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Reaffirmation Agreements in Chapter 7 Bankruptcy Proceedings

A DEBTOR WHO FILES FOR CHAPTER 7 bankruptcy relief must state an intention to retain or surrender personal property—usually a car. After the passage of the Bankruptcy Abuse Prevention Consumer Protection Act (BAPCPA) in 2005, the options available to the debtor wanting to keep a car were greatly restricted.[1]

Prior to the passage of BAPCPA, five circuits—including the Ninth—allowed debtors who wanted to keep their cars to carry out this intention by selecting from three options:[2]

1) A redemption agreement, which allowed the debtor to pay the creditor the present value of the vehicle soon after filing bankruptcy.[3]

2) A reaffirmation agreement, which imposed personal liability on the debtor if the debtor later defaulted on the car loan.[4]

3) The "ride-through" option,[5] which allowed a debtor to continue making payments on the vehicle without requiring a reaffirmation agreement to be filed with the bankruptcy court.[6]

The other circuits rejected the ride-through option and only recognized a debtor's right to indicate an intention to redeem or reaffirm.[7]

In the five circuits that permitted it, the ride-through option was extremely popular, because debtors could retain their vehicles without having to assume personal liability for the car loans.[8] The ride-through option also prevented creditors from impinging on a debtor's right to a fresh start because it did not impose personal liability on the debtor for the car loan. When a debtor selected the ride-through option a creditor still retained the right to repossess the vehicle if the debtor later defaulted on the loan.[9]

After BAPCPA, key provisions in Bankruptcy Code Sections 362 and 521 restricted a debtor's ability to state a ride-through intention when filing for Chapter 7 bankruptcy relief.[10] A debtor who seeks to retain a vehicle after filing for Chapter 7 relief is now required to state a permissible intention—which after BAPCPA is either an intention to reaffirm or redeem.[11]

Failure of a debtor to indicate a permissible intention may allow a creditor to exercise nonbankruptcy options, such as to invoke an ipso facto clause,[12] a contract provision that permits a creditor to declare the contract in default by virtue of the other party's insolvency or bankruptcy.[13] However, courts have held that a creditor is not permitted to exercise an ipso facto clause when a debtor complies with the newly adopted BAPCPA provisions under Sections 362 and 521 in the reaffirmation agreement process.[14] As such, even if a bankruptcy judge denies a reaffirmation agreement, a creditor is not permitted to exercise an ipso facto clause unless the creditor demonstrates that the debtor failed to comply with Sections 362 and 521.

Debtor Compliance

When a debtor files for bankruptcy, the automatic stay is triggered and prevents a creditor from repossessing a vehicle without permission from the court.[15] Generally, ipso facto clauses in installment contracts are unenforceable as a matter of law.[16] The bankruptcy code has afforded the debtor protections upon filing for bankruptcy pursuant to Bankruptcy Code Sections 365(e)(1)(B)[17] and 541(c)(1)(B),[18] which generally restrict or render unenforceable ipso facto clauses.

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However, under a new BAPCPA provision, Bankruptcy Code Section 362(h)(1)(A), the automatic stay can now be terminated in a Chapter 7 bankruptcy case when a debtor fails to timely file a statement of intention pursuant to Section 521(a)(2)(A), which requires a debtor retaining a vehicle with a secured loan to indicate either an intention to redeem or reaffirm. If a debtor fails to state an intention to redeem or reaffirm, the secured creditor has the right to take whatever action is permissible under nonbankruptcy law pursuant to Section 521(a)(6).[19] Accordingly, when a secured creditor has a permissible ipso facto clause in the loan agreement, a debtor's failure to comply with Sections 362 and 521 can trigger the ipso facto clause

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and leave the debtor vulnerable to repossession of his or her vehicle.

