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Reaffirmation and Redemption

Presented by

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REAFFIRMATION AND REDEMPTION

The issues related to the reaffirmation of debts and the redemption of collateral from the liens of creditors arise primarily out of the conflict between the needs and desires of debtors to maintain possession and ownership of property securing claims and the monetary interests of creditors to receive compensation for relinquishing their contractual right to seize and dispose of the property. In the words of the clients, the debtors want "to keep our stuff," and the creditors want "to get paid." A basic tenet of bankruptcy law is that bankruptcy discharges a debtor's personal liability on debts, with certain exceptions, but it does not eliminate the rights of a secured creditor in its collateral. *Johnson v. Home State Bank*, 501 U.S. 78, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991). The resolution of how and under what circumstances a debtor retains property securing a claim are governed chiefly by §§ 521(2), 524(c), 524(d) and 722 of the Bankruptcy Code.

I. STATEMENT OF INTENTION

The logical starting point in any discussion of reaffirmation and redemption is 11 U.S.C. §521(2), which provides:

The debtor shall-

> (2) if an individual debtor's schedule of assets and liabilities includes consumer debts which are secured by property of the estate-
>
> (A) within thirty days after the date of the filing of a petition under chapter 7 of this title or on or before the date of the meeting creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, the debtors shall file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is

claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property.

(B) within forty-five days after the filing of a notice of intent under this section, or within such additional time as the court, for cause, within such forty-five day period fixes, the debtor shall perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph; and

(C) nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title.

This provision, which applies only to consumer debts secured by property of the estate, was added to the Bankruptcy Code in 1984. It requires the debtor to file a statement of intention indicating whether he intends to surrender or retain property securing consumer debt and to perform that intention within 45 days thereafter. If the debtor intends to retain the property, §521(2) appears to give the debtor three options: (1) exempt it;[1] (2) redeem it; or (3) reaffirm the debt. However, some courts have held that the debtor has a fourth option of retaining the property by remaining current on his payments and otherwise complying with the terms of the contract. The Courts of Appeal in the Second, Fourth, Ninth, and Tenth Circuits have held that a debtor has this fourth option of riding the debt through the bankruptcy. *Capital Communication Fed. Credit Union v. Boodrow (In re Boodrow)*, 126 F.3d 43 (2nd Cir. 1997), cert. denied, 522 U.S. 1117, 118 S. Ct. 1055, 140 L.Ed. 2d 118 (1998); *Home Owners Funding Corp. of Am. v. Belanger (In re Belanger)*, 962 F.2d 345 (4th Cir. 1992); *McClellan Fed. Credit Union v. Parker (In re Parker)*, 139 F.3d 668 (9th Cir. 1998); *Lowry Fed. Credit Union v. West*,

[1] A debtor has the right pursuant to 11 U.S.C. §522(f) to avoid judicial liens and non-possessory, non-purchase money liens on certain property to the extent the liens impair the debtor's exempt interest in the property .

882 F.2d 1543 (10th Cir. 1989). If you are a debtors' attorney in a district that allows ride-through, you must counsel each client who intends to keep his residence to be current on the mortgage(s) on the date of the petition. The same is true of vehicle loan payments, unless the debtor intends to redeem the vehicle.

The Courts of Appeal for the First, Fifth, Seventh, and Eleventh Circuits have rejected this fourth option and held that the debtor's only options under §521(2) are to indicate his intent to surrender the property or to retain it through redemption, reaffirmation or avoidance of the lien on exempt property. *Bank of Boston v. Burr* (*In re Burr*), 160 F.3d 843 (1st Cir. 1998); *Johnson v. Sun Fin. Co.* (*In re Johnson*), 89 F.3d 249 (5th Cir. 1996); *In re Edwards*, 901 F.2d 1383 (7th Cir. 1990); *Taylor v. AGE Fed. Credit Union* (*In re Taylor*), 3 F.3d 1512 (11th Cir. 1993). As expected, the lower courts in the other circuits are split on the issue. See *In re Price*, 281 B.R. 240 (Bankr. D. Del. 2002) (no ride-through); *In re Stefano*, 134 B.R. 824 (Bankr. W.D. Pa. 1991) (ride-through allowed); *In re McNeil*, 128 B.R. 603 (Bankr. E.D. Pa. 1991) (no ride-through); *In re Lock*, 243 B.R. 332 (Bankr. S.D. Ohio 1999) (no ride-through); *In re Tameling*, 173 B.R. 627 (Bankr. W.D. Mich. 1994) (ride-through allowed); *In re Laubacher*, 150 B.R. 200 (Bankr. N.D. Ohio 1992) (no-ride through); *In re Canady-Houston*, 281 B.R. 286 (Bankr. W.D. Mo. 2002) (ride-through allowed); *In re Gerling*, 175 B.R. 295 (Bankr. W.D. Mo. 1994) (no ride-through).

