The Nuances of the Consumer Bankruptcy Appeal Process

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Introduction: The Appellate Process Should Be a Well-Known Path

There is a 1.1 percent chance that a petition for writ of certiorari will be granted by the US Supreme Court. *Caperton v. A. T. Massey Coal Co.*, 129 S. Ct. 2252, 2272 (U.S. 2009); *see also The Chief Justice's 2010 Year-End Report on the Federal Judiciary*, www.supremecourt.gov/publicinfo/year-end/year-endreports.aspx. Despite the unlikelihood that any case may be granted review by the Supreme Court, there have been at least five published Supreme Court opinions in the 2010 and 2011 calendar years thus far on consumer bankruptcy issues. Three of these cases deal with issues spawned by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). Although consumer bankruptcy cases do not often make headlines and in most cases individually do not justify the cost of an appeal, the appeals are being heard by the highest court in the land, as they involve a significant segment of the population seeking bankruptcy relief.

The appellate process has considerable impact on how consumer bankruptcy is practiced. Consumer bankruptcy attorneys who are familiar with the appeal process and are known to appeal adverse opinions have a significant advantage in obtaining a favorable outcome for their clients. The appellate process should be a well-known path for all consumer bankruptcy practitioners.

Recent Trends in Consumer Bankruptcy and Appeals

We find ourselves on a bleak economic landscape as consumer bankruptcy attorneys. No longer are we filing bankruptcies to stop the imminent foreclosure on a home or get back the repossessed car. The prevailing trend is to file Chapter 7 bankruptcies because most debtors want to get rid of their homes. The severe undervaluation of homes is making it unwarranted to hang on to the home. Even in circumstances where a totally unsecured second mortgage (such as in *Lane v. W. Interstate Bancorp (In Re Lane)*, 280 F.3d 663 (6th Cir. 2002)) can be stripped, clients are still choosing not to keep their homes, as their value is so dramatically reduced. People are leaving their state of residence, such as in Michigan, to find jobs and are abandoning homes whose values have dramatically fallen. The question posed is how can we keep home ownership a part of the motivation for filing bankruptcy? The answer to this question can be developed through the appeal process.

Is an Accelerated Mortgage Note Subject to Modification?

In the process of foreclosing a mortgage, the mortgagor must declare a default and accelerate the balance owed on the promissory note. The balance, therefore, can no longer be paid in installments but is immediately due and owing. A Chapter 13 plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence. 11 U.S.C. § 1322(b)(2). This provision is tempered by 1322(c)(2), which states that in a case in which the last payment on the "original payment schedule" for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to Section 1325(a)(5). The phrase "original payment schedule" is a term that is not defined in the Bankruptcy Code. Is the definition of that phrase broad enough to encompass the last accelerated payment due on the promissory note? Can the mortgage claim then be bifurcated and crammed down pursuant to 11 U.S.C. § 506(a)(1)? *See In re Nepil*, 206 B.R. 72 (Bankr. D.N.J. 1997); *accord In re Padgett,* 273 B.R. 277 (Bankr. M.D. Fla. 2001). The appellate process can provide the definition lacking in the code to assist clients facing foreclosure to keep their homes.

Can Non-Residential Mortgages Be Modified and Paid Beyond the Term of the Plan?

Landlords with multiple pieces of property—some income-earning and some not—are not subject to the anti-modification mortgage provision of 11 U.S.C. § 1322(b)(2) because they hold non-residential mortgages. Similarly, where the debtor's home mortgage is not protected from modification because the debtor's use of the property is not exclusively as a "principal residence," as it may also include a commercial use, can he or she also modify the mortgage payment by increasing or decreasing the payment, reducing the interest, reducing the payment period, and bifurcate the loan under 11 U.S.C. § 506(a)? The term "principal residence" is not defined by the code. The appellate process can be used by consumer bankruptcy practitioners to expand opportunities for their clients to retain severely devalued homes by defining the term. *See Lomas Mortgage Inc. v. Louis*, 82 F.3d 1, 3–6 (1st Cir. 1996). In some instances, the amortization of the

bifurcated secured loan balance may still create a payment that is too large to pay in five years. May a debtor who is either a landlord or a homeowner who has expanded the use of the home to include commercial purposes amortize the remaining secured loan beyond the maximum of five years permitted for a Chapter 13 plan? Does the debtor have the ability to both modify under § 1322(b)(2) and maintain the regular monthly payments under § 1322(b)(5)? These issues are ripe for appeal. *See Federal Nat'l Mortgage Ass'n v. Ferreira (In re Ferreira)*, 223 B.R. 258, 261–62 (D.R.I. 1998); *Enewally v. Washington Mut. Bank (In re Enewally)*, 276 B.R. 643, 647–52 (Bankr. C.D. Cal. 2002).

