IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
LITTLE ROCK DIVISION

IN RE: RODNEY L. WASHINGTON **CASE NO. 4:02-bk-23642**
CHAPTER 7

ORDER GRANTING MOTION TO REDEEM PROPERTY AND DETERMINING AMOUNT OF SECURED CLAIM

On July 18, 2003, Rodney L. Washington's ("**Debtor**") Motions to Redeem Property and Northeast Arkansas Federal Credit Union's ("**NEAFCU**") Response to the Motions came on for hearing. Debtor appeared through his attorney, Charles J. Gardner. NEAFCU appeared through its attorney, Lance Owens. In open court, the parties requested that they be allowed to file written stipulations and briefs. The Court granted the request and took the matter under advisement.

The issues presented in this case are whether the three loans that Debtor has with NEAFCU are cross-collateralized and whether wholesale value or retail value is the appropriate redemption value of the collateral under 11 U.S.C. §§ 722 and 506(a). This is a core proceeding under 28 U.S.C. § 157(b)(2), and the Court has jurisdiction to enter a final judgment in this case.

FACTS[1]

On April 9, 1999, Debtor applied for a Visa Platinum credit card with a $25,000.00 limit. NEAFCU approved Debtor's application on April 13, 1999, and issued Debtor the credit card. The credit card agreement contained the following language relevant to this proceeding:

10. If you have other loans or credit extensions from issuer, or take out other loans or

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[1] The parties stipulated to the facts as recited in this opinion.

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> credit extensions with issuer in the future, collateral securing those loans or credit extensions will also secure your obligations under this agreement. However, unless you expressly agree otherwise, your household goods and dwelling will not secure your obligation under this agreement even if issuer has, or later acquires, a security interest in the household goods or a mortgage on the dwelling. . . .

On February 11, 2002, Debtor obtained two separate purchase money loans from NEAFCU for a 2001 BMW 530i ("**BMW**") and a 1991 Nissan 300 ZX ("**Nissan**"). Each car was pledged as collateral for its purchase money loan under individual Note and Disclosure Statements (the "**Notes**"). The phrase "All loans are cross-collateralized as noted in Security Agreement section" was inserted below the vehicle description on the front of both Notes under the heading "Security Offered". The Security Agreement section, found on the reverse side of both Notes, contained the following language:

> THE SECURITY FOR THE LOAN-By signing this security agreement in the signature area or by signing the statement referring to this agreement on the back of the check you receive for your loan, you give the credit union what is known as a security interest in the property described in the "Security Offered" section. . . .
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> WHAT THE SECURITY INTEREST COVERS-The security interest secures the loan described in the Truth in Lending Disclosures and any extensions, renewals, or refinancings of that loan. It also secures any other loans you have with the credit union now or in the future including any credit card loans and any other amounts you owe the credit union for any reason now or in the future, except any loan secured by your principal residence. If the property description is marked with one star (*), or the property is household goods as defined by the Credit Practice Rule, the property will secure only this loan and not other amounts you owe.

The credit card balance owed to NEAFCU is stipulated at $25,101.52. The original amount of the BMW note was $38,846.37, and the stipulated balance is $32,868.65. The original amount of the Nissan note was $6,303.92, and the stipulated balance is $3,587.76. The loan value of the BMW is $30,425.00; the wholesale value is $29,500.00-$30,500.00; and the retail value is $37,825.00. The current loan value of the Nissan is $6,000.00, the wholesale value is $6,500.00, and the retail value is

$9,995.00.

DISCUSSION

Debtor seeks to redeem the BMW and the Nissan. "An individual debtor may . . . redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt . . . by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured." 11 U.S.C. § 722. According to 11 U.S.C. § 506(a),[2] the amount of the allowed secured claim is the portion of the creditor's claim that is supported by the value of the collateral, and the debtor need only pay the amount of the secured claim in order to redeem property.[3] *See In re Tripplett*, 256 B.R. 594, 596 (Bankr. N.D. Ill. 2000). Accordingly, in order to redeem the property, the Debtor must pay the lesser of (1) NEAFCU's entire claim, or (2) the value of the collateral (*i.e.*, the allowed secured claim). *See* §§ 722; 506(a); *Tripplett*, 256 B.R. at 596. A Debtor can redeem his or her property only through a lump sum payment to the creditor. *In re McCall*, 199 B.R. 173, 175 n. 5 (Bankr. E.D. Ark. 1996) ("There is no such concept as redeeming property over a period of time.").

Although the Debtor may redeem his property under § 722, a dispute remains as to whether the loans are cross-collateralized and whether wholesale value or retail value is the appropriate valuation

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[2] "An allowed claim of a creditor secured by a lien on property . . . 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. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property . . ." 11 U.S.C. § 506(a).

