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Bankruptcy Law - In Re Mitchell: Standards of Valuation in Chapter 13 Proceedings Under 11 U.S.C. § 506(a)

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BANKRUPTCY LAW

IN RE MITCHELL: STANDARDS OF VALUATION IN CHAPTER 13 PROCEEDINGS UNDER 11 U.S.C. § 506(a)

I. INTRODUCTION

In re Mitchell[1] marks the first examination by a circuit court of valuation standards used in Chapter 13 proceedings to establish the value of a creditor's secured claim in a vehicle.[2] In *Mitchell*, the Ninth Circuit held that the standard to be applied in most cases is a vehicle's wholesale value[3] and that any other standard, such as retail value, should be applied only where the debtor uses a vehicle as part of a going concern.[4] This note will show that the *Mitchell* majority arrived at its rule by grounding its analysis in well-settled bankruptcy philosophy[5] and by

1. *In re* Mitchell, 954 F.2d 557 (9th Cir.) (per Schroeder, J., with whom Goodwin, J., joined; Noonan, J., dissenting), *cert. denied*, 113 S. Ct. 303 (1992).

2. *Id.* at 560. While its immediate concern was the valuation of a car, *Mitchell* should apply to most cases where valuation standards are at issue and the debtor proposes to retain the property which has been used as collateral to secure an indebtedness. *See In re* Balbus, 933 F.2d 246, 248 (4th Cir. 1991), *infra* notes 116-26 and accompanying text; *but see In re* Nobleman, 968 F.2d 483 (5th Cir. 1992), *cert. granted*, ___ U.S. ___, 1992 WL 303365 (Dec. 7, 1992), *infra* note 55.

The Bankruptcy Code does not use the terms secured or unsecured "creditors." Rather, it refers to creditor's "claims" against a debtor as either secured or unsecured. 11 U.S.C. § 506(a) (1988); H.R. REP. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5863, 6312; S. REP. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5854. The term "claim" is defined as a right to payment or a right to an equitable remedy for breach of performance if such breach gives rise to a right to payment. 11 U.S.C. § 101(5) (1988).

3. *Mitchell*, 954 F.2d at 560.

4. *Id.*; *see also In re* Wabash Valley Power Assoc., 77 B.R. 991 (Bankr. S.D. In. 1987). For the Ninth Circuit's definition of going concern, and a comparison with other commentators' definitions, *infra* note 107.

5. Commentators and courts have identified two primary purposes of bankruptcy law. First, bankruptcy hopes to provide debtors with a "fresh start" through a discharge

strictly construing the structure of 11 U.S.C. § 506(a) in accord with its legislative history.[6]

II. FACTS

Mitchell's[7] facts revolve around the commonplace purchase of a new family car. On January 14, 1987 George and Carol Mitchell signed a conditional sales contract for a 1987 Cadillac El Dorado.[8] They paid a $5,000.00 down payment and agreed to pay sixty monthly installments of $585.00 plus an annual interest rate of eleven percent.[9] Thus, upon full performance of the contract, the Mitchells would pay $31,940.00 for the Cadillac.[10] General Motors Acceptance Corporation (hereinafter "GMAC") claimed that pursuant to the contract, it retained a security in-

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of indebtedness. Second, bankruptcy law tries to create an equitable arrangement of the rights of creditors where there are not enough assets of a debtor to be distributed in full satisfaction of all creditors' claims. Grogan v. Garner, 111 S. Ct. 754, 659 (1991) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)); *In re* Stewart, 14 B.R. 959, 961 (Bankr. N.D. Ohio 1981); *In re* Mensch, 7 B.R. 805, 806 (Bankr. S.D.N.Y. 1980); *see also In re* Britton, 950 F.2d 602, 606 (9th Cir. 1991); H.R. Doc. No. 137, 93d Cong., 1st Sess. 71 (1973); H.R. REP. No. 595, 95th Cong., 1st Sess. 4, 117-18, 125 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6077-78, 6086; THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 3-4, 225-52 (1986); *see also generally* Thomas H. Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985).

6. 3 COLLIER ON BANKRUPTCY, ¶ 506.03, at 506-5 to 506-14 (15th ed. 1992) [hereinafter 3 COLLIER]; *infra* notes 53-65 and accompanying text discussing the legislative history of Section 506(a).

7. *In re* Mitchell, 954 F.2d 557 (9th Cir.), *cert. denied*, 113 S. Ct. 303 (1992).

8. *Id.* at 558.

9. *Id.*

10. *Id.* The purchase price included accessories and a sixty-month, unlimited mileage mechanical service contract. A debate outside the scope of this article arose in *Mitchell* over this service contract. General Motors Acceptance Corporation contended that the value of the contract added to the value of the car, thus it should be included in the car's value under any standard of valuation. Appellant's Opening Brief at 26-28, Mitchell v. General Motors Acceptance Corp., 954 F.2d 557 (9th Cir.) (No. 90-15952), *cert. denied*, 113 S. Ct. 303 (1992) [hereinafter Appellant's Opening Brief].

In opposition, the Mitchells argued that the service contract was not the proper subject of a security interest under either California law or the Bankruptcy Code, that at trial GMAC failed to claim a security interest in the service contract, its premiums or proceeds, and that GMAC failed to assert that the value of the service contract enhanced the value of the vehicle. Appellees' Responding Brief at 44-47, Mitchell v. General Motors Acceptance Corp., 954 F.2d 557 (9th Cir.) (No. 90-15952), *cert. denied*, 113 S. Ct. 303 (1992) [hereinafter Appellees' Responding Brief].

The Ninth Circuit agreed with the debtors and held that the value of the contract was not to be included in the total value of the car under any standard, because the service contract did not contain language granting GMAC a security interest. *Mitchell*, 954 F.2d at 561.

terest in the vehicle, all parts and accessories thereon, all insurance premiums financed by the seller, and all service contract premiums financed by the seller.[11]

On March 4, 1988, the Mitchells filed for protection under Chapter 13 of the Bankruptcy Code.[12] Their reorganization plan, confirmed by the bankruptcy court on May 11, 1988, offered to pay one hundred percent of the value of their creditors' allowed secured claims, and ten percent of their creditors' allowed unsecured claims.[13]

GMAC filed a claim as a secured creditor of the Cadillac and asserted that its allowed claim in the value of the El Dorado should be $27,062.25.[14] The Mitchells objected and the bankruptcy court held a hearing to determine the value.[15] In the ensuing battle of appraisers, two distinct positions emerged. The debtors' expert testified that the Cadillac had a value of $20,761.00 on March 4, 1988, the date they filed their petition, while GMAC's appraiser, using the same market guide as the Mitchells' expert, testified that the vehicle had a value on that day of $24,185.00.[16] The $3,424.00 difference resulted from the

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11. *Supra* note 10.

