No.

IN THE

Supreme Court of the United States

CHARLES E. HARRIS, III,

Petitioner,

v.

MARY K. VIEGELAHN, CHAPTER 13 TRUSTEE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

J. TODD MALAISE
STEVEN G. CENNAMO
MALAISE LAW FIRM
909 N.E. LOOP 410, STE. 300
SAN ANTONIO, TEXAS
(210) 732-6699

MARK T. STANCIL
Counsel of Record
ALAN E. UNTEREINER
MATTHEW M. MADDEN
ROBBINS, RUSSELL, ENGLERT, ORSECK, UNTEREINER & SAUBER LLP
1801 K STREET, N.W., STE. 411L
WASHINGTON, D.C. 20006
(202) 775-4500
mstancil@robbinsrussell.com

QUESTION PRESENTED

Chapter 13 of the Bankruptcy Code allows debtors to repay their creditors by turning a portion of their monthly income over to a Chapter 13 trustee for distribution to those creditors. At any time, however, a debtor may convert a Chapter 13 bankruptcy case to one under Chapter 7. Congress has provided that "[e]xcept" where the conversion is made in bad faith, the resulting Chapter 7 estate is limited to the debtor's property "as of the date" the original Chapter 13 petition was filed; it does not include wages or property that the debtor acquired *after* the petition date. 11 U.S.C. § 348(f).

The question presented is:

Whether, when a debtor in good faith converts a bankruptcy case to Chapter 7 after confirmation of a Chapter 13 plan, undistributed funds held by the Chapter 13 trustee are refunded to the debtor (as the Third Circuit held in *In re Michael*, 699 F.3d 305 (2012)) or distributed to creditors (as the Fifth Circuit held below).

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PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Fifth Circuit (App., *infra*, 1a–28a) is reported at 757 F.3d 468. The district court's decision (App., *infra*, 29a–49a) is reported at 491 B.R. 866. The bankruptcy court's opinion (App., *infra*, 50a–51a) is unreported.

JURISDICTION

The Fifth Circuit issued its decision on July 7, 2014. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

In pertinent part, 11 U.S.C. § 1307(a) provides:

> The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time.

In pertinent part, 11 U.S.C. § 348 provides:

> (e) Conversion of a case under section 706, 1112, 1208, or 1307 of this title terminates the service of any trustee or examiner that is serving in the case before such conversion.
>
> (f)(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;

* * * * *

(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.

11 U.S.C. § 1327(b) provides:

Except as otherwise provided in the plan or the order confirming the [chapter 13] plan, the confirmation of a plan vests all of the property of the estate in the debtor.

STATEMENT

This case presents an opportunity to resolve a recurring and important question of bankruptcy law that has "divided courts for thirty years" (App., *infra*, 2a) and on which two courts of appeals are now in acknowledged disagreement. This persistent division concerns whether a debtor is entitled to funds held by a trustee pursuant to a confirmed Chapter 13 plan when a debtor exercises his right to convert his bankruptcy case to a proceeding under Chapter 7. In the decision below, the Fifth Circuit required those funds to be distributed to petitioner's creditors (*id.* at 1a–28a); in contrast, the Third Circuit requires the return of such funds to the debtor (*In re Michael*, 699 F.3d 305 (2012)).

Under Chapter 7, creditors are paid out of the debtor's *pre-petition* assets (and *only* those assets). Under Chapter 13, by contrast, the debtor's estate

includes his *post-petition* income, which is most often what is used to pay his creditors. In exchange for a debtor's voluntary election to pay creditors in Chapter 13 out of his future income—funds that would be off-limits in a Chapter 7 proceeding—a Chapter 13 plan generally allows the debtor to continue to possess and use pre-petition assets that he might otherwise have to relinquish to creditors (such as a house or an automobile). "The Chapter 13 bankruptcy tends to be favored by debtors who have fallen behind on secured loan payments, such as mortgages and car loans, since it enables the debtor to maintain possession of the property while catching up on payments through a court-approved re-payment plan." App., *infra*, 36a.

A debtor has the right to convert his bankruptcy proceeding from Chapter 13 to Chapter 7 "[a]t any time during the Chapter 13 proceeding." App., *infra*, 37a (citing 11 U.S.C. § 1307(a)). "[C]onversion from Chapter 13 to Chapter 7," the Fifth Circuit recognized, "'necessarily ends the Chapter 13 case, which also terminates that Chapter 13 estate.'" *Id.* at 18a (quoting *In re Michael*, 699 F.3d at 313)). In the absence of a showing that the conversion was done in bad faith, the converted case "is effectively backdated to the date on which the Chapter 13 petition was filed" and the "'property of the estate'" in Chapter 7 is that which existed "'*as of the date of filing of the [Chapter 13] petition*.'" *Id.* at 37a (quoting 11 U.S.C. § 348(f)(1)(A)) (emphasis and alteration in original).

The Fifth Circuit held that, notwithstanding such a good-faith conversion, a Chapter 13 trustee should distribute any funds in its possession to creditors. The Third Circuit, in contrast, has held

that such funds should be refunded to the debtor. In short, a debtor's "fresh start" in bankruptcy is routinely thousands of dollars fresher in the Third Circuit (and many bankruptcy courts) than it is in the Fifth Circuit (and many other bankruptcy courts).

This Court's guidance is needed to resolve that split and to provide uniformity in the administration of the Nation's bankruptcy laws. The issue presented is undeniably recurring and important: Each year approximately 320,000 Chapter 13 proceedings are initiated, of which 60,000 are eventually converted to Chapter 7. See *infra* pages 29–30. At the same time, the monetary stakes are often too small, or the resources of debtors too meager, to justify not only litigating the issue in bankruptcy court but also pursuing multiple appeals to the district court and the court of appeals, thus ensuring that the issue has rarely been presented for this Court's review. This case is an excellent vehicle for resolving this pure question of law.

