

## **CONVERSION**

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This is a taboo topic. It is out there but nobody really wants to talk about it until it is too late. Conversion is moving from one Chapter of the bankruptcy code to another Chapter. Sometimes it is voluntary and sometimes there is not a whole lot of choice. What are the steps required to convert, when should you convert, why should you convert and then what happens? Remember you cannot convert to a Chapter unless the Debtor is eligible for that Chapter.

### **CHAPTER 7 TO CHAPTER 13**

The majority of the time the case is converted to Chapter 7 is because the US Trustee has determined that the case should not be a Chapter 7. Either there are issues with the Means Test causing the US Trustee to issue a Motion to Convert or to Dismiss. There could be issues with the income going forward. The debtor is then presented with the issue of voluntarily converting, voluntarily dismissing, or having a court hearing to determine if the case can stay a Chapter 7. There are instances when the Debtors will want to convert on their own. This issue arises if there is a huge change of circumstance (i.e. increase in income), discovery of an asset the debtor wants to keep, a breakdown with a creditor on a secured debt (reaffirmation issues) and of course when the trustee determines an asset that the debtor needs to protect, has too much equity and the trustee will not be reasonable. These are just some reasons for a conversion from Chapter 7 to Chapter 13.

The debtor must file a motion to convert from Chapter 7 to Chapter 13 and give notice. An example is attached. Below are the documents that should be filed with the conversion from Chapter 7 to Chapter 13:

1. Chapter 13 plan.
2. Amended Attorney Fee 2016 and disclosure of the Chapter 7 filing fee.
3. Amended Schedules I and J.
4. Amended Schedule A if there is a new appraisal done for Chapter 13 purposes so the information on A matches the appraisal.
5. Amended means test.
6. Equity analysis if required by your local Chapter 13 Trustee.
7. Amended Statement of Financial Affairs if there is a change in the legal fees paid.
8. Amend any other schedule to reflect correct information.
9. Chapter 13 Trustee should be sent the required documents. Do not assume the Chapter 7 trustee is sending them over.

## **CHAPTER 13 TO CHAPTER 7:**

This is where all the fun and litigation is taking place. There are a lot of reasons for converting from Chapter 13 to 7. The debtor has lost the income that has funded the plan, the debtor has decided not to keep an asset they thought they wanted before, change of circumstances (a car has blown up). Debtor may want to try to protect a post-petition asset from the trustee.

An important factor is that the day of the filing of the Chapter 13 controls for determination of the assets and the conversion date creates a look back for debts and filing date. Debtor files Chapter 13 on Feb 1, 2012 and converts the case to Chapter 7 on December 5, 2013. The Feb 1, 2012 is used to determine assets and their values. The December 5<sup>th</sup>, 2013 date is used for determining the debts that are included.

The day of the original filing is the date for determining the days between filing for eligibility. A debtor must be eligible for a Chapter 7 discharge on the day of the filing of the Chapter 13, not the day of the conversion. Technology should make this an easy determination.

Judge Waldron addressed this issue here:

*The court writes to address a recurring problem that should not occur in an era when technology has made information concerning a bankruptcy filing available, literally twenty-four/seven. The records of the Clerk establish the Debtors in this chapter 7 case, 02-36073 (the “present case”), had, on August 1, 1997, filed a chapter 7 case, 97-34330 (the “prior case”) and had received a chapter 7 discharge in that prior case on November 18, 1997. This present chapter 7 case was initially filed as a chapter 13 case on August 16, 2002 and was, on December 30, 2003, converted to a chapter 7 case. As a result of the Debtors’ prior chapter 7 case, it appeared the Debtors were not entitled to a chapter 7 discharge in this present case. The court, sua sponte, issued an Order (Doc. 81) fixing a time in which counsel for the Debtors could file a memorandum to support the grant of a chapter 7 discharge to the Debtors and prevent the dismissal of this present case. No memorandum was filed. The court determines the Debtors are not entitled to a chapter 7 discharge [11 U.S.C. § 727(a)(8)] and this present case must be dismissed [11 U.S.C. § 707(a)].*  
*IN Re Hiatt 312 BR 150 (Bankr. S.D. Ohio 2004)*

Converting from Chapter 13 to Chapter 7 is done by a Notice as opposed to a Motion. (Example attached). 11 USC 1307 (a) debtor may convert a case under this chapter to a case under Chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.