12. *Id.* at 559. Chapter 13 contains the provisions for reorganization of the debts of individuals with less than $100,000.00 in noncontingent, liquidated, unsecured debts and less than $350,000.00 in noncontingent, liquidated, secured debts. 11 U.S.C. § 109(e) (1988); 11 U.S.C. §§ 1301-1330 (1988). Chapter 13 is used by individual wage earners with regular income and small sole proprietors for whom Chapter 11 reorganization is too cumbersome. *In re* Balbus, 933 F.2d 246, 251 (4th Cir. 1991); H.R. REP. No. 595, 95th Cong. 1st Sess. 310 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6277.

The Bankruptcy Code also contains provisions for liquidation of an individual's debts and equity in non-exempt assets under Chapter 7. 11 U.S.C. §§ 701-766 (1988). Reorganizations are provided for municipalities under Chapter 9. 11 U.S.C. § 109(a) (1988); 11 U.S.C. §§ 901-946 (1988). Business entities can file for protection against creditors while liquidating their assets under Chapter 7 or reorganizing their debt burden under Chapter 11. 11 U.S.C. § 109(b), (d) (1988); 11 U.S.C. §§ 701-766 (1988); 11 U.S.C. §§ 1101-1174 (1988). Family farmers with regular annual income qualify as debtors under Chapter 12. 11 U.S.C. § 109(f), (g) (1988); 11 U.S.C. §§ 1201-1231 (1988).

13. *Mitchell*, 954 F.2d at 559.

14. *Id.*

15. *Id.*

16. *Id.* Both appraisers used the Kelley Blue Book valuation guide to arrive at their respective figures. This type of evidence of value is used routinely in bankruptcy courts to establish a vehicle's value, at times in conjuction with expert testimony and also standing alone. *See Mitchell*, 954 F.2d at 559; Memphis Bank & Trust Co. v. Walker, 14 B.R. 264, 265 (D.C. W.D. Tenn. 1981); *In re* Crockett, 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980); *see also* S. REP. No. 65, 98th Cong., 1st Sess. 5-6 (1983) ("The Committee . . . encourages reference to trade publications as appropriate indicia of the market value of

debtors' appraiser's reliance on the wholesale value, while the creditor's appraiser relied on the retail value contained in the valuation guide for the year and make Cadillac in question.[17]

The bankruptcy court found that GMAC's position should prevail and the Mitchells appealed.[18] The Bankruptcy Appellate Panel reversed in favor of the debtors, and GMAC in turn filed an appeal with the Ninth Circuit.[19]

III. BACKGROUND

A. 11 U.S.C. §§ 506(a) AND 1325

1. *11 U.S.C. § 506(a)*

An understanding of the well-settled precepts of valuation under 11 U.S.C. § 506(a) is a prerequisite to understanding the various valuation standards used in bankruptcy proceedings.[20] For instance, the value of an item used to secure an indebtedness can change throughout a single bankruptcy proceeding, and no determination of value is binding upon a debtor or creditor if it becomes necessary to make a subsequent determination of the value of the same piece of property at a later time.[21]

The first sentence of 11 U.S.C. § 506(a) provides that:

> [a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount

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the property in question." (cited in 3 COLLIER, ¶ 506.03, at 506-13 to 506-14)).

17. *Mitchell*, 954 F.2d at 559.

18. *Id.*

19. *Id.*; Mitchell v. General Motors Acceptance Corp., (*In re* Mitchell), BAP No. NC-89-1222-JVAs, Amended Memorandum, (9th Cir. BAP June 15, 1990).

20. 11 U.S.C. § 506(a) (1988).

21. S. REPT. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5854; 3 COLLIER ¶ 506.04 at 506-25, n.22; *see also* David Gray Carlson, *Secured Creditors and the Eely Nature of Bankruptcy Valuations*, 41 AM. U. L. REV. 63, 66-70 (1991) [hereinafter Carlson, *Secured Creditors*]; James F. Queenan, *Standards for Valuation of Security Interests in Chapter 11*, 92 COM. L.J. 18, 25-28 (1987) [hereinafter Queenan, *Standards for Valuation*]; Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1062-63 (1985) [hereinafter Fortgang & Mayer, *Valuation in Bankruptcy*].

> subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim.[22]

This first sentence of 11 U.S.C. § 506(a) thus divides a secured debt into two claims, one secured and the other unsecured.[23] Each bifurcated claim is treated throughout the pendency of the bankruptcy case as "separate and independent" components of the original indebtedness.[24]

The division of a claim into secured and unsecured portions under 11 U.S.C. § 506 is valid "only for the purpose for which the determination is made."[25] Thus, the standard of valuation can change depending on the purpose of the valuation.[26] For example, value of property that is exempt from being used to satisfy creditors' claims is defined as the "fair market value as of the date of the filing of the petition."[27] Similarly, when a Chapter 7 debtor tries to redeem collateral under 11 U.S.C. § 722, the value of the item is the price the debtor would pay to replace the item: its present fair market value (or the amount of the claim if the claim is less than fair market value).[28]

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22. 11 U.S.C. § 506(a) (1988).

23. H.R. REP. No. 595, 95th Cong., 1st Sess. 124 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6085:

> To the extent of the value of the security interest, [the secured creditor] is treated as having a secured claim, entitled to be paid in full under the plan, unless, of course, he accepts less than full payment. To the extent that his claim against the debtor exceeds the value of his collateral, he is treated as having an unsecured claim, and he will receive payment along with all other general unsecured creditors.

See 3 COLLIER ¶ 506.04, at 506-15 to 506-16; Jeffrey K. Robison, *The Debtor's Right to Restrict Lienholder Recovery to the Value of the Encumbered Property Under Section 506 of the Bankruptcy Code*, 11 J. CORP. L. 433, 435 (1986); *supra* note 2.

24. 3 COLLIER, ¶ 506.04 at 506-15; *see also In re* Lopez-Soto, 764 F.2d 23, 26 (1st Cir. 1985); Barash v. Public Finance Corp., 658 F.2d 504, 507 (7th Cir. 1981).

25. 124 CONG. REC. S17411 (daily ed. October 6, 1978).

26. 124 CONG. REC. H11095 (daily ed. September 28, 1978) ("A valuation early in the case in a proceeding under sections 361-363 would not be binding upon the debtor or creditor at the time of confirmation of the plan.").

27. 11 U.S.C. § 522(a)(2) (1988); *In re* Walsh, 5 B.R. 239, 240 (1981).

28. 11 U.S.C. §§ 506(a), 722 (1988); S. REP. No. 989, 95th Cong., 2d Sess. 95 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5881; *see also In re* Mcquinn, 6 B.R. 899, 900 (Bankr. D. Nb. 1980) ("[T]he retail value of the collateral includes costs such as dealer overhead, salesperson's commissions, and profit which the debtor should not be required to

By contrast, where a secured creditor requests relief from stay under 11 U.S.C. § 362, the wholesale value of an item given as security is used to determine whether the creditor's interest is adequately protected; relief is granted if the wholesale value of the collateral is less than the amount owed to the creditor.[29]

The second sentence of 11 U.S.C. § 506(a) describes how valuation is to be done: Congress mandated that goods given to secure payment or performance are to be valued "in light of the purpose of the valuation *and* the proposed disposition or use of the property involved." [emphasis added][30] The phrasing of the second sentence of 11 U.S.C. § 506(a) has led courts to use inconsistent valuation standards in determining the allowed amounts of secured claims on vehicles in Chapter 13 plans.[31] The valuation standards courts have used include retail value,[32] "open market value,"[33] the amount realized by the creditor upon foreclosure and sale,[34] the wholesale/average trade-in value,[35] and liquidation value.[36]

Counsel for debtors and creditors have contributed to the confusion as to what standard of valuation properly implements 11 U.S.C. § 506(a) by their partisan arguments emphasizing ei-

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pay . . . . ").

