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Protecting Negative Equity from Bifurcation Under § 1325(a)(*) of the Bankruptcy Code

Ryan Taylor*

I. INTRODUCTION

The Constitution confers upon Congress the power “to establish . . . uniform Laws on the Subject of Bankruptcies throughout the United States.” However, disuniformity of treatment in bankruptcy occurs among the states when Congress fails to define a term of art. The hanging paragraph (§ 1325(a)(*)) of the Bankruptcy Code exemplifies such disuniformity. The undefined term is “purchase-money security interest,” and a circuit split has arisen over whether a purchase-money security interest includes negative equity financing. Currently, the Ninth Circuit stands alone and in opposition to the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Tenth, and Eleventh Circuits, holding that negative equity may not be included as part of a purchase-money security interest. Dissenting opinions and lower bankruptcy court decisions bolster the Ninth Circuit’s stance, despite being against the majority of its sister circuits. Thus, this issue is not

2. Compare AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1164 (9th Cir. 2010) (finding that negative equity is not part of a purchase-money security interest), with Reiber v. GMAC, LLC (In re Peaslee), 585 F.3d 53, 57 (2d Cir. 2009) (determining that negative equity is part of a purchase-money security interest as decided by the New York Court of Appeals).
3. See, e.g., In re Peaslee, 585 F.3d at 56.
4. Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177 (2d Cir. 2008).
5. See infra Part IV(A) (discussing the nature of the split and why the split is merely derivative of state law).
6. See, e.g., Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 503 (6th Cir. 2010); Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 858 (7th Cir. 2010); In re Peaslee, 585 F.3d at 57; Ford Motor Credit Corp. v. Dale (In re Dale), 582 F.3d 568, 575 (5th Cir. 2009); Ford Motor Credit Co. v. Mierkowski (In re Mierkowski), 580 F.3d 740, 743 (8th Cir. 2009); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1286 (10th Cir. 2009); Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 628 (4th Cir. 2009); Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1301 (11th Cir. 2008). But see In re Penrod, 611 F.3d at 1163.
7. See, e.g., In re Penrod, 611 F.3d at 1160; In re Mierkowski, 580 F.3d at 743–47 (Bye, J., dissenting); In re Ford, 574 F.3d at 1294 (Tymkovich, J., dissenting); AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 392 B.R. 835, 860 (B.A.P. 9th Cir. 2008).
as seemingly one-sided as a cursory counting of circuit courts would indicate.

This Note’s central issue is how purchase-money security interest should be interpreted as applied to negative equity, which arises when a debtor trades in his or her current car with an outstanding balance and rolls that balance into a financing plan for a new car. Negative equity is defined as the market value of an old car minus the outstanding balance.\(^8\)

Whether negative equity financing is part of a purchase-money security interest warrants in-depth consideration because a debtor in Chapter 13 bankruptcy may or may not be required to repay that portion of the transaction in full. On the one hand, the debtor will be liable for the claim’s entirety, including the negative equity financing, if that financing is part of a purchase-money security interest. On the other hand, if negative equity financing is not part of a purchase-money security interest, the negative equity portion of the claim will be converted into an unsecured claim, reducing the size of the secured obligation. Accordingly, debtors seek to strip negative equity from the secured claim to decrease their secured obligations. Creditors who hope to recoup the total amount of the claim face the same consequences but with interests inverse to the debtor.\(^9\) The foregoing outcomes illustrate the substantial economic implications since nearly 40% of new car purchases include negative equity financing.\(^10\)

Bankruptcy courts thus far have provided two different interpretations of purchase-money security interest that lead to different results for both the debtor and the creditor.\(^11\) Under the majority of circuit courts, a purchase-money security interest includes negative equity, preventing the debtor from splitting the creditor’s claim into secured and unsecured claims under § 1325(a)(*);\(^12\) the entire finance plan is a purchase-money security interest.\(^13\) Conversely, the Ninth Circuit considers negative equity a nonpurchase-money security interest.

\(^8\) See infra Part II(A) (discussing and defining negative equity).

\(^9\) See, e.g., In re Peaslee, 547 F.3d at 181.

\(^10\) See Danny Hakim, Owing More On an Auto Than It’s Worth As a Trade-In, N.Y. TIMES (Mar. 27, 2004), http://www.nytimes.com/2004/03/27/business/owing-more-on-an-auto-than-it-s-worth-as-a-trade-in.html?src=pm (referencing a J.D. Power & Associates’s study, which found that 38% of new car buyers have negative equity, up from 25% in 2001); see also In re Ford, 574 F.3d at 1284.

\(^11\) See infra Part II(C) (discussing negative equity and the consequences of its secured or unsecured status).

\(^12\) See, e.g., In re Penrod, 611 F.3d at 1160–61.

\(^13\) Id.
while leaving the outstanding balance solely related to the new car as a purchase-money security interest.\textsuperscript{14} Thus, creditors find reprieve in the majority of circuits and hardship in the Ninth Circuit under Chapter 13; this is inversely so for debtors.

This Note argues that the majority of circuit courts reached the correct result and that the Ninth Circuit should have reversed a recent bankruptcy appellate panel's decision to align itself with the majority of its sister circuits.\textsuperscript{15} This Note proceeds in three parts. Part II delineates the typical situation in which this issue arises, the relevant bankruptcy statutes, and the consequences resulting from the status of negative equity as either a purchase-money or a nonpurchase-money security interest. Part III argues that Article 9 of the Uniform Commercial Code supports the finding that purchase-money security interests indeed include negative equity financing, and that the policies underlying the Bankruptcy Code and the Uniform Commercial Code support this result. In Part IV, collateral issues are discussed, including why this is a pseudo split and why Congress need not act.\textsuperscript{16} Part V concludes.

II. Background

A. The Situation in Which Negative Equity Arises

Whether the negative equity portion of a new car purchase is part of a purchase-money security interest becomes relevant when the debtor files for bankruptcy under Chapter 13.\textsuperscript{17} Prior to filing, the situation typically unravels as follows. The debtor, whom will be referred to as James, decides to purchase a new car to replace his old car. The new car's value is $25,000 and the old car's market value is $6,000. James trades in his old car and receives a $6,000 credit towards the new car. The old car was originally valued at $20,000, and James took out a loan in that amount. However, James still owes $10,000 for the old car. In connection with James's new car purchase, the dealer pays off the balance of $4,000 on James's previous loan and rolls it into the price of the new car. This is defined as the negative equity, which is

\textsuperscript{14} Id. at 1164.
\textsuperscript{15} See generally AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 392 B.R. 835 (B.A.P. 9th Cir. 2008).
\textsuperscript{16} The dual status rule and the transformation rule are inconsequential to the analysis herein and thus are not discussed; they are relevant only in jurisdictions that do not consider negative equity as part of a purchase-money security interest. See Geoffrey M. Collins, Note, Negative Equity and Purchase-Money Security Interests Under the Uniform Commercial Code and the BAPCPA, 95 Cornell L. Rev. 161, 172–75 (2009), for a general discussion of both rules.
\textsuperscript{17} See Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177, 180 (2d Cir. 2008).
the market value of the old car, $6,000, less the outstanding debt, $10,000. Thus, the total amount financed for the new car is $29,000, which consists of the new car's value of $25,000 and the negative equity valued at $4,000.\textsuperscript{18} With his obligations tidily rolled into a single finance plan, James files for bankruptcy within 910 days after purchasing the new car.\textsuperscript{19} In so filing, James and similarly situated debtors expose the disuniformity between the circuits in defining purchase-money security interest and its scope.

