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CARS IN CHAPTER 13: DOES NEGATIVE EQUITY DESTROY THE JURISDICTION OF THE HANGING PARAGRAPH?

DAVID GRAY CARLSON*

INTRODUCTION

The Bankruptcy Code's notorious "hanging paragraph" gives purchase money car lenders a preference in chapter 13 cases. Whether the hanging paragraph applies to a security interest on a car is not a foregone conclusion. But if it does apply, in a cram down, the car must be deemed worth what the purchase money debt is. Yet over one-third of all car loans involve "negative equity" with respect to a trade-in. Negative equity refers to the unpaid loan on an old car "traded in" when the buyer purchases a new car. The new lender often pays off the old loan and adds the deficit (the "negative equity") to the purchase money obligation of the buyer with regard to the new car. When negative equity is present, the new car secures a purchase money obligation and also a loan that arguably did not enable the acquisition of the new car. Access to the hanging paragraph requires that the

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1 According to this provision:

"For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing." 11 U.S.C. § 1325(a) (2006).

49 U.S.C. § 30102 defines "motor vehicle" as "a vehicle driven or drawn by mechanical power and manufactured primarily for use on public streets, roads, and highways, but does not include a vehicle operated only on a rail line." Id. at § 30102(a)(6). This definition makes clear that private railway cars continue to be subject to bifurcation in chapter 13. Id. The above-quoted provision has been called "the hanging paragraph," AmeriCredit Fin. Servs. v. Tompkins, 604 F.3d 753, 756 (2d Cir. 2010), the "dangling paragraph," KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY, § 446.1, § 451.1 (Bankruptcy Press, Inc., 3d ed. 2000 & Supp. 2007-1), the "910-paragraph," In re DeSardi, 340 B.R. 790, 811 (Bankr. S.D. Tex. 2006), and § 1325(a)(*), AmeriCredit Fin. Servs. v. Penrod (In re Penrod), 636 F.3d 1175, 1178 (9th Cir. 2011); In re Murray, 346 B.R. 237, 238 n.1 (Bankr. M.D. Ga. 2006) ("[F]or ease of identification, the hanging paragraph of § 1325(a) will be referred to as '§ 1325(a)(*).')." Obtuse and ungrammatical, the hanging paragraph leads the league in generating direct appeals from the bankruptcy court to the court of appeals. Laura B. Bartell, The Appeal of Direct Appeal--Use of the New 28 U.S.C. § 158(d)(2), 84 AM. BANKR. L.J. 145, 176 (2010).

2 See Monica Griffth Braud, Note, The Car Crunch: Did the "Hanging Paragraph" in BAPCPA Completely Eliminate the "Cram Down" Option for Many Chapter 13 Debtors?, 36 S.U. L. REV. 361, 363 (2009) (discussing effect of hanging paragraph on cram down advantage and stating that in order for hanging paragraph to apply, creditor must have purchase-money security interest securing debt which is subject of particular claim).

3 Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 857 (7th Cir. 2010) ("[I]n almost 40 percent of all car sales the consideration includes a trade-in with negative equity . . . ."). For a description of car financing, see Juliet M. Moringiello, (Mis)use of State Law in Bankruptcy: The Hanging Paragraph Story, 2012 WIS. L. REV. _____ (forthcoming 2012) (stating that "[a] lender extends negative equity financing when a car buyer offers a trade-in vehicle that is encumbered by a security interest securing a debt that exceeds the value of the vehicle").
collateral be purchase money collateral. Does the presence of negative equity in the car loan dissipate the hanging paragraph? If so, the hanging paragraph is one-third defeated.

Let me give a stock example, which I will use throughout my discussion. Imagine that the debtor has a beat-up car worth $2,000, but he owes $5,000 on it to a purchase money lender. The debtor decides to buy a new car. The debtor approaches a new dealer, who extends $9,000 in purchase money credit on the new car. He also takes the old car as a trade-in and so credits $2,000 toward the purchase price. This trade-in, though, is encumbered by the purchase money security interest owned by the first lender. The dealer advances $5,000 to the old lender to exonerate the security interest. He then adds $3,000 of negative equity to the $9,000 obligation, so that the debtor owes $12,000. The debtor's total obligation now consists of $9,000 in purchase money credit and $3,000 in negative equity on the old trade-in.

The preferential promise of the hanging paragraph is limited to purchase money lenders. But when negative equity is present, do we still have a purchase money security interest?

The circuits are now split on whether the hanging paragraph applies in light of negative equity. Nine circuits insist that the $3,000 negative equity portion is somehow still a purchase money obligation, even though this $3,000 refinances a loan for the price of the trade-in that the debtor no longer owns. The Ninth Circuit, however, has dissented in AmeriCredit Financial Services v. Penrod (In re Penrod). The Penrod court found that the negative equity was not a purchase money obligation and remanded for further proceedings on what (if anything) the car lender deserved under the hanging paragraph.

Other commentators have thoroughly analyzed whether negative equity is a purchase money obligation within the meaning of the UCC (on the assumption that the UCC provides the answer to what a federal statute means).

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4 See In re Ellegood, 362 B.R. 696, 704 (Bankr. E.D. Va. 2007) (stating that "a creditor must possess a purchase money security interest in collateral to be excluded from the application of Section 506").

5 See Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 500 (6th Cir. 2010) (holding that negative equity financing constitutes purchase money obligation under Uniform Commercial Code); In re Howard, 597 F.3d at 855 (noting that Uniform Commercial Code does not mention negative equity); Reiber v. GMAC, LLC (In re Peaslee), 585 F.3d 53, 57 (2d Cir. 2009) (holding negative equity is purchase money obligation in New York); Ford Motor Credit Corp. v. Dale (In re Dale), 582 F.3d 568, 575 (5th Cir. 2009) (holding negative equity constitutes purchase money obligation under Texas law); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1285 (10th Cir. 2009) (stating "entire debt incurred by the debtors is therefore a 'purchase money obligation'"); Wells Fargo Fin. Acceptance Co. v. Price (In re Price), 562 F.3d 618, 626 (4th Cir. 2009) (stating that "negative equity financing of an automobile gives rise to a purchase money security interest"); Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1300–01 (11th Cir. 2008) (holding negative equity is properly regarded as encompassed under creditor's purchase money security interest).


