

Annual Spring Meeting

Case Conversion Strategies: What Works and What Doesn't

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Problems in the Code

By Jennifer B. Lyday and Joshua Plummer

Oversight Results in Uncertainty for Small Business Owners Converting to Subchapter V



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n February 2020, Congress codified the Small Business Reorganization Act of 2019 (SBRA) as subchapter V of chapter 11 of the Bankruptcy Code. In doing so, Congress established a relative safe haven for eligible small businesses that provides a more streamlined and less costly chapter 11 relief process.²

However, in its haste to "permit qualifying small business debtors to file [for] bankruptcy in a timely, cost-effective manner,"3 Congress seemingly failed to amend § 348(b) — a critical Code section that grants timeline extensions in most instances when cases are converted from one chapter to another.4 As a result, many small businesses converting their cases to subchapter V quickly find themselves mired in a purgatory of rapidly expiring deadlines and additional litigation, with no consensus on a solution.5 Whether Congress's omission regarding § 348(b) is by oversight or intent,6 the recommended solution remains the same: Congress must amend § 348(b) to allow for extensions in subchapter V conversion cases, as they already do with other chapter 11 conversions, to provide judicial clarity and meet the SBRA's intent.

Section 348

Section 348 provides clarity regarding the "effects of conversion" on a debtor's case. Debtors often convert their bankruptcy cases to different chapters of the Bankruptcy Code for various reasons, including unforeseen ineligibility under the

- See Small Bus. Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079.
- In re Thurmon, 625 B.R. 417, 419 (Bankr. W.D. Mo. 2020). In re Keffer, 628 B.R. 897, 905 (Bankr. S.D. W.Va. 2021) (quoting *In re Seven Stars on the Hudson Corp.*, 618 B.R. 333, 339-40 (Bankr. S.D. Fla. 2020)).
- Id.: see also 11 U.S.C. § 348(b).
- See generally Keffer, 628 B.R. 897; In re Seven Stars on the Hudson Corp., 618 B.R. 333; In re Trepetin, 617 B.R. 841 (Bankr. D. Md. 2020); In re Tibbens, No. 19-80964, 2021 WL 1087260 (Bankr. M.D.N.C. Mar. 19, 2021). The court in each of these cases comes to its
- conclusion in a different manner.

 It is difficult to know whether Congress's failure to amend § 348(b) was intentional or not, but circumstantial evidence indicates that it was most likely unintentional. First, § 348 was originally drafted in 1978 and last amended in 2010 (see Pub. L. No. 95-598, 92 Stat. 2568; Pub. L. No. 111-327, 124 Stat. 3558), while the SBRA was not even drafted until 2019. *Supra* n.1. In addition, aside from § 348, the key language — "the order for relief under this chapter" — is only contained in 16 other sections. *See* §§ 701, 727, 923, 1102, 1110, 1121, 1141, 1188, 1189, 1192, 1201, 1221, 1228, 1301, 1305 and 1328. Of those 16 sections, 11 are incorporated into § 348(b). Id.; see also § 348(b). Of the five unincorporated sections, three of them are from the newly codified subchapter V. See §§ 1188, 1189 and 1192. This is noteworthy because all other chapter 11 sections using the key language are incorporated into \S 348. See $\S\S$ 348(b), 1102, 1110, 1121 and 1141. Thus, to find that Congress's omission was intentional, one would have to assume that Congress intended to incorporate all other relevant chapter 11 sections but chose to exclude the relevant subchapter V sections. The more plausible explanation is that Congress simply failed to account for amending § 348 when it created subchapter V with the SBRA

original chapter filing or changed circumstances.7 However, while converting a case to another chapter may be necessary or beneficial to the debtor, conversions present several new complexities. For example, conversions often result in shifting rules regarding the property that makes up the estate, and the passage of time prior to the conversion frequently conflicts with filing deadlines under the new chapter. Section 348 anticipates these issues and provides statutory remedies for most of them.

Section 348(f)(1)(A) clarifies what property makes up the estate in cases converted from chapter 13 to another chapter.8 In addition, § 348(b) addresses expired - or rapidly expiring - filing deadlines under enumerated sections that arise when debtors convert to a new chapter.9 For example, § 1121(b) provides that under a chapter 11 case, "only the debtor may file a plan until 120 days after the date of the order for relief under this chapter" to file a plan. 10 After a debtor converts their case to chapter 11, confusion is likely to ensue over when the 120-day deadline to file a new plan began. Was it the date that the order for relief under the original chapter was granted, or the date of conversion? If the former, this could be particularly stressful for a debtor when a substantial amount of time has passed since the original filing, and a filing deadline under the new chapter is either looming or lapsed.

Luckily, § 348(b) provides a cogent solution to this common issue. To resolve the possible ambiguity, § 348(b) provides that in cases that have been converted under §§ 706, 1112, 1208 or 1307, "the order for relief under this chapter" in § 1112(b) and 12 other enumerated sections of chapters 7, 11, 12 and 13 — "means the conversion of such case to such chapter."11 Thus, in effect, § 348(b) grants automatic extensions to debtors under these enumerated sections by "resetting the clock" for filing deadlines to the date of conversion.

10 11 U.S.C. § 1121(b) (emphasis added)

11 11 U.S.C. § 348(b)

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See 11 U.S.C. § 348(b) ("Unless the court for cause orders otherwise, in sections 701(a), 727(a)(10), 727(b), 1102(a), 1110(a)(1), 1121(b), 1121(c), 1141(d)(4), 1201(a), 1221, 1228(a), 1301(a), and 1305(a) of this title, "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of his title means the conversion of such case to such chapter.").

The Omission

Unfortunately, when Congress codified the SBRA, it did not amend § 348(b) to incorporate the sections of subchapter V containing deadlines. 12 For example, § 1189, which provides for a 90-day deadline for debtors to file a plan under subchapter V, is not incorporated in § 348(b). As a result, after converting to subchapter V proceedings, small business debtors are not eligible for the same "extension" to file a plan under § 1189 that § 348(b) automatically grants under § 1121(b) for debtors who convert to chapter 11. Instead, they find themselves immediately scrambling to file for an extension before the 90-day deadline lapses, if it has not already.¹³

Although the requirement for additional litigation to attain an extension is not an insurmountable death knell,¹⁴ at a minimum it frustrates Congress's intent for a streamlined and cost-effective proceeding for qualified small businesses.¹⁵ This frustration is amplified by the fact that the additional litigation would be wholly unnecessary if a debtor had converted the case to a general, non-small-business-friendly chapter 11 proceeding, and so is only necessary due to Congress's failure to amend § 348(b) when codifying the SBRA.

How Courts Have Dealt with the Omission

Although only a handful of courts have issued opinions on a debtor's request for extensions under § 1189 after converting to subchapter V, the disparate results of those courts underscore the urgency of the issue at hand. 16 One court adopted a strict interpretation and held that debtors immediately placed themselves in default of § 1189(b) when they elected to convert to subchapter V, claiming that "Congress purposefully set a short deadline for a debtor to file a plan" and "set a very high standard for an extension of that deadline."17

Another court held that a "court may extend deadlines in § 1189 even after the periods have lapsed" when the need for the extension is "due to circumstances for which the debtor should not justly be held accountable."18 However, the judge in that case went on to deny the requested extension because numerous delays were "fully within the debtor's control," before offering limited consolation that his ruling was not fatal to the debtor's case because "a late-filed plan [does not] doom a subchapter V case."19

In another case, which cited both aforementioned cases, the court noted that no courts "have articulated any kind of step-by-step basis upon which to evaluate motions to convert filed after deadlines ... have passed" before establishing its own "evaluative device." Although the court's analysis is coherent, metered and fair - and arguably debtor-friendly — its complex evaluation also provides the best possible illustration for understanding the necessity for Congress to amend § 348(b) to incorporate §§ 1188 and 1189.21 The court

started with an analysis of whether conversion was appropriate under § 1307(d) — the chapter in which the debtor initially filed — before moving on to the question of whether conversion or immediate dismissal was proper in the new chapter under § 1112(b).²²

Before deciding on § 1112(b), the court engaged in a circular analysis by first ensuring that the debtor did not run afoul of § 1189 to confirm that § 1112(b)(4)(j) was not triggered.²³ Next, after determining whether conversion was proper, the court finally engaged in evaluating the request for extension, but noted that the extension request must be made by a *separate motion*, and still left open the possibility that the extension request may be denied by the court for cause, fault or other bad faith.²⁴

The Practical Effect of an Overly **Complicated Judicial Analysis**

Although the *Keffer* court provides an effective analysis that may offer the best option for courts evaluating these cases in the future, it should be noted that the resulting "evaluative device" is overly complex and inconsistent with the principles of judicial efficiency and consistency.²⁵ In fact, some debtors might even hesitate to convert to the streamlined subchapter V proceeding designed specifically for them due to this uncertainty of outcome.²⁶ Moreover, the litigious framework made necessary by the omission of subchapter V sections from § 348(b) is inconsistent with congressional intent regarding subchapter V. While denial of a § 1189 extension following conversion might not be fatal to a debtor's case per se, debtors are nonetheless required to litigate the same things multiple times, which results in additional filings, time and costs.²⁷ This runs in direct contradiction to Congress's noted intent for subchapter V to "permit qualifying small business debtors to file [for] bankruptcy in a timely, cost-effective manner."28

Even the Keffer court noted that "it would have been helpful for Congress to [have provided] some guidance with respect to conversion from other bankruptcy chapters" before arriving at the conclusion that "it is up to the courts to interpret those laws" as best they can when unforeseen circumstances require debtors to convert their proceedings midstream.²⁹ In *Trepetin*, the court noted that Congress expressed "significant concern for small business debtors, wanting to

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¹² Id · see also 11 II S.C. & 1189 13 See, e.g., In re Keffer, 628 B.R. at 899

¹⁴ See In re Tibbens, 2021 WL 1087260, at *6 (stating that Congress did not intend to have late-filed plan doom subchapter V case).

¹⁵ Keffer, supra n.3.

¹⁶ Supra n.5.

¹⁷ In re Seven Stars on the Hudson Corp., 618 B.R. at 338-39, 345.

¹⁸ In re Tibbens. 2021 WL 1087260, at *8.

²⁰ In re Keffer, 628 B.R. at 909.

²³ Id. Section 1112(b)(4)(i) states that "failure to ... file or confirm a plan, within the time fixed by this title." is grounds for "cause" to dismiss under § 1112(b)(1), thus a debtor requesting conversion after the expiration of the 90-day timeline to file a plan under § 1189 might automatically qualify for dismissal. However, the court reasoned that as long as the grounds for the requested extension are "attributable to circumstances for which the debtor should not justly be held accountable" per § 1189, § 1112(b)(4)(j) is not triggered, and conversion — rather than dismissal — is proper.

²⁴ Id.; see also In re Tibbens, 2021 WL 1087260, at *9 (declining to extend deadlines, stating that numerous delays "occurred in the administration of the chapter 13 case that were fully within the debtor's control and for which he should be held accountable").

²⁵ In re Keffer, 628 B.R. at 909; see also In re Seven Stars on the Hudson Corp., 618 B.R. 333; In re Trepetin, 617 B.R. 841; In re Tibbens, No. 19-80964, 2021 WL 1087260 (noting disparate analyses and outcomes in various jurisdictions)

²⁷ In re Keffer, 628 B.R. at 909 (noting that Keffer court framework requires that appropriateness of conversion be evaluated under two different chapters and § 1189 be litigated at two different steps in framework, with second final, dispositive § 1189 analysis requiring separate motion) 28 ld. at 905 (quoting In re Seven Stars on the Hudson Corp., 618 B.R. at 339-40).

²⁹ In re Keffer, 628 B.R. at 910; see also In re Tibbens, 2021 WL 1087260, at *4. In Keffer, the debtor did not know they could not file under chapter 13 until after the Internal Revenue Service processed their tax returns, while the debtor in Tibbens had to convert from chapter 13 because they discovered that they exceeded the debt limitations of chapter 13 cases after filing

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provide them with a *realistic option* for reorganizing and saving their business operations" that "balance[d] the ... goals of speed and access." Thus, it stands to reason that Congress did not intend the current result where debtors face the prospect of potential *denial* of conversion to subchapter V or, at best, the prohibitively expensive purgatory of *additional litigation* necessitated by compulsory extensions due to an unanticipated conversion.

The Recommendation

As the Keffer court noted, "[s]ubchapter V is a valuable tool for qualifying debtors and will facilitate reorganizations that

30 In re Trepetin, 617 B.R. at 846-47 (emphasis added)

were not possible before."³¹ However, it is not a valuable tool for small business owners when a small oversight in the process of statutory amendment leaves them in a purgatory of uncertainty, time and cost. Therefore, consistent with congressional intent for the SBRA and in the interests of judicial efficiency, it is imperative that Congress amend § 348(b) to incorporate the relevant sections from subchapter V conversion cases as they already do with all other chapter 11 conversions. abi

Editor's Note: ABI's newly formed Subchapter V Task Force (see p. 45) is seeking input from those who have had experience working with subchapter V. To participate in a survey on subchapter V, please visit abi.org/subvsurvey.

31 In re Keffer, 628 B.R. at 910.

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Problems in the Code

By Christian C. Onsager

Section 348 and Post-Confirmation, **Pre-Conversion Claims**

The situation is common: A vendor does postconfirmation business with a debtor operating under a confirmed chapter 11 plan, but the debtor defaults under the plan and the case is converted to chapter 7 before a payment has been made to the vendor. How does the vendor fare upon conversion? Under 11 U.S.C. § 348(a), conversion "does not effect a change in the date of the filing of the petition, the commencement of the case, or the order for relief" except as provided in subsections (b) and (c). Neither subsection changes this rule for purposes of the automatic stay imposed by § 362(a) or the requirements of § 503(b) for determining administrative-expense claims. Whereas § 348(f) implements special provisions regarding property of the estate in converted chapter 13 cases, conversion does not otherwise change what § 541 defines as property of the estate. This article addresses the interplay of the literal language of 11 U.S.C. § 348(d) and other Bankruptcy Code sections.



