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BUT CAN SHE KEEP THE CAR? SOME THOUGHTS ON COLLATERAL RETENTION IN CONSUMER CHAPTER 7 CASES

Marianne B. Culhane and Michaela M. White[1]

I. INTRODUCTION

On November 15, 2001, at the Eugene P. and Delia S. Murphy Conference held at Fordham University School of Law, we addressed the topic of reaffirmation. Reaffirmation means making a new contract to pay and retain personal liability on a debt that would otherwise be discharged in Chapter 7.[2] While unsecured debts may be reaffirmed, debtors more often reaffirm to persuade a secured creditor to let them keep collateral. We will look at reaffirmation in that aspect, as one of several Chapter 7 collateral retention tools.

Many consumer debtors come into Chapter 7 with a heavy load of secured debt on their cars and household goods.[3] Those who own homes carry big mortgages as well. These secured claims, plus exemptions, often leave no value for unsecured creditors, causing the trustee to abandon the collateral. After the discharge removes the debtors' personal liability, the liens remain attached to the collateral,[4] and when the stay ends, the secured creditors may repossess.[5]

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1. Professors of Law, Creighton University Law School.

2. 11 U.S.C. §§ 707 *et seq.* (2000).

3. *See* Marianne Culhane & Michaela White, *Debt After Discharge, An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 738–44, 748–50 (1999). This study was funded by grants from the Endowment for Education of the National Council of Bankruptcy Judges, the Bankruptcy Section of the Nebraska State Bar Association, and Creighton University.

4. Johnson v. Home State Bank, 501 U.S. 78, 83 (1991); *see also* Long v. Bullard, 117 U.S. 617, 620-21 (1886).

5. *See In Re* Boodrow, 192 B.R. 57, 60 (Bankr. N.D.N.Y. 1995).

Repossession is not always what a secured creditor wants, however. Often, the creditor hopes the debtor will keep the collateral, and continue paying for it.[6] After all, if the creditor retakes and sells a car or refrigerator, the creditor will recover only a low liquidation value. When the debtor keeps the asset, however, the creditor may collect much more from the debtor than repossession would yield. Consumer creditors are frequently undersecured. A few years ago, for example, an auto finance executive told the Reporter for the National Bankruptcy Review Commission that new car loans were undersecured by an average of $4,000.[7] Such shortfalls are a powerful incentive to seek retention payments rather than settle for repossession and liquidation value. Not surprisingly, many creditors routinely pursue retention arrangements.

The debtor's wish may coincide with the creditor's hope.[8] Often, the debtor is the person with the highest and best use for consumer collateral.[9] Allowing the debtor to retain collateral prevents lost value, and the secured creditor is better off if the debtor pays more for retention than liquidation value.

Professor William Whitford developed the concept of varying values of the same collateral to debtors and creditors more than twenty years ago. Assume a Chapter 7 debtor owns a car, several

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6. *See, e.g.*, Ronald J. Mann, *The Role of Secured Credit in Small Business Lending*, 86 GEO. L.J. 1, 15-20 (1997) (describing the ineffectiveness of repossession and liquidation of collateral in the context of small business borrowers); RICHARD HYNES & ERIC POSNER, THE LAW AND ECONOMICS OF CONSUMER FINANCE 10-11 (Olin Law & Economics, Working Paper No. 117, 2001); Barry Adler et al., *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 586 (2000) (arguing that continued payments exceed value of liquidation even more so with consumers than with small businesses).

7. Professor Elizabeth Warren served as Reporter to the NBRC, and she is the source for this information. Professor Warren says the executive promised (threatened) to deny saying it if his or her name were revealed. *See* e-mail from Elizabeth Warren to Michaela White (Dec. 12, 1999) (on file with the Fordham Journal of Corporate & Financial Law).

8. *See* William C. Whitford, *A Critique of the Consumer Credit Collection System*, 1979 WIS. L. REV. 1047, 1060 (1979); *see also* William C. Whitford, *The Appropriate Role of Security Interests in Consumer Transactions*, 7 CARDOZO L. REV. 959, 961-64 (1986).

9. *See generally* Whitford, *supra* note 8.

years old, but in decent condition, subject to a $10,000 lien. Assume further that repossession would net the creditor only $6,000. The debtor needs a car to get to work, is familiar with this car's quirks, and knows that if it were lost, she would have to replace it at retail price, with all the hassle and time off work that used-car shopping entails. Thus, she values the car at much more than $6000. She may fear that no one would give her credit to buy another car soon after bankruptcy. These fears may cause the debtor to overvalue retention, leading her to agree to pay too much, that is, more than replacement cost or more than she can afford.

Professor Barry Adler and his co-authors recently explored the same hypothesis, using slightly different terminology. They agree that typical consumer collateral has two values, value to the debtor (AD) and liquidation value to the market (AM). Whenever AD>AM, both the debtor and society realize a surplus (AD - AM) if the debtor retains the asset. The surplus is lost entirely if the creditor repossesses.[10]

Certainly, retention may be in the debtor's best interest, but only under three conditions: 1) she needs the asset for her fresh-start life; 2) retention will cost no more than she would have to pay to replace the asset, and 3) she can afford the cost to retain. If the debtor does not need the collateral or binds herself to pay too much, retention will frustrate, rather than further, Chapter 7's central goal: the fresh start. The debtor and her family may suffer prolonged financial hardship, and the economy may lose the fresh start's productivity enhancement.[11]

A central goal of Chapter 7 is to grant individuals a fresh start. The fresh start of course helps the debtor and her family, but its impact does not stop there. Relieving the debtor benefits the rest of society by reviving the debtor's incentive to work and participate productively in the economy. An overburdened debtor foreseeing only wage slavery, year upon year of losing most income to prior creditors, has little incentive to work. She and her family may become public charges or even turn to crime. On the other hand, a

10. Adler et al., *supra* note 6.

11. *See id.* at 600; *see also* Local Loan v. Hunt, 292 U.S. 234, 244 (1934); Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1059-63 (1987).

debtor who expects to retain most of her wages will work to earn, and the long-term benefit to society will outweigh the loss to creditors. As Professor Adler and his co-authors have said, "[S]ome observers may find [these benefits] sufficiently compelling to outweigh the virtues of freedom of contract."[12]

Recognizing these dangers, Congress has limited freedom of contract for retention in Chapter 7. However, recent empirical evidence[13] and hearings before the National Bankruptcy Review Commission[14] indicate that Chapter 7's retention provisions do not adequately protect the fresh start.[15] Debtors frequently bind themselves to pay more than they can afford and more than replacement cost.[16] While the Code expects debtor's counsel to protect the debtor in retention negotiations, debtor's counsel are sometimes unwilling and may have too little information to counter their client's wishes and the creditor's leverage. Also, the law on retention in Chapter 7 is not uniform across the nation.[17] More retention tools are available in some circuits than in others.

This Article will argue that retention of collateral by Chapter 7 debtors ought to be facilitated, but only where retention will further the fresh start and yield creditors more than liquidation value. Part I will review Chapter 7's current retention tools, and examine their shortcomings. Part II will discuss provisions of the 2001 House and Senate Bills, which would increase creditor control and raise the price of retention in Chapter 7. Part III will suggest an alternative plan to better protect the fresh start by reducing both the cost and creditor control of retention.

Our focus here is on Chapter 7. Some may argue that debtors who wish to retain assets should do so in Chapter 13. However, helping Chapter 7 debtors retain assets is necessary, despite Chapter

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12. Adler et al., *supra* note 6, at 600.

