



Ep. 26: Repossessions and Bankruptcy Post-COVID, Post-Fulton

July 21, 2021

COVID-19's economic impact on borrowers' ability to repay loans has had major repercussions for auto lenders, and the U.S. Supreme Court recently issued a decision relating to repossessions in bankruptcy. As COVID borrower relief programs wind down, what is the forecast for auto repossessions?

Rudy Cerone:

Hi, good afternoon. This is **Rudy Cerone**. I'm a member of McGlinchey Stafford and a bankruptcy and creditor's rights practitioner for the last 35 years. And with me is **Colin Quillinan**. He's in our Albany office in the consumer financial services group. Colin will be attacking this question from the compliance context and I'll address it from the recent U.S. Supreme Court and bankruptcy context. So with that in mind, let's get started.

Colin, when a consumer defaults on their car payment, what type of protections do they normally have before the car gets repossessed? And is that different from state to state?

Colin Quillinan:

Thanks, Rudy, and good to be here talking to you today. I appreciate taking the time and I'm looking forward to our conversation. And to answer your question, the consumer has a few protections prior to repossession, and it does change from state to state. I would say about half the states, 25 to be exact right now, have what they call a pre-representation "right to cure" requirement where, essentially, the creditor is required to, under state law, send a notice to the borrower or to the customer that they're in default. And if they don't "cure" that default, so that would be, you know, [pay] the past due payments of basically what put them in default in the first place, that the borrower will have their car repossessed. And so, those 25 states have different requirements across the country. Some of them, you know, will give the borrower 10 days to cure or 15 days to cure. So it's really important for creditors to understand what types of requirements are in place.

Some as well also have a kind of “perpetual right,” so the borrower can default on a car payment 30 times throughout their life of their contract, and the creditor is going to always be required to send that notice. Other times, other states have requirements where it's only once or twice during the life of the contract. So again, creditors need to be aware of that as well. And I think the trickiest part of this, of these 25 states, [these rights] are not all found in the statutes and regulations. In most states, it's pretty straightforward. You know, your compliance or legal teams can dive into the statutes, and most people are aware of what's required in that regard. But in some of these states, about seven, have this requirement via case law. So it's kind of an always-evolving set of requirements, particularly in those states. There are protections in place prior to repossession, and the creditors need to be aware of those requirements because there could be some potentially very costly lawsuits, or severe penalties if they don't follow them.

Rudy Cerone: Well, Colin, what types of protections does the consumer have after their car is repossessed? I mean, can they get the car back before it's sold at auction?

Colin Quillinan: Yes, there are protections. The most prominent protection is found in the Uniform Commercial Code (UCC). It's the “right to redeem.” That's going to be the same in pretty much every state. Essentially what the right to redeem is – under the UCC, there's a notice that's required under Article Nine, Section Six, prior to Disposition, the creditor has to send a notice to the borrower that essentially sets forth their right to redeem. And that's basically paying the amount of the accelerated amount due. So that could be potentially very, a very large amount.

Rudy Cerone: That's the entire amount of the loan.

Some states do require what they call “right to reinstate.” And that is much more appealing to borrowers because all that the borrower has to do in order to get their car back prior to the auction is pay the past due amounts.

Colin Quillinan: Exactly, that's the entire amount of a loan. So if somebody's got \$40,000 remaining on their loan, you know, they have to come up with \$40,000 pretty quickly, prior to the auction. And that's very hard, especially when you think about, you know, this person has got their car repossessed because they couldn't make a car payment. So most likely, they're not going to be able to come up with that larger amount. Now, however, there are some states that do require what they call “right to reinstate.” And that is much more appealing to borrowers because all that the borrower has to do in order to get their car back prior to the auction is pay the past due amounts, and usually the reasonable expenses of retaking and storing that the creditor incurred in repossession. More than likely, [if] Borrower is going to exercise any kind of a post-repossession right, it's going to be the right to reinstate rather than the right to redeem, although the right to redeem obviously exists. So that's something that creditors need to be aware of, because that right to reinstate doesn't exist in every state. It's only in about 10 across the country. And again, similar to the right to cure prior to repossession, there are

varying requirements, varying amounts of days that you have to give the borrower the right to reinstate, whether it has to be perpetual throughout the length of the entire contract, or only once or twice. So there are very specific requirements that creditors need to be aware of and borrowers, they have those protections in place.

Rudy Cerone:

Colin, you know, there have been protections that had put into place because of the COVID pandemic. I understand that they're either ended or coming to an end. How would they affect the right to repossession of the vehicle after default?

Sixteen states put in some type of a protection, basically put a repossession moratorium in place that made it impossible during those time periods that repossessions could take place, or there would be severe penalties that creditors would have to face.