The philosophical and intellectual battle between these competing interpretations of §521(2) has many interesting components. The most relevant may be the enforceability of bankruptcy default clauses, contained in most security agreements and mortgages, declaring a loan in default upon the filing of a bankruptcy. If the debtor

remains current with his payments and complies with all other contractual terms, the only potential default is the bankruptcy default clause. The Bankruptcy Code contains provisions that limit the application of such clauses. 11 U.S.C. §365(e) provides that an *executory contract* or *lease* may not be terminated on the basis of a bankruptcy default clause "at any time after the commencement of the case." 11 U.S.C. §541(c)(1)(B) protects *property of the estate* from forfeiture, modification or termination due to a bankruptcy default clause. 11 U.S.C. §§362(a)(3) and (5) prevent repossession prior to discharge and abandonment or the lifting of the stay. However, there is no provision in the Bankruptcy Code that explicitly proscribes the enforcement of bankruptcy default clauses in non-executory contracts after the case is closed or the property is otherwise abandoned from the estate.[2] In a case decided before the enactment of §521(2), the Sixth Circuit held that the debtor could not avoid the enforcement of the default clause after the chapter 7 trustee abandoned a vehicle. *GMAC v. Bell*, (*In re Bell*), 700 F.2d 1053 (6th Cir. 1983). If the Sixth Circuit's analysis in *Bell* is correct, even those debtors who avoid the mandate to select one of the three retention options face the specter of the enforcement of the creditor's lien rights post-discharge solely on the basis of the bankruptcy default clause. Implicit in the rulings of the courts granting debtors the ride-through option is that *Bell* is not correct, and bankruptcy default clauses are unenforceable post-discharge. Otherwise, the debtor is being invited to "ride through" and off a cliff. Since the enactment of §521(2), I am not aware of any case in which a creditor has been so bold as to repossess collateral in a ride-through jurisdiction post-

[2] For an exhaustive, if not exhausting, discussion of this issue see the opinion of Judge Louis Phillips in *In re Lair*, 235 B.R. 1 (Bankr. M.D. La. 1999).

discharge solely on the basis of the bankruptcy default clause. In a case arising prior to the enactment of §521(2), a car lender did repossess a car after the discharge was granted. *In re Horton,* 15 B.R. 403 (Bankr. E.D.Va. 1981). The debtor was current with the payments and the only justification for the repossession was the default clause. Judge Bonney held that the repossession was not in violation of the stay because the stay was no longer in effect, but that the repossession was unlawful. He held that the retail installment sales contract was in fact an executory contract, and that pursuant to §365(e), the default clause was invalid and unenforceable. *In re Horton*, 15 B.R. at 405.

If the debtor fails to state his intention or fails to comply with his stated intention, the normal remedy is to grant the creditor relief form the automatic stay allowing it to pursue its state court remedies. *In re Amoakohene*, 299 B.R. 196 (Bankr. N.D. Ill. 2003). The courts have stated that in cases with special circumstances more severe remedies may be appropriate. *BankBoston v. Claflin* (*In re Claflin*), 249 B.R. 840 (1st Cir. BAP 2000); *In re Donnell*, 234 B.R. 567 (Bankr. D.N.H. 1999). The Bankruptcy Court for the Southern District of Florida dismissed a case for cause pursuant to §707(a) due to the debtors' failure to comply with the provision of §521(2). *In re Harris*, 226 B.R. 924 (Bankr. S.D. Fla. 1998).

II. REAFFIRMATION AGREEMENTS

A. 1. <u>The Basics</u>

A reaffirmation agreements is the only mechanism by which the debtor's personal liability on a dischargeable debt survives the bankruptcy discharge. Reaffirmation agreements are governed by 11 U.S.C. §524 (c) and (d). These provisions apply to *all*

debts, not just consumer debts. To be enforceable the agreement must comply with the following four requirements:

1. Made Prior To Discharge

The agreement must be made prior to the entry of the discharge. Most courts have held that an agreement is "made" upon the execution of the writing setting out the terms of the agreement. *In re Collins*, 243 B.R. 217 (Bankr. D. Conn. 2000). However, the Bankruptcy Court for the Middle District of Florida held in *In re LeBeau,* 247 B.R. 537 (Bankr. M.D.Fla. 2000), that the agreement was "made" when the parties reached an agreement and debtors commenced performance, despite the fact it had not yet been reduced to writing. So long as the agreement is *made* before discharge, it can be *filed* after discharge. *In re Davis*, 273 B.R. 152 (Bankr. S.D. Ind. 2002).

