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# Consequences of Converting a Bankruptcy Case

by

David G. Epstein\*

This paper discusses some of the consequences of converting a bankruptcy case from one chapter to another.

At present, there are four different forms of bankruptcy: chapter 7, chapter 9, chapter 11, chapter 13. Congress is currently considering creating yet a fifth form of bankruptcy for farmers. Most individual debtors are now eligible for relief under three of the chapters, 7, 11, or 13.<sup>1</sup> Corporate and partnership debtors can now choose between chapter 7 and chapter 11.

The various chapters of the Bankruptcy Code differ in both policy and particulars. A chapter 7 case involves liquidation of the "property of the estate"<sup>2</sup>—usually as promptly as practicable. In the typical chapter 11 case or chapter 13 case, the debtor's "property of the estate" is not liquidated. Rather, the debtor retains his, her or its<sup>3</sup> property. Creditors are paid pursuant to a court-approved plan out of future earnings.

Bankruptcy concepts such as "property of the estate" are common to chapters 7, 11, and 13. Chapter 1 of the Bankruptcy Code, General Provisions, chapter 3 of the Bankruptcy Code, Case Administration, and chapter 5 of the Bankruptcy Code, Creditors, the Debtor and the Estate, generally apply to all bankruptcy cases.<sup>4</sup> The application of these basic bankruptcy concepts, however, varies from chapter to chapter. For example, the term "property of the estate" has a different meaning in a chapter 13 case from a chapter 7 or 11 case.<sup>5</sup>

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<sup>1</sup>Section 109 sets out who is eligible to be a debtor for each chapter. There is nothing in the language of section 109 that would prevent an individual debtor who is eligible for relief under chapter 13 to proceed under chapter 11 instead. In *In re Moog*, 774 F.2d 1073 (11th Cir. 1985), the court reversed the lower courts' dismissal of a consumer debtor's chapter 11 petition: "We see nothing in the current Bankruptcy Code or its legislative history or the Bankruptcy Act that would suggest that a consumer debtor may not seek relief under chapter 11." 774 F.2d at 1075. *But cf. In re Winshall Settlor's Trust*, 758 F.2d 1136, 1137 (6th Cir. 1985).

<sup>2</sup>See 11 U.S.C. section 541. In the remaining footnotes, provisions of the Bankruptcy Code will be cited simply to the appropriate section number.

<sup>3</sup>In the remainder of the article, the pronouns "he" and "his" will be used in a way that is intended as sexually neutral. Honest!

<sup>4</sup>Section 103.

<sup>5</sup>See section 1306. See generally H. DRAKE & J. MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE § 5.09 (1983).

If a debtor is dissatisfied with his initial choice of a chapter, he can change his mind and choose another chapter. Section 706 governs conversion from chapter 7; section 1112 deals with conversion from chapter 11; section 1307 controls conversion from chapter 13. A motion to convert can be filed by either the debtor or by a "party in interest." Generally, motions to convert are filed by debtors who after trying to effect a rehabilitation under chapter 11 or chapter 13 now want to liquidate under chapter 7.

#### I. STATUTORY PROVISION AND RULE: OVERVIEW OF SECTION 348 AND RULE 1019

Section 348 and Rule 1019 deal with the consequences of such a conversion. Section 348 is divided into five lettered paragraphs. Paragraph (a) establishes the general rule that the important date in a converted case is the date that the original petition was filed—that date will be deemed the date of the "filing of the petition," the date of the "commencement of the case," and the date of the "order for relief." Paragraphs (b) and (c) set out a number of specific exceptions to this general rule—detail those situations in which the date of the order of conversion shall be the important date. Paragraph (d) provides that a claim against the estate or the debtors that arises after the order for relief but before conversion shall be treated for all purposes as if such claim had arisen immediately before the filing of the petition, unless the claim qualified as an administrative expense in which case it shall be treated as an administrative expense even after conversion. Paragraph (e) terminates the service of any trustee or examiner who was serving before the conversion.