7 Id. at 1164.

8 See Dienna Ching, Does Negative Equity Negate the Hanging Paragraph?, 16 AM. BANKR. INST. L. REV. 463, 463–64 (2008) (introducing debate over whether negative equity is purchase money security interest and discussing courts' reliance on UCC for guidance in resolving debate); Rachel M. Helmers,
to add to this analysis, although I will rehearse the basics in the name of completeness. All of these studies focus on the debt side of the equation: given the concept of purchase money obligation, does negative equity fit within that category? Basically, the academic studies and the Ninth Circuit say no. All other circuit courts except the Ninth Circuit say yes (though sometimes over dissenting opinions). Both sides in this debate take positions on whether negative equity is "like" or "unlike" paradigmatic purchase money obligations. As philosophy teaches, criteria of like-unlike are strictly subjective in nature, which is to say that the choice on the debt side of the question is purely legislative. Being legislative, there cannot be a right or wrong answer—only force of will.

It would do well if there was an objective answer to that question, and I hope to provide one in this Article by making a different point, not on the debt side of the equation, but on the asset side. Whether or not negative equity is part of the purchase money obligation on the debt side, courts and commentators have overlooked the fact that the new car is proceeds of the old car. With regard to the new car, the old lender has a proceeds security interest on the new car. The dealer who extended negative equity refinancing credit to the debtor is subrogated to the rights of the first lender, who (we shall reasonably assume) had a purchase money

Another Thorn in the "Semantic Briar Patch" of the Hanging Paragraph: Is Negative Equity a Purchase Money Security Interest?, 93 MARQ. L. REV. 1217, 1254 (2010) (arguing that until Congress explicitly includes negative equity under purchase money security interest, federal courts are left to apply term from UCC); Moringiello, supra note 3, at 18 (discussing use of UCC to define purchase money security interest).

9 See Ching, supra note 8, at 467 ("Negative equity financing is the process by which the consumer obtains a new loan to satisfy the antecedent debt still owed on the vehicle ... ."); Helmers, supra note 8, at 1219 (discussing negative equity as being form of antecedent debt); Moringiello, supra note 3, at 8 (explaining how lender extends negative equity financing when buyer trades in old vehicle under security interest that is securing debt that is greater than value of that vehicle).

10 See AmeriCredit Fin. Servs. v. Penrod (In re Penrod), 611 F.3d 1158, 1164 (holding "creditor does not have a purchase money security interest in the 'negative equity' of a traded in vehicle"); Ching, supra note 8, at 465 (arguing that negative equity is not purchase money security interest).

11 Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279, 1289 (10th Cir. 2009) (Tymkovich, J., dissenting) (claiming negative equity is not a transactional cost, but "a transfer of money for value").


13 G.W.F. HEGEL, HEGEL'S SCIENCE OF LOGIC 419–20 (A.V. Miller trans., 1969) ("Whether or not something is like something else does not concern either the one or the other; each of them is only self-referred, is in and for itself what it is; identity or non-identity, as likeness or unlikeness, is the verdict of a third party distinct from the two things.").

14 In re Knepper, 405 B.R. 568, 569 (Bankr. W.D. Pa. 2009) ("The negative equity is included as part of the Lender's purchase money security interest.").

15 Id. (stating when negative equity on trade-in is used to finance new car, resulting security interest constitutes purchase money security interest).

16 Equitable subrogation has been defined as follows:

(1) Payment must have been made by the subrogee to protect his own interest. (2) The subrogee must not have acted as a volunteer. (3) The debt paid must be one for which the subrogee was not primarily liable. (4) The entire debt must have been paid. (5) Subrogation must not work any injustice to the rights of others.
security interest on the old car. Therefore the dealer has, on the one hand, an undisputed $9,000 purchase money security interest on the new car, plus a $3,000 proceeds security interest on the new car. Under the UCC, the proceeds security interest inherits the priority attributes of the purchase money security interest on the trade-in. So the proceeds security interest for $3,000 is, by inheritance, a purchase money security interest in the new car. On this basis, we can confirm that the academicians and the Ninth Circuit have it wrong, for a change. The majority of the circuits have it right, albeit on subjective grounds, not for the objective reason I have just described.

I should confess that this argument is based on the following logical move. A purchase money security interest has a priority over competing after-acquired property liens. The security interest on the proceeds of purchase money collateral has that same priority. The controversial move is to render symmetric the relationship between superpriority and purchase money status. Under this move, any proceeds security interest that has the priority of a purchase money security interest is a purchase money security interest. On this view, the proceeds of purchase money collateral remains purchase money collateral. In the chain of proceeds, purchase money status is inherited in each generation of proceeds. If this premise is accepted, then the majority of appellate courts are vindicated in ruling that negative equity does not compromise the jurisdiction of the hanging paragraph.

This article proceeds according to the following plan. First, I discuss the hanging paragraph and how it increases the entitlements of car lenders in chapter 13 cases. Second, I briefly describe the definition of "purchase money obligation," on which the jurisdiction of the hanging paragraph depends. I will survey how the two sides in our debate argue that negative equity is "like" or "not like" paradigmatic

Simon v. United States, 756 F.2d 696, 699 (9th Cir. 1985).


See In re Diaconx Corp., 79 B.R. 602, 604 (Bankr. E.D. Pa. 1987) (stating UCC § 9-312 provides exception to rule that security interests in same property have priority in order in which they were perfected).

See In re Williams, 82 B.R. 430, 434 (Bankr. N.D. Miss. 1988) ("The Court recognizes that when proceeds of a sale initiated by a secured creditor are not sufficient to satisfy in full the lien of the priority secured creditor, that priority creditor retains the entire sum realized as a result of the sale.").

See Kunkel v. Sprague Nat'l Bank, 128 F.3d 636, 644 (8th Cir. 1997) (discussing superpriority interest of purchase money security interest).

See In re Smith, 401 B.R. 343, 347-48 (Bankr. S.D. Ill. 2008) (indicating Bankruptcy Code does not define "purchase money security interest" and Illinois has defined the term as incorporating security interests in goods to extent that goods are purchase-money collateral with respect to that security interest).

Marathon Petroleum Co. v. Cohen (In re Delco Oil, Inc.), 599 F.3d 1255, 1258 (11th Cir. 2010) (indicating Bankruptcy Code defines proceeds of collateral as cash collateral).

See In re McAllister, 267 B.R. 614, 620-21 (Bankr. N.D. Iowa 2001) (explaining "dual status" doctrine for security interests, adopted by a number of courts, supplies that a "purchase-money security interest does not lose its status as such, even if: (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation; (2) collateral that is not purchase-money collateral also secures the purchase-money obligation; or (3) the purchase-money obligation has been renewed, refinanced, consolidated, or restructured").
purchase money obligations. Finally, I will discuss the nature of the proceeds security interest that the car lender has in a new car (because the old car has been traded for it). The proceeds security interest has the purchase money priority, and on this basis I argue that the two security interests the car lender has are both purchase money security interests—one, through subrogation, a proceeds security interest, and the other, by direct grant.

