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ABOUT THE AUTHOR

Frank Drake has more than 30 years of legal experience, with a concentration in bankruptcy and commercial litigation. Frank represents credit unions, banking and financial institutions, consumer and commercial lenders, and student loan agencies. Frank has taught classes on bankruptcy and commercial law for various Bankers Associations as well as the National Association of State-Chartered Credit Union Supervisors and various states' Credit Union Leagues.

Redemption Funding and the Credit Union

December 1, 2005 | by

For nearly all of the twenty-six years since our current Bankruptcy Code was passed, Chapter 7 debtors rarely have resorted to redeeming their property pledged as collateral to lenders, including credit unions. "Redemption" in bankruptcy means paying just the car's value, not the higher balance owed on it. Within the last few years, that obscure right has become the new darling of Chapter 7 bankruptcy debtors nationwide. The rise of a new species of secured lender, the "redemption funder," coupled with APR's at around 23%, has made it all possible.

As a result, your credit union has begun receiving "Motions for Redemption" from lawyers representing members who have filed Chapter 7 bankruptcy. Understanding and responding to these motions is important. Ignoring them will only cost money. Attending to them appropriately can mean recovering money equal to the net proceeds of a repossession and resale, but without the attendant risks, costs, and delays.

Why Bankrupt Members Resort to Redemption

Routinely, members who file bankruptcy owe their credit union the "Big Three"- a car loan, some kind of signature loan, and a credit card balance. Typically, all three loans are cross-collateralized by the security interest in the debtor's car. That means if he is in "payment default" of any of those three debts to the credit union, a bankrupted member risks losing the car to repossession. Before redemption funding became available, credit unions could require members in Ch. 7 bankruptcy to reaffirm all their debts, to keep from losing their beloved "pride rides." Refusal meant losing the ride to repossession.

As a result, bankrupted members reluctantly reaffirmed debts with balances much greater than their cars' values. Aside from losing the car, the only other alternative was to hand the credit union a single payment equal to the car's full value or the loan balance, whichever is less, all at once. This payment is redemption under 11 USC S722 . If a member can redeem, bankruptcy law gives him clear title to his car, entirely free of your lien. Few members in bankruptcy have the cash available to make this type of payment. Enter the redemption funder, with enticing promises of lower monthly payments, fresh credit, and a way to dump all those pesky credit union debts.

How Redemption Funding Works

In a clever bit of marketing, redemption funders have blanketed offices of bankruptcy attorneys nationwide with brochures and pamphlets advertising redemption loans. The APR, typically 23%, is not prominently displayed. Across the country, debtors are finding the brochures in their lawyers' waiting rooms. Despite stratospheric interest rates, redemption loans often mean lower monthly payments, since the redemption amount loaned on an "upside down" car is often far less than what was owed on it. The new loan is just for the car's value, not for the full payoff of your credit union car loan.

The total amount paid over the new redemption loan's life often approaches the balance originally owed on the credit union car loan, but few borrowers care. What matters more to a borrower than a lower monthly payment amount? Funders' delinquency rates range between 4% and 7%, but the high APR compensates nicely.

Bankruptcy redemption is an obscure law, even to many bankruptcy lawyers. At least one funder's brochures have provided lawyers with sample pleadings for obtaining permission from the Judge to redeem.

Redemption funders will lend not only the money to redeem the car, but also the fee for the member's lawyer to file the motion. At least one such lender ties the amount loaned for the lawyer's fee to the amount of the redemption: the lower the approved redemption amount, the higher the fee! That helps explain why Motions for Redemption often propose the lowest possible "book value" as the amount the Court should approve for payment. It also explains why bankruptcy lawyers embrace Ch. 7 redemptions as a guaranteed revenue enhancer. Their fees range from $200 to $600 to whatever the market will bear.

A debtor does not usually have his "pride ride" specifically appraised to establish its value for bankruptcy redemption. Instead, the redemption funder will furnish a print-out of whichever national used auto price guide affords the lowest "presumptive" valuation. The Blue Book, Black Book, Kelley, or NADA valuation, whichever establishes the lowest wholesale value usually appears in the format of an actual appraisal, is attached to the Motion as "Exhibit A." Read the fine print. It admits the lender never actually saw the car. The list of value-adding "options" is whatever the debtor said it is, as is the mileage. What better way to conceal those after-market sub-woofers and 20″ spinners?

The member's lawyer files the model Motion in Bankruptcy Court which asserts the presumptive wholesale value of the car. He mails you a copy, and then he waits. He hopes that while you are deciding how to respond, you will do nothing. After the time expires for you to respond (usually about 18 days from mailing), the Bankruptcy Judge grants the unopposed Motion and signs an Order. That Order allows the member, or his redemption funder, to mail you a check for the modest valuation amount he selected in his Motion. You must accept that amount, release your lien, deliver any title you hold to the redemption funder, and like it. The balance of the debt disappears in the Chapter 7 bankruptcy discharge. If you were asleep at the switch, case closed!

How to React Correctly to a Motion for Redemption

There it is, lying on your desk. That letter from a familiar law firm which might as well have “Motion for Redemption” stamped on the envelope. But, don’t loathe it the way you did the initial Chapter 7 bankruptcy notice. Don’t stuff the Motion into the debtor’s file and resolve to scorch the originating loan officer. If you effectively work to elevate the redemption amount to where it belongs, view it as an expedient, safe, and efficient alternative to an involuntary repossession and resale.

Forget the fact that it will be the debtor who drives away in the car instead of a new buyer. This is all about the money. Look closely at the amount the debtor proposes to pay to redeem the car. Does it fairly match or exceed what you would probably net after paying the repossession guy and resale lot? If so, then sit back and wait for the check. More likely, it does not. Suspect any figure that the debtor has chosen as too low. Without even considering those sub-woofers or wheel spinners, it’s time to fight for a better figure.

