

No. 08-3954

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re DAWN S. SHOCKLEY AND JOHN R. SHOCKLEY,
Debtor.

DAWN S. SHOCKLEY and JOHN R. SHOCKLEY,
Debtors-Appellants

— v. —

DAIMLERCHRYSLER FINANCIAL SERVICES AMERICAS, LLC
Creditor-Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF OHIO

**BRIEF AMICUS CURIAE IN SUPPORT OF DEBTORS
POSITION SEEKING AFFIRMANCE IN PART, ON BEHALF OF PROFESSORS INGRID M.
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INTEREST OF *AMICI CURIAE*

The *amici curiae* offering this brief are law professors that devote their careers to the study and teaching of bankruptcy and commercial law.¹ They are particularly interested in the issue before the court because of its significant implications for secured transactions both within bankruptcy and outside of bankruptcy.

This case concerns the meaning of “purchase-money obligation.” The term “purchase-money obligation” has application far beyond chapter 13 and far beyond creditors referred to in Bankruptcy Code section 1325(a)(9)(*), who extend credit that allows debtors to buy cars for their personal use within 910 days of bankruptcy and receive “purchase money security interests.” A complicated and well-established system of priorities and rights, both state and federal, turns on its meaning. A broad construction would upset these systems and the rights of those who rely on them daily in making credit decisions. It would also re-allocate well-established distributions.

¹ Pursuant to Rule 29(c)(3) of the Federal Rules of Appellate Procedure, the following identifies the amici curiae: Ingrid M. Hillinger, Professor of Law, Boston College Law School, Michael Hillinger, Associate Dean and Professor of Law, Southern New England School of Law, Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center, and Jean Braucher, Roger C. Henderson Professor of Law, University of Arizona, James E. Rogers College of Law.

The purchase-money concept has a venerable past. The policies that animated it historically continue to underlie it today. This friend of the court brief seeks to explain the source of the purchase-money concept, its evolution under Article 9 and its vital role in modern-day commercial affairs. Understanding the role that the purchase-money concept has played in the past and presently is a helpful guide for determining its role in the future, as well as its meaning in chapter 13 cases.

SUMMARY OF ARGUMENT

This issue in this case is not how much a chapter 13 debtor must pay his or her creditors. Chapter 13 requires debtors to commit all their projected disposable income to the payment of their prepetition debts. The issue is how much one creditor will receive at the expense of the debtor's unsecured creditors (or the failure of the debtor's chapter 13 plan altogether). A chapter 13 estate is finite. To the extent one creditor gets more, other creditors get less. Sections 1322 and 1325 of the Bankruptcy Code determine how to allocate a chapter 13 debtor's disposable income. A provision of the 2005 amendments to chapter 13, which was added at the end of section 1325(a)(9) and is referred to herein as "section 1325(a)(9)(*)," accords special protection and special benefits to holders of purchase-money obligations which their debtors incurred within 910 days of bankruptcy with respect to cars purchased for personal use. Section 1325(a)(9)(*)'s special protections and benefits are at the expense of the debtor's unsecured creditors. A broad interpretation of what a "purchase-money obligation" encompasses will increase the purchase-money holder's pay out. That increased payout to creditors holding 910 claims, contrary to the primary goal of Congress' 2005 amendments to chapter 13, will decrease the pay out to all the debtor's unsecured creditors. Increasing the required pay out to that secured creditor will also make it more

difficult for the chapter 13 debtor to retain his or her car. The term “purchase money security interest” in section 1325(a)(9)(*) should be narrowly construed to carry out Congressional intent to provide meaningful recoveries for unsecured creditors in chapter 13 cases rather than nothing, as is typical chapter 7 liquidation cases.

The U.C.C. Article 9 definition of “purchase-money security interest” governs in Bankruptcy, including in 11 U.S.C. § 1325(a)(9)(*). Had Congress intended a different meaning in Bankruptcy, it would have defined the term in section 101, the definitional provision, or defined it for purposes of section 1325. It did not. “Purchase-money security interest” [PMSI] has a well-established meaning at state law. Re-defining it in bankruptcy would upset the rules upon which creditors base their daily credit decisions. Furthermore, no important national interest or bankruptcy policy exists to justify such a redefinition.

Historically, courts used the purchase-money concept to encourage parties to extend credit to borrowers who had given a prior creditor a security interest in the borrower’s current and after-acquired assets. Courts, through one device or another, gave the subsequent purchase-money creditor priority over the borrower’s prior filed creditors. The purchase-money creditor had a special equity in the

purchase-money collateral. But for the purchase-money creditor's extension of credit, the debtor would not have the collateral.

This same policy of encouraging parties to extend credit to borrowers underlies Article 9's purchase-money concept. Article 9 promises the purchase-money creditor of consumer goods special protections, privileges and benefits to encourage parties to extend credit to consumers. However, these protections, privileges and benefits are limited to and by the policies that animate them. Only holders of purchase-money security interests are entitled to those protections, benefits and privileges and then, only to the extent their security interest is a PMSI. A creditor's PMSI is limited to the purchase-money obligation owed.

At bottom, rules that turn on purchase-money status are loss allocation rules. Section 1325(a)(9)(*) is no different in that regard. It allocates a greater pay out to the holder of the purchase-money obligation as defined at the expense of the debtor's similarly situated secured creditors and the debtor's unsecured creditors.

