

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

CAREY WITHERSPOON
and SUSIE WITHERSPOON,

Case No. 02-16614

Debtors.

**ORDER SUSTAINING THE OBJECTION TO THE CLAIM OF CAPITAL ONE AUTO
FINANCE TO THE EXTENT THAT THE DEFICIENCY BALANCE BE TREATED
AS AN UNSECURED CLAIM**

Leonard N. "Chip" Maldonado, Attorney for Debtors
Brenda Drendel Hetrick, Attorney for Capital One Auto Finance
John C. McAleer III, Chapter 13 Trustee

This matter is before the Court on the debtors' objection to the claim filed by Capital One Auto Finance. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and the Court has the authority to enter a final order. For the reasons indicated below, the Court is sustaining the objection to the claim to the extent that the deficiency balance owed by the debtors to Capital One Auto Finance should be treated as unsecured.

STIPULATED FACTS

Debtors filed a Chapter 13 petition on November 20, 2002. In their filing, debtors listed Capital One Auto Finance as a creditor on a 1999 Ford Contour. Debtors listed the value of the collateral on their Schedule D as \$7,400.00 with a debt owed of \$8,232.16, leaving an unsecured balance of \$823.16. The debtors proposed in their Chapter 13 plan to pay the debt of \$7,400 with interest at 9% for a total secured claim of \$10,362.42.¹ Capital One submitted a Proof of

¹The information that is placed on the Chapter 13 plan has changed since this case was filed. Chapter 13 plans no longer indicate the total secured claim but indicate just the collateral

Claim for \$15,157.80 which included a principal amount of \$8,615.82 and interest at 28.010%. The debtors filed an objection to the claim on December 11, 2002. Capital One filed an objection to confirmation of plan on January 6, 2003. The debtors amended their Chapter 13 plan on January 14, 2003. The amendment proposed to still value the collateral at \$7,400, but pay interest at 24.95% and make a preference payment amount of \$241.00 with a total secured claim of \$13,018.80.² On January 23, 2003, the Court sustained debtors' objection to the claim of Capital One and "Ordered that the Claim filed by Capital One Auto Finance be disallowed to the extent that it exceeds the amount contained in the Debtor's Chapter 13 Plan." The debtors' Chapter 13 plan was confirmed on February 6, 2003, using the information from the amended Chapter 13 plan filed on January 14, 2003. On October 10, 2003, the debtors submitted a second amended Chapter 13 plan that was subsequently confirmed on November 7, 2003, but the changes to the plan did not affect Capital One. The Witherspoons have maintained insurance with ALFA Insurance with Capital One listed as the lien holder and a comprehensive and collision deductible of \$500 in accordance with the creditor's requirements. Capital One has requested and received Certificates of Auto Insurance. On or about May 6, 2004, debtor, Carey Witherspoon, was involved in an automobile accident that resulted in the total loss of the vehicle. On May 27, 2004, an adjuster for ALFA Insurance completed a "total loss evaluation" which valued the vehicle with a retail value of \$4,600, listed the vehicle pre-accident as in "Good condition" and adjusted the value for mileage by \$1,340 for a net value of \$3,260. With

value and interest rate.

²At the time this issue was pending, the Supreme Court had not issued their decision in *Till v. SCS Credit Corporation*, ---U.S.---, 124 S.Ct 1951, 158 L.Ed.2d 787 (2004) matter that would have provided guidance to the Court and attorneys as to the appropriate interest rate to be used in the plan.

the deductible of \$500 and adjusting for taxes and fees, ALFA Insurance is holding a check in the amount of \$2,906.90.³ On June 25, 2004, the Witherspoons filed a Motion for Instructions Re: Insurance Payment for Secured Collateral That was Destroyed. On July 27, 2004, the Court issued an order granting motion for instruction and directed that the insurance proceeds be paid to Capital One. As of July 28, 2004, the Witherspoons have made their plan payments to the Chapter 13 Trustee via wage order in the total amount of \$11,992.66. As of July 28, 2004, Capital One has been paid by the Trustee a total of \$3,769.37. The debtors now object to the claim of Capital One and propose to reduce the value of the secured claim to the amount paid by the Trustee to Capital One along with the insurance proceeds and reclassify any deficiency as unsecured.