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Overview

Chapter 11 plans usually provide that the debtor-in-possession's property (i.e., the estate) vests in the reorganized debtor free of all interests in the property, except as the plan specifically provides. The reorganized debtor's property is therefore presumably available as payment to both the creditors whose claims are treated under the plan and those whose claims arise following confirmation. Before resorting to conversion, any creditor with a claim that is treated under a plan can enforce the contract with the debtor that the plan creates, and creditors with post-confirmation claims can pursue them under whatever law governs the debt.

After confirmation, the automatic stay is no longer a bar to these collection actions. Under § 362(c)(1), the stay ceases as to the debtor's property when it is no longer property of the estate. In an entity chapter 11, this happens upon confirmation absent a plan provision that changes the result under § 1141(b)² or under a liquidating plan. Therefore, enforcing a post-confirmation claim against property of an entity "debtor" is not stayed.3 Under

- See generally in re Benjamin Coal Co., 978 F 2d 823 (3d Cir., 1992)
- post-confirmation (e.g., if the property carries significant built-in gain for tax purposes and transferring it to a liquidating trust would be considered a taxable event). See In re Westholt Mfg. Inc., 20 B.R. 368, 371-72 (Bankr. D. Kan. 1982), and In re
- O'Connor, No. 99-36662, 2003 Bankr, LEXIS 816 (Bankr, N.D. Tex, July 10, 2003). The analysis changes in an individual case because the debtor is not discharged until completion of the plan.

§ 362(c)(2), the stay ceases after the debtor's discharge, which in an entity chapter 11 also occurs upon confirmation (assuming the plan is not a liquidating plan).4 Hence, there is no stay against pursuing the entity debtor for post-confirmation debts.5

What happens, then, if the reorganized debtor defaults under the confirmed plan and the case is converted as provided in § 1112(b)(4)(N)? Since conversion does not effectuate a rescission of the confirmed plan,6 does not alter the date of the order for relief and does not alter the effect of § 541 in chapter 11 cases, the property of the chapter 7 estate upon conversion consists only of whatever property did not vest in the debtor under the terms of the plan. This is often not much, at least if the plan has been substantially consummated.8 Upon conversion, two different bundles of assets exist: (1) the estate's property to the extent that anything remained property of the estate post-confirmation under the terms of the plan, and (2) everything else, which is the reorganized debtor's property.

Pre-Confirmation Conversion: "All's Well"

When a chapter 11 case is converted to chapter 7 before confirmation, everything seems to work out properly. Section 348(a) provides that except for a limited number of statutes listed in § 348, it is the same old case, but under a new chapter. Claims retain their existing priority, and § 348(d) turns any claim not falling within § 503(b) into a pre-petition claim, which (among other things) makes the claim dischargeable for individuals.9 Administrativeexpense claims retain their priority in the converted case under § 507(a), and post-petition claims, to the extent that they were not of benefit to the

- 11 U.S.C. § 1141(d)(1) and (3).

 See In re Braude Jewelry Corp., 333 B.R. 156, 159 (Bankr. N.D. III. 2005), and Nat'l City Bank v. Troutman Enters. (In re Troutman Enters.), 253 B.R. 8, 13 (B.A.P. 6th Cir. 2000) (permitted creditors to file involuntary case against reorganized debtor, even though chapter 11 case had been converted to chapter 7).
- 6 Nat'l City Bank v. Troutman Enters. (In re Troutman Enters.), 253 B.R. 8, 13 (B.A.P. 6th
- See generally Rogers v. Freeman (In re Freeman), 527 B.R. 780 (Bankr. N.D. Ga. 2015) (citing cases). The Freeman court noted that this conclusion is not unanimous. Id. at 786
- Therefore, conversion of a chapter 11 case after the plan has become effective is often not a useful remedy. However, at least one court in *dicta* has suggested that the chapter 7 trustee would be empowered to pursue avoidance of fraudulent transfers made by the reorganized debtor. See Tracar SA v. Silverman (In re Am. Preferred Prescription Inc.), 250 B.R. 11 (E.D.N.Y. 2000), rev'd on other grounds, Silverman v. Tracar SA (In re Am. Preferred Prescription Inc.), 255 F.3d 87 (2d Cir. 2001). See also Donaldson v. Bernstein
- 9 Entities are not discharged under chapter 7. See 11 U.S.C. § 727(a)(1).

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estate (*i.e.*, do not fall within § 503(a)), are general unsecured claims. Moreover, all the property that the debtor has acquired post-petition remains property of the estate under §§ 541(a)(7) and 1115.

The conversion of post-petition claims into pre-petition claims is also necessary to invoke the automatic stay under § 362(a) against continued actions to collect such claims. Section 362(a) applies in the main to stay collection of claims "that arose before the commencement of the case under this title." The treatment of post-petition, pre-conversion claims as pre-petition claims thus operates to invoke the stay.

Post-Confirmation Conversion: "All's Not So Well"

This scheme does not appear to work as well if the case is converted to chapter 7 *after* confirmation (and substantial consummation) of a plan.¹⁰ Section 348(d) does not differentiate between claims that arose post-petition but preconfirmation and those that arose post-confirmation against the reorganized debtor. Therefore, vendors (including bankruptcy counsel providing services necessary to implement the plan)¹¹ that extend credit to the reorganized debtor in the belief that they will be free of any entanglement with the bankruptcy court might be in for a rude surprise: Section 348(d) renders the post-confirmation claim into one that is deemed to have "arisen immediately before the date of the filing of the petition."¹²

The statute leads to two anomalous results in this circumstance. The first is that the post-confirmation claim is not entitled to administrative-expense priority. The courts reason that the claim cannot be an "actual, necessary cost and expense of preserving the estate" because the services were not performed for, or the goods were not supplied to, the estate, but rather to the reorganized debtor. Thus, the post-confirmation creditor ends up with a general unsecured claim. While it is difficult to argue with the textual analysis that leads to this result, it seems harder to justify it from a policy perspective. The rehabilitative goal of chapter 11 is not furthered by subjecting a party that is extending credit to a reorganized debtor to a lower priority in a converted case than is enjoyed by those who extend credit to the debtor-in-possession.

The second anomalous result is that since the post-confirmation claim is deemed to have arisen prior to the original petition, its collection is stayed by § 362(a). 4 Section

362(a)(1) stays the commencement or continuation of any proceeding against the debtor on a pre-petition claim, § 362(a)(6) stays any act against the debtor to collect a pre-petition claim, and § 362(a)(1) stays any act to create or enforce a lien against property of the debtor if the lien secures a pre-petition debt. Effectively, the post-confirmation creditor, whose claim on conversion is considered a pre-petition claim, is forced to obtain a relief from the stay in order to pursue the debtor's assets that did not become property of the estate. Oddly enough, while the creditor is stayed from reaching the debtor's assets, nothing stops the debtor from continuing to dispose of them as it sees fit without any court oversight, because the property is not property under the control of the chapter 7 trustee.¹⁵

Interpreting § 348(d) to reinstate the stay in an entity case seems to lead to an absurd result. Since the chapter 7 estate created on conversion often consists of little property, staying post-confirmation claimants from pursuing the reorganized debtor and its assets serves no purpose. Rather, it gives the reorganized debtor a free pass: Upon conversion, the reorganized debtor could stiff its post-confirmation creditors while remaining in control of its assets, all of which vested in the reorganized debtor free and clear of any claims or interests.¹⁶

Conversion of an individual's case is potentially even worse. Conversion creates the same two sets of assets, but unlike in the entity case, the debtor *will* obtain a discharge in the chapter 7. Since post-confirmation debts are treated as pre-petition debts, they too will be discharged unless they are excepted from discharge under § 523.¹⁷ The post-confirmation creditor cannot pursue non-estate assets, or the debtor. While § 348(f)(1)(C) and (2) address this problem in the conversion of chapter 13 cases, no parallel exists for individual chapter 11 cases.

This result runs contrary to two clear Code policies: (1) the Bankruptcy Code was meant to encourage parties to do business with reorganized debtors; and (2) plan confirmation is meant to bring certainty and finality to the debtor's affairs and end the bankruptcy court's oversight so that parties can deal with the reorganized debtor without fear of court intervention. The problem is not that a post-confirmation creditor will be unable to readily demonstrate "cause" to lift the stay under § 362(d)(1), 18 but that the post-confirmation creditor is forced to deal with the stay at all.

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¹⁰ Conversion of a case post-confirmation may seem odd, but it is contemplated specifically in § 1112, which provides that the failure to perform a confirmed plan is grounds for conversion. In fact, courts have the power to reopen a closed case to effectuate conversion. Donaldson v. Bernstein, 104 F.3d 547, 552 (3d Cir 1997)

¹¹ Whether some services may in fact be considered to still be of benefit to the "estate" under some courts' broad interpretation of the term (e.g., when a liquidating trust is considered a continuation of the estate) is beyond the scope of this article.

¹² By subjecting a post-confirmation claim to "time travel" upon conversion, the statute gives some color to the argument that the claim is therefore discharged by the order confirming the chapter 11 plan. Fortunately, the courts have avoided this troublesome circularity. See generally In re Pavlovich, 952 F.2d 114 (5th Cir 1992)

¹³ See Zurich Am. Ins. Co. v. Lexington Coal Co. LLC (In re HNRC Dissolution Co.), 371 B.R. 210, 232 (E.D. Ky. 2007), and In re Frank Meador Buick Inc., 59 B.R. 787, 791 (Bankr. W.D. Va. 1986). Similarly, the chapter 7 trustee cannot surcharge a secured creditor under § 506(c) for credit that was extended post-confirmation. In re Maine Pride Salmon, 180 B.R. 337 (Bankr. D. Me. 1995).

¹⁴ See generally In re Sheets, No. 12-31723, 2014 Bankr. LEXIS 4198 (Bankr. E.D. Va. Sept. 29, 2014).

¹⁵ See In re Pauling Auto Supply, 158 B.R. 789 (Bankr. N.D. lowa 1993), in which a debtor voluntarily turned over its re-vested assets to the trustee on conversion. The court found that the assets were not property of the estate and essentially held that the trustee should have returned the assets to the corporate debtor, but declined because everyone had assumed, albeit erroneously, that the assets had become assets of the chapter 7 estate.

¹⁶ Id. One might argue that the chapter 7 trustee can control the entity's non-estate assets by controlling the entity. However, § 704 does not specifically grant this authority, and the argument leads to other conceptual problems. For example, if a trustee controls non-estate assets through the control of the entity, then abandonment of corporate estate assets under § 554 (a valuable trustee bool) would not result in the trustee being divested of control over the asset.

¹⁷ A court could conclude that § 1141(d)(5)(B) offers the sole route to a discharge for an individual chapter 11 debtor who defaults on her plan, but nothing in the Bankruptcy Code mandates this result.

¹⁸ Alternatively, the converted case would presumably be dismissed if there were no material assets to administer, but again, the problem is that the post-confirmation creditor is still potentially involved in the converted case. Also, the post-confirmation creditor is unlikely to receive notice of a conversion motion and is therefore unlikely to be afforded the opportunity to argue whether conversion is appropriate. Even if the creditor receives notice and participates, the post-confirmation creditor's expectation of being insulated from the effects of the bankruptcy case is frustrated.

One tradeoff that bankruptcy embodies is that in return for the stay of the creditor's collection rights, most or all the debtor's assets that would have been available pursuant to a collection action are aggregated and liquidated, and the proceeds distributed ratably to creditors in a single proceeding by a trustee. In a case that converts post-confirmation, however, many of these assets will not be property of the chapter 7 estate because they vested in the debtor on confirmation, and conversion does not reverse this vesting. Therefore, the trade-off for the post-confirmation creditor is far out of balance.

It is tough to argue that the "debtor" referenced in § 348(d) — against which the post-confirmation claim lies — does not include a reorganized debtor. Section 1112 is clear that it is the reorganized "debtor" whose default under a confirmed plan is the event that can trigger conversion.¹⁹

19 11 U.S.C. § 1112(b)(4)(N).

Adopting disparate interpretations of the term "debtor" would not only be judicial legislation, but would also run afoul of the Bankruptcy Code's definition of a "debtor" as a person "concerning which a case under this title has been commenced," which encompasses a reorganized debtor in this context.

Conclusion

Courts have not always been rigorous in their analyses of the effects of post-confirmation conversion. Nonetheless, the plain meanings of §§ 348, 503 and 362 leave little room for a judicial solution. Post-confirmation creditors in converted entity cases should be able to obtain relief from the stay and be no worse off; the same creditors in converted individual cases may not fare that well. abi

20 11 U.S.C. § 101(13). One wonders when, if ever, any person who has been the subject of a petition is no longer a "debtor" under this definition.

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Consumer Corner

By Hon. ELIZABETH L. GUNN AND SHELBY KOSTOLNI

Post-Petition Appreciation: Whose Line (Item) Is It, Anyway?



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Iluctuations in the value of real estate and personal property items occur often, resulting in the prediction of future value feeling like seeking the answer from a Magic 8 Ball. The fluid nature of real estate values is not solely an issue for real estate agents, homebuyers or homeowners; it also frequently arises in bankruptcy cases, especially consumer cases. Courts continue to struggle with and deepen a split of authority as to who has the right to the post-petition appreciation of a consumer debtor's real property: the debtor or the debtor's estate (and, thus, creditors). In considering the question, bankruptcy courts struggle with the intersection of two sections under chapter 13: 1306 (additions to § 541 property of the estate in chapter 13) and 1327 (effect of confirmation). Even considering the same sections, the answers continue to differ.

As eloquently stated in a recent case on the issue, "harmonizing the inharmonious is a tall order." Most courts considering the issue have found that §§ 1306 and 1327 do not seamlessly fit together. Over time, four general approaches to reconcile §§ 1306 and 1327, and when and where property vests, have developed: (1) estate termination; (2) estate transformation/conditional vesting; (3) estate preservation; and (4) estate replenishment.² In addition, depending on the terms of any local form chapter 13 plan, some of these options may not be applicable in all jurisdictions. Before examining recent decisions from the Ninth Circuit and the U.S. Bankruptcy Court for the Eastern District of Michigan, it is helpful to understand each category.