When a debtor needs to delay the entry of the discharge to enter into a reaffirmation agreement, Bankruptcy Rule 4004(c)(2) provides the means to do so. It provides:

> Notwithstanding Rule 4004(c)(1), on motion of the debtor, the court may defer the entry of a order granting a discharge for 30 days and, on motion within that period, the court may defer entry of the order to a date certain.

When a discharge is entered prior to the making of a reaffirmation agreement, the courts disagree as to whether the they have the authority to set aside, temporarily, the discharge order to validate the reaffirmation agreement. The Bankruptcy Court for the District of New Hampshire, pursuant to Bankruptcy Rule 9024 (Federal Rule of Civil Procedure 60), allowed a debtor's motion to vacate the order of discharge so he could enter into a reaffirmation agreement related to the debt on his mobile home. *In re*

Edwards, 236 B.R. 124 (Bankr. D.N.H. 1999). The court found the existence of special circumstances to justify the extraordinary remedy, to wit: (1) the debtor had not been derelict in his attempts to reaffirm the debt, and (2) the debtor would suffer severe prejudice if the motion was denied. See also *In re Solomon*, 15 B.R. 105 (Bankr. E.D. Pa. 1981); *In re Long*, 22 B.R. 152 (Bankr. D. Me. 1982); and *In re Tuan Tan Dinh*, 90 B.R. 743 (Bankr. E.D. Pa. 1988). However, the Bankruptcy Court for the Southern District of Texas refused to vacate a discharge to validate a reaffirmation agreement. *In re Rigal*, 254 B.R. 145 (Bankr. S.D. Tex. 2000). It held that it had no authority to vacate the discharge order in such circumstances. See also, *In re Brinkman*, 123 B.R. 611 (Bankr. N.D. Ind. 1991).

2. Clear and Conspicuous Disclosures

The reaffirmation agreement must contain two "clear and conspicuous" statements advising the debtor as follows:

a) That agreement may be rescinded at any time prior to the discharge or within sixty days after such agreement is filed with the court, whichever is later, by giving notice of the rescission to the creditor.

b) That agreement is not required under the Bankruptcy Code, non-bankruptcy law, or any agreement not in accordance with §524(c).

3. Filed With The Court

The agreement must be filed with the court. The 60-day right of rescission does not begin to run until the agreement is filed.

4. Attorney Declaration or Court Approval

The reaffirmation agreement must either be accompanied by a declaration by the debtor's attorney or approved by the court. The attorney's declaration certifies the following:

a) The agreement represents a fully informed and voluntary agreement of the debtor;

b) The agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and

c) The attorney has fully advised the debtor of the legal effect and consequence of the agreement and any default thereunder.

If the reaffirmation agreement is not accompanied by the attorney's declaration, then the court must conduct a hearing at which the debtor appears in person. The court must re-inform the debtor of the disclosures set out in the second conspicuous statement and must advise the debtor of the legal effect and consequences of the agreement and any default thereunder. The court approves the agreement if it finds that the agreement imposes no undue hardship on the debtor or a dependent of the debtor and is in the debtor's best interest. The court's approval is not required to the extent the debt is a consumer debt secured by real property.

B. Advanced Reaffirmation Issues

1. Agreement Terms & Negotiation

A majority of the courts hold that a reaffirmation can be accomplished only through the mutual consent of the parties. Obviously, the creditor cannot impose an agreement upon the debtor, but neither can the creditor be compelled to agree to a reaffirmation,

even if the debtor agrees to reaffirm upon the same terms as the original contract. *In re Turner*, 156 F.3d 713 (7th Cir. 1998); *In re Amoakohene*, 299 B.R. at 200-01; *Sears, Roebuck & Co. v. Spivey*, 265 B.R. 357 (Bankr. E.D.N.Y. 2001); *In re Donley*, 131 B.R. 193 (Bankr. N.D. Fla. 1991). There are cases to the contrary. In *In re French,* 185 B.R. 910 (Bankr. M.D.Fla. 1995) the court held that if the debtor proposes to reaffirm the debt per the terms of the original contract, he has met his obligations under §521(2). See also, *In re Thomas*, 186 B.R. 470 (Bankr. W.D. Mo. 1995).

Some courts have allowed creditors to negotiate any legal term into a reaffirmation agreement. For example, in *In re Booth*, 242 B.R. 912 (6th Cir. BAP 2000), the reaffirmation agreement required the rescission to be in writing. The debtor orally rescinded the agreement within the 60 days allowed by §524(c), but did not rescind it in writing. The court held that even though §524(c) does not require the notice of rescission be in writing, the inclusion of the requirement in the agreement was binding on the debtor, and his attempted oral rescission was ineffective. *In re Booth*, 242 B.R. at 916.

