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Debtor's Dilemma: The Economic Case for Ride-Through in the Bankruptcy Code

ABSTRACT. Following the 2005 amendments to the Bankruptcy Code, a Chapter 7 debtor hoping to retain an encumbered asset such as a motor vehicle after bankruptcy faces at least five options. The Bankruptcy Code allows a debtor to redeem the asset, reaffirm the debt, or convert to a Chapter 13 proceeding. Alternatively, a creditor may simply agree to forbear on its right to repossess collateral, leaving the asset in the debtor's possession. In certain circumstances a bankruptcy court may also impose a binding nonrecourse debt arrangement known colloquially as "backdoor ride-through."

This Note employs an economic framework to show how these retention options fall short of Chapter 7's policy goals: a "fresh start" for debtors, adequately protected interests for secured creditors, and national uniformity of bankruptcy law. After illustrating the shortcomings of the status quo, this Note argues that enacting a statutory ride-through provision—a successor to an option available in five circuit courts of appeals before 2005—would better accord with the principles and policy underlying bankruptcy law.

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INTRODUCTION

On August 11, 2011, Carolyn Denise Bowden filed a Chapter 7 bankruptcy petition in North Carolina.[1] Bowden's Chapter 7 petition allowed her to discharge her unsecured obligations, such as credit card debt. For secured debt, however, Bowden's creditors retained a set of ownership rights with respect to the collateral securing her loans. Bowden owed a loan balance of $4,534 on a 2006 Chevrolet Trailblazer to Ally Financial when she filed for bankruptcy.[2] For Bowden and Ally Financial, the treatment of the outstanding debt on the Trailblazer presented a key procedural inquiry in the bankruptcy process, determining who would retain the vehicle and how retention costs would be allocated.

Bowden was one of nearly one million individuals who filed a Chapter 7 petition in 2011.[3] Chapter 7 bankruptcy filings that year amounted to more than twice the total of all civil and criminal cases filed in federal district courts.[4] In her colossal debtor class, Bowden's vehicle-retention dilemma was commonplace: one study estimated that the average Chapter 7 debtor entered bankruptcy with about $4,890 of secured motor vehicle debt.[5] In total, Bowden and her peers brought collective assets of more than $108 billion and liabilities of $196 billion into bankruptcy proceedings—particularly significant figures considering each debtor earned an average annual income of just over $30,000.[6] In both human and economic terms, the aggregate significance of secured personal debt in consumer bankruptcy is dramatic.

Given the stakes, the recurrent vehicle-retention dilemma seems the sort of modest procedural puzzle for which the Bankruptcy Code ought to have a straightforward solution. Yet the treatment of secured debt in Chapter 7

1. *In re* Bowden, No. 11-06168-8, 2012 WL 589657, at *1 (Bankr. E.D.N.C. Feb. 22, 2012).

2. *Id.*

3. STATISTICS DIV., ADMIN. OFFICE OF U.S. COURTS, 2011 REPORT OF STATISTICS REQUIRED BY THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 16 (2012), http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2011/BAPCPA-report.pdf [hereinafter 2011 BANKRUPTCY STATISTICS].

4. A total of 367,692 cases were filed in federal court in 2011. STATISTICS DIV., ADMIN. OFFICE OF U.S. COURTS, JUDICIAL BUSINESS OF THE UNITED STATES COURTS: 2011 ANNUAL REPORT OF THE DIRECTOR 9 (2012), http://www.uscourts.gov/uscourts/Statistics/JudicialBusiness/2011/JudicialBusiness2011.pdf.

5. Marianne B. Culhane & Michaela M. White, *Debt After Discharge: An Empirical Study of Reaffirmation*, 73 AM. BANKR. L.J. 709, 732, 738 (1999). This figure was calculated by dividing the $5.1 million in total motor vehicle debt by the 1,043 cases in the Culhane and White sample. *Id.*

6. 2011 BANKRUPTCY STATISTICS, *supra* note 3, at 16, 32.

bankruptcy has long proven woefully opaque. Three options have been available to Chapter 7 debtors for decades. Section 521 of the Bankruptcy Code ("the Code") permits Bowden either to surrender the Trailblazer to Ally Financial to satisfy her outstanding debt, redeem the Trailblazer by paying Ally the value of the Trailblazer, or reaffirm the debt by agreeing to a post-bankruptcy repayment schedule and renewing her commitment to pay Ally in full. As this Note describes, each of these options presents significant drawbacks for Bowden and other Chapter 7 debtors.

Beyond the three statutory options lies a prospective fourth, which is the focus of this Note. In addition to redeeming or reaffirming, a debtor may in certain circumstances retain an asset simply by continuing to make regular payments according to the pre-bankruptcy loan schedule, or "ride-through" the asset. Unlike the statutory retention options, ride-through allows a debtor to retain an asset without entering a new repayment agreement, renewing personal liability, or paying the remaining loan balance up front.

This Note distinguishes between three types of ride-through: common law, backdoor, and statutory. Beginning in the 1990s, courts divided over whether the Code allowed a Chapter 7 debtor to retain an asset by *common law ride-through*. By the time Congress reacted in 2005, common law ride-through was recognized in five circuits and rejected in four others.[7] One professor called the circuit split on common law ride-through the "most controversial consumer credit issue arising in cases under the United States Bankruptcy Code."[8]

In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).[9] Courts initially struggled to interpret the amendments but eventually reached the consensus that BAPCPA had eliminated common law ride-through. Ride-through was not entirely defunct, however, because courts construed BAPCPA to prevent a creditor from repossessing collateral as long as the debtor attempted to reaffirm, even if the reaffirmation agreement was later rejected. This opened a new retention option termed *backdoor ride-through*.

Still other retention options exist entirely outside of Chapter 7. In certain cases, a Chapter 7 debtor may retain an asset by reaching an informal agreement through which the creditor promises not to repossess as long as the

7. *See infra* notes 29-30 and accompanying text.

8. Ned W. Waxman, *Redemption or Reaffirmation: The Debtor's Exclusive Means of Retaining Possession of Collateral in Chapter 7*, 56 U. PITT. L. REV. 187, 187 (1994).

9. Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.).

debtor continues regular payments. A debtor may also convert to Chapter 13 bankruptcy, although, as this Note explains, conversion is unlikely following BAPCPA. The complex spectrum of retention options—reaffirmation, redemption, backdoor ride-through, forbearance, and Chapter 13—creates unpredictability, thwarts bankruptcy's vision of uniformity,[10] and fosters bargaining inequities among debtors and secured creditors involved in Chapter 7 proceedings. Moreover, the existing options are inconsistent with the policy goals underlying Chapter 7 bankruptcy.

To resolve the debtor's dilemma, this Note advocates replacing reaffirmation with *statutory ride-through*, which would give Chapter 7 debtors the option to retain an asset by simply electing to continue payments post-bankruptcy. In Bowden's case, statutory ride-through would allow her to elect to retain the Trailblazer without entering a revised repayment agreement or renewing personal liability for the asset. If she failed to make a single payment on the Trailblazer, however, Ally could repossess. This Note argues that statutory ride-through would improve the position of debtors without injuring creditors, compared with the status quo.

Other scholarship has recognized the merit of ride-through. As early as 1997, the National Bankruptcy Review Commission (NBRC) recommended replacing reaffirmation with ride-through, but it later abandoned its position.[11] In 2002, Professor Scott Ehrlich made a similar argument at length, reasoning that ride-through generally benefits both debtors and creditors compared with reaffirmation.[12] More recently, a student note examined the effect of BAPCPA on ride-through and offered policy reasons for why courts should continue to recognize common-law ride-through after BAPCPA.[13] Another note detailed

10. *See infra* notes 120-123 and accompanying text.

11. 1 NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 166 (1997). The Commission originally recommended a ban on reaffirmations because it viewed reaffirmation as inconsistent with the policy goals underlying Chapter 7 bankruptcy. *Id.* After entertaining concerns from interested parties, including creditors who worried that ride-through would lead debtors to damage collateral, the Commission modified its position to endorse "limited reaffirmation rights for certain secured debts." *Id.* at 167. The Commission then abandoned its advocacy for ride-through, reasoning that if limited reaffirmation rights were available, the Code need not "provide an independent right to retain property." *Id.*

12. Scott B. Ehrlich, *The Fourth Option of Section 521(2)(A)—Reaffirmation Agreements and the Chapter 7 Consumer Debtor*, 53 MERCER L. REV. 613 (2002).

13. Christopher M. Hogan, Note, *Will the Ride-Through Ride Again?*, 108 COLUM. L. REV. 882, 922-23 (2008). In 2011, another student note advocated that courts consider the purpose rather than the text of the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) and eliminate ride-through. Allyson MacKenna, Note, *Bankruptcy—Mimsy Were* the development of backdoor ride-through in the Eastern District of North Carolina, offering reasons why the new option is consistent with bankruptcy policy and the Code.[14]

This Note builds on existing scholarship in three principal ways. First, it introduces and applies a simple economic framework to explain the incentives of debtors and creditors during Chapter 7 proceedings, which is critical to measuring the merit of various asset-retention alternatives. Second, it examines the effect of backdoor ride-through from a creditor's perspective, offering reasons why the new option should lead creditors to prefer statutory ride-through to the status quo. The creditor focus has practical importance because creditor coalitions have historically wielded significant lobbying power in Congress on bankruptcy issues. Finally, this Note moves beyond a discussion of existing alternatives to propose that Congress formally enact statutory ride-through as a § 521 retention option.

Part I of this Note illustrates the effect of BAPCPA on the asset-retention options available by statute. Part II then introduces an economic framework to explain why debtors and creditors rationally avoid each of the statutory options. Part III describes the retention alternatives that exist outside § 521 in practice. Part IV shifts from analysis to advocacy, explaining the policy objectives of Chapter 7 bankruptcy and describing how the current retention alternatives fail to promote those goals. From this foundation, Part V shows how statutory ride-through is consistent with Chapter 7 policy and improves the position of debtors and creditors relative to the status quo. In economic terms, statutory ride-through is a "Pareto superior" policy compared with the status quo, because it improves the position of at least one player without worsening the position of another.[15] As asset-retention options have splintered and Chapter 7 petitions hover near one million,[16] the need for reform of § 521 is more pressing than ever.

the Borogoves: A "Ride-Through" the Looking Glass with the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act, 33 W. NEW ENG. L. REV. 657, 691-95 (2011).

14. Christopher McGowan Badger, Note, Coastal Federal Credit Union v. Hardiman*: You Can Still "Ride-Through" the Eastern District of North Carolina*, 88 N.C. L. REV. 2249, 2265-66 (2010).

15. *See, e.g.*, YEW-KWANG NG, WELFARE ECONOMICS: INTRODUCTION AND DEVELOPMENT OF BASIC CONCEPTS 30 (1980).

16. *See supra* text accompanying note 3. In 2010, there were 1,071,769 consumer cases filed under Chapter 7. STATISTICS DIV., ADMIN. OFFICE OF U.S. COURTS, 2010 REPORT OF STATISTICS REQUIRED BY THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 12 (2011), http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2010/2010BAPCPA.pdf.

I. A TALE OF TWO DEBTORS

For Michael and Christine Price and Kimberly Miller, "it was the worst of times."[17] Like Carolyn Bowden, both debtors—Michael and Christine Price filing jointly[18] and Kimberly Miller individually—sought to cure their insolvency by filing Chapter 7 bankruptcy petitions. Both debtors filed in Delaware.[19] Both hoped to retain their motor vehicles, encumbered by creditor liens, after emerging from bankruptcy. But the Prices filed their petition in 2001, and Miller filed hers in 2010. During the intervening decade, BAPCPA had taken effect.