I. THE HANGING PARAGRAPH

The negative equity in a car loan is an issue uniquely limited to chapter 13 cases. In chapter 13, debtors are generally invited to bifurcate undersecured claims in two. This is done pursuant to Bankruptcy Code section 506(a)(1):

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 . . . .

As a result of bifurcation under section 506(a)(1), the undersecured creditor has two claims. One is a perfectly secured claim and the other a perfectly unsecured claim. The secured claim may be paid over time, but the present value of the payment must equal the value of the collateral. This treatment is known by the unpleasant name of "cram down." The second claim is perfectly unsecured and may be differently treated.

In general, car lenders slept through the enactment of the Bankruptcy Code in 1978, unaware of or insouciant toward its radical impact on American middle class living. In contrast, the home lending industry vividly saw that cram down was a major impediment to collecting on a defaulted mortgage. It therefore insisted that the home mortgage be removed from the cram down table. This was achieved in

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26 In re Weinstein, 227 B.R. 284, 291–92 (B.A.P. 9th Cir. 1998) (indicating where undersecured creditor’s claim is bifurcated, one claim is secured equal to amount of collateral and other is unsecured claim equal to remainder of obligation).
27 See 11 U.S.C. § 1325(a)(5)(B)(ii) (stating value of property to be distributed under plan on account of claim cannot be less than allowed amount of such claim).
28 Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 501 (6th Cir. 2010) (discussing "cram down").
29 Id. (implying Bankruptcy Code was amended to prevent cram down of certain secured creditor obligations).
30 See In re Young, 199 B.R. 643, 651 (Bankr. E.D. Tenn. 1996) (suggesting that cram downs of undersecured mortgages are permissible).
31 See Grubbs v. Houston First Am. Sav. Ass’n, 730 F.2d 236, 246 (5th Cir. 1984) (noting statutory
section 1322(b)(2). According to this provision, debtors are invited to modify secured claims, but not "a security interest in real property that is the debtor's principal residence," the last payment of which extends beyond the maximum time period permitted in a chapter 13 plan. Even so, prior to 1993, many courts managed to rule that underwater home mortgages might be bifurcated, and, so long as the secured portion was paid out according to the old mortgage agreement, the home mortgage was not being modified within the meaning of section 1322(b)(2). The Supreme Court put an end to this dodge in the important case of Nobelman v. American Savings Bank. Since then, things have been looking up for mortgage lenders, at least in chapter 13 cases.

In the long gestation period leading up to the enactment of BAPCPA, car lenders saw no reason why they should not have the same privilege that home lenders had. But oddly, Congress did not amend section 1322(b)(2) to add car loans to the home mortgage exception. Such a move would have been conceptually simple. But BAPCPA was not about elegance or simplicity. Accordingly, Congress appended a postamble or "hanging paragraph" to section 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 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 exception was created because of special needs of home-mortgage lenders).
during the 1-year period preceding that filing.\footnote{11 U.S.C. § 1325(a).} Oddly, this provision does not say that cram down, allowed in section 1325(a)(5), is forbidden as to car loans. Rather, it says that, in applying cram down, "section 506 does not apply."\footnote{Id.}

Basically, a consensus has emerged about the meaning of the hanging paragraph. According to this consensus, the value of the car is deemed to be the amount of the car debt.\footnote{See Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 501 (6th Cir. 2010) (construing hanging paragraph to protect purchase money security interest on vehicles).} For example, take our $2,000 car securing a debt of $5,000. Suppose instead of trading this car in for a new one, the debtor filed for chapter 13 protection. In the chapter 13 case, we are to pretend the $2,000 car is really worth $5,000.\footnote{See Capital One Auto Fin. v. Osborn, 515 F.3d 817, 820–21 (8th Cir. 2008) (holding creditor entitled to unsecured deficiency under state law); In re Wright, 492 F.3d 829, 830 (7th Cir. 2007) (finding creditors cannot divide their loans into secured and unsecured components). At least we are to do so when the debtor proposes to keep the car. 11 U.S.C. § 1325(a)(5)(B). When the debtor proposes to foist the car on the car lender, 11 U.S.C. § 1325(a)(5)(C), the car suddenly falls in value to $2,000, even though section 506(a) is not supposed to apply in cram downs. In surrender cases, the car lender enjoys an unsecured deficit claim against the debtor. AmeriCredit Fin. Servs., Inc. v. Long (In re Long), 519 F.3d 288, 300–01 (6th Cir. 2008) (allowing creditor's unsecured deficiency claim). For a blistering critique, see Jean Braucher, A Guide to Interpretation of the 2005 Bankruptcy Law, 16 AM. BANKR. INST. L. REV. 349, 401–07 (2008).}

Protection under the hanging paragraph is limited to purchase money security interests created within 910 days prior to the bankruptcy. And here, at last, we reach the significance of the Ninth Circuit's opinion in Penrod. If negative equity spoils the purchase money status of the car lender, the car lender may be bifurcated into secured and unsecured portions.

Courts have long wrestled with impure purchase money security interests. In doing so, two rules developed.

According to the transformation rule, any impurity in the purchase money debt means that the lender was entitled to no purchase money status whatsoever. Such a rule is praised by consumer advocates for discouraging "collateral add-on" clauses and "debt add-on" clauses in consumer security agreements.\footnote{A cross-collateralization clause was the source of a classic statement of the doctrine of unconscionability in contract. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965) (characterizing unconscionability as "absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party"). Some have suggested that the transformation rule might persist in consumer cases but should definitely be rejected in purely commercial cases, such as those involving priority to inventory. See In re Mid-Atlantic Flange Co., Inc., Bankruptcy No. 78-1928EG, 1979 WL 30070 (Bankr. E.D. Pa. Mar. 22, 1979) (recognizing distinction between consumer and commercial context); D. Benjamin Beard, The Purchase Money Security Interest in Inventory: If It Does Not Float, It Must Be Dead!, 57 TENN. L. REV. 437, 446–48 (1990) (discussing relationship between purchase money security interests in inventory and floating liens). Another virtue cited for the transformation rule is that it does not implicate a bankruptcy court in the tedious work of allocating payments between the purchase money and nonpurchase money parts of the security interest. See In re Booker, 9 B.R. 710, 712 (Bankr. M.D. Ga. 1981) (finding preexisting debt and preexisting collateral included in transaction defeated purchase money status). Also, some courts think that, because purchase...}

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clause anticipates that the consumer buys a series of items on purchase money credit. For example, the consumer buys in sequence items A, B, and C. The clause guarantees that, where the debt on item A is still outstanding, items B and C are collateral for it. The negative equity in the car deal we are discussing is a version of collateral add-on, except that the debtor terminates her equity interest in item A before acquiring item B (the new car). Nevertheless, item B is collateral for the debt still owing on item A. Debt add-on involved future advances after the debtor acquired item A. Under a debt add-on clause, item A is collateral for a future advance given for purposes unrelated to the acquisition of item A.