A. The Bankruptcy Court Proceedings

In early 2010, Petitioner Charles E. Harris, III, fell $3,700 behind on his home mortgage. App., *infra*, 3a. As a result, he filed for relief under Chapter 13 of the Bankruptcy Code. *Ibid.* Harris proposed a payment plan under which he would resume paying his mortgage, and his mortgage arrears and other debts would be repaid in full over 60 months out of $530 garnished from his wages each month by Respondent Mary K. Viegelahn, the Chapter 13 Trustee. *Id.* at 3a–4a. The bankruptcy court confirmed that plan in April 2010. *Id.* at 30a.

Petitioner was not able to keep his mortgage current. Accordingly, in November 2010 his mortgagor received (without opposition from petitioner) relief from the automatic bankruptcy stay to begin foreclosure proceedings on petitioner's home. App., *infra*, 4a. At that point, as required by petitioner's confirmed Chapter 13 plan, respondent stopped distributing $372 of petitioner's monthly wages to his mortgagor because the mortgagor had been granted leave to seek repayment of petitioner's mortgage arrears through foreclosure. *Ibid.*

Having failed to save his home, petitioner filed a notice converting his case to Chapter 7 in November 2011. Section 1307(a) of the Bankruptcy Code entities a Chapter 13 debtor to convert his case to Chapter 7 "at any time." Whereas Chapter 13 provides for creditors to be paid out of a portion of the debtor's future wages, Chapter 7 provides for repayment from the liquidation of property interests held by the debtor on the date he filed his original bankruptcy petition (subject to certain statutory exceptions). Compare 11 U.S.C. § 541 with *id.* § 1306. Any property the debtor acquired *after* his original petition date (including his post-petition wages) is not property of the Chapter 7 estate once the debtor has made a good-faith conversion. *Id.* § 348(f). A conversion to Chapter 7 also automatically "terminates the service" of the Chapter 13 trustee. *Id.* § 348(e). It is undisputed that petitioner's conversion to Chapter 7 was done in good faith.

At the time of petitioner's conversion, and after petitioner had assigned some funds to pay his attorneys' fees, respondent held $4,319.22 of petitioner's post-petition garnished wages. App.,

infra, 5a. Notwithstanding the conversion of petitioner's case to Chapter 7, respondent distributed those post-petition wages to petitioner's creditors, instead of returning them to petitioner. Petitioner moved to compel the refund of that money as having been distributed without authority.

The bankruptcy court granted petitioner's motion, ordering respondent to refund to petitioner the money she had distributed to creditors after petitioner's conversion to Chapter 7. Respondent appealed, and the bankruptcy court stayed its order upon respondent's posting of a $10,000 bond.[1]

B. The District Court's Decision

The district court affirmed the bankruptcy court's refund order. App., *infra*, 29a–49a. The court "agree[d] with the Third Circuit's reasoning" in *In re Michael*, 699 F.3d 305 (2012), that "the funds in question must be returned to the debtor." App., *infra*, 34a. The court acknowledged the deep division among bankruptcy courts on that issue, and found "more persuasive" the reasoning of those courts that had agreed with the bankruptcy court's position—

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[1] Petitioner's case thereafter proceeded under Chapter 7. With his home and mortgage out of the case, petitioner's only remaining assets were exempt from his estate under 11 U.S.C. § 522(b)(2). Accordingly, debtor's newly appointed Chapter 7 trustee reported to the court in December 2011 what had been true for months: Petitioner had "no property available for distribution from the estate over and above that exempted by law." On February 23, 2012, the bankruptcy court granted petitioner a discharge pursuant to Section 727 of the Bankruptcy Code.

"including, most recently, the Third Circuit." *Id.* at 43a

The district court reasoned that returning any undistributed funds to the debtor upon conversion was necessary to maximize a debtor's incentive to try to repay his creditors by proceeding under Chapter 13 in the first place. App., *infra*, 43a. The Bankruptcy Code, the court explained, implements a "Congressional policy of encouraging debtors to attempt a Chapter 13 bankruptcy—through which a debtor will pay his creditors at least as much and likely more than he would have under Chapter 7." *Ibid.* Such a policy can be achieved only if the debtor can convert to Chapter 7 "without penalty if that attempt fails." *Ibid.*

In fact, the court explained, the rule urged by the trustee "would create" a powerful reason for debtors to *avoid* Chapter 13 altogether—"precisely the kind of disincentive to file a Chapter 13 bankruptcy that Congress was trying to avoid." App., *infra*, 47a. A debtor's post-petition wages, the court noted, are not included in a Chapter 7 estate, and a debtor who elects to proceed under Chapter 7 from the start puts those funds beyond the reach of his creditors. But a debtor who chooses to put those funds *within reach* of his creditors in order to attempt to make a Chapter 13 plan work should not be penalized by the loss of more of those funds to his creditors after such a plan has proven unworkable. A Chapter 13 trustee's *post-conversion* disbursement to creditors of a debtor's post-petition wages, the court held, is antithetical to that policy. *Id.* at 43a–45a; see also *id.* at 45a ("'If debtors must take the risk that property acquired during the course of an attempt at

repayment will have to be liquidated for the benefit of creditors if chapter 13 proves unavailing, the incentive to give chapter 13—which must be voluntary—a try will be greatly diminished'" (quoting *In re Bobroff*, 766 F.2d 797, 803 (3d Cir. 1985)).

This case, the district court added, provides a telling illustration of the potential disincentives to using Chapter 13 that would arise if the funds in question were distributed to creditors rather than returned to the debtor:

> Here, Debtor attempted to repay his debts under Chapter 13, making payments under the confirmed plan for more than a year and a half. There is no dispute that the funds at issue would not have been part of the Chapter 7 estate if Debtor had filed a Chapter 7 petition originally; nor does the Trustee allege that Debtor converted to Chapter 7 in bad faith.