Because of the BAPCPA amendments to the Bankruptcy Code, the *Price* and *Miller* courts reached opposite conclusions as to whether a debtor could elect to ride-through an asset in bankruptcy. This Part illustrates how BAPCPA modified debtors' post-bankruptcy collateral retention options and describes the textual basis for the Delaware bankruptcy court's reversal on the issue of common law ride-through. It then situates these developments in a national context in which the circuit split gave way to the extinction of common law ride-through following BAPCPA.

A. In re Price*: Ride-Through Before BAPCPA*

In June 2001, Michael and Christine Price secured a loan for approximately $20,000 from the Delaware State Police Federal Credit Union with their Toyota Corolla and Sienna.[20] Six months later, the Prices filed a joint Chapter 7 bankruptcy petition.[21] For debt secured by personal property, including the Toyotas, § 521(2) required the Prices to

> (A) within thirty days after the date of the filing of a petition under chapter 7 . . . file with the clerk a statement of . . . intention with respect to the retention or surrender of such property and, if applicable,

17. CHARLES DICKENS, A TALE OF TWO CITIES 3 (Henry Holt & Co. 1931) (1859).

18. Because Michael and Christine Price filed jointly, the Bankruptcy Code treated them as an individual debtor. *See* 11 U.S.C. § 302 (2006).

19. *See In re* Miller, 443 B.R. 54 (Bankr. D. Del. 2011); *In re* Price, 281 B.R. 240 (Bankr. D. Del. 2002), *rev'd sub nom.* Price v. Del. State Police Fed. Credit Union, 370 F.3d 362 (3d Cir. 2004).

20. *In re* Price, 281 B.R. at 240.

21. *Id.*

> specifying that such property is claimed as exempt,[22] that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;
>
> (B) within forty-five days after the filing of a notice of intent . . . perform [their] intention with respect to such property . . . ; 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 . . . .[23]

The options available under § 521(2)(A)—surrender, redemption, and reaffirmation—proved inadequate for the Prices. If they elected to satisfy their debt by surrendering the vehicles to the Credit Union, the Prices would emerge from bankruptcy without a vehicle. Redemption required them to pay the Credit Union a lump sum equal to the liquidation value of the Corolla and Sienna, which they could not afford to do.[24] To reaffirm, finally, the Prices would have to enter a formal agreement with the Credit Union promising to repay the outstanding loan according to a revised post-bankruptcy schedule. Reaffirming would allow the Prices to retain their vehicles, but if they missed a scheduled payment the Credit Union could repossess.[25] In that case the Prices

22. Federal and state law both exempt certain property from forfeiture. The federal exemptions, set in 2010 and subject to periodic adjustments, allow debtors to retain $21,625 in real property, $3,450 in one motor vehicle, and $1,450 in jewelry. *See* 11 U.S.C. § 522(d); *see also id.* § 104 (providing for adjustments). For a list of personal and homestead exemptions under state law as of 2000, see Lars Lefgren & Frank McIntyre, *Explaining the Puzzle of Cross-State Differences in Bankruptcy Rates*, 52 J.L. & ECON. 367, 376-77 (2009).

23. 11 U.S.C. § 521(2)(A)-(C) (2000).

24. *Id.* § 722. Liquidation value, or "foreclosure value," is "the net amount [a secured creditor] would realize upon foreclosure and sale of the collateral." Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 953 (1997). In 1997, the Supreme Court ruled that the appropriate valuation standard for a Chapter 13 cramdown, through which a debtor retains collateral for business use over a creditor's objection, was the "replacement value" of the asset, or "the price a willing buyer in the debtor's trade, business, or situation would pay a willing seller to obtain property of like age and condition." *Id.* at 956, 959 n.2. Although some courts applied the replacement-value standard for Chapter 7 debtors as well, the Delaware bankruptcy court never adopted this standard. Other Third Circuit bankruptcy courts continued to use liquidation value in Chapter 7 cases. *See, e.g.*, *In re* Basher, 291 B.R. 357, 363 n.10 (Bankr. E.D. Pa. 2003) ("[A] Chapter 7 case . . . would not implicate application of the *Rash* replacement value test in a cramdown context."). When the Prices filed, liquidation value was required to redeem.

25. Outside of bankruptcy, secured creditors have the right to repossess collateral following an event of default. *See* U.C.C. § 9-609(a)(1) (2000); *infra* note 117.

would be personally liable for any deficiency arising from the sale of the vehicles. Because motor vehicles are typically worth less than the debt they secure,[26] if the Prices defaulted after reaffirming they would likely find themselves without a car and nonetheless mired in debt.

To avoid the unfavorable statutory options, the Prices indicated that they would simply "retain [the] collateral and continue to make regular payments,"[27] or ride-through the vehicles in bankruptcy. If granted, ride-through—like reaffirmation—would allow them to retain encumbered collateral as long as they did not miss a scheduled payment. The key difference was that ride-through made their debts nonrecourse after bankruptcy, allowing the Credit Union to repossess the Toyotas but not to recover any repayment deficiency.[28] In other words, if the Credit Union repossessed the vehicles and sold them for less than the outstanding debt, the Prices would not be obligated to finance the difference.

The Prices supported their ride-through election with precedent from the Second, Fourth, Ninth, and Tenth Circuits that construed § 521(2)(A) to allow a debtor who is current on loan payments to retain an asset without redeeming or reaffirming.[29] The Credit Union countered by citing decisions by the First, Fifth, Seventh, and Eleventh Circuits that explicitly rejected common law ride-through,[30] and it contended that the Prices were limited to the three statutory retention options.

The Third Circuit agreed with the Prices, reversing the bankruptcy court's judgment for the Credit Union and joining the circuits permitting common law ride-through.[31] The resulting circuit split continued until the eve of

26. In 1995, an auto industry executive stated that new-car lenders were undersecured by an average of $4,000 at the time the debtor filed bankruptcy. *See* Culhane & White, *supra* note 5, at 741-42 (citing a confidential conversation between Harvard Law School Professor Elizabeth Warren and an industry executive).

27. *In re* Price, 281 B.R. 240, 240-41 (Bankr. D. Del. 2002), *rev'd sub nom.* Price v. Del. State Police Fed. Credit Union, 370 F.3d 362 (3d Cir. 2004).

28. U.C.C. § 9-615.

29. *In re* Price, 281 B.R. at 242 (citing McClellan Fed. Credit Union v. Parker (*In re* Parker), 139 F.3d 668, 673 (9th Cir. 1998); Capital Commc'ns Fed. Credit Union v. Boodrow (*In re* Boodrow), 126 F.3d 43, 53 (2d Cir. 1997); Home Owners Funding Corp. of Am. v. Belanger (*In re* Belanger), 962 F.2d 345, 347-49 (4th Cir. 1992); Lowry Fed. Credit Union v. West, 882 F.2d 1543, 1547 (10th Cir. 1989)).

30. *Id.* at 244 (citing Bank of Bos. v. Burr (*In re* Burr), 160 F.3d 843, 849 (1st Cir. 1998); Johnson v. Sun Fin. Co. (*In re* Johnson), 89 F.3d 249, 250 (5th Cir. 1996); Taylor v. AGE Fed. Credit Union (*In re* Taylor), 3 F.3d 1512, 1517 (11th Cir. 1993); *In re* Edwards, 901 F.2d 1383, 1387 (7th Cir. 1990)).

31. *Price*, 370 F.3d at 367-68, 379.

BAPCPA. The split produced geographic inequities for debtors and creditors, undermined the constitutional vision of "uniform Laws on the subject of Bankruptcies throughout the United States,"[32] and "constitute[d] a matter of significant controversy and concern in consumer bankruptcy cases throughout the nation."[33] It was expected that BAPCPA would remedy the problem.

B. The BAPCPA Amendments

In 2005, Congress recodified Bankruptcy Code § 521(2) as § 521(a)(2), which left intact its core provisions requiring a debtor to file a statement of intention electing to either surrender, redeem, or reaffirm.[34] The BAPCPA amendments did not change the terms of surrender, but rather raised the cost of redemption by requiring a debtor to pay "the price that a retail merchant would charge," rather than liquidation value.[35]

BAPCPA also increased the cost of reaffirmation by imposing new procedural safeguards. Post-BAPCPA § 524(c) requires a creditor to make specific disclosures to a reaffirming debtor and requires the debtor's lawyer to file an affidavit certifying that the debtor will not suffer undue hardship as a result of the reaffirmation agreement.[36] Section 524(c)(6) also requires a court

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32. U.S. CONST. art. I, § 8, cl. 4.

33. Waxman, *supra* note 8, at 204.

34. 11 U.S.C. § 521(a)(2) (2006).

35. *See id.* § 506(a)(2) (stating that for Chapter 7 debtors, the value of the secured claim on personal property "shall be determined based on the replacement value," defined as "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"); *id.* § 722 (allowing a Chapter 7 debtor to redeem "by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien in full at the time of redemption"). The BAPCPA amendments codified the Supreme Court's decision in *Rash*, which required replacement value in Chapter 13 cramdowns, as applicable to Chapter 7 debtors as well. *See supra* note 24. Prior to BAPCPA, courts were mixed on whether *Rash* applied to Chapter 7 debtors; many continued to require liquidation value to redeem. *Id.* Although in some circuits the revised version of § 722 merely codified existing common law, the net effect of BAPCPA was to "call for a higher price for redemption than under case law prior to [BAPCPA]." Jean Braucher, Rash *and Ride-Through Redux: The Terms for Holding on to Cars, Homes and Other Collateral Under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 468 (2005).

36. 11 U.S.C. § 524(c). Reaffirming debtors and creditors were already required to satisfy a statutory checklist, but its scope was expanded by BAPCPA. For a detailed discussion of the new procedural requirements for lawyers, debtors, creditors, and courts, see David B. Wheeler & Douglas E. Wedge, *A Fully-Informed Decision: Reaffirmation, Disclosure and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 789 (2005).

to review the agreement if the lawyer refuses to sign the affidavit, if the debtor's income falls short of reaffirmation payments,[37] or if the debtor is pro se.[38] Courts are instructed to reject any reaffirmation agreement that "impos[es] an undue hardship on the debtor or a dependent of the debtor" or is not "in the best interest of the debtor."[39] The new procedures are important because they both present a heightened hurdle to reaffirmation and create the possibility of backdoor ride-through, as described in Section III.C.

Compared with the explicit revisions to the redemption and reaffirmation options, the BAPCPA amendments did not address common law ride-through at all. Shortly after the enactment of BAPCPA, an American Bankruptcy Institute online poll reported that thirty-two percent of respondents "agreed strongly" that BAPCPA eliminated common law ride-through, but twenty-eight percent "strongly disagreed" with the same statement.[40] Courts found the amendments equally unclear. A bankruptcy court compared deciphering the effect of BAPCPA on ride-through to solving "a Rubik's Cube that arrived with a manufacturer's defect,"[41] and the Ninth Circuit called it "hardly the very model of a well-drafted statute."[42] The skeletal legislative record of BAPCPA added little clarity. Professor Jean Braucher noted that for the BAPCPA amendments, "[t]here is no Senate committee report, and the House Judiciary Committee report contains only a paraphrase of the provisions addressing ride-through."[43] Indeed, the House Judiciary Committee report does not contain the phrase "ride-through" at all.[44]

While the text and legislative history contain few answers, other factors suggest that Congress intended BAPCPA to eliminate ride-through. In her

37. This is particularly important because "many among the debtors' bar staunchly refuse to endorse a client's reaffirmation efforts." Wheeler & Wedge, *supra* note 36, at 804.

38. 11 U.S.C. § 524(c)(6)(A), (d). Courts also reviewed reaffirmation agreements filed by pro se debtors for undue hardship under the pre-BAPCPA Bankruptcy Code. *See* 11 U.S.C. § 524(c)(6)(A), (d) (2000).

39. 11 U.S.C. § 524(c)(6)(A) (2006).