In a significant case the First Circuit reversed both the Bankruptcy Court and the Bankruptcy Appellate Panel in holding that a credit union did not violate the automatic stay by conditioning its agreement to the reaffirmation of a debt secured by the debtors' residence upon the debtors' reaffirmation of an unsecured debt. *In re Jamo*, 283 F.3d 392 (1st Cir. 2002). The debtor was current with the payments on the mortgage, but on the basis of the *Burr* decision, the debtor had to reaffirm the debt or surrender the residence. Even though the debtor was willing to reaffirm the debt, the credit union refused to reaffirm unless the reaffirmation included both the secured and unsecured debts. The

First Circuit held that linking the two debts was neither a *per se* violation of the automatic stay, nor a violation of the stay on the facts of that case. *In re Jamo*, 283 F.3d at 400-403.

In a case that preceded the Eleventh Circuit's *Taylor* case, the Bankruptcy Court for the Northern District of Alabama held that a credit union violated the automatic stay when it refused the debtor's tender of payments on a secured loan in an attempt to force the debtor to pay unsecured loans. *In re Guinn*,102 B.R. 838 (Bankr. N.D. Ala. 1989).

2. Attempts to Induce Reaffirmation Agreements in Ride-Through Districts

The issues set out above do not arise often in ride-through districts because the creditor does not have the leverage to force a debtor to reaffirm an unsecured debt by linking it to the reaffirmation of a secured debt. However, if the debtor defaults in payments the creditor may be able to refuse to tender the payment of the debt to force a reaffirmation.

A more prevalent problem in ride-through districts is the refusal of certain creditors to provide payment coupons, statements and documents related to the loan to debtors who refuse to reaffirm debts. One court has held that this practice does not violate the automatic stay. *In re Young*, 2001 WL 349000 (Bankr. E.D.Va. 2001).

3. <u>Attorney Certification</u>

The courts take the obligations of debtors' attorneys imposed by the certifications of §524(c)(3) very seriously and have not hesitated to impose sanctions upon attorneys who fail to meet those obligations. The leading cases concerning the obligation, of debtors' attorneys pursuant to §524(c)(3) are *In re Vargas*, 257 B.R. 157 (Bankr. D.N.J. 2001); *In re Melendez*, 235 B.R. 173 (Bankr. D. Mass. 1999) (*Melendez II)*; *In re Melendez*, 224 B.R. 252 (Bankr. D. Mass. 1998) (*Melendez I*); *In re Bruzzese*, 214 B.R.

444 (Bankr. E.D.N.Y. 1997); and *In re Izzo*, 197 B.R. 11 (Bankr. D.R.I. 1996). From these cases we discern the following:

1. Signed attorney declarations or certifications attached to reaffirmation agreements constitute representations to the court subject to Rule 9011 *In re Vargas*, 257 B.R. at 164; *Melendez II*, 235 B.R. at 188-89; *Melendez I*, 224 B.R. at 257-58; *In re Bruzzese*, 214 B.R. at 451

2. Attorneys may remain "advocates" for their clients and decline to sign the declaration. *In re Vargas,* 257 B.R. at 163.

3. If the attorney does sign the declaration, he must make an independent determination of the effect of it upon the clients' finances. *In re Vargas*, 257 B.R. at 163-64.

4. If the attorney cannot determine the effects the reaffirmation agreement will have on the debtor's finances, or whether it will cause the debtor undue hardship, he should not sign it. *In re Vargas*, 257 B.R. at 164.

5. When post petition expenses exceed income, absent further explanation, the declaration appears to be without foundation and merits inquiry by the court *Melendez II*, 235 B.R. at 197; *Melendez I*, 224 B.R. at 259; *In re Izzo*, 197 B.R. at 11.

6. If the reaffirmation agreement is related to the retention of property upon which the creditor allegedly has a security interest, the attorney is obligated to do the following:

    a) Review the contract and other relevant documents to determine if the creditor has a valid security interest.

    b) Determine if the debtor is still in the possession of the property.

    c) Verify the amount of the creditor's claim and the value of the collateral.

    d) Determine if the creditor is likely to seek to repossess the property.

    e) Discuss relevant financial disclosures with the debtor.

f) Ensure that the agreement is entered into voluntarily by the debtor and absent creditor misrepresentation or coercion.

g) Ensure the debtor understands the consequences of the agreement and any default thereunder.

h) Ensure the debtor knows his options with respect to the collateral under the Bankruptcy Code, and to alternative sources of credit.

Melendez II, 235 B.R. at 197-203.

