Secured Claims Under Section 1325(a)(5)(B): Collateral Valuation, Present Value, and Adequate Protection

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I. Introduction

Chapter 13 of the Bankruptcy Reform Act[1] was a legislative response to the inability of the former Act[2] to meet the needs of overburdened consumer debtors.[3] Although most consumer bankrupts desired to work out repayment plans, the vast majority were opting for straight liquidation instead of Chapter XIII.[4] Especially in view of the attractiveness of repayment as opposed to liquidation,[5] Chapter XIII clearly was not adequately placing the repayment option before the consumer bankrupt.

The vague status of secured creditors under Chapter XIII has been cited as a major cause of the infrequency of resort to repayment plans under the old Act.[6] This ambiguity not only resulted in inconsistent treatment of secured claims among the several districts but also facilitated the abuse of Chapter XIII by secured creditors.[7] In some districts, secured creditors were afforded extra-ordinary powers merely as a result of their secured status, without regard to the actual value of their security interest.[8] Secured creditors were able to use the leverage inherent both in the uncertainty of the law[9] and in the security interests in personal effects[10] to coerce debtors

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[1]11 U.S.C. §§ 1301-1330 (Supp. IV 1980).

[2]11 U.S.C. §§ 1-1103 (1976) (repealed 1979).

[3]*See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 116 (1977) *reprinted in* [1978] U.S. Code Cong. & Ad. News 5963, 6076 [hereinafter cited as House Judiciary Committee Report]. The old Act was simply unable to meet the needs occasioned by the enormous growth in the incidence of consumer credit transactions in the post-World War II era. *Id.*, [1978] U.S. Code Cong. & Ad. News at 6076. Consumer credit was rare when the Act was drafted, and the Act was designed with the business debtor in mind. *Id.* at 116-17, [1978] U.S. Code Cong. & Ad. News at 6076-77.

[4]5 Collier on Bankruptcy ¶ 1300.02, at 1300-20 (15th ed. L. King 1981) [hereinafter cited as Collier].

[5]*See* House Judiciary Committee Report, *supra* note 3, at 118, [1978] U.S. Code Cong. & Ad. News at 6078-79.

[6]*See* 5 Collier, *supra* note 4, ¶ 1325.01[2][E].

[7]*See id.* ¶ 1325.01[2][E][1].

[8]*See id.* at 1325-18.

[9]*See* House Judiciary Committee Report, *supra* note 3, at 181, [1978] U.S. Code Cong. & Ad. News at 6142.

[10]*See id.* at 124, [1978] U.S. Code Cong. & Ad. News at 6085.

into paying them sums greatly in excess of the value of their security interests.[11]

The new Chapter 13, therefore, was specifically drafted to define the rights of secured creditors and to eliminate past inequities by bringing these rights into proportion with the actual value of their secured claims. Secured creditors were brought under the strict scrutiny and control of bankruptcy courts and were assured that they would receive the full economic value of their secured claims—no more and no less.[12]

This Article focuses on the two-step process whereby the secured creditor receives the value of his claim under a Chapter 13 plan.[13] First, the amount of the secured claim is determined; second, the amount is paid to the creditor in installments over the period covered by the plan. Judicial conflict abounds at both of these stages.

II. Amount of a Creditor's Secured Claim

Bankruptcy Code Section 506(a) gives a secured creditor a "secured claim" against the debtor's estate to the extent of the value of his collateral and an "unsecured claim" to the extent of any balance remaining.[14] In addition, section 1325(a)(5)(B) of the Code provides that a debtor's repayment plan under Chapter 13 may not be confirmed over the objections of the holder of a secured claim unless:

> (i) the plan provides that the holder of such claim retain the lien securing such claim; and
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim . . . .[15]

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[11]*See id.*, [1978] U.S. Code Cong. & Ad. News at 6085.

[12]*See id.* at 181, [1978] U.S. Code Cong. & Ad. News at 6141-42.

[13]More specifically, this Article discusses problems of collateral valuation, present value determination, and adequate protection in connection with the minimum guarantees afforded secured creditors by section 1325(a)(5)(B) of the Bankruptcy Code. Problems relating to proof of value, adequate protection during the interim between filing and confirmation, and post-petition interest under section 506(b) are beyond the scope of this Article.

[14]11 U.S.C. § 506(a) (Supp. IV 1980). Consequently, if the value of the collateral exceeds the amount of the debt to the creditor, the creditor's entire claim is secured. If, however, the value of the collateral is less than the amount of the debt, the creditor's claim is bifurcated. To the extent of the collateral's value, he has a secured claim, but to the extent of the remainder of the debt he must queue with the general creditors. *See* S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978) *reprinted in* [1978] U.S. Code Cong. & Ad. News 5787, 5854 [hereinafter cited as Senate Judiciary Committee Report].

[15]11 U.S.C. § 1325(a)(5)(B) (Supp. IV 1980).

Consequently the value of the collateral securing a debt governs the extent of a secured creditor's rights under a Chapter 13 plan.

Courts have experienced substantial difficulty with collateral valuation in this context. Disparity has developed among courts regarding the appropriate measure of value. Moreover, inconsistency has developed regarding the proper time at which value should be determined. As will be shown, the lack of a consistent scheme of collateral valuation in this Chapter 13 context is a result of insufficient regard for the purpose of the valuation and the policies behind the Code.

A. Measure of Value

Determination of the value of collateral, hence the amount of a creditor's secured claim, has consequences beyond those pertaining to the creditor's rights under section 1325(a)(5)(B). Whether a debtor has equity in collateral for purposes of lifting the automatic stay hinges on a determination of the collateral's value.[16] Value determination is also crucial in the context of adequate protection.[17]

Because of the variety of purposes for which a value determination must be made, the Code makes it clear that "value shall be determined in light of the purpose of the valuation . . . ."[18] Moreover, legislative history indicates that a determination of value for one purpose was not intended to bind the parties in later proceedings to determine value for another purpose.[19]

The purpose of valuation under section 1325(a)(5)(B) is to ensure, as a matter of fairness, that a secured creditor who is forced to accept a repayment plan will receive the equivalent of what he would

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[16]*See, e.g.*, Imperial Bank v. El Patio, Ltd. (*In re* El Patio, Ltd.), 6 Bankr. 518 (C.D. Cal. 1980).

[17]*See, e.g.*, ABD Fed. Credit Union v. Williams (*In re* Williams), 6 Bankr. 789 (E.D. Mich. 1980).

[18]11 U.S.C. § 506(a) (Supp. IV 1980). Section 506(a) also provides that "the proposed disposition or use" of the collateral is to be considered in determining value. *Id.* It is difficult to imagine how the proposed disposition or use of collateral would affect its value for purposes of determining the extent of a creditor's secured claim. Cases discussing value in this context have paid lip service to the "proposed disposition or use" language, but have not allowed the language to influence their determination of value. *See, e.g., In re* Damron, 8 Bankr. 323, 325 (S.D. Ohio 1980). *Cf. In re* Crockett, 3 Bankr. 365, 367 (N.D. Ill. 1980) (debtor's continued use of collateral made repayment feasible and enhanced value of creditor's secured claim). The language was probably intended to apply to value determinations in other contexts. For example, if value was being ascertained for purposes of determining whether a secured creditor was adequately protected, the proposed use of the collateral would be highly relevant insofar as the use would result in future depreciation.

