



1 of 1 DOCUMENT

Collier Consumer Bankruptcy Practice Guide

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CHAPTER 24 Conversion of Cases from One Chapter to Another

1-24 Collier Consumer Bankruptcy Practice Guide P 24.02

P 24.02 Conversion from Chapter 13 to Chapter 7

[1] Voluntary Conversion

[a] Reasons for Conversion

Conversion to chapter 7 is one of several options available to a debtor who cannot complete a chapter 13 plan. The other options are modification of the plan, which is usually preferable if it is feasible, a hardship discharge, if the debtor qualifies for one, and dismissal of the case.

One advantage of conversion is that it allows postpetition debts arising before conversion to be treated as if they arose prepetition.ⁿ¹ These debts may thus be discharged if they are dischargeable under chapter 7. This may make conversion an attractive option if the debtor has significant unsecured postpetition debts.

MORE INFORMATION

Postconfirmation modification of plans and dismissal are examined in chapter 22 and chapter 23 *supra*, respectively. A detailed discussion of the hardship discharge can be found in chapter 29 *infra*. For a discussion of which debts are dischargeable in chapter 7 *see* chapter 26 *infra*.

PRACTICE NOTE

Conversion of the case does not create a new automatic stay when stay relief has been previously granted.ⁿ² It may sometimes be possible, however, to move to have a stay reimposed if the debtor can ensure that the creditor's rights will be protected.ⁿ³ However, if this does not appear likely and the debtor needs a new stay to prevent an imminent event such as foreclosure, an involuntary dismissal at the trustee's request and refiling under chapter 13 may be preferable, assuming the debtor is again in a position to propose and carry out a confirmable plan. Section 109(g) would not preclude such a refiling as long as the dismissal was not voluntary or brought about by the debtor's willful failure to follow court orders or prosecute the case.ⁿ⁴

The debtor may wish to convert if the reasons for the initial choice of chapter 13 no longer apply. For example, the debtor may have chosen chapter 13 to protect property, such as an automobile, from repossession. If that property is

later destroyed or is no longer of value to the debtor, chapter 13 may no longer be necessary.

MORE INFORMATION

The use of chapter 13 in dealing with secured creditors is examined in chapter 14 *supra*.

Conversion may also be advantageous when the debtor is unable to complete his or her plan and is ineligible for a hardship discharge, yet wishes to obtain a discharge of unsecured debts or to preserve the effect of lien avoidance or other orders obtained under chapter 13.ⁿ⁵ If a case is voluntarily or involuntarily dismissed, rather than converted, liens avoided in the bankruptcy are reinstated.ⁿ⁶

WARNING

The major disadvantage of conversion is that if there is nonexempt property in the estate, it is liquidated regardless of what the unsecured creditors have already received under the plan (at least to the extent necessary to pay all creditors in full with interest). Therefore, in cases in which the debtor has nonexempt assets and can meet the requirements, a hardship discharge is often preferable to conversion.

[b] Debtor's Absolute Right to Convert

The debtor may convert a chapter 13 case to a chapter 7 liquidation case, at any time.ⁿ⁷ The right to convert to chapter 7 is unqualified and may not be waived.ⁿ⁸

Unlike section 1307(b), which states that the *court* shall dismiss a case upon request of the debtor, section 1307(a) provides that the *debtor* may convert a case to chapter 7. There is no need for the court to review the propriety of the conversion, since there are no preconditions on the right to convert similar to the limitation of the debtor's absolute right to dismiss to only those cases originally commenced under chapter 13.ⁿ⁹ Once the debtor files a notice of conversion, the conversion is automatic and immediate; it cannot be delayed by the court.ⁿ¹⁰

However, a debtor converting from chapter 13 to chapter 7 by right may still be subject to the means-test formula of section 707(b) if his or her current monthly income at the time of filing the chapter 13 exceeded the applicable state median income.ⁿ¹¹ If after applying the mean test a presumption of abuse arises, the debtor may rebut the presumption by showing special circumstances.ⁿ¹² For the debtor that legitimately is unable to carry out a confirmable chapter 13 plan, this hurdle should not be insurmountable.

