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No Free Ride: 9th Circuit Permits Lender to Repossess Vehicle When Bankruptcy Debtor Fails to Recommit

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In Dumont v. Ford Motor Credit Company*, the Ninth Circuit Court of Appeals confirms the Bankruptcy Code does not protect a debtor's personal property collateral if the debtor fails to commit to redeem, reaffirm or assume the underlying loan—even if the debtor continues timely to make loan payments.*

In *Dumont v. Ford Motor Credit Company*, 581 F.3d 1104 (9th Cir. (Cal.) Sep. 15, 2009), the Ninth Circuit interpreted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") and, in particular, 11 U.S.C. § 362(h)(1)(A) of the Bankruptcy Code to require a debtor to make an affirmative election to redeem, reaffirm or assume an underlying secured loan if the debtor intends to retain possession of the vehicle. The practical implication of the *Dumont* decision is an increase in secured lenders' leverage in negotiations with debtors who seek to retain personal property collateral in a bankruptcy case.

Under prior law, a debtor could retain personal property after filing for bankruptcy by making payments as if the bankruptcy never occurred—i.e., a debtor could "pay and drive" and his or her vehicle "ride-through" the bankruptcy case.[1] Debtors elected to "ride-through" knowing that they may have difficulty securing financing for another vehicle of similar quality. If the debtor later decided that he or she no longer wanted the vehicle (or could not make the required payments), the debtor could walk away from the vehicle without any liability. In turn, many debtors disfavored the other options: redemption requires the debtor immediately to pay the lesser of the fair market value of the goods or amount of the lender's claim, and reaffirmation and assumption leave the debtor personally liable for the reaffirmed or assumed loan.

The downside of the "ride-through" for secured creditors was that they were forbidden by the automatic stay (and later by the discharge injunction) from repossessing the collateral until the debtor stopped making payments or otherwise defaulted on the loan. During the interim, the collateral might decrease in value faster than payments were coming in. Then, once the debtor's bankruptcy case was discharged, if the debtor defaulted on the loan, the lender was prohibited from seeking any deficiency from the debtor.

The *Dumont* Court provides greater leverage to secured lenders. In *Dumont*, Antoinette Dumont purchased a Ford Taurus in 2003 with a loan from Ford Motor Credit Company ("Ford"). The loan agreement contained a clause that made Dumont's filing for bankruptcy an event of default—a so-called "ipso facto"

clause—clauses which are generally disfavored and unenforceable in a bankruptcy case. In 2006, Dumont filed a Chapter 7 petition for relief from her creditors. In her Statement of Intention filed with the Bankruptcy Court, Dumont indicated that she would retain the vehicle but she did not commit to redeem, reaffirm or assume the underlying loan. Instead, Dumont continued timely to make loan payments to Ford. On August 15, 2006, Dumont received a discharge of her qualified debts from the Bankruptcy Court. Without any advance notice, Ford repossessed the vehicle the following month.[2] Dumont reopened her bankruptcy case and challenged Ford's repossession of the vehicle, claiming it violated the discharge injunction. The Bankruptcy Court denied the motion and the Bankruptcy Appellate Panel for the Ninth Circuit affirmed. The Ninth Circuit was left to decide whether the ride-through option remains available under BAPCPA.

Guided by the traditional canons of statutory interpretation and constitutional requirement that bankruptcy laws be uniform, the Ninth Circuit held that, with one possible exception, debtors cannot "ride-through" a vehicle in a bankruptcy case.[3] Specifically, Section 362(h)(1)(A) requires a debtor to file a Statement of Intention and indicate that he or she will surrender the personal property or retain it and, if the debtor chooses the latter, the debtor is **required** to elect to redeem, reaffirm **or** assume the underlying loan. If a debtor fails fully to comply, even if he or she continues to make payments, the automatic stay is terminated and the vehicle is no longer property of the bankruptcy estate or protected by the discharge injunction, leaving the vehicle vulnerable to repossession. The Court left open the question as to whether a debtor who commits to reaffirm but is unable to do so can "ride-through" the vehicle (e.g., the debtor and lender are unable to agree as to the terms of a reaffirmation or the bankruptcy court refuses to approve the proposed reaffirmation). It further held that Ford's ipso facto clause was enforceable.[4]

In sum, *Dumont* counsels secured creditors to: (1) include an ipso-facto clause in their loan documents; (2) review bankruptcy Statements of Intention to confirm that, if the debtor elects to retain personal property collateral, he or she commits to redeem, reaffirm or assume the underlying loan; (3) recognize in negotiations with bankruptcy debtors both the reduced ability of a debtor to choose to ride-through and the carve out from the eradication of the "ride-through" option if the debtor's and lender's negotiations are unsuccessful or the Court rejects the proposed reaffirmation; and (4) if the debtor fails to make the 362(h)(1)(A) election, comply with state and federal law when exercising remedies.

If you have further questions , please contact your regular Pillsbury attorney or the authors below.

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[1] In *McClellan Federal Credit Union v. Parker*, 139 F.3d 668 (9th Cir. 1998), the Court interpreted BAPCPA to allow a debtor to (1) surrender the collateral, (2) redeem the collateral, (3) reaffirm the debt on agreed upon terms, or (4) "ride-through."

[2] The Ninth Circuit viewed Ford's actions here as "sharp practice," even though it expressed no opinion as to whether Ford violated state (*e.g.*, Cal. Civ. Code § 2983.3 or Com. Code § 9601, *et seq*.) or non-bankruptcy federal laws.

[3] Under *Dumont*, at least where the debtor has not attempted to reaffirm, the *Parker* decision is "superceded" by BAPCPA.

[4] The *Dumont* Court found that 11 U.S.C. § 521(d) of the Bankruptcy Code provides "just the trump" Ford needed to overcome the general prohibition in 11 U.S.C. § 365(e)(i)(B) of the Bankruptcy Code against the enforcement of an ipso facto clause.