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PAY AND RETAIN DRIVES AWAY: 9th Circuit Permits Creditor's Repossession of Vehicle After Debtor Failed to Reaffirm

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SUMMARY: In *Dumont v. Ford Motor Credit Company*, the Ninth Circuit Court of Appeals held that BAPCPA supersedes the court's pre-BAPCPA opinion that permitted debtors to retain collateral without reaffirming or redeeming the debt so long as payments were continued and timely ("pay and retain").ⁱ The Court's *Dumont* holding finds that the Bankruptcy Code does not protect the collateral if the debtor fails to actually redeem, reaffirm, or assume the credit obligation. Filing a statement of intention without more is not enough to keep the property.

In *Dumont v. Ford Motor Credit Company*, 581 F.3d 1104 (9th Cir. (Cal.) Sep. 15, 2009), the Ninth Circuit interpreted 11 U.S.C. § 362(h)(1)(A) of the Bankruptcy Code as requiring the debtor to affirmatively elect one of three choices (redemption, reaffirmation, or assumption) if the debtor desires to retain possession of a vehicle secured by a loan. As a practical matter, this decision increases the leverage of secured creditors during negotiations with debtors who wish to retain collateral in bankruptcy cases.

Prior to enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), debtors filing for bankruptcy in the Ninth Circuit could retain personal property that secures a loan merely by continuing to make timely payments.ⁱⁱ The pre-BAPCPA law effectively permitted debtors to "ride-through" (a.k.a., "pay and drive" or "pay and retain") as if the bankruptcy filing never occurred. Debtors frequently engaged in the practice of either filing a statement of intention without selecting one of the options or would state an intention to reaffirm but would not execute a reaffirmation agreement. Debtors elected the "pay and retain" option because their vehicles were often worth less than what was owed and they would likely experience difficulty in securing similar financing terms after bankruptcy. An additional bonus for debtors with the "pay and retain" option was that if they were unable to make the required payments in the future or no longer wanted the vehicle, the debtor could walk away without personal liability. In light of these benefits, few debtors preferred the other options – redemption requires a single lump sum payment for the lesser of the fair market value of the collateral or the amount of the creditor's secured claim; reaffirmation holds the debtor personally liable for the reaffirmed debt; and surrendering the collateral leaves the debtor without a vehicle.

“Pay and retain” affected secured creditors because they were prohibited by the automatic stay, and later the discharge injunction, from repossessing the property unless the debtor stopped making timely payments or committed some other default under the loan documents. This presented a problem under the right set of facts where the collateral depreciated faster than the receipt of payments. Additionally, if the debtor’s default occurred after the discharge, the creditor was prohibited from seeking the deficiency from the auction sale price and the principal.

The *Dumont* case gives secured creditors increased leverage in negotiating reaffirmation agreements. In *Dumont*, the Debtor financed a vehicle with Ford Motor Credit Company (“FMCC”). The loan agreement contained an “ipso facto” provision – a clause providing that the mere filing of a bankruptcy case is a default under the loan documents.ⁱⁱⁱ The Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code in 2006. She timely filed a Statement of Intention indicating that she would retain the vehicle but did not state whether she would redeem or reaffirm the loan. The Debtor continued to make timely loan payments to FMCC. She received a discharge of all qualified debts in August of 2006. In September 2006, FMCC repossessed the vehicle.^{iv} The Debtor reopened her bankruptcy case to challenge FMCC’s repossession of the vehicle and grounded her argument as a violation of the discharge injunction. The Bankruptcy Court denied the motion. The Bankruptcy Appellate Panel for the Ninth Circuit affirmed. This set the stage for the Ninth Circuit to decide whether “pay and retain” is a viable option post-BAPCPA.

The Ninth Circuit held that, with two *possible* exceptions, debtors cannot “pay and retain” a vehicle in bankruptcy.^v The court relying on the traditional canons of statutory interpretation read Section 362(h)(1)(A) to require both: (i) the filing of a Statement of Intention; and (ii) an affirmative indication on the statement as to whether the debt will be surrendered, redeemed, or reaffirmed. Even if timely payments are made post-petition, the automatic stay is terminated as to debtors that fail to comply with both requirements. This results in the vehicle losing its classification as property of the bankruptcy estate and the protections of the discharge injunction. In other words, the vehicle becomes susceptible to repossession. It remains to be seen whether debtors that commit to reaffirming but are unsuccessful in completing the process (e.g., the debtor is unable to reach an agreement with the creditor or the bankruptcy court outright refuses to approve the agreement) can “pay and retain.”

The take home messages applicable to both consumer bankruptcy attorneys and secured creditors are: (i) to ensure that debtors electing to retain collateral commit to either reaffirming or redeeming; and (ii) during negotiations of reaffirmation agreements, remember that unsuccessful negotiations or the Court’s rejection of the agreement may result in the right to “pay and retain.”

The take home messages applicable only to secured creditors are: (i) to include ipso-facto provisions in all loan agreements; and (ii) if the debtor fails to properly make the election on the Statement of Intention, be sure to comply with all federal and state laws when enforcing your rights.

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ⁱ In *McClellan Fed. Credit Union v. Parker (In re Parker)*, 139 F.3d 668 (9th Cir. 1998) the Ninth Circuit Court of Appeals held that debtors are not limited to reaffirmation or redemption. Continuing to make payments and retaining the collateral without reaffirming or redeeming was permissible.

ⁱⁱ *Id.* The Court interpreted the pre-BAPCA code to allow a debtor to (1) redeem the collateral; (2) reaffirm the debt on negotiated terms; (3) surrender the collateral; or (4) pay and retain.

ⁱⁱⁱ Ipso facto provisions are generally disfavored and unenforceable in bankruptcy cases by the prohibitions found in 11 U.S.C. § 365(e)(i)(B). Nonetheless, the *Dumont* court held that reading 11 U.S.C. § 521(d) together with 11 U.S.C. § 365(e)(i)(B) results in a “trump” over the general provision based on the facts of this case.

^{iv} While the Court did not analyze whether FMCC’s actions violated state or nonbankruptcy federal laws, it did express that it found FMCC’s actions as a “sharp practice.” On the other hand, the Court noted, “a decision to repossess might make financial sense under certain sets of assumptions.”

^v Under *Dumont*, the *Parker* decision *might* survive where the debtor has attempted to reaffirm but is unable to reach an agreement with the creditor or the bankruptcy court outright refuses to approve the agreement. A second possible exception involves loan agreements that do not include an ipso facto provision. As a practical matter, we recognize that nearly all loan agreements contain these provisions.