13. *See* Culhane & White, *supra* note 3, at 709.

14. NATIONAL BANKRUPTCY REVIEW COMMISSION, FINAL REPORT 146-47, 152-55, *available at* http://www.abiworld.org/legis/review/ (last visited Feb. 20, 2002).

15. *See generally* Culhane & White, *supra* note 3 (indicating that abuse of the reaffirmation process threatens two goals of Chapter 7; "the fresh start for honest debtors and equitable treatment for law-abiding creditors").

16. *Id.*

17. *See infra* note 29.

13's wide array of property retention tools. Most Chapter 7 debtors could not repay much unsecured debt in any reasonable time, and so belong in Chapter 7. Empirical evidence suggests that most filers would remain in Chapter 7 even if a mechanical means-test were to be substituted for current Section 707(b).[18] Debtors with too little income to succeed in Chapter 13[19] may still be able to pay a fair price for some needed collateral. Permitting that to happen in Chapter 7, when the debtor has the highest and best use for the property,[20] benefits not only the debtor but also her secured creditors and the economy as a whole.

Further, using asset retention as an incentive to file Chapter 13 has not necessarily resulted in much payment to unsecured creditors, especially when the administrative costs to collect are considered.[21]

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18. *See, e.g.*, Marianne Culhane & Michaela White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 31 (1999) (stating that only 3.6% of a sample of Chapter 7 debtors would have been barred from Chapter 7 by means-testing in 1997's proposed bankruptcy reform legislation). The article cites several other empirical studies by Ernst & Young for VISA. *Id.* These studies found that 15% (later amended to 11%), of a different sample of Chapter 7 debtors would have been barred. *Id.* at 29-30. For a summary and critique of these studies, see GENERAL ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: ANALYSIS OF FOUR REPORTS ON CHAPTER 7 DEBTOR'S ABILITY TO PAY (June 1999).

Professor Jean Braucher, in her Murphy Conference article, suggested that a better and much simpler means-test might be based on the Australian model, which requires debtors to pay unsecured creditors, over a three-year period, a sizeable portion of one year's above-median income. *See* Jean Braucher, *Means Testing Consumer Bankruptcy: The Problem of Means*, 7 FORDHAM J. CORP. & FIN. L. 407 (2002). She also indicated that the Australian experience was that only 3-5% of debtors fell within that requirement. *Id.*

19. While Chapter 13 is a favorite of Congress and some judges, most Chapter 13 debtors fail to finish their plans. *See, e.g.*, NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS, FINAL REPORT 90 (E. Warren, Rep., 1997) [hereinafter NBRC REPORT] (stating that in only 32% of Chapter 13 cases are payments completed); William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection and Consumer Protection in Consumer Bankruptcy*, 68 AM. BANKR. L.J. 397, 410 (1994).

20. *See* Whitford, *The Appropriate Role of Security Interests in Consumer Transactions, supra* note 8, at 963.

21. Figures from the Executive Office for United States Trustees indicate that general unsecured creditors as a group received 18-22% of total Chapter 13 disbursements in 1998-2000. Gordon Bermant & Ed Flynn, *Chapter 13*

The retention incentives too often lead instead to plans where all payments go to secured creditors,[22] or to strategic use by debtors who access Chapter 13 just long enough to cure an arrearage on a house and then dismiss their case. Professor Braucher has wisely said that Chapter 13 might better be left to debtors who really want to pay unsecured debt under court supervision.[23] To that group could be added the minority of debtors with so much disposable income that they are required to pay unsecured creditors as the price of a discharge.

II. CHAPTER 7'S CURRENT RETENTION TOOLS

Current Chapter 7 law and practice offer three routes to retain collateral after discharge: redemption, ride-through and reaffirmation.[24]

Disbursements in Fiscal Year 2000: Steady Growth, 20 AM. BANKR. INST. J. 20, 21 (Nov. 2001). The average total per case paid to general unsecured creditors was $1787 in 1998 and $2182 in 2000. *Id.*; *see also,* Scott Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13,* 7 AM. BANKR. L. REV. 415, 418 (1999). "In half of the cases . . . the debtors paid only slightly more than the Chapter 13 filing fee in unsecured debt. . . . [U]nsecured creditors in more than 75% of the cases collected less than the typical . . . debtor's attorney fee." *Id.* at 418. Professor Norberg's study cited above was limited to a single federal judicial district. He is currently working on an ambitious multi-district study of Chapter 13.

22. *See, e.g., In re* Greer, 60 B.R. 547, 554 (Bankr. C.D. Cal. 1986) (confirming Chapter 13 plan that pays nothing to unsecured creditors).

23. Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means-Testing as a Distraction and the National Bankruptcy Review Commission's Report as a Starting Point,* 6 AM. BANKR. INST. L. REV. 1, 22 (1998).

24. One additional route to retention in Chapter 7 is lien avoidance under 11 U.S.C. § 522(f). 11 U.S.C. § 522(f) (2000). That Section allows avoidance of some judicial liens on all collateral and nonpossessory nonpurchase money liens on some types of personal property, if these impair exemptions. *Id.* The Federal Trade Commission regulation making it an unfair trade practice to take a nonpossessory nonpurchase money security interest in certain household goods has somewhat reduced the importance of § 522(f) as a device for avoiding security interests. *See* 16 C.F.R. § 444.2(a)(4) (2001).

A. Redemption

A debtor may redeem under Section 722, freeing up tangible personal property purchased for household use.[25] Redemption currently requires a lump-sum payment of the value of the collateral or unpaid balance of the debt; whichever is less, within forty-five days after the first meeting of creditors.[26] The creditor has no veto power here; it may only challenge the valuation. On the other hand, since payment is certain, quick, and equal to expected liquidation value, the creditor should be indifferent.

Of course, that same quick lump-sum payment requirement means the Chapter 7 debtor may not be able to redeem a car or any other big-ticket items. She probably could not raise so much cash so soon. Our reaffirmation study confirmed that while the sample debtors proposed on their Statements of Intention to retain 79% of their encumbered cars, only 4% planned to do so by redemption.[27]

B. Ride-Through

If lump-sum redemption will not work for a debtor, she might look into ride-through,[28] a judicially developed route to retention. In four circuits, debtors who are current in payments and not otherwise in default have a right to retain a house, car or other collateral by continuing to make payments and otherwise fulfilling their original contract.[29] The lien will not be released until the debtor has paid the

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25. 11 U.S.C. § 722.

26. *See id.* §§ 521(2)(B) & 722; *see also In re* Edwards, 901 F.2d 1383 (7th Cir. 1990); *In re* Bell, 700 F.2d 1053 (6th Cir. 1983).

We understand that a debtor might be able to finance redemption with a loan from a third party, and then repay that loan in installments. At least in 1995, when the cases in our database were filed, however, that practice was apparently not widespread.

27. *See* Culhane & White, *supra* note 3, at 739 (noting that the debtors proposed on their Statements of Intention to surrender 21% of the cars subject to security interests).

28. *See, e.g.*, Mark R. Campbell & Robert C. Hastie, *Executory Contracts: Retention Without Assumption in Chapter 11 – "Ride-Through" Revisited,* 19 AM. BANKR. INST. J. 33 (2000).