However, debtor compliance with newly adopted Sections 362 and 521 does not require the debtor to ensure the agreement is approved by the court. Courts have consistently held that compliance under Sections 362 and 521 only requires a debtor seeking to reaffirm a car loan to: 1) file a statement of intention indicating an intent to reaffirm, 2) cooperate with the creditor in filing a reaffirmation agreement with the bankruptcy court, and 3) act upon the intention to reaffirm by attending the reaffirmation hearing set by the bankruptcy court.[20]

Some courts have allowed a debtor to cure the failure to indicate an intention to reaffirm when a debtor timely executes a reaffirmation agreement.[21] Nevertheless, a debtor's failure to comply with Sections 521 and 362 is risky and could leave the debtor vulnerable to repossession of his or her vehicle by the secured creditor.[22] After a debtor has complied with Sections 521 and 362, the final determination of whether the reaffirmation agreement is legally enforceable is governed by Bankruptcy Code Section 524(c).

Approval of Reaffirmation Agreement

Pursuant to Section 524(c), a reaffirmation agreement is unenforceable unless the agreement is approved by the bankruptcy court. Provisions under Section 524(c) grew out of concerns about the long history of coercive and deceptive actions by creditors to secure reaffirmation agreements of discharged debt.[23]

Section 524(c) provides two ways that a debtor can request approval of a reaffirmation agreement by the bankruptcy court.

First, an attorney can certify the agreement does not pose an undue hardship on the debtor or a dependent of the debtor and that he or she provided the debtor with disclosures regarding the reaffirmation agreement, including that the agreement is voluntary.[24] Alternatively, a bankruptcy judge can determine that the reaffirmation agreement does not pose an undue hardship on the debtor or a dependent of the debtor and that the agreement is in the best interest of the debtor.[25]

After debtors have complied with Sections 362 and 521, they can first attempt to have a reaffirmation agreement approved by the bankruptcy court by asking their attorneys to sign a declaration along with the reaffirmation agreement.[26] The attorney declaration must state that the attorney: 1) informed the debtor that the agreement is voluntary, 2) informed the debtor about the consequences of reaffirming a discharged debt, and 3) determined the agreement does not pose undue hardship on the debtor or a dependent of the debtor.[27] If a debtor's attorney certification is not filed with the court or one is not filed because the debtor is unrepresented, the debtor must seek approval of a reaffirmation agreement from the bankruptcy court.

When a debtor requests that a bankruptcy judge approve a reaffirmation agreement, the request is made directly at a reaffirmation hearing.[28] At a reaffirmation hearing, a bankruptcy judge has the duty to carefully examine the debtor's financial circumstances and ensure that the reaffirmation agreement: 1) does not pose an undue hardship on the debtor or a dependent of the debtor, and 2) is in the best interest of the debtor.[29] Moreover, a presumption of undue hardship arises when the debtor's monthly income less the debtor's monthly expenses as shown on the debtor's completed and signed statement in support of the agreement is less than the scheduled payments on the reaffirmed debts.[30]

When Congress passed BAPCPA, new Bankruptcy Code Section 524(k) expanded consumer debtor protections in the reaffirmation agreement process by requiring creditors to provide additional disclosures to the debtor in a timely manner so as to ensure the debtor is fully aware of the consequences of entering into a contract imposing personal liability of a discharged debt.[31] Congress, however, did not seek to eliminate or restrict subsequent review and approval by a bankruptcy judge of a reaffirmation agreement.[32] More importantly, Congress did not include any language when it passed BAPCPA and amended Section 524 that an ipso facto clause would be triggered if a bankruptcy court denied a reaffirmation agreement. If Congress had wanted to give a secured creditor the right to exercise an ipso facto clause upon denial of a reaffirmation agreement, it could have done so by inserting such language in Section 524, since Congress had already amended that section when it passed BAPCPA.

During the reaffirmation agreement hearing, a debtor is unable to compel a judge presiding over the reaffirmation hearing to approve a reaffirmation agreement.[33] In fact, the bankruptcy court has held that a debtor's concern over a creditor-relief provision, such as an ipso facto clause, if the court disapproves the reaffirmation agreement is not warranted, and is not sufficient to overcome a presumption of undue hardship.[34] Thus, a debtor can comply with Sections 362 and 521 and still not have an enforceable reaffirmation agreement because the bankruptcy judge has ruled, pursuant to Section 524, that the agreement poses either an undue hardship and/or is not in the best interest of the debtor. However, some creditors have tried to impose an additional obligation on debtors by advising them that if they are unable to get a reaffirmation agreement approved by the bankruptcy judge, an ipso facto clause in the contract will be triggered and leave them vulnerable to repossession of their cars.[35]

