremsky
William Brewer, Esq.
James Haller, Esq.

1. NEGATIVE EQUITY

   a. DESCRIPTION OF ISSUE:

Debtors frequently modify the rights of secured creditors by splitting, or "bifurcating," the creditor's claim into two parts: the secured portion which is equal to the value of the collateral and an unsecured portion represented by any amount owed over the value of the collateral. 11 U.S.C. § 506. The 2005 enactment of the "hanging paragraph" at the end of section 1325(a) created an exception to this common method of dealing with secured creditors. The exception is carefully limited 1) in time, 2) by type and use of the goods, and 3) by the type of claim protected. Specifically, the debt must have been incurred within 910 days of the filing of the petition, 2) the collateral must be a motor vehicle acquired for personal use of the debtor and 3) the creditor must have a purchase money security interest securing the debt that is the subject of the claim. 11 U.S.C. § 1325(a)(9).

The issue that has been raised since the amendments of the bankruptcy code in 2005 under the Bankruptcy Abuse Protection and Consumer Protection Act (BAPCPA) is whether the "negative equity" in a trade in car can be considered part of the PMSI in the purchase of a new car. This issue only exists for purchases of new cars within the 910 days of filing the bankruptcy.

Negative equity is defined "when the debtor trades in a motor vehicle for a new one, with the outstanding balance of the loan secured by a security interest in the old motor vehicle being refinanced by the loan made to the debtor to enable the debtor to acquire the new motor vehicle and that is secured by a security interest in the new motor vehicle." 4-506 Collier on Bankruptcy P 506.03.

The bankruptcy courts initially examining this issue created differing opinions. Some courts ruled that a "transformation rule" applied which means that if a portion of the secured claim is for negative equity, then the entire debt is transformed into a non-PMSI claim which can be crammed down. See e.g. In re Blakeslee, 377 B.R. 724 (Bankr. M.D. Fla. 2007) *In re Burt*, 378 BR 352 (Bankr. D. Utah 2007).

Another line of analysis adopted a "dual status" rule in which a PMSI is created in the amount of the value of the new vehicle, and the portion of the loan used to pay off the trade-in vehicle is just an ordinary secured interest. *See In re Padgett*, 389 B.R. 203 (Bankr. D.Kan. 2008), *Wells Fargo Financial North Carolina 1, Inc. v. Price*, 2007 WL 5297071 (E.D.N.C. Nov 14, 2007), *In re Bray,* 365 B.R. 850, (Bankr. W.D. Tenn. 2007), *CitiFinancial Auto v. Hernandez- Simpson*, 369 B.R. 36 (D.Kan. 2007), *In re Acaya*, 369 B.R. 564 (Bankr. N.D.Cal. 2007), *In re Conyers*, 379 B.R. 576 (Bankr. M.D.N.C. 2007), *In re Honcoop*, 377 B.R. 719 (Bankr. M.D.Fla. 2007), *In re Hayes*, 376 B.R. 655 (Bankr. M.D.Tenn 2007), *In re Westfall*, 376 B.R. 210 (Bankr. N.D. Ohio 2007), *In re White*, 352 B.R. 633 (Bankr. E.D.La. 2006), *In re Johnson,* 380 B.R. 236 (Bankr. D.Or. 2007), *GMAC v. Horne* 2008 WL 2662024 (E.D.Va. 2008), *In re Brodowski*, 2008 WL 2852878, (Bankr. S.D.Tex. 2008), *In re Mancini*, 2008 WL 2744579 (Bankr. M.D.Pa. 2008), *In re Munzberg*, 388 B.R. 529 (Bankr. D.Vt. 2008), *In re Riach*, 2008 WL 474384 (Bankr. D.Or. 2008), *In re Tuck*, 2007 WL 4365456 (Bankr. M.D.Ala. 2007).

However, the majority opinion in now seven circuit court of appeals is that a debtor may not cram down the "negative equity" portion of the debt. See *In re Peaslee*, 585 F.3d 53, 57 (2d Cir. 2009) (per curiam); *In re Price*, 562 F.3d 618, 624-29 (4th Cir. 2009); *In re Dale,* 582 F.3d 568, 573-75 (5th Cir. 2009); *Howard v. AmeriCredit Fin. Servs.*, 2010 U.S. App. LEXIS 4168 (7th Cir. 2010); *In re Mierkowski*, 580 F.3d 740, 742-43 (8th Cir. 2009); *In re Ford*, 574 F.3d 1279, 1283-86 (10th Cir. 2009); *In re Graupner*,537 F.3d 1295, 1300-03 (11th Cir. 2008).

PRACTICE TIPS:

1) Check the date of purchase of encumbered vehicles for the 910 deadline to avoid the issue entirely.
2) Check if any of the other exceptions in the hanging paragraph would apply to allow a cram down. Was the vehicle 1) acquired for personal use 2) of the debtor?
3) Check if the transaction is truly a trade in or a refinancing of an older note. If a refinancing, argue novation and ability to cram down.

2. OTHER 910 CAR ISSUES

a. IS THE CAR ACQUIRED FOR THE PERSONAL USE OF THE DEBTOR?

Under the hanging paragraph in section 1325(a)(9) of the code, if the vehicle is NOT acquired for the personal use of the debtor, then the claim can be bifurcated or crammed down under section 506. This section will address this issue.

i. Time period

The time period relevant in this inquiry is the time the vehicle was purchased. *In re Lorenz*, 368 B.R. 476, 485 (Bankr. E.D. Va. 2007);*In re Phillips*, 362 B.R. at 301-02 (Bankr. E.D. Va. 2007); Solis, 356 B.R. at 408-09; *In re Heglar*, 2009 Bankr. LEXIS 2579 (Bankr. M.D.N.C. 2009); *In re Strange*, 2010 Bankr. LEXIS 241 (Bankr. M.D. Ga. Jan. 20, 2010)

ii. Acquired for personal use vs. business use

The main issue that is generally raised in the bankruptcy court is whether the use of the debtor of the car was for business or personal use. The cases reviewing this issue vary on a very liberal to conservative spectrum. They all use some form of a "totality of circumstances" test.