Under the transformation rule, the presence of non-purchase money collateral or non-purchase money debt means that the lender forfeits purchase money status on all items A, B, C, etc.

If a dual status rule is followed, then the security interest is considered partly a genuine purchase money security interest and partly a non-purchase money security interest. Under such a rule, it becomes necessary to allocate past repayments to either the purchase money or the non-purchase money side of the obligation. When a security agreement provides an allocation formula, courts are willing to abide by it, and indeed have even been persuaded to institute the dual status rule rather than the transformation rule when such allocations are contractually provided for. Some courts have found in state retail legislation formulas for allocations upon which they base a dual status rule. Other courts have refused to bring such legislation to the aid of purchase money secured parties. Other courts have used a money status gives special privileges to the secured party, it is fair that the burden on the secured party is extremely high in showing that the security interest is purely purchase money. In re Gonzales, 206 B.R. 133, 135 (Bankr. N.D. Tex. 1997) ("The secured creditor bears the burden of showing that it has a security interest and the extent of that security interest."); In re Jones, 5 B.R. 655, 657 (Bankr. M.D.N.C. 1980) (arguing lenders bear burden of preparing pure purchase money security agreements "without attempting to burden it with complicated and ambiguous impediments").

One commentator points out that the hanging paragraph applies "if" the creditor has a purchase money security interest. In contrast, section 1326(a)(4) refers to "personal property . . . securing a claim attributable in whole or in part to the purchase price of such property." 26 U.S.C. § 1326(a)(4). Section 1326(a)(4), also added by BAPCPA, shows Congress knew how to subdivide mixed security interests. Failing to do so in the hanging paragraph therefore shows that Congress intended the transformation rule. See generally Ching, supra note 8, at 501–09.


See In re Linklater, 48 B.R. 916, 919 (Bankr. D. N.M. 1985) ("The policies underlying both the dual status rule and the transformation rule are served when the dual status rule is properly applied."); In re Keller, 29 B.R. 91, 93 (Bankr. M.D. Fla. 1983) (sustaining purchase money security interest because security agreement provided for first-in-first-out payment allocation); In re Mattson, 20 B.R. 382, 385 (Bankr. W.D. Wis. 1982) (finding agreement contained method to allocate payments and preserve dual status).


In re Norrell, 426 F. Supp. 435, 436 (M.D. Ga. 1977) (holding state statute to be unrelated to purchase money security interest); In re Beasley, 23 B.R. 404, 406 (Bankr. E.D.N.C. 1982) (noting that benefits of
first-in-first-out system, with payments first allocated to purchase money claims. On the other hand, when no such allocation is described in the security agreement, courts have chosen the transformation rule and proclaimed the purchase money status to have ended. Most notoriously, some courts have ruled that the failure of a security agreement to segregate the "purchase money" debt from the debt covering sales tax and interest charges is enough to trigger the transformation rule. Yet even here, some courts have supplied a tracing rule in aid of the purchase money secured party when the contract or legislation is unavailable.

If these allocation difficulties can be solved, the dual status rule works well enough in priority disputes. Suppose, under state law, secured party A claims a floating security interest on after-acquired property. A second secured party B claiming an impure purchase money security interest is in a priority dispute with A. Suppose B's security interest contains $9,000 in genuine purchase money debt and $3,000 in "negative equity," which we shall deem not purchase money debt, for the sake of illustration. In such a case, B is first for $9,000 (the amount of genuine purchase money obligation), A is second for whatever her claim is, and B is third for $3,000 for the negative equity.

Dual status is easy to understand in the context of priority between competing liens. But where "purchase money" stands for eligibility for the benefits of the hanging paragraph, the dual status rule operates mysteriously.

statute are not available if creditor-seller waits for litigation to ensue); In re Trotter, 12 B.R. 72, 74 (Bankr. C.D. Cal. 1981) (holding California statute does not apply first-in-first-out).


See In re Littlejohn, 20 B.R. 695, 697 (Bankr. W.D. Ky. 1982) (holding where no formula for applying payments exists, security interest in consumer goods is not purchase money); see also In re Hobdy, 18 B.R. 70, 73 (Bankr. W.D. Ky. 1982); In re Coomer, 8 B.R. 351, 355 (Bankr. E.D. Tenn. 1980); In re Mulcahy, 3 B.R. 454, 457 (Bankr. S.D. Ind. 1980). In In re Norrell, state retail sales legislation existed to require that payments from the debtor be first used to disencumber the first item bought on credit. 426 F. Supp. at 436. But the contract had no apportionment formula, and the court proclaimed the purchase money security interest unperfected because the secured party had never filed a financing statement. See In re Slay, 8 B.R. 355, 358 (Bankr. E.D. Tenn. 1980) (holding because no repayment had occurred at all, it was possible to allocate between purchase money and nonpurchase money advances for purposes of dual status rule).

Snap-On Tools, Inc. v. Freeman (In re Freeman), 956 F.2d 252, 255 (11th Cir. 1992) (using transformation rule when insufficient allocation methods are made in agreement); In re Lee, 169 B.R. 790, 793 (Bankr. S.D. Ga. 1993) (noting that the contract had no apportionment formula, and the court proclaimed the purchase money security interest unperfected because the secured party had never filed a financing statement. See In re Slay, 8 B.R. 355, 358 (Bankr. E.D. Tenn. 1980) (holding because no repayment had occurred at all, it was possible to allocate between purchase money and nonpurchase money advances for purposes of dual status rule).


An intractable problem is whether the installments actually paid prior to default reduce the purchase money or the non-purchase money part of the loan. See David Gray Carlson, Purchase Money Under Article 9 of the Uniform Commercial Code, 29 IDAHO L. REV. 793, 822–23 (1993); Ching, supra note 8, at 497–98.

The hanging paragraph, therefore, belongs on a long list of provisions that use the purchase money
To illustrate, I return to my stock example, where the debtor has borrowed $12,000 to obtain a new car that costs $9,000. Of the total $12,000 loan, $3,000 refinances the loan on the trade-in.

