

BY DONALD R. LASSMAN

Safe Driving Through Chapter 7

A Road Map for the Retention of Leased Vehicles

A motor vehicle is frequently the most important asset possessed by a consumer debtor, and its retention during and after bankruptcy might be key to a debtor's successful financial rehabilitation. Default under a motor vehicle lease is often a precipitating event for a bankruptcy filing, and for many consumer debtors, chapter 13 provides a reliable framework for curing the default.¹

For many other debtors, bankruptcy might be caused by financial obligations wholly unrelated to a motor vehicle lease, so chapter 7 may present a better alternative; retention of the motor vehicle during and after bankruptcy could be equally paramount for such debtors. However, the process for addressing post-filing obligations of debtors and creditors under personal property leases in chapter 7 cases is murky, and courts that have addressed this issue have suggested differing approaches to this prickly area of the law. A recent decision by the U.S. Bankruptcy Court for the District of Massachusetts surveys the landscape of divergent decisions on the treatment of personal property leases in chapter 7, and suggests a procedure that harmonizes an otherwise-discordant landscape of case law.



Donald R. Lassman
Law Office of Donald
R. Lassman
Needham, Mass.

Donald Lassman is
a chapter 7 trustee
and solo practitioner
in Needham, Mass.

The Statutory Framework

Assumption of personal property leases² in chapter 7 is expressly addressed in § 365. The chapter 7 trustee has 60 days after the order for relief to assume or reject personal property leases.³ Absent assumption or rejection by the trustee within the applicable time period, the lease is deemed rejected,⁴ the leased property is no longer property of the estate, and the automatic stay is terminated.⁵

Pursuant to § 362(h), the protections of the automatic stay might also be lost if a debtor fails to timely file the statement of intent required by § 521(a)(2) and perform the actions specified in the statement of intent.⁶ Failure to timely com-

ply with the provisions of § 362(h) also eliminates the important protections afforded debtors in § 365(e)(1) with respect to the operation of "ipso facto" clauses after the filing of a bankruptcy case, such that the mere fact of filing for bankruptcy will constitute an event of default under a lease that might otherwise not be in default.⁷

Because lease rejection terminates the automatic stay as to the relevant property, if a debtor wants to retain leased property, a debtor should timely file the statement of intention, serve it on the lessor,⁸ alert the lessor in writing of its intent to assume the lease as promptly as possible after case commencement,⁹ and, within 30 days thereafter, notify the lessor in writing that the lease is assumed.¹⁰

While a chapter 7 trustee has the sole right to assume or reject a lease when the case is filed, nothing in the Bankruptcy Code suggests that the debtor cannot promptly notify the lessor of its intention to assume the lease. Moreover, as a practical matter, chapter 7 trustees are unlikely to assume personal property leases because there is no benefit to the estate.

Two Schools of Thought

Courts have developed two different approaches for assumption of motor vehicle leases in chapter 7 cases.¹¹ One approach holds that assumption is accomplished by complying with the reaffirmation requirements of § 524(c).¹² This approach has been criticized for unnecessarily interjecting the onerous requirements of the reaffirmation process into the lease-assumption process described in § 365(p), which contains no reference to § 524.¹³

The second approach holds that assumption and reaffirmation are two distinct legal concepts imposing different rights and obligations on the parties, and therefore the requirements of § 524(c) do not apply to lease assumption.¹⁴ This approach is extra-judicial and has been criticized for the lack of court

1 Section 1322(b)(7) provides that a chapter 13 plan may, "subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section."

2 While motor vehicle leases are most commonly the subject of the court decisions, the reasoning of those decisions applies to any lease of personal property.

3 The trustee may seek an extension of the 60-day period. See 11 U.S.C. § 365(d)(1).

4 See 11 U.S.C. § 365(d)(1).

5 See 11 U.S.C. § 365(p)(1).

6 See 11 U.S.C. § 362(h)(1)(A). This Code section references the statement of intention that debtors must file pursuant to § 521(a)(2). However, § 521(a)(2) plainly applies solely to liabilities that are secured by property of the estate. Leasehold liabilities are not secured by property of the estate (*i.e.*, the leased property is owned by the lessor, not the debtor), so the inclusion of leased property on the statement of intention, while contemplated by § 362(h)(1)(A), is clearly not contemplated by § 521(a)(2). However, § 521(a)(2)(A) does not include assumption as one of the options available to debtors on their statement of intention. Nevertheless, Part 2 of Official Form 108 ("Statement of Intention for Individuals Filing Under Chapter 7") requires debtors to list their personal property leases and indicate whether the leases will be assumed.