7. The courts annulled the reaffirmation agreements in each of the cases cited above. In two cases the attorneys were ordered to disgorge fees. *In re Vargas*, 257 B.R. at 167 (disgorgement of entire fee); *In re Bruzzese*, 214 B.R. at 451 (disgorgement of $200.00).

III. REDEMPTION

A. <u>Basic Issues</u>

The redemption of certain property is allowed pursuant to 11 U.S.C. §722, which provides as follows:

> An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien

Not all property may be redeemed. The statute contains five elements discussed below.

1. **Tangible Personal Property**

Section 722 allows only for the redemption of tangible personal property. The debtor cannot redeem real property. *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed. 2d 903 (1992). Debtors' attorneys have been persistent in their attempts to strip down or strip off liens on real estate in chapter 7, but without success. See *In re Talbert*, 344 F.3d 555 (6th Cir. 2003) (cannot strip wholly unsecured second mortgage); *Ryan v. Homecomings Financial Network*, 253 F.3d 778 (4th Cir. 2001); *In re Marante*, 2003 W.L. 21361765, 16 Fla. L. Weekly Fed. B 107 (Bankr. S.D. Fla. 2003) (lien stripped in chapter 13 does not carry over upon conversion to chapter 7); *In re Thomas*, 260 B.R. 884 (Bankr. M.D. Fla. 2001); *In re Carter*, 240 B.R. 420 (M.D. Ala. 1999).

There is no definition of "tangible personal property" in the Bankruptcy Code. The case of *In re Walker*, 173 B.R. 512 (Bankr. M.D.N.C. 1994) represents an interesting determination of personal property versus real property. The debtors contracted with the creditor for the purchase and installation of vinyl siding and trim, and they granted it a purchase money security interest in the goods purchased. The siding and trim were affixed to the debtors' home. The creditor timely and properly filed a UCC financing statement, identifying its collateral as "vinyl siding and trim" and checking the box on the financing statement indicating it was a fixture filing. The debtors filed a chapter 7 bankruptcy. The creditor filed a secured proof of claim, describing its collateral as "goods" and its claim as "purchase money security interest in vinyl siding." It left blank the box on the proof of claim in which a security interest in real estate is indicated. The debtors moved to redeem their collateral from the creditor's lien pursuant to §722.

The creditor argued that its collateral was affixed to house and had become real property, and therefore, it was no longer tangible personal property and not subject to redemption under §722. The court held that pursuant to the Uniform Commercial Code, the fixture filing protected the creditor's rights in the vinyl siding as to third parties, but under applicable North Carolina law, as between the debtor and the creditor, the siding remained personal property. It held, therefore, that the debtors could redeem the vinyl siding and trim.[3] As to the allowed amount of the claim, the court held that the appropriate valuation was the amount that the creditor would realize if it were permitted to exercise its right to remove the siding and trim from this house and sell it. The evidence established that once removed the siding and trim could be sold for $150.00. The court granted the debtors' motion to redeem for $150.00.

2. **Intended Primarily for Personal Family on Household Use**

The personal property that is redeemed from the lien must be held primarily for personal, family, or household use. The Fourth Circuit held in *In re Runski*, 102 F.3d 744 (4th Cir. 1996) that the debtor could not utilize §722 to redeem medical and office equipment. See also *In re Pipes,* 78 B.R. 981 (Bankr. W.D.Mo. 1987) (denied redemption of truck owned by debtor-wife, but used by debtor-husband in his work as a mechanic; parties divorced at time of attempted redemption). Creditors should be diligent in ascertaining the use to which the *debtor* employs its collateral and oppose attempts to redeem business assets or other assets not used by the debtor for personal, family, or household use.

[3] See also *In re Hall*, 11 B.R. 3 (Bankr. W.D. Mo. 1980), in which the debtors were allowed to redeem an installed fence.

Prior to *Dewsnup v. Timm,* 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), some courts allowed the redemption of business property pursuant to 11 U.S.C. §506(d). See *In re Sprecher,* 65 B.R. 598 (Bankr. C.D.Ill. 1986). Under *Dewsnup* such redemptions are no longer available.

2. Consumer Debt

Closely aligned with, but distinct from, the previously discussed redemption-right element is that the debt must be a consumer debt. The former element relates to the nature of the collateral; the latter to the nature of the debt. A lien may encumber household items without being a consumer debt. A consumer debt is defined in 11 U.S.C. §101(8) as one "incurred by an individual primarily for a personal, family, or household purpose." A debt incurred with a profit motive is not a consumer debt. *Lind Waldock & Co. v. Morehead*, 1 Fed. Appx. 104, 2001 W.L. 7516 (4th Cir. 2001) (not published in Federal Reporter). Income tax debt is not a consumer debt. *In re Westberry*, 215 F.3d 589 (6th Cir. 2000). Property taxes are not a consumer debt. *In re Stovall*, 209 B.R. 849 (Bankr. E.D. Va. 1997).