40. Philip R. Principe, *Did BAPCPA Eliminate the "Fourth Option" for Individual Debtors' Secured Personal Property?*, AM. BANKR. INST. J. (Oct. 2005), http://www.abiworld.org/webinars/JudgesPerspective/principe10-05.pdf. According to the American Bankruptcy Institute, the poll was open to the Institute's members and the public. *See Newsroom*, AM. BANKR. INST., http://news.abi.org/statistics (last visited Jan. 21, 2013).

41. *In re* Donald, 343 B.R. 524, 529 (Bankr. E.D.N.C. 2006).

42. Dumont v. Ford Motor Credit Co. (*In re* Dumont), 581 F.3d 1104, 1110 (9th Cir. 2009).

43. Braucher, *supra* note 35, at 460 n.13; *see also In re* Dumont, 581 F.3d at 1111 (noting that, in interpreting BAPCPA, "legislative history is not an able guide").

44. *See* H.R. REP. NO. 109-31 (2005).

study of the legislative history of BAPCPA, bankruptcy attorney Susan Jensen describes how a coalition of "'consumer creditors, including banks, credit unions, savings institutions, [and] retailers . . . play[ed] a major role in the effort to effect consumer bankruptcy reform."[45] Based on the perceived dominance of creditor coalitions, some have suggested that creditor groups outright drafted the BAPCPA amendments.[46] There is reason to believe that the participating creditor groups opposed ride-through: creditors had "expressed concern" about ride-through in the past,[47] and eliminating common law ride-through ranked "[h]igh on the wish lists" of certain influential creditor groups during BAPCPA negotiations.[48] If Congress sympathized with creditor interests to the extent perceived in the scholarship, it almost certainly intended to eliminate common law ride-through. Without a clear statutory directive, however, the fate of ride-through fell to the courts.

C. In re Miller*: The Death of Ride-Through*

Nearly a decade after *In re Price*, Kimberly Miller filed a Chapter 7 bankruptcy petition in Delaware.[49] When Miller filed bankruptcy, Chrysler Financial had a security interest in a Chrysler Town and Country minivan that she had purchased from a dealer in 2006.[50] Like the Prices, Miller faced obligations under § 521 with respect to the vehicle; and like the Prices, she found the statutory retention options unfavorable. She accordingly asserted that she was up to date on loan payments and would ride-through her Chrysler

45. Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485, 498-99 (2005) (quoting *Bankruptcy Reform Act of 1999—Part II: Hearing on H.R. 833 Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 106th Cong. 5 (1999) (statement of George Wallace, Esq., on behalf of the Consumer Bankruptcy Reform Coalition)). House Judiciary Committee Chairman Henry Hyde remarked after the debate of one amendment, "[L]et me pay my respects to the creditor lobby. They are awesome." *Id.* at 528 (quoting 145 CONG. REC. H2723 (daily ed. May 5, 1999)).

46. *See In re* Steinhaus, 349 B.R. 694, 706 (Bankr. D. Idaho 2006) ("Congress drafted, or allowed to be drafted by others and then enacted, provisions with 'loose' and imprecise language."); Braucher, *supra* note 35, at 457 (scorning BAPCPA as "a case study of what can go wrong when an interest group uses its muscle to pass a complex piece of legislation without a careful, expert drafting process").

47. 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 11, at 167.

48. William C. Whitford, *A History of the Automobile Lender Provisions of BAPCPA*, 2007 U. ILL. L. REV. 143, 172.

49. *In re* Miller, 443 B.R. 54, 55 (Bankr. D. Del. 2011).

50. *Id.* at 55.

in bankruptcy, citing *In re Price*.[51] Her petition thus placed the perplexing question of post-BAPCPA ride-through squarely before the Delaware Bankruptcy Court.

To determine the effect of BAPCPA on ride-through, the court parsed its text. New § 521(a)(2) added a single phrase to pre-BAPCPA § 521(2). To the flush language stating that "nothing in subparagraphs (A) and (B) . . . shall alter the debtor's or the trustee's rights with regard to such property under this title," § 521(a)(2) appended "except as provided in section 362(h)."[52] Section 362(h), also new under BAPCPA, allowed a creditor to repossess

> (1) . . . if the debtor fails within the applicable time set by section 521 (a)(2) –
>
> > (A) to file timely any statement of intention required under section 521(a)(2) with respect to such personal property or to indicate in such statement that the debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property pursuant to section 722, enter into an agreement of the kind specified in section 524(c) . . . ; and
> >
> > (B) to take timely the action specified in such statement . . . unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.[53]

The *Miller* court determined that the amendments to § 521 did not by themselves eliminate ride-through, but § 362(h)(1)(A) evidently required surrender, redemption, or reaffirmation to prevent a creditor from repossessing.[54] The court concluded that Miller's election to "retain collateral and continue to make regular payments" was unsupported by BAPCPA.[55] In Delaware, common law ride-through was no longer an option.[56]

51. *Id.* at 56.

52. 11 U.S.C. § 521(a)(2)(*) (2006).

53. *Id.* § 362(h)(1). Section 362 governs the "automatic stay," an injunction against creditor repossession that is triggered by a bankruptcy filing. *See id.* § 362(a).

54. *In re Miller*, 443 B.R. at 58.

55. *Id.* (quoting *In re* Steinhaus, 349 B.R. 694, 701 (Bankr. D. Idaho 2006)).

56. While Chapter 7 debtors could no longer elect to ride-through an asset, the *Miller* court noted that BAPCPA had "narrowed," rather than eliminated, the ride-though option. *Id.*

Other courts have agreed, referencing the statutory text and case law to conclude that BAPCPA eliminated common law ride-through.[57] After BAPCPA, § 521 permits Chapter 7 debtors to retain collateral only by redeeming or reaffirming, each on the less favorable terms imposed by BAPCPA. The remainder of this Note considers the insufficiency of post-BAPCPA asset-retention options, illustrating the advantages of statutory ride-through over the status quo.

II. RATIONAL AVOIDANCE OF § 521

The two seemingly straightforward asset-retention options offered in post-BAPCPA § 521 mask a more complex reality. Prior to BAPCPA, Professors Culhane and White observed that some debtors and creditors were reaching asset-retention agreements outside of § 521.[58] This Part explains that result, employing a simple economic framework to describe why debtors and creditors frequently avoid surrender, redemption, and reaffirmation. The analysis shows that most—even the vast majority—of secured debt in Chapter 7 bankruptcy is not reaffirmed, and yet the assets are neither redeemed nor surrendered. The framework underpins the subsequent analysis of this Note, providing a metric to evaluate both the § 521 options and asset-retention alternatives.

A. Economic Framework

The retention dilemma faced by Bowden, Miller, and the Prices is shaped by their incentives as well as the incentives of their secured creditors during bankruptcy proceedings. Each debtor-creditor pair shares a stake in the same asset, but their subjective valuations of that asset differ. Consider three values: V_D, V_C, and L. V_D is the value of the asset to the debtor at the time of the

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This language was deliberate: in 2008, the Delaware Bankruptcy Court permitted a debtor to ride-through when the debtor had signed a valid reaffirmation agreement that was later rejected by the court. *See In re* Baker, 390 B.R. 524, 532 (Bankr. D. Del. 2008). This outcome is termed "backdoor ride-through." *See infra* Section III.C.

57. *See, e.g.*, *In re* Linderman, 435 B.R. 715, 718 (Bankr. M.D. Fla. 2009) ("Nationally, debtors no longer can keep personal property without reaffirming the debt or redeeming the property. All debtors are treated similarly in every circuit.").

58. Culhane and White discovered that although seventy-two percent of debtors indicated that they intended to reaffirm their vehicle debt, two-thirds of those reaffirmations were never filed in court. Culhane & White, *supra* note 5, at 739-40. They then traced motor vehicle records and found "quite a few" still registered to non-reaffirming debtors. On this basis, Culhane and White concluded those parties had reached a retention agreement outside of court. *Id.* at 741-43.

bankruptcy filing. V_C is the value of the same asset to the secured creditor, or its liquidation value.[59] L is the outstanding loan, or the amount the debtor owes at the time of filing bankruptcy. It will generally be the case that $V_D > L > V_C$.

Debtors typically value the asset above the value of the outstanding loan ($V_D > L$), for three reasons. First, debtors emerge from Chapter 7 bankruptcy as subprime borrowers who will struggle to secure a loan immediately after bankruptcy.[60] Since debtors often rely on their assets, particularly motor vehicles, the inability to replace them disincentivizes surrender.[61] The Hardimans, who were among the first debtors allowed to retain assets through backdoor ride-through, exemplify this predicament: they attempted to reaffirm debt on a Chevrolet Equinox for more than twice its value because they had "three children and the Chevrolet [was] their only reliable means of transportation."[62] Second, psychological literature has shown that individuals exhibit a strong preference for assets they already possess. This phenomenon has been called the "endowment effect" or "status quo bias," and it is based on studies demonstrating that people demand a higher price for products they own than they are willing to pay for the same product.[63] Third, there are transaction costs associated with searching for, obtaining, and, in the case of a motor vehicle, registering a replacement asset. These costs can be avoided through retention. Empirical evidence supports the assertion that debtors highly value collateral: a high percentage of debtors hope to retain collateral

59. Liquidation value is "the amount that the secured creditor 'would receive if it repossessed the collateral and sold it in the most beneficial manner it could.'" *In re* Ard, 280 B.R. 910, 915 (Bankr. S.D. Ala. 2002) (quoting *In re* Dunbar, 234 B.R. 895, 899 (Bankr. E.D. Tenn. 1999)) (internal quotation marks omitted).

60. Katherine Porter, *Life After Debt: Understanding the Credit Restraint of Bankruptcy Debtors*, 18 AM. BANKR. INST. L. REV. 1, 9-16 (2010) (noting that few debtors had taken out loans within the year following bankruptcy, but three years out the majority had secured new credit).

61. *See, e.g.*, Dumont v. Ford Motor Credit Co. (*In re* Dumont), 581 F.3d 1104, 1108 (9th Cir. 2009) ("Debtors usually need a car to travel to and from work, school, medical appointments, and other important activities. Having just filed for bankruptcy, they understandably expect to experience difficulty securing financing for another vehicle.").

62. Coastal Fed. Credit Union v. Hardiman, 398 B.R. 161, 166 (E.D.N.C. 2008). The Hardimans are discussed further in Section III.C.

63. *See* Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1342 (1990) (finding a strong and immediate endowment effect, expressed as reluctance to trade, among subjects who were randomly awarded certain mugs or pens).

after emerging from bankruptcy,[64] and many reaffirm the debt at a high interest rate.[65]

It will also be true that creditors value the asset less than the outstanding loan ($L > V_C$), because consumer debts are typically undersecured, or have negative equity.[66] Used household goods, like washing machines or refrigerators, can be resold only at a fraction of their retail value. Motor vehicles depreciate most the moment they are driven from the lot and yet are paid off according to a flat monthly schedule,[67] leaving new-car lenders undersecured by an average of $4,000 when a debtor declares bankruptcy.[68] While not all consumer debt will adhere to this ordinal ranking, this Note assumes $V_D > L > V_C$ for encumbered assets.

B. The Inadequacy of Surrender, Redemption, and Reaffirmation

Assuming $V_D > L > V_C$, economic analysis and empirical evidence show that debtors and creditors are likely to avoid each of the three options available under § 521. The first option, surrender, creates a social loss. Redemption is attractive but will rarely be feasible. Reaffirmation, finally, is laden with transaction costs and subject to judicial rejection.

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64. *See In re* Dumont, 581 F.3d at 1108 (noting that debtors frequently elect to continue payments on "underwater" debts); Culhane & White, *supra* note 5, at 739 (finding that seventy-nine percent of Chapter 7 debtors intended to retain their encumbered vehicles through bankruptcy).

