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Ride Through Option for Real Property Survived BAPCPA

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The Bankruptcy Abuse Protection Act of 2005 (“BAPCPA”) largely eliminated the so-called “ride through” option for security interests in personal property; however, for nearly two years there was no clear indication as to whether the ride through option still existed for security interests in real property. Recently, in In re Caraballo, the Connecticut Bankruptcy Court confronted this uncertainty head on and determined that the ride through option still exists for real property. 386 B.R. 398, 400 (Bankr. D. Conn. 2008). Importantly for bankrupt individuals, utilizing the ride through option allows them to “keep their property during and after bankruptcy by remaining current on their payments, which prevents creditors from imposing harsher terms on debtors during the bankruptcy process.” Christopher M. Hogan, Note, *Will the Ride Through-Ride Again?*, 108 COLUM. L. REV. 882, 883 (2008).

In coming to its conclusion that the ride through option exists for real property, the court in Caraballo looked at the statutory language of 11 U.S.C.A. § 521(a)(6) (2005) and 11 U.S.C.A. § 362(h)(1) (2005) as amended by BAPCPA, congressional intent, and case law from other circuits. Caraballo at 402. Applying its conclusion, the court held that the mortgage holder could not foreclose on the debtor who did not reaffirm as long as payments continued on the mortgage. Id. Following the lead of other circuits and applying its own reasoning, the Connecticut Bankruptcy Court gave a clear indication to practitioners in the Second Circuit that,

although the ride through option no longer exists for personal property, it still exists for real property.

Part I of this memo will examine the background of the real property and the personal property ride through options in the Second Circuit before BAPCPA. Part II will outline a few major changes from BAPCPA to the code that affected the ride through options. Next, in Part III, Section A, the facts and procedure of Caraballo will be presented. Section B is an in-depth look at the reasoning the court applied in reaching its conclusion. In coming to its conclusion, the court took three things into account: statutory language, congressional intent, and case law from other circuits dealing with the same issue. Part IV will examine subsequent case law reflecting the outcome of Caraballo. Finally, in Part V, this memo will analyze the outcome of this decision and the effects it will have on practitioners.

I. The Real Property and the Personal Property Ride Through Options in the Second Circuit Prior to BAPCPA

Prior to BAPCPA, Second Circuit authority established that a ride through option existed for security interests in both personal property and real property. See BankBoston, N.A. v. Sokolowski (In re Sokolowski), 205 F.3d 532, 534 (2d Cir. 2000) (relying on reasoning that a “debtor who is current on loan obligations [is permitted] to retain the collateral and keep making payments under the original loan agreement”); Capital Commuc’ns Fed. Credit Union v. Boodrow (In re Boodrow), 126 F.3d 43, 53 (2d Cir. 1997) (finding bankruptcy code “does not prevent a bankruptcy court from allowing a debtor who is current on loan obligations to retain the collateral and keep making payments under the original loan agreement”).

Although Sokolowski and Boodrow were dealing with personal property, the reasoning was applicable to both personal property and real property. The court in Caraballo noted that

“those decisions were [not] limited to loans secured by personal property. In at least one instance, the Second Circuit Court of Appeals affirmed the ride through option on a loan secured by real property Furthermore at least one court has applied the Boodrow rationale to a case involving real property.” In re Caraballo, 386 B.R. at 401 n. 5 (internal citations omitted). In 1999, in In re Suarez, the Second Circuit Court of Appeals effectively allowed a ride through option for real property when it denied that creditor’s motion to compel. In re Suarez, No. 98-5034, 1999 WL 753381 (2d Cir. 1999). Similarly, in In re Gaines, the court remarked that the code “includes an implied fourth option . . . in addition to the expressed options of reaffirmation, redemption, and surrender.” In re Gaines, 243 B.R. 221, 224 (Bankr. N.D.N.Y. 1999). That court specifically stated that the rationale used to imply the fourth option, the ride through, applied for real property in the Second Circuit. Id. at 224 n. 7. In conclusion, despite the major Second Circuit authority that is cited in Caraballo examining personal property, the reasoning also applies to real property.

II. Changes because of BAPCPA

BAPCPA amended 11 U.S.C.A. § 521(a)(6) and 11 U.S.C.A. § 362(h)(1) to substantially change the ride through option by eliminating it as an option for personal property. Both sections of the code clearly state that the ride through option no longer exists for a chapter 7 debtor’s personal property. 11 U.S.C.A. § 521(a)(6) (“[I]n a case under chapter 7 of this title in which the debtor is an individual, not retain possession of *personal property* as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such *personal property* unless”) (emphasis added); 11 U.S.C.A. § 362(h)(1) (“In a case in which a debtor is an individual, the stay provided by subsection (a) is terminated with respect to

personal property of the estate”) (emphasis added); see Caraballo, 386 B.R. at 401. With respect to personal property, BAPCPA makes it clear that the debtor has three options: surrender, redeem, or reaffirm; there is clearly no longer a fourth option: the ride through option. 11 U.S.C.A. § 362(h)(1)(A) (“debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property . . . or [reaffirm].”).