**B. The Central Bankruptcy Statutes: § 506 and § 1325(a)(*)**

Generally, Chapter 13 bankruptcy grants debtors two options. First, the debtor may opt to surrender the collateral.\textsuperscript{20} Surrendering the collateral satisfies the creditor's secured claim, "leaving the creditor with only an unsecured deficiency claim."\textsuperscript{21} The unsecured portion is repaid on the same terms as other unsecured claims.\textsuperscript{22} Thus, the debtor's surrender of the collateral effectively bifurcates the creditor's claim because the creditor's secured claim is satisfied by repossessing the collateral, and the debtor's remaining amount owed becomes an unsecured claim.\textsuperscript{23}

Second, the debtor may elect to keep the collateral.\textsuperscript{24} The creditor's objection to this option will go ignored so long as the debtor makes payments equivalent to the market value of the collateral to the creditor.\textsuperscript{25} Under this option, § 506(a)(1) requires that the allowed secured claim be equivalent to the value of the collateral.\textsuperscript{26}

Section 506(a)(1) provides, in part, that:

\textsuperscript{18} See In re Penrod, 611 F.3d at 1159, for another example to help clarify the concept of negative equity being rolled into the price of a new car. Negative equity creates further problems in states that permit the debtor to bifurcate the creditor's claim. See also Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1290 (10th Cir. 2009) (Tymkovich, J., dissenting). Debtor's payments prior to filing for bankruptcy must be adjusted to determine whether they apply, and to what proportion they apply, to either the nonpurchase-money portion or to the purchase-money portion. Id.

\textsuperscript{19} 11 U.S.C. § 1325(a)(*) (2006) ("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 period 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.").

\textsuperscript{20} See Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 506 (6th Cir. 2010).

\textsuperscript{21} Id.

\textsuperscript{22} Id.

\textsuperscript{23} Id.

\textsuperscript{24} Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 854 (7th Cir. 2010).

\textsuperscript{25} Id.

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 . . . and is an unsecured claim to the extent that the value of such creditor’s interest is less than the amount of such allowed claim . . . . Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . . .

Thus, the creditor’s claim is secured up to the value of the collateral and unsecured for the amount of the claim in excess of the value of the collateral. Bifurcating the secured creditor’s claim is often referred to as “stripping down” or “cramming down” the secured claim to the collateral’s value.

Though debtors generally find reprieve under § 506(a)(1), Congress added § 1325(a)(*) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) in response to complaints from car dealers and financiers. Section 1325(a)(*) aims to curtail bankruptcy abuse by preventing debtors from purchasing vehicles and then declaring bankruptcy, which would allow them to keep the vehicle and merely pay for its depreciated value. Section 1325(a)(*) proscribes the bifurcation of a claim in two contexts. First, § 1325(a)(*) applies when five conditions are met:

1. the creditor must have a purchase-money security interest;
2. that purchase-money security interest must secure the debt;
3. the debt must have been incurred within 910 days preceding the date of the filing of the petition;
4. the collateral for that debt must consist of a motor vehicle; and
5. the motor vehicle must have been acquired for the debtor’s personal use.

Second, § 1325(a)(*) applies where the collateral for the debt consists of anything of value, other than a vehicle, provided that the debt was

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27. Id.
28. Id.
29. E.g., In re Howard, 597 F.3d at 853; Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 628 (4th Cir. 2009).
30. In re Howard, 597 F.3d at 854.
31. Id. at 854–55.
32. 11 U.S.C. § 1325(a)(*) (“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 period 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.”).
33. Id.
incurred within one year prior to filing for bankruptcy.\textsuperscript{34} This Note concerns only the first application of § 1325(a)(*)

This Note’s central issue is whether a purchase-money security interest includes negative equity. Congress made clear under what conditions § 1325(a)(*) applies with the unambiguous language of § 1325(a)(*), but left to the states the responsibility of defining the scope of a purchase-money security interest.\textsuperscript{35}

\section*{C. Consequences Resulting from Negative Equity’s Characterization}

Chapter 13 requires debtors to pay all secured claims in full.\textsuperscript{36} An unsecured claim need not be paid in full, provided that the debtor pays all disposable income over the life of the plan;\textsuperscript{37} unsecured creditors must also receive as much of the debtor’s payment plan as they would otherwise receive if the debtor’s assets were liquidated under Chapter 7.\textsuperscript{38} The difference in secured and unsecured claims highlights the importance of determining whether negative equity can be included as part of a purchase-money security interest, especially because negative equity financing can represent a substantial percentage of the finance plan.\textsuperscript{39}

The transactions brought before the circuits show that, on average, 19.8\% of the total amount financed was negative equity.\textsuperscript{40} Between these cases, the lowest percentage was 9.9\% in the Fifth Circuit\textsuperscript{41} whereas the highest was 26.4\% in the Eighth Circuit.\textsuperscript{42} Furthermore, the average dollar amount of negative equity between the appellate

\textsuperscript{34} Id.
\textsuperscript{35} E.g., In re Howard, 597 F.3d at 855.
\textsuperscript{36} AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 392 B.R. 835, 842 (B.A.P. 9th Cir. 2008).
\textsuperscript{37} Id.; 11 U.S.C. § 1325(b)(1)(B).
\textsuperscript{39} E.g., In re Howard, 597 F.3d at 855 (determining that $8,000, or 22.5\%, of the $35,500 finance plan constituted negative equity).
\textsuperscript{40} See AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1159–60 (9th Cir. 2010); Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 500 (6th Cir. 2010); In re Howard, 597 F.3d at 855; Ford Motor Credit Corp. v. Dale (In re Dale), 582 F.3d 568, 570–71 (5th Cir. 2009); Ford Motor Credit Co. v. Mierkowski (In re Mierkowski), 580 F.3d 740, 741 (8th Cir. 2009); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1281 (10th Cir. 2009); Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 621–22 (4th Cir. 2009); Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177, 181 (2d Cir. 2008); Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1298 (11th Cir. 2008).
\textsuperscript{41} In re Dale, 582 F.3d at 570–71.
\textsuperscript{42} In re Mierkowski, 580 F.3d at 741.
cases was $5,976. The lowest amount of negative equity financed was $2,838 in the Fourth Circuit, and the highest amount was $8,071 in the Eighth Circuit.

These figures bring to light the two significant consequences resulting from negative equity's classification as either a purchase-money security interest or a nonpurchase-money security interest. First, creditors in jurisdictions in which negative equity is included as part of a purchase-money security interest enjoy the benefits attendant to that status. Purchase-money security interests "enjoy 'super-priority' rights over other types of security interests and liens." As stated in section 9-324(a), "a perfected purchase-money security interest in goods . . . has priority over a conflicting security interest in the same goods." Thus, sellers or financiers holding a purchase-money security interest in vehicles are guaranteed to receive the present value of the entire claim under Chapter 13 bankruptcy, not just the present value of the vehicle. This creditor-friendly result ensures that the seller or financier will recoup the total amount financed, including negative equity that may represent up to 26.4% of the total amount borrowed to finance the purchase. The importance of this result is further highlighted by the fact that nearly 40% of all vehicles financed in the United States include rolled-in negative equity.

Second, creditors are disadvantaged in jurisdictions that construe negative equity as a nonpurchase-money security interest. Here, the total amount of the claim is crammed down to the value of the collateral, granting the creditor a secured claim up to the value of the collateral and an unsecured claim for the portion representing the negative equity. However, the creditor's unsecured claim is no windfall be-

43. See In re Penrod, 611 F.3d at 1159–60; In re Westfall, 599 F.3d at 500; In re Howard, 597 F.3d at 855; In re Dale, 582 F.3d at 570–71; In re Mierkowski, 580 F.3d at 741; In re Ford, 574 F.3d at 1281; In re Price, 562 F.3d at 621–22; In re Peaslee, 547 F.3d at 180–81; In re Graupner, 537 F.3d at 1298 (11th Cir. 2008).
44. In re Price, 562 F.3d at 621.
45. In re Mierkowski, 580 F.3d at 741. All numbers in notes 40–45 were rounded for clarity.
46. In re Penrod, 611 F.3d at 1161.
48. See, e.g., 11 U.S.C. § 1325(a)(*) (2006) (assuming that all five conditions listed in 1325(a)(*) are satisfied to prevent the debtor from cramming down the claim to the collateral's value).
49. See Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 858 (7th Cir. 2010).
50. E.g., Hakim, supra note 10; Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1284 (10th Cir. 2009).
cause such claims are typically worth little in bankruptcy.\textsuperscript{52} Again, this amount is substantial to creditors because it may represent a quarter of the total amount the debtor borrowed to finance the purchase of the new car. Both of these outcomes play into the policy that courts provide to justify their conclusions in characterizing negative equity.\textsuperscript{53}