65. *See* Culhane & White, *supra* note 5, at 755-56 (observing double-digit interest rates in reaffirmation agreements, with one debtor reaffirming unsecured credit card debt at a sixty percent interest rate).

66. *See* Marianne B. Culhane & Michaela M. White, *But Can She Keep the Car? Some Thoughts on Collateral Retention in Consumer Chapter 7 Cases*, 7 FORDHAM J. CORP. & FIN. L. 471, 472 (2002) ("Consumer creditors are frequently undersecured."). A creditor is undersecured when the outstanding debt is greater than the fair market value of the asset.

67. In the automobile industry, this is sometimes referred to as "drive-off depreciation." Prior to the enactment of BAPCPA, an automobile creditor representative testified before the House Judiciary Committee that "[secured vehicle lenders] suffer the greatest losses . . . in the early years of the vehicles [sic] life when depreciation is the greatest." Whitford, *supra* note 48, at 178 (quoting *Bankruptcy Reform Act of 1998; Responsible Borrower Protection Act; and Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998: Hearing on H.R. 3150, H.R. 2500, and H.R. 3146 Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary*, 105th Cong., pt. 3, at 88 (1998) (statement of Jeffrey A. Tassey, Senior Vice President of Government and Legal Affairs, American Financial Services Association)); *see also In re* Robson, 369 B.R. 377, 382 (Bankr. N.D. Ill. 2007) ("Generally, vehicles depreciate the most when they are newest . . . .").

68. *See supra* note 26.

First, because debtors value collateral at V_D, an amount greater than the outstanding loan, and creditors value it only at resale value V_C,[69] surrender imposes a deadweight loss of $V_D - V_C$. Transferring collateral from a debtor to a creditor thus creates economic distortion by forcing a transfer of an asset from a high- to low-value user.[70] Moreover, because $V_D > L$, a debtor will not voluntarily surrender an asset; and because $L > V_C$, a creditor would typically prefer continuing to collect payments to repossessing the asset.[71] Surrender represents a bargaining failure, realized only if all other options fail.

Similarly, redemption is almost always infeasible for debtors in practice. To redeem, a debtor must pay the full amount of an outstanding loan up front during bankruptcy, which courts have noted is generally impossible.[72] Empirical evidence supports the conclusion that debtors are rarely in a position to redeem. In 1995, Professors Culhane and White found that seventy-nine percent of Chapter 7 debtors intended to retain their encumbered asset through bankruptcy, but only four percent of debtors hoped to do so by redeeming.[73] This is significant because redemption offers a relatively inexpensive method of collateral retention; at that time, it required only the liquidation value of the

69. The creditor retains an unsecured claim for $V_C - L$, but will collect only a minute fraction of that amount. After resale, the creditor retains an unsecured claim for the deficiency, to be asserted against other unsecured creditors in bankruptcy proceedings. 11 U.S.C. § 506(a) (2006). Such claims are virtually worthless, as unsecured creditors generally collect just a few cents on the dollar in Chapter 7 bankruptcy.

70. The same argument applies to repossession, which is a functionally equivalent creditor remedy. Professor Alan Schwartz notes that "[r]epossession 'destroys value' because individual debtors commonly value goods in excess of their market prices but repossessing creditors at best resell at these prices. Because repossession imposes greater harms on debtors than it creates gains for creditors, it actually minimizes welfare." Alan Schwartz, *The Enforceability of Security Interests in Consumer Goods*, 26 J.L. & ECON. 117, 119 (1983); *see also* Culhane & White, *supra* note 66, at 474 ("[R]etention 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.").

71. The latter inequality assumes that creditors do not significantly discount L for the risk of nonpayment, which is a reasonable assumption for the reasons described in Section V.D.

72. *See, e.g.*, Price v. Del. State Police Fed. Credit Union (*In re* Price), 370 F.3d 362, 376 (3d Cir. 2004) (noting that "chapter 7 debtors . . . are, by definition, insolvent and unlikely to possess the funds to buy their secured property outright"); *see also The Honorable Eileen W Hollowell Discusses Reaffirmation*, U.S. BANKR. CT. FOR THE DIST. OF ARIZ., http://www.azb.uscourts.gov/default.aspx?PID=84 (last visited Oct. 19, 2012) (advising debtors, via video recording, that "sometimes [redemption is] an option; rarely, though, because usually it's more money than you're going to have") [hereinafter *Hon. Hollowell on Reaffirmation*].

73. Culhane & White, *supra* note 5, at 739.

asset.[74] Following BAPCPA, it is even less likely that a debtor would redeem, because BAPCPA raised the cost of redemption to retail rather than liquidation value.[75] In sum, redemption presents a theoretically favorable option to debtors, but it is rarely available in practice.

Following the constructive repeal of common law ride-through, reaffirmation is the single statutory alternative to redemption for post-bankruptcy collateral retention. On its face, reaffirmation is an attractive option. Reaffirmation agreements typically require a debtor to reaffirm L. Because $V_D > L > V_C$, in theory, debtors and creditors should each get a surplus from entering a reaffirmation agreement as compared to surrendering the asset.[76] Yet like redemption, reaffirmation is rare in practice, for two reasons.

First, uncertainty about judicial approval may deter debtors and creditors from reaffirming debt. Reaffirmation agreements frequently do not succeed in court, either because they fail the § 524(c)(6) requirement of being in the debtor's best interests,[77] or because the parties withdraw the agreement before

74. *See supra* note 24 and accompanying text.

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

76. In practice, bargaining power inequities account for the skewed distribution of reaffirmation surplus. Barry Adler and his colleagues demonstrate that if bargaining power were shared, a debtor and creditor would each benefit from entering a reaffirmation agreement. Barry Adler, Ben Polak & Alan Schwartz, *Regulating Consumer Bankruptcy: A Theoretical Inquiry*, 29 J. LEGAL STUD. 585, 601 (2000). If the debtor has no bargaining power, however, the debtor, "who likely is a relatively poor person, not only realizes little ex post surplus but also faces a higher interest rate." *Id.* at 604. The latter case is arguably closer to reality due to two underlying inequities. First, creditors are better able to handle delays in the negotiation process. A debtor must comply with the § 521 timeline to propose a reaffirmation agreement. *See* 11 U.S.C. § 521(a)(1)-(2) (2006). A creditor who refuses to negotiate may repossess the asset after forty-five days and resell for liquidation value. *Id.* § 521(a)(*). Similarly, creditors have less to lose if the parties cannot agree to a reaffirmation agreement because creditors forfeit the difference between the lien and resale value of the asset, whereas the debtor loses an asset that may have become literally priceless to them. *See supra* note 61. Indeed, the House Judiciary Committee observed that the "unequal bargaining position of debtors and creditors, and the creditors' superior experience in bankruptcy matters" leads to an overabundance of reaffirmations. H.R. REP. NO. 95-595, at 163 (1977); *see also* Ehrlich, *supra* note 12, at 616-17 (noting that creditors occupy "an unfair bargaining position where they can demand fees and changes in payment terms as a condition to agreeing to the reaffirmation"). For a discussion of bargaining power in two-party agreements, see JOEL WATSON, STRATEGY: AN INTRODUCTION TO GAME THEORY 216-22 (2d ed. 2008).

77. BAPCPA requires courts to reject a reaffirmation agreement upon finding that the agreement either would impose an undue hardship on the debtor or the debtor's dependents, or is not in the debtor's best interest. *See* 11 U.S.C. § 524(c)(3)(A), (6)(A).

judicial review.[78] In 2011, more than 300,000 reaffirmation agreements were filed, but "[s]lightly less than [one] percent of cases in which a reaffirmation agreement was filed had [a] reaffirmation agreement approved by . . . the court."[79] Some districts allow reaffirmation agreements to be "implicitly accepted without further court action," or approve multiple agreements in a single motion.[80] As described in Section III.B, agreements may also have been filed and subsequently withdrawn prior to judicial review. Nevertheless, under BAPCPA's stringent reaffirmation requirements, it is likely that a significant portion of the filed agreements were rejected in court.

Second, reaffirmation agreements are costly, so even if they were automatically enforceable, debtors and creditors might avoid entering into them. According to Professor Scott Ehrlich, the cost of reaffirming typically ranges from "a few hundred to several thousand dollars for each agreement."[81] This financial burden may outweigh any surplus obtained through reaffirmation,[82] in which case rational debtors and creditors will opt to negotiate outside of court.

III. ASSET-RETENTION ALTERNATIVES

Where § 521 falls short, alternatives have emerged to fill the statutory void. A debtor may convert to Chapter 13, although this option is rarely employed in practice. More commonly, creditors agree to forbear on their right to repossess collateral, leading to a de facto ride-through arrangement. It is likely this option is particularly popular following BAPCPA. Finally, courts that reject reaffirmation agreements may allow debtors to retain collateral through a binding nonrecourse arrangement called backdoor ride-through. This Part completes the asset-retention picture, which serves as the backdrop for the normative analysis to follow.

78. *See infra* Section III.B.

79. 2011 BANKRUPTCY STATISTICS, *supra* note 3, at 12. The report does not distinguish between reaffirmations of secured and unsecured debt. Because more than half of consumer debt is secured, however, it is likely that a significant portion of the reaffirmation agreements involved secured debt.

80. *Id.*

81. Ehrlich, *supra* note 12, at 616. This includes the requisite disclosures, income schedules, and affidavits required by 11 U.S.C. § 524(c). *See also supra* notes 36-39 and accompanying text. For a sample reaffirmation form, see *United States Bankruptcy Court: Reaffirmation Agreement Cover Sheet*, U.S. CTS. (Dec. 2009), http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Bk%20Forms%20Dir%201209/B_027_1209f.pdf.

82. *See* Ehrlich, *supra* note 12, at 616.

A. Chapter 13 Bankruptcy

At first glance, converting to Chapter 13 bankruptcy seems an attractive option for debtors who are dissatisfied with Chapter 7 retention. Whereas Chapter 7 allows individual filers to discharge unsecured debts in exchange for forfeiting assets, Chapter 13 allows a debtor to retain assets in exchange for paying a portion of future income to creditors.[83] A debtor who files a Chapter 7 petition may later convert to Chapter 13.[84]

The disappearance of common law ride-through left debtors a choice between the less attractive statutory asset-retention options. Theoretically, then, more debtors should file or convert to Chapter 13 petitions following BAPCPA. The empirical evidence on this point is inconclusive, however. Before BAPCPA, a student note observed a loose correlation between circuits allowing common law ride-through and lower levels of Chapter 13 filings,[85] but an empirical study declared a similar hypothesis "unfounded."[86] Rather, it seems likely that other considerations outweigh asset retention in the choice to file either a Chapter 7 or 13 petition.[87]

Following BAPCPA, it is even less likely that a Chapter 7 debtor would convert to Chapter 13, because BAPCPA also raised the price of Chapter 13 collateral retention as part of a plan to deter abusive filers.[88] Before BAPCPA,

83. The Code requires a Chapter 13 debtor to propose a creditor repayment plan through which the debtor commits a portion of future income to satisfying creditor claims. 11 U.S.C. §§ 1322-1323. To be approved, a Chapter 13 plan must award creditors at least as much as they would have received in Chapter 7. *Id.* § 1325(a)(4).

84. *See id.* § 706(a).

85. *See* Hogan, *supra* note 13, at 909.

86. Culhane & White, *supra* note 5, at 726 ("Districts with both a right to ride-through and a high Chapter 13 percentage would, we thought, have the lowest reaffirmation rates of all. Now that the facts are in, it is clear that our Chapter 13 theory was unfounded. . . . [T]here is no correlation, direct or inverse, between Chapter 13 and reaffirmation rates within our districts.").

87. For example, filers who are lured by the fresh start offered by Chapter 7 may be reluctant to agree to a payment plan awarding their future income to creditors.