Id. at 47a–48a.

To whatever extent its holding might "incentivize bad-faith conversions" to "'game the system,'" the court stated that Section 348(f)(2) of Bankruptcy Code provided Congress's response. Under that provision, the result of a *bad-faith* conversion is that all debtor's property *on the date of conversion* (including any post-petition wages) is included in the "property of the estate" in the resulting Chapter 7 case. *Id.* at 47a. Indeed, the district court reasoned, Congress's answer to bad-faith conversions in Section 348(f)(2) "provides additional support for the idea that Congress would

want the disputed funds to be returned to [the] [d]ebtor" upon his good-faith conversion. *Ibid.*

Finally, the district court observed that there is "nothing unfair about returning [undistributed, post-petition wages] to a debtor rather than to his creditors." App., *infra*, 45a. During the pendency of the Chapter 13 case, creditors would already "'have had the benefit of distribution from debtors' wage contributions, which would not have been available to them under Chapter 7.'" *Id.* at 45a–46a (quoting *In re Boggs*, 137 B.R. 408, 410 (Bankr. W.D. Wash. 1992)). Given that creditors had already received value to which they were entitled only at the debtor's election, "'there seems no inherent inequity in refunding undisbursed wage contributions to debtors on conversion.'" *Id.* at 46a (same).

C. The Court of Appeals' Decision

Respondent appealed a second time, and the court of appeals reversed. The Fifth Circuit held that, notwithstanding petitioner's good-faith conversion to Chapter 7, his post-petition wages were appropriately distributed to his creditors under his Chapter 13 plan. The court of appeals recognized that this "question of law" is one that "has divided courts for thirty years." App., *infra*, 2a. In addition to the Third Circuit's contrary decision in *In re Michael*, the Fifth Circuit cited eight bankruptcy court "[o]pinions holding that the funds should be returned to the debtor," and twelve bankruptcy court "[o]pinions holding that the funds should be distributed to creditors." *Id.* at 2a n.1.

Unlike the Third Circuit, the Fifth Circuit found "little guidance in the Bankruptcy Code." App., *infra*,

22a. It turned instead "to considerations of equity and policy," and in doing so relied heavily on Judge Roth's dissent from the Third Circuit's *In re Michael* decision to conclude that such considerations favor creditors rather than debtors. See *id.* at 22a–28a.

Again acknowledging contrary decisions by the Third Circuit and numerous bankruptcy and district courts, the court of appeals concluded that, although "payments made under the plan do not give creditors any vested rights to payment, * * * the creditors' claim to the undistributed funds is superior to that of the debtor." App., *infra*, 28a.

REASONS FOR GRANTING THE PETITION

I. The Court Of Appeals' Decision Conflicts With The Third Circuit And Deepens The Widespread Division Among Lower Courts

The court of appeals acknowledged that its decision conflicts with the Third Circuit's decision in *In re Michael*, 699 F.3d 305 (2012), and that this issue "has divided courts for thirty years." App., *infra*, 2a. This Court should grant the petition in order to resolve that longstanding dispute and settle this important and recurring question of bankruptcy law.

A. The Third Circuit, presented with nearly identical facts in a case two years ago, reached the opposite conclusion from that reached by the court of appeals below. The Third Circuit held that "undistributed plan payments held by a Chapter 13 trustee at the time of conversion must be returned to the debtor absent bad faith." *In re Michael*, 699 F.3d at 316.

In *Michael*, as here, the debtor's Chapter 13 plan required regular mortgage payments outside the plan and monthly wage garnishments from which the Chapter 13 trustee would pay debtor's mortgage arrears and unsecured consumer debt. 699 F.3d at 307. After confirmation of the plan, the debtor again fell behind on his mortgage. *Ibid.* His mortgagor received relief from the automatic bankruptcy stay to foreclose on debtor's home. *Ibid.* The trustee tried to continue sending debtor's mortgagor the same portion of the monthly wage garnishments as before, but the mortgagor refused those payments because of its relief from the stay and commencement of foreclosure proceedings. *Ibid.* Having been unable to salvage his home by proceeding in Chapter 13, the debtor converted his case to Chapter 7 more than three years later.

By that time, the Chapter 13 trustee had accumulated nearly ten thousand dollars in debtor's post-petition wages because of the distributions refused by the mortgagor. 699 F.3d at 307. Both the bankruptcy court and the district court ordered the Chapter 13 trustee to return any undistributed funds, post-conversion, to the debtor. *Id.* at 307–08. The Third Circuit affirmed. In a majority opinion by Judge Ambro, the court held that, although "the Code provide[s] no clear answer to this question," *id.* at 308, a number of its provisions compel the conclusion that Congress intended for undistributed funds to be returned to the debtor, *id.* at 308–10. As explained below, the Fifth Circuit in this case expressly disagreed with each step in the Third Circuit's analysis.

First, the Third Circuit pointed to Section 348(f). 699 F.3d at 308. Section 348(f) states that funds held by a Chapter 13 trustee when a debtor converts his case to Chapter 7 do not become property of the Chapter 7 estate unless the conversion is made in bad faith. 11 U.S.C. § 348(f). Although Section 348(f) does not "resolve explicitly" whether those funds get returned to the debtor or distributed to his creditors, the Third Circuit concluded that "§ 348(f)'s language and legislative history express Congress's preference as to what property belongs to a debtor after conversion, and ultimately direct our decision." 699 F.3d at 308–09; see also *id.* at 314 (explaining that the history of Section 348(f) "supports that Congress's intended outcome is that payments held by the Chapter 13 trustee revert to the debtor on conversion"). The court further reasoned that "§ 348(f)(2) logically requires that a debtor receive the property if he acts in good faith" by providing that "a debtor who converts in bad faith is not entitled to this post-petition property." *Ibid.*

According to the Fifth Circuit, however, the Third Circuit "fail[ed] to recognize that undistributed post-petition wages * * * constitute only a subset of the debtor's post-petition property." App., *infra*, 21a. Therefore, in the Fifth Circuit's view, "distributing the remaining payments held by the trustee at the time of conversion neither renders § 348(f)(2) superfluous nor removes the disincentive for bad faith in most cases." *Id.* at 22a.