Redefining "purchase-money obligation" under section 1325 to include something it has never included would alter established, carefully calibrated federal and state loss allocation principles. It would give the purchase-money creditor greater protections, greater privileges, and greater benefits than either Congress or Article 9 intended. It would so at the expense of the debtor's other

creditors or the debtor. No bankruptcy policy supports such a broad reading of purchase-money obligation. No public policy animating the purchase-money concept, historically or today, supports such a broad reading. Finally, no special equity or principle of fairness justifies including a debtor's negative equity as part of a 910-day car lender's purchase-money obligation.

ARGUMENT

A. The State Law Defines When a Lender Has a Purchase-Money Obligation.

Section 101 of the Bankruptcy Code, its definitional provision, does not define “purchase-money security interest” [PMSI]. Nevertheless, the Bankruptcy Code relies on the term in sections 522(f), 524(k)(3)(G) and 1325(a)(9)(*). The absence of a definition suggests Congress chose to rely on the Article 9 state law definition. The Bankruptcy Code’s deference to and incorporation of the state law definition of PMSI finds further support in section 547(c)(3) of the Bankruptcy Code. Section 547(c)(3) is one of several exceptions or defenses to a preference action.² Section 547(c)(3), the so-called “enabling loan exception,” impliedly defines when a lender has a PMSI. It provides:

- The trustee may not avoid under this section a transfer –
- (3) that creates a security interest in property acquired by the debtor -
 - (A) to the extent that such security interest secures new value that was -
 - (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
 - (ii) given by or on behalf of the secured party under such agreement;
 - (iii) given to enable the debtor to acquire such property; and

² A preference is defined in 11 U.S.C. § 547. That section prohibits the payment of money from a debtor to a creditor on a pre-existing debt, which payment was made within ninety (90) days prior to the bankruptcy filing when the debtor was insolvent, or within one (1) year if the creditor is deemed an insider of the debtor.

- (iv) in fact used by the debtor to acquire such property; and
- (B) that is perfected on or before 30 days after the debtor receives possession of such property.

Section 547(c)(3) mirrors the Article 9 definition of when a lender has a PMSI. Section 9-103 of the Uniform Commercial Code states, in relevant part:

“purchase-money obligation” means an obligation of an obligor incurred for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

Congress could have defined PMSI in Bankruptcy Code section 1325. *See, e.g.,* 11 U.S.C. § 547(a)(1) (defining “new value” for purposes of § 547). It did not. Congress therefore presumably intended the well-established state law definition to apply. Moreover, no important national interest exists to reject “well-established commercial rules which have proven workable over time.” United States v. Kimbell Foods, Inc. 440 U.S. 715 (1979). Indeed, re-defining PMSI for purposes of section 1325 could upset “intricate state laws of general applicability on which private creditors base their daily commercial transactions.” *Id.* at 729.

B. The *Price* of Collateral Is Only Relevant When Determining a Seller’s Purchase-Money Obligation and Value Given to Enable Acquisition of Rights In Collateral Applies to Lender’s Purchase Money Obligation.

Determining a creditor’s purchase-money obligation is key to application of section 1325(a)(9)(*). Section 9-103 of the Uniform Commercial Code defines “purchase-money obligation.” Unlike Athena, section 9-103 did not spring, full-

blown, from the head of Zeus. Former section 9-107 begat section 9-103 and case law begat former section 9-107. As Grant Gilmore, principal architect of Article 9, observed, “[t]here is much less novelty in Article 9 than meets the eye and most of that novelty is a mere matter of terminology.” Grant Gilmore, The Purchase Money Priority, 76 Harv. L. Rev. 1333, 1337-38 (1963).

Under Revised Article 9, a creditor can only have a PMSI in goods or software. See U.C.C. § 9-103(1)(1), (b), (c). A creditor’s security interest is a PMSI only to the extent the goods are purchase-money collateral with respect to that security interest. See U.C.C. § 9-103(b)(1). “Purchase-money collateral” requires collateral that secures a purchase-money obligation with respect to that collateral. See U.C.C. § 9-103(a)(1).

Section 9-103(a)(1) states:

“purchase-money obligation” means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

Section 9-103(a)(1) is defining two different purchase-money obligations: a *seller’s* purchase-money obligation and a *lender’s* purchase-money obligation. A *seller’s* purchase-money obligation encompasses the amount of the purchase price the seller “financed.” For instance, the seller may have financed the entire purchase price (“*all of the price* of the collateral”). On the other hand, it may have

financed just 80% of the purchase price (“*part of the price*”). The portion of the price that the seller financed constitutes the purchase-money obligation owed to the seller. A *lender’s* purchase-money obligation is more complicated. It consists of (1) the amount of value the lender gave to the debtor, (2) which value enabled the debtor to acquire rights in the goods, (3) which value the debtor, in fact, used to acquire the goods. *See Forks In the Road: Driving A 910-Car Through the Hanging Paragraph* (detailing decision tree in negative equity cases)(Addendum at 44).

Section 9-103 derives from former section 9-107. Section 9-107 was much clearer in this regard. It provided:

A security interest is a “purchase money security interest” to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Former Official Comment 1 stated:

Under this Section a *seller* has a purchase money security interest if he retains a security interest in the goods; a *financing agency* has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and *also when it makes advances to the buyer (e.g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose.*

Official Comment 2 explained:

*When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This Section therefore provides that the purchase money party must be one who gives value “by making advances or incurring an obligation”: the quoted language **excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.***

Uniform Commercial Code, 1962 Official Edition, *available at* HeinOnline, 23 U.C.C. Drafts p. 628, at 408 (emphasis added). The 1972 Amendments made no change to section 9-107. Final Report, Permanent Editorial Board for the Uniform Commercial Code, 9-107, at 47 (April 25, 1971).