88. BAPCPA attempted to curb abusive bankruptcy filings by raising the cost of collateral retention in Chapter 13, and then pushing high-income Chapter 7 debtors into Chapter 13. To target abusive filers, BAPCPA revised § 707(b) to implement a means test, which denied Chapter 7 relief to debtors who either acted in bad faith or had sufficient income to repay debts. BAPCPA requires debtors who fail the means test to file petitions under Chapter 13. 11 U.S.C. § 707(b). For further discussion of the means test, see generally Jensen, *supra* note 45, which discusses legislative history; and Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231 (2005), which discusses the effect for individual filers.

all secured claims on consumer assets were bifurcated in bankruptcy.[89] Bifurcation divided claims into a secured portion for the value of the collateral and an unsecured claim for the deficiency.[90] Because creditors collect little on their unsecured claims,[91] bifurcation ultimately reduced debtor repayment. The post-BAPCPA Code no longer bifurcates the claims of secured creditors if the asset was acquired within the previous year, or if the secured asset is a car that was purchased within the 910 days (approximately two-and-a-half years) before bankruptcy.[92] Instead, the entire loan is treated as secured debt, and full repayment is required.[93]

By requiring full repayment for certain types of collateral, BAPCPA makes Chapter 13 a less desirable means of asset retention. If evidence on the correlation between Chapter 13 filings and the existence of common law ride-through was mixed before BAPCPA, after BAPCPA conversion is even less likely.[94] In fact, Professor Braucher has predicted that "with higher repayment requirements for some collateral in Chapter 13, many debtors who would have filed in Chapter 13 before will now file in Chapter 7."[95]

B. Forbearance on Repossession

To avoid the costs and rejection risk associated with reaffirmation, debtors and creditors may instead reach an agreement outside of court. In recent years,

89. 11 U.S.C. § 506(a) (2000).

90. *Id.*

91. *See supra* note 69.

92. 11 U.S.C. § 1325(a)(*) (2006).

93. *Id.*

94. Professor Adler and his colleagues analyzed the payoff to debtors and creditors of converting from Chapter 7 to Chapter 13 under the pre-BAPCPA Code. They demonstrated that a debtor would only convert to Chapter 13 when the present value of payments to creditors in Chapter 13 is less than $V_D - \beta (V_D - V_C)$, where β represents the debtor's bargaining power in Chapter 7 bankruptcy. Adler et al., *supra* note 76, at 605-06. (As published, the article adds rather than subtracts V_D and $\beta (V_D - V_C)$. The typographical error has been corrected here.) Using this equation, the authors concluded that debtors would prefer Chapter 13 in four situations: when their Chapter 13 payments are small; when V_D, the value to the debtor, is large; when β, the debtor's bargaining power in Chapter 7, is small; and when $(V_D - V_C)$, the total surplus between debtor and creditor value, is small. *Id.* at 606. The BAPCPA amendments did not affect V_D or V_C, on the right-hand side of the equation, but instead increased the required payments to creditors. The Adler model thus supports the conclusion that fewer Chapter 7 debtors would convert to Chapter 13 following BAPCPA.

95. Braucher, *supra* note 35, at 459 n.9. For further discussion of the failure of debtors to complete Chapter 13, see *infra* note 130.

out-of-court agreements have most commonly taken the form of forbearance, in which a creditor promises to forbear on its repossession rights.[96] A forbearing creditor agrees not to repossess collateral as long the debtor continues making regular loan payments, leading to a voluntary form of ride-through.

Forbearance is particularly likely in two circumstances. First, if a creditor suspects that a court might reject a reaffirmation agreement and if the resale value of the collateral is low, the creditor might acquiesce because it expects that a few monthly payments will be worth more than repossession. Alternatively, a creditor might believe that a fresh-start debtor will ride-through the asset to full repayment.[97] In that case, the personal liability secured by reaffirmation is worthless, and the agreement imposes needless transaction costs.

There is some evidence that out-of-court bargaining occurred before BAPCPA.[98] By increasing the costs associated with § 521 retention options, BAPCPA amplified the incentive for debtors and creditors to employ other

96. During the 1990s, debtors and creditors reached another form of out-of-court retention agreement, rogue reaffirmations. Rogue reaffirmations are illegal reaffirmation agreements obtained when creditors approach debtors directly to reaffirm, rather than filing with the court as required by § 524. Despite their unenforceability, rogue reaffirmations once comprised roughly one-half of all reaffirmation agreements. 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 11, at 162. To induce rogue reaffirmations from debtors, creditors used everything from "offers of post-bankruptcy credit" to "deceptive threats of repossession." Culhane & White, *supra* note 66, at 483. Not only did unsuspecting debtors believe the agreements were binding, but because rogue reaffirmations look identical to valid agreements, courts had to check records to ascertain their validity. Their prevalence was curbed by a series of class action lawsuits that resulted in sizable sanctions against major retailers. Sears, for example, settled class action lawsuits related to rogue reaffirmations for approximately $500 million, and similar class actions were brought against General Motors Acceptance Corporation and Circuit City. *See* Ehrlich, *supra* note 12, at 628-29. A coalition of state attorneys general also brought suit against Federated Department Stores. *Id.* Rogue reaffirmations have generated no major litigation since the 1990s, and although data are unavailable, one could conclude from this lack of litigation that the frequency of rogue reaffirmations has subsided.

97. Braucher, *supra* note 35, at 476 (noting that a Chapter 7 debt discharge helps debtors pay secured debts, and "this gain in creditworthiness may more than offset the creditor's loss of recourse against the debtor personally after discharge"); Ehrlich, *supra* note 12, at 696 ("The cost to the creditor of processing the reaffirmation agreement and the nominal increase in value received by establishing the debtor's post-discharge personal liability rarely justify the effort.").

98. *See supra* note 58. Judge Hollowell advises Chapter 7 debtors that a creditor may say, "We don't want to bother with [reaffirmation]. Don't worry; just make your payments. Everything will be fine." *Hon. Hollowell on Reaffirmation*, *supra* note 72.

methods of retention in order to avoid surrender.[99] It is therefore likely that forbearance occurs more frequently in the post-BAPCPA world.

C. Backdoor Ride-Through

Backdoor ride-through is the only new retention option following BAPCPA. Compared with forbearance, which occurs in lieu of judicial proceedings, and common law ride-through, which gave debtors in five circuits the option to ride-through, backdoor ride-through is an ex post remedy applied by courts. To qualify for backdoor ride-through, a debtor must satisfy the requirements of § 524,[100] including filing a reaffirmation agreement. If the court rejects the agreement,[101] it may instead allow the debtor to take advantage of backdoor ride-through. As discussed above, Congress probably intended to eliminate ride-through in 2005,[102] and thus likely did not intend to create backdoor ride-through, either.[103]

The Eastern District of North Carolina was among the first to recognize backdoor ride-through. Landon and Daffney Hardiman filed a Chapter 7 petition there in 2007.[104] At that time the Hardimans had an outstanding loan of more than $20,000 on a Chevrolet Equinox with a fair market value of $9,000. The couple entered a reaffirmation agreement on the Equinox with Coastal Federal Credit Union, their lender.[105] Based on pre-petition income and expenses, the bankruptcy court determined that they would run a monthly deficit of more than $1,000 after making reaffirmation payments.[106] The

99. For further discussion, see Braucher, *supra* note 35, at 462-63, which predicts that eliminating ride-through across all jurisdictions would lead to an increase in voluntary ride-through among creditors.

100. 11 U.S.C. §§ 362(h), 521(a)(2), (a)(6) (2006).

101. A court will reject a reaffirmation agreement upon finding that it imposes an undue burden or is against the debtor's best interests. *See supra* note 39 and accompanying text.

102. *See supra* notes 46-48 and accompanying text.

103. Hogan reaches this conclusion, observing that "backdoor ride-through could be accused of bordering on judicial activism, or at least operating contrary to congressional intent." Hogan, *supra* note 13, at 918 (footnote omitted).

104. Coastal Fed. Credit Union v. Hardiman, 398 B.R. 161, 166 (E.D.N.C. 2008). *See generally* Badger, *supra* note 14 (discussing the facts of the case, and approving the *Hardiman* holding because it is consistent with BAPCPA and consumer bankruptcy policy).

105. *Hardiman*, 398 B.R. at 166.

106. The district court also expressed concern with discrepancies between the prepayment income asserted by the Hardimans in their initial Chapter 7 application and in the filed reaffirmation agreement. *Id.* at 166 n.3.

Hardimans nonetheless insisted they could comply with the reaffirmation terms, although they admitted "it would be hard sometimes."[107]

After rejecting the reaffirmation agreement for undue hardship, the district court nonetheless allowed the Hardimans to retain the Equinox. Because the Hardimans had attempted to reaffirm, the court concluded they had met the burden of §§ 521(a)(2) and 362(h). Although the reaffirmation agreement was ultimately rejected, Coastal's repossession rights continued to be barred by § 362. This gave rise to a binding nonrecourse loan agreement through which the Hardimans retained the vehicle and Coastal was enjoined from repossessing it.

Coastal appealed, protesting that the result reached by the court was absurd and out of line with congressional intent.[108] The *Hardiman* court rejected both arguments,[109] and so far other courts have ruled similarly.[110] In a growing number of jurisdictions, backdoor ride-through now permits a limited ride-through option for debtors whom courts believe will be unduly burdened by a reaffirmation agreement. While not uniformly accepted or particularly prominent, the advent of backdoor ride-through is important because it alters the incentives of debtors and creditors during Chapter 7 proceedings, as discussed in the next Part.

IV. SHORTCOMINGS OF THE STATUS QUO

This Part evaluates the success of post-BAPCPA asset retention by first describing the goals of Chapter 7 bankruptcy, and then illustrating how the options available following BAPCPA fall short with respect to each objective. Repayment plans under Chapter 13 are inconsistent with the fresh-start policy and frequently fail. Forbearance protects the fresh start as well as creditors' interests, but it is available to Chapter 7 debtors only on an irregular basis.

107. *Id.* at 166.

108. *Id.* at 167.

109. The court concluded there were "plausible reasons" Congress might have mandated this outcome and no clear expression of contrary legislative intent. *Id.* at 179.

110. *See, e.g.*, *In re* Baker, 390 B.R. 524, 532 (Bankr. D. Del. 2008) ("[B]ecause the Debtors timely entered into a reaffirmation agreement (regardless of whether the agreement was approved by the Court) they may retain their vehicle while staying current on their loan payments."); *In re* Blakeley, 363 B.R. 225, 230 (Bankr. D. Utah 2007) ("Having entered into the reaffirmation agreement 13 days after the first meeting of creditors, Debtor fully complied with the requirement under § 521(a)(6), and the remedy found under § 521(a)(6) i[s] inapplicable to this Debtor.").

Backdoor ride-through, finally, benefits debtors but injects unforeseen risk into bankruptcy proceedings for secured creditors.

A. The Three Policy Goals of Chapter 7

Consumer bankruptcy policy serves three policy objectives: to give debtors a fresh start, protect creditors' interests, and promote national uniformity of law. Each objective takes root in the origins of bankruptcy law and serves significant macroeconomic policy goals.

Chapter 7 first protects the paradigmatic honest debtor by allowing individuals to "obtain a fresh start, free from creditor harassment and free from the worries and pressures of too much debt."[111] In addition to promoting peace of mind, it has been noted that the Chapter 7 debt discharge prevents the development of an insolvent underclass[112] and incentivizes entrepreneurship by offering a mandatory insurance policy for failed business endeavors.[113] Professor Thomas Jackson has additionally contended that the fresh start "heightens creditors' incentives to monitor [by] enlist[ing] creditors in the effort to oversee the individual's credit decisions even when the individual has not fully mortgaged his future."[114]

The interest in protecting creditors' interests serves as an important policy counterweight to the fresh start. Guaranteeing secured creditors first confers positive externalities on non-debtor consumers, because a favorable bankruptcy payout lowers ex ante interest rates on consumer loans.[115] Secured creditors' interests also have practical importance because the centrality of secured lending to the U.S. economy has made them "the subject of particular

111. H.R. REP. NO. 95-595, at 125 (1977); *see also* Charles G. Hallinan, *The "Fresh Start" Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 57 (1986) (identifying as a reason for bankruptcy relief "a perception of insolvent debtors as potentially valuable contributors to the nation's economic development, whose participation in the economy was impeded by the hopelessness of their financial conditions").