Second, the Third Circuit in *Michael* examined Section 348(e) of the Bankruptcy Code, which "'terminates the service[]' of the Chapter 13 trustee" when a case is converted to Chapter 7. 699 F.3d at

310 (quoting 11 U.S.C. § 348(e)). Termination of the trustee's service upon conversion, Judge Ambro explained, "seemingly renders [the trustee] powerless to make payments to creditors under a Chapter 13 plan." *Ibid.* The trustee retains certain ancillary duties, post-conversion, "to account for the funds that came into his possession by filing a final report under Federal Rule of Bankruptcy Procedure 1019(5)(B)(ii)," *ibid.*, but those "limited duties" do not imply "that he is permitted to distribute funds under a plan that is no longer operative," *id.* at 314.

The Fifth Circuit, by contrast, thought that the Third Circuit had taken the language of Section 348(e) "'too literally.'" App., *infra*, 10a (quoting *In re Parrish*, 275 B.R. 424, 430 (Bankr. D.D.C. 2002)). "'[T]here is no logical reason,'" the court believed, "'why distribution of funds pursuant to the previously confirmed reorganization plan cannot be included" among the Chapter 13 trustee's post-conversion "administrative duties." App., *infra*, 11a (quoting *In re Michael*, 699 F.3d at 320 n.8 (Roth, J., dissenting)).

Finally, the Third Circuit construed Section 1327(b) of the Bankruptcy Code as requiring the undistributed wages to be returned to the debtor. Section 1327(b) provides that confirmation of a Chapter 13 plan "vests all of the property of the estate in the debtor" "[e]xcept as otherwise provided in the plan or the order confirming the plan." 11 U.S.C. § 1327(b). "The implication" of that directive, the Third Circuit concluded, "is that property held by the Chapter 13 Trustee after plan confirmation is 'under the control of the debtor as of the date of [a

later] conversion' for purposes of § 348(f)(1)." 699 F.3d at 310 (alteration in original).

The Third Circuit also noted that the Ninth Circuit had reached the same conclusion by relying on Section 1327(b)'s counterpart in Chapter 12 of the Bankruptcy Code (which applies to family farmers and fishermen). *Ibid.* (citing *Arkison* v. *Plata (In re Plata)*, 958 F.2d 918, 922 (9th Cir. 1992)). In *Plata*, the Ninth Circuit relied on cases construing Chapter 13 to hold that "postconfirmation funds held by the Chapter 12 trustee but remaining unpaid to creditors at the time the Chapter 12 case was converted to a Chapter 7 liquidation revested in Debtors at the time of the conversion." 958 F.2d at 922. Where nothing in the confirmed Chapter 12 plan "either required or even provided for the later payment by the trustee of any undisbursed funds to creditors in the event of a conversion to Chapter 7," a debtor's vested rights in the property of the estate at plan confirmation controlled. *Ibid.*[2]

Once again, the Fifth Circuit rejected this analysis, concluding that it "ignor[ed] the clear exception to this general rule" for actions required by the confirmed plan. App., *infra*, 19a. As the Fifth Circuit viewed the statute, when a Chapter 13 plan calls for funds to be collected and distributed by a

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[2] There is every reason to believe that the Ninth Circuit would reach the same conclusion with respect to a conversion from Chapter 13 to Chapter 7. At least one bankruptcy court in that Circuit has already concluded that *Plata* controls the same question under Chapter 13. *In re Horne*, No. 97-20171, 2002 WL 33939743, at *4 (Bankr. D. Idaho Jan. 10, 2002).

trustee, the plan excludes such funds from the "property of the estate" that "vests" "in the debtor." See *id.* at 18a–19a.

In addition to its statutory analysis, the Third Circuit concluded that policy considerations favor requiring Chapter 13 trustees to return undistributed funds to the debtor upon conversion. The Third Circuit sided with bankruptcy courts that have concluded there is "nothing 'unjust' in returning undistributed plan payments to a debtor." 699 F.3d at 312 (citing *In re Boggs*, 137 B.R. at 410). After all, the court explained, "creditors ultimately will receive as much, if not more, than they would have received if the debtor initially had filed under Chapter 7." *Ibid.* Moreover, returning undistributed funds to debtors "furthers Congress's preference that on conversion to Chapter 7 a Chapter 13 debtor receive all post-petition property that is held by the Chapter 13 trustee, but still is under the control of the debtor, so that debtors are encouraged to attempt to repay their debts through reorganization rather than liquidation." *Id.* at 316. A contrary rule, the Third Circuit emphasized, "would dissuade debtors from filing under Chapter 13" in the first place. *Id.* at 315.

In the Fifth Circuit's view, however, "[b]oth the district court in this case and the Third Circuit in *Michael*" placed too much weight on "a congressional policy of encouraging debtors to attempt repayment through Chapter 13 and removing disincentives that would discourage this." App., *infra*, 22a. A debtor would not be "meaningfully deterred" from pursuing reorganization under Chapter 13, the court posited, "by the knowledge that payments made under a confirmed Chapter 13 plan will not be returned to

him if he chooses to convert to Chapter 7." *Id.* at 24a. In that respect, the court agreed with Judge Roth's dissenting opinion in *Michael* that post-petition wages are different from other property the debtor acquires after filing a bankruptcy petition. *Id.* at 23a–26a. The Fifth Circuit likewise sided with Judge Roth in concluding that "strong considerations of fairness" supported post-conversion payments to creditors. *Id.* at 26a. In particular, it held that "'the attached wages are the *quid pro quo* that the debtor has given up during the pendency of the reorganization in return for being permitted to stave off foreclosure and cure the mortgage default * * * and enjoy the automatic stay.'" *Id.* at 26a–27a (quoting *In re Michael*, 699 F.3d at 319 (Roth, J., dissenting)).