[19]*See* Senate Judiciary Committee Report, *supra* note 14, at 68, [1978] U.S. CODE CONG. & AD. NEWS at 5854.

have realized if allowed to pursue the remedies available to him outside of bankruptcy.[20] In virtually all cases, therefore, the value of collateral for section 1325(a)(5)(B) purposes should be what the creditor would receive upon repossession and sale of the collateral.[21] This sum would be, simply, the net amount[22] which would be realized through a commercially reasonable sale[23] in the market to which the creditor has access.[24]

In a number of section 1325(a)(5)(B) cases, however, courts have failed to comply with the legislative mandate of determining value in light of the purpose of the valuation. *In re Willis*[25] is perhaps the most extreme example of this phenomenon. In *Willis*, the court established valuation guidelines to "eliminate the need for repetitious hearings on present and future value of collateral at . . . Chapter 13 confirmation hearings."[26] Under the guidelines, automobiles are valued at their blue book value and furniture, appliances, carpeting, and draperies are valued on a cost-less-depreciation

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[20]*See* Chrysler Credit Corp. v. Van Nort (*In re* Van Nort), 9 Bankr. 218, 221 (E.D. Mich. 1981); *In re* Damron, 8 Bankr. 323, 325-26 (S.D. Ohio 1980).

[21]More specifically, the value should be the value the collateral would have in the creditor's hands upon his repossession. In most cases, this value would be determined by ascertaining what the creditor would receive through a commercially reasonable disposition of the collateral. *See* U.C.C. § 9-504(3) (1978). If, however, the security agreement relieves the creditor of his obligation to dispose of the collateral, the creditor should not be bound by the above standard. For example, collateral with speculative value would arguably be worth more in the creditor's hands if he were not obligated to dispose of the collateral.

Similarly, valuation should account for any going-concern value that the collateral would have in the creditor's hands. Thus, if a creditor is entitled under his security agreement to realize the going-concern value of business assets held as collateral, the value of the business assets should be determined in light of their value as part of a going-concern. It has been posited that a creditor should benefit from going-concern value even in the absence of a right outside of bankruptcy to realize such a value. *See* Comment, *Bankruptcy Reform Act of 1978: Chapter 13 Cramdown of the Secured Creditor*, 1981 WIS. L. REV. 333, 343 & nn. 62, 65. This analysis is unsound because it places a creditor in a better position in bankruptcy than he would have been in outside of bankruptcy. *See* note 20 *supra* and accompanying text.

[22]Because the debtor's retention of the collateral relieves the creditor of expenses associated with resale, the creditor should not be allowed to realize the full amount he would receive on resale. The amount which would be received on resale must be reduced by selling costs to determine the amount to which the creditor is entitled. *See* Comment, *supra* note 21, at 342.

[23]*See* note 21 *supra*.

[24]*See In re* Klein, 10 Bankr. 657, 660 (E.D.N.Y. 1981); *In re* Damron, 8 Bankr. 323, 326 (S.D. Ohio 1980); Virginia Nat'l Bank v. Jones (*In re* Jones), 5 Bankr. 736, 739 (E.D. Va. 1980); *In re* Crockett, 3 Bankr. 365, 367 (N.D. Ill. 1980); *In re* Adams, 2 Bankr. 313, 313-14 (M.D. Fla. 1980).

[25]GMAC v. Willis (*In re* Willis), 6 Bankr. 555 (N.D. Ill. 1980).

[26]*Id.* at 557.

basis.[27] A valuation hearing is held in the "exceptional situations" in which the guidelines do not establish values acceptable to the parties in interest.[28] Even then, however, it is questionable whether a party would be allowed to prove a value in excess of that established by the guidelines.[29]

By relegating the valuation hearing to the status of a "last resort," the *Willis* court demonstrated complete disregard for the importance of value determination under Chapter 13[30] and the flexibility with which Congress intended courts to approach questions of

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[27]*Id.* at 557-58. Specifically, the guidelines provided that value be determined in the following manner:

(a) *Automobiles*

The Average Trade-In value as shown in the N.A.D.A. Official Used Car Guide for the month in which was filed the debtor's petition for relief will be taken as present value.

(b) *Furniture*

The cost of the furniture new will be used as a base against which the following percentages shall be applied to determine present value:

Less than one year old	75%
One year to two years old	50%
Two years to three years old	25%
More than three years old	0

(c) *Appliances (including TV and Stereo)*

The cost of the appliances new will be used as a base against which the following percentages shall be applied to determine present value:

Less than one year old	80%
One year to two years old	65%
Two years to three years old	50%
Three years to four years old	25%
More than four years old	10%

(d) *Carpeting and Draperies*

The cost of the finished goods new will be used as a base against which the following percentages shall be applied to determine present value:

Less than one year old	25%
One year to two years old	10%
More than two years old	0

[28]*Id.* at 558.

[29]*Id.* at 557.

[30]*See* text accompanying notes 6-13 *supra.* For example, the *Willis* court did not believe it was necessary "to take recognition of the probability that a stove will outlast a television set." 6 Bankr. at 558. Both of these items are depreciated at the same rate under the guidelines. It is likely that a creditor with a security interest in the stove would not agree with this generalization, and rightly so. The question of value is too fact-sensitive to be resolved by a handful of general guidelines. Within practical limits, accuracy in determining value should not be sacrificed for the sake of expediency. As stated by one court, "however tempting the easier route to resolution may be, the Court finds that it cannot equate ease with equity nor fairness with fair market value." *In re* New York, New Haven & Hartford R.R., 4 Bankr. 758, 791 (D. Conn. 1980).

valuation in order to ensure proper compensation of secured creditors under section 1325.[31] The guidelines purport to approximate the value of collateral in the abstract, without regard to the actual amount a creditor could expect to receive upon repossession and sale of the collateral. No consideration is given to the market available to the creditor on resale or the actual condition of the collateral.[32]

In light of the significance afforded the value determination process under Chapter 13, it is inconceivable that Congress intended for courts to adopt inflexible valuation standards and discourage use of the valuation hearing. It is more reasonable to infer that Congress intended for the valuation hearing to acquire increased significance in promoting equitable distribution of the bankrupt's assets.

Disregard of the valuation's purpose in determining the value of collateral was evinced in *In re Miller*, in which the parties agreed that the value of an automobile for purposes of section 1325(a)(5)(B) was the debtor's replacement cost.[33] Had the creditor been a retail dealer, the debtor's replacement cost would have approximated the value the creditor would have realized upon repossession and sale of the automobile.[34] In *Miller*, however, the creditor's customary means of disposition would likely have been through the wholesale market.[35] Consequently, the section 1325(a)(5)(B) value of the automobile was lower than the parties believed, and the creditor's secured claim was inflated. Under these circumstances, the court could have appropriately refused to confirm the plan, instructed the parties on the proper means of valuation, and rescheduled the confirmation hearing.[36]

Similarly, in *In re Jordan*[37] neither party argued the proper standard for a section 1325(a)(5)(B) valuation. *Jordan* involved a question of the value of a husband's interest in entireties property for purposes of determining the amount of a judicial lien-creditor's secured claim. The creditor argued that the value should be the husband and wife's combined equity in the property; the debtor-husband contended

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[31]This flexibility is implicit in the wording of section 506(a). *See* Virginia Nat'l Bank v. Jones (*In re* Jones), 5 Bankr. 736, 738 (E.D. Va. 1980).

[32]The current condition of the market available to the creditor is also an important consideration. *See In re* Crockett, 3 Bankr. 365, 367 (N.D. Ill. 1980).

[33]Ford Motor Credit v. Miller (*In re* Miller), 4 Bankr. 392, 393 (S.D. Cal. 1980).

[34]The replacement cost would actually exceed the value which the creditor would realize on resale by an amount equal to the creditor's selling costs. *See* note 22 *supra*.

[35]The creditor was Ford Motor Credit, a finance company.