III. Analysis

A preliminary issue that courts must address is whether federal or state law governs interests in property.\textsuperscript{54} Many circuit courts have found that state law governs, reasoning that it typically creates property rights in bankruptcy.\textsuperscript{55} This reasoning derives from the Supreme Court's opinion in \textit{Butner v. United States}:

Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a windfall merely by reason of the happenstance of bankruptcy. The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests \ldots.\textsuperscript{56}

Federal law thereafter dictates whether an interest in property is enforceable under Chapter 13 once the status of the security interest is determined.\textsuperscript{57}

Article I, Section 8 of the United States Constitution grants Congress the power to establish uniform bankruptcy laws,\textsuperscript{58} but Congress forewent the opportunity to provide a uniform definition of property rights in the context of bankruptcy law under § 1325(a)(\textsuperscript{*}).\textsuperscript{59} Prior to

\textsuperscript{52} Id. at 854.
\textsuperscript{53} See infra Part III (discussing the arguments for including negative equity as part of a purchase-money security interest).
\textsuperscript{54} See, e.g., Wells Fargo Fin. Acceptance v. Price (\textit{In re Price}), 562 F.3d 618, 624 (4th Cir. 2009).
\textsuperscript{55} See, e.g., Nuvell Credit Corp. v. Westfall (\textit{In re Westfall}), 599 F.3d 498, 502 (6th Cir. 2010); \textit{In re Howard}, 597 F.3d at 855; Ford Motor Credit Corp. v. Dale (\textit{In re Dale}), 582 F.3d 568, 573 (5th Cir. 2009); \textit{In re Ford}, 574 F.3d at 1283; \textit{In re Price}, 562 F.3d at 624; Reiber v. GMAC, LLC (\textit{In re Peaslee}), 547 F.3d 177, 184 (2d Cir. 2008).
\textsuperscript{57} 9A AM. JUR. 2D Bankruptcy § 1543 (2011).
\textsuperscript{58} U.S. Const. art. 1, § 8, cl. 4.
\textsuperscript{59} \textit{In re Peaslee}, 547 F.3d at 184–86 (certifying question to the Court of Appeals of New York to clarify the meaning of purchase-money security interest under New York law).
the enactment of § 1325(a)(*), courts generally looked to state law to define purchase-money security interest\textsuperscript{60}: "Congress, presumably aware that its prior use of this term of art had led courts to resort to state law," again left the term undefined, evincing as its intent the continued resort to state law.\textsuperscript{61} This Note will treat as resolved in favor of state law the subordinate issue of whether federal or state law governs property interests.

A. Parsing the Uniform Commercial Code for Guidance

The Uniform Commercial Code provides both a firm ground upon which courts reason that negative equity is part of a purchase-money security interest and a logical place to look for guidance because Article 9 defines both security interests in personal property and purchase-money security interests.\textsuperscript{62} Three definitions listed under section 9-103 of Article 9 allow for a syllogistic approach to ascertaining the definition of purchase-money security interest: "[a] security interest in goods is a purchase-money security interest . . . to the extent that the goods are purchase-money collateral with respect to that security interest;"\textsuperscript{63} "purchase-money collateral" means "goods . . . that secure[ ] a purchase-money obligation incurred with respect to that collateral;"\textsuperscript{64} a "purchase-money obligation" is 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."\textsuperscript{65}

Thus, the two-prong definition of purchase-money obligation establishes two ways in which a purchase-money obligation may arise: (1) where an obligation of the debtor is incurred as all or part of the "price" of the collateral or (2) where the debtor is given "value" to enable the debtor to acquire the collateral.\textsuperscript{66} The two prongs serve to reinforce that the debtor's purchase-money obligation can be to either a dealer or a third party financier.\textsuperscript{67}

\textsuperscript{60} E.g., In re Price, 562 F.3d at 624.
\textsuperscript{61} Id. (quoting In re Peaslee, 547 F.3d at 184 n.13) (internal quotation marks omitted); In re Peaslee, 547 F.3d at 184 n.13.
\textsuperscript{62} E.g., Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 855 (7th Cir. 2010).
\textsuperscript{63} U.C.C. § 9-103(b)(1) (2011).
\textsuperscript{64} Id. § 9-103(a)(1).
\textsuperscript{65} Id. § 9-103(a)(2).
\textsuperscript{66} Reiber v. GMAC, LLC (In re Peaslee), 913 N.E.2d 387, 389 (N.Y. 2009).
\textsuperscript{67} E.g., In re Howard, 597 F.3d at 855-56 ("The 'value given' part of the definition is intended to make clear that the obligations can be to a finance company, as in this case, rather than to the seller.").
Generally, courts that construe these Uniform Commercial Code provisions use a two-step framework. First, a court will determine whether negative equity properly falls within one of the two prongs in section 9-103(a)(2). Second, if that condition is satisfied, the purchase-money security interest must have a "close nexus between the acquisition of collateral and the secured obligation." Although, Official Comment 3 (Comment 3) to section 9-103 states that "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."

The language contained in section 9-103 does not readily make clear whether the definition of purchase-money obligation encompasses negative equity financing. All circuit courts that have addressed this issue look to Comment 3 to aid their interpretations. As the Fifth Circuit recognized, the Uniform Commercial Code's Official Comments are undoubtedly "the most useful aids to interpretation and construction." Though the Official Comments are not binding, they "occupy an unusual position as aids to statutory interpretation" and are "an indispensable [sic] part of the [Uniform Commercial Code] framework." Thus, Courts have favorably looked to Comment 3, which provides a non-exhaustive list of items that constitute a purchase-money security interest:

\[\text{The "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administra-}\]

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68. E.g., In re Peaslee, 913 N.E.2d at 389-90.
69. E.g., id. at 389.
70. Id. at 390 (quoting U.C.C. § 9-103 cmt. 3) (internal quotation marks omitted) (concluding that the financing of negative equity was "inextricably linked to the financing of the new car").
71. U.C.C. § 9-103 cmt. 3.
72. Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177, 185 (2d Cir. 2008).
73. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1162 (9th Cir. 2010); Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 502-03 (6th Cir. 2010); Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 856 (7th Cir. 2010); Ford Motor Credit Corp. v. Dale (In re Dale), 582 F.3d 568, 574 (5th Cir. 2009); Ford Motor Credit Co. v. Mierkowski (In re Mierkowski), 580 F.3d 740, 742 (8th Cir. 2009); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1284 (10th Cir. 2009); Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 626 (4th Cir. 2009); In re Peaslee, 547 F.3d at 185; Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1301–02 (11th Cir. 2008).
74. In re Dale, 582 F.3d at 574 (quoting Weathersby v. Gore, 556 F.2d 1247, 1256 (5th Cir. 1977)) (internal quotation marks omitted).
tive charges, expenses of collection and enforcement, attorney’s fees, and other similar obligations.\textsuperscript{76} That negative equity is included between the listed items is both conceivable and within reason.\textsuperscript{77} Specifically, negative equity may properly fall within \textit{expenses incurred in connection with acquiring rights in the collateral or other similar obligations} listed in Comment 3.\textsuperscript{78} The Seventh Circuit said of the former that it “seems a pretty good description of negative equity;”\textsuperscript{79} the debtor assumes the obligation in connection with his acquiring ownership of the vehicle.\textsuperscript{80} Other circuit courts have similarly concluded that negative equity indeed falls within \textit{other similar obligations}.\textsuperscript{81} Therefore, satisfying either prong permits a finding that negative equity is included as a purchase-money security interest, given that the second step is satisfied.