112. Eric A. Posner, *Should Debtors Be Forced into Chapter 13?*, 32 LOY. L.A. L. REV. 965, 969 (1999) ("The bankruptcy law is motivated in part by the fear that tough loan-forgiveness laws would produce a class of people who would be continually dependent on social welfare programs.").

113. *See, e.g.*, Wei Fan & Michelle J. White, *Personal Bankruptcy and the Level of Entrepreneurial Activity*, 46 J.L. & ECON. 543 (2003).

114. Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1426 (1985).

115. Barry E. Adler, *The Soft-Landing Fallacy and Consumer Debtors*, 7 FORDHAM J. CORP. & FIN. L. 499, 500 (2002).

congressional solicitude."[116] Outside of bankruptcy, secured creditors have the right to repossess secured collateral and retain the proceeds on sale, guaranteeing them at least the liquidation value of the encumbered asset.[117] In order to avoid depriving them of the benefit of their bargain in bankruptcy, the Code requires that secured creditors receive "adequate protection," meaning they collect their interest or its "indubitable equivalent."[118] In § 521, redemption and reaffirmation actually improve the position of secured creditors relative to their position under nonbankruptcy state law by allowing a creditor to collect a portion of the deficiency in addition to the asset value.[119]

Finally, bankruptcy law must be uniform. The U.S. Constitution empowers Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States."[120] While the text suggests mere authorization, the Supreme Court has interpreted the Bankruptcy Clause as a "uniformity requirement,"[121] and lower courts have construed it as a "mandate."[122] According to Professor Randolph Haines, the Framers drafted the Clause because they believed that "[o]nly a uniform federal law" would "permit all creditors to offer a sufficient collective incentive for the debtor to disclose and turn over all his assets . . . [and] ensure that nonresident creditors would receive notice of the bankruptcy and entitle them to share pro rata in distributions."[123] Today, uniform laws also enhance the predictability of

116. Dumont v. Ford Motor Credit Co. (*In re* Dumont), 581 F.3d 1104, 1111 (9th Cir. 2009).

117. Outside of bankruptcy, following default, a secured creditor has the right to repossess the collateral securing the loan. *See* U.C.C. § 9-609(a)(1) (2000). The repossession remedy affords a creditor the right to enter the debtor's premises, repossess the collateral, and dispose of the collateral through a "commercially reasonable" method. *Id.* §§ 9-610, 9-627 (defining "commercially reasonable"). When a consumer files for Chapter 7 bankruptcy, however, an "automatic stay" is triggered, which prevents creditors from reclaiming assets. *See supra* note 53.

118. 11 U.S.C. § 361 (2006).

119. A creditor collects retail value of collateral from redemption, liquidation value from surrender, and the lien value when a debtor reaffirms. *See supra* Section II.B. The Code further stipulates that if a debtor fails to comply with § 521 notice requirements, a creditor is entitled to "take whatever action as to such property as is permitted by applicable nonbankruptcy law." 11 U.S.C. § 521(a)(*).

120. U.S. CONST. art. I, § 8, cl. 4.

121. Ry. Labor Execs.' Ass'n v. Gibbons, 455 U.S. 457, 469 (1982).

122. *See, e.g.*, *In re* Metromedia Fiber Network, Inc., 299 B.R. 251, 268 (Bankr. S.D.N.Y. 2003); *In re* Claussen, 118 B.R. 1009, 1012 (Bankr. D.S.D. 1990); *In re* Pelter, 64 B.R. 492, 495 (Bankr. W.D. Okla. 1986); *In re* Lausch, 12 B.R. 55, 55 (Bankr. M.D. Fla. 1981); Wenners v. Great State Beverages, Inc., 663 A.2d 623, 624 (N.H. 1995).

123. Randolph J. Haines, *The Uniformity Power: Why Bankruptcy Is Different*, 77 AM. BANKR. L.J. 129, 155-56 (2003).

post-bankruptcy dispositions, serving the interests of both debtors and creditors by providing the predictability necessary to undergird a robust market for consumer loans.

The goals of a fresh start for debtors, protection for creditors, and uniformity of law are central to evaluating the policy merit of retention alternatives. Unfortunately, both § 521 and practical retention alternatives violate these fundamental goals of Chapter 7.

B. The General Case Against Reaffirmation

The rational avoidance of reaffirmation by both debtors and creditors has diminished its frequency in practice. When reaffirmation agreements succeed, however, bankruptcy scholars, courts, and policymakers have recognized that they frustrate Chapter 7's policy goals by renewing personal liability for pre-bankruptcy debts after the debt discharge.[124]

The renewed personal liability is particularly problematic because so many Chapter 7 debtors agree to unsustainable reaffirmation terms. As described in Section II.B, due to the uncertainty and costs associated with reaffirming, a creditor will only require a debtor to reaffirm when there is the most to lose and the highest probability of loss. Unsurprisingly, this leads to reaffirmation agreements only when the debtor has a low ability to pay. Despite procedural safeguards in the Code, one study found that among reaffirming debtors, "[f]ewer than half . . . had any income remaining after expenses and reaffirmation payments, and only a third had more than $100 per month left."[125]

124. *See, e.g.*, *In re* Wilhelm, 369 B.R. 882, 883 (Bankr. M.D.N.C. 2007) ("Reaffirmation agreements are . . . contrary to one of the primary goals of the Bankruptcy Code: to provide a debtor with a fresh start."); H.R. REP. NO. 95-595, at 163 (1977) ("To the extent that reaffirmations are enforceable, the fresh start goal of the bankruptcy laws is impaired."); Culhane & White, *supra* note 5, at 765 ("Reaffirmation . . . too often . . . burdens and impedes [the fresh start].").

125. Culhane & White, *supra* note 5, at 762. Bankruptcy Judge Mary Diehl explained the realities of Chapter 7 reaffirmation agreements for unrepresented debtors this way: "[Creditors] say, 'We know you really want to keep this car, so just sign here, and you can keep paying this car at 27% interest . . . .' The debtor will sign this without ever undertaking the analysis of whether they can afford it . . . ." Mary Grace Diehl et al., *The Consumer Bankruptcy Panel: Views from the Bench—Five Years of BAPCPA*, 26 EMORY BANKR. DEV. J. 225, 240 (2010); *see also* Culhane & White, *supra* note 66, at 479-80 ("Experience under the [Bankruptcy] Act of 1898 showed that . . . debtors all too often reaffirmed beyond their ability to repay . . . ." (footnote omitted)).

The fact that creditors are most likely to press reaffirmation agreements with debtors who can least afford to reaffirm further frustrates the fresh start, because debtors who reaffirm and later default are worse off than if they had simply surrendered the collateral. They lose the underlying asset and yet continue to face liability for any repayment deficiency, which they may be unable to discharge because the Code limits repeat bankruptcy filings.[126] Since reaffirmation is riddled with pitfalls from a debtor's perspective, it is no surprise that reaffirmation agreements are "largely creditor-driven."[127]

C. The Drawbacks of Chapter 13 and Forbearance

Chapter 13 serves different policy goals than Chapter 7, so it may be expected that it likewise fails to promote Chapter 7's fresh start. Rather than offering a debt discharge, Chapter 13 bankruptcy allows debtors to retain assets in exchange for garnishing wages, which by definition impairs their post-bankruptcy earning power.[128] Particularly after BAPCPA, which amended Chapter 13 to deter abusive filers, it would be difficult to argue that Chapter 7's paradigmatic "honest debtor" should be pressed into Chapter 13.[129] Moreover, as with reaffirmation agreements, debtors frequently agree to Chapter 13 repayment plans they cannot maintain.[130]

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126. *See* Badger, *supra* note 14, at 2266 (citing 11 U.S.C. § 727(a)(8) (2006)).

127. 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 11, at 146. In the past, creditors have "aggressively pursued debtors for reaffirmations." Culhane & White, *supra* note 66, at 479-80. To secure reaffirmation agreements, creditors have even resorted to "misleading information or threats." Ehrlich, *supra* note 12, at 625 (quoting OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, STATEMENT OF ADMINISTRATIVE POLICY: H.R. 833—BANKRUPTCY REFORM ACT OF 1999 (1999)). Under creditor pressure, debtors in circuits that allowed ride-through prior to BAPCPA regularly reaffirmed debts. *See* Culhane & White, *supra* note 5, at 726 (finding an inverse relationship between the ride-through option and reaffirmation agreements, but noting that a significant number of debtors in ride-through districts nonetheless reaffirmed).

128. *See* Posner, *supra* note 112, at 969 (discussing the argument that the means test, which targets abusive Chapter 7 filers by pushing them into Chapter 13, "would defeat a purpose of bankruptcy law"). For further discussion of the means test, see *supra* note 88.

129. *See supra* note 88.

130. Estimates of debtor default rates on Chapter 13 repayment plans range from approximately two-thirds to nearly 100%. *See* Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 440 (1999) (estimating that 68% of plans were dismissed before completion); 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, 410-11 (1994) (observing default rates of up to 97% percent). In 2011, fewer than one-quarter of Chapter 13

Creditor forbearance, on the other hand, protects the fresh start. Because forbearance agreements are nonrecourse, if a debtor fails to make a scheduled payment following bankruptcy, a forbearing creditor may repossess the asset but take no further action. Forbearance agreements aggravate other inequities, however. Since a debtor has no right to demand forbearance, creditors control when and to whom the option is available. As discussed above, the practical result is that creditors voluntarily forbear only when they expect full repayment, requiring debtors who are likely to default to reaffirm debt. Secured creditors are also repeat players in consumer bankruptcy proceedings and so are familiar with the full slate of retention options. Experienced counsel may inform some debtors of the options outside § 521. Pro se or poorly advised debtors, however, will proceed unaware of nonstatutory alternatives, which aggravates bargaining inequities. This is critical, for in 2011 more than ten percent of debtors who filed reaffirmation agreements appeared pro se.[131]

D. The Trouble with Backdoor Ride-Through

After the *Hardiman* court endorsed backdoor ride-through in the Eastern District of North Carolina, Christopher Badger argued that the new retention option would "always be in the debtor's best interest."[132] Badger pointed out that backdoor ride-through protected the fresh start by keeping loans nonrecourse after bankruptcy, and that it additionally "does not significantly harm the creditor in most situations."[133] As this Section shows, however, backdoor ride-through in fact imposes unforeseen risks on secured creditors and frustrates national uniformity of bankruptcy law, both of which represent departures from Chapter 7 policy goals.

Three variables illustrate the source of potential creditor loss from a ride-through arrangement. As in Section III.A, at the time of bankruptcy, a creditor values the asset at its resale value (V_C). *R* is the asset value at the time of repossession. *P* represents the total payments on collateral received by the

plans were completed, and many were modified at least once prior to completion. 2011 BANKRUPTCY STATISTICS, *supra* note 3, at 60. This was an increase from 14% completion in 2010 and only 6% in 2009. *Id.* at 13. The U.S. Supreme Court has noted that the "vast majority" of Chapter 13 plans fail. *See* Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 960 (1997) (quoting Assocs. Commercial Corp. v. Rash (*In re* Rash), 90 F.3d 1036, 1066 (5th Cir. 1996) (en banc) (Smith, J., dissenting)).