According to Professor Gilmore,

The second branch of the definition [i.e., § 9-107(b)] includes some interests whose claim to purchase money rank may not have been clear under pre-Code law. It has always been clear that a person taking by assignment from a seller inherited the seller’s purchase money interest and presumably it would never have been doubted that a person who, on the buyer’s behalf, advances the purchase price directly to the seller has a purchase money interest. *It has been less clear whether a person who advances money to the buyer, which the buyer then uses to pay the price, has such an interest;* under pre-Code law he could not use the conditional sale device, and the traditional concept of purchase money mortgage assume that the mortgage runs in the first instance directly to the seller. *Such a person does have a purchase money interest under paragraph (b) of 9-107. It should be noted, however, that the person claiming the purchase money interest will have to show both that his advance was made for the purpose of enabling the debtor to acquire the collateral and that it was in fact so used.* To avoid what could turn out to be a complicated proof, a person who wants to be sure of having a purchase money interest will be well advised to make his advance directly to the seller (or by check made out to the seller’s order).

Gilmore, 76 Harv. L. Rev. at 1373 (emphasis added).

Section 9-103(a)(2) continues former section 9-107's distinction between a seller purchase-money obligation and a lender purchase-money obligation. It simply defines both in one section. Section 9-103(a)(1) defines "purchase-money obligation" as "an obligation of an obligor incurred [1] as all or part of the price of the collateral or [2] for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." Presumably, the revisors chose to define both types of purchase-money obligation in one provision because the definition of PMSI had become a much more complicated task in light of the "transformation rule," an unwelcomed judicial development under former Article 9. Section 9-103's length, precision, and seeming circularity, are a product of the revisors' desire to eradicate any and all vestiges of the transformation rule in non-consumer goods transactions.

The collapse of former sections 9-107(a) and (b) into a single provision, section 9-103(a)(2), was not intended to eliminate the historical distinction between a seller's purchase-money obligation and a lender's purchase-money obligation. Had the revisors intended such a change, presumably they would have used different language. Moreover, they would have signaled such a momentous change. Nothing in section 9-103's text, its official comments, or the legislative

history to Revised Article 9 reflects any intention to change the distinction between a lender's purchase-money obligation and a seller's purchase-money obligation.

C. Value a Lender Gives to Enable a Debtor to Pay Off a Prior Lender's Purchase-Money Obligation Is Not Value that Enables the Debtor to Buy a New Car.

Value a lender advances to a debtor, which the debtor uses to pay off an existing lien in the debtor's old car, is value that enables the debtor to pay off his or her existing car lender. It is not value that enables the debtor to buy the new car. It is easiest to visualize and understand the underlying nature of these negative equity transactions by applying Professor Gilmore's practical suggestion. As he noted, "a person who wants to be sure of having a purchase money interest will be well advised to make his advance directly to the seller (or by check made out to the seller's order)." Gilmore, 76 HARV. L. REV. at 1373. If the lender wanted objective proof of who was paid what, let's consider what checks the lender would write in a fact pattern like the fact pattern presented in these negative equity cases. The lender would write two checks. It would write one check (Check One) jointly payable to Debtor and Car Dealer. That check would go toward the purchase of the new car. Check One would be in an amount equal to the amount a first-time car buyer, buying on secured credit, would owe to Car Dealer. The lender would write another check (Check Two) jointly payable to Debtor and Old Car Lender.

The amount of Check Two would equal the outstanding purchase-money obligation Debtor owed Old Car Lender on his or her old car.

In practice, a lender may advance all the funds to the car dealer on behalf of the debtor. Nevertheless, the dealer will apply a portion of the funds advanced to pay off the debtor's old car loan. Otherwise, the dealer cannot sell the debtor's old car. The funds that go to pay off Old Lender, of necessity, do *not* go to purchase the new car. They do not enable the debtor to acquire the new car. They go to Old Lender. Borrowing a thought from Judge Clark, "[r]etiring this overhang from the old vehicle may effectuate the transaction, but effectuating the transaction does not" mean the lender's value enabled the debtor to acquire the new car. In re Sanders, 2007 WL 3047233, *11 (Bankr. W.D. Tex. 2007).

D. Obligations for Expenses Incurred in Connection with Acquiring Rights in the Collateral Do Not Include Obligations Incurred for Paying Off a Prior Purchase-Money Lender's Car Loan.

Section 9-103, Official Comment 3, states:

As used in subsection (a)(2), the definition of "purchase-money obligation," the "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

As noted above, a debtor's obligation to repay a new car lender for funds it advanced to pay off an old car lender is not an obligation incurred to acquire rights

in the new car. It is an obligation incurred to pay off an old car lender. The obligations described in Official Comment 3 are obligations a debtor incurs in connection with *acquiring* the collateral. They are the class of obligations a first-time car buyer would incur if the car buyer bought on secured credit, obligations closely associated with and related to the transaction - acquisition of the new car. In a 1992 Report, a Permanent Editorial Board (PEB) Study Group made the following of recommendation for revising Article 9:

D. The official comment to § 9-107 should be revised to make clear that purchase money debt includes related obligations such as interest, collection expenses, and the like.

