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Pass Through No Longer Permitted¹

By: Trev E. Peterson

Until the United States Bankruptcy Court for the District of Nebraska's recent decision involving the "pass through," *In re Sanabria*, Neb. Bankr. 04-153 (Bkr. Neb. 2004), the question was whether Nebraska would permit a consumer debtor in a Chapter 7 case to elect to simply make payments to a secured creditor under the note and security instrument, rather than either reaffirming, redeeming or surrendering consumer collateral in a Chapter 7 case. In a typical Chapter 7 case, a consumer debtor has three statutory options concerning secured property. First, the debtor can surrender the property. The Bankruptcy Code does not explain exactly how this surrender is to occur. Typically, the debtor will select the surrender option and do nothing more with the collateral. If the secured creditor obtains relief from the automatic stay, the secured creditor could foreclose its security interest under state law. Nothing in the Bankruptcy Code actually requires the debtor to deliver possession of the "surrendered" property to the secured creditor. Frequently, secured creditors will need to foreclose on the secured creditor's lien to eliminate subordinate liens or other interests in the collateral.

The second option for the consumer debtor was to reaffirm the debt. This option technically requires the consent of the secured party, since a written reaffirmation agreement between the creditor and the lender will need to be filed with the Bankruptcy Court; and there is no way for a debtor to compel reaffirmation. The downside to reaffirmation is that the debtor remains personally liable on the debt after the discharge. If, for example, the debtor reaffirms a car debt, then defaults on payments under the debt and the car is sold for less than the amount of the debt, the debtor can still be held liable for the deficiency. This places the risk of loss following default directly on the debtor. The other problem with reaffirmation, is that if the period to rescind the reaffirmation agreement passes, the debtor cannot discharge the personal liability under the reaffirmation agreement without a second bankruptcy filing.

The third alternative is to redeem the collateral. This option permits the debtor to purchase the secured property for the value of the collateral on the date of the redemption. Redemption must be done before the Chapter 7 discharge is entered (typically four months after the date of filing of the case) and, without a different agreement from the creditor, must be completed for cash before the discharge. Generally, a Chapter 7 debtor has no spare cash to redeem collateral and cannot borrow funds to redeem collateral, unless there is a friend or family

¹ The services or benefits mentioned in this article are with respect to bankruptcy relief under Title 11 of the United States Code. We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code.

member willing to either lend the redemption funds or cosign or guaranty a loan to enable the debtor to redeem the property.

A fourth alternative arose, the so called "pass through." Under this fourth alternative, if the debtor was not in default under the note and security agreement at the time of the filing of the case, the debtor would propose to simply keep the collateral and make payments under the note and security document. Assume, for example, that the debtor owns a car that is driven to and from work, worth \$10,000 at the date of filing, with a loan having a \$9,000 balance on the date of filing. The \$1,000 in equity is exempt under Neb. Rev. Stat. §25-1556(4). If the debtor is current in payments under the security documents, and there are no other defaults (for example, the car is insured), the debtor could opt to reaffirm the debt or allow the debt to "pass through" the bankruptcy. If the debtor exercised its "pass through" option, the debtor would continue to make payments under the security documents and if the debtor completes payments, the creditor's claim will be paid in full and the lien will be released. If the debtor defaults after discharge, the debtor will be discharged from any personal liability under the debt. If the secured creditor sells the car for less than the balance of the debt due at the time of the sale, the debtor has already been discharged and the debtor cannot be held liable for the shortfall.

In Re Sanabria, involved an attempt by a consumer debtor to pass through a car debt by retaining the car and making payments. The creditor filed a motion for relief from the automatic stay and the Bankruptcy Court, noting that there is a split in the circuit courts (four permitting and four prohibiting pass through), the Court held that the Eighth Circuit would likely adopt the position that the debtor is required to either reaffirm, redeem or surrender the collateral. Thus, following *Sanabria*, pass through is no longer available as an alternative to consumer debtors in Nebraska, assuming that the Eighth Circuit does not adopt a different position.

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