



The relief described hereinbelow is SO ORDERED.

Signed November 06, 2006.

A handwritten signature in cursive script that reads "Robert D. Berger".

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ROBERT D. BERGER  
United States Bankruptcy Judge

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IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF KANSAS

In re:

LARRY BERNICE SMITH and  
VICKIE ELAINE SMITH,  
Debtors.

Case No. 06-20508  
Chapter 13

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MEMORANDUM AND ORDER DENYING CONFIRMATION OF CHAPTER 13 PLAN<sup>1</sup>

Confirmation of Debtors' Chapter 13 plan is pending before the Court. Citifinancial Auto ("CA") objects to confirmation based on the plan's treatment of its 910-car claim. This matter constitutes a core proceeding<sup>2</sup> over which this Court has jurisdiction.<sup>3</sup> The Court interprets 11 U.S.C. § 1325(a)'s hanging paragraph as a matter of law.<sup>4</sup> Based upon the parties' stipulation of facts and arguments of counsel, the Court sustains CA's Objection to

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<sup>1</sup> Debtors are represented by David A. Reed. Citifinancial Auto is represented by Charles R. Hay.

<sup>2</sup> 28 U.S.C. § 157(b)(2)(L).

<sup>3</sup> 28 U.S.C. § 1334.

<sup>4</sup> *In re Young*, 237 B.R. 791, 795 (10th Cir. B.A.P. 1999) (interpretation of a statute is decided as a matter of law).

Confirmation.

***Factual Background***

Debtors purchased a 2003 Ford Thunderbird during the 910 days preceding their April 19, 2006, bankruptcy filing. Debtors purchased the car from Laird Noller Ford which assigned the note and security agreement to CA. The loan document required the Debtors to provide and maintain insurance for the vehicle. The parties do not say, but apparently the Debtors provided sufficient proof of insurance at the time of sale because no cost for property insurance is included in the original note and security agreement. At the time of sale, the contract balance was \$34,217.37. By September 2005, the Debtors had paid down the contract balance to \$27,207.95. At that time, CA purchased collateral protection insurance for the vehicle pursuant to the terms of the retail installment agreement. The policy provided coverage from September 2005 to September 2007 and cost \$5,028.00. As allowed by the loan document, CA added the insurance cost to the contract balance, resulting in a balance of \$31,486.82 as of the petition date.

Debtors' first plan proposed to bifurcate and cram down CA's entire claim and pay CA \$19,185.00. Debtors' amended plan proposes to pay CA the contract balance as of the petition date plus accrued prepetition interest, but less the \$5,028.00 cost for insurance. The amended plan does not provide for postpetition interest. Neither the first plan nor the amended plan addresses the claim resulting from the insurance debt. CA objects to the plan pursuant to the new provision of 11 U.S.C. § 1325(a) commonly referred to as the hanging paragraph and argues the Debtors must pay the entire \$31,486.82 plus postpetition interest. CA further argues the Debtors' requirement to provide insurance was an essential term of the sales contract and, as such, should be included in CA's 910-car claim.

## *Discussion*

The issue is how should CA's 910-car claim and CA's claim for the insurance cost be treated in Debtors' plan in order for it to be confirmed. CA's objection has been partly resolved by the amended plan. The parties now agree CA has a 910-car claim which may not be crammed down to the collateral's value. Further, pursuant to this Court's previous ruling in *Wampler*, CA is not entitled to postpetition interest.<sup>5</sup> Thus, the issue left to determine is whether CA's claim should be reduced to the unpaid balance of the purchase price excluding the cost of insurance. Stated another way, does CA's claim for its purchase money security interest in the vehicle include the cost of insurance under the hanging paragraph?

The discussion begins with the statute. The unnumbered paragraph of §1325(a) reads, in pertinent part, as follows:

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 . . . 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. (Emphasis added).

The Bankruptcy Code does not define "purchase money security interest," and the Supreme Court has recently cautioned against borrowing definitions from non-bankruptcy statutes without an explicit direction from Congress.<sup>6</sup> Even so, property interests are created and determined by state law,<sup>7</sup> and bankruptcy courts have uniformly looked to the applicable state's Uniform

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<sup>5</sup> *In re Wampler*, 345 B.R. 730 (Bankr. D. Kan. 2006).

<sup>6</sup> *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, – U.S. –, 126 S. Ct. 2105, 2113 (2006).

<sup>7</sup> *Butner v. United States*, 440 U.S. 48, 99 S. Ct. 914 (1979).

Commercial Code to define “purchase money security interest.”<sup>8</sup> On the other hand, the UCC specifically comments that with regard to “purchase money security interest,” its definition addresses primarily perfection and priority issues under Article 9, and the definition does not determine whether a security interest is a purchase money security interest under the Bankruptcy Code.<sup>9</sup> Thus, the state law definition remains helpful, but not controlling, in determining the question before the Court.<sup>10</sup>

Under Kansas law, a purchase money security interest secures an “obligation incurred as all or part of the purchase price of the collateral” or “value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.”<sup>11</sup> The secured party bears the burden of proving (1) its loan allowed the debtor to obtain the collateral; and (2) the debtor used the funds to acquire rights in the collateral.<sup>12</sup> A secured debt may be comprised of both a purchase money component representing the collateral’s price and a nonpurchase money component representing any other additional debt associated with the transaction.<sup>13</sup> Thus, the

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<sup>8</sup> *In re Billings*, 838 F.2d 405, 406 (10th Cir. 1988).

<sup>9</sup> K.S.A. § 84-9-103 (2001), Official UCC Comment 8 (“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 definitions 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.”).