The most generous courts simply require the Debtor to demonstrate that the "acquisition of the vehicle enabled the debtor to make a significant contribution to the gross income of the family unit." *In re Hill*, 352 B.R. 69, 73 (Bankr. W.D. La. 2006), *In re Marinez*, 363 B.R. 525 (Bankr. S.D. Tex. 2007) *In re Johnson*, 350 B.R. 712, 716 (Bankr. W.D. La. 2006. *In re Andoh*, 370 B.R. 377, 384 (Bankr. D. Colo. 2007) ("While, indeed, each case will present its own set of circumstances to be included in the "totality of circumstance," this Court finds that the analysis of the "totality of the circumstances" as enunciated in In re Hill, re Hill, is both persuasive and instructive as a general guide to analyzing the question of what the phrase "acquired for the personal use of the debtor.")

The courts that take a moderate approach require more than use of the vehicle to earn income. This approach generally recognizes the dual role vehicles play (business and personal use) and examines the totality of the circumstances to determine if the car is predominantly used to perform functions of a business or trade. This approach was introduced in *In re Joseph,* 2007 Bankr. LEXIS 1049 (Bankr. W.D. La. 2007). See also *In re Garrison*, 2007 Bankr. LEXIS 2749 at page 5 (Bankr. D. Alaska June 1, 2007) ("A factor that appears critical in making the distinction between business and personal use is whether the debtor is required to use the vehicle in the course of her employment."); *In re Powell*, 403 B.R. 583, 586 (Bankr. C.D. Ill. 2009)("Examples of a business purpose include where the debtor's employer required him to have a particular vehicle to conduct the business of the employer, and paid for

its costs and expenses to operate, or where the debtor actually uses the vehicle within the scope of employment."); *In re Lowder*, 2006 Bankr. LEXIS 1191 (Bankr. D. Kan. June 28, 2006) ("If Debtor's employer required her to have this automobile to conduct the business of that employer, paid for its costs or expenses to operate, or if she used it within the scope of her employment…[or], for example, if a debtor was required to use his automobile to regularly carry equipment and supplies to a construction site, and acquired it for that purpose, that debtor might be able to demonstrate that the intended use was for business, instead of personal use.") *In re LaDeaux*, 373 B.R. 48, 52 (Bankr. S.D. Ohio 2007); In re Martinez, 363 B.R. 525, 2007 WL 744643 (Bankr. S.D.Tx. 2007).

This approach was also recently followed by Judge Surratt-States in *In re Ozenkoski*, 417 B.R. 794, 799 (Bankr. E.D. Mo. 2009). The court states:

> To determine whether the Vehicle was acquired for personal use for purposes of § 1325(a), this Court asks whether the business needs served by acquiring the Vehicle are ancillary to the personal needs of Debtor or whether the personal needs are secondary to Debtor's use in his business or trade. The test used by the Hill Court effectively deems a personal use vehicle a business vehicle if there exists any business use at all. The Hill test is unreasonable because it allows a vehicle primarily used to satisfy personal needs to easily escape the restrictions of § 1325(a) simply because a debtor drives to work in it. In contrast, the Solis Court's "substantial and material test" assumes personal use unless the car is used almost entirely for business purposes. The Solis test is unreasonable because it ignores the fact that, in reality, most business vehicles will occasionally be used to satisfy personal needs. The test articulated in Joseph allows a reasonable amount of personal use which will naturally occur in the course of the ownership of a business vehicle. Thus, the Joseph test is the most reasonable test to use in the instant case.

The Debtor's brief in *Ozenkoski* is attached to this material.

The third method is whether the car is used to satisfy significant and material personal needs of the debtor, even if it is also used for business purposes. This is a very strict interpretation of this section. It was introduced

by the court in *In re Solis*, 356 B.R. 398, 411 (Bankr. S.D. Tex. 2006)(Personal use is determined when "at the time of the acquisition the acquirer intended that a significant, material portion of the use of the vehicle would be (a) for the benefit of the debtor(s) in the bankruptcy case, (b) for non-business purposes, and (c) for satisfaction of debtor(s)' wants, needs, or obligations. In reaching conclusions as to what is significant and material, the Court must take into consideration all of the facts and circumstances of the case.") See also *In re Phillips*, 362 B.R. 284, 303-04 (Bankr. E.D. Va. 2007); *In re Lorenz*, 368 B.R. 476, 485 (Bankr. E.D. Va. 2007)("[W]e continue to find the "significant and material" rationale used by the Solis court more persuasive. With all due respect, it seems to us that the Hill, Johnson, and Joseph courts attempted to define "personal use" by determining what it was not, which does not track the Plain Meaning Rule as closely as attempting to define what personal use is.");*In re Wilson*, 2006 Bankr. LEXIS 3325 (Bankr. D. Kan.2006); *In re Fletcher*, 2007 Bankr. LEXIS 3549 (Bankr. S.D. Fla. 2007); *In re Heglar*, 2009 Bankr. LEXIS 2579 (Bankr. M.D.N.C.2009).

iii. Acquired for a third party

In another line of cases states if the car is purchased for the use of a non-filing person like a spouse, child etc., the car will not be considered to be purchased for the debtor's personal use and can be crammed down. In 2010 Judge Walker wrote an opinion collecting cases on this matter. He states:

> Even though they often apply slightly different tests, courts have reached consistent results when deciding whether the personal use is "of the debtor." As a general rule, when someone other than the debtor is the exclusive user of a vehicle, the vehicle does not fall within the scope of the hanging paragraph. In addition, courts often find that when a non-filer is the primary user of the vehicle, the hanging paragraph does not

