

"Cram down"—lenders cram back



Wes Smith

By Wes Smith
CLE Committee Chairperson
Kansas Bar Association

As most lenders are aware, the 2005 modifications to the Bankruptcy Code made it increasingly difficult for Chapter 13 debtors to modify claims secured by their vehicle. If the vehicle is a "910 car," (the vehicle was purchased with the creditor's money for personal use within 910 days of the filing of the bankruptcy case) the debtor must pay the full debt secured

by the vehicle, or let the creditor repossess and sell the motor vehicle. However with loans that do not meet this "910 car" criteria, a debtor can divide the claim on a personal vehicle into a "secured" portion which must be repaid in full, and an "unsecured" portion which gets repaid with other unsecured debts under the plan. This has historically been referred to as a "cram down." (scholars have pondered whether the term comes from the "cramming down" the value of the car to a lesser amount, or "cramming" the value down the lender's throat)

The ability of the debtor to "cram down" a portion of their car loan makes the role of valuation in a bankruptcy proceeding critical to the outcome of a case. It should come as no surprise that valuation of a vehicle is generally a source of great

disagreement between the creditor and debtor. The creditor wants the vehicle valued as highly as possible because any amount owed beyond the value of the vehicle will be typically discharged. The debtor, on the other hand, wants the value lower, so the amount they pay to the creditor is reduced.

For many years, bankruptcy courts have struggled to find a valuation approach that can be consistently applied in a uniform manner. In recognizing that a uniform approach would provide predictability for debtors and creditors, Congress adopted a "replacement value" standard as part of the Bankruptcy Code amendments in 2005. This was intended to resolve much of the uncertainty that existed under prior law. However, due to the numerous factors and possibilities in evaluating "replacement value" in each individual case, ambiguities in applying the "replacement value" standard continued. As a result, debtors and creditors found themselves continuing to battle it out in court with valuation issues.

The disparity and confusion of the proper method of valuing a used car in Kansas has recently been tackled by the United States Bankruptcy Court for the District of Kansas. In September 2009, United States Chief Bankruptcy Judge Robert E. Nugent adopted an approach in *In re Cook* that at least one other bankruptcy court in the District of Kansas has begun to follow. This new approach tends to give used vehicles a higher value than previous methods adopted by the court.

In *In re Cook*, GMAC objected to the debtor's bankruptcy plan when the debtor proposed only paying \$9,280 on the

secured claim of \$15,829. The court heard testimony from car experts on both sides. The debtor's expert appraised the "replacement value" of the vehicle using its National Automobile Dealers Association (NADA) Trade-In value after reconditioning at \$9,400. The creditor's expert, on the other hand, appraised the "replacement value" of the vehicle using its NADA Clean Retail value at \$12,400, plus some other factors which ended up at \$14,200.

After finding the testimony of both experts to be credible, the court determined the best starting point for "replacement value" of personal use vehicles is the NADA Clean Retail, adjusted for necessary deductions resulting from the condition of the specific vehicle being valued. These may include (but are not limited to) mechanical, body, and interior repairs as well as deductions to account for excessive mileage. After taking the necessary repairs into account, the court determined that a retail merchant would charge \$11,375 for a vehicle similar to the one the debtor had in her possession, and found that to be the replacement value under the Bankruptcy Code.

Under the approach of *In re Cook*, two debtors possessing vehicles of the same make, model, and year may end up with

a different value based on the condition of the vehicle. However, the consistent use of NADA Clean Retail value as the starting point for determining "replacement value" will go a long way in providing predictability and uniformity to creditors forced to enter the bankruptcy system.

With the adoption of NADA

Clean Retail, secured creditors are in a much better starting position than in the past. NADA Clean Retail represents the highest value that NADA uses to appraise used vehicles. The high starting point values the car as if it were in mint condition. Even though debtors have the opportunity to submit evidence to adjust the NADA Clean Retail downward for defects in the car, the baseline number starts much higher than it has in the past. Assuming debtors will have no option other than to keep their cars, secured creditors will reap the benefit of having the car valued at a higher price and thus keeping a larger percentage of their loan secured.

Wes Smith is the past-president of the Bankruptcy and Insolvency Section of the Kansas Bar Association. He currently serves as the CLE Committee Chairperson for the Kansas Bar Association.

He is a partner at Stevens & Brand, LLP and primarily represents debtors and community banks in bankruptcy cases. Wes is an Adjunct Professor of Law at the University of Kansas, teaching commercial law and is frequently a lecturer on bankruptcy and commercial law for continuing education classes. In 2009, he was chosen as one of the Best Lawyers in America in the area of bankruptcy.

The views expressed in this article are those of the author and not necessarily those of the Kansas Bankers Association.