29. 11 U.S.C. § 362(d) (1988); *see also In re* Lackow, 16 B.R. 566, 570 (Bankr. S.D. Fla. 1981), *aff'd*, 22 B.R. 1018 (D. Fla. 1982).

30. 11 U.S.C. § 506(a) (1988); *In re* Lopez-Soto, 764 F.2d 23, 26 (1st Cir. 1985); Barash v. Public Finance Corp., 658 F.2d 504, 507 (7th Cir. 1981); *see also* 3 COLLIER, ¶ 506.04 at 506-15; John B. Butler, III, *Valuation of Secured Claims Under 11 U.S.C. 506(a)*, 89 COM. L.J. 342, 343-44 nn.17-20 (1984).

31. *In re* Smith, 42 B.R. 198, 200 (Bankr. N.D. Ga. 1984); *In re* Cook, 38 B.R. 870, 875 (Bankr. D. Utah 1984) (wholesale value); *In re* Reynolds, 17 B.R. 489, 493 (Bankr. N.D. Ga. 1981) (retail replacement cost).

32. *Reynolds*, 17 B.R. at 493.

33. *In re* Beranek, 9 B.R. 864, 865 (Bankr. D. Colo. 1981); *In re* Miller 4 B.R. 392, 394 (Bankr. S.D. Cal. 1980) ("[T]he median value between retail and wholesale values would most accurately approximate that open maket value . . . .").

34. *In re* Stumbo, 7 B.R. 939 (Bankr. D. Colo. 1981).

35. *In re* Cook, 38 B.R. 870, 875 (Bankr. D. Utah 1984) ("[W]here the collateral is a car and the secured claimant does not present evidence on its usual commercially reasonable method of selling cars, courts have presumed that the value of the car is the wholesale value shown by industry used car guides."); *see also In re* Van Nort, 9 B.R. 218, 221 (Bankr. E.D. Mi. 1981); *In re* Jones, 5 B.R. 736, 738 (Bankr. E.D. Va. 1980); *In re* Crockett, 3 B.R. 365, 367 (Bankr. N.D. Ill. 1980). *Compare* Memphis Bank & Trust Co. v. Walker, 14 B.R. 264, 265 (D.C.W.D. Tenn. 1981).

36. *In re* Goodwin's Discount Furniture, Inc., 18 B.R. 29, 32-33 (Bankr. D. Me. 1982).

ther the first or second phrase of its second sentence.[37] As a result, counsel's partisan and adversarial approach to bankruptcy litigation has sometimes led bankruptcy courts to analyze 11 U.S.C. § 506(a) as if it contained the disjunctive "or" rather than the conjunction "and."[38]

Counsel for creditors emphasize the use of a high valuation standard (such as retail value), and tend to support this position by guiding the courts to the second phrase of the second sentence of 11 U.S.C. § 506(a) (i.e. "in light of . . . the proposed dispostion and use").[39] By implication, a creditor's standard for valuing vehicles in Chapter 13 cases would be based primarily upon whether or not the debtor proposed to retain and use the vehicle.

Debtors' attorneys, on the other hand, focus almost exclusively on the first phrase of the second sentence of 11 U.S.C. § 506(a) (i.e. "in light of the purpose of the valuation"), and use it to promote the use of a lower standard, for example, the collateral's wholesale value.[40] This approach implies that the control-

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37. *In re* Balbus, 933 F.2d 246, 248-51 (4th Cir. 1991); *see also In re* Claeys, 81 B.R. 985, 990-91 (Bankr. D. N.D. 1987):

> [A] valuation is made . . . it seems, upon the emphasis given to the first and second sentences of section 506(a). The first sentence, providing that the claim is secured to the extent of the value of the creditor's interest in the property, suggests that since it is the creditor's interest that is being valued and not the collateral itself, it should not make any difference whether the debtor is retaining the property. Yet, the language of the second sentence suggests that the proposed disposition or use of the collateral itself must be considered when determining that value.

Counsel for the Mitchells and for GMAC aligned themselves according to this debtor-creditor dichotomy. Appellant's Opening Brief at 10-17, *Mitchell* (No. 90-15952); Appellees' Responding Brief at 20-22, *Mitchell* (No. 90-15952). The greatest strength in the Ninth Circuit's approach to the valuation issue lies in the court's ability to find a balance between the two positions.

38. *Infra* note 113 and accompanying text.

39. *See In re* 222 Liberty Assocs. 105 B.R. 798, 803 (Bankr. E.D. Pa. 1989); *In re* Courtright, 57 B.R. 495, 497 (Bankr. D. Or. 1986); *see also In re* Usry, 106 B.R. 759, 761 (Bankr. M.D. Ga. 1989).

40. *Mitchell*, 954 F.2d at 560; *In re* Smith, 92 B.R. 198, 200 (Bankr. N.D. Ga. 1984) ("[I]t is the creditor's interest in the estate's interest in property which must be valued."); *In re* Boring, 91 B.R. 791, 794 (Bankr. S.D. Ohio 1988) ("Most courts recognize that the debtor's proposed retention and use of collateral does not emasculate the fact that it is in the first instance the creditor's interest in the collateral that must be valued.").

ling event in the valuation process is the *purpose* of the valuation. However, both phrases from 11 U.S.C. § 506(a) must be used in the valuation process along with 11 U.S.C. § 1325.

2. *11 U.S.C. § 1325*

This section sets forth the requirements that must be satisfied for a debtor's Chapter 13 reorganization plan to be confirmed.[41] Toward this goal, 11 U.S.C. § 1325(a)(5) provides that:

> (a) except as provided in subsection (b), the court shall confirm a plan if —
> (5) with respect to each allowed secured claim provided by the plan —
> (A) the holder of such claim has accepted the plan;
> (B)(i) the plan provides that the holder of such claim retain the lien securing the 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 . . . .[42]

Thus, 11 U.S.C. § 1325 uses the amount of the secured creditor's claim to establish the minimum amount to be paid to the creditor through the Chapter 13 reorganization plan.[43] The amount of the secured claim is to be determined under 11 U.S.C. § 506(a),[44] which defines in its first sentence the value of a creditor's allowed secured claim as "the creditor's interest in the estate's interest in the property."[45]

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41. 11 U.S.C. § 1325 (1988); S. REP. No. 989, 95th Cong., 2d Sess. 142 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5928; H.R. REP. No. 595, 95th Cong., 1st Sess. 430 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6385.

42. 11 U.S.C. § 1325(a)(5)(A), (a)(5)(B)(i), (a)(5)(B)(ii) (1988).

