

**RELATED
AREAS OF PRACTICE**

Banking and Creditors Rights

SACRAMENTO

400 Capitol Mall, 27th Floor
Sacramento, CA 95814
Tel: 916.321.4500

BAKERSFIELD

5080 California Ave., Suite 250
Bakersfield, CA 93309
Tel: 661.864.3800

SAN LUIS OBISPO

1432 Higuera Street
San Luis Obispo, CA 93401
Tel: 805.786.4302

WALNUT CREEK

1350 Treat Boulevard, Suite 105
Walnut Creek, CA 94597
Tel: 925.395.2380

WWW.KMTG.COM

Legal Alerts are published by Kronick Moskowitz Tiedemann & Girard as a timely reporting service to alert clients and other friends of recent changes in case law, opinions or codes. This alert does not represent the legal opinion of the firm or any member of the firm on the issues described, and the information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney with whom you normally consult.

A CHAPTER 13 DEBTOR MAY BIFURCATE A NEGATIVE EQUITY MOTOR VEHICLE LOAN IN A CHAPTER 13 PLAN

In re Penrod, (9th Cir., July 16, 2010)

Recent studies show that over one third of all motor vehicles purchased in the United States are purchased with negative equity loans. Negative equity loans are loans that include loan funds to purchase a motor vehicle, including purchase price, taxes, and license, plus loan funds to pay the unpaid balance of a loan on the purchaser's trade-in vehicle (the negative equity) after deducting its trade in value. In *Penrod*, the Ninth Circuit Court of Appeals broke ranks with eight other Circuit Courts and held that the negative equity component of a negative equity motor vehicle loan is not purchase money. The practical effect of the holding is to permit chapter 13 debtors to bifurcate a negative equity motor vehicle loan into a purchase money secured claim for the purchase price component and a nonpurchase money claim for the negative equity component of the loan, then to strip off the lien of the nonpurchase money component (to the extent it is not secured by equity in the motor vehicle) and to treat it as an unsecured claim in a chapter 13 plan.

Facts

When the debtor purchased a 2005 Ford Taurus, the debtor traded in her 1999 Ford Explorer and financed the purchase through a Ford dealership. The purchase price of the Taurus was approximately \$25,600, including tax and license. The dealership allowed the debtor a \$6,000 trade in credit for her Explorer, leaving an unpaid balance of \$7,000 on her Explorer loan, which the Ford dealership paid. The dealership rolled the \$7,000 balance of the Explorer loan into the \$25,600 purchase price for the Taurus, and, after the debtor made a \$1,000 down payment, made a negative equity loan of \$31,700 to the debtor, with interest accruing at the rate of twenty percent. The Ford dealership assigned this loan to the lender. The debtor filed a chapter 13 bankruptcy petition 523 days later and proposed in her chapter 13

plan to bifurcate the negative equity Taurus loan into a secured claim for the purchase price of the Taurus and an unsecured claim for the negative equity component. The lender objected to plan confirmation contending that the entire negative equity loan was purchase money and could not be bifurcated pursuant to section 1325(a) of the Bankruptcy Code. The bankruptcy court confirmed the plan over the lender's objection.

Discussion

As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Section 1325 (a) of the Bankruptcy Code was amended to prevent bifurcation of a motor vehicle loan made within 910 days of the filing of a bankruptcy petition to the extent the lender has a purchase money security interest in the motor vehicle. The issue before the Ninth Circuit in *Penrod* was whether the negative equity component of the debtor's motor vehicle loan was purchase money. Looking to both California law under the California Commercial Code and the California Automobile Sales Finance Act and the Bankruptcy Code for authority, the Ninth Circuit held that the negative equity component of a negative equity loan is not part of the purchase price of the motor vehicle and a creditor does not have a purchase money security interest in the negative equity of a vehicle traded in during a new vehicle purchase. Since this decision creates a split of authority amongst the Circuit Courts, it is likely that this issue will be decided by the United States Supreme Court.

Questions

If you have any questions concerning the content of this Legal Alert, please contact the following from our office, or the attorney with whom you normally consult.

Bruce A. Scheidt, Hayne R. Moyer, Candice L. Fields or Bruce A. Emard | 916.321.4500