7 11 U.S.C. § 521(d).

8 Fed. R. Bankr. P. 1007(b)(2).

9 11 U.S.C. § 365(p)(2)(A).

10 11 U.S.C. § 365(p)(2)(B).

11 For an earlier and excellent discussion of the differing views on reaffirmation as a condition of lease assumption, see "Leases: To Reaffirm or Not?," *Am. Bankr. L.J.* 14 (2015). The question posed by the author at the end of the article has now been answered by one court in the District of Massachusetts.

12 See, e.g., *In re Creighton*, 427 B.R. 24 (Bankr. D. Mass. 2007); *In re Eader*, 426 B.R. 164 (Bankr. D. Md. 2010); *Thompson v. Credit Union Fin. Grp.*, 453 B.R. 823 (W.D. Mich. 2011); *In re Garaux*, 2012 WL 5193779 (Bankr. N.D. Ohio 2012).

13 *Williams v. Ford Motor Credit Co. LLC*, 2016 U.S. Dist. LEXIS 62402, *15 (E.D. Mich. 2016).

14 See, e.g., *In re Hayden*, 2014 Bankr. LEXIS 1791 (Bankr. D. Vt. April 22, 2014); *In re Perlman*, 468 B.R. 437 (Bankr. S.D. Fla. 2012); *Bobka v. Toyota Motor Credit Corp.*, 586 B.R. 470 (S.D. Cal. 2018); *In re Ebbrecht*, 451 B.R. 241 (Bankr. E.D.N.Y. 2011).

supervision and debtor protections inherent in the reaffirmation process.¹⁵

Directions for Successful Lease Assumption

The U.S. Bankruptcy Court for the District of Massachusetts recently had the opportunity to explore the issues that debtors and creditors confront when attempting to maintain the *status quo* for leased motor vehicles. In *In re Anderson*,¹⁶ the chapter 7 debtor sought to assume a pre-petition car lease and notified the leasing company of his intentions. The lease was not in default at the time of the filing, and the debtor wanted to retain the car and continue tendering payments. The leasing company insisted that the debtor enter into a reaffirmation agreement as a condition of assuming the lease and keeping the car, relying on an earlier Massachusetts case¹⁷ that found that lease assumption under § 365(p) was a “species of reaffirmation.”¹⁸

The court succinctly stated the two issues presented by the debtor’s assumption request as being “whether reaffirmation is a prerequisite for lease assumption”¹⁹ and “whether, upon execution of a lease-assumption agreement pursuant to Section 365(p), the debtor’s personal liability under the assumed lease is subject to his bankruptcy discharge.”²⁰ The first issue is procedural (What form should lease assumption take?), while the second issue is substantive (What will the impact of lease assumption be on the parties to the assumption agreement?).

The court neatly disposed of the first issue, declining to follow *Creighton* and instead joining the courts that ruled that reaffirmation is not a prerequisite to lease assumption. Relying in large part on statutory construction, the court based its decision on the following: (1) the alternative “and/or” structure used in § 362(h)(1)(A) suggests that reaffirmation and lease assumption are “independent procedures”;²¹ and (2) adding reaffirmation to the lease-assumption process in § 365(p) would (i) “add a timing requirement to Code Section 365(p) that appears nowhere in the statute,”²² (ii) render § 365(p)(2)(C) meaningless because reaffirmation must take place prior to entry of the discharge order,²³ (iii) “render assumption for a chapter 7 debtor drastically different from assumption for debtor or trustees in chapter 11 and 13 cases,”²⁴ and (iv) “undercut the purpose of 365(p)”²⁵ to facilitate a debtor’s retention of leased property.

Resolution of the second issue presented a greater challenge for the court. The court first discussed the differing results that other courts have reached; some courts (such as the U.S. Bankruptcy Court for the Southern District of Florida in *Abdemar*) have concluded that lease assumption creates a nondischargeable post-petition liability,²⁶ while other courts (such as the U.S. Bankruptcy Court for the Western District of Michigan in *Thompson*) have concluded

that the debt is dischargeable and that lease assumption simply suspends “what would otherwise be the lessor’s right to retrieve the leased property.”²⁷