43. *Mitchell*, 954 F.2d at 559; 11 U.S.C. § 1325(a)(5)(B)(ii) (1988); *supra* note 42.

44. H.R. REP. No. 595, 95th Cong., 1st Sess. 430 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6385.

45. 11 U.S.C. § 506(a) (1988); *In re* Cook, 38 B.R. 870, 873 (Bankr. D. Utah 1984):

> The purpose of the collateral valuation under Section 1325(a)(5)(B)(ii) is not to assume that secured claimants will receive under the plan as much money as debtors would have to spend to replace the collateral. Instead, the purpose of collateral valuation under Section 1325(a)(5)(B)(ii) is to protect secured claimants from loss by assuring that they will receive under the plan as much money, or its equivalent, as they

The interplay of 11 U.S.C. §§ 506(a) and 1325(a)(5) requires a court to place a value on property of the bankruptcy estate before a plan of rehabilitation is confirmed.[46] Creditors must show that the estate has an interest in the property used by the debtor as collateral.[47] Then the nature (i.e. fee, leasehold, joint tenancy) of the estate's interest in the property must be disclosed.[48] Finally, the court must determine the standard of valuation to accurately calculate the value of the creditor's allowed secured claim.[49]

Participants in a Chapter 13 proceeding must use *both* phrases of the second sentence of 11 U.S.C. § 506(a) to determine what standard of valuation is to be used in placing a value on property used as collateral. Thus the purpose of the valuation is established under 11 U.S.C. § 1325 and then the proposed disposition and use of the property securing the debtor's obligation to the creditor is considered.[50]

B. The Legislative History of 11 U.S.C. § 506(a)

The Bankruptcy Code[51] does not define the term "value."[52] Likewise, it contains no specific directive on what standards of valuation to use in the course of a bankruptcy proceeding. However, courts must define both value and valuation standards on a case-by-case basis.[53]

One approach to defining these key elements of a bankruptcy proceeding has been to use 11 U.S.C. § 506(a) in conjunc-

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would receive if they were permitted to sell the collateral in a commercially reasonable manner.

See also In re Malody, 102 B.R. 745, 750 (9th Cir. BAP 1989) and *infra* notes 70-91 and accompanying text discussing *Malody*.

46. *Supra* note 43 and accompanying text.

47. 3 Collier, ¶ 506.04 at 506-17 to 506-18.

48. *Id.*

49. *Id.*

50. *In re* Balbus, 933 F.2d 246, 248 (4th Cir. 1991).

51. The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984).

52. 11 U.S.C. § 101(1)-(61) (1988).

53. S. Rep. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5854; H.R. Rep. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 6312.

tion with other sections of the Bankruptcy Code.[54] This interplay between chapters of the Bankruptcy Code is done frequently in order to achieve consistent application in analogous situations.[55]

Reliance on legislative history is the second method used to define value under 11 U.S.C. § 506(a).[56] The report of the House Committee on the Judiciary regarding proposed amendments to the Bankruptcy Code in 1978 contains the definitive source of congressional intent regarding the meaning and use of 11 U.S.C. § 506(a).[57] The House report stated that:

> '[v]alue' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value. Courts will have to determine value on a case-by-case ba-

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54. For example, Chapter 13 cases often refer to Chapter 12 cases in valuation issues. *See* In re Malody, 102 B.R. 745, 748-49 (9th Cir. BAP 1989)(citing In re Courtright, 57 B.R. 495 (Bankr. D. Or. 1986)); *see also* United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 108 S. Ct. 626, 630 (1988) (drawing an analogy between the use of the phrase "interest in property" in 11 U.S.C. § 362 and its use in 11 U.S.C. § 506(a)).

The Bankruptcy Code facilitates and encourages such comparisons and analogies. For instance, the wording of 11 U.S.C. § 1225(a)(5)(B)(i),(ii) and 11 U.S.C. §1 325(a)(5)(B)(i), (ii) are identical, thus making comparisons between the results in one section applicable to similar situations under the other; *see supra* note 41 and accompanying text.

The limits to using results under one chapter of the Code within the context of a case arising under another chapter are contained in sections 102 and 103. 11 U.S.C. §§ 102(8), 103(a)-(i) (1988).

55. *In re* Nobleman, 968 F.2d 483, 485 (5th Cir. 1992), *cert. granted*, ___ U.S. ___, (1992); 1992 WL 303365 (Dec. 7, 1992). *Nobleman* represents the possible outer limits of *Mitchell*'s analytical approach. The Supreme Court granted certiorari in *Nobleman* in order to settle a conflict between circuits on the issue of whether homeowners may use 11 U.S.C. § 506(a) and Chapter 13 to bifurcate mortgages on principal residences. Permitting this approach would allow debtors to satisfy debts on their home mortgages at less than bargained for prices.

However, tension exists in this situation between 11 U.S.C. §§ 506(a) and 1322(b)(2). The latter section precludes debtors from modifying the terms of mortgages on principal residences. 11 U.S.C. §§ 506(a), 1322(b)(2) (1988); *Nobleman*, 968 F.2d 485-89; *see also* Dewsnup v. Timm, 112 S. Ct. 773, 775 (1992); *In re* Houghland, 886 F.2d 1182, 1183 (9th Cir. 1989).

If the Court ultimately holds in *Nobleman* that the interplay between 11 U.S.C. §§ 506(a) and 1322(b)(2) is controlled by the provisions of 11 U.S.C. § 506(a), the *Mitchell* approach will in effect have been extended to the home mortgage arena.

56. *Mitchell*, 954 F.2d at 559; Appellant's Opening Brief at 23-25, *Mitchell* (No. 90-15952); Appellees' Responding Brief at 6-16, *Mitchell* (No. 90-15952).

57. H.R. REP. No. 595, 95th Cong., 1st Sess. 356 (1977), *reprinted in* 1978 U.S.C.C.N. 6312.

> sis, taking into account the facts of each case and the competing interests in the case . . . .[58]

The Senate Committee Report on the companion bill further explained the use and approach to value under 11 U.S.C. § 506(a).[59] The Senate Committee stated that:

> [w]hile courts will have to determine value on a case-by-case basis, the subsection makes it clear that valuation is to be determined in light of the purpose of the valuation and the proposed disposition or use of the subject property. This determination shall be made in conjunction with any hearing on such disposition or use of property or on a plan affecting the creditor's interest.[60]

In 1981, the Senate reviewed the Bankruptcy Code for further refinements and adjustments. The Senate Judiciary Committee issued a report[61] which described the reasons for the various proposals for changes in the Code. The Committee proposed to amend 11 U.S.C. § 506(a) and establish a preference for the use of a resale market standard "with the choice of wholsale [sic] or retail measurements of value to be determined by reference to the condition of the property and the debtor's proposed use or disposition thereof."[62] Thus the first sentence of 11 U.S.C. § 506(a) would be deleted and replaced with a "reference" to the condition of the property, and the creditor's half of the second sentence of 11 U.S.C. § 506(a) would be retained and dominate the valuation analysis.