[36]*See* Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537, 543 (N.D. Ga. 1980) in which the court, unsatisfied with the parties' arguments in connection with the present value of the creditor's secured claim, requested new arguments on the issue.

[37]Jordan v. Borda (*In re* Jordan), 5 Bankr. 59 (D.N.J. 1980).

that the value was one-half the total equity.[38] The court recognized the fault in the parties' arguments, that is, that they were viewing section 1325 value without regard to the creditor's actual realization on resale.[39]

"The starting point for valuing [the creditor's] claim," stated the court, "should be an understanding of exactly what he has without, for the moment, a consideration of the bankruptcy . . . ."[40] Upon foreclosure and sale, the creditor could sell only the husband's right of survivorship and the husband's interest as a tenant in common with the wife.[41] The amount received for these rights would likely be less than the value argued by either party.[42] Nevertheless, the court adopted the debtor's measure of value, finding that measure to be "more appropriate" than the creditor's.[43] Again, it would seem to have been *most* appropriate if the court had refused to confirm the plan, instructed the parties regarding the proper measure of section 1325 value, and requested new arguments on the valuation issue.[44]

A final case which poses an interesting problem regarding section 1325(a)(5)(B) value is *In re Stumbo*,[45] in which Chrysler Credit Corporation was the assignee of a security interest in an automobile sold to the debtor by the dealer-assignor. By the terms of the assignment contract, the dealer agreed that in the event Chrysler Credit repossessed the automobile the dealer would purchase the automobile from Chrysler Credit for $10,676.29, a sum clearly in excess of the automobile's actual value. After assignment of the security interest, the debtor filed a Chapter 13 petition.

At the confirmation hearing Chrysler Credit successfully argued that the value of its secured claim was $10,676.29—the amount it would receive upon repossession and sale of the automobile to the

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[38]*Id.* at 61-62.

[39]*Id.* at 62.

[40]*Id.*

[41]*Id.*

[42]The court referred to Newman v. Chase, 70 N.J. 254, 359 A.2d 474 (1976) in which the purchaser of the husband's interest in entireties property acquired the husband's right of survivorship and became a tenant in common with the wife. The purchaser did not, however, have the right to demand partition of the property. *Id.* at 262, 359 A.2d at 478-79. Though the purchaser was entitle to receive one-half of the rental value of the property from the wife, who retained possession, he was also obligated to account for one-half of the costs associated with the property. *Id.* at 266-68, 359 A.2d at 480-81. In *Newman*, the result of these calculations was that the purchaser received no income from the property; rather, he was obligated to account to the wife for his share of the net loss on the property. 5 Bankr. at 62 n.5.

[43]5 Bankr. at 62.

[44]*See* note 36 *supra.*

[45]7 Bankr. 939 (D. Colo. 1981).

dealer.[46] In accepting Chrysler Credit's argument, the court reasoned:

> The proposed valuation is the amount which the creditor could receive if it were granted its property under foreclosure as the cram-down provisions of § 1325(a)(5) are a simple substitution by the Congress of payment to the creditor of the amount it would receive if it in fact foreclosed upon the property.[47]

At first blush, the *Stumbo* court's argument appears to be sound because it looks to the position of the creditor upon foreclosure and sale to determine the amount of its secured claim. The decision, however, has not been followed by other bankruptcy courts.[48] The logic often used in rejecting *Stumbo* is reflected in *In re Cooper*,[49] in which the court reasoned that "'value' as used in § 506(a) . . . contemplates current fair market value of the particular collateral."[50] Because the price established by the repurchase agreement bore no relation to the value which would be established by the marketplace, it would be error to use the figure as the collateral's section 506(a) value.[51]

This argument, however, does not adequately respond to the position adopted by the *Stumbo* court. That argument, properly premised on the *purposes* of section 1325(a)(5)(B) valuation, is not adequately rebutted by the mere assertion that section 506(a) contemplates fair market value. Few would attack the result obtained in *Cooper*. In a Chapter 13 proceeding, the unfairness inherent in allowing a creditor and a third party to arbitrarily establish inflated

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[46]*Id.* at 939-40.

[47]*Id.* at 940.

[48]*See In re* Clements, 11 Bankr. 38, 39 (N.D. Ga. 1981); *In re* Beranek, 9 Bankr. 864, 865-66 (D. Colo. 1981); Chrysler Credit Corp. v. Van Nort (*In re* Van Nort), 9 Bankr. 218, 221 (E.D. Mich. 1981); Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537, 539-40 (N.D. Ga. 1980); *In re* Willis, 2 C.B.C.2d 141, 144 (W.D.N.C. 1980); Virginia Nat'l Bank v. Jones (*In re* Jones), 5 Bankr. 736, 739 n.1 (E.D. Va. 1980); *cf. In re* Fortson, 14 Bankr. 710, 711 (N.D. Ga. 1981) (failure to use value stated in repurchase agreement does not deny creditor adequate protection).

[49]Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537 (N.D. Ga. 1980). *But see* Chrysler Credit Corp. v. Van Nort (*In re* Van Nort), 9 Bankr. 218 (E.D. Mich. 1981), which poses a somewhat stronger argument. The *Van Nort* court argues that the rights under a repurchase agreement are not among the interests intended to be protected by section 1325. *Id.* at 220-21. "The interest protected by § 1325(a)(5) is the right a creditor has to realize the value of certain property—the property subject to its lien." *Id.* at 221. Though this reasoning is superior to that used by the *Cooper* court, it still does not adequately explain *why* the rights under a repurchase agreement are not among the interests protected by section 1325.

[50]7 Bankr. at 539-40.

[51]*Id.* at 540.

collateral value to the detriment of the bankrupt and unsecured creditors is self-evident. To rebut the *Stumbo* court's argument, however, it is necessary to show that the purposes of section 1325(a)(5)(B) do *not* demand that the creditor be guaranteed the amount he would receive under the repurchase agreement.

Section 1325(a)(5)(B) is meant to ensure that a secured creditor will receive the equivalent of recourse to the collateral which was the inducement for extending the loan to the debtor. In other words, section 1325(a)(5)(B) protects the creditor's expectations of recovery against the debtor in the event of default. As long as only the debtor and creditor are involved, these expectations are protected by guaranteeing the creditor the amount he would receive upon repossession and sale of the collateral.

The existence of a repurchase agreement, however, alters the creditor's expectations. Though the creditor still only expects to recover the value of the collateral from the debtor, he anticipates additional recovery from the dealer in the amount by which the repurchase price exceeds the market value of the collateral in the creditor's hands. Thus, permitting the creditor to recover only the fair market value of the collateral in his hands *does* protect his expectations of recovery *as against the debtor.*

Although the creditor's expectations of recovery against the dealer are, admittedly, thwarted, the creditor is clearly in the best position to protect his bargain with the dealer. The insertion of a provision that, upon the debtor's bankruptcy, the dealer is required to tender the repurchase price to the creditor and is subrogated to the rights of the creditor would protect the creditor's expectations of recovery against the dealer *at the expense of the dealer*—not at the expense of the debtor.