131. 2011 BANKRUPTCY STATISTICS, *supra* note 3, at 52. This estimate assumes that any filing in which an attorney did not file an affidavit to accompany the reaffirmation agreement was pro se. *Id.* at 55 n.3.

132. Badger, *supra* note 14, at 2271.

133. *Id.* at 2266.

creditor between the time of bankruptcy and repossession. A creditor could be made worse off by ride-through only if the post-petition reduction in asset value due to depreciation and damage outweighs the offsetting payments received during the same time period ($V_C - R > P$).

In lobbying against common law ride-through, creditors protested that their interests would not be adequately protected if a debtor could retain an asset without renewing personal liability. Without liability for reduced collateral value, they contended, a debtor had no incentive to maintain the value of the collateral between bankruptcy and later default, and might neglect or damage the asset.[134] Alternatively, the asset might depreciate too quickly for the loss of value to be offset by incoming payments. In either case, depreciation would outweigh payments ($V_C - R > P$), so the creditor would suffer a loss. In these situations, creditors insisted that reaffirmation was required to protect their interest in collateral.[135]

A Chapter 7 debtor has little incentive to damage assets post-bankruptcy, which casts doubt on creditors' most vocal concerns. By electing to either reaffirm or ride-through debt, a debtor signals a strong interest in retaining the collateral. For this reason, the Third Circuit in *In re Price* called the fear that debtors would intentionally damage ride-through assets "overstated and entirely hypothetical."[136] Instead, the court reasoned, "[i]t is just as reasonable to assume, given the difficulty insolvent consumers may have in obtaining future financing, that such debtors would have ample incentive to maintain their collateral, such as their automobiles, in good condition."[137]

To the extent that creditors' fears are justified, however, they face the greatest risk when expected payment (P) is low, such as when default is expected after few payments. Likewise, if the expected damage or depreciation ($V_C - R$) is high, a creditor might prefer to repossess rather than risk further

134. 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 11, at 167 (noting that creditors "wanted debtors to have an incentive to take care of the collateral and felt that personal liability provided that incentive"). In economic terms, this distortion of incentives is called the "moral hazard" problem.

135. *See supra* Sections II.B, III.B.

136. Price v. Del. State Police Fed. Credit Union (*In re* Price), 370 F.3d 362, 377 (3d Cir. 2004).

137. *Id.* Professor Ehrlich further contends that the personal liability that accompanies reaffirmation agreements is unlikely to improve the debtors' incentives in any case. Ehrlich, *supra* note 12, at 665-66; *see also* Culhane & White, *supra* note 5, at 719 ("The effect [of reaffirmation] is to transform the claim into a nonrecourse debt. The debtor's personal liability has been discharged but the lien lives on as a strong incentive to voluntary payment.").

value impairment. As discussed above, with this risky debtor class a creditor would be most inclined to require a reaffirmation agreement.[138]

Unfortunately for creditors, it is also with risky debtors that a court would be most likely to reject a reaffirmation agreement. A finding of undue hardship, which compels a court to reject proposed reaffirmation terms,[139] arises when a debtor has relatively low income compared with required repayments. In this circumstance, a creditor would also expect fewer repayments prior to default, meaning *P* would be low. Similarly, if the debtor knows that long-term asset retention is unlikely, the debtor faces reduced incentives to maintain the collateral, so the expected damage and depreciation will be large.

The injury to creditors from backdoor ride-through is thus twofold. First, they must accept a binding nonrecourse retention arrangement with relatively high-risk debtors—the precise class with whom creditors would be disinclined to reach such an agreement voluntarily. Second, backdoor ride-through impairs the benefit of reaffirmation by posing an omnipresent threat in the cases in which reaffirmation would be valuable. This Note will return to both of these drawbacks to backdoor ride-through in Section V.D, emphasizing the advantages of statutory over backdoor ride-through from a creditor's perspective.

Backdoor ride-through also frustrates the uniformity of Chapter 7 bankruptcy proceedings. BAPCPA effectively resolved the circuit split by extinguishing common law ride-through, but it created uncertainty as to whether courts that reject reaffirmation agreements must, or may, allow a debtor to take advantage of backdoor ride-through. While not as divisive as a circuit split, the new puzzle adds unpredictability and irregularity to the treatment of secured debt in Chapter 7 proceedings. Most bankruptcy courts that have reached the issue have allowed backdoor ride-through,[140] but many have not yet ruled on it.[141] Some courts, including the Ninth Circuit, have

138. *See supra* Sections III.B, IV.B.

139. *See supra* text accompanying note 39.

140. In December 2011, the Bankruptcy Court for the Eastern District of Michigan denied a creditor's motion for rehearing when the debtor was permitted a backdoor ride-through. *In re* Reed, No. 10-67727, 2011 WL 6328677, at *1 (Bankr. E.D. Mich. Dec. 14, 2011). In its analysis, the court first cited seven post-BAPCPA opinions endorsing backdoor ride-through. *Id.* at *3. The court further reasoned that "[s]ince Congress didn't remove 'if applicable' with passage of BAPCPA even though this language was heavily relied upon by courts to justify ride-through provisions, such congressional inaction, while not dispositive, suggests a lack of intention to eliminate the ride-through option espoused by many courts." *Id.* at *4 (quoting 11 U.S.C. § 521(a)(2)(A) (2006)).

141. This is due partly to a recurrent problem of mootness. *See infra* note 157 and accompanying text.

specifically reserved the question.[142] Other courts impose additional preconditions to backdoor ride-through. For example, the debtor profiled in the Introduction, Carolyn Bowden, was unable to retain her Trailblazer because her attorney had refused to sign the reaffirmation agreement, even though Bowden filed in a district that recognized backdoor ride-through.[143] The Western District of Virginia followed the same approach, reasoning that allowing backdoor ride-through in that case would create "a very powerful incentive to debtors and their counsel not to make the hard choices themselves but to try and put them before the court."[144] The *Hardiman* court suggested that a creditor could obtain relief from backdoor ride-through by showing "cause" under § 362(d).[145]

Finally, even in districts where backdoor ride-through is firmly established, it is difficult to predict when the new rule will apply. The process for evaluating reaffirmation agreements under BAPCPA is not uniform.[146] Because backdoor ride-through arises from a rejected reaffirmation agreement, it cannot hope to be uniform either.

V. TOWARD STATUTORY RIDE-THROUGH

In the wake of BAPCPA, the consumer bankruptcy system has become a labyrinth of inequity, failing to protect both debtors' and creditors' interests

142. Dumont v. Ford Motor Credit Co. (*In re* Dumont), 581 F.3d 1104, 1112 n.14 (9th Cir. 2009) (acknowledging that the decision "leaves the law of ride-through unclear, creating uncertainty for many Chapter 7 debtors and creditors alike").

143. *In re* Bowden, No. 11-06168-8, 2012 WL 589657, at *3-4 (Bankr. E.D.N.C. Feb. 22, 2012). Bowden filed in the Eastern District of North Carolina, the same district that had decided *Hardiman*. *See supra* notes 104-107 and accompanying text. Since the Code requires a proposed reaffirmation agreement to be "accompanied by a declaration or an affidavit of the attorney that represented the debtor" during negotiations, 11 U.S.C. § 524(c)(3), the *In re Bowden* court concluded that the missing signature rendered Bowden's agreement unenforceable. *In re Bowden*, 2012 WL 589657, at *3. The signature requirement is critical because it ensures that the debtor's attorney fulfilled her obligation to evaluate whether the proposed reaffirmation agreement is in the debtor's best interests. *See In re* Minardi, 399 B.R. 841, 853 (Bankr. N.D. Okla. 2009) (noting that the Code places the "responsibility . . . for both oversight and approval or reaffirmation agreements" with the debtor's counsel); *see also supra* note 36 and accompanying text.

144. *In re* Harvey, 452 B.R. 179, 186-87 (Bankr. W.D. Va. 2010).

145. Coastal Fed. Credit Union v. Hardiman, 398 B.R. 161, 183 (E.D.N.C. 2008).

146. *See* Lisa A. Napoli, *Reaffirmation After the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Many Questions, Some Answers*, 81 AM. BANKR. L.J. 259, 271-74 (2007) (describing how the BAPCPA amendments to § 524 resulted in "non-uniform procedures for the evaluation of reaffirmation agreements").

and frustrating national uniformity of law. This Part explains why statutory ride-through succeeds where the present options do not. It first describes the proposed reform and its anticipated impact, and then discusses the policy merit of statutory ride-through following BAPCPA. In particular, while ride-through has been urged as a pro-debtor policy, this Part describes how it would also benefit creditors compared with backdoor ride-through.

A. Blueprint for Reform

This Note proposes the following revisions to § 521(a)(2):

> (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, file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if ~~applicable~~ **retaining such personal property,**[147] specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to ~~reaffirm~~ **ride-through** ~~debts secured by~~ such property; and
> >
> > (B) within 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, perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph;

147. This Note adopts the language from post-BAPCPA § 362(h) to avoid confusion related to the meaning of "if applicable," which gave rise to the circuit split on common law ride-through prior to BAPCPA. *Compare In re* Boodrow, 126 F.3d 43, 51 (2d Cir. 1997) ("[Section] 521(2) appears to serve primarily a notice function, not necessarily to restrict the substantive options available to a debtor who wishes to retain collateral securing a debt."), *and In re* Belanger, 962 F.2d 345, 348 (4th Cir. 1992) ("[I]f the phrase 'if applicable' is given effect . . . the debtor must specify a choice of the options if applicable. But if these options are not applicable, the debtor need not specify them."), *with In re* Burr, 160 F.3d 843, 848 (1st Cir. 1998) ("[Congress] intended chapter 7 debtors to elect surrender or retention, and then, 'if' retention is 'applicable,' to specify which of the following three retention options they intend to employ.").

> except that 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 (h)~~.

The redemption and surrender options exist as under BAPCPA.[148] Section 362(h), which explicitly limits a debtor to the § 521 options, is deleted.[149] The portions of § 524 pertaining to reaffirmation agreements, beginning with § 524(c), are also unnecessary.

Although common law and backdoor ride-through functioned without a statutory provision establishing their contours, a Code provision describing statutory ride-through would also be useful. This Note does not propose specific text for that provision, but advocates two components. First, statutory ride-through should be available to all debtors who are paid-to-date at the time of bankruptcy proceedings, and also to those who are able to cure any default on payments "within a reasonable time" of filing the Chapter 7 petition.[150] The latter provision is known as "reinstate-and-cure" in Chapter 13 proceedings, and it would have the effect of making statutory ride-through available to a broader class of Chapter 7 debtors. Second, a debtor who elects statutory ride-through is bound by the terms of the original contract and must continue loan payments as before bankruptcy. If a ride-through debtor commits an act of default within the terms of that contract, the creditor may repossess the asset but may not assert a claim against the debtor for a repayment deficiency.

B. How Statutory Ride-Through Improves Uniformity

Statutory ride-through promotes uniform bankruptcy proceedings by encouraging debtors and creditors to operate within the contours of the Code, and by eliminating uncertainty in interpreting retention provisions. First, when

148. There are compelling arguments for reducing the cost of redemption to liquidation value (V_C), as it was before BAPCPA in many circuits. *See supra* note 24. Allowing secured creditors to collect retail value enables them to collect both the secured amount and a portion of the unsecured claim in bankruptcy. Thus when a debtor redeems, secured creditors take some of the funds otherwise payable to unsecured creditors. This Note supports the position that liquidation value would better effectuate the normative principle that "equity is equality," *see* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 353 (1993), but it focuses primarily on statutory ride-through rather than the cost of redemption as a corrective policy measure.

149. By endorsing ride-through, the dominant option outside § 521, the revision voids the need for the specific limiting provision of BAPCPA. *See supra* notes 52-54 and accompanying text.