[c] Procedure for Conversion by Debtor

The procedure for conversion by the debtor is governed by *Federal Rule of Bankruptcy Procedure 1017(f)*.ⁿ¹³ Recognizing that the statute provides for conversion by the debtor to chapter 7 without a motion or court order, the Rule requires only a notice of conversion to be filed by the debtor.ⁿ¹⁴ *Rule 1017(f)(3)* provides that the date of filing of the notice of conversion shall be deemed the date of the conversion order for purposes of applying *Rule 1019* and *section 348(c) of the Bankruptcy Code*, which refers to the "conversion order." It also requires that the clerk forward a copy of the conversion notice to the United States trustee.ⁿ¹⁵

FORMS

For a form of a debtor's notice of conversion from chapter 13 to chapter 7 see *Collier Consumer Bankruptcy Forms, Form CS12.12-1* (Matthew Bender).

Once the case has been converted, proceedings in the converted case are governed by *Federal Rule of Bankruptcy Procedure 1019*. Although that Rule does not require new schedules to be filed in the converted case unless the court so

directs,ⁿ¹⁶ the debtor must file a supplemental schedule of debts which have arisen since the chapter 13 case was filed, since such debts are dischargeable in the converted case.ⁿ¹⁷ A statement of intention under section 521(a)(2) must also be filed. Courts disagree about whether a chapter 7 means test form, Official Form 22A, must be filed after conversion.^{n17a}

If the conversion order is entered after confirmation of a plan, the debtor must file a list of property which has been acquired after the filing of the petition and before the conversion order, a schedule of unpaid debts incurred after confirmation and before the conversion order, and a schedule of executory contracts entered into or assumed after the petition and before the conversion order.ⁿ¹⁸ The clerk is then required to transmit copies of all such schedules to the United States trustee.ⁿ¹⁹

New time periods for filing claims, dischargeability complaints and objections to discharge come into being, although claims actually filed in the chapter 13 case are deemed filed in the chapter 7 case.ⁿ²⁰ The chapter 13 trustee must turn over to the chapter 7 trustee all records of the estate and nonexempt property,ⁿ²¹ at least if the chapter 7 trustee desires possession. (If the amounts of property are nominal, the chapter 7 trustee may not wish to take possession, since chapter 7 trustees are encouraged to abandon property in nominal asset cases.)ⁿ²² And the chapter 13 trustee must transmit to the United States trustee a final report and account.ⁿ²³

MORE INFORMATION

Abandonment of property is discussed in chapter 28 *infra*.

[2] Involuntary Conversion

[a] Reasons for Conversion

A conversion to a chapter 7 can be ordered against a debtor's will pursuant to section 1307(c) or 1307(e) upon motion of a party in interest, such as a creditor or the trustee, or the United States trustee. Section 1307(c) permits conversion "for cause" and section 1307(e), added in 2005,ⁿ²⁴ allows for conversion if the debtor fails to file a tax return under section 1308. In order for a case to be involuntarily converted to chapter 7, both sections require that such conversion be in the best interest of creditors and the estate.

Section 1307(c) of the Bankruptcy Code enumerates 11 specific occurrences which constitute sufficient cause for conversion, including failure to file necessary papers and failure to make plan payments. In most cases, however, conversion is not in the best interests of creditors unless there are significant nonexempt assets that would be liquidated for the benefit of creditors in a chapter 7 case. In most places, involuntary conversions are relatively rare.

If such assets do exist, it may be a good strategy for a creditor to move to convert the debtor's case to chapter 7, especially if there are few other creditors with whom they would be shared. On the other hand, it may be preferable to pursue those assets outside of bankruptcy after the case is dismissed, so that they would not have to be shared with other creditors.

However, the case of a debtor who is a farmer may not be converted involuntarily.ⁿ²⁵ Moreover, a debtor who is faced with a conversion motion may exercise the right to dismiss the case voluntarily before the motion is decided, pursuant to section 1307(b).

MORE INFORMATION

For a discussion of a debtor's absolute right to dismiss a chapter 13 case that has not been converted from another chapter *see* chapter 23 *supra*.

[b] Procedure for Requesting Conversion

The procedure for a motion to convert a case to chapter 7 is governed by *Federal Rule of Bankruptcy Procedure 1017(f)(1)*.ⁿ²⁶ Such a motion must be served on the debtor and the trustee and initiates a contested matter governed by *Federal Rule of Bankruptcy Procedure 9014*. The burden is on the moving party to demonstrate cause for the conversion.

MORE INFORMATION

For a discussion of procedures in contested matters *see* chapter 32 *infra*.

