

**DEFINING “PURCHASE-MONEY SECURITY INTEREST”
AS USED IN THE HANGING PARAGRAPH OF THE
BANKRUPTCY CODE: *FORD MOTOR CREDIT CO. V. DALE*
(*IN RE DALE*), NO. 08-20583, 2009 WL 2857998 (5TH CIR.
SEPT. 8, 2009)**

Highlight

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Rebecca Ann Dale (Appellant) purchased a shiny 2006 Ford F150 pick-up truck from Gullo Ford Mercury of Conroe, Texas.¹ In exchange for her “built Ford tough” F150, Appellant traded in her old vehicle with a negative equity of \$4,760, which Ford paid off and included in the new vehicle’s total sale price.² Among other miscellaneous items, “the total sale price also included a gap insurance premium . . . and an extended warranty charge.”³ Ford financed the entire sale price of \$48,271.02 at 0% interest.⁴

Unfortunately for Appellant, she filed for bankruptcy less than one year later.⁵ Under her Chapter 13 plan, Appellant sought to bifurcate Ford’s claim between secured and unsecured portions.⁶ Ford Motor Credit Company, LLC (Appellee) objected to the Appellant’s Chapter 13 plan, claiming that the 2006 Ford F150 secured the entire balance.⁷ The bankruptcy court held that Appellee’s “purchase-money security interest” did not include “the pay-off of negative equity, the gap insurance premium, and the extended warranty charge.”⁸ On appeal, the district court reversed the bankruptcy court, holding that Appellee’s purchase-money security interest did in fact include the entire debt.⁹

The issue before the Fifth Circuit was whether Appellee’s purchase-money security interest includes the “portion of the debt

¹ Ford Motor Credit Co. v. Dale (*In re Dale*), No. 08-20583, 2009 WL 2857998 at *1 (5th Cir. Sept. 8, 2009).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.*

attributable to negative equity, gap insurance, and the extended warranty.”¹⁰

The general rule allows a Chapter 13 debtor to “modify the rights of a secured creditor with a purchase-money security interest in a vehicle by bifurcating the claim into secured and unsecured portions based on the vehicle’s then-market value.”¹¹ Congress, however, enacted the “hanging paragraph” in 11 U.S.C. § 1325(a) as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).¹² “The hanging paragraph is an exception to this general rule, preventing bifurcation of a claim when the creditor has a ‘purchase-money security interest’ (securing the claimed debt) in a motor vehicle acquired for the debtor’s personal use within 910 days of the debtor’s bankruptcy filing.”¹³ Here, there was no dispute that the debt was incurred within 910 days of filing for bankruptcy, the debt was secured by a motor vehicle, and Appellant acquired the vehicle for her person use.¹⁴ The only question for the court to consider was the meaning of purchase-money security interest.¹⁵

The Fifth Circuit recognized that purchase-money security interest was a term of art with no ordinary meaning and not defined by the bankruptcy code.¹⁶ The court then examined the meaning of the term under state law.¹⁷ Section 9.103 of the Texas Business and Commerce Code provided the following definitions:

In Texas, a “purchase-money security interest” in goods is defined as a security interest in goods that are “purchase-money collateral,” and “purchase-money collateral” is in turn defined as goods that secure a “purchase-money obligation.” . . . [P]urchase money obligation” [is defined] as “an obligation incurred as all or part of the price of the collateral or for

¹⁰ *Id.* at *3.

¹¹ *Id.* at *2.

¹² *In re Dale*, 2009 WL 2857998 at *1.

¹³ *Id.*

¹⁴ *Id.* at *3.

¹⁵ *Id.* The Fifth Circuit noted that, while bankruptcy courts across the country had failed to agree, the emerging majority position held that “the hanging paragraph prevents bifurcation of vehicle loans, including those portions attributable to negative equity pay off.” *Id.* at *2.

¹⁶ *Id.* at *3.

¹⁷ *Id.* “It is common in the bankruptcy context to look to state law to define security interests created under state law.” *Id.* Both parties agreed Texas law was the relevant law in this case. *See id.*

value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.”¹⁸

The Fifth Circuit looked to Official Comment 3 to the Texas Business and Commerce Code to further explain what was included in “price” and “value given.”¹⁹

As used in subsection (a)(2), the definition of “purchase-money obligation,” the “price” of collateral or the “value given to enable” includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney’s fees, and other similar obligations.²⁰

The Fifth Circuit noted that this inclusive explanation of price and value given was not exhaustive.²¹ The listed items all related to the acquisition or maintenance of the vehicle, as was the Appellant’s debt.²² Also, negative equity financing, gap insurance, and extended warranties are properly considered “obligations for expenses incurred in connection with acquiring rights in the collateral.”²³ Finally, the term value given clearly includes negative equity financing, because “discharge of the amount owed on the old vehicle” constituted value to Appellant.²⁴

Thus, under Texas law, “purchase-money obligations” include negative equity, gap insurance, and extended warranties.²⁵ “Appellee had a ‘purchase-money security interest’ in the debt associated with those items. The Code’s hanging paragraph operates to prevent bifurcation of this debt.”²⁶ This interpretation of purchase-money security interest allows the addition of the hanging paragraph to the

¹⁸ *Id.*

¹⁹ *Id.* at *4.

²⁰ *Id.* at *3.

²¹ *Id.* at *4.

²² *Id.* at *5.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at *6.

²⁶ *Id.*

bankruptcy code to greatly alter the respective rights of creditors and debtors. This is particularly significant for car dealers because new cars greatly decrease in value as soon as they leave the dealership. Car dealers, previously limited to the present value of the collateral, may rest easier knowing that the hanging paragraph, at least in the Fifth Circuit, will prevent bifurcation of their claims.²⁷

²⁷ *Id.* at *2.