LAW

Since the automobile accident resulted in the total loss of the vehicle and the insurance company paid out the fair market value of the car to Capital One (See Court's Order Granting Motion for Instruction), the Witherspoons involuntarily surrendered the collateral securing Capital One's claim. The issue of this case then, is whether this involuntary relinquishment of collateral allows the debtors to modify their confirmed Chapter 13 plan and reclassify the remaining balance of Capital One's claim (previously secured by the vehicle) as an allowed unsecured claim. The debtors assert that 11 U.S.C. § 502(j) gives the Court the power to modify a plan postconfirmation for cause, and that the automobile accident and insurance payout to Capital One is good cause for modifying the plan postconfirmation to reclassify any deficiency

³The parties' stipulated facts gives the value of the insurance check at \$2,906.90, but the Debtors' Motion Re: Insurance Proceeds states the check value at \$2,000.00. Whatever the correct amount is, the Court ordered all insurance proceeds be paid directly to Capital One.

balance owed to Capital One as unsecured. Capital One argues that this type of postconfirmation modification is not permissible.

There have been a multitude of cases involving the issue of whether or not a debtor in a Chapter 13 bankruptcy can modify his or her plan postconfirmation to voluntarily surrender collateral securing a debt and reclassify the deficiency as unsecured. There is a split of authority among the districts as to whether such a voluntary surrender and modification is allowed, with only one circuit court decision on the topic. *See Chrysler Financial Corp. v. Nolan (In re Nolan)*, 232 F.3d 528, 531 (6th Cir. 2000) (“[T]here is a clear and fairly even split of authority amongst the federal district courts.”).

However, this case does not involve the commonly litigated issue of voluntary surrender of collateral and modification. The debtors in this case surrendered the collateral involuntarily as a result of the vehicle being “totaled” in the automobile accident. Due to the circumstances surrounding this involuntary surrender the Debtors argue the proposed modification should be allowed by the Court under 11 U.S.C. § 502(j) for good cause.

Postconfirmation modification of a Chapter 13 plan is controlled by 11 U.S.C. § 1329. This section does not expressly allow the debtor to alter, reduce or reclassify a previously allowed secured claim. *Nolan*, 232 F.3d at 533. Although § 1329 does not expressly allow postconfirmation reclassification of claims, a claim may be reconsidered for cause. 11 U.S.C. § 502(j). Section 502(j) states in pertinent part that “[a] claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case.” Bankruptcy Rule 3008 states that “[a] party in interest may move for reconsideration of an order allowing or disallowing a claim against the estate.” “Section 502(j) and Bankruptcy Rule 3008 grant the bankruptcy court the power to reconsider for cause secured

claims that previously have been allowed.” *In re Rayborn*, 307 B.R. 710 (Bankr. S.D.Ala 2002) citing *In re International Yacht and Tennis, Inc.*, 922 F.2d 659, 662 (11th Cir. 1991).

Reconsideration under § 502(j) is a two-step process. *Rayborn*, 307 B.R. at 720. A court must first decide whether “cause” for reconsideration has been shown. *Id.* Then the court decides whether the “equities of the case” favor allowance or disallowance of the claim. *Id.*; 11 U.S.C. § 502(j). “Bankruptcy Courts have substantial discretion in deciding what constitutes ‘cause’ for reconsidering a claim pursuant to section 502(j).” *In re Coffman*, 271 B.R. 492, 498 (Bankr. N.D. Tex. 2002); *In re Davis*, 237 B.R. 177, 181-81 (M.D. Ala. 1999). This Court finds that the May 6, 2004 automobile accident that resulted in the total loss of the vehicle is “cause” for reconsideration of Capital One’s claim under § 502(j).

