

# TUCKER | HESTER, LLC

## **“RIDE THROUGH” WHAT IS THE EFFECT OF § 521?**

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A CLE Presentation

By: William J. Tucker\*  
Attorney at Law  
[bill@tucker-hester.com](mailto:bill@tucker-hester.com)

Tucker | Hester, LLC  
[www.tucker-hester.com](http://www.tucker-hester.com)

Pennsylvania Center, Suite 100  
429 North Pennsylvania Street  
Indianapolis, IN 46204-1816

317.833.3030 | 317.833.3031 [fax]

\*Also written by: Amanda G. Koziura

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## **ISSUES**

1. What can happen to the Debtor if there is no formal reaffirmation agreement but the debtor continues to make regular payments and retains the collateral?
2. On a reaffirmation agreement, what liability does the debtor's counsel face with the reaffirmation affidavit if the debtor subsequently defaults?

## **BANKRUPTCY CODE**

### **Section 521 of the Bankruptcy Code**

(a) The debtor shall –

(1) ...

(2) if an individual debtor's schedule of assets and liabilities includes 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 of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, the debtor 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) 30 days after the first date set for the meeting of creditors under section 341(a) or within such additional time as the court, for cause, within such 30-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 except as provided in section 362(b);

...

(6) in a case under chapter 7 of this title in which the debtor is an individual, not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not later than 45 days after the first meeting of creditors under section 341(a), either –

(A) enters into an agreement with the creditor pursuant to section 524(c) with respect to the claim secured by such property; or

(B) redeems such property from the security interest pursuant to section 722.

If 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 nonbankruptcy law, unless the court determines on the motion of the trustee filed before the expiration of such 45-day period, and after notice and a hearing, that such property is of consequential value or benefit to the estate, orders appropriate adequate protection of the creditor's interest, and order the debtor to deliver any collateral in the debtor's possession to the trustee, and

### **Section 524 of the Bankruptcy Code**

(a)...

(b)...

(c) An 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 any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if

–

- (1) such agreement was made before the granting of the discharge under section 727, 1141, 1228, or 1328 of this title;
  - (2) the debtor received the disclosures described in subsection (k) at or before the time at which the debtor signed the agreement;
  - (3) such agreement has been filed with the court and, if applicable, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that –
    - (A) such agreement represents a fully informed and voluntary agreement by the debtor;
    - (B) such agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and
    - (C) the attorney fully advised the debtor of the legal effect and consequences of –
      - (i) an agreement of the kind specified in this subsection; and
      - (ii) any default under such an agreement;
  - (4) the debtor has not rescinded such agreement at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim;
  - (5) the provisions of subsection (d) of this section have been complied with; and
  - (6)(A) in a case concerning an individual who was not represented by an attorney during the course of negotiating an agreement under this subsection, the court approves such agreement as –
    - (i) not imposing an undue hardship on the debtor or a dependent of the debtor; and
    - (ii) in the best interest of the debtor.
  - (B) Subparagraph (A) shall not apply to the extent that such debt is a consumer debt secured by real property.
- (d) In a case concerning an individual, when the court has determined whether to grant or not to grant a discharge under section 727, 1141, 1228, or 1328 of this title, the court may hold a hearing at which the debtor shall appear in person. At any such hearing, the court shall inform the debtor that a discharge has been granted or the reason why a discharge has not been granted. If a discharge has been granted and if the debtor desires to make an agreement of the kind specified in subsection (c) of this section and was not represented by an attorney during the course of negotiating such agreement, then the court shall hold a hearing at which the debtor shall appear in person and at such hearing the court shall –
- (1) inform the debtor –
    - (A) that such an agreement is not required under this title, under nonbankruptcy law, or under any agreement not made in accordance with the provisions of subsection (c) of this section; and
    - (B) of the legal effect and consequences of –
      - (i) an agreement of the kind specified in subsection (c) of this section; and
      - (ii) a default under such an agreement; and
  - (2) determine whether the agreement that the debtor desires to make complies with the requirements of subsection (c)(6) of this section, if the consideration for such agreement is based in whole or in part on a consumer debt that is not secured by real property of the debtor.
- (e) Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.
- (f) Nothing contained in subsection (c) or (d) of this section prevents a debtor from voluntarily repaying any debt.
- (g)(1)(A) After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.
- (B) An injunction may be issued under subparagraph (A) to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust described in paragraph (2)(B)(i), except such legal actions as are expressly allowed by the injunction, the confirmation order, or the plan of reorganization.

## **Section 704 of the Bankruptcy Code**

(a) The trustee shall--

- (1) collect and reduce to money the property of the estate for which such trustee serves, and close such estate as expeditiously as is compatible with the best interests of parties in interest;
- (2) be accountable for all property received;
- (3) ensure that the debtor shall perform his intention as specified in section 521(2)(B) of this title;
- (4) investigate the financial affairs of the debtor;
- (5) if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;
- (6) if advisable, oppose the discharge of the debtor;
- (7) unless the court orders otherwise, furnish such information concerning the estate and the estate's administration as is requested by a party in interest;

## **Section 365 of the Bankruptcy Code**

(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on

—

- (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
- (B) the commencement of a case under this title; or
- (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

## **DISCUSSION**

### **I. Pre-BAPCPA allowance of “ride-through” by some jurisdictions.**

Under § 521(a)(2), when a debtor files for chapter 7 bankruptcy, the debtor must file a statement of intention with all the creditors that have a secured interest in the debtor's property. The debtor must indicate whether he intends to surrender, redeem, or reaffirm the property. Under § 524(c), the debtor can reaffirm the debt by entering into a new loan agreement with the creditor.