Ipso Facto Clauses

The bankruptcy code explicitly restricts the enforceability of ipso facto agreements pursuant to Bankruptcy Code Sections 362, 541(c)(1)(B), and 365(e)(B). Since the overriding purpose of a Chapter 7 bankruptcy relief is to provide the honest but unfortunate debtor with a fresh start, courts view ipso facto clauses as unenforceable as a matter of law.[36]

After BAPCPA, Congress created a carveout for secured creditors to exercise an ipso facto clause. However, the ability of a creditor to exercise the clause can only be triggered under very limited circumstances. The secured creditor's right to exercise an ipso facto clause can be further limited if a creditor refuses to provide a debtor with a reaffirmation agreement or file such an agreement with the bankruptcy court.[37] Thus, a secured creditor can lose the ability to exercise an ipso facto clause if the secured creditor thwarts a debtor's ability to carry out a debtor's intention to reaffirm pursuant to Bankruptcy Code Section 362(h)(1)(B).[38]

Bankruptcy courts have held that a creditor does not have the right to exercise an ipso facto clause when a debtor complies with Sections 362 and 521, but the bankruptcy judge denies the agreement at a reaffirmation hearing.[39] More importantly, courts have recognized that the provisions under Section 521(d), which can trigger an ipso facto clause, when working in concert with other sections of the code, can only be invoked by a debtor's failure to comply with Sections 362 and 521.[40] The bankruptcy courts have rejected the position argued by creditors that the language of Section 521(d) allows a secured creditor to exercise an ipso facto clause when a debtor has complied with Sections 362 and 521.[41]

Courts have further held that when a debtor complies with Sections 362 and 521, the debtor may retain possession of the collateral after the entry of discharge and the closure of the case without fear that the secured creditor will exercise an ipso facto provision and repossess the collateral, so long as the debtor remains current.[42] Since a secured creditor is not entitled to exercise an ipso facto clause after the bankruptcy court has denied a reaffirmation agreement, a creditor cannot thereafter repossess the vehicle without violating the automatic stay or discharge injunction when there is no payment or insurance default.[43] In fact, the bankruptcy court has found a secured creditor in violation of the discharge injunction and awarded compensatory damages along with return of the vehicle pursuant to Bankruptcy Code Section

105 after the creditor repossessed a vehicle when a debtor complied with Sections 362 and 521 and the bankruptcy judge denied the reaffirmation agreement at a reaffirmation hearing.[44]

The passage of BAPCPA brought many sweeping changes to the bankruptcy code, especially as they relate to consumer debtors filing for Chapter 7 bankruptcy. One key change was elimination of a debtor's ability to retain personal property securing a debt, such as a vehicle, without stating a permissible intention to either retain or redeem as required by Bankruptcy Code Sections 362 and 521. BAPCPA also created a limited carve-out for creditors to exercise an ipso facto clause under Bankruptcy Code Section 521 when the debtor failed to comply with Sections 362 and 521—provided the clause is permissible under applicable nonbankruptcy law.[45] Debtor compliance with Sections 362 and 521 does not require a debtor to get approval of the reaffirmation agreement. Sections 362 and 521 only require the debtor to enter the reaffirmation agreement.

When a bankruptcy court denies a reaffirmation agreement under Section 524(c) and the debtor has complied with Sections 362 and 521, bankruptcy courts have consistently held that a creditor cannot exercise an ipso facto clause. Since the approval of a reaffirmation agreement is out of the control of the debtor, courts have held that Section 521(d), which allows creditors to exercise a permissible ipso facto clause, is not triggered.

If a creditor exercises an ipso facto clause after the debtor has complied with Sections 362 and 521 in entering into a reaffirmation agreement that is denied by the judge, the creditor may be in violation of the automatic stay or discharge injunction. In such cases, the court may award compensatory and punitive damages against the secured creditor. ■

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[1] Bankruptcy Abuse Prevention Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005).

[2] In re Dumont, 581 F. 3d 1104, 1109 (9th Cir. 2009).

[3] 11 U.S.C. §722. Since many debtors are unable to pay a vehicle's present value even if it is less than the outstanding loan, this option is often economically infeasible.