> apply. In re Lewis, 347 B.R. 769 (Bankr. D. Kan. 2006) (car purchased by debtor for independent adult daughter who had bad credit was not a 910 car); In re Solis, 356 B.R. 398 (Bankr. S.D. Tex. 2006) (car purchased for the use of independent adult son was not a 910 car); In re Finnegan, 358 B.R. 644 (Bankr. M.D. Pa. 2006) (car purchased for the use of non-filing spouse, who used it for his business, was not a 910 car); In re Davis, No. 06-10461, 2006 Bankr. LEXIS 3465, 2006 WL 3613319 (Bankr. M.D. Ala. Dec. 8, 2006) (car purchased for exclusive use of non-filing spouse was not a 910 car); In re Smith, No. 07-30201, 2007 Bankr. LEXIS 1872, 2007 WL 1577668 (Bankr. S.D. Tex. May 29, 2007) (car purchased exclusively for use of non-filing spouse was not a 910 car); In re Beasley, No. 07-40280, 2007 Bankr. LEXIS 3467, 2007 WL 2986124 (Bankr. M.D. Ga. Oct. 9, 2007) (Laney, J.) (car purchased exclusively for use of debtor's spouse, who was a debtor in a separately filed bankruptcy case, was not a 910 car); In re Pearson, No. 07-00478, 2008 Bankr. LEXIS 743, 2008 WL 687058 (Bankr. E.D.N.C. Mar. 7, 2008) (car purchased for the use of non-filing spouse was not a 910 car, even when the debtor later became its sole user); In re Ford, No. 07-28188, 2008 Bankr. LEXIS 1381, 2008 WL 1925153 (Bankr. E.D. Wis. Apr. 29, 2008) (car purchased for the exclusive use of non-filing fiance was not a 910 car); In re Geddes, No. 308-00713, 2008 Bankr. LEXIS 2677, 2008 WL 4490113 (Bankr. M.D. Tenn. June 17, 2008) (car purchased for the exclusive use of debtor's adult daughter was not a 910 car); In re Matthews, 378 B.R. 481 (Bankr. D.S.C. 2007) (car purchased by debtor and her mother that was used by debtor only for transporting her mother, when debtor had another car for her personal use, was not a 910 car); In re Adaway, 367 B.R. 571 (Bankr. E.D. Texas 2007) (car purchased for non-filing spouse's transportation while debtor and his other vehicle were out of town on business for extended periods of time was not a 910 car); In re Adams, No 06-51651, 2007 Bankr. LEXIS 616, 2007 WL 675958 (Bankr. M.D. Ga. Mar. 1, 2007) (Hershner, J.) (car purchased for use primarily by non-filing spouse was not a 910 car); In re Press, No. 06-10978, 2006 Bankr. LEXIS 2296, 2006 WL 2734335 (Bankr. S.D. Fla. July 26, 2006) (car purchased primarily for use of co-filing spouse was not a 910 car); compare In re Grimme, 371 B.R. 814 (Bankr. S.D. Ohio 2007) (car purchased for debtor's son, who occasionally took debtor on errands was a 910 car).

In re Strange, 2010 Bankr. LEXIS 241, 15-16 (Bankr. M.D. Ga. Jan. 20, 2010).

PRACTICE TIPS

1) Review the purchase agreement on the loan paperwork to determine if the loan was marked for personal or business use.

2) Always ask your client about the use of the vehicle.

3) If the client is buying a vehicle prior to bankruptcy for some type of business reason, advise the client to reflect that use upon the purchase agreement.

3. INTEREST ON SECURED DEBTS

Prior to the passage of BAPCPA, the Supreme Court ruled on the appropriate rate of interest in *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951 (2004). In general the formula is the Wall Street Journal Prime Rate plus a certain amount (usually 1-3) to adjust for risk.

After the passage of BAPCPA, the issue has been raised whether the 910 day anti-cram down provision found in the hanging paragraph of section 1325(a)(9) prevented a debtor from "cramming down" the contract interest rate to the "*Till"* interest rate. Most courts have ruled that the *Till* rate of interest still applies. See *In re Trejos*, 352 B.R. 249 (Bankr. D. Nev. 2006); *In re Brill*, 350 B.R. 853 (Bankr. E.D. Wis. 2006) (holding in post-BAPCPA 910 vehicle case where original contract provided for 0% interest that Till analysis applied to establish interest rate on secured claim); *In re Sparks*, 346 B.R. 767 (Bankr. S.D. Ohio 2006); *In re Soards*, 344 B.R. 829 (Bankr. W.D. Ky. 2006); In re Scruggs, 342 B.R. 571 (Bankr. E.D. Ark. 2006) (holding in post-BAPCPA 910 vehicle case where original contract provided for 0% interest for 60 months that Till analysis applied to establish interest rate on claim); *In re Pryor*, 341 B.R. 648 (Bankr. C.D. Ill. 2006); *In re Shaw*, 341 B.R. 543 (Bankr. M.D. N.C. 2006); *In re DeSardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006); *In re Brown*, 339 B.R. 818 (Bankr. S.D.Ga. 2006); *In re Wright*, 338 B.R. 917 (Bankr. M.D. Ala. 2006); *In re Brooks*, 344 B.R. 417 (Bankr. E.D. N.C. 2006); *In re Taranto*, 365 B.R. 85, 90 (B.A.P. 6th Cir. 2007); *In re Fleming*, 339 B.R. 716, 722 (Bankr. E.D. Mo. 2006)("The 910 Day Car Language has no impact on the requirement to pay present value set forth in Section 1325(a)(5)(B)(ii) other than to clarify the dollar amount of the claim which must receive present value. Till still controls what interest rate is required to ensure present value");

In re Robinson, 338 B.R. 70, 75 (Bankr. W.D. Mo. 2006); *In re Bufford*, 343 B.R. 827, 835 (Bankr. N.D. Tex. 2006).

Note that some courts have held that because the anti-cram down provision effectively states that section 506 (Determination of Secured Status) does not apply, that a claim falling qualifying under that provision should not be provided any interest rate. However, most if not all of those courts have been overruled or discredited. *In re Wampler*, 345 B.R. 730 (Bankr. D. Kan. 2006), disagreed with by, *In re Wilson*, 374 B.R. 251 (10th Cir. BAP 2007); *In re Taranto*, 344 B.R. 857 (Bankr. N.D. Ohio), rev'd, 365 B.R. 85 (6th Cir. BAP 2007). *In re Kinsey*, 368 B.R. 888 (Bankr. D. Kan. 2007), vacated by, *In re Jones*, 530 F.3d 1284 (10th Cir. 2008). *In re Dean*, 2006 Bankr. LEXIS 3412 (Bankr. M.D. Ga. Sept. 12, 2006), rev'd, 537 F.3d 1315 (11th Cir. 2008).