29. For cases holding that debtors who are current have a right to ride-through, that is, retain collateral without reaffirmation or redemption *see In re* Parker, 139

full contract price, but the ride-through debtor does not reinstate personal liability.[30] If the debtor quits making payments, the creditor is limited to retaking the collateral. No deficiency judgment will be allowed.

Except in those four circuits, however, debtors have no clear right to impose ride-through on an unwilling creditor. Nevertheless, some creditors allow it. Home mortgagees, for example, commonly acquiesce in ride-through. Presumably the high value and low mobility of real estate collateral, plus mortgage insurance[31] and state anti-deficiency laws make personal liability disposable to them.[32]

Our research indicates that ride-through by creditor consent may be very common for cars as well.[33] This is more surprising, for

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F.3d 668 (9th Cir. 1998); *In re* Boodrow, 126 F.3d 43 (2d Cir. 1997); *In re* Belanger, 962 F.2d 345 (4th Cir. 1992); *In re* Lowry Federal Credit Union, 882 F.2d 1543 (10th Cir. 1989). Four other circuits hold that debtors have no right to ride-through without creditor permission. *See In re* Burr, 160 F.3d 843 (1st Cir. 1998); *see also In re* Johnson, 89 F.3d 249 (5th Cir. 1996); *In re* Taylor, 3 F.3d 1512 (11th Cir. 1993); *In re* Edwards, 901 F.2d 1383 (7th Cir. 1990).

30. *In re* Edwards, 901 F.2d 1383.

31. The importance of mortgage insurance was emphasized in the NBRC Report stating, "[m]ortgage insurance, not deficiency liability, furnishes security for secondary market investors in shaky home mortgage markets." John Mixon & Ira B. Shepard, *Antideficiency Relief for Foreclosed Homeowners: USLIA Section 511(b)*, 27 WAKE FOREST L. REV. 455, 462 (1992), NBRC REPORT, *supra* note 19, at 243 n.627 (citing John Micon & Ira Shepar's article).

32. In our sample, debtors proposed to surrender or the stay was lifted on 25% of the encumbered homes (including mobile homes). Culhane & White, *supra* note 3, at 744-48. Reaffirmation agreements were actually filed for less than 15% of the homes, which leaves 60% as possible ride-throughs. *Id.* Mobile home lenders apparently sought reaffirmation agreements much more often than other home lenders. *Id.* Reaffirmation agreements were filed on only 6% of non-mobile homes, but were filed on 31% of mobile homes. *Id.*

33. *Id.* at 739-40. Our sample debtors proposed on their Statements of Intention to surrender 21% of the encumbered cars, and to retain the rest, almost always by reaffirmation. However, reaffirmation agreements were filed on only 21% of the vehicles. If another 3 or 4% were redeemed, that leaves 55% of the cars as possible ride-throughs. *Id.*

Certainly, creditors may have waited until after discharge to repossess in some of these cases, but it seems unlikely that they took that route for all or even most of the cars the debtors wanted to retain and pay for. It is also unclear whether auto lenders in 1995 openly allowed ride-through or required debtors to sign reaffirmation agreements, which the lenders failed to file with the court, as required

anti-deficiency laws usually do not cover cars,[34] and the high mobility and rapid depreciation of vehicles might lead a lender to value personal liability.

C. Reaffirmation

Ride-through is not available to debtors who are in default or who live in the wrong circuit[35] and have a creditor who objects. As we have seen, redemption will often be useless as well.[36] For many debtors, that leaves reaffirmation as the only route to retention. Reaffirmation under Section 524(c) means making a new contract on whatever terms the creditor imposes, for reaffirmation requires the creditor's agreement.[37] Creditors can and often do hold out for more than the original contract price.[38] Unlike redemption or ride-through, the reaffirmation agreement renews the debtor's personal liability as well, so she faces not only repossession but also judgment and wage garnishment if she cannot make the promised payments.

Due to the unequal bargaining power among the parties, there is a real danger the debtor will agree to pay too much. In a desperate attempt to keep the car, she may rush into a burdensome contract. Experience under the Act of 1898[39] showed that creditors aggressively pursued debtors for reaffirmations, and debtors all too

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by Bankruptcy Code § 524(c). In either case, the debtor's personal liability would not have been reinstated, so the debtors were *de facto* riding through.

34. *See, e.g.*, CAL. CIV. PROC. CODE § 580b (2001) (providing that anti-deficiency law applies only to loans secured by real property or a mix of real and personal property).

35. *See supra* note 29 and accompanying text.

36. *See* Culhane & White, *supra* note 3, at 739.

37. 11 U.S.C. § 524(c) (2000).

38. Creditors add attorneys' fees and other costs to reaffirmation agreements. *See, e.g., In re* Pendlebury, 94 B.R. 120 (Bankr. E.D. Pa. 1988). The recent case of *In re Jamo* is a more extreme example. *In re* Jamo, 262 B.R. 159 (B.A.P. 1st Cir. 2001). The First Circuit did not recognize a right to ride through, so the debtors told their creditor they wanted to reaffirm their home mortgage. *Id.* The creditor said it would not agree unless the debtors also reaffirmed $24,000 of unsecured debt, and repeatedly threatened foreclosure. *Id.* The First Circuit's Bankruptcy Appellate Panel found that holding the house hostage for reaffirmation of the unsecured debt violated the automatic stay. *Id.*

39. Bankruptcy Act of 1898, 30 Stat. 544 (1898).

often reaffirmed beyond their ability to repay, nullifying the fresh start.[40]

Congress recognized that danger in the Bankruptcy Code, and set limits on reaffirmation. The agreement must be in writing, made before discharge, and filed with the court.[41] The writing must disclose the debtor's right to rescind, which lasts until the later of discharge or sixty days after the agreement is filed with the court.[42] The time limits and filing requirement are intended to help the debtor's lawyer and the court protect the debtor from the creditor's leverage. The Code makes debtor's counsel the gatekeeper of reaffirmation, rather than a mere adviser to the client. Counsel are to review each reaffirmation, and then approve and certify only those agreements that do "not impose an undue hardship on the debtor or a dependent of the debtor."[43] If the debtor is *pro se*, the court is to take on this role, approving reaffirmations only if they meet the undue hardship standard and are "in the best interest of the debtor."[44] If counsel or the court refuses to approve, the reaffirmation agreement is not legally binding.[45]

Despite these limits, debtors sign and counsel approve many ill-advised reaffirmations. First, the empirical evidence is that debtors often bind themselves to pay more than they can afford. The median net income of debtors who reaffirmed one or more debts was only $19,740.[46] Even if we exclude both housing reaffirmations and interest costs, these debtors still reaffirmed an average of $4670, or 24% of their net income.[47] Worse still, the income and expense schedules showed that more than half of these debtors had no money left or even a monthly deficit after non-housing reaffirmation

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40. *See* 1973 REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Rep. No. 95-595, at 116; *see also* DAVID STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEMS, PROCESS, REFORM 61-62 (Brookings Institute 1971).

41. 11 U.S.C. §§ 524(c)(1) & (3).

42. *Id.* § 524(c).

43. *Id.* § 524(c)(6)(A)(i).

44. *Id.* § 524(c)(6)(A)(ii).

45. *Id.* §§ 524(c)(3) & (6).