Court Approaches to Vesting Estate Termination

As generally accepted, the estate-termination approach results in all property vesting in the debtor at plan confirmation and the estate ceasing to exist.3 This view is based on a reading of § 1327(b) that results in all property vesting in the debtor at confirmation.4 The estate-termination approach attempts to harmonize § 1306(b)'s giving debtors possession of the property of the estate and § 1327(b)'s vesting of title and ownership by finding § 1327(b) to be the more specific, and thus controlling, section as to the ownership of appreciation of property in the estate.5 However, in jurisdictions where the required local form plan provides for vesting only at discharge, this approach is inapplicable.

Estate Preservation/Conditional Vesting

In these substantially similar approaches, all property is deemed estate property until entry of discharge.6 The theory of estate preservation is based on an interpretation of § 1327(b) finding that confirmation does not disturb the existence of the estate, only the debtor's responsibilities toward the property of the estate.7

Similarly, conditional vesting gives the debtor the right to use the property of the estate, but it is not a final right until the plan is complete and the debtor obtains a discharge.8 These approaches rely on the premise that § 1327(b) does not remove property from the estate, but only places control of the property in the debtor pending the completion of the chapter 13 case.9

Estate Transformation

The estate-transformation approach is seen as a compromise between the extreme estate-termination and estate-preservation/conditional-vesting approaches.10 It holds that at plan confirmation there is an estate transformation where all property of the estate becomes property of the debtor, except for post-petition income and property considered essential to the performance of the plan.11 (However, this raises a new issue on how you define whether property is "essential" to performance of the plan, but that question is outside the scope of this article.)

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In re Elassal, 2023 WL 5537061, *4 (Bankr. E.D. Mich. 2023) (citing City of Chicago v. Fulton, 141 S. Ct. 585, 591 (2021)).

² These approaches are very succinctly defined in In re Baker, 620 B.R. 655, 663-64

Baker, 620 B.R. at 663

Calif. Franchise Tax Bd. v. Jones (In re Jones), 420 B.R. 506, 514 (B.A.P. 9th Cir. 2009) (citing In re Petruccelli, 113 B.R. 5, 15 (Bankr. S.D. Cal. 1990)).

⁵ Petruccelli, 113 B.R. at 15. See also Oliver v. Toth (In re Toth), 193 B.R. 992, 996 (Bankr. N.D. Ga. 1996) (finding *Petruccelli* analysis most persuasive; policy reasons (being able to obtain credit and use property after confirmation) support concluding that vesting at confirmation ends the estate); *In re Dagen*, 386 B.R. 777, 782 (Bankr. D. Colo. 2008) (stating that "only the estate termination approach gives effect to the literal

⁶ Baker, 620 B.B. at 664

Id. at 663-64. Id. at 664.

In re Brensing, 337 B.R. 376, 383 (Bankr. D. Kan. 2006) (citing Sec. Bank of Marshalltown, lowa v. Neiman, 1 F.3d 687, 690 (8th Cir. 1993)). 10 Telfair v. First Union Mortg. Corp., 216 F.3d 1333, 1340 (11th Cir. 2000) (citing In re

Heath, 115 F.3d 521, 524 (7th Cir. 1997); In re McKnight, 136 B.R. 891, 894 (Bankr.

Consumer Corner: Post-Petition Appreciation: Whose Line (Item) Is It, Anyway?

Estate Replenishment

Finally, the estate-replenishment approach results in all property of the estate becoming property of the debtor on confirmation, but the estate continues to exist and "refills" with property defined in § 1306 acquired by the debtor after confirmation.¹² The vesting in the estate of post-petition property is without regard to whether the property is necessary to the plan's performance.13

Recent Cases, Opposite Results

Two recent cases each faced the question of whether appreciated value of the debtor's real property was property of the estate or property of the debtor. In In re Castleman, the Ninth Circuit considered an appeal where the question was whether pre-conversion real estate appreciation belongs to the estate or the debtors who converted from a chapter 13 reorganization to a chapter 7 liquidation.¹⁴ When the Castlemans originally filed for chapter 13, they listed their residence in their schedules with a value of \$500,000 and a secured lien of \$375,077, and claimed a homestead exemption in the \$124,923 balance based on Washington's state exemptions.¹⁵

The Castlemans successfully made chapter 13 plan payments for 20 months, but after a job loss, the pandemicdeferred payments and a serious health diagnosis for John Castleman, they decided that they could no longer make their payments and converted to chapter 7.16 The problem was that during the 20 months it took the Castlemans to make this determination, their home value had appreciated to approximately \$700,000, leaving \$200,000 of equity unprotected by their original homestead exemption.¹⁷

After conversion, the chapter 7 trustee moved to sell the home to recover the appreciated/unprotected value for the estate. The Castlemans objected to the sale on the basis that the post-petition appreciation value (i.e., the "new" equity) was property of the debtor — not property of the estate. 18 In the Ninth Circuit, there is long-standing authority that even if a debtor amends the homestead exemption post-petition, ¹⁹ post-petition appreciation inures to the bankruptcy estate, not the debtor.²⁰ In other words, the Castlemans could not simply have increased their claimed homestead exemption (to the extent available) to exempt the new equity.

In its analysis, the court noted the potential benefits to debtors and creditors of a chapter 13 case: The ability for debtors to retain property while creditors receive a higher return than in chapter 7. The court noted that post-confirmation property of the estate is defined not by § 1306 (titled "Property of the Estate"), but rather by § 348(f) (titled, "Effect of Conversion," which explains converting from

chapter 13 to another chapter). Under § 348(f), property of the estate after a good-faith conversion includes property that was part of the estate as of the petition date that remains in the possession or control of the debtor upon conversion.

Only in cases of bad-faith conversion does all property, whether acquired pre- or post-petition, become property of the chapter 7 estate. Because the appreciation was not "property' acquired post-petition, merely a change in valuation for prepetition property, the court concluded that the appreciation was not a separate asset, and because it was part of pre-petition property, the appreciation belonged to the chapter 7 estate.²¹

Following closely on the heels of Castleman, in In re Elassal the U.S. Bankruptcy Court for the Eastern District of Michigan found that post-petition, nonexempted appreciation of real property belongs to the debtor in a chapter 13 case.²² Wendy Elassal filed a chapter 13 petition in March 2021 in which she valued her home at \$250,000, which was encumbered by \$228,000 of liens.²³ She claimed a homestead exemption in the remaining \$22,000 of value. Her ownership of the property was subject to three conditions arising from her pre-petition divorce: (1) her former spouse would make 24 monthly mortgage payments in lieu of child and spousal support; (2) she would sell or refinance the property on or before Dec. 31, 2022 (21 months after the petition date), to pay the former spouse's equity position; and (3) she would be responsible for any mortgage payments after Jan. 1, 2023.24

The debtor's chapter 13 plan, which provided for the sale of the home and included the exempt value in the liquidation analysis, was confirmed at the end of July 2021.²⁵ In February 2023, Elassal moved to sell the property for \$435,000 and use all proceeds (the \$22,000 exempted, plus approximately \$171,000 of post-confirmation appreciation) to purchase a new residence without modifying her plan.²⁶ The chapter 13 trustee objected, arguing that Elassal should only be entitled to keep proceeds after payment in full of all her creditors.

The court described the situation as one that no party to the case could have predicted at confirmation — not the debtor, nor the trustee or the unsecured creditors. At confirmation, the debtor agreed to make a payment to creditors based on the liquidation analysis of whether her home appreciated or depreciated over the life of the plan. In considering whether the proceeds were property of the chapter 13 estate, the court compared the protections of chapter 7 vs. chapter 13. The court noted that while chapter 7 estates generally encapsulate appreciation, the standard is different in chapter 13.21

Next, the court recognized that many courts (including Castleman) have found that appreciation is property of the estate when a case is converted from chapter 13 to chap-

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11 Baker, 620 B.R. at 664
12 Id. at 663.
14 In re Castleman, 75 F.4th 1052, 1054 (9th Cir. 2023) 15 Id.
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19 See generally Wilson v. Rigby, 909 F.3d 306 (9th Cir. 2018).

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²⁰ Schwaber v. Reed (In re Reed), 940 F.2d 1317, 1323 (9th Cir. 1991). 21 Castleman 75 F 4th at 1055-56 22 *Elassal*, 2023 WL 5537061 at *1

²⁴ Id. at *2.

²⁵ Id. at *10.

²⁶ Id. at *2.

ter 7.28 However, the court noted that chapter 13 cases "still present ... the best avenue for debtors to retain property in bankruptcy, and the unqualified right to dismiss their chapter 13 proceedings protects them from any adverse consequences of conversion to chapter 7."29 The court further held that in chapter 13, "disposable income does not include prepetition property or its proceeds."30 Ultimately, the Elassal court determined that the proceeds were not newly acquired property, thus they did not fall under the definition of property of the estate under § 1306, and Elassal could retain all sale proceeds while continuing to pay the dividend to creditors over the term of her originally confirmed plan.³¹

Is Conversion the Key Factor?

On their face, the results in *Elassal* and *Castleman* appear to be in direct contradiction. However, at their core, these cases highlight the different results that may arise depending on the procedural history and current chapter of a debtor's case. The question of estate property is much clearer in unconverted cases. However, these definitions are complicated in converted cases, which does not mean that a party who is subject to a chapter 13 plan that they cannot afford to complete is without options.

As noted by the *Elassal* court, such debtors can seek to dismiss (or take actions that result in the dismissal of) the chapter 13 case and refile a chapter 7 petition. In that situation, it eliminates the question of whether the appreciation is or is not property of the estate. Elassal and Castleman highlight the fact that debtors need to consider the value of the property at all points during their case, particularly when considering whether to convert or dismiss. abi

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²⁷ Id. at *6. 28 Id. (citing In re Adams, 641 B.R 147 (Bankr. W.D. Mich. 2022); Coslow v. Reisz, 811 Fed. App'x 980 (6th Cir. 2020)).

²⁹ Id. at *6 (quoting In re Adams, 641 B.B. at 156).

³⁰ Id. at *10 (citing In re Burgie, 239 B.R. 406, 410 (B.A.P. 9th Cir. 1999)).

³¹ Id. at *11.

Feature

By Shane Creason

Post-Confirmation Property of the Estate in Subchapter V

The Small Business Reorganization Act of 2019¹ has currently been in effect for more than four years. Thus far, empirical data indicates that subchapter V is operating as intended: as a more affordable and effective reorganization tool for small businesses.2 Despite this, courts have yet to fully explore the ambiguities and gaps in subchapter V. One such area is the fate of the bankruptcy estate after confirmation, which has been a point of confusion in chapter 13 and, to a lesser extent, chapter 12.

The statutory framework of subchapter V poses unique challenges in addressing what constitutes property of the estate post-confirmation. In most respects, subchapter V disregards whether the debtor is an individual.³ Instead, the scope of property of the estate post-confirmation depends on whether the plan is a consensual or cramdown plan. The practical result of this framework is that the circumstances in which property becomes, remains and leaves the bankruptcy estate post-confirmation differ from traditional chapter 11 cases, if the plan is crammed down. This article explores the relevant statutes in subchapter V confirmation and discusses the ambiguities and some issues that may arise from them.



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General Statutory Framework of Subchapter V Confirmation

Subchapter V replaces § 1115 with § 1186.4 Section 1186(a) uses substantially the same language as § 1115, and §§ 1206 and 1307, upon which § 1115 is based.5 These sections effectively state the same thing: that property of the estate includes postpetition § 541 property and post-petition earnings of the debtor.

However, § 1186(a) differs significantly from the other provisions in two important respects. First, § 1186(a) applies only if the plan is confirmed under § 1191(b), the cramdown provision. Second, § 1186(a) applies to entities and individuals alike, which differs from § 1115, making it operate more like § 1207.7 As such, the scope of post-confirmation estate property can be entirely different if a plan is consensual or a cramdown.

Consensual Confirmation: Section 1191(a)

Consensual plans in subchapter V function similarly to traditional chapter 11 plans. Confirmation under § 1191(a) results in all property of the estate vesting in the debtor unless the plan or confirmation order provides otherwise.8 This means that upon confirmation of a plan under § 1191(a), the automatic stay terminates and no longer protects the debtor's property, unless the plan or order confirming the plan preserves the estate and provides for the vesting of the property of the estate under § 1141(b) at some later time.

This outcome generally poses no issue because the parties effectively consented to such treatment through a consensual plan. Thus, cases confirmed under § 1191(a) are relatively straightforward and give rise to little, if any, statutory ambiguity as to the existence of property of the estate post-confirmation.

Cramdown Confirmation: Section 1191(b)

Cramdown plans in subchapter V function differently than in traditional chapter 11 because the Bankruptcy Code provisions governing cramdown in subchapter V closely parallel those that govern chapters 12 and 13. Confirmation under § 1191(b) triggers the application of § 1186(a), regardless of whether the debtor is an entity or an individual.¹⁰ Section 1186(a) provides that property of the estate consists of property of the estate under § 541, and post-petition § 541 property and earnings "before the case is closed, dismissed, or con-

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¹ Pub. L. No. 116-54, 133 Stat. 1079 (codified in 11 U.S.C. §§ 1181-1195 and scattered sections of titles 11 and 28). Unless otherwise noted, references to sections are Bankruptcy Code sections, title 11.

² Hon. Michelle M. Harner, Emily Lamasa & Kimberly Goodwin-Maigetter, "Subchapter V Cases by the Numbers," XL ABI Journal 10, 12, 59-60, October 2021, available at abi. org/abi-journal: see also "Chapter 11 Subchapter V Statistical Summary Through June 30. 2023," U.S. Trustee Program, available at justice.gov/ust/page/file/1499276/download (both links last visited Jan. 23, 2024).

³ See 11 U.S.C. § 1181(a) (making §§ 1115 and 1141(d)(5) inapplicable in subchap-

See 11 U.S.C. § 1181(a).

⁵ See generally 11 U.S.C. §§ 1115(a), 1207(a), 1306(a). 6 11 U.S.C. § 1186(a)(1), (2).

⁷ See 11 U.S.C. § 1115(a) (applying "[i]n a case in which the debtor is an individual"). Compare 11 U.S.C. §§ 1207, 1186(a).