The Senate Committee on the Judiciary proposed these changes because, in the Committee's view:

> [C]ourts have, in too many cases, undervalued collateral property to an extent which denies adequate protection to secured creditors. Problems of proof which creditors face are compounded by ju-

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58. *Id.*

59. S. REP. No. 989, 95th Cong., 2d Sess. 68 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5854.

60. *Id.*

61. S. REP. No. 65, 98th Cong., 1st Sess., 5-6 (1983) (cited in 3 COLLIER, ¶ 506.03 at 506-13 to 506-14).

62. *Id.*

> dicial confusion over what standard should be employed — wholesale or retail, resale or straight line depreciation. Many courts have fixated upon wholesale resale at [sic] the appropriate standard, even for property with a high resale value in the retail market. Whereas the Bankruptcy Reform Act sought to encourage valuation on a case-by-case basis in focusing on the proposed use of the property in question as a determinant factor, the original intent of the Congress in this regard has not uniformly been carried into practice by the courts.[63]

However, when Congress amended the Bankruptcy Code, it included only a few of the amendments suggested by the Senate Judiciary Committee.[64] The rejected proposals included the changes to 11 U.S.C. § 506(a).[65]

III. THE COURT'S ANALYSIS

Counsel of record for both sides in the *Mitchell*[66] dispute aligned themselves according to the debtor-creditor dichotomy and obtained different results when they applied 11 U.S.C. § 506(a) to their renditions of the facts.[67] Thus, when the bankruptcy court entered its order for relief, GMAC's lien totalled $27,062.25. The debtors' valuation under 11 U.S.C. § 506(a) left GMAC with a secured claim of $20,761.00 (the wholesale value of the Cadillac) and an unsecured claim of $6,301.25.[68] This lat-

63. *Id.*

64. The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 (1984).

65. 3 COLLIER, ¶ 506.02 at 505-12. Using failed proposals for legislation to divine legislative intent carries some risk because there is no record regarding why the legislators voted against the legislation. However, when GMAC appeared before the Ninth Circuit in the *Mitchell* case, its argument emphasized the proposed use or disposition of the collateral. This is the same reasoning that appeared in the Senate Committee's report in favor of amending 11 U.S.C. § 506(a). GMAC thus put itself into the position of appearing to ask the court to legislate where Congress had refused to do so, and lessened the Mitchells' burden of proving legislative intent from failed legislation. *See* Appellant's Opening Brief at 9-26, *Mitchell* (No. 90-15952); Appellees' Responding Brief at 14-16, *Mitchell* (No. 90-15952).

66. *In re* Mitchell, 954 F.2d 557 (9th Cir.), *cert. denied*, 113 S. Ct. 303 (1992).

67. Appellant's Opening Brief at 9, 13, *Mitchell* (No. 90-15952); Appellees' Responding Brief at 16-19, *Mitchell* (No. 90-15952).

68. *Mitchell*, 954 F.2d at 559.

ter claim under the Mitchells' proposed plan would only be paid at only ten percent of its value, a total of about $630.00. Accordingly, GMAC would receive $21,391.00, plus interest, using the Mitchells' valuation.

In contrast, GMAC asserted that under 11 U.S.C. § 506(a) it had a secured claim of $24,185.00 (the retail value of the vehicle), leaving only $2,877.25 unsecured to be paid at ten percent of its value, or approximately $287.73.[69] Therefore, GMAC would receive $24,472.73, plus interest, under its valuation, a difference of $3,081.00 before interest.

A. MAJORITY

The *Mitchell* decision relied heavily on the analysis and holding of *In re Malody*,[70] and affirmed *Malody's* analytical approach. The Ninth Circuit specifically noted in *Mitchell* that *Malody* stood as the leading Ninth Circuit case on valuation standards, and approved its holding.[71] Thus, a clear understanding of *Malody* is necessary to understand *Mitchell* fully.

In *Malody*, the debtors bargained with a single creditor, Valley National Bank (VNB), in two separate transactions for the purchase of two vehicles.[72] Under the terms of the first purchase, the Bank loaned the Malodys $9,739.19 and retained a perfected security interest in a 1985 Ford Tempo.[73] The Malodys received the car and agreed to make monthly installment payments on the principal, plus interest.

The second transaction occurred six months later. VNB agreed to loan the Malodys $18,383.34 toward the purchase of a 1986 Ford Bronco II in exchange for a perfected security interest in the vehicle.[74]

Eighteen months later, the Malodys filed for protection

69. *Id.*
70. 102 B.R. 745 (9th Cir. BAP 1989).
71. *Mitchell*, 954 F.2d at 560.
72. *Malody*, 102 B.R. at 746.
73. *Id.*
74. *Id.*

under Chapter 13 of the Bankruptcy Code.[75] As of the date of their request for an order for relief, the Malodys owed VNB $6,457.75 for the Tempo, and $15,902.10 for the Bronco and valued both vehicles at their wholesale values.[76] They filed their plan concurrently with their voluntary petition, giving them thirty days from the date of their request for an order for relief to begin making payments to creditors in comformance with their plan for reorganization.[77]

The Malodys argued that the collateral should be valued at the amount a creditor would receive upon repossessing and selling the vehicles.[78] VNB argued that because the debtors retained possession of the vehicles, the value of the creditor's claim is the replacement cost to the debtors or, alternatively, the going concern value because "their retention adds to the estate by assisting in the effectuation of the debtors' Plan."[79]

The Bankruptcy Appellate Panel in *Malody* rejected the creditor's position on four grounds. First, valuation for the purpose of confirming a Chapter 13 plan under 11 U.S.C. § 1325(a)(5)(b)(ii) is to "protect a secured claimant from loss by assuring that it will receive as much money under the plan as it would receive if it were permitted to sell the vehicles in a commercially reasonable manner," and because the debtors' replacement cost is not an accurate reflection of this amount.[80]

Second, because the vehicles in *Malody* were not essential to the successful completion of the debtors' plan, replacement value would not be the appropriate measure of value.[81] An example of collateral that can be essential to an effective reorganization is farm land that produces crops from which the debtors can generate income which in turn is used to service their debt.[82]

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75. *Id.*; *supra* note 12.

76. *Malody*, 102 B.R. at 746.

77. *Id.*; 11 U.S.C. § 1326(a)(1) (1988).

78. *Malody*, 102 B.R. at 747.

79. *Id.*

80. *Id.* at 749 (citing *In re* Cook, 38 B.R. 870, 873 (Bankr. D. Utah 1984)); *see In re* Petry, 76 B.R. 651, 653 (Bankr. C.D. Ill. 1987); Memphis Bank & Trust Co., 14 B.R. 264, 265 (D.C.W.D. Tenn. 1981); *In re* Klein, 10 B.R. 657, 660 (Bankr. E.D.N.Y. 1981); *In re* Van Nort, 9 B.R. 218, 220-21 (Bankr. E.D. Mi. 1981).

81. *Malody*, 102 B.R. at 749.

82. *In re* Courtright, 57 B.R. 495, 497-98 (Bankr. D. Or. 1986).