COMMENTS:

Security agreements normally provide that the collateral secures not only the principal amount of a loan, or the remaining balance of the price in case of a security interest retained by a seller, but also other obligations of the debtor that are closely associated with and related to the transaction. The obligations typically include those for interest or time-price differential, default charges, expenses of collection efforts following a default, costs of required insurance not obtained by the debtor, and the like. Because these obligations are so closely related to the obligation to pay the price or enabling loan in a PMSI transaction they should be treated as a component of purchase money debt that is secured by a PMSI.

A fair reading of § 9-107 can accommodate treatment of these associated and related obligations as purchase money debt. Accordingly, a clarifying revision to the official comment should provide adequate guidance for the courts.

PEB Study Group, Section 14, at 102, U.C.C. Article 9, ALI & NCCUSL (1992).

The comments suggest the PEB was concerned with correcting an overly narrow view of what obligations the terms “price” and “value” would encompass. The protections and benefits of PMSI status should extend to and include obligations the debtor incurred in addition to the “bare” price of goods. Obligations like interest, finance charges, sales taxes, duties -- obligations intimately associated with the acquisition of the goods - obligations any purchaser on secured credit would incur - those and only those obligations would also be entitled to purchase-money status. An obligation incurred to pay off an existing lender is not an obligation any purchaser on secured credit would incur to obtain rights in the goods.

Including costs incident to acquisition of collateral is not new nor is excluding costs unrelated to the acquisition. In Bucyrus-Erie Co. v. Casey, 61 F.2d 473 (3d Cir. 1932), an insolvent company had purchased three excavating machines from Bucyrus-Erie Co. [the seller]. The company had executed three conditional sale contracts in favor of the seller.³ In the company’s subsequent receivership, the seller filed a claim that included the outstanding purchase price, costs to repair the machines, and money due on an open account. According to the seller, title to the excavators could not pass to the receiver until all claims were

³ The seller under a conditional sales contract was the forerunner to the Article 9 purchase-money seller. *See* U.C.C. § 2-401(1).

paid. The trial court held title to the excavators passed to the receiver upon payment of the unpaid purchase price. Id. at 473.

On appeal, the issue was what obligations were encompassed under the Pennsylvania Conditional Sales Act. It defined “conditional sale” as

any contract for the sale of goods under which possession is delivered to the buyer and the property in the goods is to vest in the buyer at a subsequent time upon the payment of part or all of the price or upon the performance of any other condition or the happening of any contingency.

Id. at 474. According to the Court of Appeals for the Third Circuit, the seller failed to “show that the transactions involved in the open account were in any way related to sales of the three excavators.” Id. The seller argued that the phrase “upon the performance of any other condition” meant “any other condition whatsoever, although in no way related to the payment of the price of the excavators.” Id. The Third Circuit refused to read it so broadly:

We construe the expression “upon the performance of any other condition” as meaning any other condition incident to such sale. We do not mean that the condition is restricted to the payment of a part of whole of the purchase price, but it may include other conditions of the happening of other contingencies incidental to the transaction; for example, that the property be kept free from liens; that the cost of repairs to the article sold be paid by the vendee; that the machine be kept in good operative condition; the vendee pay the cost of retaking, keeping and storing the machine; that insurance be maintained; that payment be made for the vendor’s expenses in erecting or installing the machinery. These we think are examples of condition which the vendor could reasonably require to be performed within the meaning of the expression “upon the performance of any other conditions”.

Id. Any other reading would result in “a chattel mortgage for an undisclosed amount, resulting in inequities to other creditors.” Id.

No reason exists to construe the costs incident to sale any differently today than in 1932. As one commentator noted, from the beginning, the drafters sought “to distinguish the security transaction where security is taken to secure some performance that resulted in a current addition to the borrower’s assets and well-being from that in which the security is taken solely to better an existing creditor’s position in relation to other existing creditors.” Kelly, UNIFORM COMMERCIAL CODE DRAFTS, vol. 4, at 286 (Comment to Tentative Draft No. 1- Article VII (1948)), quoted in D. Benjamin Beard, The Purchase Money Security Interest in Inventory: If It Does Not Float, It Must Be Dead!, 57 Tenn. L. Rev. 437, 483 (1990). Allowing a car lender’s purchase-money obligation to include funds advanced to pay off an existing car lender would permit the car lender to better its position in relation to the debtor’s other creditors.

E. What Would Grant Gilmore Do?

According to Professor Gilmore, Article 9 codified the purchase-money concept “to provide for the financing of new equipment free of prior liens.” Gilmore, 76 Harv. L. Rev. at 1337. Pre-Code, courts, including the United States Supreme Court, had used title devices to accomplish this objective. United States

v. New Orleans Railroad, 79 U.S. 362 (1870), is instructive. There, bondholders of an insolvent railroad company had brought a foreclosure action. During the trial, it was discovered that the United States had sold the railroad company two locomotives and ten cars [rolling stock]. The company had given the United States a bond for the purchase-money. The bondholders wanted to sell the rolling stock. The lower court denied their request. On appeal, the bondholders argued their first mortgage expressly included after-acquired property, their interest attached to the rolling stock as soon as it was purchased, and their interest “displaced any junior lien.” Id. at 364.

According to the Supreme Court, the appellants had

an erroneous view of the doctrine by which after-acquired property is made to serve the uses of a mortgage. That doctrine is intended to subserve the purposes of justice, and not injustice. Such an application of it as is sought would often result in gross injustice. A mortgage intended to cover after-acquired property can only attach itself to such property in the condition in which it comes into the mortgagor’s hands. If that property is already subject to mortgages or other liens, the general mortgage does not displace them, though they may be junior to it in point of time. It only attaches to such interest as the mortgagor acquires; and if he purchase property and give a mortgage for the purchase-money, the deed which he receives and the mortgage which he gives are regarded as one transaction, and no general lien impending over him, whether in the shape of a general mortgage, or judgment, or recognizance, can displace such mortgage for purchase-money.