Rule 1019 is divided into eight paragraphs.<sup>6</sup> Paragraph (1) deals with lists and statements filed prior to conversion: lists and statements filed in the "superseded" chapter 11 or chapter 13 case shall be deemed filed in the chapter 7 case after conversion. Paragraph (2) requires notice to creditors of the order of conversion. Paragraph (3) deals with time limits in a "reconversion" — chapter 7 to chapter 11 or 13 and then back to chapter 7.<sup>7</sup> Under paragraph (4), all claims filed in the "superseded" chapter 11 or chapter 13 case shall be deemed filed in the chapter 7 case. Paragraph (5) covers turnover of records and property of the estate to the chapter 7 trustee. Paragraph (6) requires the debtor in possession or trustee in the superseded case to file re-

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<sup>6</sup>See generally 2 COLLIER ON BANKRUPTCY ¶ 348.07 (15th ed. 1986).

<sup>7</sup>Note that Rule 1019(3) speaks only of the effect of reconversion — 7 to 13 back to 7 — on time limits for filing claims and discharge complaints. What is the effect of a mere conversion — 11 to 7? Is there a "negative pregnant" in Rule 1019(3)? *F & M Marquette National Bank v. Richards*, 780 F.2d 24 (8th Cir. 1985), held that the conversion of a case from chapter 11 to chapter 7 generated a new time period for dischargeability complaints.

port and schedule of postpetition debts. Paragraph (7) calls for notice to the holders of postpetition, preconversion claims of the time for filing proofs of their claims. Under paragraph (8), any extension of time for the filing of a claim against surplus shall be applicable to holders of postpetition claims who failed to timely file under paragraph (7).

While section 348 and Rule 1019 deal with the consequences of conversion in considerable detail, there are still a number of questions arising from the conversion of a bankruptcy case from chapter 11 or 13 to chapter 7 that courts have been called on to answer:

(1) When a chapter 13 case is converted to chapter 7, are the debtor's postpetition/preconversion earnings included in the property of the estate?

(2) When a chapter 13 case is converted to chapter 7, what property can the debtor claim as exempt?

(3) When a chapter 11 case is converted to chapter 7, do creditors have to file proofs of claim?

## II. CONVERSION FROM CHAPTER 13 TO CHAPTER 7 AND PROPERTY OF THE ESTATE

### A. THE PROBLEM

Assume, for example, that Floyd Lawson files a chapter 13 petition on January 15. On April 5, Floyd files a motion to convert to chapter 7 and a conversion order is entered. Are Floyd's earnings from January 15 to April 5 included in the "property of the estate" in the chapter 7 case?

### B. WHAT THE BANKRUPTCY CODE DOES AND DOES NOT SAY ABOUT THIS PROBLEM

As earlier noted, the concept of property of the estate is common to both chapter 13 and chapter 7. In chapter 13, however, property of the estate includes more than it does in chapter 7. Under section 541, property of the estate is generally limited to the debtor's interest in property "as of the commencement of the case," i.e., the debtor's property as of the time of the filing of the bankruptcy petition. Section 1306, however, "broadens the definition of property of the estate for chapter 13 purposes to include all property acquired and all earnings from services performed by the debtor after the commencement of the case." Thus, Floyd's earnings from January 15th to April 5th are property of the estate so long as he remains in chapter 13. Do these earnings remain property of the estate after the case is converted to chapter 7?

It is clear from section 348(a) that Floyd's chapter 7 case is to be treated as filed on January 15th. It is not clear whether it is to be treated as if it were filed as a chapter 7 case on January 15th.

C. CASE LAW SUPPORTING THE POSITION THAT POSTPETITION/  
PRECONVERSION EARNINGS ARE PROPERTY OF THE ESTATE

*In re Lindberg*,<sup>8</sup> a June, 1984, case, is the only circuit court decision that directly speaks to the question of whether property of the estate includes postpetition/preconversion earnings when a chapter 13 case is converted to chapter 7. Under *Lindberg*, Floyd's earnings from January 15th to April 5th would be property of the estate. The Eighth Circuit there states, by way of dictum, "The bankruptcy courts are in general agreement that in a case converted from chapter 13 to chapter 7 the property of the estate consists of all property in which the debtor has an interest on the date of conversion."<sup>9</sup>

This quotation from *Lindberg* was dictum. The question before the Eighth Circuit in *Lindberg* was whether the date of filing the initial chapter 13 petition or the date of the order of conversion to chapter 7 was the relevant date for determining what exemptions may be claimed. At the time of their chapter 13 petition, the Lindbergs lived in their home in New Town, and claimed this house as their homestead. Prior to the conversion of their case to chapter 13, the Lindbergs moved to their farm in Burke County. They now wanted to claim this farm as their homestead. The Eighth Circuit reasoned that since the property of the estate is determined as of the time of conversion, this should also be the time which should control exemptions.