Suppose now that the car debt has been paid down so that the debtor owes $8,000 for the purchase money part of the debt and $2,000 for the negative equity part of the debt. The car is still worth $9,000. The hanging paragraph applies, but we apply the dual status rule as the Penrod court would do. In such a case, the hanging paragraph becomes useless. The hanging paragraph prohibits bifurcation under Bankruptcy Code section 506(a), but only with regard to the purchase money obligation. It permits bifurcation for the non-purchase money part of the obligation.

Accordingly, the debtor can write a chapter 13 plan that pays the present value of $8,000 for the purchase money obligation. Bifurcation, so far, does not contribute to the result, so the hanging paragraph is not offended. Once the purchase money debt is secured, the car still has $1,000 of residual value, against which the secured creditor claims $2,000 in negative equity debt. The hanging paragraph does not apply to this part of the debt. The debtor may bifurcate the negative equity debt and pay only $1,000 of it on a secured basis.

In the above example, the hanging paragraph was otiose—that is, it did no work. This was because the car was worth more than the purchase money debt (but less than the total debt).

Suppose, alternatively, that the car is worth $6,500, whereas the purchase money debt is for $8,000 and the negative equity debt is worth $2,000. Here the secured creditor is entitled to be treated as secured for $8,000, even though the car is worth $6,500. Here the hanging paragraph successfully transfers wealth to the car lender.

So, to summarize, if the dual status rule applies, the hanging paragraph does no work where the value of the car exceeds the purchase money debt. But where the car is worth more than the purchase money debt, the hanging paragraph still improves the cram down rights of the car lender (where negative equity is deemed not a purchase money obligation and where the dual status rule is applied).

If the thesis of this Article is correct, however, courts can skip the complexities of the dual status rule and simply find that the hanging paragraph applies concept for purposes other than the adjudication of priority. One may start with the UCC itself, which makes purchase money security interests in consumer goods automatically perfected. U.C.C. § 9-309(1) (2000). In 1975, the Federal Trade Commission proclaimed an unfair trade practice of nonpurchase money security interest in consumer goods. 16 C.F.R. § 444.2 (2012); see also Am. Fin. Servs. Ass'n v. FTC, 767 F.2d 957, 963–64 (D.C. Cir. 1985). Thereafter, purchase money status was required for the very existence of a security interest in consumer goods. In 1978, the Bankruptcy Code permitted the avoidance of security interests on certain items of exempt property, but it excluded the purchase money security interest from this unfavorable treatment. 11 U.S.C. § 522(f)(1)(B) (2006). In chapter 11, the automatic stay on boats, trains, and airplanes was initially limited if a lender claimed a purchase money security interest on these items. 11 U.S.C. § 1110(a) (1994). In 1994, however, Congress deleted the limitation of such protections to purchase money security interests only and protected any such security interest on such items in chapter 11. See Kathryn Hoff-Patrinos, Aviation Finance Revisited: The 1994 Amendments to Section 1110 of the Bankruptcy Code, 69 AM. BANKR. L.J. 167, 170–71 (1995).
straightaway to any security interest that is partly purchase money and partly negative equity.

II. THE CASE FOR NEGATIVE EQUITY AS PURCHASE MONEY OBLIGATION

Purchase money lenders have been called the heroes of commercial law. They are the "founder[s] of the feast." They bring into existence property the debtor would not otherwise have. The very existence of the purchase money priority allows the debtor to get credit which, otherwise, "debt overhang" would prevent.

Purchase money priority traditionally mattered only if some person had a floating lien that automatically attached to the debtor's after-acquired property. Purchase money priority is based on the notion that, for the after-acquired property creditor, the newly acquired item is a windfall. The purchase money lender, being the founder of the feast, feeds first. Hyena-like, the after-acquired property lender only obtains the leftovers, even if, technically, the after-acquired property creditor's lien attached prior in time to the lien of the purchase money lender.

Historically, the purchase money priority always had a strict limitation. The advance of credit to the debtor had to be traced to the acquisition of the collateral. According to Judge William Howard Taft, slightly before he became the governor general of the Philippines:

When [] that which is given the appearance of a vendor's or purchase-money lien is really only a device to secure money borrowed for other purposes of the mortgagor than the buying of the addition in question, then the attempt to supplant the first lien of the mortgage under the after-acquired property clause is a fraud upon the mortgage, and the pseudo purchase-money lien must be postponed to that of the [after-acquired property] mortgage.

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62 See Carlson, supra note 56, at 794.
63 See Harris v. Youngstown Bridge Co., 90 F. 322, 328 (6th Cir. 1898) (listing Supreme Court cases examining purchase money priority limitations).
65 Taft was one of two Supreme Court justices to have ruled the Philippines for a time. The other was Justice Frank Murphy. Symposium, *The Case for Returning Politicians to the Supreme Court*, 61 HASTINGS L.J. 1353, 1392 (2010).
66 Harris, 90 F. 322 at 329.
The requirement that the proceeds of the loan actually be used to acquire the collateral is what threatens to deprive impure purchase money security interests of hanging paragraph coverage.

The courts of appeals that have considered whether negative equity qualifies as a purchase money obligation have, by a large majority, ruled for the car lenders: negative equity is indeed part of the purchase money obligation owed by debtors. This result is reached by a careful reading of Article 9's definition of "purchase money obligation." 

As others have noted, it is not obvious that courts should look to the highly technical UCC definition for defining the federal term "purchase money security interest." For one thing, the UCC, though highly uniform, is not perfectly uniform. Use of state law therefore potentially leads to different results in different locations. Why shouldn't the federal courts develop their own uniform federal definition of purchase money obligation? In addition, the authors of the comments to the UCC warn against borrowing from the UCC for bankruptcy cases: according to Comment 8 to the UCC section 9-103:

"Cash sale price" means the 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 such sale had been a sale for cash instead of a retail installment transaction . . . . The cash sale price may also include any amount paid to the buyer or to a third party on behalf of the buyer to satisfy a lease on or a lien on or a security interest in a motor vehicle used as a trade-in on the motor vehicle which is the subject of a retail installment transaction under this article.

Id.
the dual-status rule, allocation of payments rules, and burden of proof standards for non-consumer-goods transactions is not intended to affect or influence characterizations under other statutes. Whether a security interest is a "purchase-money security interest" under other law is determined by that law. For example, decisions under Bankruptcy Code Section 522(f) have applied both the dual-status and the transformation rules. The Bankruptcy Code does not expressly adopt the state law definition of "purchase-money security interest." Where federal law does not defer to this Article, this Article does not, and could not, determine a question of federal law.71

Be that as it may, courts have generally ignored this advice and have slavishly looked to the UCC to define what a purchase money security interest is.72

UCC section 9-103(b)(1) defines a purchase money security interest as a security interest "to the extent that the goods are purchase-money collateral with respect to that security interest."73 Note that this definition contains the phrase "to the extent." This indicates that a security interest might be part purchase money and part not. Also, this definition requires us to know what "purchase-money collateral" is. We must move on for definitional help.