The United States Trustee or a party in interest may convert a Chapter 13 case to a Chapter 7 for several reasons 11USC 1301 (c):

- (1) unreasonable delay by the debtor that is prejudicial to creditors;*
- (2) nonpayment of any fees and charges required under chapter [123](#) of title [28](#);*
- (3) failure to file a plan timely under section [1321](#) of this title;*
- (4) failure to commence making timely payments under section [1326](#) of this title;*
- (5) denial of confirmation of a plan under section [1325](#) of this title and denial of a request made for additional time for filing another plan or a modification of a plan;*

- (6) material default by the debtor with respect to a term of a confirmed plan;*
- (7) revocation of the order of confirmation under section [1330](#) of this title, and denial of confirmation of a modified plan under section [1329](#) of this title;*
- (8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;*
- (9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section [521 \(a\)](#);*
- (10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section [521 \(a\)](#); or*
- (11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.*

Further the US Trustee or a party in interest can convert a case for failure to file tax returns (federal state, local).

### **WHAT DOCUMENTS ARE TO BE FILED?**

The next series of questions are what documents are required to be filed and when are they to be filed by? Most of the trustees in the district advise me that they do not receive anything.

Bankruptcy Rule 1019-B (1) requires the debtor to file not later than 14 days after conversion a Schedule of unpaid debts incurred after the filing of the petition and before the conversion of the case, including the name and address of each holder of a claim. Is that just the post-petition debts added by amendment or is that post-petition debts not added by amendment or both?

Bankruptcy Rule 1019-C in a case converted after confirmation requires that the debtor file a 1019 C (i) **a schedule of property not listed in the final report and account acquired after the filing of the petition but before conversion, except if the case is converted from chapter 13 to chapter 7 and §348(f)(2) does not apply;**

1. Amended Means Test. The clerk's office requires this. You could have a means test filed that will show the debtor is ineligible for Chapter 7 because it does not reflect the current income situation. You could file a motion under 101 (10A)(A)(ii) and request a new date for the filing of the means test. There may be a simpler way of dealing with this. File an amended I and J showing the current income and expense that resulted in the basis for the conversion and eligibility at this time. This can resolve the potential US Trustee issues.
2. Amended Schedules I and J.
3. Amendments adding in new creditors. Do not file an amended D, E, or F the clerks do not want to see that. Be prepared to pay the filing fee.
4. Amended 2016 legal fee disclosure.
5. Statement of Intent (if there are secured debts).
6. Any other schedule that reflects a change.
7. There is no local Rule 1019-B in the Southern District of Ohio

## **WHAT IS PROPERTY OF THE CONVERTED CASE?**

### **1. Who Gets the Money?**

There is a split amongst the jurisdiction as to who gets the undistributed post-petition funds on hand. Section 348 does not exactly address the funds paid to the Chapter 13 trustee that are being held by the trustee. These are the undistributed funds. Due to the debtor's monthly payment and the distribution rules of Chapter 13, there can be a considerable sum of money on hand. The cases clearly have come down and stated the money does not belong to the Chapter 7 Trustees. The question is do these funds belong to the Debtor or to the Chapter 13 Trustee for distribution to Creditors?

The two cases that evidence the split in the jurisdiction are **Vierelahn v Harris 2014 WL 3057095 (In Re Harris) (5<sup>th</sup> Cir. July 7 2014)** and **In re Michael 699 Fd 305 (3<sup>rd</sup> Cir. 2012)**. *Michael* held that the funds are to be returned to the debtor, while *Harris* adopted the dissent's position in *Michael* and held the funds belong to the trustee for distribution pursuant to the plan. The Chapter 13 Trustees in this district are holding onto the funds received through conversion and distributing to the creditors. Debtor counsel should be aware of the timing of the conversion and what funds are on hand.

