UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

ROGER A. PHILLIPS Case No. 96-15699 K

Debtor

The question before the Court is whether the recent Second Circuit decision in the case of *GMAC v. Valenti (In re Valenti)*, 105 F.3d 55 (2d Cir. 1997), requires a change in the way car loans are treated in Chapter 13 cases in the Buffalo division of this District.[1]

The methodology that has been in place here for more than two decades was explained in the case of *In re Rossow*, 147 B.R. 1 (Bankr. W.D.N.Y. 1992). At the meeting of creditors conducted under 11 U.S.C. § 341, the Standing Chapter 13 Trustee uses the "NADA" guide for this region to establish the "trade-in" value of the vehicle, taking account of all suitable additions and subtractions for various equipment options, unusual mileage, damage to the vehicle, etc. That is the "presumptive" value of the vehicle for purposes of 11 U.S.C. § 506(a) and, consequently, for purposes of 11 U.S.C. § 1325(a)(5)(B)(ii). If the car lender is represented at the § 341 meeting, it is free to argue for a higher valuation; and whether the lender is represented at the meeting or not, the debtor is free to argue for a lower valuation. If there is no contest among the three potential participants (the debtor, the lender, and the Trustee), then at the confirmation hearing the Court adopts the NADA trade-in value (as adjusted to consider options,

[1] It is this writer's understanding that automobile valuations in the Rochester division of this District are more typically established by stipulation than is the case in the Buffalo division.

mileage, etc.) as the § 506(a) value, and confirms the Plan which the debtor has proposed and which has incorporated that value.

On the other hand, if a contest is presented at the confirmation hearing or if the lender or the debtor request an opportunity to obtain an appraisal or to provide other evidence of actual value of the vehicle in question, such an opportunity is provided and the Court will conduct an evidentiary hearing if necessary. NADA trade-in value is not and never has been "dispositive" of the value of a vehicle in this District. Rather, it is the "presumptive" value - the starting point - and becomes the established value in the absence of contest.

As explained in the *Rossow* decision, the reason that it is NADA trade-in value that has been used, rather than NADA "retail" or NADA "loan" value is because it has been thought that trade-in most closely approximates the price at which the debtor would theoretically be able to purchase the identical car from someone else. This Court noted in *Rossow* precisely what the Second Circuit noted in *Valenti*. The Second Circuit noted that use of retail value,

> ignores the possibility that the debtor could replace the vehicle at a cost below retail by purchasing another car 'as is' from a non-dealer. In addition, the debtor's car may have infirmities that would reduce its value below the retail price. The retail price includes not only a vehicle, but also dealer clean-up and fix-up costs, a dealer profit margin, and warranty. Therefore, fixing a vehicle's value under § 506(a) at retail may well compensate the creditors beyond the actual value of that creditor's collateral. In many cases, valuing a car at retail would be the same as reaffirming the debtor's original obligation.

Valenti, 105 F.3d at 62.

So far so good, with respect to this District's established methodologies.

However, the Second Circuit also criticized the use of "wholesale" (which it equated with liquidation) value as the sole measure of valuation of a vehicle. Focusing on the language of 11 U.S.C. § 506(a) the Circuit noted that although wholesale value might reflect "the value of [the] creditor's interest," it would not alone reflect "the purpose of the valuation" and "the proposed disposition or use of such property." *Id*. at 61. The Circuit observed that § 1325(a)(5)(B)(ii) only comes into play if the debtor is electing to keep the car. For that purpose, the valuation must be higher than wholesale.[2]

Thus, the Circuit stated that "the value of the creditor's allowed claim must account for the likely replacement cost of the . . . vehicle. This restrains bankruptcy courts from automatically designating the wholesale value as the value of a creditor's allowed claim." *Id.*

Again, there would seem to be no problem for the established methodology here. It is NADA trade-in value that is the starting point used here. The problem arises in the fact, brought to the Court's attention here by Chrysler Financial Corporation in its Objection to Confirmation of the present Chapter 13 Plan, that the values reported by the NADA guide under the heading trade-in are in fact wholesale values. Thus, Chrysler argues that to use NADA trade-in to establish the value of the vehicle fails to consider the intended "disposition or use" as commanded by the *Valenti* decision and violates the Second Circuit's teaching that proper construction of § 506 "restrains bankruptcy courts from automatically designating the wholesale value as the value of a creditor's allowed claim." *Id.*

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[2] In *Valenti,* the Circuit seems to have presumed that wholesale is what the lender would net after repossession. As discussed later, that is by no means an established proposition.

This issue has been briefed by Chrysler Financial Corporation and by the Debtor. The Chapter 13 Trustee has confirmed with the National Automobile Dealers Association that "for purposes of the NADA Guide, the editors do not distinguish between the terms [trade-in and wholesale], and have chosen to represent the wholesale value by using the term 'trade-in'."[3] Moreover, this Court granted leave to local counsel for General Motors Acceptance Corporation and Ford Motor Credit Company to file an amicus curiae brief in support of Chrysler's arguments and leave to an attorney who represents a large percentage of consumer debtors in this Court to file an amicus curiae brief in opposition thereto and in support of the Debtor's arguments.

Two types of arguments are raised on the Debtor's behalf. The first is that the *Valenti* decision does not command any particular starting point for valuation. Indeed, the Second Circuit stated,

> We believe the correct result is that no fixed value, whether it be retail, wholesale, or some combination of the two, should be imposed on every bankruptcy court conducting a § 506(a) valuation. None of these values would accurately reflect the value of the collateral in every Chapter 13 cramdown. . . . Therefore, as long as bankruptcy courts consider both the purpose of the valuation and the proposed use and disposition of the property, we believe that they have satisfied the requirements of § 506(a).
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> This outcome purposely leaves some degree of discretion in the hands of bankruptcy judges to shape the proceedings in the way

[3]Letter to Chapter 13 Trustee Albert J. Mogavero, Esq., dated March 3, 1997, from Marilyn Ross, Director-Corporate Legal Affairs, Legal and Regulatory Group, of the NADA, 8400 West Park Drive, McLean, Virginia.