B. Timing of Valuation

The Code is silent on the issue of *when* collateral should be valued for purposes of determining the amount of a creditor's secured claim. A few courts, however, have misread the Code and determined that section 1325(a)(5)(B) provides that collateral should be valued on the effective date of the plan for this purpose.[52]

Section 1325(a)(5)(B) prohibits confirmation of a plan over a secured creditor's objection unless the plan provides for payment of the equivalent of the amount of the creditor's secured claim on the

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[52]*See, e.g., In re* Klein, 10 Bankr. 657, 660-61 (E.D.N.Y. 1981); GMAC v. Willis (*In re* Willis), 6 Bankr. 555, 559 (N.D. Ill. 1980); *In re* Smith, 4 Bankr. 12, 12 (E.D.N.Y. 1980).

date of confirmation.[53] A careful reading of the section reveals that it does not address the question of when the secured claim is to be determined. It merely provides that the amount of the secured claim, whenever determined, must be paid to the creditor "as of the effective date of the plan."[54] If the payments are made in installments, the creditor is entitled to compensation for the time value of his money.[55]

The source of the difficulty encountered by some courts in interpreting section 1325(a)(5)(B) is probably the section's directive that "the value . . . of *property* to be distributed under the plan" must be determined as of the plan's effective date.[56] "Property" in the preceding passage clearly refers to the property, usually cash, which the debtor proposes to give the creditor in satisfaction of the creditor's claim.[57] A careless reading of the section, however, might lead the reader to believe that "property" refers to the collateral securing the debt.[58] Hence, the erroneous interpretation.

Why was Congress silent regarding the date of valuation for purposes of establishing the creditor's secured claim under section 1325(a)(5)(B)? This silence is clearly in accord with Congress' desire that "value" be a flexible concept.[59] Therefore, it might be argued that Congress did not intend for any single date to be used for purposes of determining a creditor's secured claim in this context. Rather, courts should be permitted to establish the appropriate valuation date on a case-by-case basis.

It must be emphasized, however, that the flexibility envisioned by Congress was flexibility depending on the purpose of the valuation and the circumstances of the case.[60] Selection of a single date

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[53]*See* 11 U.S.C. § 1325(a)(5)(B) (Supp. IV 1980), *reprinted in* text accompanying note 15 *supra*.

[54]*Id.* § 1325(a)(5)(B)(ii).

[55]*See* text accompanying notes 115-25 *infra*.

[56]11 U.S.C. § 1325(a)(5)(B)(ii) (Supp. IV 1980) (emphasis added).

[57]*See, e.g.*, GMAC v. Hyden (*In re* Hyden), 10 Bankr. 21, 22-23 (S.D. Ohio 1980) (quoting 5 COLLIER, *supra* note 4, ¶ 1325.01[2][E][2][b][ii][A][2], at 1325-24).

[58]In *In re* Smith, 4 Bankr. 12, 12 (E.D.N.Y. 1980), for example, the court stated: "This Court finds that the value of the collateral as of the date of the confirmation hearing was $2,600. *This is also deemed to be the value as of the effective date of the plan within the meaning of section 1325(a)(5)(B)(ii). . . .*" (emphasis added). In support of this statement the court cited 5 COLLIER, *supra* note 4, ¶ 1325.01[2][E][2][b][ii][A][3][b][i], at 1325-25. That passage in *Collier* states that "[t]he value of property to be distributed under the plan is to be ascertained as of the effective date of the plan." *Id.* Therefore, the court must have believed that "property to be distributed under the plan" meant "collateral."

[59]*See* note 31 *supra*.

[60]*See* Senate Judiciary Committee Report, *supra* note 14, at 68, [1978] U.S. CODE CONG. & AD. NEWS at 5854; House Judiciary Committee Report, *supra* note 3, at 356, [1978] U.S. CODE CONG. & AD. NEWS at 6312.

for purposes of determining a creditor's secured claim does not contravene this notion of flexibility.[61] To the contrary, logic would seem to require that valuation for a particular purpose be performed consistently. A single valuation date should be established for the purpose of determining a creditor's secured claim under section 1325(a)(5)(B).

The effect of the valuation date on the ultimate distribution of a debtor's assets must be considered in determining the date which best furthers the goals of Chapter 13. Whether the valuation date is significant in this respect depends on whether the collateral is depreciating or appreciating.[62]

Seemingly, in the case of depreciating collateral, a secured creditor would benefit at the expense of general creditors if the collateral is valued early in the proceedings. An earlier valuation would certainly increase the amount of the creditor's secured claim. However, to the extent that a delay in valuation would cause a decrease in the creditor's secured claim, the creditor would be entitled to recovery based on adequate protection.[63] The creditor therefore would receive the same amount regardless of when his secured claim was determined.

If, on the other hand, the collateral is appreciating, the timing of valuation does affect the amount a secured creditor will ultimately receive. Although the Code protects the creditor against depreciation of his collateral during the automatic stay, it does not provide a corresponding guarantee that the creditor benefit from appreciation of his collateral during the same period. Consequently, the longer the creditor delays valuing his secured claim, the greater his recovery under the Chapter 13 plan will be.

Valuing the collateral at a date other than the filing date would, therefore, allow a secured creditor to speculate at the expense of general creditors. The creditor would delay valuation as long as possible, knowing that he was protected against depreciation of the

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[61]For example, the legislature intended for the filing date to be used to determine the amount of a creditor's secured claim for adequate protection purposes. In discussing the treatment of secured claims, the House Judiciary Committee stated: "[f]or the creditor, the bill requires that once the secured claim is determined, the court must insure that the holder of the claim is adequately protected." House Judiciary Committee Report, *supra* note 14, at 181, [1978] U.S. CODE CONG. & AD. NEWS at 6141. Adequate protection is guaranteed from the time the petition is filed. *See* 11 U.S.C. §§ 361, 362(d)(1) (Supp. IV 1980). Therefore, the secured claim must be determined as of the filing date when the court is faced with an adequate protection question.

[62]If the value of the collateral is static, of course, the date of valuation will have no effect on the distribution of the debtor's assets.

[63]*See* 11 U.S.C. § 362(d)(1) (Supp. IV 1980); GMAC v. Miller (*In re* Miller), 13 Bankr. 110, 117 (S.D. Ind. 1981).

collateral and hoping that the collateral would appreciate, thereby increasing his secured claim—a perfect hedge.

Clearly, allowing a secured creditor to speculate at the expense of general creditors is contrary to the purposes of the Code.[64] If the potential for speculation is to be eliminated, the secured creditor's claim must be established as of the date the Chapter 13 petition is filed.

Valuing a creditor's secured claim as of the filing date is desirable in other respects as well. It is sensible to use the filing date because "[t]hat is the date on which the estate [is] created and the creditor's rights [become] fixed."[65] In addition, the debtor's task of formulating a plan in compliance with section 1325 is simplified because of his ability to judge the value of a creditor's secured claim in retrospect.[66] Similarly, the court would always have the benefit of hindsight when questions arise concerning the amount of a secured claim.[67]

III. Payment of the Secured Claim

A. Present Value

A secured creditor's entitlement to compensation for the time value of his claim arises from the language of section 1325(a)(5)(B)(ii) which allows the court to confirm a plan only if "with respect to each allowed secured claim provided for by the plan . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim . . . . "[68] After a thorough examination of the legislative history of Chapter 13 and 11, several courts have interpreted the language of section 1325(a)(5)(B)(ii) to require the application of present value analysis to proposed deferred payments.[69] Simply

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[64]*See In re* Adams, 2 Bankr. 313, 314 (M.D. Fla. 1980); *cf.* Annot., 21 A.L.R. Fed. 289, 291-94 (1974) (discussing the date of valuation and the ability of secured creditors to speculate at the expense of other creditors under the old Bankruptcy Act).

[65]*In re* Adams, 2 Bankr. at 314.

[66]Bankr. R. 13-201 permits the debtor to file his Chapter 13 plan within 10 days of the filing of his petition. Determining the amount of secured claims as of the filing date would, therefore, allow the debtor to exercise hindsight in estimating the payments which should be made to secured creditors under the plan.