[3] Some courts have explained the amount of the secured claim as being "the lesser of the unpaid balance of the claim or the value of the collateral." *In re Ard*, 280 B.R. 910, 913 n.3 (Bankr. S.D. Ala. 2002) (citing *Sears, Roebuck & Co. v. Spivey* (*In re Spivey*), 265 B.R. 357, 363 (Bankr. E.D.N.Y. 2001)).

method for redemption.[4] Debtor argues that the three loans are not cross-collateralized and that the value of the vehicles for purposes of redemption is the wholesale value of each. Conversely, NEAFCU argues that the three loans are cross-collateralized and that the Court should use the retail value as the redemption value.

To determine the amount the Debtor must pay to redeem the vehicles, the Court must first decide if the loans are cross-collateralized in order to ascertain the amount of NEAFCU's entire claim. Once that determination is made, the Court will then determine the amount of NEAFCU's allowed secured claim based on the valuation of the collateral.

A. Cross-collateralization

The enforceability of cross-collateralization clauses is a matter of state law. *See National Bank of Eastern Arkansas v. General Mills, Inc.*, 283 F.2d 574, 576 (8th Cir. 1960). Cross-collateralization clauses are generally enforceable under Arkansas law. *See National Bank of Commerce of El Dorado (In re McMullan),* 196 B.R. 818, 828 (Bankr. W.D. Ark. 1996) (citations omitted). "Parties to a loan transaction may agree that a mortgage given to secure a particular debt may also secure some other existing or future debt." *Id.*; *see also* ARK. CODE ANN. § 4-9-204(a) (stating, "[e]xcept as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral."). However, contract provisions "to the effect that security is afforded for indebtedness other than that specifically described are not favored by equity and will be construed rather strictly." *General*

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[4] Although NEAFCU argues that Debtor should be barred from redemption because his "extravagant living" caused him to be in default, NEAFCU provides no authority on this point; therefore, the Court finds no reason why Debtor should be prohibited from redemption on this basis, given the plain language of § 722.

Mills, 283 F.2d at 577 (applying Arkansas law). In Arkansas, either antecedent debt or subsequent debt may be secured by a cross-collateralization clause. *Id*. at 576. The Arkansas Supreme Court stated :

> Where a mortgage is given to secure a specific debt named, the security will not be extended as to an antecedent debt unless the instrument so provides and identifies those [antecedent debts] in clear terms, and, to be extended to cover debts subsequently incurred, these [subsequent debts] must be of the same class and so related to the primary debt secured that the assent of the mortgagor will be inferred.

Hendrickson v. Farmers' Bank & Trust Co., 189 Ark. 423, 73 S.W.2d 725, 729 (1934). This standard also applies to security interests in personal property as well as to mortgages on real property. *See e.g., In re Russell*, 165 B.R. 262, 263 (Bankr. E.D. Ark. 1994). Nevertheless, "a security interest does not attach under a term constituting an after-acquired property clause to consumer goods . . . unless the debtor acquires rights in them within ten days after the secured party gives value." ARK. CODE ANN. § 4-9-204(b)(1).

Having reviewed the documents at issue, the Court finds that the credit card debt and the vehicle loans are cross-collateralized through the language in the car Notes, not through the language in the credit card agreement.[5] The vehicles became security for the credit card debt based on the language contained in the Notes stating that collateral securing the Note also secures past loans including credit card loans. Arkansas law requires a clear identification of antecedent debt in order for collateral securing that instrument to also secure the antecedent debt. *Hendrickson*, 189 Ark. 423, 73 S.W.2d at 728. The clear language in both Notes effectively cross-collateralizes the credit card loan with both car loans.

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[5]The credit card agreement language, stating that collateral securing future loans also secures the credit card agreement, constitutes an after-acquired property clause. Under § 4-9-204(b)(1), that clause does not effectively cross-collateralize the credit card agreement with the subsequent car notes because the Debtor did not acquire rights to the cars within ten days, as the statute requires.

The Notes are also cross-collateralized with each other. These debts were incurred on the same day, and the Notes are identical except for the individual vehicle information on each. It is clear by the language in the Notes that the parties intended for the debts to be cross-collateralized. The phrase "All loans are cross-collateralized as noted in Security Agreement Section" found on the front of the Notes as well as the language in the Security Agreement (this agreement "secures any other loans you have with the credit union now or in the future") provide for the cross-collateralization of the Notes. Debtor argues that NEAFCU should have listed each car on both Notes. Although such language may have reinforced the parties' intent, it is still very clear from the language on both the front and back of the Notes that each car was to be collateral for both Notes. Parties to a loan agreement may agree that a security interest given to secure that particular debt may also secure other debts. *See McMullan,* 196 B.R. at 828. The Debtor and NEAFCU made such an agreement in the Notes, and the Court will give effect to this agreement.