Since the Court finds cause to reconsider the claim, the Court must now balance the equities of the case. The debtors maintained insurance on the vehicle with Capital One listed as the lien holder and a comprehensive and collision deductible in accordance with the creditor’s requirements, and had provided Capital One with Certificates of Auto Insurance. The debtors were not defaulting on their payments to Capital One. Nor did they abuse or neglect the collateral causing excessive depreciation. The debtors maintained the car in good condition until the accident, as was evidenced by the “total loss evaluation” completed by the insurance adjuster. The debtors were acting in good faith and had done everything they were supposed to do under the plan. On the other hand, if the Court does allow the plan to be modified Capital One will lose its secured status to any unpaid portion of its claim, resulting in less money received by the creditor than it would have received under the plan. Based on the totality of the circumstances, the equities favor the debtors. Therefore, the Court can reconsider the claim under § 502(j).

In reconsidering the claim under § 502(j), the Court turns to § 506(a) to determine upon modification, the extent to which a claim is secured. *In re Zieder*, 162 B.R. 114 (Bankr. D. Ariz. 2001)⁴. Section 506(a) provides that an allowed claim “is a secured claim to the extent of the value of such creditor’s interest in the estate’s interest in” the collateral securing the claim, and “is an unsecured claim to the extent that the value [of the collateral] is less than the amount of such allowed claim.” 11 U.S.C. § 506(a). When these provisions are applied to the facts of this case, they compel the conclusion that Capital One’s remaining claim must be reconsidered for cause and, when reconsidered, it becomes an unsecured claim by operation of law. There is now no collateral securing Capital One’s claim. As a result, § 506(a) by its express terms makes the balance of Capital One’s claim unsecured. “[W]here there is no longer any collateral to secure a debt, the debt is then unsecured.” *Rayborn*, 307 B.R. at 725. Capital One’s debt became unsecured when the collateral was totaled and the insurance proceeds were ordered to Capital One. Because the vehicle is gone, the insurance proceeds were paid to Capital One, and the Witherspoons have done everything they were supposed to do, the Court determines that under § 502(j) and § 506(a) the remaining balance of Capital One’s claim is reclassified as unsecured and the debtors can modify their Plan accordingly.

The Court acknowledges that it previously followed the Sixth Circuit’s approach as set out in *Nolan*, and held that a debtor could not voluntarily surrender collateral and reclassify the balance as unsecured. *See In re Jackson*, 280 B.R. 703 (Bankr. S.D.Ala. 2001). However, the *Nolan* court did not address § 502(j) and it was not brought up by the parties in that action. In

⁴The *Zieder* case (and others) hold that secured claims may be reconsidered postconfirmation and the claims may become unsecured once the collateral is surrendered, even if the surrender is voluntary. By citing *Zieder* the Court is not indicating that it supports the *Zeider* rationale in all cases, at least at this time.

contrast, the Witherspoons' raised § 502(j) and argued that it permits the Court, under the present circumstances, to reclassify their remaining debt to Capital One as unsecured. The Court finds that under proper circumstances § 502(j) does allow the requested reclassification, and agrees with the debtors that the present circumstances are proper. Additionally, the present case is different from *Nolan* and *Jackson* because it involves an involuntary surrender due to unintentional destruction of the collateral, as opposed to the voluntary choice of the debtors to surrender their collateral after the value had depreciated. Furthermore, the debtors in *Jackson* caused excessive depreciation to the secured collateral in their possession and had made only minimal payments to their creditor when they attempted to surrender and reclassify their debt. In contrast, the debtors in this case had made timely preference payments to Capital One, the collateral was in good condition before the accident, and the insurance proceeds were paid directly to Capital One.

THEREFORE IT IS ORDERED:

The debtors' objection to the claim of Capital One Auto Finance is sustained to the extent that the secured claim of Capital One Auto Finance is reduced to the amount received by the creditor with the remaining balance treated as unsecured.

Dated: August 27, 2004


MARGARET A. MAHONEY
U.S. BANKRUPTCY JUDGE