

SECURED DEBTS, LEASES, and REAFFIRMATIONS IN CHAPTER 7 BANKRUPTCY

UNSECURED DEBTS: Unsecured debts are obligations for which there is no collateral. Your obligation on unsecured debts will be discharged in bankruptcy except taxes, fines, penalties, domestic support, domestic settlement obligations, student loans, restitution, and debt incurred through fraud. You should never reaffirm an unsecured debt.

SECURED DEBTS

A debt is secured if you gave the creditor a lien against your property. That property is “collateral” for the loan. The secured creditor has the right to sell the collateral if the debt is not paid. Typically, secured debts may include **home loans** (whether they be 1st, 2nd, or 3rd mortgages, equity lines of credit, or deeds of trusts), **auto loans**, and **loans on furniture, appliances, tools, and jewelry**.

Except for some secured debts in chapter 13, a discharge in bankruptcy will terminate your *personal* obligation to pay the debt. However, if you are in default, it will not interfere with a secured creditor’s rights to repossess and sell the collateral (house, car, *etc.*) and recover any monies from that sale to apply to the debt.

Homes & Mortgages, Home Equity Loans

If you want to retain your **home**, you must continue to keep your payments current, even if you no longer receive monthly billing statements. Mail in your personal check at least 2 weeks in advance of the due date. Do not go to the creditor’s office to make your payments, and do not wait for a bill to be sent. **It is a huge mistake** for you to listen to a creditor who tells you not to make payments, if you want to keep collateral. If you are behind in your payments, even if only one day, the creditor may begin foreclosure and/or require that you sign a reaffirmation agreement to avoid foreclosure; mail in the check for accounts on which you wish to keep the collateral. *Do not rely on an automatic debit of your checking account or electronic payment arrangements, which many creditors will discontinue upon notice of bankruptcy.* After you receive a chapter 7 discharge in your bankruptcy case, even if you are keeping your house and all payments are current, your obligation on the mortgage debt will have been discharged in the bankruptcy; however, the mortgage lien stays with the property. A credit report will likely show a zero (\$0) balance on your mortgage account, nevertheless, if you want to keep your house you should keep making your mortgage payments.

Autos & Purchase Money Security Interests (PMSI) in Personal Property

PMSIs are security agreements by which tangible personal property, such as automobiles, washers, dryers, furniture, VCR, TV, stereos, lawnmowers, jewelry, tools, etc. becomes collateral for a loan. A creditor can obtain a PMSI in these items in different ways. First, you may go to a merchant to purchase an item for which the merchant arranges financing. Often this financing is done at the store where you promise to pay the finance company the amount of the purchase price (plus interest). Another way is that you could go to your bank or credit union and arrange for financing to purchase an item, such as an automobile. With financing pre-arranged, you then go to a dealer or private party, and enter into an agreement to buy a product. The dealer will contact your bank or credit union and coordinate the paperwork for financing. In both ways, either by financing the purchase at the store or pre-arranging the financing before you go to the seller, the creditor will get a PMSI in that item. Before you file bankruptcy, if you fail to pay a creditor with a PMSI, the creditor will repossess the collateral. When a chapter 7 bankruptcy is filed, your personal obligation to repay the creditor will be discharged, but the creditor will retain the right to repossess and sell the collateral; whether you have defaulted in payments or not.

When you file bankruptcy, if you have PMSI creditors, you have 3 options available, under the new law:

1. Retain the collateral and redeem. To redeem means to pay to the creditor the lower of the balance of the loan or the replacement value of the collateral, in one lump sum (no installment payments allowed).
2. Retain the collateral, continue making payments, and reaffirm the debt. To reaffirm means to sign a new contract that will not be discharged in the bankruptcy, or
3. Surrender the collateral to the creditor.

When your chapter 7 bankruptcy is filed, you will have signed and we will send to your secured creditors a document entitled “Statement of Intentions.” In that statement you will have indicated whether you wish to: retain and reaffirm; retain and redeem; retain and pay; or surrender collateral for each PMSI creditor. If you have stated an intention to retain the collateral, according to the new law, you must either redeem the collateral or reaffirm the debt, within 45 days of the Meeting of Creditors. Within 45 days of the Meeting of Creditors, you must either sign a reaffirmation agreement with the creditor (which must then be approved by the court), redeem the collateral by paying the full replacement value of the collateral to the creditor, or surrender the collateral to the creditor.

However, based upon our experience, because it is often not profitable for a creditor to repossess collateral when you have not defaulted in payments, you **might** be able to retain the collateral by simply continuing to make payments (But, there is **no guaranty** that the creditor will not repossess.) If you have more questions about this, please make an appointment).