4. Dischargeable Debt

Section 722 allows the right of redemption of property only from liens securing dischargeable debts. Therefore, if a debtor commits fraud or engages in some other action in connection with the transaction or event creating the lien that renders the debt non-dischargeable, he is not able to utilize §722 to redeem the property. Despite this requirement, courts have allowed redemption prior to the deadline for the objection to discharge. See *In re Jewell*, 232 B.R. 904 (Bankr. E.D. Tex. 1999).

I find no cases in which a debtor attempted to redeem property from a debt previously determined to be a non-dischargeable debt, or in which the debtor redeemed property from a lien securing a debt that was subsequently held to be non-dischargeable. The court in *In re Pipes*, 78 B.R. at 984, provided as an alternative basis for the denial of the redemption that the debt did not appear to be dischargeable.

A trap for the unwary creditor may exist here. If a debtor files a motion to redeem, alleging that the underlying debt is dischargeable, and obtains by default an order allowing the redemption, then the creditor, in a subsequent adversary proceeding seeking to except the debt from discharge, may be collaterally estopped from denying that the debt is dischargeable. Such a result is unlikely. By analogy to those cases that have held a creditor is not prevented from challenging the validity of an exemption in a §522(f) lien avoidance proceeding because of its earlier failure to object the claim of exemptions, *In re Morgan,* 149 B.R. 147 (9th Cir. 1993), a creditor is unlikely to be precluded from establishing the exception to discharge in this circumstance. A closer case arises when the sequence is reversed, i.e. the bar date expires without an exception to discharge complaint being filed, and the debtor then moves to redeem the property. The issue will then arise as to whether the creditor can defend against the redemption on the grounds that the debt is not dischargeable. I believe that the debtor would prevail in this instance.[4]

5. **<u>Property Must Be Exempt or Abandoned</u>**

This element is fairly simple. The redemption of property represents property that the debtor is going to keep. The debtor does not keep property of the estate. Property of

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[4] This fact scenario would be unusual because the debtor should redeem, at the latest, within 75 days of filing, and the bar date, at the earliest, should be no sooner than 80 days after the filing.

the estate is liquidated by the chapter 7 trustee. Therefore, the debtor redeems only that property which he has exempted from the estate or which the trustee abandons from the estate pursuant to 11 U.S.C. §554.

B. Redemption of Motor Vehicles

The redemption of motor vehicles is without question the hottest current redemption issue. The issue has come to the forefront by the convergence of three factors: 1) first, the emergence of funding sources, such as 722 Redemption Funding[5] out of Cincinnati, Ohio, to finance redemptions; 2) secondly, the fact that due to a number of factors[6] the amount of debt encumbering a vehicle often greatly exceeds the vehicle's value; 3) and finally, the realization by debtors' attorneys that the redemption of a vehicle pursuant to §722 may significantly reduce debtors' vehicle payments, and that in many cases redemption is more beneficial to debtors than a chapter 13 cram down.

The advantages of redemption are even greater in those courts in which debtors are not allowed to ride the car loan through the bankruptcy. When confronted with an agreement reaffirming a debt of $16,000 at 8% secured by a car with a liquidation value of $9,000.00, the option of borrowing $9,000 to redeem the vehicle, even if the rate is 24%, offers a lower payment and less risk. In the ride-through districts, the incentive to

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[5] Contact information: 888-721-2800 or www.722redemption.com

[6] These factors include: the typical car loan is now for a term of 60 months and some are as long as 84 months; consumers are more frequently trading vehicles in circumstances in which they owe more on the vehicle than the trade-in value and "rolling" the negative equity into the new loan; the purchase of vehicles by consumers at the end of a lease is which there is negative equity; and the practice of some car dealers in inflating the sales price of vehicles in excess of the actual value to consumers whose bad credit limits their bargaining position.

redeem is not as great because the debtor is not confronted with the risk of personal liability to the creditor on a reaffirmed, reinstated debt.

1. **Redemption Value Standard**

Following the ruling in *Associates Commercial Corp. v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed. 2d 148 (1997), in which the Supreme Court held that pursuant to 11 U.S.C. §506(a) the value of property retained by a chapter 13 debtor is the replacement value, many practitioners assumed that the same or a similar standard would apply in §722 redemptions. Such is not the case. Section 506(a) provides that valuation of property "shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property." In *Rash* the Supreme Court emphasized that in a chapter 13 cram down "the creditor obtains at once neither the property nor its value....." *Id.* at 962-63, 109 S. Ct. at 1519. The Court reasoned that the "double risks" of the debtor's subsequent default and the deterioration in the value of the collateral points away from a "foreclosure-value standard." *Id.* at 962-63, 109 S.Ct. at 1519. Implicit in the Court's reasoning is that if the creditor were at once receiving the property or its value, then the foreclosure value would be appropriate.