[67]*See* Chemical Bank v. American Kitchen Foods, Inc. (*In re* American Kitchen Foods, Inc.), 2 *Bank. Ct. Dec.* (CRR) 715, 719 (D. Me. June 8, 1976) (valuation of collateral as of filing date "involves judicial hindsight and is therefore easier, as a rule, than where neither the amount nor the condition of the collateral can be confidently forecast . . . ."). *But see* Comment, *supra* note 21, at 345 n.71 (arguing that current valuation is easier than retrospective valuation).

[68]11 U.S.C. § 1325(a)(5)(B)(ii) (Supp. IV 1980).

[69]GMAC v. Miller (*In re* Miller), 13 Bankr. 110 (S.D. Ind. 1981); GMAC v. Hyden

put, section 1325(a)(5)(B)(ii) requires that the present value of the debtor's proposed stream of future payments equal the value of the secured claim. The rationale behind this requirement is most clearly stated by the court in *In re Benford*:[70] "One need not possess a great deal of business and financial acumen to appreciate that a dollar today is worth more than a dollar tomorrow."[71]

There is no dispute that a Chapter 13 plan must provide for the time value of the secured creditor's claim to be confirmed. Nor is there any disagreement that interest payments readily provide a simple mechanism of accounting for time value.[72] The rub occurs when the parties attempt to determine the appropriate interest rate. The number of methods employed to arrive at the appropriate interest rate almost equals the number of decisions confronting this issue: the legal judgment rate;[73] the average of an arbitrary floor rate, the debtor's contract rate, and the statutory maximum rate on installment contracts;[74] the average of the debtor's contract rate and the current contract rate;[75] the contract rate;[76] the IRS rate;[77] the average of the legal judgment rate and the contract rate;[78] the prime rate;[79] the three-month United States Treasury Bill rate;[80] arbitrary rates;[81] the current contract rate;[82] and the current market rate.[83]

(*In re* Hyden), 10 Bankr. 21 (S.D. Ohio 1980); GMAC v. Anderson (*In re* Anderson), 6 Bankr. 601 (S.D. Ohio 1980); *In re* Ziegler, 6 Bankr. 3 (S.D. Ohio 1980); *In re* Crockett, 3 Bankr. 365 (N.D. Ill. 1980); GMAC v. Lum (*In re* Lum), 1 Bankr. 186 (E.D. Tenn. 1979).

[70]14 Bankr. 157 (W.D. Ky. 1981).

[71]*Id.* at 158.

[72]5 COLLIER, *supra* note 4, ¶ 1325.01[3][b][ii], at 1325-26.

[73]*In re* Marx, 11 Bankr. 819, 822 (S.D. Ohio 1981); *In re* Williams, 3 Bankr. 728, 732 (N.D. Ill. 1980).

[74]GMAC v. Hyden (*In re* Hyden), 10 Bankr. 21, 27 (S.D. Ohio 1980).

[75]GMAC v. Miller (*In re* Miller), 13 Bankr. 110, 113 (S.D. Ind. 1981); *In re* Kibler, 8 Bankr. 957, 960 (D. Hawaii 1981).

[76]Memphis Bank & Trust Co. v. Walker (*In re* Walker), 14 Bankr. 264, 266 (W.D. Tenn. 1981); *In re* Clements, 11 Bankr. 38, 40 (N.D. Ga. 1981); GMAC v. Anderson (*In re* Anderson), 6 Bankr. 601, 610 (S.D. Ohio 1980); *In re* Rogers, 6 Bankr. 472, 475 (S.D. Iowa 1980); *In re* Smith, 4 Bankr. 12, 13 (E.D.N.Y. 1980).

[77]*In re* Caudle, 13 Bankr. 29, 38 (W.D. Tenn. 1981) (citing 26 U.S.C. § 6621); *In re* Strong, 12 Bankr. 221, 225 (W.D. Tenn. 1981); *In re* Crotty, 11 Bankr. 507, 510 (N.D. Texas 1981); *In re* Ziegler, 6 Bankr. 3, 6 (S.D. Ohio 1980).

[78]*In re* Klein, 10 Bankr. 657, 661-62 (E.D.N.Y. 1981).

[79]Ford Motor Credit v. Miller (*In re* Miller), 4 Bankr. 392, 394 (S.D. Cal. 1980).

[80]GMAC v. Willis (*In re* Willis), 6 Bankr. 555, 557 (N.D. Ill. 1980).

[81]Chrysler Credit Corp. v. Van Nort (*In re* Van Nort), 9 Bankr. 218, 222 (E.D. Mich. 1981); *In re* Weaver, 5 Bankr. 522, 523 (N.D. Ga. 1980); *In re* Crockett, 3 Bankr. 365, 368 (N.D. Ill. 1980); GMAC v. Lum (*In re* Lum), 1 Bankr. 186, 188 (E.D. Tenn. 1979).

[82]Chrysler Credit Corp. v. Cooper (*In re* Cooper), 11 Bankr. 391, 394 (N.D. Ga. 1981).

[83]*In re* Benford, 14 Bankr. at 160.

This plethora of rates demonstrates, if not the courts' answer to "creative financing," the blatant inequities among districts in the treatment of secured creditors.

Clearly, what is needed is a uniform measurement of the appropriate interest rate to be applied to the deferred payments. To be useful, the selected measure must be susceptible of uncomplicated application to a broad range of financial transactions.

An appropriate starting point to develop a useful measure is to focus on the purpose of using present value analysis in a Chapter 13 setting. Generally, present value can be viewed as the value of money at a present date which will be paid or received in future periods. For the secured creditor, the present value of his claim is the amount he would realize if he had the full amount of his allowed secured claim in his hands on the effective date of the plan and could invest it at the prevailing rate of return for a period equal to the length of the debtor's plan.[84] Outside of bankruptcy, the prevailing rate of return or interest rate will be largely determined by: (1) preferences of individuals for current consumption over future consumption; (2) the supply of potentially productive investments; and (3) anticipated inflation.[85] These elements are reflected in the current market rate which is the result of all borrowers and lenders stating their beliefs as to each of the three elements. No one lender or borrower can affect the market rate. If a lender sets his interest rate or price of credit too high, no one will borrow from him. Conversely, if a borrower's risk is greater than the risk compensated for by the market rate, no one will lend money to him. Thus, the current market rate of interest could serve as a uniform and straightforward measure to be employed in the present value analysis of section 1325(a)(5)(B)(ii).

As in the case of valuation of collateral, the appropriate market is the market which the secured creditor confronts.[86] For example, a creditor in the business of making automobile loans could lend the money to another debtor at the prevailing interest rate charged on automobile loans if he had the money in his hands rather than restricted to the bankrupt's rehabilitation. The prime rate is immaterial because it represents the lowest rate of interest on short-term loans charged to businesses with the highest credit rating, a money market measure of the cost of capital.[87] Similarly, the legal judgment rate is immaterial because the creditor is not limited to what he

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[84]*In re* Smith, 4 Bankr. 12, 13 (E.D.N.Y. 1980).

[85]W. SHARPE, INVESTMENTS 79-84 (1981).

[86]*See* notes 20-24 *supra* and accompanying text.

[87]L. SCHALL & C. HALEY, INTRODUCTION TO FINANCIAL MANAGEMENT 551-52 (1977).

could collect on a judgment granted by a court but may go into the market for automobile loans and receive the rate that the market is currently willing to give lenders.