However, BAPCPA did not expressly eliminate the real property ride through option. Without express language taking away the fourth option for real property, the court in Caraballo had to make a decision. The court could have interpreted BAPCPA as taking away the ride through option for all property. On the other hand, the court could have viewed the BAPCPA amendments as only affecting the ride through option for personal property. Luckily for debtors, the court chose to interpret the BAPCPA amendments as not taking away the ride through option for real property.

Before BAPCPA, lack of ambiguity in the case law allowed attorneys to confidently advise clients in this area; however, BAPCPA added uncertainty into the equation, which left practitioners doubtful that the case law was still authoritative on the subject of ride through options for real property. The previous case law had first established that the ride through option existed for personal property. The ride through option was extended to real property by the courts applying the same rationale used for the personal property ride through option. The changes to the code from BAPCPA raised the question as to whether the previous tendency to use the same rationale for personal property and real property should persist. The potential new treatment arose because the ride through option for personal property was specifically addressed in BAPCPA, and real property was not mentioned.

III. *In re Caraballo*

Originally, the debtor in Caraballo sought to reaffirm the debt owed to the creditor, and the debt that the debtor was seeking to reaffirm was secured by real property mortgages. In attempting to do this, the debtor in Caraballo filed two reaffirmation agreements. Caraballo, 386 B.R. at 400. At a hearing where the creditor did not appear, the court orally granted the debtor's motion and later issued orders approving the reaffirmation agreements. Id. After originally allowing the reaffirmation agreements, the court vacated its orders sua sponte. Id. The court vacated the orders based on the best interests of the debtor. Id. In analyzing the best interests of the debtor, the court raised an issue that needed to be dealt with before deciding whether the reaffirmation agreements should be granted. The issue was whether Boodrow and Sokolowski remained "binding authority that . . . a debtor has an option ('the ride through option') to retain real property collateral and maintain performance under the subject loan documents." Id. A sub-issue the court addressed was whether "the secured creditor may not foreclose based solely on the debtor's filing of the bankruptcy petition and failure to reaffirm." Id.

The court in Caraballo focused its inquiry about the possible existence of the real property ride through option in the Second Circuit on three areas: the statutory language of 11 U.S.C.A. § 521(a)(6) and 11 U.S.C.A. § 362(h)(1) as amended by BAPCPA, congressional intent, and case law from other circuits. Caraballo at 402. It was clear that if the ride through option still existed, it would be in the best interests of the debtor. The best interests of the debtor would be preventing the creditor from foreclosing the debtor's property or including unfavorable terms in a reaffirmation agreement.

The first area that the court explored was the statutory language of 11 U.S.C.A. § 521(a)(6) and 11 U.S.C.A. § 362(h)(1) as amended by BAPCPA. It states that the ride through

option does not exist for personal property. The code does not say “property,” but rather, it makes a clear distinction; the subcategory known as personal property is the class of property it addresses. A debtor can no longer utilize the ride through option for personal property during bankruptcy proceedings. See supra Part II. The court focused on the wording of the code as amended by BAPCPA, and it emphasized the words “personal property” in the amended code as a reason why the ride through option for real property was not eliminated. Caraballo, 386 B.R. at 401. After its initial plain language interpretation of the two sections of the code, the court continued its inquiry by looking at Congressional intent.

The second area that the court explored was the congressional intent in passing BAPCPA. Prior to enacting BAPCPA, Congress was aware that the option existed for both personal property and real property, and the language of the anti-ride through BAPCPA amendments specifically eliminated it for personal property only. Caraballo, 386 B.R. at 401; see supra Part II. Upon analyzing Congress’s intent when it passed BAPCPA, the court pointed out that “[t]he court assume[s] that Congress passed each subsequent law with full knowledge of the existing legal landscape.” Caraballo, 386 B.R. at 402 (internal quotation and citation omitted). Therefore, the court in Caraballo assumed that Congress knew the existing legal landscape in the Second Circuit.

Assuming that Congress knew the existing legal landscape, it is important to clarify the exact landscape of the time. The legal landscape at the time was that a ride through option was available for both personal and real property. See Sokolowski, 205 F.3d at 534; Boodrow, 126 F.3d at 53; supra Part I. Therefore, according to the court in Carraballo, Congress knew that the ride through option existed for both real and personal property, yet it only eliminated the ride through option for personal property in the statute. Therefore, “Congress was aware that there

was a ride through option for real property and intended to leave it intact post-BAPCPA.”
Caraballo, 386 B.R. at 402.

Finally, the third area that the court explored was the precedent from other courts’ analyses of the effect of BAPCPA on the ride through option for real property. The court found support for its holding in bankruptcy court decisions from other circuits, which have also recognized that while the personal property ride through option has been abrogated, the real property ride through option still exists. See In re Wilson, 372 B.R. 816, 820 (Bankr. D.S.C. 2007) (finding that the ride through option exists even after BAPCPA for real property only); In re Bennett, No. 06-80241, 2006 WL 154082, at *1 (Bankr. M.D.N.C. 2006) (finding that the abrogation of the personal property ride through option does not apply to the real property ride through option). While these decisions did not control the court in Caraballo, they provided examples of how other circuits had dealt with the same issue. Thus, the court in Caraballo relied, in part, on those cases for support.