Colin Quillinan:

In a number of states, that type of protection was not put in place. In the majority of states, the repossessions kind of continued. Obviously, you would assume that the regulators had a close eye on what was going on. But in about, I believe it was, 16 states put in some type of a protection, basically put a repossession moratorium in place. That made it impossible during those time periods that repossessions could take place, or there would be severe penalties that creditors would have to face. What was tricky about that was that they were all varying time periods, you know. Some of them began in April of 2020, some didn't go into effect until the fall of 2020. Some of them were put in place by emergency legislation. Some of them were put in place by Attorney General opinions, others in place by executive orders. So it was very hard to follow.

Coming into the summer of 2021, they're all pretty much gone. There are a few lingering ones. I think that Washington, DC's is tied to their emergency health order, or emergency health period. That's ongoing. So creditors will certainly need to keep an eye out there. But most of them are basically at their end. And so what we're seeing now, and what we've kind of anticipated throughout the industry is that there's going to be now an influx of repossessions. During that time period, in a number of places you couldn't repossess the car, it just wasn't an option. And borrowers didn't have to make payments during those time periods because they couldn't, you know, their car couldn't get repossessed. So now coming out of that time period, we're anticipating the number of repossessions is going to go up. And I think that the regulators are anticipating that as well. So they're going to be taking a close look at some folks, at creditors, to make sure that what they're doing is correct. And especially, they're going to take a look back during those time periods and say, "Hey, during those time periods, did everyone follow the rules?" Like I said, in those states that have those moratoria in place, which the majority of states did not, but there were a good number that did

Rudy Cerone:

Well, with the COVID stimulus basically over, the relief to consumers and the average person is ending. Plus it seems that used car prices are going up. And so the vehicles that are repossessed are more valuable than they used to be. What kinds of things should the lenders be doing right now to prepare for what you're seeing as a possible uptick in repossessions?

Colin Quillinan:

Sure. So they're going to get a lot of attention. They're going to get a lot of attention from regulators. They're going to get a lot of attention from plaintiff's attorneys. And so now's a perfect time, and really it's something that should have been going on for quite some time now, but preparing their policies and procedures. You know, a well drafted compliance management system will do great things. When a regulator comes in and sees you have a well-equipped CMS in place, where your board is apprised of everything that's going on. You have policies and procedures that have been updated to show that any kind of new requirements that were put in place in the last year, or going forward, are built into policies. That your employees are trained, that you're monitoring those business units that were specifically dealing in those states, or that are dealing in those states that have the right to reinstate or the right to cure. That you're showing the regulators that you're on top of everything. So kind of going in and making sure everything is up to snuff. And then as well, just thinking about things kind of just generally, you know. Knowing the impact of mobile collateral, these are cars, right? So, you know, you're going to enter into a contractual relationship with somebody in some state. And if that person moves to California or Ohio or Maryland, or Louisiana, which – that's a whole different bag of tricks in Louisiana. You know, when you get your car repossessed in Louisiana, we recommend consulting with local counsel. It's basically no self-help repossession. They're mostly judicially required, judicial involvement. So just know that the regulator is going to be watching, and you need to prepare for your next exam.

[Property of the bankruptcy estate is] protected by a provision in the Bankruptcy Code called the "automatic stay." What the automatic stay does [is] it stops all collection activity. And that means it'll stop repossessions. It'll stop lawsuits attempting to collect.

Rudy Cerone:

The whole point of bankruptcy is to be a collective collection proceeding, where everything is funneled into a single proceeding in the bankruptcy case, right? When a consumer files bankruptcy, basically everything that person owns becomes what we call property of the bankruptcy estate. And it's protected by a provision in the Bankruptcy Code, Section 362, called the "automatic stay." What the automatic stay does, just generally, it stops all collection activity. And that means it'll stop repossessions. It'll stop lawsuits attempting to collect. It'll stop administrative proceedings attempting to collect on a debt, and against either the debtor, or the collateral that the lender may have. So with respect to automobiles in particular, there are three subsections of the automatic stay provision that will affect the ability to go forward with any type of collection or repossession activity. And one is, they can't, the creditor cannot exercise any control over any property that is owned by the debtor. Two, the creditor cannot attempt to collect on the debt that underlies the obligation that the collateral secures. And the third is that, [the creditor] cannot enforce or attempt to perfect any lien on the property. You know, automobiles are unique in that they're titled vehicles, right? And if the lien of the creditor is generally not noted on the title of the vehicle, then the security interest will not be perfected on that vehicle. Well, the automatic stay prevents the creditor from attempting to perfect, except under certain exceptions. So it basically

stops all collection and all repossession activity of the credit against the debtor or the vehicle.