Section 9-103(a)(1) defines purchase money collateral as "goods . . . that secures a purchase money obligation incurred with respect to that collateral."74 This provision requires us to know what a purchase money obligation is. Dissatisfied, we once again must move on.

Section 9-103(a)(2) defines "purchase-money obligation,"75 and finally, after frustrating and needless delay, we reach the nub of the matter. A purchase money obligation "means 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."76

This definition subdivides purchase money obligations into two types. First, there is credit supplied by the seller. This is nicknamed "the conditional sale" in honor of its historical origin.77 Then there is the enabling loan—a third party's loan "enables" the debtor to purchase the collateral.78 The question at hand is whether negative equity qualifies as either conditional sales credit or enabling credit.

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71 U.C.C. § 9-103 cmt. 8 (2000).
72 In re Johnson, 380 B.R. 236, 240 (Bankr. D. Or. 2007) (stating definition of purchase money security interest is lifted from UCC); but see In re Westfall, 376 B.R. 210, 217 (Bankr. N.D. Ohio 2007) (arguing for federal definition), rev'd, 599 F.3d 498 (6th Cir. 2010).
73 U.C.C. § 9-103(b)(1).
74 Id. at § 9-103(a)(1).
75 Id. at § 9-103(a)(2).
76 Id.
78 See id. at 381 (describing enabling loan).
Courts finding that negative equity is a purchase money obligation have relied on Comment 3 to UCC section 9-103:

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.

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation.79

According to the majority of courts relying on this comment, negative equity is like sales tax or freight charges and, therefore, part of the notion of "purchase-money obligation."80 Some of these courts are emboldened by pro-consumer disclosure laws governing car sales, which define negative equity as part of the price of a car.81 Others emphasize that the purchase of the new car and the trade-in are a "single transaction," which in decency ought not to be broken into parts.82

The contrary view simply denies a close nexus between negative equity, on the one hand, and price of the car or enabling value, on the other.83 Congress, apparently, knew how common negative equity deals were, yet did not mention them in the hanging paragraph.84 If old debt is part of the purchase money obligation, the concept of purchase money security interest would be converted "from a defined term to one that can be expanded at the will of the parties."85 It has been pointed out that for the purpose of voidable preference law, purchase money

79 U.C.C. § 9-103 cmt. 3.
80 See, e.g., Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498, 503–04 (6th Cir. 2010); Howard v. AmeriCredit Fin. Servs. (In re Howard), 597 F.3d 852, 857 (7th Cir. 2010); Reiber v. GMAC, LLC (In re Peaslee), 585 F.3d 53, 57 (2d Cir. 2009); Ford Motor Credit Co. v. Dale (In re Dale), 582 F.3d 568, 570, 571 (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, 1282–83 (10th Cir. 2009); Wells Fargo Fin. Acceptance v. Price (In re Price), 562 F.3d 618, 626–27 (4th Cir. 2009); Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295, 1300 (11th Cir. 2008).
81 See In re Howard, 597 F.3d at 856–57; In re Mierkoski, 580 F.3d at 746. For the contrary view, see Americredit Fin. Servs. v. Penrod (In re Penrod), 636 F.3d 1175, 1179 (9th Cir. 2010); Moringiello, supra note 3, at 14–15.
82 See In re Ford, 574 F.3d at 1284–85 (explaining how common this is in automobile industry); In re Price, 562 F.3d at 625 (terming transactions as a packaged deal).
83 In re Mierkowski, 580 F.3d at 746 (Bye, J., dissenting) ("A new vehicle may be purchased without financing negative equity but cannot be purchased without paying tax, title, license, etc."); see In re Ford, 574 F.3d at 1289 (Tymkovitch, J., dissenting) (stating negative equity not transaction cost).
84 In re Mierkowski, 580 F.3d at 745–46 (Bye, J., dissenting) (explaining that legislative history of BAPCPA supports a broad reading of hanging paragraph); Moringiello, supra note 3, at 37–38 (discussing how Congress intended for uniformity).
85 In re Ford, 574 F.3d at 1291 (Tymkovitch, J. dissenting).
lenders are given a grace period for perfection, but only if they give "new value." Therefore, voidable preference law supports expelling negative equity from the purchase money obligation. Furthermore, section 9-103(a)(2) refers to "all or part of the price." Negative equity implies a loan that is more than the price and so inclusion of negative equity exceeds the definition.

I offer no opinion on the comparative quality of such arguments, which are carefully reviewed in the literature, except to note that matters of likeness and unlikeness are subjective criteria. Instead, I wish to examine the point that the new car is proceeds of the old car, and if the old car was purchase money collateral, so is the new car. As proceeds of the old car, the new car inherits the purchase money status of the old car.

III. PROCEEDS

Purchase money priority factors in Article 9's concept of a "proceeds" security interest.

From UCC section 9-315(2) we learn that "a security interest attaches to any identifiable proceeds of collateral." "Proceeds," in turn are defined as, inter alia, "whatever is acquired upon the sale . . . of collateral." Under this definition, the new car is acquired upon the sale of the trade-in, and so the old lender has a proceeds security interest in the new car.

Of course, the new lender takes out the old lender by advancing loan proceeds in satisfaction of the old lender's debt. In doing so, by ordinary principles of subrogation, the new lender becomes the owner of the old lender's purchase money security interest. After this occurs, the debtor tenders her equity interest in the old car (which is valueless) in exchange for a reduction of the old purchase money debt, and also in exchange for the new car. The new car is, therefore, proceeds of the old car. The old security interest automatically attaches to the new car as a proceeds security interest.

Key in this vision is the idea that the new car lender is subrogated to the rights of the old car lender. The Restatement of Property (Mortgages) describes the

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86 Beasley v. Fidelity Fin. Servs., Inc. (In Re Beasley) 102 F.3d 334, 335 (8th Cir. 1996) ("Section 547(b)(3)(B) allows a creditor a twenty-day grace period in which to perfect an interest securing new value.").
88 Americredit Fin. Servs. v. Penrod (In re Penrod), 611 F.3d 1158, 1164 (9th Cir. 2010) (holding purchase money obligation does not include negative equity).
90 Ching, supra note 8, at 481 ("If negative equity debt is included as part of the obligation, the total obligation incurred exceeds the original sale price of the new vehicle.").
91 See, e.g., id. (discussing conflicting views on whether negative equity has purchase money status when it is included in financing transactions to purchase new vehicles).
93 Id. at § 9-102(a)(64)(A).
principle of subrogation:

(a) One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the performance would otherwise discharge the obligation and the mortgage, they are preserved and the mortgage retains its priority in the hands of the subrogee.