All three loans are therefore cross-collateralized. The effect of the cross-collateralization is that the loan amounts will be aggregated since the entire amount owed to NEAFCU is secured by the BMW and the Nissan. The total amount of the debt to NEAFCU as of the date of stipulation, June 18, 2003, is $61, 557.93. Accordingly, in order to redeem the vehicles, the Debtor must pay the lesser of this amount or the value of the collateral (*i.e.*, NEAFCU's allowed secured claim). *See* §§ 722; 506(a); *Tripplett*, 256 B.R. at 596.

B. Valuation

Having found that the loans are cross-collateralized, the Court turns to the issue of determining the value of the vehicles. The United States Supreme Court considered valuation of vehicles in a Chapter 13 context in *Associates Commercial Corp v. Rash*, 520 U.S. 953 (1997). The *Rash* court held that §

506(a) requires application of a "replacement value" standard (rather than a foreclosure, liquidation, or wholesale value standard) when a debtor exercises a cramdown against a secured creditor under 11 U.S.C. § 1325(a)(5)(B). *Id*. Courts post-*Rash*, however, have unanimously held that the holding in *Rash* is limited to Chapter 13 cases. *See In re Weathington*, 254 B.R. 895, 899 (B.A.P. 6th Cir. 2000) (stating that the Panel could not find any cases which apply the retail or replacement valuation standard in a Chapter 7 case post-*Rash*). Other courts reason that *Rash* does not apply in a Chapter 7 redemption context because a Chapter 7 secured creditor in redemption is not exposed to the dual risks of further default and collateral depreciation, as is a Chapter 13 secured creditor in a cramdown, since the secured creditor in a Chapter 7 redemption receives a lump sum payment and releases its lien against the collateral. *See, e.g., Ard*, 280 B.R. at 914-15; *In re Henderson*, 235 B.R. 425, 428 (Bankr. C.D. Ill. 1999); *In re Dunbar*, 234 B.R. 895, 898 (Bankr. E.D. Tenn. 1999); *In re Donley*, 217 B.R. 1004, 1007 (Bankr. S.D. Ohio 1998).

This Court agrees that the *Rash* replacement valuation standard is limited to Chapter 13 cramdowns and does not extend to Chapter 7 redemptions. The vast majority of courts considering this issue have found that wholesale value[6] is the appropriate starting point for valuation in a Chapter 7 vehicle redemption. *See*, *e.g.*, *Ard*, 280 B.R. at 914-15 (citing cases). The Court may then consider other evidence pertinent to value in determining whether a reduction or increase in value in a particular case is

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[6]Some courts call this standard "liquidation value," or "foreclosure value," or use the terms interchangeably. Those courts that use these terms interchangeably generally define them as, "what a secured creditor would receive if it repossessed the collateral and sold it in the most beneficial manner it could," which is generally at auction or by other "wholesale means." *See*, *e.g.*, *Ard*, 280 B.R. at 914-15 (citations omitted).

appropriate. *See*, *e.g.*, *Ard*, 280 B.R. at 914-15. This Court joins the other post-*Rash* authorities in holding that the appropriate starting point for valuation in a Chapter 7 vehicle redemption context is the wholesale value of the vehicle. In this case, the parties stipulated that the wholesale value of the Nissan is $6,500.00, and that the wholesale range for the BMW is $25,000.00-$35,000.00. The parties did not submit additional evidence warranting an increase or decrease in the vehicles' values. Accordingly, the Court will use the wholesale value of the Nissan of $6,500.00, and the midpoint of the stipulated wholesale range for the BMW, $30,000.00, as reasonable values. Therefore, the Court finds that the total value of the collateral for redemption purposes is $36,500.00.

CONCLUSION

The Court finds that the amount of NEAFCU's allowed secured claim is $36,500.00, and that the balance of the debt owed to NEAFCU ($25,057.93) is unsecured. Debtor may redeem the BMW and the Nissan by paying $36,500.00 in a lump sum payment to NEAFCU within thirty (30) days from the date of entry of this Order.

In accordance with this order and opinion, it is hereby

ORDERED that NEAFCU's allowed secured claim is $36,500.00; the balance of NEAFCU's debt ($25,057.93) is unsecured; and it is further

ORDERED that Debtor's Motion to Redeem is **GRANTED**; Debtor may redeem the BMW and the Nissan by paying $36,500.00 in a lump sum payment to NEAFCU within thirty (30) days from the date of entry of this Order.

IT IS SO ORDERED.

HONORABLE AUDREY R. EVANS
UNITED STATES BANKRUPTCY JUDGE

DATE: August 25, 2003

cc: Mr. Charles J. Gardner, attorney for Debtor
Mr. Lance Owens, attorney for NEAFCU
Mr. A. Jan Thomas, Jr., Chapter 7 Trustee
U.S. Trustee