The importance of defining the creditor's relevant market becomes clear if the Chapter 13 plan is viewed as an involuntary loan where the secured creditor is forced to forgo the investment opportunities he would have had outside bankruptcy. Recognition of this inequitable situation led the court in *In re Cooper*[88] to posit that the "best method to ascertain the value of money to a creditor paid over a period of time is to determine what that particular creditor routinely receives as negotiated finance charges over the period of time with similar collateral."[89] The *Cooper* court held that the most equitable method of interest rate determination is the recognition of a rebuttable presumption that "[i]t is the *current* rate of return on negotiated loans made by the secured claimant to borrowers of a class similar to the Chapter 13 debtor which is determinative of the rate to be allowed the holder of an allowed secured claim paid in deferred terms under 1325(a)(5)(B)(ii)."[90]

Employing the prevailing interest rate, as of the effective date of the plan, which the creditor would receive for a similar financial transaction involving a comparable time period, risk, and collateral, best replicates the current market interest rate and is superior to any method which results in a lower rate. As the *Cooper* court noted, any rate lower than current market rate would fall short of complying with the adequate protection requirement of sections 361, 362(d)(1), and 363(e).[91]

The court in *In re Benford*[92] reached the conclusion that the current market rate is the optimal measure while seeming to reject the method applied in *In re Cooper*. A closer examination, however, reveals that the two courts utilized the same method of interest rate determination. The *Benford* court's announcement that the prevailing market rate on the date on which the plan becomes effective as the preferable method of interest rate determination was based on its belief that:

> The touchstone of providing present value of a claim to be paid in the future is responsiveness to current market conditions. A rule that the contract rate applies would lack such responsiveness. For instance, if a plan were confirmed

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[88]Chrysler Credit Corp. v. Cooper (*In re* Cooper), 11 Bankr. 391 (N.D. Ga. 1981).
[89]*Id.* at 395.
[90]*Id.* at 394 (emphasis added).
[91]*Id.*
[92]14 Bankr. 157 (W.D. Ky. 1981).

> today, an installment contract entered into by the debtor two years ago would likely contain an interest rate below the present market rate.[93]

So far, the *Benford* and *Cooper* courts are in agreement. The *Benford* court attempted to distinguish *Cooper* by asserting that the use of the prevailing rate available to the creditor "would result in a debtor being charged disparate interest rates depending on the secured creditor, and thus sacrifice consistency for the sake of flexibility."[94] This distinction evaporates, however, when one recognizes that the crux of the market interest rate method depends on how each secured creditor's relevant market is defined and on what interest rate is available in that market. For example, it would make little sense to allow a mortgagee to benefit from the rate of 21% currently available to consumer lenders when the current home mortgage yield is only 17% merely to treat all secured creditors consistently. The purpose of section 1325(a)(5)(B)(ii) is to equitably provide each secured creditor what *he* would have had outside bankruptcy but for the debtor's financial demise—no more and no less.[95]

Moreover, the current market interest rate *is* the prevailing interest rate the creditor would be able to obtain in a similar transaction on the effective date of the plan. The *Benford* court implicitly recognized this fact when it gave the bank thirty days to provide proof of the market interest rate.[96] Presumably, the bank would present to the court evidence of the interest rate that it and its geographic competitors are currently negotiating on such transactions.

Thus, the adequate protection provisions of the Code require that secured creditors subject to the cram-down effects of section 1325(a)(5)(B) be given the time value of their claims. The market interest rate, as represented by the prevailing interest rate available to the creditor in a similar transaction outside bankruptcy, at the ef-

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[93]*Id.* at 159.

[94]*Id.* at 160.

[95]One commentator contends that the market will "likely charge an additional risk premium above that reflected in the contractual interest rate" because the Chapter 13 plan exposes the creditor to more risk than a loan to another debtor. *See* Comment, *supra* note 21, at 357. This argument misdetermines the creditor's relevant market. Outside of bankruptcy the creditor presumably would undertake a similar transaction with another debtor who has collateral and risk similar to that which was possessed by the Chapter 13 debtor *before* his bankruptcy. Obviously, the creditor would not seek out other bankrupt debtors as new customers nor is the Chapter 13 debtor a part of the creditor's relevant market. Thus, the riskiness of the Chapter 13 plan is not relevant to the determination of an appropriate interest rate which would be available to the creditor outside of bankruptcy.

[96]*Id.* at 161.

fective date of the plan, is the most accurate measure of the present value of the deferred payments. With this straightforward and uniform method of calculating the present value available, this Article will explore the necessity of and means of providing adequate protection of the value of the claim throughout the life of the Chapter 13 plan.

B. Adequate Protection During the Plan

Section 1325(a)(5) provides that the court shall confirm the debtor's rehabilitation plan if (1) the secured creditor accepts the plan; (2) the secured creditor retains his lien and receives deferred payments with a present value equal to his allowed secured claim; or (3) the debtor surrenders the collateral securing the claim.[97] The requirements of section 1325(a)(5)(B) resemble the adequate protection provisions of section 361.[98] In fact, section 103(a) makes Chapter 3 applicable to Chapter 13 cases.[99] Moreover, section 1325(a)(1) requires that the debtor's plan comply with all of the provisions of Chapter 13.[100] Section 1303 grants the debtor the same rights and powers of a trustee and subjects him to the same limitations in their exercise relating to the use, sale, or lease of property other than in the ordinary course of business.[101] One such limitation, section 363(e), allows the court, upon the secured creditor's request, to prohibit or condition the use, sale, or lease of the property as is necessary to provide adequate protection of the secured creditor's interest in the property.[102]

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[97]11 U.S.C. § 1325(a)(5) (Supp. IV 1980).

[98]*Id.* § 361 provides three nonexclusive methods of adequately protecting a secured creditor's interest in property: (1) periodic cash payments; (2) an additional or replacement lien; or (3) other relief that insures receipt of the indubitable equivalent.

[99]*Id.* § 103(a) states in part: "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, or 13 of this title."

[100]*Id.* § 1325(a)(1).

[101]*Id.* § 1303 provides: "Subject to any limitations on a trustee under this chapter, the debtor shall have, exclusive of the trustee, the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f), and 363(*l*), of this title."

[102]*Id.* § 363(e) states:

> Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. In any hearing under this section, the trustee has the burden of proof on the issue of adequate protection.

See Brickel v. Merchants Nat'l Bank (*In re* Brickel), 11 Bankr. 353, 355 (D. Me. 1981); Ford Motor Credit Co. v. Lewis (*In re* Lewis), 8 Bankr. 132, 136 (D. Idaho 1981); Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537, 542 (N.D. Ga. 1980); GMAC v. Lum (*In re* Lum), 1 Bankr. 186, 187 n.1 (E.D. Tenn. 1979).

Both the provisions of section 1325(a)(5)(B) and the linkages between section 363 and Chapter 13 indicate Congress' intent that the debtor's rehabilitation should not be at the expense of his secured creditors. This intent is most clearly pronounced by the legislative history which accompanies section 1325(a)(5)(B). After noting that the enacted version of section 1325(a)(5)(B) will "significantly protect secured creditors in chapter 13," the legislative history reports:

> Of course, the secured creditors' lien only secures the value of the collateral and to the extent property is distributed of a present value equal to the allowed amount of the creditor's secured claim the creditor's lien will have been satisfied in full. Thus the lien created under section 1325(a)(5)(B)(i) is effective only to secure deferred payments to the extent of the amount of the allowed secured claim. To the extent the deferred payments exceed the value of the allowed amount of the secured claim and the debtor subsequently defaults, the lien will not secure unaccrued interest represented in such deferred payments.[103]

According to *Collier*, however, the secured creditor's interest in property need not be adequately protected in the sense of providing additional security or payments to account for depreciation in the value of the collateral or for the interest component of the deferred payments.[104]

1. Depreciation.—Dealing first with the problem of collateral depreciation, *Collier* states:

> Section 1325(a)(5)(B)(i) assures the holder of an allowed secured claim that its lien cannot be directly affected by a chapter 13 plan without its consent, although various indirect deleterious effects, resulting from depreciation, deterioration, damage, or loss may nonetheless occur during the extension period. There is no requirement that a chapter 13 plan provide protection to the holder of an allowed secured claim against whatever diminution in value may result to the property securing the allowed secured claim in which the lien is retained. Section 1325(a)(5)(i) [sic] merely requires a provision in the plan for the *retention* of the lien.[105]

If a Chapter 13 plan fails to adequately protect a secured credi-

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[103]124 CONG. REC. 32,410 (1978).