In its holding, the court established that the ride through option still exists for real property after BAPCPA in the Second Circuit, and the creditor could not foreclose simply because the debtor did not reaffirm. Caraballo, 386 B.R. at 402. Under the ride through, a debtor whose real estate mortgage is not in default does not have to reaffirm the debt or surrender the real estate. Id. at 400. The debtor can retain the real estate by continuing to make the scheduled mortgage payments. Id. Thus, since the debtor in Caraballo was not in default, the court disapproved the debtor’s mortgage reaffirmation agreements as not being in her best interests “because she could retain the subject real property without reaffirming the [d]ebt.” Id. at 402.

IV. Subsequent Case Law

The decision by the court in Caraballo has had an effect on federal and bankruptcy courts. Some courts have not yet addressed the issue of the ride through option in real property, and some courts have acknowledged that it is an issue that will eventually have to be determined. See In re Schmidt, 397 B.R. 481, 486 (Bankr. W.D. Mo. 2008) (acknowledging that the ride through option may still exist for real property after BAPCPA, but leaving it to be resolved by a case that deals specifically with the issue of ride through options for real property); In re Jones, 397 B.R. 775, 787-88 (S.D. W. Va. 2008) (finding that the ride through option was terminated for personal property by BAPCPA, but also noting that there are instances where a ride through option may still exist, such as the situation presented by Caraballo).

At least one court has agreed with the court in Caraballo that the ride through option still exists in the same way it existed before BAPCPA, and therefore, reaffirmation agreements are not in debtors' best interests. See In re Waller, 394 B.R. 111, 114 (Bankr. D.S.C. 2008) (citing Caraballo in the process of coming to the conclusion that reaffirmation agreements were not in those debtors' "best interests because [d]ebtors can retain real property without reaffirming the debt"). Clearly, the issue of the existence of the ride through option for real property after BAPCPA is a pertinent issue in many jurisdictions.

V. Moving Forward

In the current environment where it is not uncommon that a mortgage exceeds the value of the home, the debtor has few desirable options. While reaffirmation can preserve the home, the debtor must agree to pay the full debt, an amount that may greatly exceed the home's current value. In addition, the lender may insist upon inserting new terms into the reaffirmation

agreement. Further, since most home mortgages cannot be modified in bankruptcy, the debtor can do little more than reinstate the mortgage on its original terms in a Chapter 11 or Chapter 13 case. At least in those cases where the debtor is not yet in default, the ride through allows the debtor to remain in the home as long as scheduled mortgage payments are made, without giving up the right to discharge the underlying debt. The effect is to convert the mortgage into a non-recourse obligation.

The holding in Caraballo is important because it gives debtors an additional option to retain their homes. Before this holding and after BAPCPA, chapter 7 debtors clearly had three options concerning personal property, but it was unclear how many options existed for real property. In Caraballo, the court was faced with the choice of either limiting the options of a chapter 7 debtor when dealing with real property or allowing chapter 7 debtors to keep the ride through option as a tool for easing the burdens that result from bankruptcy.

Furthermore, several practitioners have written articles in reaction to the Caraballo holding that the ride through option for real property still exists after BAPCPA. New York Bankruptcy Lawyer Jay Fleischman reacted to the holding in Caraballo from the side of creditors by stating that “the secured creditor is left with nothing but an empty bed; no automatic stay, but no ability to repossess in the face of current payments.” Jay Fleischman, Ride Through is Alive and Well in the Second Circuit . . . Kind of, (May 5, 2008) <http://www.newyorkbankruptcylitigation.com/tag/caraballo/>. Linda J. St. Pierre, of America’s Mortgage Banking Attorneys, took a more sympathetic approach toward debtors by commenting that “[w]ith this decision, debtors who are current with their real property mortgage payments may now be able to avoid entering into reaffirmation agreements without fear of having their property foreclosed.” Linda J. St. Pierre, Conn. Rules “Ride-Through” Option re Real Property is Available Post-BAPCPA, (2008)

http://www.usfn.org/AM/Template.cfm?Section=Home&CONTENTID=9378&SECTION=Article_Library&TEMPLATE=/CM/HTMLDisplay.cfm. Similarly, McLeod Law Offices noted how a “debtor can keep her property so long as she continues to make the mortgage payments.” Reaffirming Mortgages, (June 6, 2008) <http://mcleodlawoffices.com/2008/06/reaffirming-mortgages/>.

In conclusion, while the ride through option no longer exists for personal property, it does exist for real property according to the court in Caraballo. Therefore, a debtor who remains current on her mortgage payments can keep the real property without risk of foreclosure, even without signing a reaffirmation agreement.

