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NONCONSENSUAL THIRD PARTY RELEASES IN CHAPTER 11 PLANS: HOW SIGNIFICANT IS AIRADIGM?

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I. Introduction

In March 2008, the Seventh Circuit Court of Appeals issued a decision approving a plan of reorganization that contained a nonconsensual release of third parties from liabilities to creditors. *In re Airadigm Communications, Inc.*, 519 F.3d 640 (7th Cir. 2008), *reh'g denied* (May 13, 2008). In September 2008, however, a bankruptcy court within the Seventh Circuit construed *Airadigm* narrowly to disapprove a plan of reorganization containing a third party release. *In re Berwick Black Cattle Co.*, 394 B.R. 448 (Bankr. C.D. Ill. 2008). Where does *Airadigm* fit within the existing authority on nonconsensual third party releases?

II. In re Airadigm Communications, Inc.

In *Airadigm*, a cellular service provider proposed a plan of reorganization that included a release in favor of its primary secured creditor, Telephone and Data Systems, Inc. ("TDS"). TDS agreed to provide the exit financing under the plan, and demanded a third party release provision that released it from any liability to the debtor or third parties for any act or omission in connection with the case, the plan, confirmation and consummation of the plan and the administration of plan assets, except for willful misconduct.[1] The FCC's objection to the release was rejected by the bankruptcy court, district court and the Seventh Circuit.

The Seventh Circuit noted that "[t]he question whether a bankruptcy court can release a non-debtor from creditor liability over the objections of the creditor is one of first impression in this circuit." *Id.* at 655. (The court had previously held that consensual releases were permissible in *In re Specialty Equipment Companies*, 3 F.3d 1043, 1046-47 (7th Cir. 1993)). It proceeded to hold that (a) Section 524(e) of the Bankruptcy Code does not expressly prohibit nonconsensual nondebtor releases within a plan of reorganization, and (b) bankruptcy courts have the power and discretion to approve appropriate nonconsensual nondebtor release provisions, based on the facts of the case.

On the issue of whether Section 524(e) precludes a nonconsensual release, the court held that the "natural reading of this provision does not foreclose a third-party release from a creditor's claims":

> § 524(e) does not purport to limit the bankruptcy court's powers to release a non-debtor from a creditor's claims. If Congress meant to include such a limit, it would have used the mandatory terms "shall" or "will" rather than the definitional term "does." And it would have omitted the prepositional phrase "on, or...for, such

[1] "On the Effective Date, any and all Claims of the Debtor against TDS shall be released and forever discharged. Except as expressly provided in this Plan, as of the Effective Date, neither TDS, its affiliates, parents or subsidiaries, nor any of its respective members, shareholders, officers, directors, employees, agents, attorneys, or professionals shall have or incur any liability to the Debtor, the Reorganized Debtor, or to any holder of any Claim or equity interest for any act or omission arising out of or in connection with the Case, the confirmation of this Plan, the consummation of this Plan, or the administration of this Plan or property to be distributed under this Plan, except for willful misconduct."

> debt," ensuring that the "discharge of a debt of the debtor shall not affect the liability of another entity"--whether related to a debt or not.

Id. at 656.

Having determined that Section 524(e) does not preclude such a release, the court looked for authority in the Bankruptcy Code to issue the release and found it in Section 105(a), which grants a bankruptcy court power to effect any "necessary or appropriate" order to carry out the provisions of the Bankruptcy Code, and § 1123(b)(6), which "permits a court to include any other appropriate provision not inconsistent with the applicable provisions of this title." The court stated that "this 'residual authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code." *Id.* at 657.

The Seventh Circuit stated that "whether a release is "appropriate" for the reorganization is fact intensive and depends on the nature of the reorganization" and found that "[g]iven the facts of this case, we are satisfied that the release was necessary for the reorganization and appropriately tailored." *Id.*