Revenue-Strapped States Fight the "Straddling Tax Claim"

Changes in the economy have also provoked income tax authorities to attempt to opt out of Chapter 13 bankruptcy cases. This undoubtedly reflects a governmental policy to increase revenue at the expense of Chapter 13 debtors by immediately enforcing the principal, interest, and penalties due on the tax claims that would otherwise be modified and stayed by the filing of the Chapter 13. In a series of cases, the state of Michigan challenged the Chapter 13 debtor's attempts to include treatment of income tax debt that arises after January 1 but is ultimately due on April 15. *See In re Turner*, 420 B.R. 711 (Bankr. E.D. Mich. Dec. 21, 2009); *Michigan Department of Treasury v. Hight (In re Hight)*, 434 B.R. 505 (W.D. Mich. Aug. 10, 2010); *Michigan Dep't of Treasury v. Senczyszyn (In re Senczyszyn)*, 444 B.R. 750 (E.D. Mich. Feb. 11, 2011). Commonly referred to as the straddling tax claim, it was the position of the state that such a debt could not be included in the Chapter 13 case as a pre-petition tax debt, because although payable it was not yet due and was therefore a post-petition debt. Relying on *United States v Ripley (In re Ripley)*, 926 F.2d 440 (5th Cir. 1991), as authority, the state asserted that only it could file a claim for post–petition taxes, as they became due only after April 15. Although Michigan debtors appear to be prevailing (*Hight* and *Senczyszyn*), consumer bankruptcy practitioners have to remain vigilant against revenue-strapped states. The straddling tax claim issue has far-reaching implications that could also include property tax claims that similarly become payable but not ultimately due until a later date. It represents an issue that will need an appellate resolution.

Must Non-Dischargeable Debts Wait Out the Term of the Chapter 13 Plan?

BAPCPA has made Chapter 13 less attractive to clients, as the "super discharge" (a discharge under the prior 11 U.S.C. § 1328 that discharges debts that would otherwise be non-dischargeable under Chapter 7 discharge) is not as super as it once was. Previously, under Section §1328, the super discharge enabled us to discharge fraudulent debts under 11 U.S.C. § 523(a)(2), breaches of fiduciary debts under § 523(4), and so on. Although these debts may not be discharged under the present § 1328(a), they must nevertheless be filed as adversary cases and meet the same deadlines and procedures for trials that exist in a Chapter 7 case. If there is a determination of non-dischargeabilty, the prevailing creditor's immediate satisfaction of the debt may be postponed by the court's automatic stay and the length of the plan. It will be condemned to non-discriminatory treatment and hence a *pro rata* distribution with other dischargeable unsecured creditors, but only if the automatic stay remains in place. 11 U.S.C. § 362(c)(2)(C) provides for the lift of the automatic stay upon the finding of non-dischargeability by the court. *See Boatmen's Bank v. Embry (In re Embry)*, 10 F.3d 401 (6th Cir. 1993); *In re Mu'min*, 374 B.R. 149 (Bankr. E.D. Pa. 2007). That may not be the case in a Chapter 13. BAPCPA provides yet another issue ripe for appeal.