Set forth below are three arguments in support of finding that negative equity is part of a purchase-money security interest, all of which derive from the Uniform Commercial Code: (1) that negative equity financing is part of the price of the vehicle; (2) that negative equity financing is value given to enable the debtor to acquire rights in the vehicle; and (3) that a close nexus exists between the acquisition of collateral and the secured obligation. The first two arguments speak to the first step, arguing that both seller- and financier-based new car purchases may include negative equity financing as part of a purchase-money security interest. Satisfying either prong permits progression to the second step. The third argument concludes that a close nexus exists between negative equity financing and the debtor’s acquisition of the collateral, i.e. the second step.

1. The First Prong: “Price”

The Chapter 13 debtor is liable for a purchase-money obligation if that obligation is “incurred as all or part of the price of the collateral.”\textsuperscript{82} Courts generally look to the categories in Comment 3 to determine whether price is sufficiently broad to encompass negative

\textsuperscript{76} U.C.C. § 9-103 cmt. 3.
\textsuperscript{77} E.g., \textit{In re Peaslee}, 547 F.3d at 185–86.
\textsuperscript{78} Id. at 185 (citation omitted).
\textsuperscript{79} Howard v. AmeriCredit Fin. Servs. \textit{(In re Howard)}, 597 F.3d 852, 857 (7th Cir. 2010).
\textsuperscript{80} Id.
\textsuperscript{81} Ford Motor Credit Corp. v. Dale \textit{(In re Dale)}, 582 F.3d 568, 574 (5th Cir. 2009); Graupner v. Nuvell Credit Corp. \textit{(In re Graupner)}, 537 F.3d 1295, 1301 (11th Cir. 2008) (emphasizing that Comment 3 includes \textit{other similar obligations}).
\textsuperscript{82} U.C.C. § 9-103(a)(2) (2011).
equity. The other similar obligations language of the Official Comments clarifies that the enumerated expenses are examples and non-exhaustive. Many of the examples listed—together with the expansive terms obligations for expenses incurred in connection with acquiring rights in the collateral and other similar obligations—indicate that the definition of price should be interpreted broadly. Furthermore, the expenses listed in Comment 3 "include certain expenses that might not otherwise come within the common understanding of 'price.'" Thus, a correct reading of Comment 3, backed by the canons of construction, demonstrates that negative equity financing can give rise to a purchase-money security interest.

The inclusion of certain expenses precludes a finding that price is limited to the vehicle's price tag. The expenses in support of this proposition are freight charges, demurrage, administrative charges, expenses of collection and enforcement, and attorney's fees. Both the Fifth Circuit and the Eleventh Circuit noted that negative equity properly falls within price because the express inclusion of attorney's fees nullifies the notion that price includes only "those . . . expenses that must be paid to drive the car off the lot." Indeed, the expenses enumerated in Comment 3 merely share one common feature: a slight connection to the acquisition or maintenance of the vehicle. Ejusdem generis "counsels that general words following an enumeration of particular or specified items should be construed to fall into the same class as those items specifically named." Thus, negative equity satisfies the definition of purchase-money security interest because it so falls within the same class of items listed in Comment 3: It is "inex-
tricably intertwined,” not merely attenuated, with the debtor’s acquisition of the vehicle.94

Other expenses listed in Comment 3—such as taxes, duties, and interest—are best characterized as transaction costs associated with buying a new car.95 Such costs are not directly related to the value of the collateral, but facilitate the debtor’s acquisition of the collateral.96 Negative equity shares this common feature; it facilitates and relates to the acquisition of the vehicle.97 *Noscitur a sociis* instructs that “[a] word is known by the company it keeps.”98 The context provided by the expenses listed in Comment 3 buttresses the conclusion that negative equity is a transaction cost incurred in connection with acquiring the vehicle.99 Neither taxes, duties, nor interest is related to the value of the new car.100 Those three categories are expenses beyond the collateral’s value. Negative equity, similar to the foregoing transaction costs, is beyond the car’s value, enables its acquisition, and thus may give rise to a purchase-money security interest.101 Yet, negative equity also shares a similarity with the enumerated expenses, such as expenses of collection and enforcement, and attorney’s fees, both of which are incurred to ensure that the creditor realizes the value of the security interest102: “[t]he discharge of negative equity clears the title of the trade-in vehicle, permitting the creditor to realize the value of the vehicle it receives as part of the trade.”103 This ensures that the creditor collects its benefit in the entire transaction.104 Thus, two contexts within the enumerated list in Comment 3 urge a finding that purchase-money security interest may include negative equity financing.

Comment 3 also provides that price includes “expenses incurred in connection with acquiring rights in the collateral,” which indeed encompasses negative equity. This category can be said to stand alone

94. See id. at 505.
96. Id.
97. *In re Dale*, 582 F.3d at 574.
99. *In re Price*, 562 F.3d at 626–27 (citation omitted).
100. Id.; Reiber v. GMAC, LLC (*In re Peaslee*), 913 N.E.2d 387, 389 (N.Y. 2009) (“[J]ust as ‘finance charges’ and ‘interest’ constitute obligations that are paid over and above the vehicle’s actual cost (such charges being incurred as part of the overall financing of the vehicle), negative equity is likewise part of the overall price of a new vehicle.”).
101. See *In re Price*, 562 F.3d at 627.
102. Ford v. Ford Motor Credit Corp. (*In re Ford*), 574 F.3d 1279, 1285 (10th Cir. 2009).
103. Id.
104. Id.
because "language like 'such as' or 'including'" is absent between this phrase and the additional, subsequent listed expenses.\textsuperscript{105} At first glance, no language in section 9-103 makes apparent any reason why the financing of negative equity could not fall under an "expense\[\] incurred in connection with acquiring rights in the collateral."\textsuperscript{106} An agreement between the buyer and the seller where the seller's refinancing of negative equity is an "integral part" of the transaction may properly fall within that category.\textsuperscript{107} To be sure, a New York district court stated that "it is in fact difficult to see how that [refinancing] could not be viewed as such an expense."\textsuperscript{108} The Fifth Circuit applied the above reasoning as well, quoting that district court.\textsuperscript{109}

The Sixth Circuit adopted reasoning similar to the New York District Court.\textsuperscript{110} Sitting in Ohio, the Sixth Circuit referred to an Ohio Supreme Court case that further recognized the "integral connection between the payoff of a trade-in vehicle's negative equity and the purchase of a new vehicle on an installment basis."\textsuperscript{111} The Ohio Supreme Court characterized this routine transaction as the "practical method of facilitating the release of an outstanding security interest in order that the trade-in allowance can be made."\textsuperscript{112} Furthermore, negative equity financing is typically included in the same contract as the car purchase and executed at the same time, evidencing negative equity financing as an expense necessary to acquire rights in the vehicle.\textsuperscript{113}

Another statutory scheme that courts read \textit{in pari materia} with Article 9 are certain states' respective vehicle sales acts.\textsuperscript{114} Compelling