Once the case is converted, the procedures are the same as they are if the debtor converts to chapter 7 voluntarily.

[3] Effect of Conversion

Section 348(a) provides that while conversion of a case from one chapter to another constitutes an order for relief, this does not affect the dates of the filing of the petition, the commencement of the case, or the order for relief, except as provided in subsections (b) and (c). This means that (with the exceptions listed in subsections (b) and (c) of section 348) those sections of the Bankruptcy Code that are keyed to the dates of filing of the petition, commencement of the case or entry of the order for relief are unaffected by conversion. Section 348(a) thus operates in conjunction with many other Code provisions.

[a] Property of the Estate After Conversion

Section 348(f)(1)(A) 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." Therefore, property that the debtor has acquired since the filing of the chapter 13 case does not come into the chapter 7 estate.

However, an exception to the general rule about property of the estate after conversion from chapter 13 to chapter 7 exists if the conversion is "in bad faith." In that case, property of the chapter 7 estate is the property of the estate as of the date of conversion.ⁿ²⁷

It is unclear what would constitute "bad faith" triggering this exception. One situation in which bad faith might be found would be if the debtor never really intended to proceed with a chapter 13 and had filed a chapter 13 case simply to protect assets the debtor knew would soon be acquired. Courts clearly should not find bad faith if the debtor is unable to complete a plan due to a change in circumstances or financial hardship.

On a related matter, some cases have held that creditors had a vested right to payment as to funds paid into the chapter 13 estate when a plan has been confirmed and funds were paid to the trustee but not yet distributed to creditors at the time of conversion.ⁿ²⁸ These cases were overruled by enactment of section 348(f)(1). In accordance with section 348(f)(1), postpetition wages in the hands of the chapter 13 trustee should be returned to the debtors because they were not a part of the chapter 7 estate.ⁿ²⁹ Moreover, *Federal Rule of Bankruptcy Procedure 1019(4)* requires the chapter 13 trustee to turn over all property of the estate in his or her possession to the chapter 7 trustee, so it is doubtful that the cases were correct even when decided. After conversion, the chapter 13 plan is no longer in effect and, pursuant to section 522(b), the debtor has the right to exempt from property of the estate any property that falls within the limitations of section 522.

[b] Valuation of Property and Allowed Secured Claim After Conversion

The 2005 amendments to section 348(f)ⁿ³⁰ added a new paragraph 348(f)(1)(C), applicable to conversions from chapter

13. Additionally, the amendments make section 348(f)(1)(B) inapplicable in a case converted from chapter 13 to chapter 7.

Section 348(f)(1)(C)(i), added in 2005,ⁿ³¹ provides that with respect to cases converted from chapter 13, the claim of any creditor holding securityⁿ³² 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 the allowed secured claim made for purposes of the case under chapter 13. While paragraphs (1)(B) and (1)(C) specifically limit the use of valuations of property and allowed secured claims made in the chapter 13 case prior to conversion, nothing in the amended language dictates how property should be valued in the chapter 7 case. Thus, courts will have to look to other sources to decide the amount of the allowed secured claim in the converted case.

PRACTICE NOTE

The inapplicability of previous determinations of value in a case converted from chapter 13 to chapter 7 may be advantageous to debtors where their property's value has gone down during the pendency of the chapter 13 case.ⁿ³³

Similarly, the provision of section 348(f)(1)(B) which allowed secured claims to be reduced to the extent they were paid in chapter 13 no longer applies to cases converted from chapter 13 to chapter 7.ⁿ³⁴ The new language, however, does not describe how any reduction in the amount of the creditor's secured claim is to be determined in such cases. Certainly, the amendment should not be read as creating a negative implication that the allowed secured claim should not be reduced by payments in a chapter 13 plan, because Congress clearly could have stated that rule if it had desired that result. Rather, the provisions of section 348(f)(1)(B) and 1(C) can best be reconciled by reasoning that even if a creditor continues to be secured by its security, a chapter 7 debtor may still redeem the property by paying the remainder of the allowed secured claim.

[c] Cure of Prebankruptcy Defaults

Paragraph 348(f)(1)(C)(ii), added in 2005,ⁿ³⁵ provides that unless a prebankruptcy default has been fully cured under a chapter 13 plan at the time of conversion, in any proceeding under title 11 or otherwise, the default will have the effect it has under applicable nonbankruptcy law. The provision seems to make no significant change, except perhaps to clarify that a cure under a chapter 13 plan continues to be effective even if the plan is not completed.