The Impact of Trends on Lawyers and Clients

Fewer clients are seeking relief through Chapter 13, although BAPCPA was intended to make Chapter 7 less available. From the observations of this attorney, the human resources at the US Trustee's Office were also increased to accomplish that mission. Instead, clients are seeking other means for dealing with debt, such as debt negotiators and credit counselors. Lawyers are losing business despite the bad times clients are facing. There are a significant number of people who still need bankruptcy relief. They are reluctant to pursue bankruptcy relief because they will be ensnared in a Chapter 13 case and the prevailing "pay as much as you can" attitude, as reflected in the opinion of Justice Kagen in *Ransom v. FIA Card Services*, 131 S. Ct. 716,721 (2011). There is an attitude that Chapter 13 is not intended to give clients a fresh start as it was prior to BAPCPA. Instead, the expectation is that debtors should pay the maximum they can afford. Despite the sentiment expressed by Justice Kagen, many bankruptcy judges can recall

that Chapter 13 was created to give the "honest debtor" a "fresh start." Thus, the choice of whether your appeal is filed with the district court judge or with the bankruptcy appellate panel (where available) may depend on whether the judges in the appellate panel have emphasized the fresh start sentiment rather than the pay as much as you can afford sentiment. Researching the leanings of the possible panel members may yield a more favorable result on an appeal.

A bankruptcy appellate panel also consists of bankruptcy judges who regularly decide bankruptcy issues that are well known to them. They already have some knowledge of what the bankruptcy process is about, and that will change the way you present your appeal. For example, when you write a brief and present an oral argument to a district court judge, it is an entirely different process than making the same argument to a bankruptcy appellate panel. The panel will require you to explain far fewer concepts, whereas with a district court judge you may have to educate and write very simply and thoroughly. A district court judge not only does not regularly decide bankruptcy issues, but also may be unfamiliar with the bankruptcy process itself. Bankruptcy judges overwhelmingly write more precedent, whether binding or merely persuasive, than district court judges. If your issue is strongly supported by precedent (in other words, other bankruptcy judges), you may decide to press your appeal to a district court judge for a fresh take on the issue.

In addition to the above reasons, practicing in a bankruptcy appellate panel jurisdiction gives your client an advantage. Bankruptcy appellate panel decisions are more often cited as authority than district court opinions in terms of the numbers they present. Many bankruptcy appellate panels agree that when they write an opinion, they will consider any prior precedent of the bankruptcy appellate panel within the circuit binding upon themselves. If you are in a bankruptcy appellate jurisdiction and it has already ruled against you, it would not be prudent to appeal to that panel. The choice of a panel to decide a case has to be unanimous among all of the parties, so as soon as you elect out, it goes to a district court judge. Fed. R. Bankr. P 8001(e). The precedential value of a panel decision has run the gamut of interpretation. Courts have concluded that the panel decision is the equivalent to a district court judge decision and not binding precedent on a bankruptcy court. *Specker Motor Sales Co. v. Eisen*, 300 B.R. 687, 689 (W.D.

Mich. 2003). A bankruptcy court has concluded that a panel decision is binding precedent only upon bankruptcy courts in the district from which the appeal was taken. *Oregon v. Selden (In re Selden)*, 121 B.R. 59, 62 (D. Or. 1990). It has been suggested that appellate panel decisions will not be binding on district courts, as constitutionally the decision of a panel of Article I judges cannot be binding on Article III judges. 1-5 *Collier on Bankruptcy* P 5.02. As a matter of strategy, it is best to choose a district court that is not bound by any precedent or the bankruptcy appellate panel either.

It is easier and quicker to get a hearing from a bankruptcy appellate panel, as they impose internal deadlines upon which to decide a case and their existence is for the purpose to decide an appeal. A district court judge has a full docket concerning a myriad of different legal issues. Fed. R. Bankr. P. 8009 provides the timeline for filing briefs. Although the rule provides that the district court judge, bankruptcy appellate panel, or local rules may specify different time limits, generally plan to file your appellate brief within the fourteen days after the entry of appeal on the docket. Attorneys have relied upon their prior experience with a district court judge who happened to issue a scheduling order for briefs and have assumed that all judges follow the same procedure. They thereby fail to timely file their briefs, resulting in a dismissal of their case. Be sure you fully understand all of the Federal Rules of Bankruptcy Procedure pertaining to appeals. The rules are set under Fed. R. Bankr. P. 8001-8018. Cases have been dismissed because attorneys were not aware of the specific requirements. As mentioned above, certain district court judges issue their own scheduling orders that govern deadlines. A bankruptcy judge may treat your appeal as if it was just another civil matter. In one case, I had submitted my appellant's brief within the fourteen days required by rule, and the appellee timely responded within the same period of time. Instead of presenting our oral argument before a district court judge, our first scheduled hearing was a pre-trial conference where we sat in front of the judge for no apparent purpose.