8 See 11 U.S.C. §§ 1191(a), 1141(b) ("Except as otherwise provided in the plan or the

order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."); In re Abri Health Servs. LLC, No. 21-30700 (SGJ), 2021 WL 5095489, at *10 (Bankr, N.D. Tex. Oct. 26, 2021); In re Associated Fixture Mfg. Inc., No. BR 22-23317, 2023 WL 1931301, at *3 (Bankr. D. Utah Feb. 10, 2023).
9 11 U.S.C. § 362(c)(1) ("The stay of an act against property of the estate under [§ 362(a)]

tinues until such property is no longer property of the estate."

^{10 11} U.S.C. § 1186(a) (applies only "[i]f a plan is confirmed under section 1191(b)").

verted to another chapter." In other words, when a plan is crammed down, upon confirmation the estate is augmented with post-petition property, presumably for the use of the requisite payments of projected disposable income over the plan period.

Application of § 1186(a) results in three open questions post-confirmation: How does one harmonize the apparent conflict between § 1141(b) and 1186(a)? Upon confirmation, what, if anything, remains protected by the automatic stay? If the debtor converts to chapter 7 post-confirmation, what becomes part of the bankruptcy estate again? The answers to these questions are currently unclear and subject to disagreement. Accordingly, practitioners should recognize the statutory uncertainties and be aware of the sparse case law on these issues.

Conflict Between §§ 1186(a) and 1141(b)

Under a cramdown plan, the content of the bankruptcy post-confirmation estate needs clarification. The application of § 1186(a) directly conflicts with the vesting provision of § 1141(b).12 The ramifications of the conflicting provisions implicate a bankruptcy court's authority postconfirmation. Whether the post-confirmation debtor must seek approval for the sale of property outside the ordinary course of business or a compromise on a dispute is not entirely clear. However, since subchapter V does not amend or make § 1141(b) inapplicable through § 1181, presumably it applies to subchapter V to some extent. The case law and secondary sources suggest several different possible outcomes.

First, all property, including property of the estate under § 1186(a), revests in the debtor under § 1141(b), absent language in the plan or confirmation order stating otherwise.¹³ Under this reasoning, no property of the estate remains, and the debtor makes payments under the plan from the debtor's property. In other words, the plan and order of confirmation control, which is similar to a traditional chapter 11 case.

Second, the triggering of § 1186(a) results in the preservation of the bankruptcy estate, augmented with post-petition property and earnings for administration throughout the plan commitment period. 14 Under this theory, the vesting language contained in § 1141(b) does not remove property from the estate.

Third, all property revests in the debtor "except property required to perform obligations under the [p]lan." This middle-ground interpretation effectively empties the estate of the debtor's pre-petition property, but replenishes the estate with property acquired by the debtor post-petition, including the debtor's earnings, which are used to make the plan payments under a cramdown plan.¹⁶ Each of these outcomes is a reasonable reading of the statutes.¹⁷ Furthermore, it is foreseeable that circuit splits on this issue will arise, arriving at incompatible results.

Automatic Stay Issues

Another issue is what property remains subject to the automatic stay upon confirmation of a cramdown plan. The status of the bankruptcy estate should determine whether the stay remains in place and in what capacity.¹⁸ Suppose § 1186(a) preserves or replenishes the estate. In that case, the automatic stay does not terminate entirely at confirmation under § 362(c)(1), because at least some property of the debtor and all its earnings remain property of the estate.19

Conversely, if property vests back in the debtor, as prescribed by § 1141(b), the automatic stay may no longer protect such property, except to the extent provided for under § 362(c)(2).20 Therefore, whether the automatic stay continues to apply to post-petition creditors remains an open question.21 Awareness of this ambiguity should lead a party to consider seeking relief from the automatic stay before taking actions concerning the debtor or property of the estate preconfirmation to prevent accidental stay violations.

Conversion to Chapter 7

An additional issue arises when a post-confirmation cramdown case is converted to chapter 7. Subchapter V does not make § 1112 inapplicable, so it still applies to subchapter V cases. Therefore, in the event of conversion to chapter 7, § 348 applies to determine what constitutes property of the chapter 7 estate.

Assuming that a debtor converts to chapter 7, then analysis of what constitutes property of the new chapter 7 estate depends on what remained in the subchapter V estate postconfirmation but before conversion to chapter 7. Therefore, a court's determination of which theory of property vesting post-confirmation under § 1141(b), and the effect of § 1186(a), is correct will determine the contents and value of the chapter 7 estate post-conversion.

Conclusion

Congress enacted subchapter V, borrowing from statutes in other chapters of the Bankruptcy Code. Congress derived subchapter V from chapter 12, which was derived from chapter 13.22 This connection is evident in the sister statutes in both chapters and the legislative history.

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^{11 11} U.S.C. § 1186(a)(1), (2). 12 11 U.S.C. § 1141(b).

¹³ See In re ActiTech LP, 2022 WL 6271936 (Bankr. N.D. Tex. 2022) (confirming plan under § 1191(b) because all impaired classes did not accept it, and confirmation order provided for (1) revesting of property in reorganized debtor; and (2) termination of trustee's services as of effective date of plan, which occurred upon entry of final confirmation order).

¹⁴ See Hon. Paul W. Bonapfel, "A Guide to the Small Business Reorganization Act of 2019," 93 Am. Bankr. L.J. at 255-257 (2019) (22AD).

¹⁵ In re Bronson, 2022 WL 3637566, at *2 (Bankr. D. Ore. Aug. 23, 2022) (confirming plan providing that all property, except property required to perform obligations under plan, would revest in debtor).

16 Id. ("Interested parties should be able to know with clarity, at any given time, whether an asset or

specific earnings are property of the estate or not. Thus, in this court's view, the better rule is that Subchapter V debtor's assets acquired post-petition and post-petition earnings should not be treated as property of the estate unless and until the debtor confirms a plan under § 1191(b).")

¹⁷ See Bonapfel, supra n.14 at 242-247; Jonathan M. Seymour, "The Limited Lifespan of the Bankruptcy Estate: Managing Consumer and Small Business Reorganizations," 37 Emory Bankr. Dev. J. 1, 1 (2020) (advocating for estate-termination theory in subchapter V reorganization)

¹⁸ See 11 U.S.C. § 362(c).

¹⁹ Bonapfel, *supra* n.14 at 255-57 20 *See* 11 U.S.C. § 362(c)(2).

²¹ See 11 U.S.C. § 362(a)(3).

²² Oversight of Bankruptcy Law and Legislative Proposals, Hearing Before the Subcommittee on Antitrust, Commercial and Administrative Law. Committee on the Judiciary. House, 116th Cong. (2019) ("Modeled on ... Chapter 12 ... the Small Business Reorganization Act ... promise[s] to help the Bankruptcy Code better serve American business in the 21st century."); H.R. Conf. Rep. 99-958, 48, 1986 U.S.C.C.A.N. 5246, 5249 ("[C]hapter [12] is closely modeled after existing Chapter 13.... [H]owever, the new chapter alters those provisions that are inappropriate for family farmers."); H.R. Rep. 103-32, 2-3, 1993 U.S.C.C.A.N. 373, 374-75 ("Prior to the adoption of Chapter 12, the vast majority of farmers in need of bankruptcy protection were forced to file under the liquidation provisions of Chapter 7 ... because the requirements of Chapter 13 ... were generally inappropriate for family farmers.")

Post-Confirmation Property of the Estate in Subchapter V

However, the policies and goals of chapters 12 and 13 are aimed at different types of debtors. Chapter 13 is designed as an individual wage-earner reorganization and, to a lesser extent, a viable option for sole proprietors to reorganize, assuming that such debtors qualify under the debt limits. Chapter 12 provides for both entity and individual reorganization, but only to the extent that such entity qualifies under the prescribed definitions of "family farmer" or "family fisherman," and the policy goals behind chapter 12, the reorganization of small farming and fishing operations, is different than those of subchapter V.

Except for family farmers and fishermen in chapter 12, subchapter V is unique because it disregards differences between individuals and entities for most matters. Instead, subchapter V focuses on whether a plan is consensual or a cramdown. For example, in cramdown plans, debtors do not receive a discharge upon confirmation but rather upon completing the requisite plan payments.²³ Another example is that in the event of a cramdown, the subchapter V trustee acts as the disbursement agent unless the plan or confirmation order provides other-

23 11 U.S.C. § 1192(a)

wise.²⁴ Also, courts disagree on whether a cramdown precludes an entity from discharging debts excepted under § 523.25

This treatment will likely become more apparent as more debtors elect to file under subchapter V, if for no other reason than more debtors qualify for subchapter V than chapter 12. Taken together, one can reasonably conclude that two types of subchapter V exist: one for consensual plans that, in practice, are just small chapter 11 cases, and one for cramdown plans that proceed more like "debt-adjustment" plans provided for in chapters 12 and 13.

The underlying policies and goals of subchapter V are laudable; Congress intended to provide a more streamlined and less expensive option for business reorganization. Still, its two-track statutory structure is not perfect, and there are apparent ambiguities in its present form.

Case law will inevitably fill in the gaps and flesh out more ambiguities. Given the undeniable benefits of subchapter V cramdown plans to debtors, they may become the norm in subchapter V cases. Thus, fully understanding the implications of a cramdown plan post-confirmation is essential.

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^{24 11} U.S.C. § 1194(b) ("[E]xcept as otherwise provided in the plan or in the order confirming the plan, the

trustee shall make payments to creditors under the plan."). 25 See In re Cleary Packaging LLC, 36 F.4th 509 (4th Cir. 2022); but see In re Off-Spec Sols. LLC, 651 B.R. 862 (B.A.P. 9th Cir. 2023), appeal dismissed, No. 23-60034, 2023 WL 9291577 (9th Cir. Nov. 2, 2023)

8 Help Center







JULY 7, 2022

May a Judge Revoke a Small Business Designation under Subchapter V of Chapter 11?

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Bankruptcy Judge Gunn found the power to revoke a small business designation and proceed under 'traditional' chapter11 in lieu of dismissing or converting to chapter 7.

In the first opinion anywhere on the subject, Bankruptcy Judge Elizabeth L. Gunn of Washington, D.C. revoked the small business designation and appointed an "ordinary" chapter 11 trustee when the debtor was unable to confirm plan.

The debtor had 700 "members" who paid dues for the debtor's referrals and marketing assistance for the members' small businesses. Embroiled in

litigation with two parties, the debtor filed a petition and designated itself as a small business debtor under Subchapter V of chapter 11.

The debtor plowed through four amendments of its plan before Judge Gunn denied confirmation of the fifth amended plan. At trial, the parties had not addressed the topic, but Judge Gunn analyzed whether conversion, dismissal or something else would be in the best interests of the debtor and creditors.

In her June 29 opinion, Judge Gunn evidently believed that the debtor's business had promise and that members were receiving valuable services. Dismissal or conversion would have meant the demise of the business and would not have been in the best interests of creditors, the judge believed.

Did Judge Gunn have any alternatives beyond dismissal or conversion to chapter 7? She said that the question was a matter of first impression. The issue, she said, was the "converse" of the often-raised question of whether a debtor in an "ordinary" chapter 11 case could "convert" to Subchapter V.

Judge Gunn said that "conversion" from ordinary chapter 11 to Subchapter V was incorrect. Rather, the debtor should amend a petition by electing to proceed under Subchapter V.

Consequently, Judge Gunn said she could not "convert" to ordinary chapter 11. She therefore examined whether she had the statutory power to revoke the designation to proceed under Subchapter V.

In terms of statutory power, Judge Gunn observed:

Section 1185 specifically provides for the dispossession of a debtor in possession while remaining in Subchapter V,

but nothing in Subchapter V discusses the revocation of election to proceed thereunder by the Court or any other party.

Judge Gunn therefore "look[ed] to chapter 11 and the Bankruptcy Code as a whole to determine [whether] the election by a debtor to proceed under Subchapter V may be revoked post-petition."

"[I]f a petition may be amended to elect to proceed under Subchapter V postpetition, logically it follows that the opposite must also be an option for debtors and courts," Judge Gunn said. She found "[v]arious sections of the Bankruptcy Code [that] allow for a debtor to seek conversion from one chapter to another if the debtor is an eligible debtor under such chapter."

Judge Gunn reasoned:

[T]he ability to revoke a Subchapter V election is consistent with the Bankruptcy Code but also the Congressional

goals of ensuring that Subchapter V cases provide a quicker reorganization process. If a debtor discovers post-

petition that it is unable to meet the deadlines of Subchapter V, the option to revoke such designation provides the

ability to continue to attempt to reorganize under the rigors and requirements of standard chapter 11.

When a debtor cannot comply with the truncated deadlines inherent in Subchapter V, Judge Gunn said that "allowing for the revocation of the Subchapter V designation so that the debtor may proceed under standard chapter 11 is consistent with the right conferred to a debtor in the Bankruptcy Code to convert a case to another chapter therein."

Judge Gunn found "benefits to both debtors and creditors to allow a case to remain under chapter 11 with a revocation of the Subchapter V election in lieu of requiring a debtor to have its case dismissed and immediately refiled." She held that, "in the appropriate situations and based upon a totality of the circumstances, the Court is able order the revocation of the Debtor's Subchapter V election, even where the revocation is not specifically provided for in the Bankruptcy Code."

Judge Gunn went on to find that the debtor should not retain operational control. She called for appointment of a traditional chapter 11 trustee on revocation of Subchapter V status.

Observations

Robert J. Keach told ABI why he found the opinion "troubling." "The concern," he said, is "that only the debtor can file a plan in a Sub V, and that is a key provision driving the election to file under Sub V. If that election can be involuntarily rescinded, a key element of the statute is undermined and a basis for choosing to file is at risk. Subchapter V was passed in response to debtors avoiding chapter 11 altogether."

However, Subchapter V does not have a get-out-of-jail free card like chapter 13, where the debtor has a right to dismiss "at any time" under Section 1307(b). The absence of a provision like Section 1307(b) could be understood as leaving a debtor stuck in bankruptcy, whether the debtor likes it or not.