In sum, the Third Circuit's decision in *Michael* is squarely at odds with the Fifth Circuit's decision below. The two Circuits addressed essentially identical facts, and their resulting decisions demonstrate a sharp disagreement over what both the Bankruptcy Code and Congressional bankruptcy policy require. Each Circuit fully developed its view of the law in a careful opinion, and future decisions by other courts of appeals will likely just fall in behind one or the other side in this debate. There is no reason to believe this split among the circuits will resolve itself, and every reason to believe it will continue to deepen.

B. As the court of appeals recognized below, its acknowledged disagreement with the Third Circuit reflects a contested legal issue that "has divided courts for thirty years." App., *infra*, 2a. And so it has. On at least ten occasions, a bankruptcy court, district court, or bankruptcy appellate panel has held

(like the Third Circuit in *Michael*) that undistributed funds held by a Chapter 13 trustee should be refunded to the debtor upon conversion.[3] By contrast, on at least fifteen occasions, a bankruptcy court has held (like the court of appeals below) that such funds should be distributed to creditors.[4] These 25

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[3] *In re Murphy*, Nos. 09-81861, 12-30813, 2014 WL 2600168, at *2–*3 (Bankr. M.D. Ala. Feb. 11, 2014); *Gallagher* v. *Dockery (In re Gallagher)*, No. CC-13-1368-TaKuPa, 2014 WL 998411, at *6 (B.A.P. 9th Cir. Mar. 17, 2014); *In re Krahenbuhl*, No. 09-29618-svk, 2013 WL 3793405, at *2 (Bank. E.D. Wisc. July 19, 2013); *In re Harris*, App., *infra*, 29a–49a; *In re Harris*, App., *infra*, 50a–51a; *In re Horne*, No. 97-20171, 2002 WL 33939743, at *4 (Bankr. D. Idaho Jan. 10, 2002); *DeHart* v. *Michael (In re Michael) ("Michael II")*, 446 B.R. 665, 667 (M.D. Pa. 2011); *In re Michael ("Michael I")*, 436 B.R. 323, 331 (Bankr. M.D. Pa. 2010); *In re Boggs*, 137 B.R. 408, 410–11 (Bankr. W.D. Wash. 1992); *In re Bullock*, 41 B.R. 637, 638–41 (Bankr. E.D. Pa 1984).

[4] *In re Smith*, 511 B.R. 612, 620–21 (Bankr. W.D. Mo. 2014); *In re Markham*, 504 B.R. 1, 8 (Bankr. D. Mass. 2013); *Spero* v. *Porreco (In re Porreco)*, 426 B.R. 529, 537 (Bankr. W.D. Pa. 2010) (overruled by *In re Michael*); *Chase* v. *Winnecour (In re Chase)*, No. 03-10092, 2008 WL 2309529, at *1 (Bankr. W.D. Pa. June 4, 2008) (overruled by *In re Michael*); *In re Pegues*, 266 B.R. 328, 334 (Bankr. D. Md. 2001); *In re Salisbury*, No. 99-10431C-7G, 2000 WL 33673758, at *2 (Bankr. M.D.N.C. Nov. 17, 2000); *In re Bell*, 248 B.R. 236, 239–40 (Bankr. W.D.N.Y. 2000); *In re Hardin*, 200 B.R. 312, 314 (Bankr. E.D. Ky. 1996); *O'Quinn* v. *Brewer (In re O'Quinn)*, 143 B.R. 408, 413 (Bankr. S.D. Miss. 1992); *In re Galloway*, 134 B.R. 602, 602–04 (Bankr. W.D. Ky. 1991); *In re Halpenny*, 125 B.R. 814, 815–16 (Bankr. D. Haw. 1991); *In re Milledge*, 94 B.R. 218, 219–20 (Bankr. M.D. Ga. 1988); *Ledford* v. *Burns (In re Burns)*, 90 B.R. 301, 305 (Bankr. S.D. Ohio 1988); *Waugh* v. *Saldamarco (In re Waugh)*, 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) (overruled by

decisions, moreover, are just those in which a bankruptcy or district judge entered a written opinion on the question presented in this case; it stands to reason that the same issue has been determined on the record or by unadorned order countless times more.

This three-decade-old division is also deepening with time. In just the two years since *Michael*, the Ninth Circuit's bankruptcy appellate panel and bankruptcy courts in Alabama and Wisconsin have adopted the Third Circuit's approach (see *supra* note 3 (citing cases)), but bankruptcy courts in Missouri and Massachusetts have adopted the approach taken by the Fifth Circuit below (see *supra* note 4 (citing cases)).

Each of these conflicting decisions resolved the fate of funds meaningfully important to an individual debtor seeking a "fresh start" out of bankruptcy. Yet these sums of money—in the thousands or tens or thousands of dollars—are often not enough to justify a debtor's expenditure of limited resources to pursue one or multiple appeals. Perhaps for that reason, there have not been a large number of decisions on this issue by the Circuits. This case therefore provides this Court a somewhat rare opportunity to address and resolve a recurring question of bankruptcy law that is of tremendous practical importance and has caused problems for the bankruptcy and district courts for three decades.

In re Michael); *In re Redick*, 81 B.R. 881, 887 (Bankr. E.D. Mich. 1987).

II. The Decision Below Is Erroneous

As the Third Circuit correctly held in *Michael*, the Bankruptcy Code points—more than once—toward a requirement that Chapter 13 trustees return undistributed payments to a debtor upon conversion to Chapter 7. Such a rule is also consistent with the policy choices Congress expressed in those Code provisions by providing incentives for debtors to attempt Chapter 13 reorganizations.