[4] 11 U.S.C. §524(c).

[5] In re Dumont, 581 F. 3d at 1108 n.3 ("Ride-through was not limited to automobile loans. However, as the name implies, ride-through was used most frequently to allow debtors to hold on to an automobile.").

[6] *Id*. at 1109.

[7] *Id*.

[8] *Id*. at 1108.

[9] *Id*.

[10] 11 U.S.C. §§362(h)(1)(a), 521(a)(2)(A), 521(a)(2)(B), 521(a)(6)(B), and 521(d). In re Perez, 2010 Bankr. LEXIS 2229, at *23 n.14 (Bankr. D. N.M. July 12, 2010).

[11] In re Dumont, 581 F. 3d at 1117.

[12] *Id*. at 1114.

[13] In re Perez, 2010 Bankr. LEXIS 2229, at 37 n.26.

[14] In re Dumont, 581 3d at 1118-19 (The court held that courts have allowed the ride-through after BAPCPA when there has been substantial compliance with §§362 and 521 by the debtor.).

[15] 11 U.S.C. §362(a)(2) provides "a petition filed… operates as a stay, applicable to all entities of the enforcement, against the debtor or against property of the estate."

[16] In re Jones, 591 F. 3d 308, 312 (4th Cir. W. Va. 2010) (citing Riggs Nat. Bank of Washington, D.C. v. Perry, 729 F. 2d 982, 984-85 (4th Cir. 1984) (explaining that [ipso facto] clauses deprive debtors of the advantages of bankruptcy proceedings by causing them to default immediately upon filing a bankruptcy petition)). 11 U.S.C. §365(e)(1)(B) generally renders unenforceable any contractual terms that purport to create a default solely based on the commencement of a bankruptcy case. In re Dumont, 581 F. 3d at 1115.

[17] In re Dumont, 581 F. 3d at 1115.

[18] *Id*. at n.18.

[19] 11 U.S.C. §521(a)(2)(6) provides:

> [I]f the debtor fails to so act within the 45-day period referred to in paragraph (6), the stay under Section 362(a) is terminated with respect to the personal property of the estate or of the debtor which is affected, such property shall no longer be property of the estate, and the creditor may take whatever action as to such property as is permitted by applicable non-bankruptcy law.

[20] 11 U.S.C. §§362(h)(1)(a), 521(a)(2)(A), 521(a)(2)(B), 521(a)(6)(B), 521(d). In re Perez, 2010 Bankr. LEXIS 2229, at *29 (Bankr. D. N.M. July 12, 2010) (The court held that §521(a)(2)(B) does not require the debtor to consummate an enforceable reaffirmation agreement, since whether the agreement is enforceable depends on factors outside the debtor's power or control, but only to do all that is within the power and control of the debtor.). *See also* In re Moustafi, 371 B.R. 434, 438 (Bankr. D. Ariz. 2007); In re Husain, 364 B.R. 211, 219 (Bankr. E.D. Va. 2007); In re Barron, 441 B.R. 131, 137 (Bankr. D. Ariz. 2010); In re Chim, 381 B.R. 191, 198 (Bankr. D. Md. 2008).

[21] In re Bower, 2007 Bankr. LEXIS 2580, at 2586 (Bankr. D. Or. July 26, 2007).

[22] In re Miller, 443 B.R. 54, 59 (Bankr. D. Del. 2011).

[23] In re Grisham, 436 B.R. 896, 900 (Bankr. N.D. Tex. 2010).

[24] 11 U.S.C. §524(c)(3).

[25] 11 U.S.C. §§524(c)(3), 524(c)(6)(A)(i), and 524(c)(6)(A)(ii).

[26] 11 U.S.C. §524 (c)(3).

[27] 11 U.S.C. §524 (c)(3). When an attorney files an affidavit with the agreement, the reaffirmation agreement is typically approved without further scrutiny from the court. Many attorneys are uncomfortable certifying that the reaffirmation agreement will not pose an undue hardship because a debtor's financial circumstances could change in an instant. A debtor who had every intention of paying a car loan when an attorney certified the agreement and later unexpectedly loses a job will not only have his or her car repossessed but will also have a creditor chasing after the debtor for any potential deficiency judgment.