Colin Quillinan: How did the recent Supreme Court's *Fulton* decision affect the lender's obligation to return the car after the consumer files bankruptcy?

There are several subsections of the automatic stay provision of the Bankruptcy Code. And the one that was at issue in Fulton was basically whether, after repossession and then the debtor files for bankruptcy, was the creditor obligated to immediately return possession of the vehicle to the consumer?

Rudy Cerone: Well, as I said before, there are several subsections of the automatic stay provision of the Bankruptcy Code. And the one that was at issue in *Fulton* was basically whether, after repossession and then the debtor files for bankruptcy, was the creditor obligated to immediately return possession of the vehicle to the consumer, who is now the debtor? The provision of the automatic stay said, in some cases, in the cases that made it to the Supreme Court, that the creditor's continued possession of a repossessed vehicle was a "exercise of control" over property of the bankruptcy estate, the debtor's property. There was another line of cases that went the other way and said, basically, if the creditor did nothing more than just hold on to possession of the repossessed vehicle, that it *wasn't* in violation of that provision of the code.

So you had a split of authority between the Circuit Courts on that. And that's one of the reasons the Supreme Court will take a case in the first instance. So they took a series of cases, actually three or four that were consolidated, and they took that up on appeal from the Seventh Circuit out of Chicago. The city of Chicago has a policy of not returning vehicles that have been seized because of unpaid parking tickets. The city of Chicago makes a lot of money from parking tickets, and it's a significant portion of their yearly budget. So they were loath to return vehicles to people who had filed bankruptcy. So that decision went up to the Supreme Court. And in these days to get a unanimous decision out of the Supreme Court is very rare. Well, this was a unanimous decision Judge Barrett hadn't yet taken the bench, so it was an 8-0 decision. And it was unlike most Supreme Court cases, it was very short. It was three or four pages, and it was very narrow. And the decision basically said, it sided with those courts that said that simply retaining possession of a repossessed vehicle was not a violation of the automatic stay, and the lender, or in this case, the city of Chicago, did not have to return that vehicle to the debtor just simply by filing the bankruptcy provision.

There are other provisions of the Bankruptcy Code that allow debtors to gain possession of property that's in the hands of a third party. It's what we call the Turnover Provision. And that requires a more elaborate type of litigation in the bankruptcy, basically an ordinary lawsuit within the context of the bankruptcy case, it's called a turnover proceeding, but it takes a long time. You have a chapter 13 debtor who has a vehicle they need to get back and forth to work. And the work is going to generate the money that's going to pay the creditors in the case. So there's a bit of a tension there. It takes a

long time for ordinary lawsuits. So what we're seeing is borrowers are bringing those types of turnover lawsuits, but they're also filing emergency motions. And the bankruptcy judges are hearing these emergency motions for turnover. And that's what we're seeing as a sort of a trend right now.

Colin Quillinan: Well, what should lenders be doing now to prepare for future bankruptcy filings by consumers?

Rudy Cerone: As I said, the trend that we're seeing are these turnover proceedings in bankruptcy cases and emergency motions for turnover. What the turnover turns on in essence is, what does the creditor need to replace its possession of the vehicle? It's collateral. It's a depreciating asset. Every day that the consumer uses the vehicle, it goes down in value, because it's putting miles on it, et cetera, it could get in an accident and get lost. So what we're seeing is that the courts are requiring the debtors to prove that they have adequate insurance coverage to protect the lender against the loss of the vehicle because of its use by the debtor during the bankruptcy case. The loan that the creditor has on the vehicle is going to be repaid in the ordinary course as part of the chapter 13 repayment plan. So the whole loan itself will get repaid, but it really focuses on the protection of the creditor's interest in the vehicle as its collateral.

What we're suggesting to our lender clients is that they take a look at this trend [of increased turnover proceedings], see if it's going to be affecting their portfolios, and come up in advance with a policy or a procedure that they can have their local counsel implement to determine what the baseline would be for return of these vehicles.

Basically how much insurance, whether insurance is in place, and how much insurance for particular vehicles should be in place before they agree to turn over these vehicles voluntarily. The rest of the case can just go on as normal by their existing local counsel who deals with their bankruptcy matters.

Colin Quillinan: Thank you very much, Rudy. That was interesting. It sounds like there's a lot going on in the bankruptcy world, especially how it comes to how lenders are treating the repossessions. Thank you for listening to me about the different requirements that are generally in place outside of the bankruptcy world regarding the pre repossession, right to cure, post repossession right to redeem and reinstate. And what lenders should be doing going forward as we're coming out of this pandemic and we're more than likely going to see an uptake in repossession. So thanks very much. It was great talking to you today.

Rudy Cerone: Thank you very much. Appreciate it.

Colin Quillinan: Thank you.

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