A. Numerous provisions of the Bankruptcy Code show that Congress intended for Chapter 13 trustees to return undistributed funds to the debtor upon conversion to Chapter 7.

1. Returning undistributed funds to the debtor upon conversion follows from the text of Section 348, which governs the effect of conversion from Chapter 13 to Chapter 7. Two subsections of Section 348 provide debtors the ability to make a clean break with their Chapter 13 proceeding without any penalty.

Section 348(f) states that, "[e]xcept" when a debtor has acted bad faith, the post-conversion Chapter 7 estate comprises only the debtor's *petition-date* property, and none of the *post-petition* property (including wages) that was in the Chapter 13 estate. Until 1994, the Circuits were split over whether funds held by the Chapter 13 trustee at conversion became part of the Chapter 7 estate (with those courts answering "no" in turn split over whether the debtor or his creditors get them). App., *infra*, 5a–6a. "In 1994, Congress resolved the circuit split by enacting 11 U.S.C. § 348(f)." *Id.* at 6a. In adopting Section 348(f), therefore, Congress considered *but*

rejected making a debtor's undistributed, post-petition wages and other property available to his creditors after conversion through the resulting Chapter 7 estate. As a House Report accompanying the amendment stated, Congress's intent was to avoid the "serious disincentive" to attempting a Chapter 13 reorganization if a Chapter 7 estate included debtor's post-petition property *only in a converted case*. See *id.* at 7a–9a (quoting H.R. Rep. No. 103-835, at 57 (1994)).

In short, the Chapter 13 estate that includes debtors' post-petition wages terminates upon conversion, and the resulting Chapter 7 estate does not include those wages. It would be passing strange to think that Congress intended to permit an end-run around the legislative choice embodied in Section 348(f) by which funds that were *not* to be included in the Chapter 7 estate would nonetheless find their way to creditors. There is simply no statutory authority for the distribution to creditors of funds that are no longer the property of *any* estate.

What is more, to prevent debtors from taking advantage of this feature of the bankruptcy process, Congress provided that the Chapter 7 estate *would* retain a debtor's post-petition property if the debtor had converted his case *in bad faith*. 11 U.S.C. § 348(f)(2). That limited "except[ion]" built into the text of Section 348(f) necessarily indicates that debtors who convert their cases *in good faith* will *retain* all of their post-petition property (including undistributed post-petition wages). See *In re Michael*, 699 F.3d at 314.

The Fifth Circuit below sought to side-step that inference by noting that "undistributed post-petition

wages" are "only a subset of the debtor's post-petition property" to which the bad-faith exception applies. App., *infra*, 21a. Accordingly, the court believed, its holding would not render Congress's penalty for bad-faith conversion "superfluous." *Id.* at 21a–22a. Superfluity is not the issue, however. The point is that a debtor's post-petition wages are *among* the property that Congress intended debtors to keep upon a good-faith conversion to Chapter 7, but to lose to the Chapter 7 estate upon a bad-faith conversion. It is no answer to say, as the court of appeals did, that *most* of Congress's intent is unaffected by carving out only *part* of what it intended.

2. Moreover, Section 348(e) provides that conversion "terminates the service" of the Chapter 13 trustee. 11 U.S.C. § 348(e). That provision, as the Third Circuit concluded, incapacitates the trustee from continuing to distribute the property of the former Chapter 13 estate to creditors. See *In re Michael*, 699 F.3d at 310 (holding that Section 348(e) "seemingly renders [the trustee] powerless to make payments to creditors under a Chapter 13 plan" after conversion).

The Fifth Circuit thought that the Third Circuit had taken the language of Section 348(e) "'too literally.'" App., *infra*, 10a (quoting *In re Parrish*, 275 B.R. at 430). "'[T]here is no logical reason,'" the court believed, "'why distribution of funds pursuant to the previously confirmed reorganization plan cannot be included" among the Chapter 13 Trustee's post-conversion "administrative duties." App., *infra*, 11a (quoting *In re Michael*, 699 F.3d at 320 n.8 (Roth, J., dissenting)). Yet the ancillary "administrative duties" a Chapter 13 trustee has after conversion—

principally to account for the former Chapter 13 estate in a final report—is not the "service" that Section 348(e) is intended to "terminate[]." It is the trustee's role as the debtor's disbursing agent—collecting funds from the debtor and distributing those funds to creditors—that is meant to cease upon conversion. Restoring to a debtor any garnished wages that were not distributed while the trustee was still performing that "service" is a mere administrative duty in a way that continuing to parcel out those funds to creditors is not.

3. Section 1327(b) states that confirmation of a Chapter 13 plan "vests all of the property of the estate in the debtor" "[e]xcept as otherwise provided in the plan or the order confirming the plan." 11 U.S.C. § 1327(b). That "property of the estate" undoubtedly includes debtor's post-petition wages. 11 U.S.C. § 1306(a)(2). Whether such funds are held by the Chapter 13 trustee or by the debtor, they are property of the estate, vested in the debtor, unless and until those funds are distributed to creditors. Indeed, the court of appeals recognized that creditors lack any vested interest in such funds until they receive them. App., *infra*, 14a–18a (rejecting respondent's contrary argument).

When a Chapter 13 case is converted after plan confirmation, however, the Chapter 13 estate ceases to exist. The former "property of the estate" that was vested in the debtor upon plan confirmation (§ 1327(b)) *remains* vested in the debtor, and it must be returned to the debtor under settled principles of property law.