Id. at 365 (1870).

In short, the United States had a special equity in the rolling stock. But for its extension of credit, the railroad company (and its bondholders) would not even have a claim to it. The Government's purchase-money claim to the rolling stock prevailed over the claim of the prior filed bondholders.

As Gilmore explained it, pre-Code, courts insured the financing of new equipment free of prior claims

by the manipulation of title theory under the system of separate security devices. Most of the specialized devices were recognized as giving the security holder title and not "merely" a lien: this was true of the conditional sale, the security lease ... and the trust receipt. The way of defeating the prior mortgagee, recognized as effective under pre-Code law, was to have the security holder's title to the new equipment come directly from the manufacturer or seller.

Gilmore, 76 Harv. L. Rev. at 1337.

This way of insuring the financing of new equipment free of prior liens was not possible under Article 9. First, Article 9 rejected the distinction between security and title. Second, Article 9 supplanted all the pre-Code security devices with a single security device, the secured transaction. Id. Article 9 handled the problem "as one of priorities and solved [it] by the introduction of the concept of the 'purchase money security interest.'" Id. at 1338.

But, as Gilmore also noted, the special protection and deference courts gave to "purchase-money" transactions posed problems and potential unfairness for

prior lien holders, typically, mortgagees. An unfairly broad claim of purchase-money status could unfairly subordinate a prior creditor.

It was characteristic of nineteenth century judicial technique to attack unfair transactions indirectly rather than directly. Following this approach the courts learned, in balancing equities between mortgages and purchase money interests, to be quite technical about what constituted a purchase money claim; the purchase money priority, a modern commentator concluded “can be assured ... only if a carefully limited, and sometimes seemingly arbitrary, procedure is observed.

Id. at 1345. To limit the purchase money priority, courts imposed technical requirements. “To rank as purchase money, a claim must be, it was often said, ‘directly’ related to the acquisition of the property.” Id.

Chief Judge Taft wrote:

When that which is given the appearance of a vendor’s or purchase-money lien is really only a device to secure money borrowed for other purposes of the mortgagor than the buying of the addition in question, then the attempt to supplant the first lien of the mortgage under the after-acquired property clause is a fraud upon the mortgage, and the pseudo purchase-money lien must be postponed to that of the mortgage. Harris v. Youngstown Bridge Co., 90 Fed. 322, 329 (6th Cir. 1898).

Id. The Article 9 purchase-money concept was a response to Article 9’s validation of after-acquired property clauses. It was designed to protect a debtor’s subsequent acquisition of assets free of prior liens - no more and no less.

As a matter of history, the triumph of the after-acquired property interest has been regularly followed by an important limitation or qualification. The after-acquired property interest, wherever it has been recognized as valid against the borrower’s creditors and in his bankruptcy, has been

subordinated to subsequent purchase money interests, which arise in connection with the financing of new acquisitions by the borrower.

Id. at 1334.

The Article 9 purchase-money concept is carefully calibrated to balance the rights and equities of the purchase money creditor and prior filed creditors. The new car lender who seeks to include a debtor's negative equity is not attempting to supplant the rights of a prior filed creditor. The possibility of an after-acquired property clause regarding consumer goods is very limited under Article 9. See U.C.C. § 9-204(b)(1). Nevertheless, the new car lender seeking to include a debtor's negative equity is seeking greater benefits than were intended for it, under Article 9 and elsewhere. In particular, concluding that its purchase-money obligation includes a debtor's negative equity would give it a greater benefit than Congress intended in section 1325(a)(9)(*) which limits its protection to claims secured by a PMSI. A lender's PMSI cannot exceed the purchase-money obligation owed. The purchase-money obligation owed is limited to the value of the collateral the debtor acquired, what was needed to enable the debtor to acquire the new car. No more, no less.

F. The Creditors' Expansive View of Purchase-Money Obligation, If Adopted, Will Alter Established Rights and Established Loss Allocation Principles, both at State Law and in Bankruptcy.

Article 9 subordinates a prior filed creditor's after-acquired property interest "to subsequent purchase money interests which arise in connection with the financing of new acquisitions by the borrower." Gilmore, 76 HARV. L. REV. at 1334. The PMSI concept always has and continues to perform that function today in the commercial context. It thereby encourages subsequent creditors to extend credit to a debtor even though a prior filed creditor exists. *See, e.g.*, U.C.C. § 9-324(a) (superpriority for PMSIs in goods other than inventory or livestock and all identifiable proceeds therefrom); U.C.C. § 9-324(b) (superpriority for PMSIs in inventory and identifiable cash proceeds received on or before delivery of the purchase-money inventory to a buyer, and instruments and chattel paper to extent purchase-money inventory creditor satisfies U.C.C. § 9-330); U.C.C. § 9-324(d) (superpriority for PMSIs in livestock and identifiable proceeds and identifiable products); *see also* U.C.C. § 9-317(e) (superpriority for PMSIs over buyers, lessees and lien creditors).