\textsuperscript{105} Ford Motor Credit Corp. v. Dale (\textit{In re Dale}), 582 F.3d 568, 575 (5th Cir. 2009).
\textsuperscript{106} Id. at 575.
\textsuperscript{107} Id.
\textsuperscript{109} \textit{In re Dale}, 582 F.3d at 575.
\textsuperscript{110} Nuvell Credit Corp. v. Westfall (\textit{In re Westfall}), 599 F.3d 498, 504 (6th Cir. 2010).
\textsuperscript{111} Id.
\textsuperscript{112} Id. (quoting Johns v. Ford Motor Credit Co., 551 N.E.2d 179, 183 (Ohio 1990)) (internal quotation marks omitted). "It is a matter of common knowledge that most new car sales are accompanied by trade-ins. Inclusion of the negative equity of a trade-in is nothing more than a convenient means of accommodating a buyer who is offering a depreciated trade-in. It is, in other words, a practical method of facilitating the release of an outstanding security interest in order that the trade-in allowance can be made . . . . Here, appellees were able to purchase the specific automobiles they desired because their trade-ins were afforded more value on paper than they actually had. They received the benefits of the negotiations and the agreements." Johns, 551 N.E.2d at 183.
\textsuperscript{113} See Wells Fargo Fin. Acceptance v. Price (\textit{In re Price}), 562 F.3d 618, 626 (4th Cir. 2009).
\textsuperscript{114} See, e.g., AmeriCredit Fin. Servs., Inc. v. Penrod (\textit{In re Penrod}), 611 F.3d 1158, 1163 (9th Cir. 2010); Howard v. AmeriCredit Fin. Servs. (\textit{In re Howard}), 597 F.3d 852, 856 (7th Cir. 2010); Ford Motor Credit Co. v. Mierkowski (\textit{In re Mierkowski}), 580 F.3d 740, 743 (8th Cir. 2009); Ford
this appeal to other statutes is section 9-201, which mandates courts to look to consumer statutes for transactions governed by Article 9: "[a] transaction subject to this article is subject to any applicable rule of law which establishes a different rule for consumers."\(^{115}\) Generally, these acts define terms such as "cash sale price"\(^ {116}\) and "time sale price,"\(^ {117}\) from which courts determine that including negative equity financing as part of the price is consistent with both the Uniform Commercial Code and a state’s respective vehicle sales act.\(^ {118}\) However, this reasoning is admittedly not without issue. As Judge Posner conceded:

\[\text{[P]robably the [Illinois Motor Vehicle Retail Installment Sales Act] shouldn’t be read literally as encompassing our case. It’s a consumer-protection statute, intended to require disclosure of the charges that make up the total price that a consumer pays for the car, rather than to prescribe what is and is not included in the purchase-money security interest. But it is at least evidence that negative equity is indeed a common element of a credit purchase of a car, and this will turn out to be important to our analysis.}\(^ {119}\)

Thus, to read the vehicle sales acts \textit{in pari materia} with Article 9 nonetheless demonstrates that including negative equity financing in price is consistent with both statutes.\(^ {120}\) Ultimately, this analysis should not be dispositive of the issue, nor has it been. Other canons of construc-

\(^{115}\) U.C.C. § 9-201 (2011); In re Howard, 597 F.3d at 856.

\(^{116}\) See, e.g., Mo. ANN. STAT. § 365.020(1) (West 2011) ("[T]he price stated in a retail installment contract for which the seller would have sold to the buyer, and the buyer would have bought from the seller, the motor vehicle which is the subject matter of the retail installment contract, if the sale had been a sale for cash or at a cash price instead of a retail installment transaction at a time sale price. The cash sale price may include any taxes, registration, certificate of title, license and other fees and charges for accessories and their installment and for delivery, servicing, repairing or improving the motor vehicle.").

\(^{117}\) See, e.g., id. ("[T]he total of the cash sale price of the motor vehicle and the amount, if any, included for insurance and other benefits if a separate identified charge is made therefor and the amounts of the official fees and time price differential."). The Illinois Motor Vehicle Retail Installment Sales Act states that the amount financed includes "all other charges individually itemized, which are included in the amount financed, including the amount actually paid or to be paid by the seller pursuant to an agreement with the buyer to discharge a security interest, lien interest, or lease interest on the property traded in, but which are not a part of the finance charge, minus the amount of the buyer’s down payment in money or goods." 815 ILL. COMP. STAT. ANN. 375/2.8 (West 2011). This language perfectly describes negative equity. In re Howard, 597 F.3d at 856.

\(^{118}\) See In re Mierkowski, 580 F.3d at 743; In re Graupner, 537 F.3d at 1301.

\(^{119}\) See In re Howard, 597 F.3d at 857.

\(^{120}\) See, e.g., AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1163 (9th Cir. 2010); In re Howard, 597 F.3d at 856-57; Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177, 186 (2d Cir. 2008). \textit{But see In re Mierkowski,} 580 F.3d at 743 (finding no issue with the
tion provide additional support for including negative equity financing in price, as discussed above. Comment 3 provides support sufficient to so conclude, making any appeal to vehicle sales acts superfluous.

In sum, negative equity appropriately falls within the listed obligations in Comment 3 because those categories are sufficiently broad to encompass negative equity and because negative equity is integral to this prevalent vehicle sales practice, thereby constituting part of a purchase-money security interest under the first prong. The second step, however, must still be satisfied.

2. The Second Prong: "Value"

Negative equity financing comfortably fits within the second prong of purchase-money obligation, which is "value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." The Fourth Circuit first defined "enable" to begin its analysis. Enable means "to give power to do something" or "to make able." A creditor's financing of negative equity can be said "to make able" the acquisition of the collateral because the acquisition would not have occurred except for that financing. Furthermore, the debtor typically incurs the entire obligation in the same contract and at the same time for the sole purpose of acquiring the new vehicle. Thus, negative equity truly enables the debtor to acquire rights in the vehicle because the negative equity financing and the purchase were a "package deal." Similarly, but for the negative equity financing, the debtor could not have acquired rights in the new vehicle.

Some bankruptcy courts have argued that a distinction exists "between enabling a transaction to occur and enabling a debtor to acquire rights in new collateral . . . ." These courts claim that negative equity only enables the transaction to occur, thereby precluding negative equity as a purchase-money security interest because it does not go

\[\text{difference in purpose between the Uniform Commercial Code and the Missouri Motor Vehicle Time Sales Act).}\]

121. Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 504 (6th Cir. 2010).
124. BLACK'S LAW DICTIONARY 606 (9th ed. 2009).
125. In re Price, 562 F.3d at 625.
126. In re Westfall, 599 F.3d at 505.
127. In re Price, 562 F.3d at 625.
128. Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1285 (10th Cir. 2009) ("[D]ischarging negative equity is necessary to complete the trade-in because otherwise the dealer would take the old vehicle subject to a lien exceeding the vehicle's value.").
towards the value of the collateral itself.130 This distinction is meaningless.131 A transaction in which negative equity financing enabled the transaction to occur necessarily enables the acquisition of rights in the collateral.132 Negative equity is essential because debtors require the trade-in value to put towards the new car.133 And if that trade-in carries negative equity, it must be extinguished because creditors are generally unwilling to accept a trade-in with an outstanding lien that hinders the dealer's or financier's ability to resell the vehicle.134 Therefore, negative equity financing is a precondition to acquiring rights in the new vehicle.135

The Ninth Circuit and other bankruptcy courts have also argued that negative equity financing is an antecedent debt, precluding it from constituting value for purposes of the second prong.136 These courts further assert that the contemporaneous nature of the negative equity financing and the new car purchase does not create a purchase-money security interest because no "new value" is given.137 This characterization, however, is mistaken. The negative equity portion of the debtor's obligation to the seller or financier does not amount to a refinancing of an antecedent debt.138 The debtor owes nothing to the seller or financier that extends credit to purchase the new car prior to financing the negative equity.139 Instead, the debtor owed an obligation to an unrelated third party.140 Therefore, the seller or financier financing both the purchase of the new car and the negative equity provides all new credit to the debtor, thereby extinguishing the antecedent debt.141