Support for the foreclosure value in redemption cases is found in the Code's legislative history. The House Report, discussing §722 states that paying "the allowed amount of the creditor's secured claim... amounts to a right of first refusal on a foreclosure sale of the property involved." H.R. Rep. No. 95-595, at 127(1977), 1978 U.S. Code Cong. Admin.News at 5787, 6088. This right of first refusal, according to the

report, is to ensure that a creditor did not "use the threat of repossession, rarely carried out, to extract more than he would be able to if he did foreclose or repossess." *Id.*

Nearly every court that has considered the issue since *Rash* has held that liquidation value is the appropriate value for the redemption of vehicles under §722. See *In re Podnar*, 302 B.R. 49 (Bankr. W.D. Mo. 2003); *In re Zell*, 284 B.R. 569 (Bankr. D. Md. 2002); *In re Ard*, 280 B.R. 910 (Bankr. S.D. Ala. 2002); *In re Ballard*, 258 B.R. 707 (Bankr. W.D. Tenn. 2001); *In re Triplett*, 256 B.R. 594 (Bankr. N.D. Ill. 200); *In re Weatherington*, 254 B.R. 895 (6th Cir. BAP 2000); *In re Dunbar*, 234 B.R. 895 (Bankr. E.D. Tenn. 1999). The Six Circuit BAP has defined liquidation as "the amount that the creditor would receive if the creditor repossessed and sold collateral in the manner most beneficial to the creditor." *In re Weatherington*, 254 B.R. 895, 899.

2. Determination of Liquidation Value

With near unanimity that a vehicle can be redeemed for its liquidation value, the courts have sought a convenient and fair method of determining that value. As is the case with determining the values of vehicles in chapter 13 cases, the courts' limited resources and the parties financial interests prohibit litigation of the issue on a case-by-case basis, but rather, dictate the application of a presumptive standard or guide in determining the values. Obviously, the parties retain the right to rebut any such presumptive value in an individual case. The three most prevalent guides to motor vehicle values are the N.A.D.A. Official Used Car Guide,[7] Kelly Blue Book,[8] and Black Book Official Used

[7] Published N.A.D.A. Official Used Car Guide Company, 8400 Westpark Dr., McLean, Va. 22102-9985. Telephone: 800-544-6232; website:nada.com/b2b

[8] website: www.kbb.com

Car Guide.[9] Most courts have adopted as the standard, primarily by default, the N.A.D.A. trade-in value, upon the express assumption that it approximates liquidation value. See *In re Podner*, 302 B.R. at 54 (noting that N.A.D.A. Guide states that it "is not an auction wholesale value," but accepting its trade-in value as a measure of its liquidation value in the absence of other evidence); *In re Zell*, 284 B.R. at 573 (using the terms wholesale, liquidation and foreclosure interchangeably and accepting debtor's contention that N.A.D.A. trade-in represents this value); *In re Ard*, 280 B.R. at 915 (stating liquidation, wholesale, and foreclosure are interchangeable and with adjustments accepting opinion of expert whose value was based on N.A.D.A. Guide trade-in); *In re Triplett*, 256 B.R. at 598 (accepting debtor's valuation of $800.00 in excess of N.A.D.A. trade-in as liquidation value).

To my knowledge, as of the writing of this manuscript no court has confronted this valuation issue in a case in which the debtor has argued that in general the N.A.D.A. trade-in value *exceeds* the liquidation value of the vehicle. From my experience the N.A.D.A. trade-in value always exceeds the Kelly Blue Book trade-in value and the Black Book wholesale value. In those cases in which the creditor liquidates repossessed vehicles at auto auctions, the National Auto Research's Black Book may be the most reliable evidence of liquidation value. Its compilation of values are based on the reports from actual auto auctions. Appended to this manuscript as Appendix A is a copy of a page from its website describing its procedures in compiling values.