These PMSI superpriority rules are loss allocation rules. They give one creditor, the holder of the PMSI, special protection at the expense of all the

debtor's other creditors. They apply to competing Article 9 creditors as well as other claimants, including filed federal tax liens. Slodov v. United States, 436 U.S. 238, 258 n.23 (1978) (decisional law has long established that purchase-money mortgagee's interest in mortgaged property is superior to antecedent liens prior in time, and therefore, "a federal tax lien is subordinate to a purchase-money mortgagee's interest notwithstanding that the agreement is made and the security interest arises after notice of the tax lien.").

The PMSI in a consumer goods context, like the PMSI in a commercial context, functions chiefly to encourage credit extensions to a debtor. In the consumer context, however, a prior filed creditor with an after-acquired property clause will rarely, if ever, exist. With minor exceptions, creditors cannot take a security interest in after-acquired consumer goods. *See* U.C.C. § 9-204(b)(1) (security interest does not attach under after-acquired property clause to consumer goods, other than accession given as additional security, unless debtor acquires rights in goods within 10 days after secured party gives value); former U.C.C. § 9-204(2) (same). In a consumer goods context, the PMSI encourages creditors to extend credit by promising such creditors special benefits. For example, section 9-309(1) recognizes automatic perfection of PMSIs in consumer goods unless a separate, non-Article 9 notice system governs, e.g., a certificate of title statute

requiring the creditor to note its lien on the face of the certificate of title.

Automatic perfection reduces the transactional costs of credit and the need for post-transaction monitoring. It thereby benefits both consumer borrowers and consumer creditors.

Purchase-money status for consumer goods has significant benefits outside of Article 9 as well. Federal law accords significant benefits to the PMSI holder. For example, in bankruptcy, a creditor's security interest in goods is protected against a debtor's competing exemption claim to the extent the creditor's interest is a PMSI. See 11 U.S.C. § 522(f)(1)(b) (debtor's avoidance power does not apply to PMSIs even though PMSI impairs debtor's exemption rights). The same holds true outside of bankruptcy. See Fed. Trade Comm. Credit Practices Reg., 16 C.F.R. § 444.2(a)(4) (unfair trade practice to take nonpossessory, nonPMSI in household goods as defined). Similarly, section 547(c)(3) shelters the purchase-money creditor from preference attack. The policy underlying section 547(c)(3) mirrors Article 9 policy. It encourages creditors to extend creditor to debtors.

All these PMSI rules allocate loss, be it loss between competing creditors or loss between a creditor and the debtor. They are carefully crafted and carefully calibrated. Any change in the definition of purchase-money in bankruptcy will disrupt these priorities in bankruptcy and create a disequilibrium between bankruptcy and other law. Further, it will render the rules, and therefore, creditor rights uncertain and unpredictable. “When states have gone far in achieving the desirable goal of a uniform law governing commercial transactions, it would be a distinct disadvantage to insist on a different one for one segment of commerce.” United States v. Kimbell Foods, 440 U.S. 715, 729 (1979) (refusing to create a separate federal priority rule for federal consensual liens).

Had Congress wanted to protect a creditor’s advance to pay off an existing car lien, it would not have used an established term with an established meaning and an established set of policies supporting it. Redefining an established term with broad application both under federal and state law would lead to pernicious results. In the context of section 1325(a)(9)(*), it would produce perverse results. It would not in any way increase the debtor’s pay out to creditors. A chapter 13 debtor is already obligated to commit his or her projected disposable income to the plan. See § 1325(b). An unduly broad reading of purchase-money obligation would do one of two things. It would preclude confirmation of a chapter 13 plan

because the debtor cannot propose a confirmable plan or it would allocate more of the debtor's disposable income to the 910-car lender at the expense of the debtor's other creditors. Section 1325(a)(9)(*) gives no hint that Congress intended either result. No policy, express or implied, supports such a redefinition. Moreover, redefining PMSI for purposes of section 1325(a)(9)(*) will upset established priorities and the legitimate expectations of those who rely on them on a daily basis. The car lender is seeking more than Congress sought to give, more than any public policy underlying PMSI would support, and more than it deserves as a matter of equity.

CONCLUSION

For the foregoing reasons, the judgment of the bankruptcy court on the issue of whether negative equity constitutes a purchase money obligation should be reversed.

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Dated: December 2, 2008

CERTIFICATE OF SERVICE

I certify that on December 2, 2008 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by placing a true and correct copy in the United States mail, postage prepaid, to their address of record.

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Dated: December 2, 2008

CERTIFICATE OF COMPLIANCE

Compliance with Type-Volume Limitations, Typeface Requirements, and Type Style Requirements

1. The brief complies with the type-volume limitations of FED. R. APP. P. 32(a)(7)(B) because:

 this brief contains 6021 words, excluding the part of the brief exempted by FED. R. APP. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of FED. R. APP. P. 32(a)(5) and the type style requirements of FED. R. APP. P. 32(a)(6)

 this brief has been prepared in a proportionally spaced typeface using Microsoft Word in Times New Roman, 14pt.

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Dated: December 2, 2008

Addendum

Legislative History of Section 9-107

- A. Uniform Commercial Code, Official Draft
Text and Comments Edition (1952)
HeinOnline, 17 U.C.C. Drafts, pp. 202-03,
Issued by ALI & NCCUSL**

Uniform Commercial Code
Official Draft

Text and Comments Edition
(1952)

With Changes and Modifications Approved by the Enlarged Editorial Board at Meetings held on December 29, 1952, February 16, 1953, May 21, 1953 and December 11, 1953.

The Executive Office
The American Law Institute
133 South 36th Street
Philadelphia 4, Pa.