[104]5 COLLIER, *supra* note 4, ¶ 1325.01[2][E][2][b][i], at 1325-21 to -23 & [2][E][2][b][ii][A], at 1325-23 to -25.

[105]*Id.* at 1325-22 to -23 (emphasis in original).

tor from diminutions in collateral value by granting him additional security or payments, the plan no longer shields the debtor but arms him with a sword with which the debtor may rehabilitate his financial condition at the secured creditor's expense.

Denying the secured creditor adequate protection of his security interest during the life of the plan is inconsistent with the purpose of the Code to not deprive a secured creditor of the benefit of his bargain.[106] The secured creditor is entitled to money or property to the extent of the value of his claim as of the effective date of the plan.[107] The secured party will receive the value of his original bargain only to the extent that he "is adequately protected in respect to that value over the life of the plan."[108]

A simple example will illustrate this point. Creditor lends Debtor $1,000 and takes a security interest in Debtor's VCR. At the confirmation hearing, the parties agree that the VCR has a liquidation value of $720. Thus, under section 506(a) Creditor has a secured claim of $720. In his Chapter 13 plan, Debtor provides for thirty-six monthly payments of $20 to satisfy Creditor's secured claim for $720.[109] After the end of the plan's second year, Debtor defaults. Debtor still owes Creditor $240, but the value of the collateral has depreciated to $140.[110] If Creditor repossesses the VCR and sells it for $140, he will incur a loss of $100.

Clearly, whenever a secured claim is satisfied at a rate slower than the rate of depreciation in value of the underlying collateral, the secured creditor will be deprived of the full value of his claim in

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[106]*See* House Judiciary Committee Report, *supra* note 3, at 338-40, [1978] U.S. CODE CONG. & AD. NEWS at 6294-97. *See* Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 560 (1935).

[107]11 U.S.C. § 1325(a)(5) (Supp. IV 1980). For methods of claim valuation, see the discussion of § 506(a) accompanying note 14 *supra*.

[108]*In re* Crockett, 3 Bankr. 365, 367 (N.D. Ill. 1980); *See* GMAC v. Miller (*In re* Miller), 13 Bankr. 110, 117-18 (S.D. Ind. 1981); ABD Federal Credit Union v. Williams (*In re* Williams), 6 Bankr. 789, 792-93 (E.D. Mich. 1980); Citizens & Southern Nat'l Bank v. Feimster (*In re* Feimster), 3 Bankr. 11, 14-15 (N.D. Ga. 1979); GMAC v. Lum (*In re* Lum), 1 Bankr. 186, 187 n.1 (E.D. Tenn. 1979). *Contra*, Associates Com. Corp. v. Brock (*In re* Brock), 6 Bankr. 105, 107-08 (N.D. Ill. 1980) (adequate protection available only between time of filing and confirmation).

[109]*See* valuation discussion accompanying notes 20-24 *supra*. In order to focus attention on the impact of depreciation on the secured creditor, this example ignores the time value of the claim which is treated separately at notes 115-25 *infra* and accompanying text.

[110]For simplicity, assume that the VCR has a useful life of two years and a salvage value of $140. Using the straight line depreciation method, the VCR would depreciate by $290 per year.

$$\frac{\$720 - \$140}{2} = \$290$$

the event that the debtor defaults before the plan is completed. The debtor may, however, provide adequate protection either by adjusting the payments under the plan so that the unsatisfied claim is never more than the value of the collateral or by supplying the creditor with additional security.[111]

For example, if Debtor knew that his VCR would depreciate in value by $290 per year, he could have fully protected the value of Creditor's claim by adjusting the monthly payment by $4.17 so that Creditor would be paid $24.17 per month.[112] To guard against a loss of $4.17 if Debtor defaults when the first payment comes due, the plan should provide for an initial payment to Creditor of $4.17 on the first day of the plan. Thus, if Debtor defaults, the unsatisfied portion of the claim will exactly equal the value of the collateral.

If the debtor does not make allowance in his plan for depreciation of the collateral, the secured creditor would have cause to request the court to lift the stay.[113] The debtor would have the burden to show that the creditor's interests are adequately protected.[114]

2. Time Value.—The same adequate protection considerations apply to providing for the payment of interest over the course of the plan to account for the time value of the creditor's claim. The

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[111]11 U.S.C. § 361(1)-(2) (Supp. IV 1980). *See, e.g., In re* Methvin, 11 Bankr. 556, 558 (S.D. Miss. 1981); Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537, 542 (N.D. Ga. 1980).

[112]The monthly depreciation adjustment of $4.17 was calculated by taking the difference between the annual rate of depreciation, $290, and the annual rate of claim satisfaction, $240, and dividing by 12.

($290 − $240) ÷ 12 = $4.17

To assist the debtor in calculating depreciation or other financial measures, the secured creditor, who normally has greater access to such data, should provide the debtor with the relevant tables or information. *In re* Clements, 11 Bankr. 38, 41 (N.D. Ga. 1981) (court ordered the creditor to provide the debtor with loan amortization information).

[113]11 U.S.C. §§ 362(d)(1), 363(e) (Supp. IV 1980). *See, e.g.*, Chrysler Credit Corp. v. Cooper (*In re* Cooper), 7 Bankr. 537, 542 (N.D. Ga. 1980). A split has developed among the courts on the applicability of section 362(d)(2) to Chapter 13 as a discrete alternative for requesting the court to lift the stay. For a well-reasoned decision finding section 362(d)(2) applicable to Chapter 13, see GMAC v. Miller (*In re* Miller), 13 Bankr. 110, 115-16 (S.D. Ind. 1981). *Accord*, State Employees' Retirement Fund v. Gardner (*In re* Gardner), 14 Bankr. 455, 456 (E.D. Pa. 1981); Provident Sav. Ass'n v. Pannell (*In re* Pannell), 12 Bankr. 51, 53 (E.D. Pa. 1981); First Nat'l Bank of Northglenn v. Pittman (*In re* Pittman), 8 Bankr. 299, 301-02 (D. Colo. 1981); First Connecticut Small Business Inv. Co. v. Ruark, 7 Bankr. 46, 47-49 (D. Conn. 1980); *In re* Zellmer, 6 Bankr. 497, 500 (N.D. Ill. 1980); Associates Commercial Corp. v. Brock (*In re* Brock), 6 Bankr. 105, 107 (N.D. Ill. 1980). *Contra, In re* Garner, 4 C.B.C. 1417, 1424 (S.D.N.Y. 1981); Carpenter v. Youngs (*In re* Youngs), 7 Bankr. 69, 71 (D. Mass. 1980); Citizens & Southern Nat'l Bank v. Feimster (*In re* Feimster), 3 Bankr. 11, 14 (N.D. Ga. 1979).

[114]11 U.S.C. §§ 362(g)(2), 363(e) (Supp. IV 1980).

legislative history of section 1325(a)(5)(B) indicates that the debtor's plan of deferred payments must have a present value equal to the value of the allowed secured claim as of the date of the confirmation hearing.[115]

In section 1325(a)(5)(B)(ii), Congress recognized the necessity of compensating the creditor for the time value of his claim by including in the plan interest payments at a rate equal to the discount rate, thereby equating the value of the future stream of payments as of the confirmation date to the value of the allowed secured claim.[116] The protection afforded by section 1325(a)(5)(B)(ii) is of practical significance, however, only if the interest component of each deferred payment is secured.