46. Culhane & White, *supra* note 3, at 762.

47. *Id.* at 754.

payments.[48]

Nevertheless, counsel approved 97% of the reaffirmations in the case files.[49] Perhaps counsel believed that running a deficit is less of a hardship than losing a car or mobile home, and thus is not "undue." Several recent decisions provide support for such thinking and hold that where the reaffirmation is before the court for a determination of whether it poses an undue hardship *and is in the best interests* of the debtor, the analysis is not solely a function of a debtor's income and expenses.[50] Perhaps reaffirmation is the lesser of two evils. However, unless the figures mislead (which they may) or income has increased, most of these debtors will soon miss payments and lose the asset, if it is worth repossessing, or have to forego food and rent payments to cover reaffirmation costs.

If the payment does not immediately bust the budget, it may still burden the fresh start. Debtors sign and counsel approve reaffirmations at very high interest rates with amortization periods longer than the likely useful life of the collateral.[51] For example, one sample debtor agreed to make seventy-four more monthly payments on a four-year old car, while another committed to fifty-four more payments on a five-year old car.[52] With interest at 19.65%, finance charges would add $6,700 to the $13,000 principal.[53] A debtor will

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48. *Id.* at 760.

49. *Id.* at 759.

50. *See* BankBoston, N.A. v. Nanton, 239 B.R. 419, 425-26 (D. Mass. 1999). In *Nanton* the district court held that the debtor's Schedules I and J (showing a monthly deficit) raised only a *prima facie* concern about her ability to pay.

While the standards of "undue hardship" and "best interest" may involve an evaluation of debtor's ability to pay, they may possibly implicate several other factors, including 1) what alternatives, other than reaffirmation, are available to a debtor who wishes to retain an interest in property, 2) whether the underlying debt is secured or unsecured, 3) if the debt is secured, the threat of repossession of and the amount of equity in the collateral, and the extent to which the collateral is a necessity to the Debtor, see *Melendez*, 224 B.R. at 259 n.9 & 260, and 4) the debtor's payment history on the collateral. *Nanton*, 239 B.R. at 425-26; *accord, In re* Claflin, 249 B.R. 840, 847 (B.A.P. 1st Cir. 2000); *In re* Strong, 232 B.R. 921, 924 (Bankr. E.D. Tenn. 1999).

51. Culhane & White, *supra* note 3, at 757-58.

52. *Id.* at 756-57.

53. The NBRC Report cited an even more egregious example: "The agreement committed (the debtors) to repay a loan on a pickup truck that cost $18,027 . . . over

have a hard time replacing her car if she still owes thousands of dollars of reaffirmation payments on it when it foreseeably wears out.

Apparently debtors and counsel too often look only for an "easy monthly payment," ignoring the total financial burden. One reason the total financial burden may be ignored is that the Truth-in-Lending Act's standardized disclosure rules do not apply to reaffirmation agreements.[54] Many of the agreements sampled did not disclose amortization period, total finance charges or total cost.[55] When the debtor and her counsel do not even know how much she binds herself to pay, it is easy to over commit.

Another indication that the fresh start is not well protected by the current Code is the high number of reaffirmations of debt that for all practical purposes is unsecured.[56] The most common use of reaffirmation in our sample was not to retain a home or car, but rather to bind the debtor to repay a retailer's claim secured by household goods.[57] To be sure, some household goods, such as artwork, antiques, jewelry, major appliances, and electronics, may be worth repossessing if a debtor does not pay to retain them. Very often, however, household goods are of low initial value, depreciate quickly, and because they are kept inside a home, must be retaken by replevin rather than less expensive self-help. In essence, the goods have little or no net liquidation value, and generally would not be repossessed. Reaffirmation of this household goods debt, usually at

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fifteen years. With compounded interest, the debtors would pay a total of $42,861.84. [When asked about] the length of the payout, the [debtor's] attorney admitted overlooking that fact." *Id.* at 756 (quoting NBRC REPORT, *supra* note 19, at 155).

54. *See* 15 U.S.C. § 1601, *et seq.* (2000). Regulation Z exempts changes in credit terms that are due to "an agreement involving a court proceeding." 12 C.F.R. § 226.20(a)(3) (2001). Federal Reserve Staff Interpretations extend this exemption to reaffirmation agreements. Truth in Lending, 46 F.R. 50288 (Oct. 9, 1981) (to be codified at 12 C.F.R. pt. 226).

55. Culhane & White, *supra* note 3, at 754.

56. *Id.* at 764.

57. Almost half to all the reaffirmation agreements in our sample were for household goods; they exceeded in number the combined total for homes and cars. *Id.* The average principal amount for household goods reaffirmations is $1060. *Id.* The interest rates on these averaged 19%, with often undisclosed six to eight-year payout periods. *Id.* at 748-51.

interest rates equal to those for completely unsecured debt, may not be in the debtor's interest or even necessary for retention.

Retailers actively solicit reaffirmation of such debts using offers of post-bankruptcy credit as a lure in addition, often, to deceptive threats of repossession.[58] The effective cost of a few hundred dollars of new credit, purchased at the cost of reaffirming a thousand dollars or more of such nominally secured debt, is extremely high. Post-bankruptcy credit would likely be available to the debtor on much more favorable terms from other sources. But debtors may not believe this and counsel too often approve such unfavorable deals.

Another problem is the willingness of some creditors to evade the oversight required by the Code. Some creditors approach even represented debtors directly, through the mail or just before or after § 341 meetings,[59] getting debtors to sign reaffirmation agreements that the creditor neither files with the court nor discloses to debtor's counsel.[60] While these rogue reaffirmations are not legally enforceable, the debtor may believe she is bound and try to pay. Sears and other national retailers[61] admitted in 1997 and 1998 to failing to file tens of thousands of reaffirmation agreements with the courts.[62] The NBRC's investigation of unfiled reaffirmations led

58. For discussion of Sears' reaffirmation practices, including offers of new credit and deceptive threats of repossession, *see In re* Melendez, 224 B.R. 252, 265-66 (Bankr. D. Mass. 1998) [hereinafter *Melendez I*].

59. 11 U.S.C. § 341. A § 341 meeting is a meeting of creditors convened by the United States trustee that the court may not attend. *Id.* Prior to the conclusion of a § 341 meeting, the debtor must be questioned to determine that the debtor understands the implications of filing for bankruptcy, including the consequences of reaffirmation. *Id.*

60. Culhane & White, *supra* note 3, at 717.

61. Some other major consumer creditors which admitted failing to file reaffirmation agreements with bankruptcy courts are GE Credit (parent of Montgomery Ward), May Department Stores, Federated Department Stores and Discover Card. *See* John Roddy, *Remedies for Systematic Violations of the Bankruptcy Discharge*, 2 CONSUMER FIN. SERVICES LITIG. 801, 803 (1999).

62. Sears entered into multimillion-dollar settlements of class action suits and paid a criminal fine of $60 million to the U.S. Justice Department. Other retailers entered consent decrees with the Federal Trade Commission. For more on these stories, see Barnaby J. Feder, *The Harder Side of Sears*, N.Y. TIMES, July 20, 1997 at Sec. 3 p. 1; *see also Briefly: Retailing Sears in New Battle Over Debt Collection*, L.A. TIMES, June 12, 1999; John Roddy, *Flawed Judgment: The Risks of Collecting Discharged Debt*, *in* 1997 CONSUMER FINANCIAL SERVICES LITIGATION 631-32 (PLI

them to believe that only half of the reaffirmation agreements debtors signed and believed themselves bound by were ever filed with the courts.[63]

Professional responsibility may demand,[64] and the current Code seems to assume,[65] that debtor's counsel can and will actively negotiate with the creditor on price and other terms, then stand firm against both creditor and client and refuse to approve when the cost is too high. Ideally, counsel would also be fully acquainted with retail replacement costs and sources of post-bankruptcy credit, good at amortization math, and familiar from beginning to end of each case with the client's income and expenses.[66] Finally, counsel should be

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Corp. Law and Practice Course Handbook, Series No. B7-7188, 1997); *Melendez I*, 224 B.R. at 261-64.