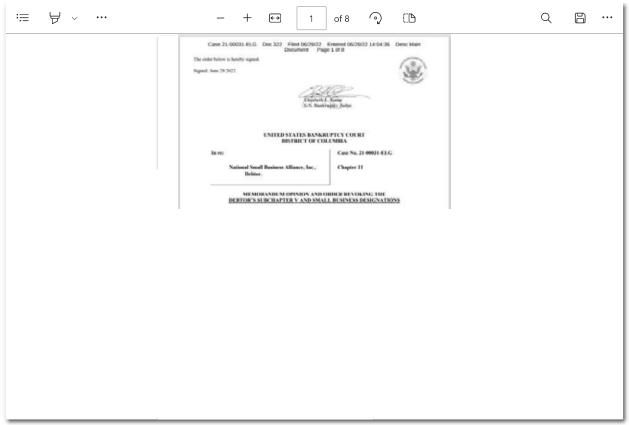
Mr. Keach saw alternatives. He noted that the "court could have just appointed a section 1104 chapter 11 trustee without changing the election." Although the "trustee could still not have filed a plan, it could have done a lot of things (operate the business, sell the assets, etc.) short of that to move the case forward. If not, the options are to dismiss or convert, not fundamentally alter the statute."

If the case were converted or dismissed, the business presumably would fail, extinguishing the debtor's interest in the enterprise. With revocation of Subchapter V status, the debtor would retain the right to file a plan. If the debtor were ultimately able to craft a confirmable plan continuing the business, the debtor at that juncture might seek redesignation under Subchapter V to retain ownership and avoid the absolute priority rule, a major feature Subchapter V.

The chair of the business restructuring and insolvency practice group at Bernstein Shur Sawyer & Nelson P.A. in Portland, Maine, Mr. Keach was the co-chair of the ABI commission that recommended the legislation Congress adopted in the Small Business Reorganization Act.

Opinion Link

№ PREVIEW



https://abi-opinions.s3.amazonaws.com/National_Business.pdf

Case Details

Case Citation National Small

Business Alliance Inc.,

21-00031 (Bankr. D.D.C.

June 29, 2022)

Case Name National Small

Business Alliance Inc.

Case Type <u>Business</u>

Court <u>D.C. Circuit</u>

Bankruptcy Tags <u>Practice and Procedure</u> <u>Business Reorganization</u>

Small Business







APRIL 28, 2016

Involuntary Servitude Claim Raised in Involuntary Chapter 11



A case is percolating through the federal courts in Washington state to test whether Congress violated the Thirteenth Amendment when it modified chapter 11 in 2005 to include an individual's post-petition income in property of the estate.

A doctor filed a chapter 7 petition owing child support and about \$1 million to unsecured creditors. He had less than \$25,000 in secured debt.

The U.S. Trustee filed a motion for conversion to chapter 11 under Section 706(b), contending that the doctor could pay his creditors in full in chapter 11 within three years. In chapter 7, creditors would recover less than 20%, according to the U.S. Trustee.

The doctor opposed conversion, arguing that an involuntary chapter 11 would violate the Thirteenth Amendment's prohibition of slavery and involuntary servitude by forcing him to pay creditors with post-petition income.









JUNE 17, 2022

Ninth Circuit Describes the Pleading and Proof for Converting from '11' to '7'

Listen to Article

0:00 / 5:43



With the statute silent, the Ninth Circuit makes rules for assets that go to the chapter 7 estate on conversion from chapter 11.

The Ninth Circuit recently wrote a checklist identifying the questions a bankruptcy court must answer when deciding whether to grant a motion for dismissal or conversion of a chapter 11 case to chapter 7.

The circuit's June 8 opinion also laid out the analysis for deciding whether assets that reverted to the debtor on confirmation of a chapter 11 plan would end up in the chapter 7 estate on conversion.

The chapter 11 debtor was an individual who owned several parcels of real property subject to mortgages. Disputing the validity of the mortgages, the debtor confirmed a

plan requiring her to place rental income from the collateral into an escrow fund pending resolution of the objections.

If the objections were overruled, the plan required the debtor to turn over the escrowed funds to the lender and to pay the lender going forward.

About five years after confirmation, the bankruptcy court ruled in favor of the debtor, but she refused to turn the escrow over to the lender. Six months later, the lender filed a motion for conversion to chapter 7.

Bankruptcy Judge Martin R. Barash converted the case and directed the debtor to turn the escrowed funds over to the lender. The district court affirmed.

The debtor appealed to the Ninth Circuit, contending that the bankruptcy court should not have converted and that the escrowed funds did not become part of the chapter 7 estate earmarked for the lender. In an opinion on June 8, Circuit Judge Danielle J. Forrest affirmed.

Conversion or Dismissal

Judge Forrest first adopted the holding of the Ninth Circuit Bankruptcy Appellate Panel by ruling that the creditor carries the initial burden of demonstrating "cause" for conversion or dismissal.

On the merits, Section 1112(b)(1) provides:

[T]he court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

In turn, "cause" is defined in Section 1112(b)(4)(N) to include a "material default" under the plan. However, the Code does not define "material default."

To determine whether the failure to pay the lender was a material default, Judge Forrest noted that an individual chapter 11 debtor does not receive a discharge until all payments are made under the plan. She agreed with her circuit's BAP that "failing to make required plan payments can be a material default of the plan, even if the debtor has

made payments for an extended period before the default or taken other significant steps to perform the plan."

Still, Judge Forrest said, every missed payment is not a material default if the amount of the payment or the period of the default was "minimal." To judge materiality, she said the court should consider the number of missed payments, the number of creditors who were not paid and how long the default occurred.

In the case on appeal, the amount of the default was at least \$200,000 and included five years of payments. Even if the debtor had not defaulted under other provisions of the plan, Judge Forrest upheld the bankruptcy court's finding of "cause."

Although there may be "cause," Judge Forrest said the court must next decide whether conversion is in the best interests of all creditors. Furthermore, she said that the court must address subsection (b)(2), which says:

The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate

The debtor claimed there were unusual circumstances to avoid conversion by invoking subsection (b)(2). On that point, Judge Forrest adopted the holding of her BAP that "unusual circumstances" are not common conditions in a chapter 11 case. In other words, "unusual circumstances" must be something more than "inherent financial pressures" on a debtor and "adversarial differences." Furthermore, the ability to cure a default is not an "unusual circumstance."

"Conversely," Judge Forrest said, an unusual circumstance could be a case where remaining in chapter 11 would yield a larger dividend for creditors.

In the case on appeal, the lender said it was willing to take a chance with a chapter 7 trustee, and no creditor objected to conversion. In addition, the bankruptcy judge found that conversion would conclude the case more quickly.

Judge Forrest found no abuse of discretion and upheld conversion to chapter 7.

Asset Turnover

The debtor argued that she should not have been required to turn the escrowed funds over to the chapter 7 trustee. Alluding to Section 1141(b), the debtor contended all assets of the estate revested in her on confirmation. Indeed, the section says that confirmation "vests all of the property of the estate in the debtor."

Judge Forrest said that the "Bankruptcy Code is silent as to what constitutes the bankruptcy estate when a Chapter 11 case is converted to Chapter 7 after plan confirmation."

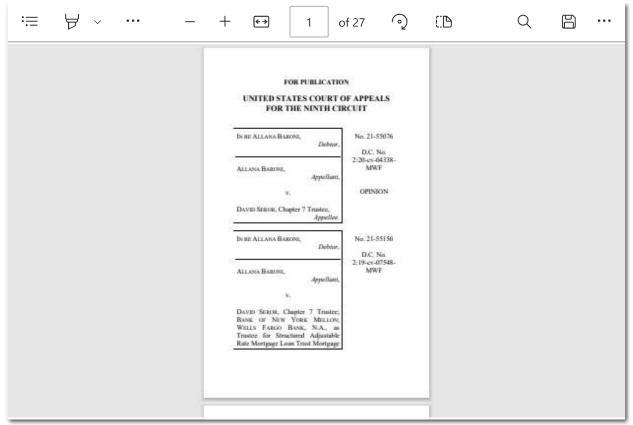
Although "courts have varied in their approach to what happens with the bankruptcy estate upon conversion from Chapter 11 to Chapter 7," Judge Forrest found an answer in the Ninth Circuit's own caselaw. She held that the "bankruptcy court should undertake a holistic analysis of the plan to determine whether its provisions deviate from the default vesting rule in 11 U.S.C. § 1141(b)."

In the case on appeal, the plan had no "express provision" saying where estate property would go on conversion. However, Judge Forrest noted that the plan required the debtor to make payments into the escrow fund if her objection to the secured claim proved unsuccessful.

Judge Forrest said that the plan did not give estate property back to the debtor on confirmation free and clear of creditors' claims and interests. She upheld the direction to turn the escrow fund over to the trustee, because revesting the assets in the debtor "upon conversion to Chapter 7 would frustrate the intent of the Plan and is contrary to many of its provisions."

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Baroni.pdf

Case Details

Case Citation Baroni v. Seror (In re

Baroni), 21-55076 (9th

Cir. June 8, 2022).

Case Name Baroni v. Seror (In re

Baroni)

Case Type <u>Business</u>

Court 9th Circuit

Bankruptcy Tags Plan Confirmation Business Reorganization

The doctor relied on the House Report accompanying the Bankruptcy Reform Act of 1978, which said that chapter 13 was made voluntary because making it mandatory might violate the Thirteenth Amendment "by forcing a debtor to work for creditors."

In 1991, the Supreme Court had no concern about involuntary servitude arising from an involuntary chapter 11 petition against an individual because post-petition wages at the time were not property of a chapter 11 estate. The Supreme Court's observation was made in *Toibb v. Radloff*, which allowed individuals to file chapter 11 petitions even if they do not conduct business. In the 2005 amendments, Congress created symmetry between chapters 13 and 11 by providing in Section 1115(a)(2) that an individual's post-petition wages become property of a chapter 11 estate.

The bankruptcy court granted the conversion motion but did not reach the constitutional question, saying the doctor lacked standing and the issue was not ripe.

District Judge Thomas S. Zilly of Seattle agreed in a March 22 opinion.

Judge Zilly quickly concluded that the bankruptcy court did not abuse its discretion by converting the case to chapter 11. He then confronted the constitutional issues.

The doctor lacked standing on the Thirteenth Amendment claim because mere conversion to chapter 11 "did not constitute injury in fact." Many steps must occur in chapter 11, the judge said, before the doctor could be compelled to devote post-petition income to payment of creditors' claims.

Similarly, the constitutional question was not ripe because injury was contingent on future events that might not occur as anticipated.

Although Judge Zilly did not reach the merits, he expressed "considerable doubt" about the doctor's constitutional argument. He cited cases for the proposition that there is no violation of the Thirteenth Amendment when someone can choose not to work, even if the choice is painful.

Case Details

Judge Name <u>Thomas S. Zilly</u>

Case Citation In re Parvin, 15-1648

(W.D. Wash. March 22,

2016)

Case Name In re Parvin

Case Type <u>Consumer</u>

Court 9th Circuit Washington

Washington Western District

Bankruptcy Tags BAPCPA at 10 Consumer Bankruptcy

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Trustee Talk

By BRIAN R. ANDERSON

When 7 Becomes 13: Compensating **Trustees upon Conversion**

chapter 7 trustee operates a difficult and risky business. A trustee must diligently discharge his/her fiduciary obligations under the Bankruptcy Code by, among other things, investigating the financial affairs of the debtor, and risks nonpayment (other than a \$60 no-asset fee) if those efforts do not bear fruit. Making matters worse, if a trustee's investigation leads to undervalued or undisclosed assets, the debtor could convert his/her case to chapter 13 to prevent the chapter 7 trustee from administering the assets for the benefit of the debtor's creditors.

In such instances, some courts have harshly ruled that a chapter 7 trustee is not entitled to compensation and that conversion is merely a cost of doing business, even though the trustee's efforts benefited the estate. Not only do these holdings unfairly shift the risk of nonpayment to chapter 7 trustees, they promote asset concealment by debtors, disincentivize diligence from hard-working trustees, and are contrary to numerous policies underlying the Code. A better approach is to allow chapter 7 trustees compensation after conversion upon a showing of "substantial services" to the estate. Such an approach best serves the intent of and policies underlying the Code, and applies equal fairness among debtors, creditors and trustees.



Brian R. Anderson Fox Rothschild LLP Greensboro, N.C.

Brian Anderson is a partner with Fox Rothschild LLP in Greensboro, N.C., and a chapter 7 trustee for the U.S. Bankruptcy Court for the Middle District of North Carolina. He also serves as a subchapter V trustee and provides strategic counsel on bankruptcy issues.

Statutory Framework

The Bankruptcy Code does not offer clear guidance on compensation for chapter 7 trustees upon the conversion of a case. This lack of guidance has become a source of controversy for trustees, who seek fair compensation for their work. Section 330(a)(1) of the Code authorizes the court to award a trustee "reasonable compensation for actual, necessary services rendered" and "reimbursement for actual, necessary expenses." However, § 326(a) sets certain limits on the compensation of trustees.

Specific to chapter 7 trustees, § 326(a) provides that "the court may allow reasonable compensation under section 330 of this title of the trustee for the trustee's services, payable after the trustee renders such services ... upon all moneys disbursed or turned over in the case by the trustee to parties in case from chapter 7 to chapter 13, the issue becomes whether the chapter 7 trustee is entitled to statutory commissions when he/she has yet to disburse funds.

interest, excluding the debtor, but including holders of secured claims." When a debtor converts his/her

Denial of Chapter 7 Trustee Compensation Upon Conversion

Courts that strictly construe § 326(a) deny chapter 7 trustee compensation unless the trustee has actually disbursed funds. Of course, disbursement rarely happens in a case converted to chapter 13, as disbursement generally occurs at the end of the case after the trustee has fully administered the estate. These courts take a hard line and view a chapter 7 trustee's compensation as being tied only to "monies disbursed or turned over," notwithstanding the fact that the trustee's services were necessary to the administration of the case.4 These courts view § 326(a) as unambiguous and state that denying a chapter 7 trustee compensation is consistent with the statute, despite the fact that a debtor's decision to convert the case might be a direct result of the trustee's efforts in the case and the fulfillment of the trustee's fiduciary responsibilities under § 704.

In addition, these courts have concluded that such a reading of the statute is consistent with congressional intent and the policy that "a debtor should always be given the opportunity to repay his debts."5 They express concern that any other interpretation "could dilute the debtor's absolute rights to convert and in essence punish the debtor (and the debtor's creditors) for exercising the rights bestowed upon them by Congress."6 Despite the harsh result, in these courts' eyes unambiguous statutory language trumps fairness concerns and quantum meruit.