[d] Effect on Preconversion Claims

Section 348(d) provides for special treatment of claims that arose during a case under chapter 13 before the case was converted to chapter 7. When a claim arises after the order for relief in a chapter 13 case but before conversion of the case under section 1307, such claim "shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition."ⁿ³⁶

By treating a preconversion claim that arises after the order for relief as if it had arisen immediately before the date the petition was filed, section 348(d) renders such claims subject to discharge in the converted case. Once these claims are treated as arising before the order for relief, they are within the ambit of *section 727(b) of the Bankruptcy Code*, which provides that a discharge in chapter 7 discharges the debtor "from all debts that arose before the date of the order for relief."ⁿ³⁷ The applicability of section 727(b) to these debts is further elucidated by section 348(b), which provides that, unless the court for cause orders otherwise, "the order for relief" for purposes of section 727(b) in the converted case means the conversion date.

Claims for administrative expenses as specified by section 503(b),ⁿ³⁸ however, are expressly excepted from the

operation of section 348(d), to the extent that such administrative expense claims continue to have priority in distribution as specified by section 507(a). These claims, although classified as administrative claims under section 507(a)(2), are subordinated to the administrative claims arising in the case after conversion by section 726(b).n39

The exception to the general rule in section 348(d) applies only to priority status, giving different treatment to preconversion administrative claims by granting them administrative priority that they would not have had had they arisen prior to the order for relief in a nonconverted case. It has nothing to do with dischargeability of those claims,n40 and therefore does not alter the application of section 727(b), via 348(b), to them.n41

FOOTNOTES:

(n1)Footnote 1. *11 U.S.C. § 348(d). See 3 Collier on Bankruptcy, P 348.05[3]* (Matthew Bender 15th Ed. Revised).

(n2)Footnote 2. *See generally In re State Airlines, 873 F.2d 264 (11th Cir. 1989)* (conversion from chapter 11 to chapter 7 does not trigger new stay).

(n3)Footnote 3. A stay may be available under section 105 particularly as to property which might be liquidated for the benefit of unsecured creditors. This may allow a debtor facing foreclosure to obtain the benefit of an applicable homestead exemption in the liquidation process.

(n4)Footnote 4. *See 2 Collier on Bankruptcy, P 109.08* (Matthew Bender 15th Ed. Revised).

(n5)Footnote 5. *11 U.S.C. § 348(f)(1)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. The language of new section 348(f)(1)(C), added in 2005, is unlikely to require debtors who convert to chapter 7 to bring a second motion of avoid a lien that was avoided in the chapter 13 case prior to conversion. *See also In re Tluscik, 122 B.R. 728 (Bankr. W.D. Mo. 1991)* (debtor may redeem property at the amount of unpaid balance of secured claim determined in chapter 13 case after conversion to chapter 7); *In re Hargis, 103 B.R. 912 (Bankr. E.D. Tenn. 1989)* (effect of lien avoidance won in chapter 13 preserved after conversion to chapter 7).

(n6)Footnote 6. *11 U.S.C. § 349. See In re Sadler, 935 F.2d 918, 24 C.B.C.2d 2017 (7th Cir. 1991)*.

(n7)Footnote 7. *11 U.S.C. § 1307(a)*.

(n8)Footnote 8. *11 U.S.C. § 1307(a). See H.R. Rep. No. 595, 95th, Cong. 1st Sess. 428 (1977), reprinted in Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i)* (Matthew Bender 15th Ed. Revised).

(n9)Footnote 9. *Compare 11 U.S.C. § 1307(a) with 11 U.S.C. § 1307(b). See also ch. 23 supra.*

(n10)Footnote 10. *In re McFadden, 37 B.R. 520 (Bankr. M.D. Pa. 1984)*; *In re Perkins, 10 C.B.C.2d 963, 36 B.R. 618 (Bankr. M.D. Tenn. 1983)* *In re McFadden, 37 B.R. 520 (Bankr. M.D. Pa. 1984)* *In re Perkins, 10 C.B.C.2d 963, 36 B.R. 618 (Bankr. M.D. Tenn. 1983)*

(n11)Footnote 11. *See P 23.03[3] supra.*

(n12)Footnote 12. *See P 23.03[3][b][vi] supra.*

(n13)Footnote 13. *Fed. R. Bankr. P. 1017(f)*.