63. NBRC REPORT, *supra* note 19, at 163.

64. A number of courts assert the power to override approval of reaffirmations by debtor's counsel. *See* BankBoston N.A. v. Nanton, 239 B.R. 419 (D. Mass. 1999) (listing cases on both sides of the issue); *see also In re* Vargas, 257 B.R. 157 (Bankr. D. N.J. 2001); *In re* Collins, 243 B.R. 217 (Bankr. D. Conn. 2000); *In re* Melendez, 235 B.R. 173 (Bankr. D. Mass. 1999) [hereinafter "*Melendez II*"]; *In re* Lindley, 216 B.R. 811 (Bankr. N.D. Ill. 1998); *Melendez I*, 224 B.R. 252 (Bankr. D. Mass 1998); *In re* Turner, 208 B.R. 434 (Bankr. C.D. Ill. 1997); *In re* Bruzzese, 214 B.R. 444 (Bankr. E.D.N.Y. 1997); *In re* Hovestadt, 193 B.R. 382 (Bankr. D. Mass. 1996).

These courts locate the source of their authority to review such reaffirmations and monitor debtors' attorneys' compliance with Section 524(c) in Section 105 and Bankruptcy Rule of Procedure 9011. *See, e.g., In re Vargas*, 257 B.R. at 165-66; *Melendez II*, 235 B.R. at 188-190; *Melendez I*, 224 B.R. at 259-60; *In re Bruzzese*, 214 B.R. at 450; *In re Hovestadt*, 193 B.R. at 386. Review is authorized under Section 105 because it allows the court to make any determination and take any action to ensure compliance with the Code, including the statutory predicates to a valid reaffirmation under Section 524(c). Moreover, Bankruptcy Rule 9011 (making FED. R. CIV. P. 11 applicable to bankruptcy proceedings) authorizes review of such agreements in order to monitor the conduct of the debtors' attorneys who may file pleadings or other papers with the court without an adequate factual foundation. *Id.*

65. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 455, 98 Stat. 333, 354, 376 (amending 11 U.S.C. §§ 524(c) & (d) (2000)).

66. In *Melendez II*, 235 B.R. at 203, the Court summarized the minimum obligations of debtor's counsel before certifying that the debtor has been fully informed of the legal effect and consequences of a reaffirmation agreement and any default thereunder as follows:

At a minimum, debtor's counsel must:

able to teach debtors how to budget and plan for the future.[67]

Some counsel fulfill all this and more, but too many do not, and the economics of the practice make it unlikely that they will soon reach the desired level. First, attorney fees for Chapter 7 cases are usually low; often well below $1000. If the attorney is a bankruptcy specialist, the practice may depend on high volume, which necessarily limits time spent on any one case. Active negotiation, with offers and counteroffers, happens too seldom. Second, the debtor may fear repossession and inability to replace collateral, leading her to insist on reaffirmation. The attorney may be unable to quell those fears, and so acquiesces.[68] Third, some creditors use groundless threats of

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(2) review the security agreement, charge slips, payment history and other documentation constituting the security interest claimed by the creditor in order to verify the amount of the creditor's claim, the validity, extent and perfection of the alleged security interest and the non-avoidability of the alleged lien under the Bankruptcy Code;

(3) question the value placed on the goods by the secured creditor and independently estimate that value;

(4) evaluate the risk of replevy by the creditor, in light of the age, condition and value of the goods versus the need of and cost to the debtor to retain the items at risk; and demand a replevy decision from the secured creditor prior to execution of the reaffirmation agreement;

(5) discuss relevant financial disclosures with the debtor;

(6) ensure that the agreement was entered into voluntarily and without creditor misrepresentations or coercion;

(7) ensure that the debtor understands the effect and consequences of the agreement and the consequences of default;

(8) ensure that the debtor is informed as to his or her options with respect to the collateral under the Bankruptcy Code; and

(9) advise the debtor as to alternative sources of credit.

Melendez II, 235 B.R. at 203; *accord, see, e.g., In re Vargas*, 257 B.R. at 165-66; *In re Bruzzese*, 214 B.R. at 452-55; *In re Hovestadt*, 193 B.R. at 386-87.

67. Jean Braucher has examined in detail what truly competent representation of Chapter 7 and 13 debtors requires. Her empirical work, however, indicates that level of representation is too seldom reached. *See* Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices - A Question of Professional Responsibility*, 5 AM. BANKR. L. REV. 165, 174, 179-85 (1997).

68. Sears, for example, used to send each of its debtors a form reaffirmation agreement that recited that the debtor wanted to reaffirm to settle discharge litigation. *In re* Iappini, 192 B.R. 8 (Bankr. D. Mass. 1995). In the vast majority of such cases, the creditor had no grounds or intention to file a complaint for exception to discharge. *Id.* Judge Hillman held that this language was "designed to entice the Debtors to reaffirm an obligation and . . . [was] without good cause and hence . . .

discharge litigation to induce reaffirmation. While the debtor may have a good defense, the costs of defending an adversary proceeding are not usually included in the ordinary Chapter 7 attorney fee. The prospects of having to pay for discovery and other defense costs, and of possibly losing anyhow, are powerful incentives to settle by reaffirmation.[69]

In sum, while a debtor's retention of collateral is usually good for her secured creditors, retention too often comes at the expense of the debtor's fresh start. Redemption and ride-through are unavailable to many debtors, and the creditor's control of reaffirmation often leads debtors and their counsel to agree to unreasonably high prices. This may lead to prolonged financial problems for the debtor and her family, and perhaps repeated bankruptcy filings.

III. RETENTION IN THE HOUSE AND SENATE BILLS

The House and Senate Bills[70] (the "Bills") propose some changes to retention that generally increase creditor control of the process, but also increase judicial oversight.

A. Redemption

While the Bills keep the lump-sum payment requirement for Chapter 7 redemption, they would make redemption even less affordable by raising the redemption price. Amending § 506's definition of allowed secured claim would do this.[71] For Chapter 7 and 13 cases filed by individual debtors, personal property intended for household use is to be valued at full retail replacement cost for goods of like age and condition, without deduction for costs of sale or

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made in bad faith." *Id.* He ordered Sears not to use that form for any future reaffirmations in his court. *Id.*

69. *See* NBRC REPORT, *supra* note 19, at 173.

70. All references to the "Bills" are to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, as passed by the House of Representatives on March 1, 2001 and to S. 420, as passed by the Senate on March 15, 2001.

71. 11 U.S.C. § 506 (2000).

marketing.[72] This is a higher measure of value than the Supreme Court imposed in *Associates Commercial Corp. v. Rash* for installment redemption in Chapter 13,[73] and substantially higher than the liquidation value many courts continue to use post-*Rash* for redemption under Section 722.[74] Raising the price to redeem, while retaining the lump-sum payment rule, would put redemption under Section 722 even further out of reach for much collateral.