> First, the limitation itself is narrow: it applies only to claims "arising out of or in connection with" the reorganization itself and does not include "willful misconduct."... This is not "blanket immunity" for all times, all transgressions, and all omissions. Nor does the immunity affect matters beyond the jurisdiction of the bankruptcy court or unrelated to the reorganization itself.... Second, the limitation is subject to the other provisions of the plan, including one that expressly preserves the FCC's regulatory powers.... Therefore, TDS cannot use this limitation as a way of skirting the FCC's regulations.... Third, the bankruptcy court found "adequate" evidence that TDS required this limitation before it would provide the requisite financing, which was itself essential to the reorganization. [citation omitted] Airadigm owes TDS $188,264,000 for its secured claims, and it owes the FCC another $33 million in secured claims for the licenses. As the bankruptcy court found, without TDS's involvement, Airadigm would be on the hook for over $221 million in debt-an amount that some other would-be financier would not likely pay considering Airadigm's financial situation. Absent TDS's involvement, the reorganization simply would not have occurred. Given how narrow the limitation is and how essential TDS was for the reorganization, the release is "appropriate" and thus within the bankruptcy court's powers.

Id. at 657.

III. Authority in Other Circuits

Authority among the other circuits remains divided. In a nutshell, the rule in the Ninth and Tenth Circuits is that Section 524(e) bars a bankruptcy court from releasing non-debtors from liability to a creditor without the creditor's consent, while in most other circuits, releases are permissible under varying standards.

A. First Circuit

There is no circuit court authority on the issue. However, the First Circuit has implied (in dicta) that it would follow the *A.H. Robbins* line of cases permitting nonconsensual nondebtor injunctions if "essential" to the reorganization. *Monarch Life Insurance Company v. Ropes & Gray*, 65 F.3d 973 (1st Cir. 1995). *See also In re Salem Suede, Inc.*, 219 B.R. 922 (Bankr. D. Mass 1998) (court denied confirmation of the plan finding that the nonconsensual injunction did not meet the *A.H. Robbins* standard).

B. Second Circuit

In *Deutsche Bank AG v. Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d. Cir. 2005), the Second Circuit stated that "[a] nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan." The Second Circuit noted that no findings had been made on whether the release was "important to the success of the plan," or whether the scope of the release was necessary, and stated that while good and sufficient consideration paid to an enjoined creditor has "weight in equity," it is not required. *See also In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285 (2d Cir. 1992), *cert. dismissed*, 506 U.S. 1088, 113 S.Ct. 1070 (1993); *In re Johns-Manville Corporation*, 837 F.2d 89 (2d Cir. 1988), *cert. denied*, 488 U.S. 868, 109 S.Ct. 176 (1988) (channeling injunction).

C. Third Circuit

In *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000), the Third Circuit indicated that such relief could be appropriate, but found that the release provision under consideration did not pass muster because it lacked the "hallmarks of permissible nonconsensual releases--fairness, necessity to the reorganization, and specific factual findings to support these conclusions." Because the bankruptcy court did not make any specific findings that the release was fair and was necessary to the debtor's reorganization, the court stated that "a release and permanent injunction cannot stand on their merits under any of the standards set forth in the case law of other circuits." The court rejected the notion that an "identity of interest" between the debtor and the releasee, standing alone, was sufficient to support a third party release: "We conclude that granting permanent injunctions to protect non-debtor parties on the basis of theoretical identity of interest alone would turn bankruptcy principles on their head. Nothing in the Bankruptcy Code can be construed to establish such extraordinary protection for non-debtor parties." 203 F.3d at 217.

D. Fourth Circuit

In re A.H. Robins, Co., 880 F.2d 694, 701-02 (4th Cir.1989) upheld a nonconsensual nondebtor release in the context of mass tort asbestos liabilities, a result later codified in Section 524(g). The court did not articulate a definite standard, but noted that "[1] where the Plan was overwhelmingly approved, [2] where the Plan in conjunction with insurance policies provided as a part of a plan of reorganization gives a second chance for even late claimants to recover... and [3] where the entire reorganization hinges on the debtor being free from indirect claims" it was within the bankruptcy court's equitable power to issue the third party injunction.

E. Fifth Circuit

The Fifth Circuit has held that Section 524(e) precludes nonconsensual third party releases. *In re Zale Corp.*, 62 F.3d 746, 761-62 (5th Cir. 1995) (but allowing temporary injunction of third-party actions where the court found that "unusual circumstances" existed to render such release proper).

F. Sixth Circuit

In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002) sets out a seven-factor test: bankruptcy courts may enjoin a nonconsensual creditor's claims against a third party only if the release meets the following stringent seven-part test: "(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and (7) The bankruptcy court made a record of specific factual findings that support its conclusions." In that case, the court held that the record did not support a finding of "unusual circumstances" to warrant the proposed third party release.