150. *See* 11 U.S.C. § 1322(b)(5) (2006).

statutory ride-through replaces reaffirmation, the alternatives outside § 521 lose their appeal. Creditors would no longer voluntarily forbear because an equivalent remedy is available by statute, and, because backdoor ride-through arises from a rejected reaffirmation agreement, the disappearance of reaffirmation would also eradicate backdoor ride-through. An expanded right to collateral retention in Chapter 7 likewise makes conversion to Chapter 13 even less likely. Statutory ride-through finally moots the pre-BAPCPA circuit split on common law ride-through and resolves two points of judicial confusion related to interpreting reaffirmation agreements under BAPCPA: whether backdoor ride-through should be imposed, and how undue hardship should be measured.[151]

C. The Pro-Debtor Case for Statutory Ride-Through

As highlighted in the Introduction, various scholars have advocated for ride-through based on the benefits it confers on Chapter 7 debtors.[152] The scholarship readily observes that ride-through generally protects the fresh start and otherwise improves the position of debtors by eliminating the substantial cost of negotiating and filing a reaffirmation agreement.

Following BAPCPA, backdoor ride-through has improved the expected outcome of a reaffirming debtor. It directly benefits debtors who are allowed to backdoor ride-through their assets by allowing them to retain those assets according to the original loan schedule. It also indirectly benefits all Chapter 7 debtors by discouraging creditors in backdoor ride-through districts from pressing unduly exacting reaffirmation terms.

Statutory ride-through is even more debtor-friendly. It confers the direct benefit of backdoor ride-through on all Chapter 7 debtors and additionally eliminates the downsides associated with reaffirmation. A debtor who reaffirms following BAPCPA cannot be certain whether that agreement will yield reaffirmation, a forbearance agreement, or backdoor ride-through. Compared with the status quo, statutory ride-through promotes the fresh-start policy as well as simplification and transparency of Chapter 7 proceedings for debtors.

151. *See supra* Section III.C.

152. *See supra* notes 11-14 and accompanying text.

D. Statutory Ride-Through as a Pro-Creditor Policy

To the well-worn pro-debtor case for ride-through, this Note adds a more novel contention: compared with post-BAPCPA asset-retention options, statutory ride-through might be framed as a pro-creditor policy as well. Professor Ehrlich laid the groundwork for this claim before BAPCPA when he contended that common law ride-through did not "unduly burden[] the secured creditor"[153] and in most cases would even benefit a creditor compared with reaffirmation. Based on this observation, Ehrlich admonished creditors who lobbied against common law ride-through to "[b]e careful what you ask for."[154] However, Ehrlich overlooked that creditors before BAPCPA could already achieve de facto ride-through via voluntary forbearance, and thus still had an incentive to preserve the reaffirmation option. Building on Ehrlich's analysis, this Section reexamines the downsides of statutory ride-through compared with alternatives from a creditor's perspective, and shows why the recent emergence of backdoor ride-through might encourage creditors to support a statutory version.

There are three reasons to believe that statutory ride-through protects creditors' interests at least as well as the status quo. First, even if a ride-through debtor does not wholly repay the outstanding loan, a creditor will generally obtain its non-bankruptcy outcome (V_C). As discussed in Section IV.D, as long as the pre-petition payment schedule offsets depreciation and damage, a creditor will be no worse off repossessing after post-bankruptcy default. This outcome is consistent with a debtor's post-bankruptcy incentives to maintain collateral and continue making payments.

Second, in the majority of cases, debtors who elect ride-through complete all outstanding loan payments. In that case creditors collect the entire outstanding loan (L), and in addition save a portion of the "few hundred to several thousand dollars" it would have cost to reaffirm.[155] Two observations support the contention that most debtors successfully ride-through assets. Prior to BAPCPA, many creditors voluntarily agreed to forbear rather than reaffirm.[156] The fact that creditors regularly bypassed renewed personal liability suggests that ride-through and reaffirmation were relatively equivalent. Ride-through appeals have been plagued by a recurrent problem of mootness, which also suggests that ride-through debtors typically achieve full repayment.

153. Ehrlich, *supra* note 12, at 699.

154. *Id.* at 696.

155. *See supra* text accompanying note 81.

156. *See supra* notes 96-98 and accompanying text.

The mootness problem arises because debtors have almost always repaid the outstanding loan by the time the case reaches an appellate court, so neither party retains standing to appeal. The Prices, for example, had fully paid the outstanding debt on their Toyotas by the time their case reached the Third Circuit.[157]

Third, and most importantly, a creditor may in any case alter the terms of the initial lending contract to address concerns that a debtor might damage ride-through assets. Many lending contracts contain "insecurity clauses" that allow a creditor to repossess if asset value is threatened. For high-value collateral, particularly vehicles, a creditor might additionally specify that failing to submit regular proof of insurance constitutes an act of default.[158] When lending agreements contain such terms, courts have recognized a creditor's right to repossess if an insured party fails to maintain insurance.[159] Moreover, by requiring a debtor to submit regular proof of insurance, a creditor may also shift the monitoring costs to the debtor. By altering the ex ante terms of the loan agreement, a creditor may thus repossess immediately following a debtor's default, virtually guaranteeing liquidation value (V_C) in any case.[160]

157. Price v. Del. State Police Fed. Credit Union (*In re* Price), 370 F.3d 362, 365 (3d Cir. 2004). Both the Prices and the Credit Union urged the court to nonetheless hear the case under an exception to the mootness doctrine for issues "capable of repetition yet evading review." *Id.* (quoting *In re* Surrick, 338 F.3d 224, 230 (3d Cir. 2003)). The majority opinion overlooked the mootness issue entirely, while one judge dissented on this ground. *Id.* at 379-82 (Sloviter, J., dissenting). Creditors have similarly argued a mootness exception in order to continue litigation against a fully paid debtor. *See* Reply Brief of BankBoston, N.A. at 6, BankBoston, N.A. v. Sokolowski (*In re* Sokolowski), 205 F.3d 532 (2d Cir. 2000) (Nos. 99-5048, 99-5054), 1999 WL 33620046, at *9.

158. "Default" is not defined by the Uniform Commercial Code, but rather by the terms of each lending agreement.

159. *E.g.*, Nevarez v. O'Connor Chevrolet, Inc., 426 F. Supp. 2d 806, 818-19 (N.D. Ill. 2006) (recognizing that a creditor "was within its rights to repossess" a vehicle when the secured lending agreement required the borrower to maintain insurance, and the creditor had been advised that the debtor's insurance policy was canceled); Ash v. Peoples Bank of Greensboro, 500 So. 2d 5, 7 (Ala. 1986) (upholding a bank's repossession of the insured's van when the "insurance clause in the security agreement required [the insured party] to keep the van insured against loss by fire, theft, and collision," and the insured failed to do so); Wagner v. Ford Motor Credit Co., 272 S.E.2d 500, 501 (Ga. Ct. App. 1980) (holding that contract terms that required a borrower to "obtain and maintain" insurance "plain[ly]" and "unambiguous[ly]" authorized a creditor to repossess when the debtor failed to do so).

160. *See supra* note 134 and accompanying text. If a debtor must maintain insurance or surrender, a debtor cannot destroy collateral and prevent the creditor from collecting V_C. Moreover, if the debtor bears the burden of proving insurance, the creditor need not incur the transaction costs of monitoring the debtor.

From a practical perspective, comparing statutory ride-through to backdoor ride-through gives creditors a reason to abandon their earlier lobbying position.[161] As discussed in Section IV.D, the circumstance in which a creditor is most likely to require reaffirmation is also that in which a court is most likely to negate the benefit of reaffirmation by imposing backdoor ride-through, which leaves creditors worse off than if they had simply forborne. Backdoor ride-through thus presents a serious dilemma for secured creditors by introducing a gambling aspect to reaffirmation agreements. Statutory ride-through, on the other hand, allows a debtor to retain collateral but preserves a creditor's right to repossess following default. Finally, because the terms of statutory ride-through adhere to the original lending agreement, creditors shape the terms of default and repossession.

It has been observed that in certain circumstances "reaffirmations have good ex ante incentive effects" because "[c]reditors who anticipate getting reaffirmations will reduce the interest rate" they charge.[162] Despite this observation, statutory ride-through should not affect the interest rates on secured consumer debt. First, the consumer credit market accounts imperfectly for risk[163] and many jurisdictions cap the interest rates charged on consumer loans,[164] making interest rates imperfectly responsive to expected repayment. If the interest rates are sticky, lower repayment may instead result in decreased availability of loans. Yet enacting statutory ride-through should not have this effect either. Creditors offer less favorable loan terms to account for lower expected repayment.[165] For the reasons described above—reaffirmation agreements infrequently succeed, creditors may protect themselves by altering ex ante contract terms, and backdoor ride-through exposes creditors to a similar risk—statutory ride-through would not reduce expected repayment for creditors compared with the status quo, and so should not affect lending practices.

161. *See* Whitford, *supra* note 48, at 172.

162. Adler et al., *supra* note 76, at 603 n.33.

163. *See generally* Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749 (2008) (discussing systemic mistakes that permeate the consumer credit market).

164. In 2003, fifteen states and the District of Columbia had a flat interest rate cap on consumer loans, and thirteen had some other form of cap. Brief for Respondent at 3, Till v. SCS Credit Corp., 541 U.S. 465 (2004) (No. 02-1016), 2003 WL 22466039, at *31-32. When high-risk consumers take out loans in those jurisdictions, secured creditors typically charge the maximum permissible interest rate.

165. *Cf.* Adler, *supra* note 115, at 500 (observing that improving creditor collection makes loan terms more favorable).

This Note does not posit that statutory ride-through is the best possible outcome for creditors, because rational creditors would prefer to eliminate backdoor ride-through and then voluntarily forbear while preserving the ability to demand reaffirmation in certain cases. It bears noting, however, that other proposals considered during the enactment of BAPCPA were materially less favorable to creditors. Bifurcation, for example, would require a Chapter 7 debtor to reaffirm only the value of the underlying collateral, while discharging the unsecured portion of the loan.[166] In that case, a creditor would receive only the asset's liquidation value at the time of bankruptcy (V_C). It is unsurprising that the bifurcation proposal was among "the biggest concern[s] of the automobile financing interests."[167]

Put into perspective, statutory ride-through—which does not renew personal liability and allows creditors to collect the full unpaid loan (L)—at least represents a compromise that would benefit all parties to Chapter 7 proceedings. Moreover, statutory ride-through will generally be at least equivalent to reaffirmation from a creditor's perspective. In any case, a creditor may ensure that it collects at least its non-bankruptcy entitlement (V_C) through ex ante contracting. Given the drawbacks associated with backdoor ride-through, creditors—and an apparently creditor-dominated Congress[168]—have more reason than ever to consider statutory ride-through as a viable alternative.

CONCLUSION

A policy is "Pareto improving" if it makes at least one party better off without making another worse off.[169] Compared with the post-BAPCPA status quo, statutory ride-through is such a policy. It benefits debtors by ensuring a fresh start, simplifying the available options, and lowering the price of collateral retention. It also protects creditors by allowing them to potentially collect both secured and unsecured portions of their loan, while eliminating the downsides of backdoor ride-through. Finally, making ride-through a statutory option would create uniform, predictable treatment of secured debt in consumer bankruptcy. Section 521 affects millions of dollars of secured debt

166. Bifurcation is available as a matter of course in Chapter 13 proceedings, although BAPCPA introduced exceptions making its terms less favorable for debtors. *See supra* text accompanying notes 89-93.

167. Whitford, *supra* note 48, at 172.

168. *See supra* notes 45-48 and accompanying text.

169. *See* NG, *supra* note 15, at 30.

and hundreds of thousands of Americans each year. Codifying statutory ride-through would represent a significant stride toward more equitable and efficient treatment of that debt.