UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
STATESVILLE DIVISION

IN RE:	)	**Case No. 99-50919**
	)	**Chapter 13**
DEBRA LYNN LEONARD,	)	
	)	
Debtor.	)	
	)	

JUDGEMENT ENTERED ON OCT 25 2000

ORDER GRANTING MOTION TO MODIFY PLAN

This matter was heard on October 3, 2000, upon the Debtor's Motion to Modify Plan and the Response of Associates Commercial Corporation ("Associates"). The Court believes the Debtor's Motion should be GRANTED. The facts are not in dispute.

FINDINGS OF FACT

1. Debra Lynn Leonard ("Debtor") filed a Chapter 13 case in this Court on July 27, 1999.

2. Prior to bankruptcy, the Debtor had financed two 1998 Chevrolet Dump Trucks with Associates.

3. Shortly after the filing, Associates moved for relief from stay to recover the trucks. At a hearing on October 5, 2000, the parties agreed that Associates would repossess and sell one of the two vehicles. The second truck was to be retained by the Debtor and paid for under her Chapter 13 Plan, as a partially secured claim.[1] A Consent Order memorializing this agreement was entered on January 20,2000, and then was amended on May 24, 2000. That Order contained a "time bomb" provision which would automatically

[1]The precise numbers do not appear in the record. The Debtor's original Plan proposed a secured claim of $50,000 and an unsecured portion of $13,746.75.

grant Associates relief from stay on the second truck if the Debtor failed to make payments.

4. Meanwhile, a Plan containing a bifurcated Associates claim was confirmed on January 12, 2000.

5. Unfortunately, the Debtor was unable to pay for the second truck and defaulted under the Consent Order. She then voluntarily allowed Associates to repossess the second truck.

6. On July 12, 2000, the Debtor filed this Motion seeking to strike all of Associates' claims. Since Associates has now sold both trucks and applied the proceeds to its debts, the Debtor believes the Court should bar the creditor's claims, subject to Associates filing deficiency claims. These deficiency claims would be treated as unsecured obligations under the Plan.

7. Associates objects to the proposed modification, arguing that the confirmed Plan gave it a secured claim on the second truck. Associates says that this claim cannot now be reclassified as unsecured, under principles of res judicata. It believes part of its claim should continue to be treated under the plan as secured, notwithstanding the fact that it now has no collateral.

Having consider the matter, the Court believes the Debtor's modification should be GRANTED. At this point, Associates has only unsecured claims.[2]

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[2]Assuming that deficiencies remain after its foreclosure sales.

CONCLUSIONS OF LAW

A confirmed Chapter 13 Plan binds both creditor and debtor. "The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such a creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." 11 U.S.C. § 1327(a). Some courts term the effect of this statute "res judicata," even though Section 1327's meaning is determined by the Bankruptcy Code and not by common law res judicata principles.

Because of this "res judicata" effect, some courts hold that confirmation freezes the character (secured or unsecured) and the amount of a claim for the bankruptcy case, and they cannot thereafter be changed. In re Coleman, 231 B.R. 397, 400 (Bankr. S.D.Ga. 1999); In re Meeks, 237 B.R. 856, (Bankr. N.D.Fla. 1999). In re Chrysler Financial Corp. v Nolan, 234 B.R. 390, 397 (N.D.Tenn. 1999). Therefore, if a debtor surrenders collateral to the lender after confirmation, these courts require the debtor to continue to pay the deficiency claim as a secured debt in the Plan. These courts believe that treating the deficiency as unsecured unfairly places the burden of postconfirmation depreciation on the creditor. Id.

This opinion is however, far from unanimous. A second group of courts, including all of the Bankruptcy Courts in North Carolina, will treat the deficiency claim as unsecured, unless the debtor is not acting in good faith or if it would be inequitable to do so. In re Jock, 95 B.R. 75 (Bankr. N.D.Tenn. 1989); In re Day,

247 B.R. 898 (Bankr. N.D.Ga 2000); In re Jones, 96-01470-5-ATS (Bankr. E.D.N.C. December 9, 1999)(Small, J.)(unpub.); In re Butler, 174 B.R. 44, 48 (Bankr. M.D.N.C.1994). These courts look not only to Section 1327, but to the rest of the statutory scheme. Other Code provisions must be considered, including Section 1329(a)(1), Section 502(j) and Section 506(a).

Turning to these provisions, one can see that there are a number of limitations to a plan's "res judicata" effect. One is that the Code permits postconfirmation plan modifications under certain situations. Modified plans must comply with other Chapter 13 provisions - specifically, Section 1322(a) (mandatory plan contents), Section 1322(b)(discretionary plan contents), and Section 1325(a)(confirmation requirements). Section 1329(a). Because Section 1325(a) so states, there is no question that a Chapter 13 debtor can surrender collateral in satisfaction of a secured claim after confirmation. The question is whether the deficiency can remain to be treated as secured after the surrender.