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130. See, e.g., id.
131. In re Price, 562 F.3d at 625 ("From a practical perspective, that distinction is meaningless. If negative equity financing enabled the transaction in which the new car was acquired, then, in reality, the negative equity financing also enabled the acquisition of rights in the new car. And that was the case here. The trade-in itself was essential to the overall transaction because trading in the old car allowed the Prices to obtain value to put toward the new car. But the Prices could not have traded in their old car unless they also extinguished their negative equity: car dealers are generally unwilling to accept a trade-in with an outstanding lien because the lien makes it difficult for the dealer to resell the car.").
132. Id.
133. Id.
134. Id.
135. Id. at 626–27.
136. See AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1163 (9th Cir. 2010).
137. See, e.g., id. at 1162–63.
138. Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 505 (6th Cir. 2010).
139. Id.
140. Id.
141. Id.
The Ninth Circuit’s argument that a purchase-money security interest can only arise for “new value” is similarly unavailing.\(^{142}\) Utilizing the in pari materia canon—“the canon that encourages courts to construe statutes together”\(^{143}\)—the Ninth Circuit cited to § 547, which defines new value.\(^{144}\) Specifically, the court focused on a particular clause: “new value . . . does not include an obligation substituted for an existing obligation.”\(^{145}\) This same language is included in section 9-102 of the Uniform Commercial Code.\(^{146}\) The court concluded that repackaging old obligations does not constitute new value.\(^{147}\) While that seems a correct reading of new value, nowhere in section 9-103 is value qualified by new.\(^{148}\) Furthermore, Official Comment 21 to section 9-102 expressly states that new value is used with respect to “temporary perfection of security interests in instruments, certificated securities, or negotiable documents . . . and with respect to chattel paper priority . . . .”\(^{149}\) Under the canon of expressio unius est exclusio alterius—i.e. the express mention of one thing excludes all others—purchase-money security interests should be excluded from Official Comment 21.\(^{150}\) This allows a reasonable inference that new value should not be read into the definition of “purchase-money obligation” in section 9-103(a)(2), especially since no inclusionary language is used. Thus, the definition of new value is inapplicable to section 9-103(a)(2); the value supplied by the dealer or financier discharging the negative equity in the trade-in vehicle need not be characterized as new value.\(^{151}\)

Article 1, Article 3, and Article 9 of the Uniform Commercial Code provide further evidence that value may include negative equity financing, even if negative equity is more properly considered as an antecedent debt.\(^{152}\) Section 3-303(a)(3) states that a negotiable instrument is “issued or transferred for value if the instrument is is-

\(^{142}\) In re Penrod, 611 F.3d at 1162.
\(^{143}\) Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1291 (10th Cir. 2009).
\(^{144}\) 11 U.S.C. § 547(a)(2) (2006) (“‘[N]ew value’ means money or money’s worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation.”); In re Penrod, 611 F.3d at 1163-64.
\(^{145}\) 11 U.S.C. § 547(a)(2); In re Penrod, 611 F.3d at 1163-64 (emphasis omitted).
\(^{147}\) In re Penrod, 611 F.3d at 1164.
\(^{148}\) U.C.C. § 9-103.
\(^{149}\) Id. § 9-102 cmt. 21.
\(^{151}\) Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 505 (6th Cir. 2010).
\(^{152}\) However, this argument is forceful only if negative equity can be properly characterized as an antecedent debt; a characterization against which this Note argues because the new credi-
sued or transferred as payment of, or as security for, an antecedent claim against any person . . . ."153 Additionally, section 9-403 references section 3-303(a) for its definition of value.154 Thus, value need not be new and may include antecedent debts under Article 3 and Article 9's section 9-403.

The definition of value under Article 1 supports this interpretation, despite recognizing that Article 3 may provide otherwise.155 Under section 1-204(2), "a person gives value for rights if the person acquires them as security for, or in total or partial satisfaction of, a preexisting claim."156 This definition of value extends to "consideration sufficient to support a simple contract"157 and is not a demanding criterion;158 it extends to both the assumption of an antecedent debt and the granting of a security interest.159 Such an interpretation is well-aligned with a purpose and policy of the Uniform Commercial Code, which "must be liberally construed and applied to promote its underlying purposes and policies," one of which is "to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties."160 Accordingly, construing value to include either the assumption of an antecedent debt or the granting of a security interest is supported by the definitions, policies, and purposes of the Uniform Commercial Code.161

This definition of value is broad enough to include negative equity financing for purchase-money security interests under the second prong. By extinguishing the preexisting claim and acquiring a purchase-money security interest, the financier has provided value according to section 1-204. Furthermore, this value "is in fact so used"162 to acquire rights in the vehicle because the debtor could not have acquired the vehicle but for the negative equity financing. The Bankruptcy Appellate Panel for the Ninth Circuit argued otherwise, stating that no connection existed between the negative equity financier discharges the antecedent debt and provides new credit to the debtor. See infra Part III(A)(2) (discussing the improper characterization of negative equity as an antecedent debt).

153. U.C.C. § 3-303(a)(3) (emphasis added).
154. Id. § 9-403(a).
155. Id. §§ 1-204, 3-303.
156. Id. § 1-204(2).
157. Id. § 1-204(4).
159. Id.; U.C.C. § 1-204.
160. U.C.C. § 1-103(a).
161. Id.
162. Id. § 9-103(a)(2).
ing and the vehicle’s acquisition. It then argued that the missing connection here is similar to the case in which a car lender rolls the debtor’s mortgage into the amount financed as well. Admittedly, the latter situation does not possess the necessary connection because of its vastly differing circumstances. However, the Bankruptcy Appellate Panel erred in claiming that no nexus exists between negative equity financing and the debtor’s acquisition of the vehicle.

3. A Close Nexus Exists Between the Acquisition of the Collateral and the Secured Obligation

Comment 3 provides that a purchase-money security interest “requires a close nexus between the acquisition of the collateral and the secured obligation.” This requirement constitutes the second step in the two-step framework. The Eleventh Circuit described negative equity financing and the new car purchase as a “package deal.” Both parts occurred simultaneously within the same transaction, and the creditor’s paying off the trade-in’s outstanding balance was a necessary precondition to the vehicle’s purchase: the debtor could not have acquired rights in the vehicle but for the negative equity financing. Additionally, extinguishing the lien on the trade-in allows the creditor to sell it, making the sale of the new vehicle possible. Therefore, negative equity is both essential to and “inextricably intertwined” with the sales transaction, creating a close nexus between the acquisition of the collateral and the secured obligation. To conclude otherwise would “not be a fair reading of the [Uniform Commercial Code].”

The Fourth Circuit concluded likewise, but added another compelling reason for finding a close nexus. The court distinguished transactions in which the creditor’s security interest arises simultane-

163. In re Penrod, 392 B.R. at 852.
164. Id.
165. Cf. Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 627 (4th Cir. 2009) (concluding that unrelated transactions being rolled into a purchase-money security interest present “very different circumstances”).
166. See infra Part III(A)(3) (discussing whether a close nexus exists).
167. U.C.C. § 9-103 cmt. 3.
169. Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1302 (11th Cir. 2008).
170. Id.
171. Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 505 (6th Cir. 2010).
172. In re Graupner, 537 F.3d at 1302.
173. Id.
175. Id.
ously with the negative equity financing from transactions in which this process is staggered.\textsuperscript{176} The second paragraph of Comment 3 provides an exclusionary effect: a purchase-money security interest cannot arise where the debtor acquires property on unsecured credit and subsequently creates a security interest in the property to secure the purchase price.\textsuperscript{177} Negative equity financing is distinct from that staggered situation.\textsuperscript{178} Here, the creditor's security interest in the purchased car arises concurrently with its financing of the negative equity.\textsuperscript{179} Thus, the second paragraph of Comment 3 does not preclude courts from finding that a close nexus exists.\textsuperscript{180}

Debtors have put forth a hyperbolic counterargument against the finding of a close nexus.\textsuperscript{181} Debtors in the Fourth, Sixth, and Tenth Circuits argued that to find a close nexus could result in predatory lending.\textsuperscript{182} The general concern is that finding a close nexus between negative equity financing and acquiring rights in a new vehicle will require a close nexus to be found "whenever a lender bundles an otherwise unrelated transaction with the purchase of a new car."\textsuperscript{183} This situation in which a creditor turns a debtor's antecedent, unrelated debt into a purchase-money security interest is unlikely.\textsuperscript{184}