Allowance of Chapter 7 Trustee Compensation

On the other hand, other courts correctly recognize that chapter 7 trustees should be adequate-

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¹ In re Murphy, 272 B.R. 483, 486 (Bankr, D. Colo, 2002); In re Fischer, 210 B.R. 467, 469

⁽Bankr. D. Minn. 1997). 2 11 U.S.C. § 330(a)(1)(A), (B)

^{3 11} U.S.C. § 326(a).

⁴ In re Evans, 344 B.R. 440, 454 (Bankr. W.D. Va. 2004) ("[H]owever laudable or desirable it might be on fairness and good bankruptcy policy grounds to award compensation ... to do so would be inconsistent with the provisions of 11 U.S.C. § 326(a)."); In re Silvus, 329 B.R. 193, 208 (Bankr. E.D. Va. 2005) (citing In re Fischer, 210 B.R. 467, 469 (Bankr D. Minn. 1997); *Murphy*, 272 B.R. at 486. In re McConnell, 2021 WL 203331, at *27 (Bankr. N.D. Ga. Jan. 4, 2021). (citing

Marrama v. Citizens Bank of Mass., 549 U.S. 365, 372 (2007)). 6 Silvus, 329 B.R. at 217.

ly and fairly compensated for their hard work, as "it is unacceptable and unwarranted to penalize hard-working interim trustees whose services have contributed to the administration of the bankruptcy estate but who have not actually distributed funds by depriving them of fees even though successor trustees, whether in a case pending under the same chapter or converted to another chapter, are successfully able to make distributions to parties in interest." They employ a variety of methods of statutory interpretation of § 326(a) and similar public policy concerns to reach the conclusion that chapter 7 trustees should be fairly compensated for discharging their duties under the Bankruptcy Code.

Ambiguity in § 326(a) Supports Trustee Compensation

First, some courts have found significant ambiguity in § 326(a). They struggle to reconcile the strict interpretation of § 326 as resulting in no compensation for the chapter 7 trustee, with the statutory language offering "reasonable compensation" awards "after the trustee renders such services." A "literal reading of § 326(a) should apply only in fully administered cases[,] and ... in cases which were not fully administered through no fault of the trustee, compensation should be awarded on a *quantum meruit* basis when the trustee preformed substantial services but did not disburse any monies." Denying compensation would "conflict with Congress's intent to encourage the conversion of Chapter 7 cases to those under Chapter 13 when circumstances permit a debtor to repay all or a portion of his or her debts."

A Narrow Reading of § 326(a) Supports Trustee Compensation

Second, courts have found that the same narrow reading of the statute, as advanced by those courts that deny compensation to a chapter 7 trustee upon conversion, works in the trustee's favor. These courts employ a strict reading of the entire statute to find statutory authority to award compensation for chapter 7 trustees in a converted case. For example, in *In re Bartlett*, 12 the court noted that the statutory phrase "in a case under Chapter 7 or 11" renders § 326(a) inapplicable to trustee compensation once the case is converted to chapter 13. Thus, even a strict statutory reading supports a trustee's right to compensation after a conversion to chapter 13.

A Broader Reading of § 326(a) Supports Trustee Compensation

Third, some courts have used a broader, more general statutory interpretation to treat chapter 7 trustees fairly upon conversion. The court in *In re Rodriguez* held that "[i]n order to encourage aggressive action by trustees, the reference to 'trustee' in the last sentence of section 326(a) must be read as a generic reference to the composite 'trustee' and to the aggregate distributions made in the case by the composite 'trustee' to all parties in interest other than the debtor." ¹³

While what constitutes substantial services depends on the specific case, the outright denial of compensation [upon conversion to chapter 13] runs counter to the Code's framework and policy and does a disservice to chapter 7 trustees everywhere.

Rodriguez reasoned that as long as the chapter 7 trustee executed some level of disbursement at some point during the entirety of the debtor's case, then all who served as trustees at some point in the process are entitled to compensation. Others read the phrase "monies disbursed or turned over" more broadly than a cash disbursement by a chapter 7 trustee. They reason that if a chapter 7 trustee's efforts lead to a disbursement to creditors in a chapter 13 plan, it is a disbursement, albeit an indirect one, that eventually finds its way to creditors.\(^{14}\)

Bankruptcy Policy Supports Trustee Compensation

Compensating chapter 7 trustees post-conversion also is consistent with the "clear policy under the Bankruptcy Code to see that case trustees are adequately and fairly compensated," as well as numerous other bankruptcy policies. Debtors are less likely to conceal assets when compensation of a chapter 7 trustee is required for pre-conversion efforts. Otherwise, a debtor may be incentivized to hide assets, then convert to chapter 13 once such assets have been discovered without then having to compensate the trustee.

In addition, denying a chapter 7 trustee compensation upon conversion works counter to the Code's desired goal of encouraging diligence to uncover all means by which creditors can be made whole, by creating a disincentive for the trustees diligently to discharge their fiduciary responsibilities.¹⁷ If a chapter 7 trustee uncovers assets that must then be

continued on page 82

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⁷ In re Rodriguez, 240 B.R. 912, 915 (Bankr. D. Colo. 1999).

⁸ In re Philips, 507 B.R. 2, 6 (Bankr. N.D. Ga. 2014) ("It is difficult to believe [that] Congress intended zero compensation to be reasonable where the trustee has expended significant effort and rendered valuable services marshaling assets on behalf of the estate — which will lead to a dividend for unsecured creditors that would not have been available but for the Chapter 7 Trustee's efforts — only to be frustrated by a conversion to Chapter 13.").

⁹ Id. (quoting 11 U.S.C. § 326(a))

¹⁰ In re Bartlett, 590 B.R. 175, 177 (Bankr. D. Mass. 2018) (quoting Matter of Parameswaran, 64 B.R. 341, 343 (Bankr. S.D.N.Y. 1986)); In re Schuck, 2007 WL 2757160, at '2 (Bankr. C.D. III. Sept. 20, 2007); In re Fernandez, No. 05-09792 (Bankr. D.P.R. Oct. 10, 2007); In re Moore, 235 B.R. 414, 416 (Bankr. W.D. Ky. 2002); afrid, Schilling v. Moore, 286 B.R. 846 (W.D. Ky. 2002). But see In re Silvus, 329 B.R. at 218 ("[R]ecovery under the theory of quantum meruit may only be had upon the basis of an implied contract. Rendering services alone, however, does not create an implied contract, nor does officiously conferring benefits uoon another.")

¹¹ In re Pivinski, 366 B.R. 285, 290 (Bankr. D. Del. 2007).

¹² Bartlett, 590 B.R. at 178; In re Colburn, 231 B.R. 778, 782 (Bankr. D. Ore. 1999); In re Scott, 2006 WL 566441 at *2 (Bankr. N.D. III. 2006) (§ 326(a) "becomes irrelevant once the case is converted").

¹³ In re Rodriguez, 240 B.R. 912, 915 (Bankr. D. Colo. 1999).

¹⁴ In re Schneider, 15 B.R. 744, 745 (Bankr. D. Kan 1981); In re Hages, 252 B.R. 789, 794 (Bankr. N.D. Cal. 2000).

¹⁵ Rodriguez, 240 B.R. at 915.

¹⁶ Bartlett, 590 B.R. at 177; Fernandez, No. 05-09792, at *3; Pivinski, 366 B.R. at 2905

¹⁷ Hages, 252 B.R. at 794; In re Berry, 166 B.R. 932, 935 (Bankr. D. Ore. 1994).

Trustee Talk: When 7 Becomes 13: Compensating Trustees upon Conversion

paid for in a chapter 13 plan, those actions have benefited the estate, and the trustee should be compensated accordingly. ¹⁸ Further, allowing chapter 7 trustee compensation creates more efficiency in the bankruptcy process and furthers the goal of allowing debtors to repay their debts by minimizing a trustee's opposition to the debtor's efforts to convert to chapter 13.

Conclusion

Compensating chapter 7 trustees upon a showing of substantial services best advances the intent and policy of the Bankruptcy Code. Doing so not only encourages diligence from the trustee and transparency from the debtor, but also reinforces desires for judicial efficiency by avoiding trustee opposition to conversion and furthers the goal of allowing a debtor to repay his/her creditors. While what constitutes substantial services depends on the specific case, the outright denial of compensation runs counter to the Code's framework and policy and does a disservice to chapter 7 trustees everywhere.

18 Hages, 252 B.R. at 794; In re Washington, 232 B.R. 814, 816 (Bankr. S.D. Fla. 1999).

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SEPTEMBER 2, 2020

Claims Discharged in Chapter 7 Revive If the Case Is Converted to Chapter 13



Courts are split over the effect on claims discharged in chapter 7 if the debtor converts the case to chapter 13.

If a chapter 7 case is converted to chapter 13 after the debtor receives a discharge, creditors with discharged claims are entitled to the allowance of their claims in chapter 13, according to Bankruptcy Judge Laura K. Grandy of East St. Louis, Ill., who took sides on an issue where the courts are split.

Judge Grandy is not announcing the end of so-called chapter 20 cases. In chapter 20, the debtor will have received a discharge in chapter 7 but will file an entirely new chapter 13 petition, not convert the chapter 7 case to chapter 13. In her court, the debtor was attempting a strategy that required conversion to chapter 13, not filing an entirely new petition.

After the debtor received his chapter 7 discharge, the trustee discovered an annuity that might be an asset. Rather than turn over the asset, the debtor converted his case to chapter 13.

The court served a notice of the chapter 13 bar date. A creditor who had not filed a claim in chapter 7 did file a claim for about \$1,300 in the chapter 13 case. The debtor objected to allowance of the claim, contending that the debt had been discharged in chapter 7.

Judge Grandy disagreed in her August 7 opinion. She admitted that the Bankruptcy Code "offers little guidance as to what happens if the debtor seeks to convert their case after receiving a Chapter 7 discharge."

Judge Grandy began by quoting Section 524(a)(2) which provides that a discharge "operates as an injunction against . . . any act, to collect . . . any such debt as a personal liability of the debtor." In other words, she said that a "discharge eliminates a debtor's personal liability for a debt, [but] it does not extinguish the liability of the bankruptcy *estate*." [Emphasis in original.]

On the other side of the fence, Judge Grandy said "there is a line of cases which have held or at least assumed that upon conversion after a discharge, any dischargeable debts scheduled in the Chapter 7 case are effectively eliminated and not entitled to distributions under the Chapter 13 plan."

Judge Grandy gave several examples for how the debtor's theory would break down in practical application. For example, no debts would remain for payment in chapter 13. Or, she said, "An unscrupulous debtor could conceal assets in the Chapter 7 in order to avoid liquidation and then convert to Chapter 13 in order to retain the asset to the detriment of creditors."

Judge Grandy summarized the analysis like this: The bankruptcy estate was formed on the filing of the chapter 7 petition. Claims in existence became claims against the estate. On conversion, the filing date remained the same. So, prepetition claims in chapter 7 became claims in the chapter 13 case. Creditors with valid claims who filed timely claims in the chapter 13 case are entitled to receive distributions "despite the existence of the Chapter 7 discharge."

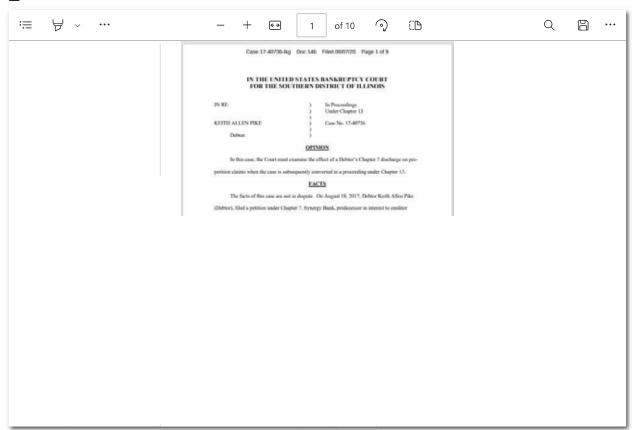
Observation

Judge Grandy's opinion does not undercut the theory for chapter 20 cases, where debtors can fully extinguish the personal obligation and underwater liens on a home mortgage. In chapter 20, the debtor files a new petition in chapter 13 (to extinguish the underwater lien) after receiving a chapter 7 discharge.

Judge Grandy's opinion explains why a chapter 20 strategy would not work by converting to chapter 13 rather than filing a new petition.

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Pike.pdf

Case Details

Case Citation In re Pike, 17-40736

(Bankr. S.D. Ill. Aug. 7,

2020)

Case Name In re Pike

Case Type <u>Consumer</u>

Court 7th Circuit Illinois Illinois Southern District

Bankruptcy Tags <u>Claims</u> <u>Consumer Bankruptcy</u>

<u>Discharge/Dischargeability</u>

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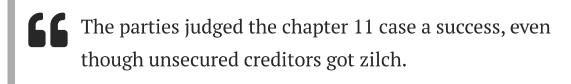
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SEPTEMBER 21, 2020

Michigan Judge Prefers Dismissal if Conversion Won't Benefit Unsecured Creditors



These days, "success" in a chapter 11 case is measured differently. A generation ago, a successful chapter 11 reorganization entailed restructuring the debt, perhaps over three years. Sales were few and far between. Today, success more often than not means selling the assets quickly.

In a chapter 11 case before Bankruptcy Judge Scott W. Dales of Grand Rapids, Mich., all the parties aside from the U.S. Trustee judged the case a success. The assets were all sold, and the debtor was evidently left with \$2.9 million in cash plus receivables.

However, the secured lender held what Judge Dales called an "unassailable" lien on cash and receivables but was owed \$17 million. All agreed that the cash belonged to the lender as "cash collateral."

Judge Dales said there was "no prospect for reorganization now" and "absolutely no prospect for payment to any unsecured creditors" in view of cash collateral orders and financing for the chapter 11 effort.

The debtor, the official creditors' committee and the lender filed a motion to dismiss the chapter 11 case. The U.S. Trustee opposed and filed a motion for conversion to chapter 7, contending that a trustee would be capable of making the final distributions.