A case can also be dismissed for inadequate records. *In re Winner Corp.*, 632 F.2d 658, 660-61 (6th Cir. 1980). The burden is on the appellant to designate all the relevant records on appeal. *Kritt v. Kritt (In re Kritt)*, 190 B.R. 382, 387 (9th Cir. BAP 1995). The failure to designate a complete record on appeal may compel the appellate court to raise adverse inferences against your appeal. While it is important to designate all the record that is

relevant to the prosecution of the appeal, you do not want the judges to unnecessarily read the entire record. If they do, it may go against you because they had to read a record that had nothing to do with the issues that were presented on appeal. Be sure you have the complete relevant record because of the potential adverse consequences.

Objecting to a Confirmed Plan

Zahn v. Fink (In re Zahn), 526 F.3d 1140 (8th Cir. 2008), has set the stage for having standing to object to a wrongly confirmed plan. *Zahn* reversed a decision that said that a Chapter 13 debtor lacked standing to object to confirmation of his own confirmed plan, reasoning that "a party cannot prosecute an appeal from a judgment in its favor." In its reversal, the court indicated that the appellant was an aggrieved party and "that a party may appeal from a judgment in his favor when there has been some error prejudicial to him, or he has not received all he is entitled to." The court then went on to note that the debtor did not receive all that he was entitled to, as the debtor wanted his original proposed plan to be confirmed, not the amended plan acceptable to the court.

Thus, all the issues created by BAPCPA can be raised without in effect having waived them by amending a Chapter 13 plan to the adverse ruling of the court. The *Zahn* case is also precedent for the proposition that an order confirming a Chapter 13 plan is a final order of the court. In finding that the confirmation order is a final order, the court stated that it is "undisputed (1) the confirmation order leaves the bankruptcy court nothing to do but execute the order, and, (2) a delay of review could prevent the debtor from obtaining relief." Having standing and a final order enables the client to appeal a confirmed plan, opening the door to reverse the findings of the bankruptcy judge who may impose a greater sacrifice upon the client on the bottom line of what the debtor must pay under the confirmed plan. There are many nuances to deciding necessary expenses and projected income discussed below that can be challenged at confirmation and preserved for appeal.

Common Reasons for Appeal

Many appeals are brought to unscramble the complications brought on by BAPCPA. For example, prior to BAPCPA there was precedent whereby we

knew what projected disposable income meant. The credit card industry wanted a solid formula to determine projected disposable income. It did not trust judges to come up with the right decision. BAPCPA was an attempt to take the outcome out of the hands of judges as to what a debtor should pay to unsecured creditors. The Supreme Court in *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010), has put it back in the hands of judges to a degree. *Lanning* will not be the last word on this conundrum, as we can see in *Ransom*. Appellate issues will resound over the conflict of the intended purpose of BAPCPA. For instance, BAPCPA created a new definition for projected disposable income that came into conflict with prior precedent. There is no real projection of disposable income. Under the old law, you simply projected your client's income in Schedule I based current paystubs minus expenses in Schedule J. If the expenses were reasonably necessary for the support of the debtor or a dependent of the debtor, you had your client's projected disposable income.

Today, the law is based on historic income for the last six months before the filing of bankruptcy. Therefore, we are compelled to use artificial numbers in the formula and project a disposable income that is totally unrelated to the present income of the debtors. The Supreme Court had to make a choice as to whether to fix the statute, which inherently does not work because you are basing your projection on historic income, or simply follow the statute. In *Lanning*, the court decided to fix the statute and give a definition of projected disposable income that would be more likely one with which a debtor could live, rather than the more onerous statute the credit card industry had written in BAPCPA. The court decided to follow the line of precedent that adopted the "forward-looking approach" and declared that bankruptcy judges had the discretion to depart from the historic six-month projection where there was an exceptional case in order to take into account foreseeable changes of debtors' income or expenses The court further stated that the incorporation of 11 U.S.C. § 707 into 11 U.S.C. § 1325 did not infer that Congress intended to eliminate the discretion courts had previously exercised. The definition of an "exceptional" case implies a degree of magnitude that has yet to be developed under case law. The debate on the degree will create a hotbed of appealable cases.