The Bills' redemption provisions also violate a central premise of the collective process in bankruptcy whereby creditors who are similarly situated are to be treated similarly. To the extent that full retail replacement value exceeds the liquidation value of the collateral, such creditors would receive greater dividends on the unsecured component of their claims than other unsecured creditors.

B. Ride-Through

The Bills would overrule the four circuits that recognize a debtor's right to retain collateral without redemption or

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72. *See* § 327 of H.R. 333 *and* § 326 of S. 420, amending 11 U.S.C. § 506 by adding new subsection (a)(2), which would provide:

> (a)(2) In the case of an individual debtor under chapters 7 and 13, such value with respect to personal property securing an allowed secured claim shall be determined based on the replacement value of such property as of the date of filing the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family or household purpose, replacement value shall mean the price a retail merchant would charge for property of that kind, considering the age and condition of the property at the time value is determined.

73. Assoc. Commercial Corp. v. Rash, 520 U.S. 953 (1997). The proposed retail replacement standard will result in higher prices than *Rash* would require, because the Supreme Court, in *Rash*'s famous footnote 6, suggested that retail might not always be the valuation standard, and that even where retail was the appropriate standard, deductions should be made for warranties and other services that the retaining debtor would not receive. *Id.* at 965 n.6.

74. Many courts continue to value collateral for redemption under 11 U.S.C. § 722 at liquidation value, on the ground that a lump sum payment protects the creditor from both the risks of debtor's default on the agreement and of deterioration of the collateral. Installment redemption in Chapter 13, which was before the Court in *Rash*, imposes both these risks on the creditor. *See, e.g., In re* Donley, 217 B.R. 1004 (Bankr. S.D. Ohio 1998); *In re* Dunbar, 234 B.R. 895 (Bankr. E.D. Tenn. 1999); *In re* Henderson, 235 B.R. 425 (Bankr. C.D. Ill. 1999).

reaffirmation,[75] allowing ride-through only by creditor permission.[76] That would provide a nationally uniform rule, unlike the present division of the circuits, but would also increase creditor control of the retention process. Debtors could no longer ride-through over a creditor's objection.

The Bills assume that some home mortgagees, however, may continue to permit ride-through. To protect these creditors from charges of violating the discharge injunction, the Bills authorize creditors with mortgages on "real estate that is the principal residence of the debtor" to send bills and other ordinary course communications to non-reaffirming debtors after discharge, if the intent is to seek payments.[77] The Bills make no similar exception for post-discharge contacts with ride-through debtors for other types of collateral.

C. Reaffirmation

Raising the redemption price and letting creditors control ride-through means even more debtors would have to reaffirm to retain their assets. The Bills would leave most of the current reaffirmation requirements in place, but add new paperwork and judicial scrutiny.[78] Debtor's counsel would still be gatekeepers, with the court acting for unrepresented debtors.

Among the changes are requirements that the creditor give a reaffirming debtor a lengthy disclosure statement, which would include 1) the Annual Percentage Rate ("APR") and the Amount Reaffirmed, 2) a list of the items of collateral and their original purchase prices, and 3) brief statements of legal advice on reaffirmation procedure and legal effect, in a Frequently Asked Questions format.

While standardized disclosure of the APR is an improvement,

75. *See supra* note 29 and accompanying text.

76. *See* §§ 304-05 of H.R. 333 and S. 420, amending 11 U.S.C. §§ 352 & 362.

77. *See* §§ 202 of H.R. 333 and S. 420, amending 11 U.S.C. § 524. Judge Sam Bufford recently considered how secured creditors might deal with ride-through debtors without violating either the automatic stay or the discharge injunction. *See In re* Henry, 266 B.R. 457 (Bankr. C.D. Cal. 2001).

78. *See supra* note 70.

the Bills do not make the Truth-in-Lending Act[79] ("TIL") applicable to reaffirmations. TIL's definition of Annual Percentage Rate ("APR") is simply imported into the Code.[80] Unfortunately, the APR and the Amount Reaffirmed are the only required disclosures;[81] there is no requirement to disclose total finance charges or even the number of payments. Those details are left to the original credit agreement, which need not be attached. Thus, the total financial burden is not revealed.

A more important innovation of the Bills is the requirement that the debtor fill out an updated income and expense statement at the time of reaffirmation. If that updated budget shows too little money for reaffirmation payments, the reaffirmation would be rebuttably presumed an undue hardship, unless the creditor is a credit union,[82] for sixty days after the agreement is filed with the Court. The debtor could attempt to rebut the presumption by submitting a written statement "identifying additional sources of funds to make the [reaffirmation] payments."[83] The Bankruptcy Court would review these presumptively undue hardship reaffirmations, even if the debtor's counsel had certified that the debtor would be able to make the payments. If the Court failed to disapprove the reaffirmation within sixty days, it would presumably become fully effective. The Bills would allow the Court to disapprove a reaffirmation if the presumption is not satisfactorily rebutted, but only upon notice and hearing to debtor and creditor, and the hearing must be held before discharge.

All other reaffirmations approved by debtor's counsel become effective as soon as they are filed with the Court. The Bankruptcy

79. 15 U.S.C. § 1601 (2000).

80. *Id.*

81. The Bills also provide that even if the disclosures are incorrect, the reaffirmation will be enforceable if the disclosures were made in good faith. *See* §§ 203 of H.R. 333 and S. 420, amending 11 U.S.C. § 524(c), by adding new subsection (l)(3).

82. The undue hardship provisions would not apply when the creditor is a credit union. A reaffirmation between a credit union and a represented debtor would become effective as soon as it is signed by the parties, certified by debtor's counsel and filed with the court. *See* §§ 203 of H.R. 333 and S. 420, adding new subsection (m) to Code § 524.

83. *Id.*

Court would apparently have no power to review and disapprove reaffirmations that debtor's counsel approves, except where the undue hardship presumption applies.

Additional judicial attention to reaffirmation's impact on the debtor's budget is a good idea. Giving the judge the final say on reaffirmations that seem to bust the budget would let the Court handle the job that many attorneys find too difficult—saying "No" to a fearful and insistent client. The presumption of undue hardship might even make reaffirmation more affordable in some cases. Rather than wait to find out if a proposed agreement will pass muster, some creditors may reduce the price enough to avoid the presumption in the first place.

There are problems, however. First, the presumption is triggered only by a monthly payment that seems too high. Again, the focus is only on an easy monthly payment, not whether the deal makes overall financial sense. Moreover, the presumption could be avoided in ways that do not reduce the price. For example, the creditor could just reduce the amount and increase the number of monthly payments. With interest, this raises, rather than lowers, total cost.

Second, the delay and extra cost might tempt the debtor and creditor to avoid the presumption by fabricating the figures on the updated budget. If they made the numbers conform, the debtor would never need to write an explanation and the reaffirmation would never go to the judge at all.[84] Maybe debtor's counsel would catch this, but counsel seldom has independent knowledge of the debtor's post-filing financial situation. It might be better to trigger the presumption using Schedules I and J,[85] which are prepared with help from counsel rather than the interested creditor. Then the debtor's written explanation could clarify what had changed since the schedules were filed.

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84. Many of these criticisms of the Bill's reaffirmation provisions were first raised by Bankruptcy Judge Eugene Wedoff of the Northern District of Illinois, in an oral presentation at the April 2001 Annual Meeting of the American Bankruptcy Institute in Washington, D.C. *See, e.g. Inside ABI*, AM. BANKR. INST. J. 32, 32 (Feb. 2001) (providing a summary of the topics Judge Wedoff would address at the annual meeting).