According to Judge Dales, the U.S. Trustee argued that dismissal would set a "bad precedent by allowing interested parties to use the bankruptcy sale process under Section 363 to skirt court-supervised distributions that would occur under a confirmed plan, or in the case of conversion, Section 727."

The debtor submitted that dismissal would make the Western District of Michigan an "attractive venue" for chapter 11 cases.

Judge Dales said he had "no legitimate interest . . . in promoting our district as a haven for chapter 11 cases." Instead, he addressed the U.S. Trustee's conversion motion by evaluating "the interests of *this* estate and the creditors of *this* estate." [Emphasis in original.]

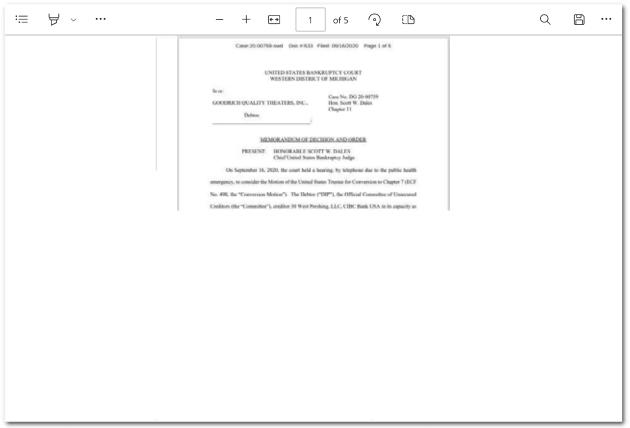
Judge Dales said there was "no serious suggestion" that the parties intended to ignore bankruptcy priorities by turning the case into a "structured dismissal" of the type outlawed by the Supreme Court in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017).

Judge Dales found "no persuasive reason" to override the wishes of the official committee and the largest unsecured creditor. Conversion to chapter 7, he said, "would increase administrative expenses and engender confusion among the creditor body, without promising any meaningful recovery for unsecured creditors."

Judge Dales denied the conversion motion and scheduled a hearing on the motion to dismiss.

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Goodrich+Quality.pdf

Case Details

Case Citation In re Goodrich Quality

Theaters Inc., 20-00759 (Bankr. W.D. Mich. Sept.

16, 2020)

Case Name In re Goodrich Quality

Theaters Inc.

Case Type <u>Business</u>

Court <u>6th Circuit</u> <u>Michigan</u> <u>Michigan Western District</u>

Bankruptcy Tags <u>Asset Sales</u> <u>Practice and Procedure</u>

Business Reorganization









AUGUST 2, 2023

Circuits Are Now Split on Who Gets Appreciation in a Home When a '13' Converts to

Listen to Article 0:00 / 9:47



Splitting with the Tenth Circuit, the Ninth Circuit holds that chapter 13 debtors lose post-petition appreciation in a home if the case converts to chapter 7.

Splitting with the Tenth Circuit, a divided panel on the Ninth Circuit held that the post-petition appreciation in the value of a home belongs to creditors when a chapter 13 debtor converts the case to chapter 7.

The dissenter on the Ninth Circuit said that the majority "effectively punishes the [debtors] for filing under Chapter 13 with the forced sale of their home.

Because that outcome is not the best reading of the Bankruptcy Code or our precedents," the dissenter said he would have held, "consistent with the Tenth Circuit, that postpetition, preconversion appreciation belongs to the [debtors] rather than the converted Chapter 7 estate."

Forced to Sell the Home

Eighteen months after confirming a chapter 13 plan, a couple were forced to convert their case to chapter 7 because the husband developed Parkinson's Disease and could no longer work.

In the chapter 13 case, the debtors had scheduled their home as being worth \$500,000. There was no equity in the home given the \$375,000 mortgage and the debtor's claimed homestead exemption of \$125,000.

After conversion, the chapter 7 trustee alleged that the property was worth \$700,000 and filed a motion for authority to sell the home. The debtors argued that the valuation at conversion didn't matter because appreciation during chapter 13 belonged to them.

Bankruptcy Judge Marc Barreca of Seattle disagreed with the debtors and held that post-petition, pre-conversion appreciation belongs to the chapter 7 estate. *In re Castleman*, 631 B.R. 914 (Bankr. W.D. Wash. June 4, 2021). To read ABI's report, **click here**.

The debtors appealed and lost again in district court. *In re Castleman*, 21-00829, 2022 BL 229708, 2022 US Dist. Lexis 116941, 2022 WL 2392058 (W.D. Wash. July 1, 2022). To read ABI's report, <u>click here</u>. The debtors appealed to the circuit.

The Majority Opinion

For the majority, Circuit Judge Michael D. Hawkins said that the courts are "heavily divided." He cited the Tenth Circuit for holding that post-petition appreciation in a nonexempt asset belongs to the debtor on conversion from chapter 13 to chapter 7. *See In re Barrera*, 22 F.4th 1217 (10th Cir. 2022). To read ABI's report, **click here**. However, he did not cite his own Ninth Circuit Bankruptcy Appellate Panel for reaching the same

result as the Tenth Circuit by giving appreciation to the debtor. *See Black v. Leavitt (In re Black)*, 609 B.R. 518 (B.A.P. 9th Cir. Dec. 31, 2019). To read ABI's report, **click here**.

Among the courts bestowing appreciation on creditors, Judge Hawkins cited the bankruptcy court's opinion in *In re Goetz*, 647 B.R. 412 (Bankr. W.D. Mo. Nov. 10, 2022). To read ABI's report, <u>click here</u>. [Note: Judge Hawkins did not cite the Eighth Circuit Bankruptcy Appellate Panel's affirmance in *Goetz v. Weber (In re Goetz)*, 651 B.R. 292 (B.A.P. 8th Cir. June 1, 2023). To read ABI's report, <u>click here</u>. Note also that *Goetz* is on appeal to the Eighth Circuit.]

Several statutes are in play. Section 348(f)(1), which underwent substantial amendment in 1994, provides that "property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion."

The amendment was intended to overrule caselaw holding that property obtained after filing a chapter 13 petition becomes estate property once the case converts to chapter 7.

Primarily relied on by the majority, Section 541(a)(6) provides that estate property includes "[p]roceeds, product, offspring, rents, or profits of or from property of the estate, except such as are earnings from services performed by an individual debtor after the commencement of the case."

Citing *In re Goins*, 539 B.R. 510, 516 (Bankr. E.D. Va. 2015), Judge Hawkins said that the equity is "inseparable" from the real estate. Citing previous Ninth Circuit opinions and Section 541(a)(6), he said that post-petition appreciation in real estate belongs to the estate, not the debtor. *Schwaber v. Reed (In re Reed)*, 940 F.2d 1317, 1323 (9th Cir. 1991); and *Wilson v. Rigby*, 909 F.3d 306, 309 (9th Cir. 2018). [Note: Judge Hawkins did not mention that the two Ninth Circuit opinions dealt with cases in chapter 7, not conversions from chapter 13.]

Although the two opinions were chapter 7 cases, Judge Hawkins found "no textual support for concluding that § 541(a) has a different meaning upon

conversion from Chapter 13."

Judge Hawkins said that "many" cases reached a different conclusion by reference to the legislative history surrounding the 1994 amendment to Section 348(f). Those courts read the amendment's legislative history as saying that appreciation after filing in chapter 13 belongs to the debtor.

Judge Hawkins did "not look to legislative history for guidance" because he concluded that the statute was not ambiguous.

Citing the Tenth Circuit's *Barrera* decision, Judge Hawkins said that "some" courts give appreciation to the debtor by relying on Section 1327(b), the statute that revests estate property in the debtor on chapter 13 confirmation. However, he said that "§ 348(f) only clarified that newly acquired, postpetition property would not become part of the converted estate."

"In sum," Judge Hawkins said, "the plain language of § 348(f)(1) dictates that any property of the estate at the time of the original filing that is still in [the] debtor's possession at the time of conversion once again becomes part of the bankruptcy estate, and our case law dictates that any change in the value of such an asset is also part of that estate. In this case, that property increased in value."

In a footnote after affirming the lower court's holding that appreciation enhanced the chapter 7 estate, Judge Hawkins said that the decision did not resolve the debtors' argument to have an administrative claim for payments they made on the mortgage after confirmation of the chapter 13 plan.

The Dissent

Circuit Judge Richard C. Tallman opened his dissenting opinion by saying that the majority created "a circuit split and effectively punishes the [debtors] for filing under Chapter 13 with the forced sale of their home." As a result, he said that "the majority sacrifices the text of the bankruptcy statutes on the altar of simplicity."

Judge Tallman characterized the majority as reaching a "simple resolution" by holding that appreciation in chapter 13 goes to the estate "because we have held [that] appreciation becomes part of the estate in a Chapter 7 case."

"But simplicity," Judge Tallman said, "cannot take precedence over the text of the Bankruptcy Code, and if we read § 348(f) in light of the Code 'as a whole' — rather than just § 541(a) — [Wilson v. Rigby] is not dispositive." The "remainder" of the Bankruptcy Code, he said, "clarifies" that "property of the estate" is defined differently in chapter 13 than it is in chapter 7.

In view of Section 1327(b), Judge Tallman said that the debtor once again becomes the owner of the home on confirmation. "It follows," he said, "that when a Chapter 13 plan has been confirmed, appreciation accrues to the debtor."

Judge Tallman quoted the decision by "our Bankruptcy Appellate Panel" in *Black* for "holding that 'the revesting provision of the confirmed plan means that the debtor owns the property outright and that the debtor is entitled to any postpetition appreciation.'" *Black, supra*, 609 B.R. at 529. The Tenth Circuit, he said, "reached a similar conclusion" in *Barrera*.

Judge Tallman went on to cite *Barrera* for holding that Section 541(a)(6) is only operative before confirmation because confirmation revests property in the debtor. He then quoted the Tenth Circuit for saying that proceeds generated from property after confirmation do not become estate property.

Consistent with the Tenth Circuit, Judge Tallman said that he "would hold... that postpetition, preconversion appreciation belongs to the [debtors] rather than the converted Chapter 7 estate."

On top of the majority's erroneous interpretation of the statute, Judge Tallman said that "the majority's reading of § 348(f)(1)(A) is also inconsistent with the statute's structure, object, policies, and legislative history." Citing the legislative history accompanying the adoption of Section 348(f)(1)(A) in 1994, he said, "Clearly, Congress believed that home equity which accrued

during Chapter 13 proceedings should not be included in the converted estate."

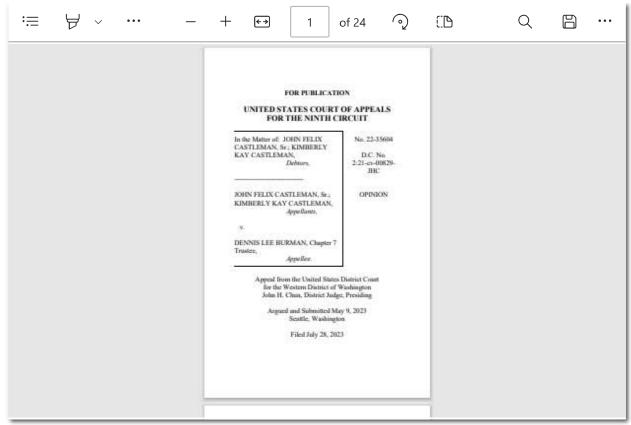
Where the majority declined to take guidance from legislative history, Judge Tallman said it was "consistent with the text of the Bankruptcy Code, directly relevant to the case at hand, and unequivocally confirms that appreciation in the value of the [debtors'] home should not become part of the converted estate."

To this writer, Judge Tallman cast his reading of the statute in terms of fairness. Had the debtors originally filed in chapter 7, he said that all of their home equity would have been exempt. By having taken a shot at chapter 13, he said they were left in a "worse position," which he called "the situation Congress sought to prevent."

Although he recommended that Congress once again amend Section 348(f) "to make the answer clear," Judge Tallman said he "would hold that the appreciation belongs to the [debtors]."

Opinion Link

№ PREVIEW



https://abi-opinions.s3.amazonaws.com/Castleman+9+Cir.pdf

Case Details

Case Citation Castleman v. Burman

(In re Castleman), 22-35604 (9th Cir. July 28,

2023)

Case Name Castleman v. Burman

(In re Castleman)

Case Type <u>Consumer</u>

Court 9th Circuit

Bankruptcy Tags <u>Asset Sales</u> <u>Plan Confirmation</u>

Consumer Bankruptcy Mortgage

Help Center







JUNE 17, 2022

Ninth Circuit Describes the Pleading and Proof for Converting from '11' to '7'

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0:00 / 5:43



With the statute silent, the Ninth Circuit makes rules for assets that go to the chapter 7 estate on conversion from chapter 11.

The Ninth Circuit recently wrote a checklist identifying the questions a bankruptcy court must answer when deciding whether to grant a motion for dismissal or conversion of a chapter 11 case to chapter 7.

The circuit's June 8 opinion also laid out the analysis for deciding whether assets that reverted to the debtor on confirmation of a chapter 11 plan would end up in the chapter 7 estate on conversion.

The chapter 11 debtor was an individual who owned several parcels of real property subject to mortgages. Disputing the validity of the mortgages, the debtor confirmed a

plan requiring her to place rental income from the collateral into an escrow fund pending resolution of the objections.

If the objections were overruled, the plan required the debtor to turn over the escrowed funds to the lender and to pay the lender going forward.

About five years after confirmation, the bankruptcy court ruled in favor of the debtor, but she refused to turn the escrow over to the lender. Six months later, the lender filed a motion for conversion to chapter 7.

Bankruptcy Judge Martin R. Barash converted the case and directed the debtor to turn the escrowed funds over to the lender. The district court affirmed.

The debtor appealed to the Ninth Circuit, contending that the bankruptcy court should not have converted and that the escrowed funds did not become part of the chapter 7 estate earmarked for the lender. In an opinion on June 8, Circuit Judge Danielle J. Forrest affirmed.

Conversion or Dismissal

Judge Forrest first adopted the holding of the Ninth Circuit Bankruptcy Appellate Panel by ruling that the creditor carries the initial burden of demonstrating "cause" for conversion or dismissal.