> they see fit. For example, it allows bankruptcy judges to insure that equity among competing creditors is maintained and that a creditor is not taking advantage of a debtor's inability to replace secured property. Furthermore, this outcome insulates decisions of the bankruptcy courts from constant challenge, and it defers to local rules and state laws related to valuation.
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> Thus, we hold that a bankruptcy court is required to consider two criteria in every § 506(a) valuation: (1) the purpose of the valuation, and (2) the proposed disposition and use of the collateral. *It is irrelevant what starting point the court uses to reach the ultimate value of the claim at issue before it, as long as the final valuation of that claim reflects § 506(a)'s dual considerations."*

Id. at 62 (citations omitted) (emphasis added).

So it is argued that the current system of using trade-in value (which is now established actually to be wholesale value) does not violate the Second Circuit's command in *Valenti*, so long as it is simply used as a starting point. The second type of argument on the Debtor's behalf takes the next step: It examines the merits beyond the starting point. Here, the arguments take issue with the *Valenti* court's failure to distinguish between wholesale and liquidation values. What the lender gets after repossession and liquidation, it is argued, is wholesale *less* the costs of repossession and sale. Consequently, it is argued, the *Valenti* decision should be interpreted as restraining the Court from using a liquidation value, rather than as restraining the Court from using a wholesale value, despite the fact that the Circuit did use the word wholesale when telling bankruptcy courts in this Circuit what they ought not to exclusively use.

Further, the debtors' advocates take issue with the lenders' advocates' proposed

solution - using the average of trade-in and retail values, which was the method which the Second Circuit approved (but did not command) in the *Valenti* decision. Essentially, the debtors' advocates assert that there is no reason to believe that any given Chapter 13 debtor could not in fact obtain a true "replacement" vehicle at a price which is closer to wholesale than to the average of wholesale and retail.[4]

After due deliberation upon all of the materials submitted, the Court rules that if it were free to interpret the *Valenti* decision as if that decision had recognized a distinction between liquidation and wholesale values and had intended only to prohibit the use of liquidation value alone, thereby permitting the use of wholesale value alone, this Court would do so. However, this writer does not believe this Court is free to so interpret the *Valenti* decision.

If there is error in the *Valenti* decision it is not for this Court to correct. The language of the *Valenti* decision will be applied as it is written. Since NADA trade-in is in fact an average wholesale value, it will not alone be found by this Court to establish value. Rather, as permitted by the *Valenti* decision, NADA trade-in value will continue to be used as the "starting point," but the § 506(a) value must be found to be somewhat higher.

On the other hand, the Court does not believe that a persuasive showing has been made, that the hypothetical "replacement value" to the Debtor is best approximated by the standard used by the Court whose decision was affirmed in the *Valenti* case - the average of NADA trade-in and retail values.

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[4] The submissions examine the availability, for example, of "auto auctions" to purchasers other than registered automobile dealers.

Rather, assuming that the *Valenti* court did believe liquidation value and wholesale value to be the same, then adding ten percent (10%) to the NADA trade-in value would present an "adjusted starting point" which, when used as the presumptive § 506(a) value, comports with the *Valenti* ruling. The Court selects ten percent (10%) for this reason: Assuming arguendo that only a dealer typically can purchase a particular vehicle at its average wholesale price, then the actual replacement cost to the debtor to obtain an identical vehicle "as is" would not exceed wholesale plus whatever "commission" a dealer would charge the debtor to acquire the vehicle at wholesale, for resale to the debtor "as is." Based on the Court's experience in approving the terms and conditions of employment of brokers, auctioneers, and other sales agents, the Court believes that ten percent (10%) would be a fair commission to pay to a dealer to obtain for the debtor a particular vehicle at wholesale price for the debtor to repurchase "as is."[5]

Consequently, NADA trade-in value plus ten percent (10%) will be the presumptive value utilized by this writer in this case and in future Chapter 13 confirmation hearings, except where the average of trade-in and retail might be less. In the latter event, the average of trade-in and retail will be utilized. (It seems to the Court that as to newer cars, the average of trade-in and retail may well be less than trade-in plus ten percent (10%)).

It is to be emphasized that this, like the predecessor standard, is simply a

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[5]Of course, no such service exists. But the *Valenti* court recognized that a creditor ought not to be permitted to "[take] advantage of a debtor's inability to replace secured property." To force a debtor to a higher valuation standard because he is excluded from participation in the wholesale market is an advantage to the lender that must be confined within reasonable limits. The fictional "market" here constructed by the Court -- that of a debtor's being able to buy a vehicle "as is" at wholesale price plus a ten percent (10%) commission -- is, in this writer's view, less of a fiction than the presumption that the average of wholesale and retail is a fair measure of replacement value.

"presumptive" value. Any party is free to offer evidence of the true value of a particular vehicle in any case, whether the value is argued to be higher or lower.

It is also to be emphasized that the standard used in the court whose decision was approved in *Valenti* was a standard established by local rule. Local rule making, of course, is the product of input from the community at large, the conduct of public hearings, and other processes. This District has no local rule on this subject. If the Bar of this District wishes to propose a local rule in this regard for use in future cases, this Court will willingly entertain the proposal whether or not it comports with the present decision.

SO ORDERED.

Dated: Buffalo, New York
April 2, 1997

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Michael J. Kaplan, U.S.B.J.