National Conference of
Commissioners on
Uniform State Laws
First National Bank Building
Omaha 2, Nebraska

Section 9-107. Definitions: "Purchase Money Security Interest".

A security interest is a "purchase money security interest" to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used; or
- (c) taken by a person who for the purpose of enabling the debtor to pay for or acquire rights in or the use of collateral makes advances or

incurs an obligation not more than ten days before or after the debtor receives possession of the collateral even though the value given is not in fact used to pay the price.

COMMENT

...

Purposes:

1. Under existing rules of law and under this Article purchase money obligations often have priority over other obligations....

Under this section a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer (e.g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose. To eliminate difficulties of tracing, a conclusive presumption is established that money advanced to a buyer ten days before or after receipt of the collateral is a purchase money loan whether or not such money was in fact used to pay the price if the purpose of the advance was to enable the debtor to acquire the collateral.

2. When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This Section therefore provides that the purchase money party must be one who gives value "by making advances or incurring an obligation": the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.

**B. 1956 Recommendations of the Editorial Board
For the Uniform Commercial Code
HeinOnline, 18 U.C.C. Drafts, pp. 261-62, 285-286
Issued by ALI & NCCUSL**

The American Law Institute

National Conference of
Commissioners on Uniform State Laws

1956 Recommendations of the Editorial Board
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9-107 Definitions: "Purchase Money Security Interest".

A security interest is a "purchase money security interest" to the extent that it is

(a) taken or retained by the seller of the collateral to secure all or part of its price; or

(b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used. [; or]

[(c) taken by a person who for the purpose of enabling the debtor to pay for or acquire rights in or the use of collateral makes advances or incurs an obligation not more than ten days before or after the debtor receives possession of the collateral even though the value given is not in fact used to pay the price.]

Reason: Subparagraph (c) is deleted for the reason that it extends the purchase money security interest concept too far. The subparagraph unnecessarily creates difficult problems in the determination of priorities between conflicting security interests since it makes priorities in affected cases depend upon the accident of whose money, as between competing secured parties, was actually used.

**C. Uniform Commercial Code, 1958 Official Edition
HeinOnline, 22 U.C.C. Drafts, pp. 189-90, 213-214
Issued by ALI & NCCUSL**

9-107. Definitions: “Purchase Money Security Interest”.

A security interest is a “purchase money security interest” to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

**D. Uniform Commercial Code, 1962 Official Edition
HeinOnline, 23 U.C.C. Drafts, p. 628, at 408.
Issued by ALI & NCCUSL**

Section 9-107. Definitions: “Purchase Money Security Interest”.

A security interest is a “purchase money security interest” to the extent that it is

- (a) taken or retained by the seller of the collateral to secure all or part of its price; or
- (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

COMMENT

Prior Uniform Statutory Provisions: None

Purposes:

1. Under existing rules of law and under this Article purchase money obligations often have priority over other obligations....

Under this Section a seller has a purchase money security interest if he retains a security interest in the goods; a financing agency has a purchase money security interest when it advances money to the seller, taking back an assignment of chattel paper, and also when it makes advances to the buyer (e.g., on chattel mortgage) to enable him to buy, and he uses the money for that purpose.

2. When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This Section therefore provides that the purchase money party must be one who gives value “by making advances or incurring an obligation”: the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.

The Review Committee that proposed the 1972 Amendments to Article 9 marked section 9-107 as “Unchanged.” Final Report, P.E.B. for U.C.C., Review Committee for Article 9 of U.C.C. at 47 (April 25, 1971)

**E. PEB Study Group
Uniform Commercial Code
Article 9
Section 14, Report (December 1, 1992)
Published by ALI & NCCUSL (1992) pp. 97-98 (notes omitted).**

14. Purchase Money Security Interests and Purchase Money Priority

COMMITTEE RECOMMENDATIONS

- A. The definition of “purchase money security interest” (PMSI) in § 9-107 should be revised to make clear that:
1. A security interest may be a PMSI notwithstanding (i) the fact that the collateral also secures other, non-purchase money debt and (ii) the fact that the purchase money debt is secured by additional collateral.
 2. A renewal, refinancing, or other restructuring of the debt secured does not destroy the purchase money character of a security interest.
 3. In the case of a cross-collateralization or a restructuring, the burden is on the secured party to prove the extent to which a PMSI survives, including the allocation of payments between purchase money and non-purchase money debt.

COMMENTS:

A substantial body of case law supports the disqualification or “transformation” of (what would otherwise be) a PMSI in the factual circumstances posited by Recommendations A.1 and A.2. However, several cases support preservation of PMSI status in those circumstances. Preservation of PMSI status contemplates a “dual status” security interest that is a PMSI to the extent purchase money obligations are secured by the

collateral purchased and a non-PMSI to the extent other obligations are secured by that collateral.

In jurisdictions where the effect of such arrangements on PMSI status is not settled, a secured party risks the loss of purchase money status if it includes in its security agreement provisions whereby other collateral would secure the purchase money debt or whereby other debt would be secured by the purchased collateral. In those jurisdictions a secured party also risks loss of PMSI status if it agrees to refinance a purchase money debt. Judicial decisions denying PMSI status when such arrangements are made force a secured party to choose between losing PMSI status, on one hand, and taking advantage of cross-collateralization provisions or agreeing to refinance the purchase money debt, on the other.