PRACTICE TIPS

1) Pay secured debts pursuant to the *Till* case unless the contract terms are completely unmodified by the plan.
2) Review the interest rate of the original contract and compare it to the local *Till* rate. It may be more affordable for a debtor to continue to pay for the debt outside of a chapter 13 plan. For example if the debtor has a 910 car loan lasting 72 months at 0% interest, then it may be less expensive for the debtor to propose paying it outside the plan then inside. The addition of the Till rate and the chapter 13 Trustee's fee could add significant interest.

4. ADEQUATE PROTECTION PAYMENTS

Adequate protection payments are required by section 1326(a)(1)(C). These payments are made to creditors that have an allowed secured claim (meaning a claim must be filed and allowed) and the creditor must have a PMSI in the property. As the court in *Robson* states:

> This provision requires a debtor to provide adequate protection payments to a creditor when three elements are present. First, a portion of the creditor's claim must become due after the order for relief, which in most cases is the filing of the bankruptcy petition. Id.; 8-1326 COLLIER ON

> BANKRUPTCY P 1326.02(1)(a) (15th ed. rev. 2006). Second, the creditor's claim must arise out of an obligation that debtor undertook to purchase the property. Third, the debtor himself must have purchased the property securing the claim. Henry J. Sommer, Trying to Make Sense Out of Nonsense: Representing Consumers Under the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005", [**6] 79 AM. BANKR. L. J. 191, 228 (2005).

In re Robson, 369 B.R. 377, 379 (Bankr. N.D. Ill. 2007)

a. Calculating the amount

i. Contractual monthly payments

The most recent case (prior to the submission of these materials) concerning the calculation of the amount of the adequate protection payment is *In re Warrington*, 2010 Bankr. LEXIS 509 (Bankr. E.D. Pa. 2010). The *Warrington* court ruled that

> "adequate protection" must be determined for "that portion of the obligation that becomes due after the order for relief." In re Singer, supra, 368 B.R. at 443. While the statute is silent as to how much will suffice to protect the lender, it is reasonable to assume that an amount which offsets depreciation in would be satisfactory. Id. citing Drive Financial Services v. Brown (In re Brown), 348 B.R. 583, 594 (Bankr.N.D.Ga.2006); David Gray Carlson, Cars and Homes in Chapter 13 After the 2005 Amendments to the Bankruptcy Code, 14 Am. Bankr.Inst. L.Rev. 301, 325-26 (2006); and United Say. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 370, 108 S.Ct. 626, 630, 98 L. Ed. 2d 740 (1988) (holding that secured lender's entitlement to adequate protection means protection against depreciation of collateral).

In the *Warrington* case, the Debtor provided proof that depreciation occurred at a rate of $53.00 per month. The Court conditioned return of the vehicle however on adequate protection payments equal to the monthly contractual amounts of $336.78 per month. This is consistent with the language of section 1326(a)(1)(C) which states in part that the debtor must make adequate protection payments “for that portion of the obligation that becomes due after the order for relief.”

ii. Depreciation

The contrary position to paying contractual payments is to instead pay the depreciation of the collateral. The basis for this is found at the beginning of section 1325(a)(1) which is prefaced by the language "Unless the court orders otherwise…" Adequate protection can be provided by as cash payments in the amount of the decline of value. *See United Sav. Asso v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 370 (1988). As such, a court can rule that adequate protection payments may be something besides contractual payments. *In re Robson*, 369 B.R. 377, 382 (Bankr. N.D. Ill. 2007)("Certainly, a debtor need not make the payment required in the retail installment contract to provide adequate protection to a creditor; that was clear in Timbers. 484 U.S. at 370 (stating that if the collateral is declining in value, adequate protection is cash payments in the amount of the decline, not in the amount of the contractual payments)"). The issue then becomes how to determine the depreciation. The Court in *In re Marks* explains the differences as follows:

> There is a difference in opinion regarding how to calculate adequate protection payments. Some districts require that it be a nominal percentage amount around 1-2% of the collateral's worth at the time of filing. See, e.g., Hill, 2007 Bankr. LEXIS 502, 2007 WL 499622, at *4 (using a 1% of the collateral's value as a fixed rate that may be rebutted by an objecting creditor); In re Beaver, 337 B.R. 281, 285 (Bankr. E.D.N.C. 2006) (recognizing 1% of value of collateral as agreed by parties sufficient for adequate protection); DeSardi, 340 B.R. at 797 (employing [**7] 1.5% of value of collateral as provided by the district's local rule). Other districts, as well as this one, recognize adequate protection payments as equaling the amount by which the collateral is depreciating. Thompson, 2008 Bankr. LEXIS 1547, 2008 WL 2157163, at *2 (citing First Fed. Bank of Calif. v. Weinstein (In re Weinstein), 227 B.R. 284, 296 (B.A.P. 9th Cir. 1998)); see also Robson, 369 B.R. 377, 380 (holding that motor vehicle lender must be compensated for depreciation of collateral in order to be adequately protected.).

In re Marks, 394 B.R. 198, 202 (Bankr. N.D. Ill. 2008).

iii. Evidence of depreciation

At trial, even in bankruptcy court, there is the issue of actual evidence. Fortunately the valuation guide books are admissible in court as an exception to the hearsay rule. The court in *Williams* recently laid out the basis for allowing guide books as evidence. The court states:

> Rule 803(17) of the Federal Rules of Evidence provides a hearsay exception for "[m]arket quotations, tabulations, lists, directories or other published compilations, generally used and relied upon by the public or by persons in particular occupations." The NADA guidebook fits well within this hearsay exception. In re McElroy, 339 B.R. 185, 188 (Bankr. C.D. Ill. 2006); See also Barry Russell, Bankruptcy Evidence Manual, § 803:30 (2008-09 Edition). Accordingly, Creditor's evidence of an $ 18,450.00 value of the vehicle is properly before the Court.