(n14)Footnote 14. *Fed. R. Bankr. P. 1017(f)(3)*.

(n15)Footnote 15. *Id.*

(n16)Footnote 16. *Fed. R. Bankr. P. 1019(1)(A)*.

(n17)Footnote 17. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d)*.

(n18)Footnote 17a. *See In re Fox*, 370 B.R. 639 (Bankr. D.N.J. 2007) (new Form 22 not required after conversion); *In re Kellett*, 379 B.R. 332 (Bankr. D. Or. 2007) (new Form 22 required, may be waived upon motion); *In re Edwards*, 367 B.R. 921 (Bankr. S.D. Ga. 2007) (new Form 22 not required for below-median income debtors because information would be unchanged from original Form 22C).

(n19)Footnote 18. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d)*.

(n20)Footnote 19. *Fed. R. Bankr. P. 1019(5); 11 U.S.C. § 348(b) and (d)*.

(n21)Footnote 20. *Fed. R. Bankr. P. 1019(2) and (3)*.

(n22)Footnote 21. *Fed. R. Bankr. P. 1019(4)*.

(n23)Footnote 22. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 93 (1977), *reprinted in* Vol. C Collier on Bankruptcy, App. Pt. 4(d)(i) (Matthew Bender) 15th Ed. Revised).

(n24)Footnote 23. *Fed. R. Bankr. P. 1019(5)*.

(n25)Footnote 24. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n26)Footnote 25. *11 U.S.C. § 1307(e)*.

(n27)Footnote 26. *Fed. R. Bankr. P. 1017(f)(1)*, formerly *Fed. R. Bankr. P. 1017(d)* prior to the 1999 Amendments to the Federal Rules of Bankruptcy Procedure.

(n28)Footnote 27. *11 U.S.C. § 348(f)(2)*.

(n29)Footnote 28. *In re Milledge*, 20 C.B.C.2d 366, 94 B.R. 218 (Bankr. M.D. Ga. 1988) *Ledford v. Burns (In the Matter of Burns)*, 19 C.B.C.2d 900, 90 B.R. 301 (Bankr. S.D. Ohio 1988)

(n30)Footnote 29. *Stamm v. Morton (In re Stamm)*, 222 F.3d 216 (5th Cir. 2000) .

(n31)Footnote 30. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n32)Footnote 31. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n33)Footnote 32. "Security" is defined in section 101; *see* ch.101 *supra*. In light of the definition of security, it is not clear what claims would be affected by the new language.

(n34)Footnote 33. *See also* § 506(a)(2), which provides that with respect to property acquired for personal, family, or household purposes replacement value shall be determined *considering the age and condition of the property at the time value is determined*. [emphasis supplied]

(n35)Footnote 34. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n36)Footnote 35. Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005.

(n37)Footnote 36. *11 U.S.C. § 348(d)*.

(n38)Footnote 37. *11 U.S.C. § 727(b)*. *See* 6 Collier on Bankruptcy, P 727.13 (Matthew Bender 15th Ed. Revised).

(n39)Footnote 38. *11 U.S.C. § 503(b)*, as amended by Pub. L. No. 109-8 (2005), effective with respect to cases

filed on or after October 17, 2005. *See* 4 *Collier on Bankruptcy*, P 503.05 (Matthew Bender 15th Ed. Revised).

(n40)Footnote 39. 11 U.S.C. § 726(b), as amended by Pub. L. No. 109-8 (2005), effective with respect to cases filed on or after October 17, 2005. *See* 6 *Collier on Bankruptcy*, P 726.03 (Matthew Bender 15th Ed. Revised).

(n41)Footnote 40. *Matter of Pavlovich*, 952 F.2d 114, 118, 26 C.B.C.2d 542, 549 (5th Cir. 1992) .

(n42)Footnote 41. *In re Ramaker*, 23 C.B.C.2d 936, 117 B.R. 959 (Bankr. N.D. Iowa 1990) ; *In re Deiter*, 33 B.R. 547 (Bankr. W.D. Wis. 1983) . *In re Ramaker*, 23 C.B.C.2d 936, 117 B.R. 959 (Bankr. N.D. Iowa 1990)