H. Eighth Circuit

In re Master Mortgage Investment Fund, Inc., 168 B.R. 930 (Bankr. W.D. Mo. 1994) approved an injunction in favor of a secured creditor and certain non-debtor affiliates that made substantial financial contributions, holding that courts have authority to issue a permanent injunction or third party release, when: (1) there is an identity of interest between the third party and the debtor, usually an indemnity relationship so that a suit against the third party either operates as a suit against the debtor, or will deplete the assets of the estate; (2) the nondebtor has contributed substantial assets to a plan of reorganization; (3) the injunction is essential to the

reorganization, without it, there is little likelihood of reorganization; (4) a substantial majority of the creditors agree to the injunction and specifically, the impacted class or classes has overwhelmingly voted to accept the proposed plan treatment (which the court considered the single most important factor); and (5) the plan provides for the payment of all or substantially all of the claims of the classes or class that are affected by the injunction.

I. Ninth Circuit

The rule in the Ninth Circuit is that Section 524(e) bars a bankruptcy court from releasing non-debtors from liability to a creditor without the creditor's consent. *In re Lowenschuss*, 67 F.3d 1394, 1401 (9th Cir. 1995). As is the case elsewhere, consensual releases are permissible. *In re Pacific Gas & Electric Company*, 304 B.R. 395, 418 (Bankr. N.D. Cal. 2004).

It bears noting that *Lowenschuss* is a 13 year old decision that involved a global release of securities fraud claims proposed by an individual chapter 11 debtor. The release did not arise from any negotiations, it was not predicated on any third party contributions to a chapter 11 plan, and the plan was not advocated by a majority of the creditors subject to the release. 67 F.3d at 1396-97. The Ninth Circuit has not confronted a case involving "unusual circumstances" analogous to those in *A.H. Robins* and similar cases. It is certainly possible that the Ninth Circuit, if faced with suitable "unusual circumstances," would approve non-debtor releases and injunctions.

J. Tenth Circuit

The Tenth Circuit also holds that Section 524(e) bars nonconsensual third party releases. *In re Western Real Estate*, 922 F.2d 592, 600 (10th Cir. 1990).

K. Eleventh Circuit

In *Munford v. Munford, Inc. (In re Munford, Inc.)*, 97 F.3d 449, 455-56 (11th Cir. 1996), in the context of a settlement agreement, the Eleventh Circuit approved a permanent injunction against nonsettling defendants where it was integral to settlement, and the bar order was fair and equitable). One bankruptcy court held that nonconsensual nondebtor injunctions are permissible under the *Master Mortgage* standard, but that the standard was not met. *In re Optical Technologies, Inc.*, 216 B.R. 989 (Bankr. M.D. Fla. 1997).

L. District of Columbia

In re AOV Industries, 31 B.R. 1005 (D.D.C. 1983), *aff'd in part on other grounds*, 792 F.2d 1140 (D.C. Cir. 1986), held a release would be appropriate where the plan provided that creditors who voted to release two nondebtor plan funders would be entitled to share in additional assets being contributed by the plan funders, and creditors were allowed to make a separate choice of whether to release the plan funders and whether to accept the plan. *In re McCall*, 1997 Bankr. LEXIS 1135 (Bankr. D.C. 1997) approved an injunction protecting co-

debtors who contributed substantial new value that is essential to the funding of a reorganization plan. . . ." *In re Heron, Burchette, Ruckert & Rothwell*, 148 B.R. 660 (Bankr. D.C. 1992) granted an injunction protecting contributing partners funding a partnership plan of reorganization.

IV. In re Berwick Black Cattle Co.

In *Berwick Black Cattle*, decided on September 23, 2008, Chief Bankruptcy Judge Perkins of the Central District of Illinois gave *Airadigm* a very narrow interpretation, and rejected the nonconsensual third party release contained in the debtors' joint chapter 11 plan.