If you choose to retain the collateral and pay, you must continue to make the regular monthly payments on time and otherwise stay current with all terms of the security agreement. Send personal checks 2 weeks before the payment is due. Do not rely on automatic debit of your account, phone pay, or quick pay. Do not wait for a statement to be sent to you. Also, after bankruptcy, the PMSI creditor may contact you to negotiate a settlement. You need to discuss this with the lender directly; otherwise, if you ignore them, you risk that they will seek to repossess the collateral.

It is **very important** that you understand that even though you state your intention to retain possession of the collateral in chapter 7, your **personal obligation on the debt will be discharged** (unless you sign a reaffirmation agreement).

How to Handle Secured Creditors in Chapter 7

A. Our office does not speak with creditors by phone. And, our fee agreement does not include negotiations with creditors for either reaffirmations or redemptions. If you want our assistance in these matters, please call and make an appointment. While there is no charge for an initial consultation about this issue, we will require additional fees for any work done after that conference.

B. If contacted by the PMSI creditor, they will inquire as to your intentions. If you want to keep the collateral, advise them that you intend to continue making payments, but do not want either to reaffirm or to redeem. If the creditor insists upon either reaffirmation or redemption, ask the creditor to send you copies of all documents you signed when the loan was made, along with any reaffirmation or redemption agreement that they are offering. If you want our assistance, please call and make an appointment.

C. An agreement with the creditor to make payments on the account as if no bankruptcy had taken place is known as a reaffirmation agreement. A reaffirmation agreement will be a new obligation that is not affected by the bankruptcy. Reaffirmation agreements require approval of the court in order to be effective. The court's approval of a reaffirmation agreement depends upon a determination that it would not impose an undue hardship on yourself or your dependents and that it would be in your best interest. Reaffirmation of debt, while allowed by the law, is not favored by the bankruptcy courts in Colorado. If you default, suit can be brought against you to collect the balance of the account. **We generally recommend against signing reaffirmation agreements.** The effect of a reaffirmation agreement is to bind you to a new contract and the bankruptcy discharge will not affect your liability for the loan; Reaffirming means you cannot discharge that debt in another chapter 7 for 8 years!

D. If the creditor insists upon a reaffirmation, we recommend that you try to negotiate a lower balance on the loan, a lower interest rate, and/or a lower payment.

E. The creditor also may be willing to settle for a lower amount if you offer to make a lump sum payoff (redemption). There may also be creditors who will be willing to finance a redemption (try searching the internet for such redemption credit services).

F. Be sure everything is in writing.

G. If you no longer want the collateral, contact the creditor and make arrangements to return the collateral. **Until you return the collateral, the creditor may continue to contact you in order to repossess it.**

Non-PMSI Security Interests

Another type of security interest is created when you pledge property, such as household goods or tools already owned by you as collateral for a loan (for example, consolidation loans with small finance companies such as AVCO, Beneficial, Associates, or General American). If this applies to you, immediately notify our office, in writing, since there may be action that we can take to eliminate such a lien.

Automobile Leases

If you have an **automobile lease** or other lease for personal property that you want to retain, you must keep current in payments, maintain required insurance, and abide by other terms of the lease agreement. If you want to assume the lease, or if the lessor has offered you that opportunity, you must make an appointment and discuss it with an attorney in our office, before you sign any documents. Assumption of a lease creates a new obligation that is not discharged in the Bankruptcy. Our fee agreement does not include representation for reviewing lease agreements or negotiating with the leasing company.

COMMON QUESTIONS:

1. *Question:* I already received my discharge. Do I still have to deal with PMSI or other lien-holding creditors?

Answer: Yes. The entry of discharge does not affect the validity of a security interest, including PMSI's.

2. *Question:* If I don't return the merchandise and can't afford to reaffirm or redeem, can the creditor come to my house to pick up the goods?

Answer: Yes. The creditor can apply to the court for an order of replevin and obtain possession. Without a court order, presented by a Sheriff, they cannot forcibly remove the goods from your house.

3. *Question:* Is there any time limit by which a secured creditor must act, or lose the security interest?

Answer: No. The security interest is valid until the full amount of the debt is paid. It is not necessary for the creditor to come to the creditors' meeting or even file a proof of claim. The rights of the secured creditor to repossess the collateral are not affected by the bankruptcy discharge.

4. *Question:* What if I don't have the collateral?

Answer: Then tell the creditor what happened to it, but do not sign the reaffirmation agreement.

5. *Question:* What if I gave the item as a gift?

Answer: Then the creditor has the right to recover the item from the person to whom it was given.

6 *Question:* Can I change my mind and return a car or house later?

Answer: Yes, so long as no reaffirmation agreement is signed, you may discontinue payments at any time and surrender collateral to the lender.