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[9] Published by National Auto Research Division of the Hearst Business, Media Corporation, 2620 Barrett Rd., Gainesville, GA 30507-7901; Telephone: 800-554-1026; Website: BlackBooksUSA.com

3. The North Carolina Data

I represent a debtor in a case pending in the Eastern District of North Carolina who has moved to redeem a 1995 G20 Chevrolet Van. The creditor is the North Carolina State Employee's Credit Union ("NCSECU"), the second largest credit union in the country. My associate and I have conducted discovery in the case and have obtained data related to the repossession of 877 vehicles by NCSECU within the last year. The data reveals the following:

1. When a vehicle is repossessed it is taken to a branch for assessment.
2. If the vehicle is in good condition, the branch will attempt to sell it before sending it to an auto auction.
3. Vehicles that are not in good condition or that have not sold within 90 days are sent to the auto auction for sale.
4. Of the 877 vehicles identified in the discovery request 566 (65%) were sold in branch sales and 311 (35%) were sold at auto auction.
5. 279 of the repossessed vehicles were model years 1994-1996. Of these, 178 (64%) were sold at branches and 101(36%) at auto auctions.
6. Without reduction for repossession costs, the 1994-1995 vehicles sold at branches brought, on the average, 77% of the N.A.D.A. trade-in value.
7. The average repossession cost of all vehicles sold at branches was $296.00.
8. The 1994-1996 vehicles sold at auto auctions brought net sales price, after the deduction of all expenses, on the average, equal to 52% of the N.A.D.A. trade-in value.

It is my intent to argue to the court that the benchmark for determining the liquidation value of a vehicle being redeemed from a lien of the NCSEU is 75%-80% of the N.A.D.A. trade-in value minus $300.00.

4. **Valuation Date**

A debtor files bankruptcy on January 2 and files his Statement of Intention on February 1. The parties fail to agree on the redemption value and the debtor files motion to redeem on March 15. The hearing is scheduled for April 15. What is the date upon which the court determines the value? The prevailing view is that, in the absence of special circumstances, the valuation date is the date of the hearing. *In re Ponder*, 302 B.R. at 54-55. *In re Henderson*, 235 B.R. 425 (Bankr. C.D. Ill. 1999); *In re Lopez*, 224 B.R. 439 (Bankr. C.D. Cal. 1998). The court admonished in *Ponder*, 302 B.R. at 55, that an earlier date might be appropriate if the creditor demonstrates undue delay, gross negligence, or other acts of the debtor that unfairly decrease the value of the collateral prior to the hearing date.

5. **Evidentiary Issues**

The debtor bears the burden of proving the redemption value by a preponderance of the evidence. *In re Ard*, 280 B.R. at 913; *In re Brown* 244 B.R. 603 (Bankr. W.D. Va. 2000). With respect to the use of the N.A.D.A. Guide, Kelly Blue Book, or the Black Book in proving the value of a vehicle, Federal Rule of Evidence 803(17) excepts from the hearsay rule published compilations generally used and relied upon by the public or by persons in particular occupations.

C. Redemption Following Conversion from Chapter 13 to Chapter 7

11 U.S.C. §348(a) provides that the conversion from chapter 13 to chapter 7 constitutes "an order for relief." 11 U.S.C. § 521(2) mandates that the debtor file the statement of intention within 30 days "of the filing of a petition under chapter 7" or on or before the § 341 creditors meeting, whichever is earlier. Though the conversion to chapter 7 is not technically the filing of a petition, Bankruptcy Rule 1019 requires the debtor to file his statement of intention within 30 days of the conversion or by the creditors meeting, whichever is earlier. Substantively, the redemption of collateral in case converted from chapter 13 to chapter 7 significantly differs from redemption in cases originally filed under chapter 7. Redemption is essentially the payment by the debtor to the creditor of the creditor's allowed secured claim. 11 U.S.C. §348(f)(1)(B) which was added to the Bankruptcy Code by 1994 Bankruptcy Reform Act, provides in connection with a case converted from chapter 13 as follows:

> Valuations of property and allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan.

This provision renders the liquidation value of the property irrelevant for purposes of redemption in the converted chapter 7. In essence the unpaid balance of the creditor's secured claim in the chapter 13 becomes the redemption amount in the chapter 7. *In re Davis*, 300 B.R. 898 (Bankr. N.D. Ill. 2003); *In re Dean*, 281 B.R. 912 (Bankr. W.D. Tenn. 2002); *In re Rogers*, 273 B.R. 186 (Bankr. C.D. Ill. 2000). If the secured claim is paid in full in the chapter 13 bankruptcy, then the redemption amount in chapter 7 is zero.

In re Archie, 240 B.R. 425 (Bankr. S.D. Ala 1999) (case filed prior to enactment of 1994 Reform Act). In most cases this "installment redemption" works to the debtor's advantage, but in those instances in which the secured claim is not reduced or is only slightly reduced through the chapter 13 payments, the application of §348(f)(1)(B) can result in a redemption amount higher than would arise from dismissal of the chapter 13 and a re-filed chapter 7.[10]

[10] Before dismissing the chapter 13 for purpose of re-filing a chapter 7 be sure the debtor is eligible to re-file pursuant to 11 U.S.C. §109(g)(2).