



In re Brown: Replacement Value Applies Even When Debtor Surrenders Property *Ellen C. Rains*¹

The recent Eleventh Circuit case of *In re Brown*, 746 F.3d 1236 (2014) held that 11 U.S.C. § 506(a)(2)'s replacement value standard applies even when a Chapter 7 or 13 debtor surrenders collateral under 11 U.S.C. § 1325(a)(5)(C). The Eleventh Circuit's decision in *In re Brown* has an important role in how personal property collateral will be valued in Chapter 7 and 13 cases in the Eleventh Circuit and thus its reasoning is important for creditors to understand.

The standard used in valuing collateral is vital for creditors because of its effect on determining what portion of a creditor's claim is secured or unsecured. Under § 1325(a)(5), a plan's treatment of an "allowed secured claim" can be confirmed if: the secured creditor accepts the plan, the debtor retains the collateral and makes payments to the creditor, or the debtor surrenders the collateral. 11 U.S.C. § 1325(a)(5)(A)-(C). The term "allowed secured claim" refers to § 506(a). See *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 957 (1997). Section 506(a)(1) bifurcates a secured creditor's allowed claim into secured and unsecured portions based on the underlying collateral's value and addresses how to determine value. A creditor's secured claim is equal to the judicially determined value of the collateral and its unsecured claim is equal to the amount of the debt that exceeds that judicially determined value. Because the standard used to value collateral has a major impact on the amount a creditor will receive from a debtor, it has been a source of major disagreement between debtors and creditors.

The Eleventh Circuit's decision in *In re Brown* was guided in large part by the United States Supreme Court's analysis in *Associates Commercial Corp. v. Rash*. In *Rash*, the Court addressed the specific situation of valuing collateral under § 506(a) when a debtor, over the objection of a secured creditor, seeks to retain and use the creditor's collateral in a Chapter 13 plan. 520 U.S. at 957. The Supreme Court recognized that the Courts of Appeals had adopted three methods of valuation under § 506(a): the foreclosure value standard, the replacement value standard, and the midpoint between the foreclosure and replacement value. *Id.* at 959. The foreclosure value standard is what the creditor could receive if it sold the debtor's interest in the property pursuant to a security agreement. *Id.* at 960. The replacement value standard is "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing buyer." *Id.* at 960.

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The *Rash* Court interpreted "disposition and use" language of § 506(a) to necessitate different valuation standards depending on whether the debtor surrendered or retained the collateral. *Id.* 962. In the retention context, the Court found that the proper standard was the replacement value standard. *Id.* at 963. Important to the Court's holding was the fact that the replacement value "accurately gauges the debtor's 'use' of the property. It values 'the creditor's interest in the collateral in light of the proposed [repayment plan] reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to...its [replacement] value.'" *Id.* at 963 (quoting *In re Winthrop Old Farm Nurseries*, 50 F.3d 72, 75 (1st Cir. 1995)).

With *Rash* as precedent, the specific issue that the Eleventh Circuit addressed in *In re Brown* was whether 11 U.S.C. § 506(a)(2)'s valuation standard applies when a Chapter 7 or 13 debtor surrenders property under 11 U.S.C. § 1325(a)(5)(C). 746 F.3d at 1240. The court noted that § 506(a)(2) was added to the Bankruptcy Code after *Rash* by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") and expressly requires use of replacement value standard. *Id.* Section 506(a)(2) provides that:

If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim *shall be determined based on the replacement value of such property* as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

11 U.S.C. § 506(a)(2) (emphasis added). The Eleventh Circuit found that when a case falls within § 506(a)(2), its specific requirements control over the broader "disposition and use" language used in § 506(a)(1) and interpreted by *Rash*. As part of its analysis, the Eleventh Circuit looked to Congressional intent and statutory construction. The Eleventh Circuit reasoned that while Congress expressly chose to limit § 506(a)(2) to certain Chapter 7 and 13 cases, it did not choose to limit it to cases where the debtor retains the collateral and such a limitation should not be read into the statute. *Id.* at 1242. Thus, the Eleventh Circuit held when a case falls under § 506(a)(2), the replacement value standard applies regardless of whether debtor retains and "uses" the collateral or surrenders the collateral. *Id.*

The valuation standard used is critical to the outcome of a bankruptcy case and there is a great need for consistency and uniformity in bankruptcy courts' approaches to this issue. In the Eleventh Circuit, the *In re Brown* decision makes it possible that the surrender of a vehicle or other personal property with a replacement value in excess of the total debt could fully satisfy the debt, rather than simply satisfying the secured claim. In such a case, the creditor would have no unsecured deficiency claim.

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