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# Sales vs. Leasing Contracts in Bankruptcy Proceedings

In the realm of bankruptcy, not all car transactions are created equal. A different set of guidelines governs lease transactions as opposed to traditional financing transactions through a retail installment sales contract (RISC). While many dealers and car finance companies may be familiar with the business-side of these transactions, not many are aware of how these situations are treated in the bankruptcy setting. The goal of this article is to provide you with a basic overview of how the process differs depending on whether or not you are the holder of a RISC or a lease.

## Bankruptcy When Holding a RISC

When a dealer or finance company has financed the sale of a vehicle through a RISC, the transaction is treated like a routine debt in the bankruptcy setting. That is to say that the holder of that RISC has a “claim” against the bankruptcy estate which is secured as to the value of the vehicle and unsecured as to any amount owed over the value of the vehicle. While, generally speaking, this claim may entitle you to some form of payment from the bankruptcy, how exactly this claim is treated depends on the type of bankruptcy that was filed.

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In a Chapter 7 “liquidating” bankruptcy (which is the type of bankruptcy most people are familiar with) a cash payment for the amount of the claim is unlikely given that there will be few assets that can be liquidated. Accordingly, most Chapter 7 proceedings involving RISCs revolve around whether or not the debtor will attempt to retain the vehicle and keep making payments, or will attempt to surrender the vehicle in satisfaction of the claim. If the debtor wishes to retain a vehicle, they must either enter into a reaffirmation agreement with the creditor or see if the creditor will continue accepting payments without a reaffirmation agreement (often referred to as a “ride through”). The only difference between the two is that, if the debt is reaffirmed, the debtor will be liable for any deficiency following a repossession, whereas if the claim is handled as a ride-through, no deficiency will be allowed. In either case, however, the decision on whether or not to continue accepting payments or to reaffirm must also be agreed to by the creditor.

In a Chapter 13 “reorganization” bankruptcy, the claim is treated differently. The goal of a Chapter 13 bankruptcy is to allow a debtor to modify debts, thereby allowing him or her to keep property that may otherwise be liquidated for the benefit of creditors in a Chapter 7 case. In such Chapter 13 cases, the debtor proposes a “plan” which sets forth the payment schedule for each creditor over (typically) a 60 month term. Unlike a Chapter 7, in a Chapter 13 case, a debtor can force the creditor to allow it to retain a secured vehicle so long as payments are made to the creditor, over the life of a plan, in an amount equal to the value of the car on the date they filed for bankruptcy. However, in certain cases where the vehicle was purchased less than 910 days before bankruptcy was filed, the entire amount of the claim (both secured and unsecured portions) must be paid over the life of the plan. In addition, as part of a Chapter 13 Plan, the debtor can typically modify the interest rate within certain limits as well.

## Bankruptcy with a Lease

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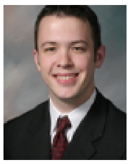
In cases where you have a lease, things proceed differently. The bankruptcy code requires that the debtor either assume or reject any unexpired leases it has, regardless of the type of bankruptcy filed. This means the debtor is left with the choice of taking the lease as is, or rejecting it. Unlike a Chapter 13 case when you have a RISC, the debtor has no means to unilaterally alter the amount owed to the creditor under a lease.

In bankruptcy, the debtor is given a certain time period within which to assume or reject a lease. Should these timelines not be met, the leases are deemed rejected as of the date the bankruptcy was filed. Furthermore, if the lease was made to someone other than an individual using the vehicle for personal, family or household use (such as a company vehicle) then, until the lease is assumed or rejected, the debtor will be required to perform under the lease, principally by paying lease payments. However, once rejection occurs, there is no further obligation between the parties. If a debtor timely assumes the contract, then the lease will continue as if no bankruptcy was filed.

As can be seen, the treatment of a car deal in a bankruptcy can change depending on whether the transaction was done through a RISC or a lease. Regardless of which path is chosen, understanding how these are treated can help prepare you to navigate the bankruptcy process.



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