The plan was a liquidating plan that created a liquidating trust, and the recapitalization of another entity with several classes of preferred stock and convertible notes. The proposed releasee was a substantially undersecured creditor, WFY, that agreed to pay administrative claims and priority claims and to invest $1 million in the new entity, in which other creditors were also entitled to invest if they so desired. 394 B.R. at 456. The bankruptcy court commented that such funding "might loosely be called 'exit financing.'" *Id.*

The plan contained what the bankruptcy court accurately characterized as a "blanket release" of WFY. No party objected to the releases. *Id.* at 457.

Distinguishing *Airadigm*, the court rejected the proposed releases and denied confirmation. First, the court deemed the releases overbroad, stating that they "go far beyond what the Seventh Circuit approved in *Airadigm*. They release not just claims arising out of the bankruptcy cases, but pre-petition claims also, including claims based on nonbankruptcy law, that exist outside of bankruptcy and that have nothing to do with the bankruptcy proceedings." *Id.* at 457. In contrast, the release in *Airadigm* applied only to claims arising out of or in connection with the reorganization and did not include willful misconduct, and the Seventh Circuit spoke disapprovingly of releases providing for "blanket immunity." *Id.* at 457-58. The bankruptcy court observed that the breadth of the release was similar to that disapproved by the Second Circuit in *Metromedia*. *Id.*

In fact, the *Black Berwick Cattle* court reasoned, the Seventh Circuit in *Airadigm* did little more than approve the narrow kind of exculpation provision that is becoming commonplace, particularly in the Second and Third Circuits.

> The Seventh Circuit's *Airadigm* opinion should be viewed in the context not only of the decisions of its sister Circuits, but also in the context of the prevalence of the particular release in question there--similar to Release 6.7--in other Chapter 11 plans. In fact, inclusion in a plan of reorganization of a narrow release of claims relating to the bankruptcy case, running in favor of the debtor, the creditors committee and all professionals and advisors, now appears to be *de rigueur* in cases filed in New York and Delaware.

> *See In re Oneida Ltd.*, 351 B.R. 79, 94 n. 22 (Bankr. S.D.N.Y. 2006); *In re PWS Holding Corp.*, 228 F.3d 224, 246-47 (3d Cir. 2000).

Id. at 359. Incidentally, the bankruptcy court described the New York and Delaware bankruptcy courts as "the cradle of innovation":

> The Southern District of New York and the District of Delaware have the highest volume of Chapter 11 filings, by far, and are the cradle of innovation. Once a new tactic, pleading or provision, gets approved for use in New York or Delaware, it seems to spread across the country like a highly contagious virus.

Id. at 459 n. 13. The bankruptcy court concluded that *Airadigm* should be quite narrowly construed:

> This Court concludes, first, that it is wrong to construe the *Airadigm* opinion as one in which the Seventh Circuit wholeheartedly embraces all manner of third-party releases. The opinion rejects, with good reason, the idea that Section 524(e) bars all third-party releases. But the court only approved, upon the satisfaction of three conditions, the narrowly tailored, bankruptcy case-specific release that is commonly seen in many Chapter 11 plans. There is nothing in the opinion to indicate that the court was signaling an intent to go beyond approval of that customary, narrow release or that the court was rejecting the limits established by the Second, Third, Fourth and Sixth Circuits.
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> * * *
>
> This Court is aware of no authority, outside of the mass tort context, that supports the granting in the plan of a nonconsensual third-party release of claims other than for acts or omissions made in the bankruptcy proceeding, with gross negligence and wilful misconduct excluded. *Airadigm* supports such a limited release, under certain conditions, and nothing more.

Id. at 459-60.

In view of this narrow interpretation, the proposed release was rejected decisively. It was not limited to exculpation for acts arising in or out of the bankruptcy case. It was not limited to creditors that had participated in the case, which the bankruptcy court held was also a requirement. *Id.* at 460. Certain creditors whose claims were being released were receiving nothing under the plan. *Id.* at 461. The plan, though "dressed up to look like a reorganization" was in fact a plan of liquidation. *Id.* It was unclear which of the three corporate and five individual releasees was actually contributing value to the plan. "Without knowing the specific

identity of the lenders, and the amount loaned by each, the Court is in no position to make the necessary evidentiary determination that might support the granting of third-party releases." *Id.* at 462. One creditor that the court identified as the real beneficiary of the liquidation was receiving a release with no apparent consideration. *Id.* Notice was inadequate as to releasors that were not "participating creditors." *Id.* Lastly, the bankruptcy ruled that it would have no jurisdiction to issue a release because the "resolution of such non-debtor claims against WFY would have no effect on the bankruptcy estates and do not involve property of either estate. As such, the claims are outside the scope even of the Court's 'related to' jurisdiction." *Id.*