85. BANKRUPTCY CODE, RULES AND OFFICIAL FORMS 960-63 (West Law School Ed. 2001).

Another problem is that the Bills allow creditors to collect payments on a reaffirmation agreement even before it has been filed with the court.[86] Creditors have shown willingness in the past to deal with debtors directly on reaffirmations and then refuse to file them with the court,[87] thus bypassing all required oversight from counsel and Court. The authorization to collect payments on unfiled agreements may only encourage this behavior.

Thus, the House and Senate Bills would increase creditor control of retention in Chapter 7, by raising the price of redemption and eliminating any right to ride-through, so that more debtors would have to seek the creditor's agreement to a reaffirmation. The Bills would counter this additional leverage somewhat by requiring judicial approval of some reaffirmations even if approved by debtor's counsel. These changes would make it harder to retain property in Chapter 7. That would be consistent with the Bills' general aim to make Chapter 7 less attractive, both absolutely and relative to Chapter 13. It is not, however, consistent with facilitating retention in Chapter 7 of property needed for the fresh start.

IV. AN ALTERNATIVE APPROACH

Perhaps the interests of all relevant parties could be protected by making retention in Chapter 7 more predictable and affordable to debtors, rather than less so, and by easing the burden on their counsel by reducing the variables.

This Article began with a discussion of retention's benefits, showing that repossession causes lost value to both debtor and creditor where the debtor has the highest and best use for the collateral and could pay more than liquidation value to the creditor for retention.[88] If retention facilitates the debtor's fresh start, encouraging and enabling her to become and remain a more productive worker, then the benefits extend beyond the immediate parties to the economy as a whole.

Making retention more predictable and affordable in Chapter 7

86. *See* §§ 202 of H.R. 333 and S. 420, adding new subsection (l) to Code § 524.

87. *See supra* notes 61-63 and accompanying text.

88. *See* Whitford, *The Appropriate Role of Security Interests in Consumer Transactions*, *supra* note 8.

will require reducing creditor control of the process, and often, reducing the price and setting other terms by rule rather than negotiation. The suggestions below are not new, although they may not have appeared in this particular constellation before.

A. Ride-Through

First, as recommended by the NBRC, ride-through should be made a matter of right, at least for debts secured by the debtor's principal residence.[89] This would continue the prevailing pattern in the home mortgage arena, and would assure debtors who were current on home mortgage payments that they could retain their homes for no more than the original contract price. Debtors who were current at time of filing can probably afford post-petition payments as well. Barring loss of job, the debtor should be even more able to do so after the discharge eliminated many other claims on her income.

Whether the right should extend to more mobile and more depreciable collateral, and include cure of defaults are closer questions. As noted earlier, our reaffirmation study indicated that many motor vehicle lenders permitted ride-through even where the law of the circuit did not require it.[90] In any event, creditors could, and probably would, permit ride-through for other debtors and other collateral, especially when that afforded them a decent opportunity at to collect more than other retention methods might yield. Further, ride-through may stay attractive to debtors for even though the debtor has to pay the whole unpaid balance to release the lien by ride-through, she need not reinstate personal liability. If the payments become too burdensome, she risks at most loss of the collateral, but not a deficiency judgment.

B. Redemption

A second change is one that Professors Jean Braucher and

89. *See* NBRC REPORT, *supra* note 19, at 165-68.

90. *See supra* note 29 and accompanying text. *See generally* Culhane & White, *supra* note 3.

William Whitford have long urged: let Chapter 7 debtors, like their Chapter 13 counterparts, redeem by installments.[91] Giving the debtor the right to redeem over time would greatly increase redemption's usefulness. Setting the redemption price, interest rate, and maximum term by statute would let debtors and their counsel know in advance of filing whether the debtor could afford to retain her assets, and should make it easier to avoid unduly burdensome deals.

The payout period should be capped, perhaps at five years for motor vehicles and mobile homes, and three years for other items. Redemption's price should also be capped at the lesser of the unpaid balance or the value of the collateral, plus interest. An appropriate measure of personal property collateral value for redemption purposes would be wholesale replacement cost, as the NBRC recommended.[92] To avoid undue incentives to file, it might be best to except from that rule motor vehicles and mobile homes purchased within a year before filing. No strip down would be allowed there.

Wholesale replacement cost is higher than liquidation value,[93] but is less than or equal to the debtor's replacement cost. Wholesale price lists are widely available for used motor vehicles and some other major consumer collateral. Thus, this pricing measure is more predictable and less fact-intensive than *Rash's* version of replacement cost,[94] and more affordable than the full retail replacement rule in the proposed legislation. It is important to have predictable pricing and

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91. *See* Braucher, *Increasing Uniformity, supra* note 14, at 23; *see also*, William Whitford, *Has the Time Come to Repeal Chapter 13?*, 65 IND. L.J. 85 (1989). While Professors Jean Braucher and William Whitford both have advocated allowing installment redemption in Chapter 7, neither necessarily subscribes to the details set out here.

92. The NBRC did not recommend installment redemption in Chapter 7. *See* NBRC REPORT, *supra* note 19, at 243-56. However, the NBRC recommended capping the reaffirmation price at wholesale replacement cost for personal property and at fair market value, less hypothetical costs of sale, for real property. *Id.* The NBRC would also have amended § 506 to require these measures of collateral value for all purposes in individual Chapter 7 and 13 cases. *Id.*

93. Even though creditors often dispose of repossessed collateral by wholesaling it, wholesale replacement cost exceeds liquidation value. Wholesale replacement cost is the cost to purchase in the wholesale market. The repossessing creditor does not net that much, since it has to take into account the costs of retaking and reselling the collateral.

94. *See supra* note 73.

not encourage litigation where the debtor cannot afford discovery and other expenses.

Installment redemption should require the debtor to reinstate personal liability for the redemption price. This would be less onerous than redemption in Chapter 13, where the debtor must give up all disposable income for three years and retain personal liability on all claims until the entire plan is finished. Since Chapter 7 debtors would not need to pay a trustee or unsecured creditors while redeeming, they would be more likely to complete redemption payments.

Creditors would be protected in several ways. First, there is the partial renewal of personal liability. Second, any insurance required under the original contract would have to be maintained. Third, the redemption price should be fully amortized, without balloon payments, over the chosen term. Fourth, since the automatic stay ends quickly in Chapter 7, repossession could be attempted more quickly than in Chapter 13, if the debtor failed to pay.

While wholesale replacement cost would often allow retention for less than the unpaid balance, and less than the reaffirmation prices common under current law, the debtor would still need protection from improvident actions. Approval from counsel or the Court should be required on the undue hardship and best interests standards currently in use, and something like the presumption of undue hardship procedure in the House and Senate bills might be added.

Use of wholesale prices, a maximum term, and a predictable interest rate, however, would ease counsel's and the Court's burden of assessing total cost. A further aid to that assessment would be additional disclosure of the true costs of the credit. There maybe little hope that more disclosure alone would deter desperate debtors. However, it should help debtor's counsel and the Court determine whether the debtor can bear the retention cost, as well as whether it exceeds replacement cost. For these reasons, requiring more disclosure in retention agreements is preferable.

In the cases where redemption would exceed the budget or otherwise threaten the fresh start, these rules should make it easier for counsel and Court to say "No." The limited term should also reduce the danger that the debtor would still owe years of payments on a car or washing machine when the asset's useful life ends.