Crucial to an understanding of section 1325 is the recognition that the allowed secured claim does not have a static value. The claim increases in value over the course of the plan as the secured creditor forgoes the ability to earn a return on his money while the debtor undergoes rehabilitation. As the value of the claim increases over time, so also must the amount of the deferred payments increase to satisfy the claim. The only way to guarantee that the secured creditor receives the full value of his claim, indeed to satisfy the requirements of section 1325, is by the debtor's provision in the deferred payments for the time value of the secured creditor's claim. Once the time value of the claim is accounted for, the secured creditor's realization of the full value of his claim is wholly dependent upon providing the secured creditor with additional security in the amount of the accrued interest (time value) to adequately protect the secured creditor in the event that the debtor is unable to comply with his plan.

Collier would deprive the creditor of the full value of his claim by interpreting section 1325(a)(5)(B)(i) to exclude from the protection of the lien retained by the creditor under the plan interest payments in excess of the deferred payments aggregating to the amount of the allowed secured claim.[117] This interpretation has no logical basis and is inconsistent with the legislative history accompanying section 1325(a)(5)(B) as well as with the purpose of the Code to adequately protect the interests of secured creditors.[118]

A few examples will show that it is essential for the present value of the stream of deferred payments to equal the amount of the

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[115]124 CONG. REC. 32,410 (1978).

[116]11 U.S.C. § 1325(a)(5)(B)(ii) (Supp. IV 1980).

[117]*See* 5 COLLIER, supra note 4, ¶ 1325.01[3][b][ii], at 1325-26 to -27.

[118]*See* House Judiciary Committee Report, *supra* note 3, at 338-40, [1978] U.S. CODE CONG. & AD. NEWS at 6294-97.

allowed secured claim in order to provide the creditor with the full value of his claim. In addition, the examples will illustrate the necessity of sheltering the interest component of the deferred payments under the umbrella of the section 1325(a)(5)(B)(i) retained lien.

Consider a case in which Creditor has an allowed secured claim for $3000. If Creditor had the $3000 available outside bankruptcy, he could invest it and earn an annual return of 18%. For simplicity, assume that Debtor's plan calls for making three equal annual payments of $1379.77.[119] An amortization schedule would show that $540.00 of the payment goes to interest (time value) and $839.77 goes to principal.[120] Therefore, if Debtor defaulted when the first payment came due, the *Collier* interpretation of the Code would give Creditor a lien for $3000, the principal, but no lien for $540.00, the time value of the $3000 on which Creditor has lost the opportunity to earn an annual return of 18%. Forcing Creditor to queue up with the other unsecured creditors may be tantamount to completely depriving him of the time value of his claim.

Without adequate protection of the interest portion of the deferred payment, the requirement that the present value of the deferred payments must equal the amount of the allowed secured claim is no longer met. This is evident when a default occurs one year into the plan. Creditor will repossess the collateral covered by the lien and presumably either retain the property worth $3000 or convert it into its cash equivalent. Thus, the repossession of the collateral can be viewed as the repayment of a $3000 loan in a lump sum of $3000 after one year. The present value as of the confirmation hearing of a $3000 payment one year hence is $2542.37.[121] Obviously, the present value of this interestless "deferred payment" does not equal the allowed amount of the secured claim of $3000. Yet section 1325(a)(5)(B)(ii) requires such an agreement of values.

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[119]The general formula for calculating present value is:

$$PV = PMT\left(\frac{1-(1+i)^{-N}}{i}\right)$$

where: PV = Present value of a debt or an account
PMT = Payment per period
i = interest rate for payment period
N = Number of periods

$$PMT = \$3000 \div \left(\frac{1-(1.18)^{-3}}{.18}\right) = \$1379.77.$$

[120]D. THORNDIKE, THORNDIKE ENCYCLOPEDIA OF BANKING AND FINANCIAL TABLES Table 2 at 202-05 (Supp. 1980).

[121]$$PV = \$3000\left(\frac{1-(1.18)^{-1}}{.18}\right) = \$2542.37.$$

Without protecting the time value of Creditor's claim by granting him additional security, Creditor is denied the benefit of his bargain, the full value of his claim outside of bankruptcy. In effect, Debtor will have exacted an interest-free loan from Creditor unless the Code is properly construed to adequately protect Creditor's valuable property interest by providing him not only the time value of his claim but also the means to realize his compensation for lost opportunities.

To support the contention that the interest component of the deferred payments is not secured, *Collier* cites the legislative history of section 1325 which contains the language: "Thus the lien created under section 1325(a)(5)(B)(i) is effective only to secure deferred payments to the extent of the amount of the allowed secured claim."[122] *Collier* assumes that the amount of the allowed secured claim is a fixed value, but, as shown above, the value of the allowed secured claim increases over time because of its inherent time value.

Congress recognized the time value of the claim when it directed the debtor to equate the present value of the deferred payments with the amount of the allowed secured claim in the preceding sentence of the same legislative history.[123] The legislative history continues: "To the extent the deferred payments exceed the value of the allowed amount of the secured claim and the debtor subsequently defaults, the lien will not secure *unaccrued* interest represented in such deferred payments."[124]

The legislative history merely indicates that to the extent the value of the allowed secured claim has not yet been augmented by its time value, the creditor will have only the amount of the secured claim secured. For example, after one year the allowed secured claim has increased in value from $3000 to $3540 because of time value. Both the $540 representing accrued interest and the $3000 representing the original value of the claim are secured by the lien. If the Debtor had not defaulted, however, the value of the allowed secured claim would have grown to $4929.10 by the end of the third year. Of that total amount, $1929.10 represents time value. At the end of the first year, $540 of the $1929.10 has been accrued and the remainder, $1389.10, is unaccrued interest. The latter amount is, of course, not secured by the lien because after the default the creditor

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[122]124 CONG. REC. 32,410 (1978).

[123]*Id.* "Of course, the secured creditors' lien only secures the value of the collateral and to the extent property is distributed of a present value equal to the allowed amount of the creditor's secured claim the creditor's lien will have been satisfied in full."

[124]*Id.* (emphasis added).

will repossess collateral worth $3540 and invest it at a return of 18% to earn that interest himself.

Thus, neither the Code nor the legislative history casts the time value of the allowed secured claim from the protection of the section 1325(a)(5)(B)(i) retained lien. In fact, the adequate protection provisions of sections 361 and 363(e) demand that the lien be supported by additional underlying collateral to assure the secured creditor of the same full value of his claim as if he had been permitted to utilize his non-bankruptcy remedies.

As in the case of depreciation, if the debtor either does not provide for the time value of the secured creditor's claim in his deferred payments or does not provide the secured creditor with additional security to protect his right to the time value of his claim, the secured creditor should request that the court lift the stay and allow the secured creditor to immediately realize the value of his claim.[125]

IV. Conclusion

There is no justification for the disparity among courts in their treatment of secured creditors under Chapter 13. This Article proposes consistent treatment of secured creditors under section 1325(a)(5) based on the purpose of that section. This purpose is simply stated: Section 1325(a)(5) is intended to guarantee the secured creditor the equivalent of recourse to his collateral on the date a Chapter 13 plan is confirmed. If problems of collateral valuation, present value, and status of the creditor during the repayment period were approached with this purpose in mind, the cases would exhibit a rational consistency currently missing in this area of the law.

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[125] 11 U.S.C. § 362(d)(1) (Supp. IV 1980).