In re Williams, 2009 Bankr. LEXIS 3365 (Bankr. D.S.C. Oct. 28, 2009); See also *In re Robson*, 369 B.R. 377, 380-381 (Bankr. N.D. Ill. 2007)

5. EQUAL MONTHLY PAYMENTS

Section 1325(a)(5)(B)(iii)(I) states effectively that (a) except as provided in subsection (b), the court shall confirm a plan if…(5) with respect to each allowed secured claim provided for by the plan--(B)(iii) if--(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts. The courts are split as to what this section requires.

a. Timing

There appear to be two separate theories of when equal monthly payments are to start. These cases are different based on the interplay between sections 1325(a)(5)(B)(iii)(I), (II) and 1326(a)(1)(C). One line of cases states that they need to start beginning with the first payment due after the chapter 13 case is confirmed and continue until the secured claim is paid in full. The rationale is essentially that 1326(a)(1)(C) deals specifically with pre-confirmation adequate protection payments. Once the case is confirmed, adequate protection payments should stop and equal monthly payments must begin. *In re Denton*, 370 B.R. 441, 446 (Bankr. S.D. Ga.

2007); *In re Espinoza*, No. 08-20778, 2008 Bankr. LEXIS 2121, 2008 WL 2954282 (Bankr. D. Utah Aug. 1, 2008); *Wells Fargo Fin. Georgia, Inc. v. Baxter (In re Williams)*, 385 B.R. 468 (Bankr. S.D. Ga. 2008); *In re Sanchez*, 384 B.R. 574, 578 (Bankr. Ore. 2008).

The second line of cases indicates that there is no requirement in the code that equal monthly payments begin at confirmation but instead requires that once they begin, they must continue to be made until the claim is paid. *In re Butler*, 403 B.R. 5, 14 (Bankr. W.D. Ark. 2009); *In re DeSardi*, 340 B.R. 790, 805 (Bankr. S.D. Tex. 2006); *In re Marks*, 394 B.R., 198, 204 (Bankr. N.D. Ill. 2008); *In re Hill*, 397 B.R. at 259, 268-69 (Bankr. M.D. N.Car. 2007); *In re Erwin*, 376 B.R. 897, 901 (Bankr. C.D. Ill. 2007); In re Blevins, 2006 Bankr. LEXIS 2422, 2006 WL 2724153, at *2 (Bankr. E.D. Cal. 2006); see also 8-1325 Collier on Bankruptcy P 1325.06.

b. Amount

There are also several lines of cases that address the amount of equal monthly payments. The first line of cases hold that equal monthly payments only refers to what the Debtor must pay in and not what the creditor must receive. The basis for this argument is found in section 1326(b) of the code which requires payment of priority claims (which would include trustee's fees and attorney's fees) along with payment to secured creditors in the plan. *In re Erwin*, 376 B.R. 897, 901 (Bankr. C.D. Ill. 2007). A recent decision states:

> The debtor is required to make equal monthly payments to the plan by § 1325(a)(5)(B)(iii), not to a particular creditor. Id. at 205. The Chapter 13 trustee, however, is not obligated to disburse equal monthly payments to the creditor because the trustee has a duty to pay priority claims. Ibid. (citing In re Erwin, 376 B.R. 897, 902 (Bankr. C.D. Ill. 2007) re Erwin, 376 B.R. 897, 902 (Bankr. C.D. Ill. 2007) (noting that accelerated payment of attorney's fees is expressly authorized by the Code, stating that a chapter 13 trustee has independent authority to administer a plan in holding that the trustee is not bound by the equal [*14] payment

> provision of § 1325 and finding that accelerated payment of debtors' attorney's fees was not intended to be precluded by the equal monthly payment provision).
>
> Section 1326 requires payment of § 507(a)(2) administrative claims (which includes debtors' attorneys' fees) before or concurrently with other claims (including secured claims). 11 U.S.C. § 1326(b); see also In re Marks, supra, 394 B.R. at 204 (citing In re Hill, No. 06-80502, 397 B.R. 259, 2007 WL 499622, at *4 (Bankr. M.D.N.C. 2007)). Thus, a plan could not be confirmed if the debtor could not make payments covering both attorney's fees and the equal monthly payment. Ibid. (citing In re Hill, supra, No. 06-80502, 397 B.R. 259, 2007 WL 499622, at *4; In re DeSardi, 340 B.R. 790, 807-08 (Bankr. S.D. Tex. 2006) (stating that § 1326 requires all § 507(a)(2) claims be paid before or at the same time as payment of other claims)).

In re Hernandez, 2009 Bankr. LEXIS 982, 13-14 (Bankr. N.D. Ill. 2009)

The second line of cases states that the "equal monthly payment provision does not allow the carve-out for the debtors' attorney's fees." *In re Espinoza*, 2008 Bankr. LEXIS 2339 (Bankr. D. Utah, 2008). Instead, section 1325(a)(5)(B)(iii)(I) requires equal payments post-confirmation. *In re Denton*, 370 B.R. 441, 446 (Bankr. S.D. Ga. 2007); *In re Espinoza*, No. 08-20778, 2008 Bankr. LEXIS 2121, 2008 WL 2954282 (Bankr. D. Utah Aug. 1, 2008); *In re Sanchez*, 384 B.R. 574, 578 (Bankr. Ore. 2008).

PRACTICE TIPS

1) Be reasonable when asking for payment of attorneys fees. Bad facts make bad law.
2) Identify the monthly payments you intend to make in your plan to creditors. Again, be reasonable.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

In re:	)	Case No. 09-43001-659
	)	
Brent Ozenkoski,	)	Chapter 13
	)	
Debtor.	)	Legal Brief

DEBTOR'S LEGAL BRIEF CONCERNING OBJECTION TO CONFIRMATION

COMES NOW Debtor, by and through his attorney, and submits the following brief on the legal issue of the Creditor GMAC's Objection to Confirmation of the Debtor's Chapter 13 Plan:

Issue

Does the business use exception of the hanging paragraph of 11 U.S.C. § 1325(a) apply to a Debtor who purchased a vehicle for which he uses in the course and scope of his employment?