<sup>10</sup> For example, K.S.A. § 84-9-103 (2001), Official UCC Comment 3, states that expenses for collection and enforcement such as attorney’s fees are included in a purchase money security interest for purposes of priority; however, these expenses are not included in a purchase money security interest under the Bankruptcy Code. *In re Watkins*, 298 B.R. 342, 352 (Bankr. N.D. Ill. 2003).

<sup>11</sup> K.S.A. § 84-9-103 (2001).

<sup>12</sup> *In re Vega*, 344 B.R. 616, 622 (Bankr. D. Kan. 2006).

<sup>13</sup> *Id.*; *In re Gibson*, 16 B.R. 257, 267 (Bankr. D. Kan. 1981); *In re Watkins*, 298 B.R. at 352.

essence of a purchase money security interest is that the collateral secures its purchase price. If the collateral also secures payment of some other debt, then to that extent it is not purchase money. For purposes of the Bankruptcy Code and interpreting purchase money security interest as used in the hanging paragraph, this Court adopts this narrow interpretation. The vehicle's unpaid purchase price as of the petition date is the value of the purchase money security interest. Other amounts incidental to the costs of a credit transaction such as collection costs, service contracts, and insurance are not included.<sup>14</sup>

The foregoing discussion addresses the first scenario under the hanging paragraph: a 910-car claim. However, the hanging paragraph also provides special treatment for a one-year "any other thing of value" claim.<sup>15</sup> Financed insurance premiums may provide the creditor with a purchase money security interest in the unearned premiums.<sup>16</sup> Thus, the hanging paragraph may still be applicable to the insurance cost in the context of automobile financing if (1) the creditor has a purchase money security interest securing the cost of the insurance; (2) the insurance policy itself is something of value; and (3) the debt was incurred one year preceding the filing.

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<sup>14</sup> See, e.g., *In re Billings*, 838 F.2d at 406 (parties agreed amounts for credit insurance and filing fee not included in purchase money security interest under 11 U.S.C. §522(f)); *In re Watkins*, 298 B.R. at 352 (attorney's fees incurred as costs of collection not part of purchase money security interest); *In re White*, – B.R. –, 2006 WL 2827321, at \*3 (Bankr. E.D. La. 2006) (costs of deficiency insurance and extended warranty not included in purchase money security interest under hanging paragraph); but see *In re Murray*, – B.R. –, 2006 WL 2457851, at \*7 (Bankr. M.D. Ga. 2006) (costs of credit insurance and extended warranty purchased contemporaneously with collateral included in purchase price and, thus, included in purchase money security interest).

<sup>15</sup> In addition to a 910-car claim, 11 U.S.C. § 1325(a)(\*) also applies "if collateral for that debt consists of any other thing of value, [and] if the debt was incurred during the 1-year period preceding that filing."

<sup>16</sup> See, e.g., *In re Barton Industries, Inc.*, 104 F.3d 1241, 1247 (10th Cir. 1997) (bank and creditor which financed insurance premiums had security interests in the returned premiums); *In re Smith*, 167 B.R. 895, 898 (Bankr. E.D. Mo. 1994) (auto credit corporation had allowed secured claim in cancellation value of insurance policy); *In re Cooper*, 104 B.R. 774, 776 (Bankr. S.D. W. Va. 1989) (car insurance premium financier entitled to secured claim in rebated unearned premiums).

### *Analysis*

In this case, Debtors purchased the vehicle in 2004 for a cash price of \$34,217.37. Not until two years later did CA purchase the insurance for an additional \$5,028.00. The insurance cost was not part of the vehicle's cash price. The insurance cost was not part of the costs of acquiring the vehicle. Thus, CA's unilateral purchase of collateral protection insurance was merely additional debt incurred as an incidental part of the transaction. As such, the insurance cost is not purchase money debt as to the vehicle. Accordingly, Debtors' treatment of CA's 910-car claim in the amended plan could be confirmed.

However, CA is not limited to a 910-car claim. CA also has a hanging paragraph claim for the cost of the insurance. First, CA loaned the funds to purchase the insurance policy within one year of the filing. Second, the retail installment contract provides, "Debtor hereby assigns to Secured Party any proceeds of any insurance written in connection with this agreement, including, without limitation, any returned premiums and dividends, as additional security, agreeing that Secured Party may cancel any such insurance upon default by Debtor and apply refunds to the balance then secured by this agreement." These words are sufficient to create a security interest.<sup>17</sup> Third, the insurance policy has value independent of the vehicle. Thus, CA holds a purchase money security interest in the unearned insurance premiums.<sup>18</sup>

Debtors' plan does not reject the insurance contracts, although Debtors' brief implies that is the Debtors' intent. The parties' briefs do not address the proposed treatment of CA's claim

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<sup>17</sup> *In re Watts*, 132 B.R. 31, 32 (Bankr. W.D. Mo. 1991) (contractual grant of security interest in insurance policies, premiums, and service contracts sufficient to create and perfect that interest).

<sup>18</sup> *See, e.g., id.*; *In re Smith*, 167 B.R. 895; and *In re Cooper*, 104 B.R. 774, for treatment of these types of claims prior to the enactment of the hanging paragraph.

for the insurance outside the context of including it in the 910-car claim. Thus, as it stands now before the Court, without any reference to CA's hanging paragraph insurance claim, Debtors' plan may not be confirmed.

***Conclusion***

Citifinancial Auto's Objection to Confirmation is SUSTAINED. The Debtors shall have 20 days to file an amended plan addressing CA's hanging paragraph claim for insurance costs.

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ROBERT D. BERGER  
U.S. BANKRUPTCY JUDGE  
DISTRICT OF KANSAS