V. Conclusion

The adage that bad facts make bad law applies well to *Black Berwick Cattle*. It was correctly decided on its facts: the debtor was liquidating, the releasee's contribution gave little to most creditors and none to some, the investment was primarily in an entity that did not benefit other creditors unless they invested in it, certain releasees gave no contribution at all, and the release was extraordinarily broad. On the other hand, the bankruptcy court's aggressively narrow interpretation of *Airadigm* seems unfounded. The characterization of *Airadigm* as doing no more than approving customary exculpation provisions, in particular, is inaccurate. The standard articulated by the Seventh Circuit in *Airadigm* – essentially, that a third party release is permissible if narrowly tailored and necessary – is loosely worded in a manner that the court of appeals expressly intended to be adaptable to a variety of facts and circumstances, and thus should be as flexible in application the tests utilized in the Second, Third and Fourth Circuits.

CIRCUIT SPLITS: THE WIDENING GAP AND ITS IMPACT ON VENUE SELECTION

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STILL NOT UNIFORM: Post-BAPCPA Calculation of Projected Disposable Income for Chapter 13 Above-Median Debtors

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Courts are currently wrestling with the question of whether or not judges retain any discretion in determining the amount of disposable income for above-median Chapter 13 debtors. A circuit split illustrating two general schools of thought has emerged. One school results in courts being bound by a rigid formula that allows for little consideration of the debtor's actual financial picture ("mechanical approach"). The other allows courts some latitude to examine a debtor's true income and/or expenses ("forward-looking approach"), but courts vary as to what degree this analysis can be performed by judges.

11 U.S.C. §1325(b)(1)

If the trustee or the holder of an allowed unsecured claim objects to confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

> (B) the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

(2) For purposes of the subsection, the term 'disposable income' means current monthly income received by the debtor…less amounts reasonably necessary to be expended—(A)(i) for the maintenance or support of the debtor or a dependent of the debtor…

(3) Amounts reasonably necessary to be expended under paragraph (2) shall be determined in accordance with…§707(b)(2) [for above-median income debtors].

(Norton 2007).

Mechanical Approach v. Forward-Looking Approach to Determining Projected Disposable Income

Mechanical Approach

• Sees the word "projected" in §1325(b)(1)(B)'s "projected disposable income" as only a modifier of the term "disposable income", which is defined in §1325(B)(2).

• Dictates that for above-median debtors, the amount that is to be paid to unsecured creditors is dictated by subtracting the total of the IRS expenses under 707(b) on Form B22C from the average of the income received in the 6 months prior to filing for BK (*see* §101(10A)(A)(i)). "Projected" is merely a word that provides for multiplying out the monthly amount to determine how much unsecured creditors would be paid in total.

• Does not permit courts to consider the debtor's actual monthly income or actual expenses as shown on Schedules I & J when determining the amount an above-median debtor must pay to unsecured creditors.

Maney v. Kagenveama, 541 F.3d 868 (9th Cir 2008) ("projected disposable income" as used in §1325(b)(1)(B), is an above-median debtor's "disposable income" as determined by strict definition of §1325(b)(2), regardless of what is shown as actual income on schedules I & J. "Projected" is merely a term that allows multiplication of the "disposable income" number to determine the amount that unsecured creditors will be paid over the plan period. "Applicable commitment period" is a temporal concept that only becomes effective when a debtor has positive "projected disposable income.")

Arguments against Mechanical Approach

• Where debtors have taken a substantial pay cut as of effective date of plan, may result in a required monthly plan payment that debtors cannot actually fund.

• Where debtors have had an increase in income as of the effective date of the plan, may result in debtors not repaying as much to unsecured creditors as they actually can.

• Ignores evidence that Congressional intent of the means testing mechanism was intended to insure that debtors repaid the maximum that they could afford. *See* In re Hanks, 362 B.R. 494 (Bankr. D. Utah 2007).

• Does not incorporate other statutory language into its approach. Notably missing is a meaningful relationship between §1325(B)(2) and the following other statutory phrases: "as of the effective date of the plan" in §1325(b); and "to be received in the applicable commitment period" and "will be applied to make payments", both in §1325(b)(1)(B).