Facts

The Debtor purchased a 2008 Chevrolet Silverado on or about June 30, 2008. GMAC financed the sale and took a Purchase Money Security Interest lien in the vehicle. The contract has small boxes indicating the use for which the vehicle is purchased. The box marked "personal" is checked on the contract, although the Debtor is prepared to testify that he did not check this box himself, that he was unaware of this box on the contract until after he filed bankruptcy, and that he disclosed to the sales person who sold him the vehicle that he intended to use the vehicle in performing his trade.[1]

The Debtor was employed fulltime as a textbook salesman at the time the vehicle in question was purchased. The Debtor was required to use his personal vehicle during the course and scope of his employment. According to the Debtor's 2008 Federal Tax Return, Form 2106 (Employee Business Expenses), the Debtor drove 45,845 miles on his personal vehicles while conducting his trade in 2008, while he only drove 5,885 for personal use. The Debtor therefore used his vehicles for business use for 89% of the total miles driven in 2008.

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[1] This factual assertion is based on the documentation accompanying the proof of claim filed by GMAC. This document has not yet been authenticated by the Court.

At some point before June 30, 2008 the Debtor began experiencing mechanical problems with his 2005 Ford Freestar Van, the vehicle he owned before he purchased the 2008 Chevrolet Silverado. The Debtor therefore sought to purchase a new vehicle because he would be unable to continue his employment if his vehicle should break down.

The Debtor owns two other vehicles besides the 2008 Chevrolet Silverado in question, a 1985 CJ7 Jeep and a 2008 150cc scooter.

The Debtor filed for bankruptcy under Chapter 13 on April 3, 2009. The Debtor submitted a proposed plan that called for the bifurcation of the claim of creditor GMAC. The Debtor sought such treatment of the claim even though the vehicle in question was purchased within 910 days of the filing of this bankruptcy under the theory that the vehicle was purchased for business rather than personal use. Both creditor GMAC and the Chapter 13 Trustee objected to the Debtor's proposed plan because of the treatment it provided for the claim of GMAC. At the confirmation hearing creditor GMAC requested permission to submit a brief on the legal issues surrounding its claim. The Chapter 13 Trustee elected not to submit a brief

Discussion

The initial consideration for the Court is which party carries the burden of proof. In the Eighth Circuit the burden of proof is on the objecting creditor. In re Coleman, 373 B.R. 907, 911 (Bankr. W.D. Mo. 2007); Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1226 (8th Cir. Neb. 1987). It is therefore GMAC's burden to persuade the Court by a preponderance of the evidence that the Debtor purchased the vehicle in question for personal use and that therefore the hanging paragraph of § 1325(a) applies.

Section 1325(a) contains a non-numerated phrase commonly referred to as the "hanging paragraph." This provision states that a debtor may not use 11 U.S.C. § 506 to bifurcate the claim of a creditor who 1) holds a purchase money security interest, 2) for a debt that was incurred within 910 days of the bankruptcy filing, 3) for a motor vehicle, 4) that was acquired for the debtor's personal use. The Debtor concedes elements 1, 2 and 3 of the hanging paragraph, but rather contends that GMAC is unable to meet its burden with respect to element 4 requiring the Debtor to have acquired the vehicle for personal use.

The Bankruptcy Code does not define "personal use." In re Lorenz, 368 B.R. 476, 485 (Bankr. E.D. Va. 2007). However, most courts are in agreement that personal use means a non-

business use. In re Joseph, 2007 Bankr. LEXIS 1049 (Bankr. W.D. La. Mar. 20, 2007).[2] As it is the Debtor's intended use at the time of purchase that is the determinative factor for the issue in question, it is therefore the burden of GMAC to establish that the Debtor purchased the vehicle to satisfy his non-business rather than his business needs.

There are highly probative and undisputed facts surrounding the acquisition of the Debtor's vehicle. At the time of purchase the Debtor was required to use his own vehicle during the course and scope of his employment.[3] The vehicle that the Debtor traded in at the time of purchase had high mileage and was deemed by the Debtor to be unreliable.[4] If the Debtor did not have a functioning vehicle he would lose his employment and thus his income. The Debtor therefore clearly intended to use the vehicle for business purposes at the time of purchase.

Several tests have emerged from the case law surrounding the business use exception of the hanging paragraph in § 1325(a). The first test was initially articulated by In re Hill, 352 B.R. 69 (Bankr. W.D. La. 2006) and is known as the "totality of circumstances" test. This test states that a vehicle is purchased for business purposes if the vehicle enables the debtor to make significant financial contributions to his household. *Id* at 73. In *Hill*, the debtors only business use of the vehicle was commuting to and from work, which was deemed sufficient by the court to be business use. *Id.*

A second test is known as the "significant and material" test. This standard was first applied by In re Solis, 356 B.R. 398, 409 (Bankr. S.D. Tex. 2006). This test holds that a vehicle is purchased for personal rather than business purposes when the actual use of the vehicle satisfies significant and material household needs. *Id* at 411. In *Solis*, the debtor was the primary driver of the vehicle in question and she did not operate the business that she claimed the vehicle was purchased to conduct. *Id*. at 403. Rather, her non-filing spouse used the vehicle on occasion to operate his disc jockey business. *Id.* Furthermore, this business was not even in operation at the time the vehicle was purchased, although the debtor did testify that she would

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[2] The business use exception of the hanging paragraph of § 1325(a) appears to be one of first impression in the Eight Circuit as the Debtor's attorney could locate no written opinions on this issue in this jurisdiction. Likewise, the Debtor could locate no decisions at the appellate level of any jurisdiction.

[3] This assertion is evidenced by the Debtor's claimed vehicle deductions on his federal tax returns.