No conceivable reason is readily ascertainable for car dealers or financiers to do so.\textsuperscript{185} A creditor holding a purchase-money security interest in the debtor's antecedent credit card debt, for example, offers that creditor little benefit. The car dealer or financier's interest in the vehicle is already sufficiently protected in Chapter 13 bankruptcy; they need not worry about the debtor's unsecured debt because they will still receive the value of the entire claim under § 1325(a)(*), assuming that negative equity is part of a purchase-money security interest. And even if the creditor is successful in transforming the unsecured credit card debt into a purchase-money security interest, that creditor will have first extinguished the prior creditor's claim. The only thinkable benefit to creditors is if they manage to secure a higher interest rate from the debtor. Thus, the creditor will merely

\begin{itemize}
\item \textsuperscript{176} Id.
\item \textsuperscript{177} Id.; U.C.C. § 9-103 cmt. 3 (2011).
\item \textsuperscript{178} In re Price, 562 F.3d at 627.
\item \textsuperscript{179} Id.
\item \textsuperscript{180} Id.
\item \textsuperscript{181} Id.; In re Sanders, 377 B.R. 836, 854 (Bankr. W.D. Tex. 2007).
\item \textsuperscript{182} Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 506 (6th Cir. 2010); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1285–86 (10th Cir. 2009); In re Price, 562 F.3d at 627.
\item \textsuperscript{183} In re Price, 562 F.3d at 627.
\item \textsuperscript{184} Id.
\item \textsuperscript{185} Id.
\end{itemize}
recoup the money paid to extinguish the antecedent debt under Chapter 13 bankruptcy, perchance a few interest payments as well. Most important, though, is that this improbable procedure likely had no impact on the debtor acquiring rights in the vehicle, destroying any semblance of a close nexus. Aside from the creditor’s position, the debtor hardly has an interest in securing the debtor’s unrelated past debts, especially if folding in those debts has no bearing on the debtor’s acquisition of the vehicle. No reasonable debtor would opt to increase his or her secured obligations if Chapter 13 bankruptcy is on the horizon. Therefore, any predatory lending concern is both an unwarranted abstraction from the problem § 1325(a)(*) aims to resolve and a practice courts are well-equipped to pierce.186

B. Legislative Intent & Policy

Both Congress’s intent and the policy underlying § 1325(a)(*) entail that negative equity is indeed included as part of a purchase-money security interest under Chapter 13 bankruptcy.187 Congress appended to § 1325(a) the “hanging paragraph,” § 1325(a)(*), as part of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)188 in response to complaints from dealers and financiers.189 This amendment remedies situations in which a debtor obtained approval of a payment plan under Chapter 13 bankruptcy, allowing the debtor to keep the vehicle and to cram down the dealer’s or financier’s claim to the depreciated value of the vehicle;190 in short, the debtor walked away with a substantial discount on the vehicle under Chapter 13 bankruptcy because of the speed at which a vehicle devalues once the debtor obtains possession. The 2005 amendments to BAPCPA disarm the debtor from utilizing this abusive tactic, preventing the debtor from cramming down the entire claim to the value of the collateral.191 At issue here is whether negative equity is protected from cram down as well.

186. The Fourth, Sixth, and Tenth Circuits recognize that the close nexus requirement will preclude any absurd results, such as a rolled-in mortgage or credit card debt. See, e.g., In re Westfall, 599 F.3d at 506; In re Ford, 574 F.3d at 1285-86; In re Price, 562 F.3d at 627.

187. See infra Part III (discussing that the Uniform Commercial Code’s text supports including negative equity as part of a purchase-money security interest).


189. Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 854 (7th Cir. 2010).

190. Id. at 854–55.

191. Id.
The title of the amendment to the Bankruptcy Code demonstrates that Congress intended to provide greater protection for dealers and financiers. Section 306 of BAPCPA is entitled “Giving Secured Creditors Fair Treatment in Chapter 13.” The title of the subsection under which § 1325(a)(*) falls further discloses Congress’s intent to protect secured dealers and financiers: “Restoring the Foundation for Secured Credit.” Thus, the two titles taken together indicate an intent to protect creditors under Chapter 13, though this is not determinative as to the extent of protection afforded to these creditors.

To read § 1325(a)(*) as proposed in this Note ultimately effectuates the intent of Congress, which is “to protect secured car lenders from having their claims bifurcated in Chapter 13.” The main thrust of § 1325(a)(*) is to require debtors to fully repay the agreed amount for a vehicle purchased within 910 days prior to Chapter 13 bankruptcy, not merely the market value of the vehicle. Because § 1325(a)(*) “intended only good things for car lenders and other lienholders,” an interpretation that excluded negative equity would indeed be an absurd result. Specifically, this absurdity exists since courts have gone so far as to say that the principal purpose of § 1325(a)(*) is to secure the negative equity that occurs for any Chapter 13 debtor when the vehicle is not worth the outstanding balance on the loan, despite not being secured by collateral.

Affirming Congress’s intent to protect creditors is that it presumably knew of the substantial percentage of car finance plans that include negative equity. Nearly 40% of all new car purchases in the United States in 2005 included negative equity financing. And with car sales ranging from 6.8 to 8.1 million each year, millions of new car

192. BAPCPA § 306; see also Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 628 (4th Cir. 2009); Fla. Dept of Revenue v. Piccadilly Cafeterias, Inc., 554 U.S. 33, 47 (2008) (noting that section headings “cannot substitute for the operative text of the statute,” but are one “tool available for the resolution of a doubt about the meaning of a statute”).
193. BAPCPA § 306.
194. In re Price, 562 F.3d at 628.
195. Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1302 (11th Cir. 2008).
196. Id. at 1303.
197. See, e.g., In re Petrocci, 370 B.R. 489, 501 (Bankr. N.D.N.Y. 2007) (“The primary purpose of the hanging paragraph of Code § 1325(a)([*]) is, in fact, precisely to take the unsecured negative equity debt 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 refusing it the Code § 506 treatment, 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.”); In re Graupner, 537 F.3d at 1203 (citation omitted).
198. In re Price, 562 F.3d at 628.
199. Danny Hakim, supra note 10; Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1284 (10th Cir. 2009).
transactions hinge on determining the scope of § 1325(a)(*) during the twelve-month period ending March 31, 2011, there were 438,788 Chapter 13 filings.200 Reading this section otherwise would vitiate Congress’s intent to protect a significant percentage of creditors in the instance of negative equity financing;201 it “would have the effect of excluding a substantial number of lawful auto finance transactions that were industry practice when BAPCPA was enacted . . . .”202 Congress certainly did not intend to weaken the propriety of millions of new car transactions. No car dealer would extend credit to pay off the debtor’s outstanding balance on his or her old car unless a purchase-money security interest would be created for the total amount financed.203 Any practice to the contrary would be detrimental to the business of car sellers or financiers, particularly because negative equity financing may represent a large proportion of the entire transaction.204 Besides, the outstanding balance on the old car was secured.205 Debtors would receive an unwarranted windfall if that once-secured debt became unsecured simply by rolling that debt into a new car purchase.206 In all likelihood, neither the loan for the old car nor the loan for the new car would have been made without the creditor retaining a secured interest for the entire amount, including the negative equity portion.207 Congress was well aware of these considerations, as well as the numerous transactions that would be affected, and surely intended § 1325(a)(*) to encompass negative equity financing.208

Essential to this result are the consequences flowing to other creditors of the debtor.209 Purchase-money security interests “enjoy ‘super-priority’ over other types of security interests and liens.”210 Thus, the general rule, “first in time, first in right,” does not apply to

201. In re Price, 562 F.3d at 628.
202. In re Graupner, 537 F.3d at 1303.
203. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 636 F.3d 1175, 1176 (9th Cir. 2011) (Bea, J., dissenting).
204. Id. at 1177.
205. Id.
206. Id.
207. Id.
208. In re Penrod, 636 F.3d at 1177.
209. Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 857 (7th Cir. 2010).
210. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1161 (9th Cir. 2010). See generally Gilmore, supra note 47 (discussing Article 9 of the Uniform Commercial Code’s triumph in holding superior purchase-money security interests over after-acquired property interests).
seller- or financier-based purchase-money security interests. The concern behind this general rule is that “new extensions of credit increase the risk of default on the old.” However, the purchase-money security interest minimizes the risk to first-in-time secured parties both because it applies only to newly purchased property and because the debt secured by this interest is “partially offset by the value of the property bought with it.” This reasoning similarly applies to unsecured creditors. The unsecured creditor faces a lesser degree of harm as well because the value of the collateral partially offsets the debt for which the secured creditor has a purchase-money security interest. This situation is distinct from that where a debtor grants a security interest in already acquired property to a previously unsecured creditor. Under these circumstances, the creditor is precluded from obtaining a purchase-money security interest that would otherwise prejudice first-in-time creditors. Accordingly, purchase-money security interests need not exclude negative equity financing—a practice that “may be essential to the flourishing of the important market that consists of the sale of cars on credit”—to protect creditors since such interests are limited to newly acquired property and marginally affect prior creditors.