However, crops are dissimilar to the type of collateral in the *Mitchell* case. Collateral which is closer to that found in *Malody* and *Mitchell* is the situation where a debtor grants a security interest in farm machinery that is used for the production of a debtor's income after bankruptcy.[83]

In both of these examples the property voluntarily encumbered by the debtor is part of an ongoing business and more than just incidental to the production of income by the debtors. Under these circumstances, according to *Malody* and *Mitchell*, the replacement/retail value of the collateral is the proper standard of valuation of the secured creditor's claim. However, the vehicles involved in *Malody* and *Mitchell* did not produce income; thus both courts applied the wholesale value of the vehicles as the standard to determine the creditors' allowed claims.

The *Malody* court's third reason for holding replacement value as an inappropriate standard focused on the fact that the risk that creditors take in extending credit is ignored: if a debtor defaults the creditor must repossess the collateral and sell it at a value less than retail value.[84]

Finally, *Malody* noted that in the context of confirmation of Chapter 13 plans, valuation balances the pressure on the debtor to pay the secured creditor under threat of repossession by ensuring that the creditor receives only what it could receive upon repossession and resale.[85] Citing the 1977 House Report of the Committee on the Judiciary, *Malody* noted that:

> [t]he [secured] creditor obtains a security interest in all of the debtor's furniture, clothes, cooking utensils, and other personal effects. These items have little or no resale value. They do, however have a high replacement cost. The mere threat of repossession operates as pressure on the debtor to

83. *In re* Sprecher, 65 B.R. 598, 599-601 (Bankr. C.D. Ill. 1986).
84. *Malody*, 102 B.R. at 750.
85. *Id.*

> pay the secured creditor more than he would receive were he actually to repossess and sell the goods.[86]

If retail/replacement value were used as the standard of valuation of a vehicle, this balance between the true value of collateral and its value as leverage for the creditor would be unbalanced to the point that debtors would be unable to obtain the fresh financial start that bankruptcy tries to offer.[87]

The *Mitchell* majority approved of this analysis, but added no additional comment or critique.[88] Instead, *Mitchell*, like *Malody*, started its analysis of valuation standards by focusing on two phrases of 11 U.S.C. § 506(a): an allowed claim of a secured creditor "is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property,"[89] and that "such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property."[90] Both *Malody* and *Mitchell* then examine these phrases in the inverse order in which they appear in the statute. Starting with the latter, both courts focused on the legislative history behind these contradicting statements.[91]

The Ninth Circuit noted that the purpose of the valuation needed to be examined and it established this purpose as the need to confirm a Chapter 13 plan.[92] The court then noted that fulfilling this purpose required compliance with 11 U.S.C. §

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86. *Id.*; H.R. REP. No. 595, 95th Cong., 1st Sess. 124 (1977); Appellees' Responding Brief at 12, *Mitchell* (No. 90-15952). In its Opening Brief, GMAC severly criticized the use of this passage by the Bankruptcy Appellate Panel in *Malody*. Appellant's Opening Brief at 23-26, *Mitchell* (No. 90-15952). GMAC argued that because the quoted text refers only to household goods and not vehicles, it does not apply to the latter items. *Id.*

The Mitchells' counter argument, however, contained a cogent point: there is nothing in the House report to indicate that the method of valuing secured claims is dependent on the type of collateral or that Congress intended to distinguish between household goods and cars. Appellees' Responding Brief at 12, *Mitchell* (No. 90-15952). Presumably, if Congress intended such a distinction, it would have made it.

87. *Malody*, 102 B.R. at 749-50.

88. The *Mitchell* decision is so bereft of independent reasoning that GMAC focused its criticism on the analysis contained in *Malody*. Appellant's Opening Brief at 17 n.18, *Mitchell* (No. 90-15952).

89. 11 U.S.C. § 506(a) (1988); *Mitchell*, 954 F.2d at 559.

90. 11 U.S.C. § 506(a) (1988); *Mitchell*, 954 F.2d at 559.

91. *Mitchell*, 954 F.2d at 559-60; *Malody*, 102 B.R. at 748.

92. *Mitchell*, 954 F.2d at 559-60.

1325.[93]

The Ninth Circuit then turned to the first sentence of 11 U.S.C. § 506(a) and analyzed the purpose of the valuation in order to establish the relative interests at stake.[94] Finding that the purpose of the valuation is satisfied if the creditor's interest in the collateral is protected, the Court posed the question of what is included in the creditor's interest.[95] In the case of a debtor who proposes to retain a vehicle under a Chapter 13 plan of reorganization, the creditor's interest in the estate's interest in the vehicle is the amount that the creditor would receive in a commercially reasonable sale of the vehicle.[96] Evidence having been heard in the *Mitchell* lower court proceedings that a commercially reasonable sale in the automobile context is an auction attended only by automobile dealers,[97] and that the price normally received at such an auction is the wholesale price,[98] the Ninth Circuit held that the valuation standard to be applied under the facts of *Mitchell* is the wholesale price.[99]

At first glance, this result appears to vindicate the Mitchell's position completely. However, the Ninth Circuit's decision can be divided into two parts: that which debtors will support and that which creditors will approve.

The pro-debtor nature of the *Mitchell* decision is found in the Ninth Circuit's support for the view expressed by a majority of lower courts which rejects an "across-the-board" application of a retail standard in every case where a creditor's interest in a vehicle needs to be evaluated.[100] The Ninth Circuit thus ap-

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93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. Appellees' Responding Brief at 26, *Mitchell* (No. 90-15952).
98. *Id.*; *see also In re* Klein, 10 B.R. 657, 660 (Bankr. E.D.N.Y. 1981):

> At the valuation hearing . . . an employee of GMAC testified as to GMAC's procedure for disposing of abandoned and repossessed cars. [The employee] stated that [repossessed] cars are sold on a "bid" market. Although [the employee] did not elaborate on this method of sale, it is evident that this procedure clearly contemplates a wholesale market value as opposed to a retail or forced-sale (liquidation) market value.

99. *Mitchell*, 954 F.2d at 560.
100. *Id.*; Queenan, *Standards for Valuation*, *supra* note 21, at 30.

proved a line of decisions which define value from the perspective of what collateral is worth in the hands of creditors after foreclosure and a commercially reasonable sale.[101] By implication, the court disapproved decisions which establish value of collateral by looking to the debtor's cost of replacing property in which they have granted an interest to a creditor and which the debtor proposes to retain in a Chapter 13 financial reorganization.[102]

Mitchell is a "pro-debtor" decision in most of the bankruptcy cases to which it may be applied. The court assigned the wholesale value to the Cadillac, the lowest value asserted as applicable. The vast majority of Chapter 13 reorganizations are used by individuals to reorganize consumer debt.[103] Their vehicles are not part of a going business concern and do not contribute to a successful reorganization, thus most Chapter 13 debtors will pay only wholesale value of a vehicle through their plan in reliance on *Mitchell.*

However, *Mitchell* becomes a "pro-creditor" decision in those instances where a creditor can show that a Chapter 13 debtor's vehicle is used for more than mere transportation, and is in fact used as part of a going concern.[104] If the vehicle contributes to a debtor's livelihood, and the debtor proposes to retain the vehicle, the cost to the debtor of replacing the vehicle will be its value. As a result, the allowed claim of the secured creditor will increase, and the debtor's fresh start after bankruptcy will be predicated on satisfying a much larger obligation.