[4] This assertion is evidenced by the amount that the Debtor received for trading in his previous vehicle and because he traded in his previous vehicle prior to completing his scheduled payment plan even though he had already paid a majority of the interest on the loan (as loan amortization is a standard practice in the vehicle finance industry) and therefore the majority of his monthly payments were being applied to the principal balance of the loan and building equity for his benefit.

have purchased a different vehicle but for the fact that her husband wanted to begin operating his business. *Id.* The court ruled that the vehicle was purchased for personal rather than business use because the vehicle was in fact used to satisfy significant and material personal needs of the debtor. *Id*. at 411.

Finally, there is the test that can best be described as the "trade use" test. This test can be found well articulated by the decision of In re Joseph, 2007 Bankr. LEXIS 1049 (Bankr. W.D. La. Mar. 20, 2007). In *Joseph*, like *Hill*, the only business use claimed by the debtors was the use of the vehicle to commute to and from work. *Id* at page 3. The court in *Joseph* essentially rejected commuting to and from work as a business use because the act of engaging in business did not begin until the debtors arrived at work and that even though the commute facilitated the generation of income, the income in and of itself was a personal motive to satisfy needs such as food, clothing and shelter. *Id* at page 10-11. Also, even though the court in *Joseph* was aware of the decision in *Solis* and cited this case for other reasons, the *Joseph* court did not endorse the significant and material test. *Id*. Rather, the court stated that a debtor must show that the vehicle is used to perform the function of a business or trade. *Id*. at page 11. The court indicated that evidence of such purposes would be "the nature of the debtor's work, how the debtor's vehicle is used to perform the debtor's job duties, whether or not the debtor's employer requires the debtor to use his or her vehicle to perform the debtor's job-related duties, whether the debtor's employer reimburses the debtor for mileage, and whether or not the debtor claims any vehicle-related expenses as business expenses on the debtor's tax returns." *Id.*

There are numerous well-reasoned cases that have reached the same conclusion as the court in *Joseph*.[5]

The Court should endorse the "trade use" test over the "totality of the circumstances" and "significant and material" tests. The fallacy of the "totality of the circumstances" test as used by

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[5] *See generally* **In re Garrison, 2007 Bankr. LEXIS 2749 at page 5 (Bankr. D. Alaska June 1, 2007)** ("A factor that appears critical in making the distinction between business and personal use is whether the debtor is required to use the vehicle in the course of her employment."); **In re Powell, 403 B.R. 583, 586 (Bankr. C.D. Ill. 2009)** ("Examples of a business purpose include where the debtor's employer required him to have a particular vehicle to conduct the business of the employer, and paid for its costs and expenses to operate, or where the debtor actually uses the vehicle within the scope of employment."); **In re Lowder, 2006 Bankr. LEXIS 1191 (Bankr. D. Kan. June 28, 2006)** ("If Debtor's employer required her to have this automobile to conduct the business of that employer, paid for its costs or expenses to operate, or if she used it within the scope of her employment…[or], for example, if a debtor was required to use his automobile to regularly carry equipment and supplies to a construction site, and acquired it for that purpose, that debtor might be able to demonstrate that the intended use was for business, instead of personal use.") In re LaDeaux, 373 B.R. 48, 52 (Bankr. S.D. Ohio 2007); In re Martinez, 363 B.R. 525, 2007 WL 744643 (Bankr. S.D.Tx. 2007).

the court in *Hill* is that this test fails to consider that the vast majority of Chapter 13 debtors are wage earners, and as wage earners they will most likely use their vehicles to commute to and from their employment. The "totality of the circumstances" test therefore renders the hanging paragraph of § 1325(a) all but meaningless in application which is clearly not consistent with Congressional intent.

Also, the "significant and material" test is a poor indicator of a debtor's actual intent at the time of purchase. The fallacy behind the "significant and material" test is that it assumes that a debtor who makes use of a vehicle for significant and material personal purposes must have acquired the vehicle for those reasons, whereas in reality the debtor may have in fact acquired the vehicle for business motives and then opportunistically used the vehicle to satisfy personal needs as well. For instance, assume that an employer provides its employee with a company vehicle to conduct company business and allows the employee to retain possession of the vehicle at all times to facilitate this purpose. This would certainly be a vehicle acquired by the employee for business use, but what if the employee also regularly used the vehicle to take his children to school on the way to work or stopped at the grocery store for his family on the way home? These are clearly "significant and material" personal uses, but that does not render the vehicle a vehicle acquired for personal use. Likewise, a rational minded small business owner cannot be expected to go to a vehicle dealership to buy one vehicle that services his business needs and an entirely separate vehicle for his personal usage when one vehicle will clearly satisfy both ends.

The critical question that the Court should consider is this: Are the business needs served by acquiring the vehicle ancillary to the personal needs of the Debtor or are the personal needs secondary to the Debtor's business or trade? This question is best answered by applying the standard used by *In re Joseph*. If a debtor cannot engage in his chosen profession without the use of his own vehicle, and the debtor acquires a vehicle to facilitate the same, then surely that vehicle has been acquired for business purposes regardless of how else the vehicle is used. In considering the business use exception of the hanging paragraph of § 1325(a) an analysis of whether a debtor uses the vehicle in the course and scope of his trade is critical to this end. The Court should therefore endorse the trade use standard for determining whether a vehicle was acquired for business rather than personal purposes as set out by the court of *In re Joseph*.

In the instant case the Debtor should prevail regardless of which standard the Court chooses to apply. The Debtor satisfies the "totality of the circumstances" test because his usage

of the vehicle in question allows him to generate income. The Debtor satisfies the "significant and material" test because the vehicle was not the only vehicle in his household at the time of purchase and the Debtor could rely on this other vehicle to satisfy his personal needs. Finally, the Debtor satisfies the "trade use" test because he is required to make use of his own vehicle by his employer and in fact uses the vehicle in question in the course and scope of his trade.