Finally, installment redemption at wholesale replacement cost should limit the leverage value of security interests in low-value household goods.

C. Residual Reaffirmation

Ride-through and redemption, as outlined above, should cover all retention of collateral cases. However, there may be some situations where reaffirmation of an unsecured claim would be in the debtor's best interests. For example, a creditor may have a well-founded claim for exception to discharge, but offer to settle for less than defense costs and the likely judgment. If debtor's counsel and the Court are convinced that the creditor has a good chance of success and the will to pursue the complaint, reaffirmation on reasonable terms might be allowed. A second instance might be where the debtor wants to reaffirm to protect a cosigner.[95] In most cases, however, voluntary payment without reinstatement of personal liability is the most appropriate method of handling those unsecured debts that the debtor is willing to pay.

D. Restore Judicial Supervision

A third recommendation is that Congress restore, with some modification, the role the Bankruptcy Court originally played when debtors wanted to take on personal liability for prepetition debt. Under the 1978 Code,[96] the Court, not the debtor's counsel, assessed whether such agreements posed an undue hardship and were in the best interest of the debtor and the debtor's dependents. This procedure implicitly recognized that these questions raise factual, legal and policy issues most appropriately decided by an impartial judicial officer rather than by the debtor's advocate and counselor. Moreover, the 1978 Code appropriately placed the burden of implementing society's interest in the fresh start policy - sometimes over the protests of a particular debtor - on the shoulders of the

95. In our empirical study, we were surprised to find that debtors did not reaffirm a greater percentage of cosigned debts than those without a cosigner. *See* Culhane & White, *supra* note 3, at 735-36.

96. 11 U.S.C. §§ 101 *et seq.* (revised Nov. 6, 1978).

judiciary rather than the debtor's lawyer.

Debtors' attorneys have not been effective guardians of the fresh start policy.[97] This fact, as well as recent revelations of widespread abuse of the reaffirmation process, has already led many bankruptcy courts to review reaffirmations even if they have the blessing of debtor's counsel.[98] Indeed, one court speculated that the absence of judicial oversight fostered the climate allowing abuse of the reaffirmation process to flourish.[99]

Ordinarily a lawyer is ethically bound to abide by a client's decisions regarding the objectives of the representation and to represent her client zealously in attempting to achieve them.[100]

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97. *See* Culhane & White, *supra* note 3, at 758-63.

98. Among the cases asserting power to override approval of reaffirmations by debtor's counsel are BankBoston N.A. v. Nanton, 239 B.R. 419 (D. Mass. 1999) (listing cases on both sides of the issue); *In re* Vargas, 257 B.R. 157 (Bankr. D.N.J. 2001); *In re* Collins, 243 B.R. 217 (Bankr. D. Conn. 2000); *Melendez II*, 235 B.R. 173 (Bankr. D. Mass. 1999); *In re* Lindley, 216 B.R. 811 (Bankr. N.D. Ill. 1998); *Melendez I*, 224 B.R. 252 (Bankr. D. Mass 1998); *In re* Turner, 208 B.R. 434 (Bankr. C.D. Ill. 1997); *In re* Hovestadt, 193 B.R. 382 (Bankr. D. Mass. 1996). This view is not unanimous. Robert Hessling, in his treatise Reaffirmation and Redemption, states that a majority of courts have recognized a lack of power to approve or disapprove of reaffirmations in these circumstances. ROBERT A. HESSLING, REAFFIRMATION AND REDEMPTION (1994). *In re Pendlebury* is an example of that view:

> Congress' intent that the court rely upon the declaration and affidavit filed by counsel is made manifest under the 1984 amendments by removal of the requirement of court approval except as to reaffirmation agreements entered into by *pro se* debtors. In practice reaffirmation hearings presently serve no useful purpose except for debtors filing *pro se*. Attorneys are rightly charged with the responsibility for advising their clients during the reaffirmation process.

In re Pendlebury, 94 B.R. 120, 124 (Bankr. E.D. Tenn. 1988).

Other cases holding that the Bankruptcy Court has no power to override counsel's approval of a reaffirmation agreement include *In re* Sweet, 954 F.2d 610 (10th Cir. 1992); *In re* Bauer, No. 97-13034-SSM, 1997 WL 752652 (Bankr. E.D. Va. 1997); *In re* French, 185 B.R. 910 (Bankr. M.D. Fla. 1995); *In re* Grinnell, 170 B.R. 495 (Bankr. D.R.I. 1994); *In re* Dabbs, 128 B.R. 307 (Bankr. N.D. Fla. 1991); *In re* Wallace, 102 B.R. 54 (Bankr. E.D.N.C. 1989); *see also* Cox v. Zale Del., 239 F.3d 910 (7th Cir. 2001) (holding that the judge cannot disallow reaffirmations that debtor's counsel approved) (dicta).

99. *In re* Izzo, 197 B.R. 11, 12, n.2 (Bankr. D.R.I. 1996).

100. MODEL RULES OF PROF'L CONDUCT AND RESPONSIBILITY 1.2(a), 1.3 (1983); *see also* MODEL CODE OF PROF'L RESPONSIBILITY 7-101(A)(1); EC 7-76; 7-8

Current procedure casts the debtor's lawyer in an *in loco parentis* relationship with her client.[101] This role is foreign to attorneys accustomed to acting as the client's advocate and counselor. It requires the lawyer to override the client's lawful, but unwise, objective of taking on personal liability for a prepetition debt.

Placing the lawyer in a position adverse to her own client has proved to be ineffective in safeguarding the discharge and in implementing the fresh start policy. Lawyers and bankruptcy judges should be restored to the roles each performs best, those of advocate and adjudicator respectively.

This proposal comes at a price. Judicial oversight and approval, however, need not entail formal courtroom hearings in every case. Use of standardized official forms, together with full disclosure of the credit terms and the debtor's current disposable income, would streamline judicial supervision. In many instances, this information would provide the Court with an adequate basis for making the undue hardship and best interest determinations after only an in-chambers review. Moreover, if the debtor is given the right to redeem collateral in installments, cases requiring more than an in-chambers review may be relatively few because such commitments are likely to be more affordable if the debt is reduced to the wholesale value of the collateral. If, however, this review suggested that taking on personal liability might be improvident, a hearing, though not necessarily one in which the debtor physically appears before the judge, would be held. Telephonic hearings may well be adequate in many cases. Bankruptcy judges should be given latitude to develop local rules of practice setting forth the circumstances in which a courtroom hearing would be required.

V. CONCLUSION

Chapter 7 debtors often need to retain some items of collateral. They should be permitted to do so where they can pay the creditor more than liquidation value without unduly burdening their budgets. Current Chapter 7 retention procedures, however, fail to strike the

(1980).

101. In order for a person to be considered *in loco parentis*, he or she must have intentionally assumed the rights and duties of a parent or guardian.

appropriate balance, and debtors often bind themselves to pay too much. The proposed legislation would not do enough to counter creditor leverage in Chapter 7.

Both debtors and creditors would be better served by recognizing a debtor's right to ride-through on some collateral, allowing installment redemption at predictable cost for other items, and increasing the Court's role in the process. These proposals would facilitate retention of collateral in Chapter 7 with much less danger to the fresh start, and would still return more to secured creditors than they could obtain by repossession. That prevents lost value and is beneficial to all parties.