At the same time, however, the Ninth Circuit's caveat regarding vehicles used in a going concern suggests that the application of the wholesale value is to be applied only under particular facts.[105] In the *Mitchell* court's view, vehicles used by a debtor in a manner that is particularly beneficial to the debtor or that is particularly detrimental to the vehicle's value requires

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101. *Mitchell*, 954 F.2d at 560.

102. *Id.*; *see also* Queenan, *Standards for Valuation*, *supra* note 21, at 30.

103. 3 COLLIER, ¶ 506.04 at 506-26 n.25; *Bankruptcy Filings Increase 22 Percent*, 22 Bankr. Ct. Dec. (CRR) Weekly News & Comment No. 15, at A7 to A11 (January 16, 1992).

104. *Mitchell*, 954 F.2d at 560.

105. *Id.*

the use of the replacement or "retail" standard of valuation.[106] Thus the definition of a going concern which can be extrapolated from *Mitchell* is an activity that assists the debtor in his financial recovery by producing income or an activity that threatens the value of the collateral.[107]

B. DISSENT

The *Mitchell* dissent agreed with the conclusion reached by the bankruptcy court. Judge Noonan noted that "[t]he key fact is that the debtor is going to use the car."[108] Accordingly, because the debtors' proposed disposition of the vehicle is to retain it for their use, and the debtors cannot sell the vehicle at wholesale, the cost of the debtors replacing the car is its value. This figure corresponds to the highest figure in the automobile valuation guide.[109]

The dissent thus emphasizes not just the fact that the debtors are retaining the subject vehicle, but that it is to be retained

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106. *Id.*

107. *Id.* Other commentators and jurists have developed alternative definitions of "going concern." *See In re* Cook, 38 B.R. 870, 875 n.11 (Bankr. D. Utah 1984):

> Property is sometimes said to have a going concern value. This expression has at least two meanings. First, going concern value may refer to property which can be sold for a higher price as inventory of an ongoing business than if sold by a closed or closing business . . . . Second, going concern value may mean that the debtor can use the property to generate income greater than the price for which the property could be sold. An example of this meaning could be tools used by a mechanic to produce income greater than the price which could be obtained at a sale in the used tool market . . . . Using this meaning when valuing a consumer's car, however, is artificial. It is not the use of the car that generates income for a Chapter 13 debtor who uses the car to drive to and from work. It is the services of the debtor unrelated to the use of the car that generate income. Thus to say that a car used to drive to and from work has a going concern value makes little sense.

See also Carlson, *Secured Creditors*, *supra* note 21, at 87-91 (discussing problems of allocating value to individual pieces of equipment used in a going concern).

Possibly the most straightforward definition of "going concern" is "a business with some sort of future." *See* Fortgang and Mayer, *Valuation in Bankruptcy*, *supra* note 21, at 1063-66 (citing FINANCIAL ACCOUNTING STANDARDS BOARD, ACCOUNTING STANDARDS § B05.103 (1984) and G. NEWTON, BANKRUPTCY AND INSOLVENCY ACCOUNTING: PRACTICE AND PROCEDURES 500-01 (2d ed. 1981)).

108. *Mitchell*, 954 F.2d at 561.

109. *Id.*; *supra* note 16.

and used by the debtors, making their successful reorganization more likely by assisting in the production of income that will be used to fund the debtors' Chapter 13 plan.

IV. CRITIQUE

Mitchell's contribution to bankruptcy law rests in two areas. First, the Ninth Circuit avoided the partisan positions that influenced some lower courts. The court adhered to the plain language of 11 U.S.C. § 506(a) and concentrated on the conjunctive word "and" rather than altering it to the disjunctive word "or." The court also used 11 U.S.C. § 506(a) in tandem with 11 U.S.C. § 1325 to find the purpose of the valuation (i.e. plan confirmation), and carefully noted that the interest to be valued was the creditor's interest in the estate's interest in the collateral. The Ninth Circuit in *Mitchell* thus provided the lower courts and bankruptcy practitioners with an invaluable lesson in statutory interpretation.

Second, the court's acknowledgment that collateral used in a going concern should be valued by a standard other than wholesale value stands as a guide to the use of legislative history. By emphasizing that different fact patterns can lead to different results, the Ninth Circuit in *Mitchell* followed Congress's instruction to conduct valuation of collateral in bankruptcy on a case-by-case basis.

The Ninth Circuit in *Mitchell* sought to reconcile the various approaches to valuation by holding that the creditor's interest in the collateral is what is being valued, and wholesale value best approximates the dollar amount of this interest.[110] However, the court also held that replacement cost to the debtor (i.e. retail value) controls valuation of vehicles where the contemplated use by the debtor of the vehicle is as part of a going concern.[111]

The Ninth Circuit's decision in *Mitchell* affirmed the approach taken by a majority of lower courts from both the Ninth and other circuits. It also affirmed the legislature's intent that

110. *In re* Mitchell, 954 F.2d 557 (9th Cir.), *cert. denied*, 113 S. Ct. 303 (1992).
111. *Id.*

valuation in the Chapter 13 context acts partly to balance the inequities between debtors and creditors by relieving the threat that repossession poses to debtors. The court also avoided making a partisan decision by affirming that circumstances exist that warrant using replacement cost to the debtor as the value of a secured creditor's claim.[112]

Mitchell successfully avoided the error made by some courts which have read 11 U.S.C. § 506(a) in the disjunctive. Instead, *Mitchell*, following *Malody*, correctly interpreted it as containing two requirements joined in the conjunctive.[113] Completely rejected by the Ninth Circuit is an "across-the-board" application of the retail price to value security interests in automobiles in Chapter 13 proceedings.[114] The court held this approach to be unsupported by case law, the Bankruptcy Code, and commentators.[115] Thus *Mitchell* endorses a balanced approach to establishing valuation standards under 11 U.S.C. § 506(a), an affirmation from a circuit court that had been missing from the reported bankruptcy decisions involving family owned vehicles prior to *Mitchell*.

In fact, the same balanced approach to 11 U.S.C. § 506(a) that is found in the *Mitchell* decision appeared under a slightly different context in a Fourth Circuit decision, *In re Balbus*.[116] *Balbus* used both prongs of 11 U.S.C. § 506(a) and its legislative history to decide the value of the collateral.[117] The *Balbus* court looked first to the purpose of the valuation at issue, and then decided on the valuation standard to be applied.[118]

In *Balbus*, the debtor had given an interest in real property as security for a debt. The holder of the debt asserted that the fair market value of *Balbus's* real property should not include hypothetical costs of sale that the creditor would incur if it re-

112. *Id.*

113. *Mitchell*, 954 F.2d at 560-51; *Malody*, 102 B.R. at 748-49; *see also In re* Balbus, 933 F.2d 246, 248-51 (4th Cir. 1991); *infra* notes 116-26 and accompanying text discussing *Balbus*.