(b) By way of illustration, subrogation is appropriate to prevent unjust enrichment if the person seeking subrogation performs the obligation: . . .

(4) upon a request from the obligor or the obligor's successor to do so, if the person performing was promised repayment and reasonably expected to receive a security interest in the real estate with the priority of the mortgage being discharged, and if the subrogation will not materially prejudice the holders of intervening interests in the real estate. 94

Needless to say, this formulation has in mind real estate mortgages, not chattel mortgages. But there is no reason why this principle should not translate directly into personal property cases. Also, subrogation is here predicated on unjust enrichment of a party intervening between the senior lien and the refinancing party. In hanging paragraph cases, there is no intervening party. 95 This simply illustrates Congress's poor choice to adopt a priority concept (purchase money status) for a non-priority purpose (eligibility for preferential treatment). The point is that the car lender refinances the old purchase money loan on the old car, accepts the old car as part of the price of the new car, and therefore, is entitled to a proceeds security interest on the new car. That there is a proceeds security interest is beyond question. The crucial issue is whether the proceeds security interest is a purchase money security interest, because the original collateral was purchase money collateral.

On reflection, it should be apparent that any proceeds security interest has a purchase money aspect to it. To see why, imagine that SP has an ordinary security interest on inventory, which itself need not have purchase money status. Imagine that Item A is part of inventory, so SP's security interest attaches to it. The merchant now sells Item A to a buyer in the ordinary course of business, who pays $1,000 for it. SP's security interest is destroyed, 96 and SP has a proceeds security

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94 RESTATEMENT (THIRD) OF PROP. § 7.6 (1997)
95 It may be conceded that a chapter 13 trustee is a hypothetical judicial lien creditor as of the day of bankruptcy. 11 U.S.C. § 544(a)(1) (2006). But this hypothetical lien is not an intervening lien. It is ex post both the purchase money and non-purchase money security interests on the car, provided these are perfected as of the day the bankruptcy petition was filed.
96 U.C.C. § 9-320(a) (stating buyers in ordinary course of business take free of security interest created by
interest on the $1,000.

Now Article 9's definition of purchase money obligation limits the concept to goods or software. The $1,000 just referred to are neither "goods" nor "software." Rather, they are "money, checks, deposit accounts, or the like." But if we waive this jurisdictional point, it can be observed that SP gave enabling credit to the merchant, which allowed the merchant to acquire the rights in the $1,000. When the buyer purchased Item A, SP's security interest was automatically released. But for this release, the buyer would not have paid $1,000 for Item A (where SP's total claim exceeds $1,000). SP, then, resembles the enabling lender in the purchase money definition. Release of the lien makes possible the acquisition of the $1,000. Ergo, the release of SP's inventory security interest "enables" acquisition of proceeds in precisely the same way as a purchase money loan.

Having said this, I must now concede that Article 9 does not limit proceeds security interests to the release of the security interest on the old collateral. In inventory cases involving the sale in the ordinary course of business, this is automatic. But where the old security interest is not released, the secured party still can claim a proceeds security interest. This is the notorious and unjustified two-for-one rule whereby the secured party can claim the old collateral and the proceeds even without a release of the lien. This point can be ignored for present purposes. In a negative equity car loan, the security interest on the old car is released, which enables the debtor to obtain a new car, which becomes automatically encumbered by a proceeds security interest. The old lender is not unlike an enabler, who can therefore claim to be a purchase money lender as to the new car as well as to the old car.

Of course, the old lender takes payment from the new lender. Under ordinary principles of subrogation, the new lender buys the rights of the old lender, which (we are stipulating) is a purchase money right. To my eye, this situation is a perfect case for subrogation.

There is, however, a fair amount of bad law out there on whether purchase money status survives refinancing. Some of these bad cases are founded on the intent of the secured party, who supposedly wanted to forfeit a valuable legal advantage in refinancing the purchase money obligation. A more intelligent view

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97 Id. at § 9-103(a)(1), (b).
98 Id. at § 9-102(a)(9).
99 Id. at § 9-320(a) (stating that buyers in ordinary course of business take free of security interest created by seller).
100 See David Gray Carlson, Bulk Sales Under Article 9: Some Easy Cases Made Difficult, 41 ALA. L. REV. 729, 741 (1990) (explaining how secured party receives double entitlement under Article 9).
101 See Carlson, supra note 56, at 822–23 (noting that some courts make burden to show security interest is purely purchase money extremely high).
of subrogation appears in *Vantigger-Witte v. Mortgage Electric Registration Systems (In re Vantigger-Witt)*.\(^{103}\) In this case, D granted a mortgage to A, which was refinanced by B. D granted C a second mortgage.\(^{104}\) D then refinanced the B mortgage with a loan from E. E was held entitled to subrogation and, therefore, priority over the second mortgage lender C.\(^{105}\) In this case, E inherited the priority of B. B in turn must have inherited A's priority, and A was most likely a purchase money lender.\(^{106}\)

In any case, subrogation is an equitable remedy, a predicate of which no *intervening* transferee of the debtor be unjustly harmed.\(^{107}\) Where there are no intervening parties at all, subrogation should follow as a matter of course. The parties that are prejudiced by permitting subrogation are the credit card issuers who typically advanced unsecured credit to the chapter 13 debtor. But these are not reliance creditors in any sense. The subrogation cases typically require that an intervening creditor *relied* on the disappearance of the old secured claim before subrogation is defeated.\(^{108}\)

Assuming, as is proper, that subrogation operates to make the new car lender the owner of the old lender's purchase money security interest, we can affirm that the new lender inherits the old lender's proceeds security interest on the new car.

What is the priority of a proceeds security interest? In competing against a buyer who buys the proceeds or a lien creditor who levies on it, there is no specific priority rule. We are thrown back to section 9-317(a)(2), where we learn that the secured party wins unless the competitor has her interest before the security interest was perfected or before the secured creditor filed a financing statement.\(^{109}\) From this we take the point that, in the case of simultaneous attachment of security interests and judicial liens or buyers, the secured party wins. It should be remembered that a proceeds security interest is an after-acquired property security interest. Once proceeds come into existence, not only does the proceeds security interest attach,\(^{110}\) but so does any floating lien that may exist. As against the floating lien, the secured party claiming the proceeds security interest is at worst always tied, and ties go to the secured party, just as it goes to the runner in baseball.\(^{111}\) Or, where both

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\(^{103}\) 354 B.R. 862, 866 (Bankr. N.D. Iowa 2006).