Usually it should not, because freezing a secured claim does violence to other applicable Code Sections.

First, Section 502 deals with the allowance or disallowance of claims. Subsection 502(j), expressly permits a claim to be reconsidered for cause, and allowed or disallowed according to the equities of the case. This denies the claim a res judicata effect. To say a claim is established for all intents and purposes in a case, writes Section 502(j) out of the Code.

Second, Section 506 makes a claim secured only to the extent of value in the collateral. 11 USC 506(a). After a creditor forecloses, he has no collateral and by definition, his deficiency claim is not secured.

Third, even if the matter were one of traditional res judicata/collateral estoppel, Section 506 says a valuation must be made "in light of the purpose of the valuation and the proposed disposition or use of the collateral." 11 U.S.C. 506(a). Therefore a bankruptcy valuation usually lacks a preclusive effect, because a valuation for one purpose is not a valuation for another.

For example, where the debtor intends to retain a vehicle, she must value the property at its replacement cost. In re Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L.E.2d 148 (1997). Replacement value is what a willing buyer in the debtor's situation would pay to obtain comparable property from a willing seller. Rash, 520 U.S. 953, 117 S.Ct. at 1882. On the other hand, when collateral is to be surrendered, the value to be used is foreclosure value. Id. Foreclosure value is the amount a buyer will pay when the seller has no choice but to sell, that is a forced sale. Id. Usually, there is a marked difference between the two numbers.

Here, because the Debtor intended to keep the vehicle, her plan set Associates' secured claim at replacement value. The truck's foreclosure value has never been determined. Since collateral estoppel bars only issues actually litigated, this plan valuation is not preclusive as to the truck's foreclosure value,

either at the filing date, or later when the vehicle was surrendered.

Fourth, one must consider the prejudicial effect of such treatment on other creditors. Plan payments are made out of a debtor's nonexempt prepetition and postpetition assets and/or his postpetition disposable income. Each of these is estate property (Sections 541 & 1306), and the plan must pay the value of these nonexempt assets to creditors. Section 1325(b). Indulging in the fantasy that a deficiency claim is still secured, and paying it as if it were, comes at the expense of all creditors who otherwise would receive these monies. This also is a windfall for the partially secured creditor, because he receives replacement value under the Plan, whereas he would have only received liquidation value had the collateral been surrendered at the outset of the case. This result turns the marshaling policies of the Bankruptcy Code upside down.[3] It also violates the Chapter 13 plan requirement that the same treatment be provided for each claim within a particular class. 11 U.S.C. § 1329(b)(1), 1322(a)(3).

Finally, as a practical matter, treating the deficiency claim as secured is unlikely to lead to its payment. Having lost their property to foreclosure, most debtors will dismiss their cases or convert to Chapter 7, rather than continue to pay a deficiency

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[3] "Equality of distribution is the key note of every law dealing with distribution of estates of insolvent debtors." H.R.Rep.No. 12889, 74th Cong., 2d Sess. 187 (1936). Claims of priority or security diminish the assets available to pay other creditors. Therefore, these claims are strictly construed.

claim as a secured debt, together with interest. As such, nothing is accomplished by requiring it to be treated this way.

That said, equity demands that a debtor not destroy or abuse collateral and then trade the wreckage to his lender in return for an unsecured claim. Fortunately, there are safeguards in the Bankruptcy Code that prevent this result. Under Section 502(j), when reconsidering a claim, the good faith of both the debtor and the affected creditor is at issue. This is implicit in that the wording of Section 502(j) that the claim may be allowed or disallowed "according to the equities of the case." Likewise, a plan, and therefore a modified plan, must be "proposed in good faith and not by any means forbidden by law." Section 1325(a)(3), 11 U.S.C. § 1329(b). In short, the deficiency claim should be treated as an unsecured claim only if the request was made in good faith and leads to an equitable result.

To this end, reclassification of a deficiency claim has been denied by a North Carolina Bankruptcy Court where the debtors lacked good faith. Butler, 174 B.R. at 48. In Butner, the debtors failed to maintain automobile insurance as required by their plan, drove their uninsured vehicle, and were involved in an accident. The Bankruptcy Court allowed the badly damaged van to be sold and proceeds applied to the secured claim. However, the Court refused to recast the lender's deficiency claim as an unsecured obligation because of the debtor's reckless behavior. Their actions demonstrated a lack of good faith.

While the treatment of deficiency claims is a problem without a perfect solution, the undersigned believes that the second line of cases better balances the interests of the partially secured creditor with those of the debtor and other unsecured creditors.

Since the record in this case is devoid of any evidence of bad faith or bad faith by the debtor, the Debtor's motion should be allowed.

SO ORDERED.

This the 23d day of October, 2000.

United States Bankruptcy Judge