On the merits, Section 1112(b)(1) provides:

[T]he court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

In turn, "cause" is defined in Section 1112(b)(4)(N) to include a "material default" under the plan. However, the Code does not define "material default."

To determine whether the failure to pay the lender was a material default, Judge Forrest noted that an individual chapter 11 debtor does not receive a discharge until all payments are made under the plan. She agreed with her circuit's BAP that "failing to make required plan payments can be a material default of the plan, even if the debtor has

made payments for an extended period before the default or taken other significant steps to perform the plan."

Still, Judge Forrest said, every missed payment is not a material default if the amount of the payment or the period of the default was "minimal." To judge materiality, she said the court should consider the number of missed payments, the number of creditors who were not paid and how long the default occurred.

In the case on appeal, the amount of the default was at least \$200,000 and included five years of payments. Even if the debtor had not defaulted under other provisions of the plan, Judge Forrest upheld the bankruptcy court's finding of "cause."

Although there may be "cause," Judge Forrest said the court must next decide whether conversion is in the best interests of all creditors. Furthermore, she said that the court must address subsection (b)(2), which says:

The court may not convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate

The debtor claimed there were unusual circumstances to avoid conversion by invoking subsection (b)(2). On that point, Judge Forrest adopted the holding of her BAP that "unusual circumstances" are not common conditions in a chapter 11 case. In other words, "unusual circumstances" must be something more than "inherent financial pressures" on a debtor and "adversarial differences." Furthermore, the ability to cure a default is not an "unusual circumstance."

"Conversely," Judge Forrest said, an unusual circumstance could be a case where remaining in chapter 11 would yield a larger dividend for creditors.

In the case on appeal, the lender said it was willing to take a chance with a chapter 7 trustee, and no creditor objected to conversion. In addition, the bankruptcy judge found that conversion would conclude the case more quickly.

Judge Forrest found no abuse of discretion and upheld conversion to chapter 7.

Asset Turnover

The debtor argued that she should not have been required to turn the escrowed funds over to the chapter 7 trustee. Alluding to Section 1141(b), the debtor contended all assets of the estate revested in her on confirmation. Indeed, the section says that confirmation "vests all of the property of the estate in the debtor."

Judge Forrest said that the "Bankruptcy Code is silent as to what constitutes the bankruptcy estate when a Chapter 11 case is converted to Chapter 7 after plan confirmation."

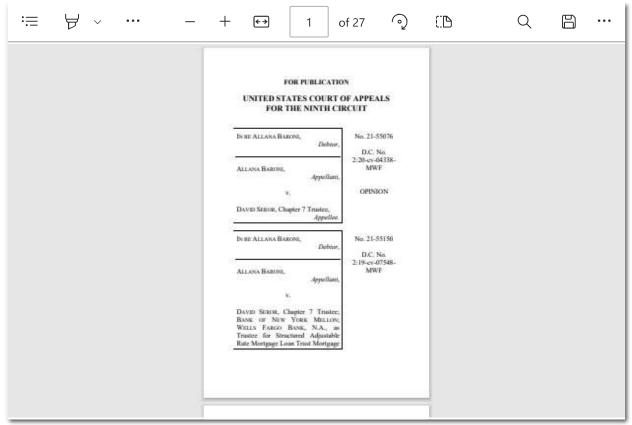
Although "courts have varied in their approach to what happens with the bankruptcy estate upon conversion from Chapter 11 to Chapter 7," Judge Forrest found an answer in the Ninth Circuit's own caselaw. She held that the "bankruptcy court should undertake a holistic analysis of the plan to determine whether its provisions deviate from the default vesting rule in 11 U.S.C. § 1141(b)."

In the case on appeal, the plan had no "express provision" saying where estate property would go on conversion. However, Judge Forrest noted that the plan required the debtor to make payments into the escrow fund if her objection to the secured claim proved unsuccessful.

Judge Forrest said that the plan did not give estate property back to the debtor on confirmation free and clear of creditors' claims and interests. She upheld the direction to turn the escrow fund over to the trustee, because revesting the assets in the debtor "upon conversion to Chapter 7 would frustrate the intent of the Plan and is contrary to many of its provisions."

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Baroni.pdf

Case Details

Case Citation Baroni v. Seror (In re

Baroni), 21-55076 (9th

Cir. June 8, 2022).

Case Name Baroni v. Seror (In re

Baroni)

Case Type <u>Business</u>

Court 9th Circuit

Bankruptcy Tags Plan Confirmation Business Reorganization

8 Help Center







NOVEMBER 22, 2023

Discharge Isn't an Automatic Bar to Conversion from '7' to '13'

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0:00 / 2:45



A district court opinion from Michigan raises the question of whether the Supreme Court's decision in Marrama is still good law after Law v. Siegel.

The receipt of a chapter 7 discharge does not automatically bar a debtor from converting a case to chapter 13, according to District Judge Nancy G. Edmonds of Detroit.

On the other hand, the right to move to convert does not ensure conversion, Judge Edmonds said in her November 14 opinion.

The debtor owned real property. Four days before receiving her general discharge in chapter 7, the debtor transferred a half interest in the property to her daughter for no consideration. Believing that the trustee would attempt to

avoid the transfer, the debtor filed a motion four months after discharge to set aside the discharge order and convert the case to chapter 13.

Finding no grounds for a so-called motion for reconsideration under Federal Rule 60(b), the bankruptcy court refused to vacate the discharge or convert the case to chapter 13.

The debtor appealed but did challenge the ruling under Rule 60(b). Rather, the debtor argued that receipt of discharge is not a bar to conversion to chapter 13. Judge Edmonds agreed in her five-page opinion.

Judge Edmonds cited *Marrama v. Citizens Bank*, 549 U.S. 365 (2007), where the Supreme Court held under Section 706(a) that the bankruptcy court has discretion to deny conversion of a chapter 7 case to chapter 13 if shown the debtor's bad faith.

Referring to *Marrama*, Judge Edmonds said that the bankruptcy court had not analyzed the debtor's good faith in filing the conversion motion.

Furthermore, there is a split of authority on a related issue. Judge Edmonds cited several courts for holding that a discharge precludes conversion to chapter 7. However, she cited other courts that disagree.

Judge Edmonds was persuaded by cases holding that discharge does not bar conversion. She remanded the case with instructions for the bankruptcy court to consider the debtor's "potential abuse of the bankruptcy process," since discharge is not an automatic bar to conversion. She also directed the bankruptcy court to consider whether the debtor was eligible for chapter 13.

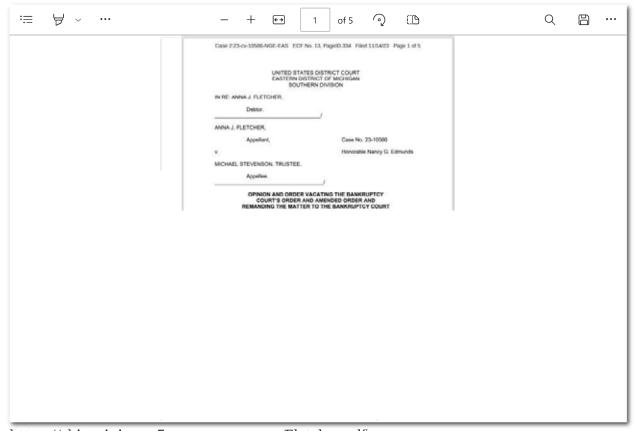
Observation

Marrama may no longer be good law following *Law v. Siegel*, 571 U.S. 415 (2014), where the Supreme Court held that a bankruptcy court may not use its equitable powers under Section 105(a) to contravene express provisions of the Bankruptcy Code.

Although *Marrama* may not be grounds for denial of conversion following *Law v. Siegel*, the debtor's ineligibility for chapter 13 might still bar conversion.

Opinion Link

PREVIEW



https://abi-opinions.s3.amazonaws.com/Fletcher.pdf

Case Details

Case Citation Fletcher v. Stevenson

(In re Fletcher), 23-10586 (E.D. Mich. November 14, 2023)

Case Name Fletcher v. Stevenson

(In re Fletcher)

Case Type <u>Consumer</u>

Court 6th Circuit Michigan Michigan Eastern District

Bankruptcy Tags <u>Practice and Procedure</u> <u>Consumer Bankruptcy</u>

8 Help Center

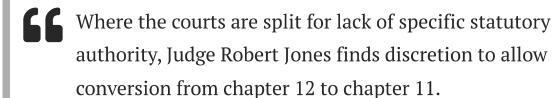






OCTOBER 16, 2018

Debtor Allowed to Convert from Chapter 12 to Chapter 11



On an issue where the courts are split, Bankruptcy Judge Robert L. Jones of Lubbock, Texas, ruled that a chapter 12 family farmer can convert the case to chapter 11.

The debtor was an elderly woman. The secured creditor had filed a motion to dismiss, contending that she was not eligible for chapter 12. The debtor responded by filing a motion for conversion to chapter 11.

The lender argued that the debtor could only dismiss the chapter 12 case, then refile under chapter 11, thus invoking Section 362(c)(3), which causes the automatic stay to terminate automatically in 30 days, at least in part.

Section 1208 deals with conversion or dismissal of a chapter 12 case. In part, it protects the debtor. For instance, a creditor cannot move for conversion to chapter 11, where creditors have more power. Likewise, a creditor may move for dismissal, but a creditors' motion for conversion to chapter 7 must show fraud. Otherwise, the court must dismiss a chapter 12 case on motion by the debtor.

Section 1208 is silent about a debtor's right to convert from chapter 12 to chapter 11. Or, as Judge Jones said in his October 3 opinion, the statute "does not explicitly authorize a debtor" to convert from chapter 12 to chapter 11.

Judge Jones decided that the court has discretion to allow conversion to chapter 11 "if the debtor is proceeding in good faith and conversion is not otherwise prejudicial to creditors or otherwise inequitable."

Judge Jones saw "no benefit to any party by dismissing and forcing [the debtor] to refile her case" in chapter 11. The stop-and-start procedure, he said, "would be more expensive and less efficient for all concerned."

Judge Jones dealt with Section 362(c)(3) by insinuating that he would have reinstated the automatic stay within the 30-day period as the statute permits, if the debtor were to have dismissed and refiled in chapter 11.

Opinion Link

http://www.txnb.uscourts.gov/sites/txnb/files/opinions/17-50307.pdf

Case Details

Judge Name	Robert L. Jones
Case Citation	In re Cardwell, 17-
	50307 (Bankr. N.D. Tex
	Oct. 3, 2018)
Case Name	In re Cardwell

Case Type <u>Business</u>

Court <u>5th Circuit</u> <u>Texas</u> <u>Texas Northern District</u>

Bankruptcy Tags <u>Automatic Stay</u> <u>Practice and Procedure</u>

Chapter 12/Farm Cases

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Faculty

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Richard H. Drew III is an Assistant U.S. Trustee with the Office of the U.S. Trustee in Shreveport, La. He began practicing with the Corporate and Financial Litigation Section of the U.S. Department of Justice's Civil Division, where he represented the U.S.'s interests in chapter 11 bankruptcies and in other commercial litigation. In 2015, Mr. Drew joined the U.S. Trustee Program in his home state of Louisiana, then in 2019 joined the Shreveport field office. In 2021, he has also served as the Acting Assistant U.S. Trustee for the San Antonio field office. Mr. Drew received his J.D. from the Louisiana State University Law Center.

Soneet R. Kapila, CPA, CFF, CFE, CIRA is a founding partner of KapilaMukamal, LLP in Fort Lauderdale, Fla., and ABI's President. For more than 25 years, he has concentrated his efforts in the areas of consulting in insolvency, fiduciary and creditors' rights matters. Mr. Kapila is a federal bankruptcy trustee and serves as an examiner, CRO, chapter 7 and 11 trustee, subchapter V trustee, liquidating trustee, corporate monitor (SEC appointments), and as a state and federal court-appointed receiver. He has been appointed in numerous matters in the Southern and Middle Districts of Florida. As a trustee plaintiff, Mr. Kapila has managed complex litigation in significant cases. He advises and represents debtors, secured creditors and creditors' committees in formulating, analyzing and negotiating plans of reorganization. As a recognized expert in fraudulent conveyance, Ponzi schemes and insolvency issues, Mr. Kapila has provided expert testimony and litigation-support services to law firms involving complex insolvency issues and commercial damages. He has worked in conjunction with the SEC, FBI and U.S. Attorney's Office, and he has served both as a consultant and expert witness for litigation matters in state and federal courts. Mr. Kapila has spoken to various groups, including ABI, New York Law School, St. Thomas University Law School, and the National Conference of Bankruptcy Judges, Southeastern Bankruptcy Law Institute, National Association of Bankruptcy Trustees (NABT), Receiver's Forum, Association of Insolvency and Restructuring Advisors, Florida

Institute of Certified Public Accountants, Turnaround Management Association, University of Miami School of Law, Florida International University School of Law, American Bar Association and the National Business Institute on topics related to insolvency, underperforming businesses and insolvency taxation. He is a Fellow of the American College of Bankruptcy and a past-president and past-chairman of the Association of Insolvency & Restructuring Advisors, for which he serves on its board of directors. Mr. Kapila has served on the advisory boards of ABI's Southeast Bankruptcy Workshop and Caribbean Insolvency Symposium. He also co-authored ABI's *Fraud and Forensics: Piercing Through the Deception in a Commercial Fraud Case* (2015). Mr. Kapila received his M.B.A. in 1978 from Cranfield School of Management.

Hon. Sage M. Sigler is a U.S. Bankruptcy Judge for the Northern District of Georgia in Atlanta, appointed in March 2018. She succeeded Hon. Mary Grace Diehl, for whom she clerked after graduating from law school. Prior to her appointment to the bench, Judge Sigler was a partner in Alston & Bird LLP's Bankruptcy Group. She is an active member of ABI's Board of Directors, NCBJ, IWIRC, TMA and the Bankruptcy Section of the Atlanta Bar Association, and she has been a volunteer presenter for the Credit Abuse Resistance Education (CARE) program. Judge Sigler was an honoree in ABI's inaugural class of "40 Under 40" in 2017. She received her B.A. in political science from the University of Florida in 2001 and her J.D. in 2006 from Emory University School of Law, where she was the executive symposium editor of the *Emory Bankruptcy Developments Journal*.