Issues in Consumer Bankruptcy Appeals

Eugene R. Wedoff
144 N. Elmwood Ave.
Oak Park, IL 60302
312-285-5849

After 28 years as a bankruptcy judge, I decided to retire. My thinking was (1) the government is willing to pay my salary regardless of what work I do and (2) this gives me the opportunity to do something useful that other people can't afford to do. So far, I've received leads for good appeals from friends at the National Consumer Law Center, the National Association of Chapter 13 Trustees, and from bankruptcy judges. There have been six appeals so far, with an interesting range of issues:

1. *Denial of plan modification in Chapter 13.* In my first appellate case, a trustee wanted to modify the debtors' plan to increase payments, and his only basis was that their net income had increased. The bankruptcy judge denied the motion, holding that the income increase, by itself, did not show that higher plan payments were required to comply with the obligation of good faith. She wanted evidence of the totality of circumstances. I had three arguments: (1) following *Bullard v. Blue Hills Bank*, 135 S.Ct. 1686 (2015), denial of plan modification, like denial of plan confirmation, is not a final order subject to appeal; (2) even if it were otherwise appealable, the debtors had made their final payment under their confirmed 60-month plan, so the appeal was moot, since plans can't be modified after 60 months; and (3) that, if the merits are reached, the bankruptcy judge's ruling was correct. Each of

these arguments was rejected in the Seventh Circuit's opinion. I was particularly unhappy about the ruling that the plan could be retroactively modified after payments were completed, but the trustee's settlement offer was too good for my client to pass by. So, sadly, my first effort to clarity the law did result in clearer law—but the opposite of what I thought was good law. *See Germeraad v. Powers*, 826 F.3d 962 (7th Cir. 2016).

2. *Dirt for debt in Chapter 13*. Can a debtor convey to the mortgage holder property that is worth less than the mortgage balance? The bankruptcy judge said yes, but the district court reversed confirmation, and I'm trying to get the Second Circuit to reverse the district court. So far, no luck, because the district court's order, according to the Second Circuit, is not final. But we haven't given up. *See HSBC Bank USA, N.A. v. Zair,* 550 B.R. 188 (E.D.N.Y. 2016). Because the arguments I'd rely on aren't set out in any published opinion, I've attached a Bankruptcy Law Letter that I wrote on this subject.

3. *Extraterritoriality of exemption law.* If a state in which the debtor used to live provides the exemption law for the debtor's bankruptcy case, does that law apply to property located in the debtor's current state of residence? The bankruptcy court said yes, the trustee appealed, and I'm trying to uphold the bankruptcy judge's decision. There is no reported decision yet, but briefing is complete and there should be a decision from the district court for

the Northern District of West Virginia in the near future. I have attached the argument from our appellees' brief.

4. *The effect of liens on a mortgage escrow account on the nonmodifiability of home mortgages.* To be protected by the anti-modification provision of § 1322(b)(2), a mortgage loan can't be secured by any lien in personal property. In another appellate case I worked, the debtor had argued that a lien on a mortgage escrow account was an interest in personalty that negated the anti-modification provision. The bankruptcy judge disagreed, although another judge in the same district supported the debtor's position. I filed an opening brief in an appeal, but it turned out that there was actually no lien, because there were no funds in any escrow account. We had to dismiss the appeal. But if there had been an actual lien, the argument is still potentially valid. *See In re Capretta,* 542 B.R. 774 (Bankr. N.D. Ohio 2015); *Stevens v. SunTrust Mortg., Inc. (In re Stevens)*, 2015 Bankr. LEXIS 4338 (Bankr. N.D. Ohio Feb. 5, 2015).

The question is basically one of interpreting a series of BAPCPA definitional amendments. Section 1322(b)(2) excepts from the debtor's right to modify secured claims any "claim secured only by *a security interest in real property* that is the debtor's principal residence." BAPCPA first defines "debtor's principal residence" to mean, among other things, "a residential structure . . . including incidental property" (11 U.S.C. § 101(13)(A)(A)), and

then defines "incidental property" to include, among other things, "escrow funds, or insurance proceeds."

5. *Fact finding in student loan dischargeability complaints.* In this case, the bankruptcy court ruled that the debtor's student loans imposed an undue hardship and made detailed findings of fact to support the ruling. The district court reversed, making contrary fact findings and adding a new factor to the undue hardship analysis—whether the debtor should have known when she incurred the student loans that the increase in income that her education was likely to produce would not be enough to repay the loans. The appeal from the district court's opinion is fully briefed—with our arguments being that the fact-finding of the bankruptcy court was entitled to deference and that the economic wisdom of incurring a student loan has nothing to do with whether repaying the loan is an undue hardship. The Eleventh Circuit should be deciding the case later this year. *See Ecmc v. Acosta-Conniff*, 550 B.R. 557 (M.D. Ala. 2016); *Acosta–Conniff v.ECMC (In re Acosta-Conniff)*, 536 B.R. 326 (2015) (Bankr. M.D. Ala. 2015).

6. *Jurisdiction to determine a debtor's tax liability.* The IRS says that a bankruptcy judge can only determine a debtor's tax liability if that determination will affect distribution of the estate, so that there's no jurisdiction over tax disputes in a no-asset case—or a case in which the only matter in dispute is a subordinated claim that won't be paid. The bankruptcy court rejected the IRS's argument, noting that tax liabilities would affect the

debtor's fresh start. The district court disagreed. I have filed a Seventh Circuit appeal, but briefing was on hold until the court determined that the district court's decision was final for purposes of appeal. *See In re Bush*, 2016 U.S. Dist. LEXIS 106671 (S.D. Ind. 2016).

This dispute has three different jurisdictional questions. First, is § 505(a) of the Bankruptcy Code a grant of jurisdiction? The subsection reads, in relevant part:

> [T]he court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

The IRS argues that although these words seem to be a grant of jurisdiction, they cannot have that effect, because bankruptcy jurisdiction can only be conferred under Title 28.

The second question is whether, even if the IRS is right on the first one, there's jurisdiction to determine the full amount of any contested claim, even if the outcome won't affect distribution of the estate. In the case on appeal, the IRS filed a claim for both the underlying tax liability and penalties. The penalties, though, are subordinated to general unsecured claims under § 726(a)(4), and the IRS argues that there isn't enough in the estate to pay all of those claims, so that determination of the amount of the penalties is not related to the bankruptcy case and so is outside 28 U.S.C. § 1334. The

question may come down to whether § 502(b) should be interpreted according to its terms: "if [an] objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim."

And finally, since the tax penalties are nondischargeable, can jurisdiction over the amount of the claim arise from the court's determination of nondischargeability? The Seventh Circuit recently made such a holding in *Siragusa v. Collazo (In re Collazo)*, 817 F.3d 1047, 1053 (2016), though it suggests that there would not be final adjudicatory authority absent party consent.

This case should also be decided in the coming year.