Another issue that the Court may wish to consider is the designation in the contract that the vehicle in question was purchased for personal use. This appears to be a common occurrence in the factual background of existing case law. Although many courts have considered this to be a relevant factor, the Debtor's attorney was unable to locate a single case where this fact was dispositive.[6] The Debtor is prepared to testify he did not indicate that the vehicle in question was being purchased for personal use during the sales transaction. Rather, the Debtor will testify that he in fact discussed his business needs with the sales professional that sold him the vehicle while the Debtor deliberated which vehicle to purchase. Furthermore, the fact that the contract was designated as a purchase for personal use was not brought to the Debtor's attention at the time of sale nor did the Debtor become aware of such a designation until after he filed for bankruptcy.[7] Therefore, at best the fact that the contract was designated as a purchase for personal use was a mistake on the part of the Debtor and in reality may have been an attempt on the part of the seller to characterize the nature of the transaction as something which it was not. The Court should therefore not consider the existence of a personal use designation in the contract dispositive in the instant case.

The contract has not been properly authenticated and accepted as evidence before the Court. The Debtor requests an evidentiary hearing before the content of the sales contract is considered.

Finally, GMAC may attempt to carry its burden by trying to persuade the Court that even if the vehicle was purchased for business rather than personal use, the hanging paragraph of § 1325(a) still applies as the vehicle is "*any other thing of value…incurred during the 1-year period preceding that filing.*" 11 U.S.C. § 1325(a), hanging paragraph. This language is the

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[6] *See generally* In re Westerfield, 2009 Bankr. LEXIS 1485, 9-10 (Bankr. D.S.C. June 8, 2009); In re Joseph, 2007 Bankr. LEXIS 1049 at page 12 (Bankr. W.D. La. Mar. 20, 2007); In re Andoh, 370 B.R. 377, 383-84 (Bankr. D. Colo 2007).

[7] The personal use designation in the contract is simply a box with an "x" crossed through it. There is no indication in the contract that the Debtor was affirmatively aware of this provision. The seller could have easily had the Debtor initial next to this provision to better indicate that the Debtor was aware of this designation as is common practice in contract execution and secured transactions.

second part of the hanging paragraph and it places a 1 year from purchase to filing limitation on a debtor's ability to utilize § 506 for "any other thing of value" rather than a 910 day limitation found in the first part of the hanging paragraph. The question is therefore what was intended by Congress to be "any other thing of value", something other than a "motor vehicle" or something other than a "motor vehicle purchased for personal use"?

The vast majority of courts considering this issue have decided that "any other thing of value" is any other thing apart from a "motor vehicle" and not apart from a "motor vehicle purchased for personal use." In re Horton, 398 B.R. 73, 76 (Bankr. S.D. Fla. 2008).[8] The Debtor is aware of only one case that prevents the majority view from being unanimous, In re Littlefield, 388 B.R. 1 (Bankr. D.ME. 2008). *Littlefinger* stands alone and is erroneous in its conclusions for three reasons. First, the rule of statutory construction that the specific governs over the general dictates if the term "other" is used in the second part of the hanging paragraph to signify distinction from the first part, and the first part of the hanging paragraph deals with motor vehicles, then any other thing of value must be something apart from a motor vehicle. In re Balsinde, 2007 Bankr. LEXIS 4058 (Bankr. S.D. Fla. Nov. 29, 2007). Second, any ambiguity of an exception limiting the rights of a debtor should be resolved in favor of limiting such an exception rather than expanding it. In re Horton, 398 B.R. at 76 (Bankr. S.D. Fla. 2008). Finally, the limited legislative history that exists supports the conclusion reached by the majority rather than the one reached by *Littlefinger*. In re Horton, 398 B.R. at 76 (Bankr. S.D. Fla. 2008). For these reasons the Court should conclude that second part of the hanging paragraph of § 1325(a) does not apply to Debtor even though he purchased his vehicle within one year of filing bankruptcy.

Conclusion

The Court should endorse the "trade use" standard in determining whether a vehicle was purchased for personal or business use under the hanging paragraph of § 1325(a) and because the Debtor purchased his vehicle to use in his profession and he actually used the vehicle during the course and scope of his employment, the Court should conclude that the hanging paragraph of § 1325(a) does not apply GMAC and therefore allow the Debtor to bifurcate creditor's objection.

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[8] *See also* In re Balsinde, 2007 Bankr. LEXIS 4058, 2007 WL 4247642 (Bankr. S.D.Fla. 2007); In re Hayes, 376 B.R. 655 (Bankr. M.D.Tenn. 2007); In re Ford, 2008 Bankr. LEXIS 1381, 14-18 (Bankr. E.D. Wis. Apr. 29, 2008); In re Parish, 2006 Bankr. LEXIS 1205, 2006 WL 1679710 (Bankr. M.D.Fla. 2006); In re Hickey, 370 B.R. 219 (Bankr. D.Neb. 2007); In re Curtis, 345 B.R. 756 (Bankr. D.Utah 2006); In re Ellegood, 362 B.R. 696 (Bankr. E.D.Va. 2007)

The Court should not be persuaded by the personal use designation in the contract, if it considers the contract at all as it is yet to be properly authenticated and introduced into evidence. Finally, the Court should not follow the flawed path laid out by *In re Littlefinger* by ruling that a motor vehicle purchased for business use is "any other thing of value" pursuant to the second part of the hanging paragraph of § 1325(a). Therefore, the objection to confirmation filed by GMAC and the Chapter 13 Trustee should be overruled and the Debtor's Chapter 13 plan should be ordered confirmed.

Respectfully Submitted,

/s/ David Gunn
By:______________________________________

David N. Gunn, EDMO #502943; MO #54880
Attorney for Debtor
1600 South Brentwood, Suite 725
St. Louis, MO 63144
Telephone: (314) 961-9822
Fax: (314) 961-9825
E-mail: dgunn@tbcwam.com

CERTIFICATE OF SERVICE

The undersigned certifies that a true copy of Debtor's Legal Brief Concerning Objection to Confirmation was served via ECF on this 15th day of July, 2009, on the parties listed below.

/s/ David Gunn
David Gunn

Mr. John V. LaBarge, Jr.
Chapter 13 Trustee
P.O. Box 430908
St. Louis, MO 63143

Angela R. Collins
Attorney for GMAC
7700 Bonhomme Avenue
7th Floor
St. Louis (Clayton), Missouri 63105