In holding otherwise, the court of appeals focused on Section 1327(b)'s caveat for contrary

vesting rights established by the confirmed plan or confirmation order. App., *infra*, 19a–20a. The court concluded that petitioner's Chapter 13 plan, by providing for monthly payments to respondent, had extinguished petitioner's vested interest in those funds. "[T]he debtor certainly does not retain possession of these payments," the court stated, and so "it would seem that the confirmation order specifically divests the debtor of any interest he may have in the payments made to the trustee." *Id.* at 20a. Not so. Prior to conversion, funds held by the debtor or by the trustee were in either case "property of the estate"; the presumption in Chapter 13 is that the debtor will *possess* the property of the estate, but the plan may direct otherwise. See 11 U.S.C. § 1306(b). As the Third Circuit held in *Michael*, the fact that some property of the estate is held by the trustee has no bearing on debtor's vested interest in all of that property. 699 F.3d at 313; see also *In re Plata*, 958 F.2d at 922 (reaching the same conclusion under Chapter 12's corresponding provision for bankrupt family farmers and family fishermen, 11 U.S.C. § 1227(b)).

Such a reading of Section 1327(b) is consistent with other provisions of the Bankruptcy Code that require the trustee to return funds to the debtor under other circumstances. See *United Sav. Ass'n of Tex.* v. *Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988) ("Statutory construction * * * is a holistic endeavor."). If a Chapter 13 plan is not confirmed, Section 1326(a)(2) requires that any funds the debtor has already paid to the trustee be restored to the debtor. Likewise, if a Chapter 13 case is dismissed, Section 349(b)(3) requires funds held by the trustee to be returned to the debtor. Creating a

different rule for conversions is nonsensical. If petitioner had moved to dismiss his Chapter 13 case instead of converting it, there is no dispute that respondent would have refunded any undistributed funds to him under Section 349(b)(3). There is "no justification for requiring a debtor to dismiss, rather than convert * * * in order to preserve" certain benefits, and any contrary requirement "creat[es] a trap for the unwary," "elevate[s] form over substance," and "inject[s] a needless degree of extra work on the part of all concerned." *In re Plata*, 958 F.2d at 922; see also *In re Michael*, 699 F.3d at 313–14 n.6.

B. After erroneously concluding that there is "little guidance in the Bankruptcy Code" bearing on this question, the court of appeals "turn[ed] to considerations of equity and policy" to fill the perceived gap. App., *infra*, 22a. In doing so, the court understated the disincentives its rule creates for debtors who are contemplating reorganization under Chapter 13, and overstated the "strong considerations of fairness" it perceived as demanding post-conversion distributions to creditors. *Id.* at 26a.

1. The decision below produces a significant disincentive against a debtor *continuing* to proceed in Chapter 13 after a change in circumstances. In this case, for example, petitioner's mortgagor received relief from the stay, and the trustee began to withhold the portion of petitioner's garnished wages that his Chapter 13 plan directed to that mortgagor. App., *infra*, 4a–5a. For a year thereafter, however, petitioner continued to make a go of his Chapter 13 plan. As a result, $158 of his monthly wages kept flowing to his other creditors.

This was an unmitigated benefit to those creditors. If petitioner had converted to Chapter 7 immediately when his mortgagor received relief from the stay, those payments never would have been made. Petitioner's modest assets (after losing his home) were exempt from a Chapter 7 liquidation, see *supra* note 1, so his creditors stood to receive nothing from the estate once he converted his case. He kept paying them anyway. But if petitioner had known that, by delaying conversion and continuing in Chapter 13, his other creditors would also end up obtaining the withheld funds his plan intended for his mortgagor, petitioner's most rational choice would have been to abandon Chapter 13 (and his creditors) at the first available opportunity.

The court of appeals' decision also provides a disincentive to attempting a repayment plan under Chapter 13 in the first place. From the debtor's perspective, one of the most significant differences between Chapter 13 and Chapter 7 is that in Chapter 13—but not Chapter 7—wages and property the debtor acquires *after* the petition date become "property of the estate." Compare 11 U.S.C. § 1306 (Chapter 13) with *id.* § 541 (Chapter 7). That provides a benefit to a debtor, who can repay his creditors out of his future income and stave off the liquidation of his house, car, and other assets to pay those debts. The debtor must feel confident, however, that if those goals are not met—*e.g.*, the car or the home is lost to creditors—that he can turn off the spigot of payments out of his post-petition income by converting his case to Chapter 7. Any risk that creditors will get "bonus" payments out of his post-petition wages *despite* such a conversion increases

the risks associated with proceeding in Chapter 13 in the first place.

Indeed, if the result below were to hold, petitioner's case will be a cautionary tale for any individual debtor contemplating Chapter 13. If petitioner had proceeded under Chapter 7 from the start, his home would have been liquidated to pay his mortgagor. Petitioner, after having surrendered his car, had no other assets that were not exempt from the Chapter 7 estate under Section § 522(b) of the Bankruptcy Code. See *supra* note 1. Accordingly, petitioner would have received a discharge of his other debts in Chapter 7 without any other asset sales or payments. His post-petition wages would have been his and his alone.

2. The court of appeals was also wrong to conclude that the "distribution of the funds to creditors is supported by strong considerations of fairness." App., *infra*, 26a.

The court relied on Judge Roth's dissent from the Third Circuit's decision in *Michael*, along with a handful of bankruptcy court decisions containing similar reasoning, to hold that it would be unfair to creditors if the Chapter 13 trustee returned payments to the debtor upon conversion to Chapter 7. See App., *infra*, 26a–28a. Those funds, the argument goes, were the debtor's "'*quid pro quo*'" for the benefits he had received during the Chapter 13 case—*i.e.*, "stav[ing] off foreclosure and cur[ing] the mortgage default." *Id.* at 26a (quoting *In re Michael*, 699 F.3d at 319 (Roth, J., dissenting)). That "'arrangement,'" the court stated, is not "retroactively alter[ed]" by conversion. *Id.* at 27a (quoting *In re Michael*, 699 F.3d at 320 n.8 (Roth, J.,

dissenting)). Nor does conversion, according to the Fifth Circuit, "undo the disadvantages that creditors may have suffered as a result of the [Chapter 13] plan." *Id.* at 27a.