### **2. WHO GETS THE PROPERTY**

What is property of the Chapter 7 estate if the Debtor converts from Chapter 13? 11 USC 348:

- (1) Except as provided in paragraph (2), when a case under chapter [13](#) of this title is converted to a case under another chapter under this title—
  - (A) 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;
  - (B) valuations of property and of allowed secured claims in the chapter 13 case shall apply only in a case converted to a case under chapter 11 or 12, but not in a case converted to a case under chapter 7, with allowed secured claims in cases under chapters 11 and 12 reduced to the extent that they have been paid in accordance with the chapter 13 plan; and
  - (C) with respect to cases converted from chapter 13—
    - (i) the claim of any creditor holding security as of the date of the filing of the petition shall continue to be secured by that security unless the full amount of such claim determined under applicable nonbankruptcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of an allowed secured claim made for the purposes of the case under chapter 13; and
    - (ii) unless a prebankruptcy default has been fully cured under the plan at the time of conversion, in any proceeding under this title or otherwise, the default shall have the effect given under applicable nonbankruptcy law.
- (2) If the debtor converts a case under chapter [13](#) of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

## **WINDFALLS**

What about windfalls, i.e. inheritance, life insurance, etc? Clearly under 11 USC 1306 (a) (1), the life insurance proceeds as after acquired property (ie after the 180 day rule) are property of the Chapter 13 estate but are not property of the Chapter 7 estate. **In Re Lynbrook** 951 F. 2d. 136 (7<sup>th</sup> Cir, 1991) ( note the 4<sup>th</sup> Circuit has a case pending on this issue **In Re Carroll** 2012 WL 5512356 (Bankr. E.D.N.C.2012) Is it bad faith to convert the case to Chapter 7 once you learn of the windfall? There are cases finding it to be bad faith. There are some cases finding it is not bad faith. **In Re Smith Case NO 10-60849** (Bank N.D. Ohio 2012). Debtor converts case claiming circumstances have changed and she cannot afford the plan payments after her husband passed away. Debtor spent \$75000 of the \$125000 life insurance between time of conversion and the Chapter 7 341 meeting. Court looked at the totality of the circumstances including what was paid to unsecured creditors in the Chapter 13. The court found she could have used the life insurance proceeds to fund the plan and found bad faith and ordered the balance of the life insurance funds turned over to the Chapter 7 Trustee. Contrast **In Re Gibson** Case # 01-17173 (Bankr S.D. Ohio 2008 Judge Hopkins). The debtor was able to keep the net proceeds of the \$100,000 personal injury award. The court decided that the post-petition accident contributed to a change of circumstance and the debtors were not attempting to manipulate the bankruptcy process. There is a discussion in this case of the trustee failing to object to the debtor's exemption.

## **WHO GETS THE EQUITY?**

Who gets the equity in the case? The debtor gets the equity in the property and the debtor should get credit for his payments to the unsecured creditors that occurred in the Chapter 13. Attached is the case of **In Re Ratliff** Case number 10-40652 (May 16, 2013) from the Northern District of Ohio, that analyzes the considerations. It finds that the debtor gets credit for the payments under the Chapter 13 that are paid to the unsecured creditors for the equity at the time of filing. This makes logical sense as why should the debtor have to pay out the equity twice once to the Chapter 13 estate and once to the Chapter 7 trustee. See also **In Re Sparks** 379 B.R. 178 (Bankr.M.D.Fla.2006)

## **THINGS TO WATCH OUT FOR WHEN CONVERTING FROM CHAPTER 13 TO CHAPTER 7**

1. The debtor loses the cramdown and the strip off. of liens. Maybe at the time of the conversion the debtor would be better served with a motion to redeem.
2. Look at the cars in the case. Has the lien been released? Is there money owed on the car? Can the Debtor reestablish the payments with the creditor to keep the car? Often time the payments are stretched out, lower interest and are only paying part of the debt.
3. Look at the funds on hand before converting. Depending on how the funds are distributed you may want to convert ASAP or let the case linger on. An example is a case that is paying class one creditors (mortgage or car payment) will continue to pay the class one creditors but if you convert some of that money may end up in the unsecured creditors hands.
4. Exemptions are determined on the day of the filing and this does not change
5. The Chapter 7 Trustee's rights may run from the original Chapter 13 341 Meeting i.e. preferences,

## CHAPTER 20

The Sixth Circuit Bap handed down a decision **IN RE CAIN** 14 FED App 0005 P Case No. 13-8045 (6<sup>th</sup> BAP) on July 14, 2014 with both Judge Humphrey and Judge Preston sitting, and found that the debtor in a Chapter 13, following a Chapter 7 discharge has the right to strip a wholly unsecured second mortgage from the property. This follows the recent 11<sup>th</sup> Circuit decision, **In Re Scantling** **2014 WL 2750349** (11<sup>th</sup> Circuit June 18, 2014). These cases are focusing on the wholly unsecured nature of the claim instead of the eligibility for discharge.