114. *Mitchell*, 954 F.2d at 560.

115. *Id.*

116. 933 F.2d 246 (4th Cir. 1991).

117. *Id.* at 249.

118. *Id.* at 252.

possessed the house.[119] If the creditor succeeded in excluding these costs, the debtor would have had to amend his bankruptcy petition and shift debt from his secured schedule to the unsecured debt schedule.[120] If this occurred, the *Balbus* debtor would exceed the limit of $100,000.00 of noncontingent, liquidated debt imposed on Chapter 13 petitioners by 11 U.S.C. § 109(e).[121] Thus the debtor would have been foreced out of bankruptcy and exposed to his creditor's enforcement and collection actions, or forced to convert his Chapter 13 proceeding to one under Chapter 7.[122]

The *Balbus* court looked first to the purpose of the valuation: to determine if unsecured debts are less than the limit imposed by 11 U.S.C. § 109(e). The court reasoned that deducting hypothetical sales costs would make this bright line limit less useful.[123] Thus the purpose of the valuation is served by certainty, not hypothesis, so the exclusion of these costs is not permitted under this prong of the 11 U.S.C. § 506(a) valuation procedure.[124]

The *Balbus* court then looked to the proposed disposition or use of the collateral. Although this sentence is phrased in the permissive disjunctive form, *Balbus* blurred the line between disposition and use by speaking of the debtor's possession and

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119. *Id.* at 247-48. Cases prior to *Balbus* considering the issue of whether hypthetical costs of sale should be deducted from a the fair market value of a debtor's property divided their opinions along the debtor-creditor dichotomy. *Supra* note 37. Those cases which held that hypothetical costs of sale should be deducted from a debtor's fair market value when the debtor proposes to retain the collateral emphasized the first sentence of 11 U.S.C. § 506(a). *See In re* Smith, 92 B.R. 287, 290 (Bankr. S.D. Ohio 1988) ("Because it is the creditor's interest in the estate's interest in property which must be valued, it is appropriate to deduct costs of sale regardless of whether a debtor intends to retain and use the property."); *In re* Boring, 91 B.R. 791, 794 (Bankr. S.D. Ohio 1988) ("Most courts recognize that the debtor's proposed retention and use of collateral does not emasculate the fact that it is in the first instance the creditor's interest in the collateral that must be valued.").

On the other hand, some courts prior to *Balbus* emphasized only the second sentence of 11 U.S.C. § 506(a) and held that hypothetical sale costs should not be deducted. *See In re* 222 Liberty Assocs., 105 B.R. 798, 803 (Bankr. E.D. Pa. 1989); *In re* Courtright, 57 B.R. 495, 497 (Bankr. D. Or. 1986); *see also In re* Usry, 106 B.R. 759, 761 (Bankr. M.D. Ga. 1989).

120. *Balbus*, 933 F.2d at 247-48.

121. 11 U.S.C. § 109(e) (1988).

122. *Balbus*, 933 F.2d at 248.

123. *Id.* at 251.

124. *Id.* at 251-52.

use of the house put up as collateral as identical concepts. However, the court did focus on disposition by noting that the debtor had no intention of selling the house. By implication, because there is no sale, no sale price is needed, and because no sale price is needed, no costs of sale need be figured or deducted from the fair market value for the purpose of this valuation.[125]

The debtor's scheduling of his debts in his bankruptcy petition remained as scheduled by Balbus, no amendment was required, and his case proceeded under Chapter 13.[126]

The strength of the *Mitchell*, *Malody*, and *Balbus* decisions lies in their reliance on careful statutory interpretation. Such reliance gave a high degree of certainty to their holdings. The same degree of certainty is missing from the *Mitchell* majority's analysis of a vehicle's role in a going concern. As a result, the Ninth Circuit created a vague exception to a bright line general rule.

The Ninth Circuit gave slight indication of the extent to which a vehicle must be linked to the production of income in order to be a part of a going concern. The court noted that even though Mr. Mitchell drove to his customers' businesses in the Cadillac in order to conduct his commercial glass contracting business, such use did not produce income.[127] Instead, according to the Ninth Circuit, the car's use was incidental to his ability to conduct his business.[128] However, the precise reason why Mitchell's use of this particular vehicle did not constitute a going concern is not articulated clearly in *Mitchell*.[129]

On the other hand, Judge Noonan's dissent implies that because the Mitchells used their Cadillac for more than just pleasure or commuting to and from work, the car produced income.[130] However, Judge Noonan also downplayed the use of the vehicle in the Mitchell's business and instead argued that valuation is only to be based on the "key fact" that the debtors proposed to

125. *Id.*
126. *Id.* at 248, 252.
127. *Mitchell*, 954 F.2d at 559.
128. *Id.*
129. *Id.* at 560.
130. *Id.* at 561.

retain the car.[131] Thus the weakness in the approach to valuation in the *Mitchell* dissent is that it de-emphasizes the purpose of the valuation by stressing the proposed use or disposition of the collateral.[132]

Neither the majority nor the dissent in *Mitchell* conducted a complete analysis of the extent that the Mitchells used their vehicle to create income through their business venture. While the need to examine this situation raises one more issue to be litigated in the course of a bankrupcty proceeding, just such an examination appears to be required under the legislative history of 11 U.S.C. § 506(a).[133]

V. CONCLUSION

The *Mitchell* decision supports a view expressed by many bankruptcy courts. The Ninth Circuit's decision promotes the philosophy underlying bankruptcy law that debtors are to receive a fresh start and creditors are to receive an equitable distribution of the debtor's assets. The court achieved this goal by basing its decision on the construction of the statutory language of the Bankruptcy Code and obeying the order of Congress to decide valuation issues case-by-case. It therefore ruled that most vehicles in Chapter 13 cases where the debtor proposes to retain the vehicle are to be valued at their wholesale price, and at higher standards where a vehicle is used as part of a going concern.

The *Mitchell* decision served the lower courts' need for clear direction on the issue of valuation and and gave other circuit courts a clear analytical approach upon which to base their decisions. However, the rule announced in *Mitchell* is limited to a specific situation: valuation of vehicles for purposes of confirmation of a Chapter 13 plan of reorganization. Left unaddressed are valuation standards where other types of collateral are involved and how Bankruptcy Code sections other than 11 U.S.C. § 1325 are to be analyzed in conjunction with 11 U.S.C. § 506(a).

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131. *Id.*

132. 11 U.S.C. § 506(a); *Mitchell*, 954 F.2d at 561.

133. *Supra* notes 53-65 and accompanying text.

Mitchell may be extended to control any Chapter 13 case where a debtor proposes to retain property used as collateral for a loan. The bankruptcy tradition of analogizing between chapters would support extending *Mitchell's* holding to such cases, absent a specific statutory prohibition.

In *Mitchell*, the Ninth Circuit successfully settled an issue that had yet to reach the circuit court level, stayed faithful to the philosophy of the Bankruptcy Code, and reached a correct result for the right reasons.

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