Under pre-BAPCPA case law, some jurisdictions choose to provide the debtor the option of “ride-through” in addition to the options of surrendering, redeeming, or reaffirming property under § 521(a)(2). This allowed a debtor to retain the collateral and continue to pay the debt as if a bankruptcy had never taken place, without a written reaffirmation agreement. The federal courts were divided on the matter, with some finding that § 521(a)(2)(A) restricted the debtor to the options specifically enumerated in that section. See *In re Johnson*, 89 F.3d 249 (5<sup>th</sup> Cir. 1996); *In re Taylor*, 3 F.3d 1512 (11<sup>th</sup> Cir. 1993); *In re Edwards*, 901 F.2d 1383 (7<sup>th</sup> Cir. 1990). Alternatively, other courts found that when a debtor is current on the loan, the debtor may continue to pay and keep the collateral without a formal reaffirmation agreement. See *In re Balanger*, 962 F.2d 345 (4<sup>th</sup> Cir. 1992); *In re Hunter*, 121 BR 609 (Bankr. ND Ala. 1990); *In re Crouch*, 104 BR 770 (Bankr. SD W.Va. 1989). Pre-BAPCPA, it was acknowledged that even where courts have not permitted a debtor this fourth option, there is nothing to prevent the debtor from doing so anyway.

### **II. Enactment of BAPCPA has rendered “ride through” inapplicable in bankruptcy.**

Following the enactment of the BAPCPA in 2005, a chapter 7 debtor may no longer retain collateral without either redeeming the property or reaffirming the debt. See *In re Steinhaus*, 349 B.R. 694 (Bkrty.D.Idaho 2006); *In re Rowe*, 342 B.R. 341 (Bkrty.D.Kan.2006); *In re Taylor*, 3 F.3d 1512 (11<sup>th</sup> Cir. 1993). This is because of the new requirements established in § 521(a)(6). However, the inapplicability of the doctrine of “ride through” has yet to be adjudicated by all jurisdictions. The following two cases are most instructive on this issue.

In the case of *In re Steinhaus*, 349 B.R. 694 (Bkrcty.D.Idaho 2006), the court held that the “ride through” option previously available to debtors who were current on their secured debt is no longer available following the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act. Post-BAPCPA, if the debtor fails to file a statement of intention in accordance with § 521(a)(2) with respect to such property, in which the debtor elects one of the three statutory options, debtor will lose protections of the automatic stay as to such property 30 days after the petition date. Also, that property of the debtor will cease to be property of the estate, and the creditor will be entitled to take whatever nonbankruptcy options it has with respect to such property.

A similar holding was made by the court in the case of *In re Rowe*, 342 B.R. 341 (Bkrcty.D.Kan.2006). In that case, it was held that the so-called “fourth option” previously available to a debtor who was current on his secured debt – to simply retain property without a formal reaffirmation agreement, while continuing to make regular payments to the secured creditor – is no longer available following the enactment of the BAPCPA. The ramifications for a debtor who fails to file a statement of intention in accordance with § 521(a)(2) with respect to such property, in which the debtor must elect one of three statutory options, will be the same as stated in *In re Steinhaus*, supra.

As previously stated, many jurisdictions did not allow a debtor the option of “ride through” in bankruptcy prior to the enactment of the BAPCPA. See *In re Johnson*, 89 F.3d 249 (5<sup>th</sup> Cir. 1996); *In re Taylor*, 3 F.3d 1512 (11<sup>th</sup> Cir. 1993); *In re Edwards*, 901 F.2d 1383 (7<sup>th</sup> Cir. 1990). Therefore, these jurisdictions will not need to litigate the unavailability of the doctrine of “ride through” under BAPCPA for debtors who attempt to retain secured property by simply staying current on their payments to the secured creditors. Demonstrative of this is the Seventh Circuit Court of Appeals decision in the case of *Matter of Edwards*, 901 F.2d 1383 (7<sup>th</sup> Cir. 1990). In that case, the Court of Appeals held a chapter 7 debtor must, as a condition of retaining property which secures an installment loan, either redeem it by paying for it in a lump sum or expressly reaffirming the debt underlying the collateral. The court held this to be true even though the debtor had performed, and continued to perform, all obligations of the installment loan agreement.

### **III. What liability does debtor’s counsel face under an affidavit on a reaffirmation when the debtor defaults?**

Under Bankruptcy Code § 524(c)(3), the attorney must sign an affidavit attesting that the agreement is a fully informed and voluntary act by the debtor, that the agreement would cause no undue hardship on the debtor, and that the attorney has fully advised the debtor of the legal effect of the agreement and default thereon. So, does signing the affidavit automatically make the attorney liable when the debtor defaults? And if so, what are the proper damages?

In *In re Vargas*, 257 B.R. 157 (B.C. D.C. N.J. 2001), the court held that an attorney certifying his client’s reaffirmation agreement has a duty to access the client’s financial circumstances. Further, the courts have the power to review the reaffirmation agreement to make sure that the attorney has done his duty. So an attorney is liable if he fails to make a satisfactory inquiry into the debtor’s finances, signs the affidavit, and the debtor defaults. What if the attorney did examine the debtor’s financial circumstances, believed there would be no undue hardship, signs the affidavit, and the debtor defaults? Would the attorney still be liable for the default even though he satisfied the requirements of 524(c)(3)?

Therefore, it has been established that an attorney may be liable for signing the affidavit where the debtor subsequently defaults on the reaffirmation agreement, but what are the damages? In *In re Vargas*, 257 B.R. 157 (Bankr. D.N.J. 2001), the court ordered the attorney to relinquish his fees. What other damages might be appropriate?