IV. COLLATERAL ISSUES

A. The Pseudo Circuit Split

In determining itself the outlier, the Ninth Circuit stated that “[w]e decline to adopt the reasoning of our sister circuits. We acknowledge that our decision creates a circuit split, and we do not do this lightly.” However, the Ninth Circuit seems to have overlooked what it later stated in its opinion: “[i]n bankruptcy, property interests are usually defined by state law.” Thus, the circuit split the Ninth

211. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 392 B.R. 835, 845 (B.A.P. 9th Cir. 2008) (“This exception has generally been justified on equitable notions: it protects vendors of goods from after-acquired property clauses generally used by banks and other financiers.”).
212. In re Howard, 597 F.3d at 857.
213. Id.
214. Id.
215. Id.
216. Id.
218. In re Howard, 597 F.3d at 858 (reasoning that Article 9 neither precludes this result nor seeks to discourage credit transactions).
219. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158, 1161 (9th Cir. 2010).
220. Id.
Circuit admittedly created is a split only insofar as federal courts interpret differently the laws of the states.

Further exposing the absurdity of this situation is the split among certain district courts within the Ninth Circuit’s territory. Currently, Arizona district courts hold that negative equity financing is part of a purchase-money security interest, preventing debtors from cramming down a creditor’s claim to the value of the collateral under § 1325(a)(+), whereas Oregon, Washington, and California federal courts have held otherwise. This difference in treatment has created a two-tiered split: a split between the circuit courts and a split between district courts under a single circuit, e.g. the Ninth Circuit. The two-tiered split is particularly troublesome because district courts deciding under state law different from its circuit court may feel constrained, even though they are appealing to a distinct, separate body of law from which the definitions of property interests are derived. On one hand, the majority of circuit courts consider negative equity financing as part of a purchase-money security interest; but on the other hand, a district court under the Ninth Circuit, for instance, may feel inclined to align itself to its appellate court, despite ruling under a differently body of law; although, the statutes are admittedly the same between the states.

The Second Circuit probably approached this issue best. Instead of relying on its own interpretation of New York law, the court certified question to the New York Court of Appeals: “[w]e believe that these questions—which are exquisitely state law issues, despite their relevance to our interpretation of the Bankruptcy Code—are best considered by New York’s highest court. We therefore offer the New York Court of Appeals the opportunity to guide us, should it opt to do so . . . .” No other federal circuit court has approached this issue by certifying question to the controlling state’s highest court, regardless of the intimate connection to state law. Though this method could have disposed of this issue with much less confusion, the majority of circuit courts nevertheless reached the right result and held negative equity as part of a purchase-money security interest.


223. Reiber v. GMAC, LLC (In re Peaslee), 547 F.3d 177, 186 (2d Cir. 2008) (emphasis added).
B. Congressional Action Not Needed

Congress need not clarify its intent as to the status of negative equity under § 1325(a)(*). At least one commentator has suggested its involvement in the wake of the General Motors bailout and the recession.\textsuperscript{224} However, complete consistency in bankruptcy cannot be attained, simply because property interests are issues of state law.\textsuperscript{225} Section 1325(a)(*) thus makes clear that a creditor having a purchase-money security interest will be made whole under Chapter 13 bankruptcy for the entire amount, leaving room for the states to determine the scope of purchase-money security interest.\textsuperscript{226} State legislatures displeased with the results reached by the federal courts, or with the highest court in New York’s case, are free to explicitly define the scope of a purchase-money security interest for purposes of § 1325(a)(*).

Even if Congress decides to define purchase-money security interest under the Bankruptcy Code, car sellers and financiers are free to adjust interest rates to account for any change in risk. Creditors in debtor-friendly jurisdictions, such as California, may either increase the individual debtor’s interest rate or marginally increase the interest rate for all debtors to account for the risk that any negative equity financed will not retain its status as a purchase-money security interest in Chapter 13 bankruptcy. If Congress subsequently decides to require uniform adoption of the majority approach, i.e. including negative equity financing as part of a purchase-money security interest, the interest rates to debtors will likely decrease because of the decreased risk to creditors when the debtor files for Chapter 13 bankruptcy. Conversely, creditor-friendly jurisdictions likely provide lower interest rates to new car purchasers because creditors will recover the entire amount from a debtor filing Chapter 13 bankruptcy; and any change to the contrary will have the effect of increasing interest rates for buyers, reflecting the increased risk posed to car dealers or financiers. Though many other factors play into setting interest rates, this issue certainly has significant impact because negative equity may amount to approximately a quarter of the total amount financed.\textsuperscript{227}

Thus, the scope of security interests has loss-allocating implications. The majority rule places accountability on debtors because they will be responsible for the entire amount under Chapter 13 and thus deter

\textsuperscript{224} Collins, \textit{supra} note 16, at 188–89.
\textsuperscript{225} Butner v. United States, 440 U.S. 48, 55 (1979) (citation omitted); \textit{In re Peaslee}, 547 F.3d at 186.
\textsuperscript{227} \textit{See infra} Part II(C) (discussing the portion of negative equity in new car purchases).
irresponsible borrowing. Under the minority rule, however, creditors may increase interest rates on a debtor-to-debtor basis or distribute risk among all debtors by marginally increasing interest rates, but may also be subject to the abuse this rule allows under § 506, i.e. allowing the debtor to pay for the depreciated value of the car.

Because state law typically defines property interests, the individual states should determine this instance of loss allocation; a position recognized by the Supreme Court when it denied certiorari. This is especially so because creditors will likely account for any change in risk posed by a change in the scope of property interests. Again, Congress should not feel compelled to act to resolve this pseudo split; the resulting loss allocation implications are merely derivative of a state’s defined property interests—an issue “exquisitely” belonging to the states.

V. Conclusion

This Note argued that negative equity financing is indeed protected from bifurcation under § 1325(a)(*) principally because a liberal reading of the Uniform Commercial Code—as it suggests it should be read—urges a finding that purchase-money security interest may include such financing. The two-step framework outlined in Part III and derived from judicial reasoning offers a sound method for resolving this issue. What this framework discloses is that both car sellers and third party financiers may include negative equity financing as part of a purchase-money security interest, provided that a close nexus exists between the new car transaction and the negative equity financing. A close nexus exists under the circumstances in which this Note’s issue arises because the new vehicle transaction could not occur except for the negative equity financing. Accordingly, the two-step framework is satisfied and thus precludes classifying negative equity financing as a nonpurchase-money security interest.

While reasoned solely through a textual analysis, the result of the two-step framework comports with policies underlying BAPCPA and the Uniform Commercial Code. New car transactions wherein the creditor pays off the balance on the debtor’s old car represent a substantial portion of car transactions in the United States, and negative equity financing allows these otherwise unrealizable deals to be made. An undue windfall would flow to debtors filing for Chapter 13 bank-

228. Butner, 440 U.S. at 55.
230. In re Peaslee, 547 F.3d at 186.
ruptcy if rolled-in negative equity, which prior to the acquisition of the new car would be protected under § 1325(a)(*), is stripped from the purchase–money security interest. BAPCPA aims to prevent bankruptcy abuse, and to hold negative equity financing as a nonpurchase–money security interest would cut against that express policy. Thus, the consequences of and the policies for negative equity financing, as well as the text from which purchase–money security interest is defined, soundly demonstrate that negative equity financing under § 1325(a)(*) retains its status as a purchase–money security interest.