You cannot fight for a better redemption amount in Bankruptcy Court without a lawyer. Perhaps you might call the debtor’s lawyer to negotiate for a higher price. If your call is not returned, it is time to consult your own lawyer. Keep in mind that your goal should be to get the redemption amount raised. Defeating redemption will likely only result in a well-plundered car dumped in your parking lot – your newest resale headache.

At this stage, your well-invested effort can save you future time and money. Pull together preferred wholesale and retail values from the month of the bankruptcy filing. Get the original dealer invoice with the listed options. A lawyer experienced in the local bankruptcy courts will know which of the national car valuation guides is routinely used by local bankruptcy judges and trustees. If he/she is not, find a new lawyer. In all three districts of North Carolina, bankruptcy judges use the NADA “trade-in” value as the presumptive starting point for valuing vehicles during Chapter 7 redemptions. The resulting figure, adjusted for actual mileage and options, is recognized in North Carolina as the standard value judges routinely approve. Similar methods have been adopted by other bankruptcy judges, but the approach varies by district. Knowing your district’s customary approach in redemption cases is priceless in responding effectively to a motion for redemption.

If your collateral was something special, such as a classic car, a customized van, or a Harley-Davidson of any model, consider seeking a specific appraisal from the original dealer. All such “goodies” added to collateral (under the label of “accessions”) are part of your collateral’s value. If the member’s lawyer refuses to agree to an appraisal or inspection, your lawyer can use that refusal as the basis for an Objection to the Motion for Redemption. The judge may then order an appraisal. Perhaps your file will reveal you repossessed this same car some months before bankruptcy. If so, see if a condition report in the file reveals options, add-ons, mileage, etc. before you gave it back. This information supports an argument that the member has deliberately understated the car’s real value.

Most objections to redemption get resolved through negotiation between lawyers. Typically, after the first several redemptions are litigated before a given bankruptcy

judge, the lawyers who practice in that court can predict an outcome, such that settlement becomes expedient.

Reminder, responding to a Motion for Redemption can be effectively handled if you:

- Pay particular attention to the proposed redemption amount
- Compare it with what you think you would net after a repossession and resale
- Compare that figure with local bankruptcy custom and practice

Call your lawyer if the difference between your figure and that proposed in the Motion induces heartburn. Either a better deal or a judge's decision should be in your future.

Benefits to Your Credit Union from Redemptions

If you are satisfied with the final redemption amount, the benefits are obvious. Imagine no repossession or storage expenses; no claims for unreturned personal contents; no Notices of Intent to Re-sell or Analysis of Deficiency; no insurance risks; and no chance your manager will want to buy the repossessed vehicle for his daughter at a sweetheart resale price.

Your lawyer should ensure there is a paragraph in the Order Allowing Redemption that sets forth a 30-day time limit to get the cash to you, *followed immediately by an automatic termination of the S362 bankruptcy stay if it does not arrive in time*. This will minimize potential future costs by avoiding a $150.00 filing fee and additional legal fees for a Motion for Relief from Stay should the redemption financing collapse.

It is true that you have not extracted a three-debt reaffirmation from a bankrupting member, in exchange for leaving him in his car. Neither have you run the risk of a last-minute rescission, nor a vengeful (and often unprovable) strip-job on your car before the Sheriff seizes it following an expensive replevin action. Instead, you are at the same place you would have been after the time and trouble of a repossession and resale. And chances are, you will have received your money significantly faster!

The Final Chapter to the Redemption (for the Credit Union)

With the redemption payment check, you will also receive an instructional letter from the redemption funder about what to do with your lien (and title, if you hold it). Most redemption funders fail to distinguish between lien assignment and a lien release. Typically, you are instructed to release your credit union lien either by signing some appropriate document, or by releasing the lien on the face of the title. Do just as you are instructed, and do it promptly.

Why the hurry? A redemption funder pointlessly assumes a risk by such instructions. Many times, a redemption funder takes more than 20 days after signing its own installment note to get its new lien filed. In the meantime, a sharp debtor could get his Chapter 7 bankruptcy discharge, and then instantly follow it with a new Chapter 13 petition. This is the dreaded "Chapter 20." If the debtor does this before the redemption funder has perfected its lien, the new lien is defeated leaving the redemption funder

with only an unsecured claim in the new bankruptcy. Even if the redemption funder's new lien is filed before a new Chapter 13 petition, unless the lien filing occurred within 20 days after the date of the new loan, the funder can still lose its security as a "preference" in the later filed Chapter 13.

Some credit unions have shown an interest in doing redemption funding, so understanding the risks is important. A good way to minimize such risks is for the redemption funder to request the creditor to assign its original lien, not to release it. There is no lapse of lien. The funder "inherits" the original lien. There is also no risk of non-perfection or preference in the face of a later filed Chapter 13. Forms exist in many DMV offices to accomplish lien transfers or assignments, but you may choose to leave that for the redemption funder to learn on their own.

Conclusion

You can avoid being skinned in the redemption game. A competent bankruptcy lawyer can effectively negotiate or fight for a better price, as well as for automatic stay-relief in the absence of payment. And perhaps consolation can be found in the fact that your ex-member has traded participation in a full-service credit union for a new 23% APR from a one-trick lender.

CONTACT US

919.250.2000
mail@smithdebnamlaw.com

RALEIGH OFFICE

The Landmark Center
4601 Six Forks Road, Suite 400
Raleigh, NC 27609

Phone: 919.250.2000
Fax: 919.250.2100

CHARLESTON OFFICE

171 Church Street
Suite 120C
Charleston, SC 29401

Phone: 843.714.2530
Fax: 843.714.2541