Arguments for Mechanical Approach

• Trustees informed Congress of their concerns about this potential result prior to the passage of BAPCPA and Congress did nothing.

• Might push more debtors into a Chapter 11 if they are above median and thus don't qualify for Chapter 7, yet are unable to confirm a Chapter 13 plan. (But see 11 U.S.C. §1129(a)(15)(B)).

Forward-Looking Approach

• Interprets "projected disposable income" as income that a debtor reasonably expects to receive during the term of his or her plan.

• Allows courts to evaluate the debtor's actual ability to repay creditors as of the effective date of the plan

Hamilton v. Lanning, 2008 WL 4879134 (10th Cir. November 13, 2008) (for evaluating income under §1325(b)(1)(B), the starting point for calculating "projected disposable income" under Chapter 13 is presumed to be the debtor's current monthly income as defined by §101(10A)(A)(i), subject to a showing of substantial change in circumstances.)

Coop v. Frederickson, 2008 WL 4693132 (8th Cir. October 27, 2008) (a debtor's "disposable income" calculation on Form 22C is a starting point for determining the debtor's "projected disposable income," but that the final calculation can take into consideration changes that have occurred in the debtor's financial circumstance as well as the debtor's actual income and expenses as reported in Schedules I & J.)

Arguments against Forward-Looking Approach

• Renders the BAPCPA-revised definition of "disposable income" nearly meaningless unless you read the statute as having an implied rebuttable presumption that leaves the statutory language as a mere starting point (doesn't Congress know how to create a presumption when it wants to?- *Kagenveama*)

• Still have the problem of potentially inflated expenses under 707(b) calculation—may not actually do creditors that much good.

Arguments for Forward-Looking Approach

• Produces a more realistic picture of debtor's ability to pay; is therefore conducive to feasible plans.

• Provides bankruptcy protection for those in most dire need of it: those who have had a recent significant drop in income and have no realistic prospects for returning to it in the near future.

CIRCUIT SPLITS: THE WIDENING GAP AND ITS IMPACT ON VENUE SELECTION
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The "Fourth Option" Post-BAPCPA

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Before passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat. 23 (2005) (BAPCPA), there was much debate as to whether a Chapter 7 debtor with secured collateral was limited to the three options listed in §521(2) of the Bankruptcy Code ("the Code"): surrender the collateral, redeem the collateral, or reaffirm the debt. Some courts had found that the debtor had a "fourth option," to retain the collateral and make the contract payments without redeeming or reaffirming the debt.[1] When BAPCPA went into effect, some assumed that the changes made to the Bankruptcy Code would put an end to the fourth option.[2] However, in the three years since BAPCPA went into effect, courts in several circuits have found that in some circumstances, the fourth option is still viable under the Code, and other courts have found that even if the fourth option is not available under the Code, a debtor may have the right under state law to retain collateral as long as the contract payments are current.

Code Sections that Affect Fourth Option

The BAPCPA amendments that affect the viability of the fourth option include changes to §521(2), which was renumbered § 521(a)(2), and the addition of three new sections, §362(h), §521(a)(6), and §521(d).

- **§ 521(a)(2)**-A debtor is required under §521(a)(2) to timely file a statement of intention stating whether the debtor plans to surrender, redeem or reaffirm and to timely perform on the stated intention.
- **§ 362(h)**- The new §362(h) provides in paragraph (1) that if the debtor does not timely file his statement of intention or does not indicate whether he will surrender, redeem, or reaffirm, the stay is terminated "with respect to personal property," and in addition, under paragraph 2, if the debtor does not "timely take the action specified" in his statement of intention, the stay will be lifted and the property will no longer be part of the bankruptcy estate.
- **§ 521(a)(6)** - Section 521(a)(6) requires that a debtor not retain possession of personal property when a creditor has "an allowed claim for the purchase price" unless the debtor timely redeems the collateral or reaffirms the debt.
- **§ 521(d)**- Section 521(d) allows *ipso facto* default clauses, which state that a debtor is in default if he becomes insolvent or files bankruptcy, to be enforced if a debtor does not comply with §521(a)(6) or with § 362 paragraphs 1 and 2.