The proposed revisions would yield the results that obtain under a proper application of current law. They reflect two important principles of the Article 9 scheme that generally are well-accepted. First, parties are given great flexibility to agree as to what collateral (i.e., now-owned or after-acquired) will secure what obligations (i.e., now-existing or later-arising). Second, PMSI's are given favored treatment. Given the general acceptability of these principles, parties to a secured transaction should not be forced to sacrifice flexibility for PMSI treatment or PMSI treatment for flexibility. Moreover, consensual refinancings and restructuring of debt, including secured debt, should not be discouraged. Parties should be free to consummate refinancings (including those that involve cross-collateralization) without concern that purchase money obligations will, as a matter of law, be deemed novations resulting in non-purchase money obligations.

Because § 9-107 provides that a security interest is a PMSI only "to the extent that it" secures a purchase money obligation, the amount of that obligation must be determined. When collateral secures both a purchase money obligation and a non-purchase money obligation, it is necessary to determine the amount of each class of secured obligations. Because the benefits of PMSI status depend on determining the amount of the purchase money obligation, the secured party invoking PMSI status should have the burden of proving that amount. Pages 97-98 (footnotes omitted).

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COMMITTEE RECOMMENDATIONS

- D. The official comment to § 9-107 should be revised to make clear that purchase money debt includes related obligations such as interest, collection expenses, and the like.

COMMENTS:

Security agreements normally provide that the collateral secures not only the principal amount of a loan, or the remaining balance of the price in the case of a security interest retained by a seller, but also other obligations of the debtor that are closely associated with and related to the transaction. The obligations typically include those for interest or time-price differential, default charges, expenses of collection efforts following a default, costs of required insurance not obtained by the debtor, and the like. Because these obligations are so closely related to the obligation to pay the price or the enabling loan in a PMSI transaction, they should be treated as a component of purchase money debt that is secured by a PMSI.

A fair reading of § 9-107 can accommodate treatment of these associated and related obligations as purchase money debt. Accordingly, a clarifying revision to the official comment should provide guidance for the courts.

**F. Uniform Commercial Code, Revised Article 9
April 16 Discussion Draft, pp. 21-23
Published by ALI & NCCUSL (1996)**

The American Law Institute

Uniform Commercial Code
Revised Article 9

Secured Transactions; Sales of Accounts, Chattel Paper,
and Payment Intangibles; Consignments
(With conforming amendments to Articles 1, 2 and 5)

Discussion Draft
(April 16, 1996)

Section 9-107. Definitions: “PURCHASE MONEY SECURITY INTEREST”; “PURCHASE MONEY COLLATERAL”; [sic]PURCHASE MONEY OBLIGATION”; “APPLICATION OF PAYMENTS”; BURDEN OF ESTABLISHING PURCHASE MONEY SECURITY INTEREST.

(a) A security interest in goods[, including fixtures,] is a “purchase money security interest” to the extent that the collateral (“purchase money collateral”) secures an obligation incurred by an obligor as the price of the collateral or for value given to enable the debtor to acquire rights in the collateral (“purchase money obligation”) if the value is in fact so used....

...

(e) A purchase money security interest does not lose its status as such even though

- (1) the purchase money collateral also secures an obligation that is not a purchase money obligation; or
- (2) collateral that is not purchase money collateral also secures the purchase money obligation; or
- (3) the purchase money obligation has been renewed, refinanced, or restructured.

(f) If the status of a security interest as a purchase money security interest or the extent to which it is a purchase money security interest is placed in issue, the secured party claiming a purchase money security interest has the burden of establishing the extent to which the security interest is a purchase money security interest.

**G. Uniform Commercial Code, Revised Article 9
Discussion Draft No. 2 (April 14, 1997), pp. 14-16
Published by ALI & NCCUSL (1997)**

The American Law Institute

Uniform Commercial Code
Revised Article 9

Secured Transactions; Sales of Accounts, Chattel Paper, and
Payment Intangibles; Consignments
(With conforming amendments to Articles 1, 2, 5 and 8)

Discussion Draft No. 2
(April 14, 1997)

Section 9-104. Definitions: “PURCHASE MONEY SECURITY INTEREST”; “PURCHASE MONEY COLLATERAL”; [sic]PURCHASE MONEY OBLIGATION”; “APPLICATION OF PAYMENTS”; BURDEN OF ESTABLISHING PURCHASE MONEY SECURITY INTEREST [former draft § 9-107]

(a) A security interest in goods[, including fixtures,] is a “purchase money security interest” to the extent that the collateral (“purchase money collateral”) secures an obligation incurred by an obligor as the price of the collateral or for value given to enable the debtor to acquire rights in the collateral (“purchase money obligation”) if the value is in fact so used.

...

(d) This subsection does not apply to a consumer secured transaction. If the extent to which a security interest is a purchase money security interest depends on the application of a payment to a particular obligation, the payment is to be applied:

(e) This subsection applies to a consumer secured transaction (and may not be varied by agreement). If the extent to which a security interest is

a purchase money security interest depends on the application of a payment to a particular obligation[, notwithstanding any contrary agreement,] the payment is to applied first to obligations that are not secured and then

(f) A purchase money security interest does not lose its status as such even if:

(1) the purchase money collateral also secures an obligation that is not a purchase money obligation;

(2) collateral that is not purchase money collateral also secures the purchase money obligation; or

(3) the purchase money obligation has been renewed, refinanced, or restructured.

(g) If the status of a security interest as a purchase money security interest or the extent to which it is a purchase money security interest is placed in issue, the secured party claiming a security interest has the burden of establishing the extent to which the security interest is a purchase money security interest.

Forks in the Road: Driving An Upside-Down 910-Vehicle Through the Hanging Paragraph