Intent on harmonizing the decisions in *Abdemar* with *Thompson*, the court suggested that court approval²⁸ of a lease-assumption agreement is the best means of ensuring that a debtor can achieve the goal of motor vehicle retention without fear of repossession, and creditors can achieve the goal of a leasehold obligation that survives the bankruptcy discharge.²⁹ The court described the road to lease assumption as follows: (1) include the lease on the statement of intention and indicate that the lease will be assumed; (2) notify the lessor in writing of the intention to assume;³⁰ (3) thereafter and within 30 days notify the lessor that the lease is assumed;³¹ (4) reach an agreement on the terms of the assumed lease; and (5) submit the written assumption agreement to the court for approval and “include a request for a determination that the assumed lease is a post-petition obligation of the debtor.”³²

The court acknowledged the speed bump that debtors might encounter should a lessor decline to agree to assumption, noting that nothing in § 365(p) suggests that a debtor can force assumption on an uncooperative lessor. However, the court notes that § 365(p)(2) simply requires debtors to provide two written notices to lessors and suggests that by doing so, lessors cannot repossess a debtor’s motor vehicle so long as the debtor is not in default³³ of any provisions of the lease agreement.³⁴

The *Anderson* decision directed the parties to file a joint motion to approve a lease-assumption agreement. However, the decision did not expressly address the elements of proof that are necessary to fulfill the test for assumption, and the court’s order approving the parties’ assumption motion, entered the day after the motion was filed, simply states, “Allowed.” Therefore, the precise contour of the facts that must be established to support personal property lease assumption in chapter 7 remains to be developed.

However, courts have generally adopted the business-judgment test when evaluating requests for the assumption or rejection of unexpired leases.³⁵ Since the *Anderson* court inserts court approval as a step in the assumption process, as it also is in the reaffirmation process, and since both processes result in the creation of a debt that

27 *Thompson v. Credit Union Fin. Grp.*, *supra* at 829.

28 The court noted that “[w]hile Section 362(p) does not require court involvement in the lease-assumption process, it certainly does not prohibit it.” *Anderson*, *supra* at *19.

29 “Permitting the parties to seek court approval of a lease-assumption agreement on terms that are mutually acceptable to them is the most efficient way to [e]nsure that the lease-assumption process does what it is intended to do — afford debtors a shot at retaining leased personal property.” *Anderson*, *supra* at *20.

30 11 U.S.C. § 365(p)(1).

31 11 U.S.C. § 365(p)(2).

32 *Anderson*, *supra* at *23.

33 The court noted that filing for bankruptcy alone will not constitute an event of default under a lease agreement (see 11 U.S.C. § 365(e)(1)(A), which renders *ipso facto* clauses unenforceable), and the “draconian consequences” of § 521(d), which has the effect of reviving an otherwise unenforceable *ipso facto* bankruptcy clause in those cases where a debtor fails to timely perform certain of its duties under § 521, are avoided as long as the debtor complies with the requirements of § 362(h). Therefore, there would appear to be little to gain by lessors who refuse to enter into lease-assumption agreements and much to gain (*i.e.*, a lease that survives chapter 7) by lessors who agree to assumption.

34 This result is essentially the same as that which debtors obtain when selecting the “retain and pay” option on the statement of intention for residential real estate mortgages.

35 3 *Collier on Bankruptcy* ¶ 365.03 (16th Ed. 2019).

15 *In re Eader*, *supra* at 167.

16 *In re Anderson*, 2019 Bankr. LEXIS 2800 (Bankr. D. Mass. 2019).

17 *In re Creighton*, *supra*.

18 *Id.* at *28.

19 *In re Anderson*, *supra* at *5.

20 *Id.*

21 *Id.* at *7.

22 *Id.*

23 *Id.* at *9.

24 *Id.* at *10.

25 *Id.* at *11.

26 *In re Abdemar*, 587 B.R. 167 (Bankr. S.D. Fla. 2018).

continued on page 77

Consumer Corner: Safe Driving Through Chapter 7

from page 39

survives bankruptcy, one might reasonably conclude that courts will adopt some or all of the factors that are currently used for reaffirmation when evaluating lease-assumption agreements.³⁶

³⁶ Factors used by courts to determine approval of reaffirmation agreements include whether (1) the debtor can afford the proposed payments, (2) the underlying agreement is valid and (3) the agreement is being entered into for an ulterior reason. 4 *Collier on Bankruptcy* ¶ 524.04 (16th Ed. 2019).

Conclusion

Debtors in chapter 7 can minimize the risk of losing leased motor vehicles by timely performing their obligations under §§ 365 and 521 and negotiating acceptable terms of a lease-assumption agreement, then submitting the completed lease-assumption agreement to the bankruptcy court for approval. **abi**

Copyright 2020
American Bankruptcy Institute.
Please contact ABI at (703) 739-0800 for reprint permission.