\(^{104}\) Id. at 864.

\(^{105}\) Id.

\(^{106}\) Id.


\(^{110}\) Id. at § 9-315(a)(2).

competitors are secured parties claiming after-acquired property security interests, the parties have their security interests at the same time (when the debtor obtains rights in the proceeds), but the UCC favors the first party to file a financing statement (even if the two secured parties are temporally equal).

As we are dealing in cars, there is a further difficulty. The security interest in proceeds becomes unperfected on the twenty first day after attachment under certain circumstances. UCC section 9-315(d)(1) requires that:

(A) a filed financing statement covers the original collateral;
(B) the proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and
(C) the proceeds are not acquired with cash proceeds[.]

Putting aside some fancy *legerdemain* with regard to (C), is the old car lender perfected with regard to the new car? Perfection as to cars is accomplished by obtaining an entry on the certificate of title. As to cars "the filing of a financing statement is not necessary or effective to perfect a security interest" in such collateral, because a certificate-of-title statute exclusively governs perfection. Superficially, it would appear, then, that (A) cannot be fulfilled. But UCC section 9-311(b) comes magically to the rescue:

Compliance with the requirements of a statute . . . described in subsection (a) for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article.

The above-referenced subsection (a) is the provision that makes certificate of title statutes the sole mode of perfecting a security interest in a car. According to UCC section 9-315 Comment 6:

Section 9-311(b) provides that compliance with the perfection requirements of a statute . . . described in Section 9311(a) "is the equivalent to the filing of a financing statement." It follows that collateral subject to a security interest perfected by such compliance under Section 9-311(b) is covered by a "filed financing statement" within the meaning of Section 9-315(d) and (e).
The magic of section 9-311(b) is that non-filing becomes transmogrified into a filing.

Because of this "pigs are deemed kosher" provision we may agree that UCC section 9-315(d)(A) is met. But does the magic also work on subsection (B) of section 9-315(d)(l)? What the secured party must show is the proceeds (i.e., the new car) are "collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed."\(^{117}\) Of course, when it comes to cars, there is no financing statement for the original collateral. There is only the request for a notation on a certificate of title.\(^{118}\) But this request constitutes "compliance with the requirements of a statute" described in section 9-311(b).\(^{119}\) Therefore the Department of Motor Vehicles (DMV) is made into "the office in which the financing statement has been filed."\(^{120}\) We can, therefore, confirm (in a white-knuckled sort of way) that the secured party has complied with (B).

So far, we have shown that the old lender has a perfected security interest on proceeds. This security interest defeats any simultaneously created interest on the new car because, under section 9-317(a), the tie always goes to the running secured party, never to an after-acquired property creditor or buyer.\(^{121}\)

There still remains the priority of a purchase money security interest on the new car, on the one hand, against, on the other hand, the proceeds security interest that also attaches to the new car. After all, the new lender in a negative equity deal claims to have one of each.

The priority of a purchase money secured party and some other secured party is governed by section 9-324(a). There we learn:

\[ \text{[A] perfected purchase-money security interest in goods . . . has priority over a conflicting security interest in the same goods, and . . . a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within 20 days} \]

\(^{117}\) Id. at § 9-315(d)(l)(B) (emphasis added).
\(^{118}\) In New York, perfection of security interests on cars is governed by N.Y. VEH. & TRAF. LAW § 2118, which provides:

(b)(1) A security interest is perfected: (A) By the delivery to the commissioner of (i) the existing certificate of title, if any, an application for a certificate of title containing the name and address of the lienholder and the required fee or (ii) a notice of lien evidencing a lien arising under section two hundred eleven of the lien law and section one hundred eleven-u of the social services law; (B) As of the time of its creation if the delivery is completed within ten days thereafter, otherwise, as of the time of delivery.

\(^{119}\) U.C.C. § 9-315 cmt. 6.
\(^{120}\) Id. at § 9-315(d)(l)(B).
\(^{121}\) See Carlson & Shupack, supra note 111, at 345 (stating lien creditors' rights must arise before perfection of security interest).
This provision is not without its problems. Suppose the purchase money lender on the old car is not the same lender as the one financing the purchase of the new car. Then section 9-324(g)(1) applies:

[A] security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral . . .

This provision favors the conditional seller over the enabling lender.

In our scenario, however, the new car dealer may have been the conditional seller. But does that mean the new car dealer is senior as to the new car over the old lender relying on a proceeds security interest? For purposes of the hanging paragraph, we do not have to worry about that issue. The point is that section 9-324(a) awards to the old lender a superpriority that accords with purchase money status. The proceeds security interest is generally a purchase money security interest (because it generally has priority over after-acquired property creditors who are not purchase money lenders). This is enough for the proceeds security interest to qualify for hanging paragraph protection. Again, we need subrogation to make the new car lender the heir to the old car lender's rights.

To summarize, the old lender's proceeds security interest is granted a superpriority, at least over subsequent secured creditors. Potentially, the old lender may lose to the new conditional seller, depending on what section 9-324(g) means. But whatever it means, the proceeds security interest has the priority of a purchase money security interest. Having the priority of a purchase money security interest, it may be deemed a purchase money security interest, for purposes of the hanging paragraph.

CONCLUSION

The circuits cannot agree on whether negative equity falls under the category of "purchase money obligation." For the moment, the question is posed as an issue whether negative equity resembles "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." Thus we find

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122 U.C.C. § 9-324(a).
123 Id. at § 9-324(g)(1).
125 UCC § 9-103(3).
courts defining a federal term ("purchase money security interest") not merely by referring to state statutes but to lowly comments not enacted into law.126

Rather than add my unauthoritative subjective opinion on whether negative equity "resembles" sales tax or storage in transit, I have proposed an objective solution to the negative equity puzzle. Provided the security interest on the trade-in was once a purchase money security interest, the new lender is subrogated to the old purchase money security interest and has a proceeds security interest in the new car with a priority defined by purchase money status. If having a purchase money priority is the same as having a purchase money security interest, this is enough to confirm that the hanging paragraph extends to the one-third of car loans involving negative equity.

126 Donald W. Banker, Some Thoughts on Agricultural Liens under New U.C.C. Article 9, 51 ALA. L. REV. 1417, 1433 (2000) ("Courts will need reminding that the Comments, notwithstanding their proximity to the statutory language in state codes, are not enacted law, but only legislative history, and that the authors of comments are fallible.").