Post-BAPCPA Fourth Option Cases

Since BAPCPA went into effect, courts have been trying to determine what effect these provisions have on the viability of the fourth option. Most courts have found that for personal property, the fourth option was eliminated by BAPCPA.[3] However, in many of these cases, the court found that the creditor could not repossess the collateral as long as the debtor was maintaining the contract payments.

- Courts in the 2nd and 4th Circuits have found these changes do not apply to real property.[4]
- Courts in the 3rd, 4th, 9th, and 10th Circuits have found that if the debtor has timely filed a statement of intention, has stated his intention to redeem or reaffirm, and has taken action on the stated intention within the time allowed, the debtor has fulfilled his obligation and the provisions in §362(h) and §521(d) do not come into play, even if the stated intention is not actually carried out (most commonly because the court denied approval of the reaffirmation), and the debtor may keep the collateral and continue making the contract payments.[5]
- Courts in the 3rd, 9th, and 10th Circuits have found that if the debtors do not comply with the requirements of § 521, the Bankruptcy Code does not protect the debtor from having the collateral repossessed, but the creditor is still subject to state law, which may prohibit the creditor from repossessing the collateral unless there is a payment default, so the debtor may in effect choose the fourth option, and retain the collateral as long as he makes the contract payments.[6]

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[1] *See Price v. Del. State Police Fed. Credit Union (In re Price),* 370 F.3d 362 (3d Cir. 2004) and *McClellan Fed. Credit Union v. Parker (In re Parker),* 139 F.3d 668 (9th Cir. 1998).

[2] *See* Principe, Philip R, *Did Bapcpa Eliminate The "Fourth Option" For Individual Debtors' Secured Personal Property?*, 24-OCT Am. Bankr. Inst. J. 6 (2005).

[3] *See, e.g., Dumont v. Ford Motor Credit Co. (In re Dumont)*, 343 B.R. 481 (9th Cir B.A.P. 2008); *In re Anderson,* 348 B.R. 652 (Bankr.D.Del.2006); *In re Blakeley,* 363 B.R. 225 (Bankr.D.Utah 2007); *In re Boring,* 346 B.R. 178 (Bankr.N.D.W.Va.2006); *In re Bower,* No. 07-60126-FRA7, 2007 WL 2163472 (Bankr.D.Or. July 26, 2007); *In re Craker,* 337 B.R. 549 (Bankr.M.D.N.C.2006); *In re Donald,* 343 B.R. 524 (Bankr.E.D.N.C.2006); *In re Ertha Rice,* No. 06-10975, 2007 WL 781893 (Bankr.E.D.Pa. Mar.12, 2007); *In re Husain,* 364 B.R. 211 (Bankr.E.D.Va.2007); *In re McFall,* 356 B.R. 674 (Bankr.N.D.Ohio 2006); *In re Moustafi,* 371 B.R. 434 (Bankr.D.Ariz.2007); *In re Norton,* 347 B.R. 291 (Bankr.E.D.Tenn.2006); *In re Openshaw,* No. 06C-24120, 2007 WL 2916294 (Bankr.D.Utah Mar.12, 2007); *In re Riggs,* No. 06-60346, 2006 WL 2990218 (Bankr.W.D.Mo. Oct.12, 2006); *In re Rowe,* 342 B.R. 341 (Bankr.D.Kan.2006); *In re Ruona,* 353 B.R. 688 (Bankr.D.N.M.2006); *In re Steinhaus,* 349 B.R. 694 (Bankr.D.Idaho 2006).

[4] *See, In re Caraballo,* 386 B.R. 398, 402 (Bankr.D.Conn.2008); *In re Wilson,* 372 B.R. 816, 820 (D.S.C.2007); and *In Re Waller*, 394 B.R. 111, (Bankr.D.S.C.2008).

[5] *See, e.g., In re Baker*, 390 B.R. 524 (Bankr.D.Del.2008); *In re Chin*, 381 B.R. 191, 198 (Bankr.D.Md.2008); *Moustafi,* 371 B.R. 434; *Openshaw,* No. 06C-24120, 2007 WL 2916294 (Bankr.D.Utah Mar.12, 2007).

[6] *See, e.g. Baker*, 390 B.R. 524; *Dumont*, 343 B.R. 481; *Rowe,* 342 B.R. 341.