[28] 11 U.S.C. §524(d).

[29] 11 U.S.C. §524(6)(A).

[30] "The presumption [of undue hardship] may be rebutted in writing by the debtor if the statement includes an explanation that identifies additional sources of funds to make the payments as agreed upon under the terms of such agreement. If the presumption is not rebutted to the satisfaction of the court, the court may disapprove such agreement. No agreement shall be disapproved without notice and a hearing to the debtor and creditor." 11 U.S.C. §524(m)(1).

[31] "[A]n agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to the extent enforceable under applicable non-bankruptcy law…[and] only if the debtor received the disclosure described in subsection (k) at or before the time at which the debtor signed the agreement." 11 U.S.C. §524(c)(2).

[32] In re Quintero, 2006 Bankr. LEXIS 906, at 908 (Bankr. N.D. Cal. May 5, 2006) (The court stated that BAPCPA includes in its title the phrase "consumer protection" and that BAPCPA's addition of 11 U.S.C. §524(k), which mandates greater disclosures about the terms of the reaffirmation agreement, is one of the primary consumer protections Congress afforded to Chapter 7 debtors that recognized a debtor's continuing need for protection from coercive and deceptive creditor actions.).

[33] In re Perez, 2010 Bankr. LEXIS 2229, at *28-29 (Bankr. D. N.M. July 12, 2010).

[34] In re Chim, 381 B.R. 191, 199 (Bankr. D. Md. 2008).

[35] At monthly reaffirmation hearings in the Los Angeles and San Fernando Valley divisions of the Central District of California, Public Counsel and pro bono attorneys counsel hundreds of pro se debtors each month before scheduled reaffirmation hearings. Every month, the most common question asked by pro se debtors is, can they repossess my car if the judge denies the agreement? Some pro se debtors report that creditors have warned them that failure to get a reaffirmation approved will result in automatic repossession of their vehicle despite their compliance with BAPCPA.

[36] In re Jones, 591 F. 3d 308, 309-10 (4th Cir. W. Va. 2010) (citing Riggs Nat. Bank of Washington, D.C. v. Perry, 729 F. 2d 982, 984-85 (4th Cir. 1984)); In re Dumont, 581 F. 3d 1104, 1108 (9th Cir. 2009).

[37] 11 U.S.C. §362(h)(1)(B) provides:

> [U]nless such statement [of intention] specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.

[38] In re Quintero, 2006 Bankr. LEXIS 906, at 909-10. The court reasoned that Congress could not have intended to leave it within a secured creditor's power to thwart a Chapter 7 debtor's attempt to retain his or her car and reaffirm the debt by failing to comply with the requirement that the creditor supply the debtor with the expanded disclosure at the appropriate time and that by failing to comply with §524(k) the creditor had in effect refused to enter into an enforceable reaffirmation agreement with the debtor and was prohibited from repossessing the car.

[39] *See supra* note 20.

[40] In re Dumont, 581 F. 3d at 1117; In re Chim, 381 B.R. at 197.

[41] In re Hardiman, 398 B.R. 161, 187 (E.D. N.C. 2008) (The court held that since the debtor had already complied with §§362 and 521, the remaining language stating, "[n]othing in this title shall prevent or limit the operation of an [an ipso facto clause]" does not apply.); In re Perez, 2010 Bankr. LEXIS 2229, at 40. The same analysis should be applied when reading the language used later in §521(d).

[42] *Id*. at 44. In re Bower, 2007 Bankr. LEXIS 2580, 2588 (Bankr. D. Or. July 26, 2007) (Because the debtor complied with §521(a)(6), the debtor could retain the vehicle after disapproval of a reaffirmation agreement so long as the debtor stayed current on payments and insurance.). *See also* In re Quintero, 2006 Bankr. LEXIS 906 at 909; In re Moustafi, 371 B.R. 434, 440 (Bankr. D. Ariz. 2007).

[43] In re Barron, 441 B.R. 131, 137 (Bankr. D. Ariz. 2010).

[44] In re Baker, 390 B.R. 524, 531-32 (Bankr. D. Ariz. 2008).

[45] In re Dumont F. 3d 1104 at 1115.