That is exactly backwards. Many debtors, including petitioner, convert their cases from Chapter 13 to Chapter 7 because the former's "benefits" have proven illusory. When petitioner converted his case—just as when the debtor in *Michael* converted his—petitioner had already lost his home. App., *infra*, 4a; see also 699 F.3d at 307. In both cases, the funds the Chapter 13 trustee held at conversion had been garnished from the debtors' wages *after* each debtor had failed to "'stave off foreclosure and cure the mortgage default.'" App., *infra*, 26a (quoting *In re Michael*, 699 F.3d at 319 (Roth, J., dissenting)). The creditors to which the Chapter 13 trustee ultimately distributed those funds after conversion had not expected to receive such payments from the estate so early in the Chapter 13 plan's term. As to those creditors, the funds held by the trustee had not been the *quid pro quo* for anything.

Moreover, when petitioner filed for bankruptcy protection, his only non-exempt asset was his home.[5] If petitioner had filed his case under Chapter 7 from the start, then his home would have been sold, his mortgagor would have received the proceeds, and the rest of his debts would have been discharged to the

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[5] Petitioner also had possession of an automobile, but he surrendered that car, on or around the petition date, to the secured lender on his car loan. App., *infra*, 27a n.12.

extent authorized by law. It was petitioner's election to proceed under Chapter 13 in an attempt to save his home that provided his other creditors any opportunity to recover anything at all. Under the circumstances, it is hard to see why those creditors are entitled to receive additional post-conversion payments out of petitioner's post-petition wages as a matter of equity. Quite the contrary; fairness demands that petitioner "not lose those earnings on conversion." *In re Michael*, 699 F.3d at 315.

III. The Issue Is Recurring And Important To The Administration Of Chapter 13

The question presented is an important issue of bankruptcy law that affects many individual debtors each year who typically cannot afford to litigate this long-disputed legal issue.

During the twelve-month period ending June 30, 2014, debtors filed 321,278 Chapter 13 cases.[6] Approximately two-thirds of Chapter 13 cases end in dismissal or conversion rather than a discharge of debts. Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 Tex. L. Rev. 103, 108 (2011). For those Chapter 13 cases that do not end in a discharge, about 26% of them are

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[6] Admin. Office of the U.S. Courts, Table F-2, *U.S. Bankruptcy Courts—Business and Nonbusiness Cases Commenced, by Chapter of the Bankruptcy Code, During the 12-Month Period Ending June 30, 2014*, at http://www.uscourts.gov/uscourts/Statistics/Bankruptcy Statistics/BankruptcyFilings/2014/0614_f2.pdf ("6/30/14 Bankruptcy Statistics").

converted to Chapter 7. *Id.* at 112. Thus, roughly 60,000 Chapter 13 bankruptcy cases are converted to Chapter 7 each year. That suggests that, in the Third and Fifth Circuits alone, there are roughly 10,000 of these conversions annually. See 6/30/14 Bankruptcy Statistics at 1–2 (reporting 17,216 Chapter 13 petitions in the Third Circuit and 39,020 in the Fifth Circuit).

When many of these conversions occur, the trustee holds payments that had been made by the debtor under the Chapter 13 plan. Although Section 1326(a)(2) instructs trustees to distribute funds in their possession to creditors "as soon as is practicable," trustees cannot do so instantaneously. Generally, distributions are made monthly or biweekly. See *In re Michael*, 699 F.3d at 316. There is every reason to believe, moreover, that there are a significant number of cases like this one, and *Michael*, in which relief from the stay by a secured home or auto lender has caused the Chapter 13 trustee to retain more than just the prior wage garnishment.

Until this Court settles the issue, debtors and trustees alike are forced to navigate the uncertainty. The Department of Justice's *Handbook for Chapter 13 Standing Trustees* candidly advises Chapter 13 trustees that

> [i]f [a Chapter 13] case is * * * converted post-confirmation, the standing trustee must distribute any funds on hand in accordance with controlling law of the jurisdiction. Courts are divided on the issue of the disposition of funds if the case is converted to chapter 7. The standing trustee must follow legal authority in the

> jurisdiction, or seek a court order regarding disposition of the funds.

U.S. Dep't of Justice, Exec. Office for U.S. Trustees, *Handbook for Chapter 13 Standing Trustees* 3-36 (Oct. 1, 2012) (internal citation omitted).

Three decades of litigation to determine the "legal authority" in each "jurisdiction" has already sapped scarce resources. Debtors, in particular, are burdened enough as it is without being saddled with the legal expense of figuring out whether a particular bankruptcy judge will adhere to the Third Circuit's view or the Fifth Circuit's. Debtors converting from a Chapter 13 repayment plan to a Chapter 7 liquidation often do so because they are eager to hasten their fresh start out of bankruptcy. The average Chapter 13 proceeding lasts three to five years; the average Chapter 7 proceeding takes roughly four months. Porter, *supra*, at 108, 116–17. In this context, certainty is important. To make rational decisions as intended by the Bankruptcy Code, a debtor contemplating conversion needs to know what funds will be restored to him and what funds will not.

Today, however, the disposition of what often amounts to a petitioner's sole remaining assets turns on the Circuit—or even just the bankruptcy court—in which a debtor finds himself. This Court should grant the petition to provide certainty to debtors and ensure "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., art. 1, § 8, cl. 4.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

J. TODD MALAISE
STEVEN G. CENNAMO
MALAISE LAW FIRM
909 N.E. LOOP 410, STE. 300
SAN ANTONIO, TEXAS
(210) 732-6699

MARK T. STANCIL
Counsel of Record
ALAN E. UNTEREINER
MATTHEW M. MADDEN
ROBBINS, RUSSELL, ENGLERT, ORSECK, UNTEREINER & SAUBER LLP
1801 K STREET, N.W., STE. 411L
WASHINGTON, D.C. 20006
(202) 775-4500
mstancil@robbinsrussell.com

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