In stating that the time of conversion determines what is property of the estate, the Eighth Circuit did not quote from or even cite to section 348. Rather, the court cited three bankruptcy court decisions: *In re Tracy*,<sup>10</sup> *In re Stinson*,<sup>11</sup> and *In re Richardson*.<sup>12</sup>

In *Tracy*, the debtor filed a chapter 13 petition on December 4, 1981. On July 23, 1982, the debtor converted to chapter 7 and moved for turnover of \$270 in postpetition/preconversion wages which his employer withheld and delivered to the chapter 13 trustee. In denying the debtor's turnover motion, the Maine bankruptcy court looked to section 348(a)—"To state that even after conversion from chapter 13 to chapter 7 this case is to be

<sup>8</sup>735 F.2d 1087 (8th Cir. 1984).

<sup>9</sup>735 F.2d at 1090. *Contra In re Lepper*, 58 Bankr. 896, 898 (Bankr. Md. 1986).

<sup>10</sup>*In re Tracy*, 10 BANKR. CT. DEC. (CRR) 541 (Bankr. Me. 1983).

<sup>11</sup>*In re Stinson*, 8 COLLIER BANKR. CAS. 2d (MB) 16 (Bankr. Or. 1982). This ruling was reversed by the district court of Oregon in an opinion that was officially reported. The district court opinion in *Stinson* can be found in 52 Bankr. 454, where it is published as an appendix to *In re Kao*, 52 Bankr. 452 (Bankr. Or. 1985).

<sup>12</sup>20 Bankr. 490 (Bankr. W.D. N.Y. 1982).

treated as commencing on December 4, 1981, does not necessarily imply that after conversion this case must be treated as a *Chapter 7* case commencing on December 4, 1981."<sup>13</sup> After noting the question left unanswered by the language of paragraph (a) of section 348, Judge Goodman looked to section 348(d) for an answer. "Treating wages earned after the filing of the chapter 13 petition but prior to the conversion of the case to chapter 7 as property of the estate is consistent with the treatment under the Bankruptcy Code of claims against the debtor which arose during the same period."<sup>14</sup> As the *Tracy* opinion correctly points out, excluding postpetition/preconversion property from property of the estate would mean that a debtor who first filed a chapter 13 petition and then filed a motion to convert to chapter 7 would be treated more favorably than a debtor who simply filed a chapter 7 petition: because the debtor converted to chapter 7, his bankruptcy covers both prepetition and postpetition/preconversion creditors.<sup>15</sup>

*Stinson*,<sup>16</sup> the second of the cases cited by the Eighth Circuit in *Lindberg* is, like *Lindberg*, a case involving an exemption claim; in *Stinson*, the Oregon Legislature enacted a statute opting out of the federal exemptions after the debtors filed their chapter 13 petition and before the conversion order. In *Stinson*, like *Lindberg*, the court's reasoning emphasized concern about a debtor benefitting by first filing a chapter 13 petition and then converting to chapter 7:

If the court were to conclude otherwise, a debtor with substantial assets which would not be exempt in a chapter 7 case, could file a petition under chapter 13, obtain confirmation of a plan based solely upon payments to the trustee from future earnings, be revested with the title to all of the nonexempt property and obtain a discharge of not only those debts in existence at the time of the chapter 13 petition but also those incurred thereafter prior to conversion.<sup>17</sup>

*Richardson*,<sup>18</sup> the third of the cases that *Lindberg* cites and relies on, was actually two independent cases dealt with in a single opinion. In holding that the postpetition/preconversion earnings of the Richardsons were property of the estate, the bankruptcy court for the Western District of New York looked to

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<sup>13</sup>10 BANKR. CT. DEC. (CRR), at 542. *But cf. In re Dennis*, 10 BANKR. CT. DEC. (CRR), 930, 932 (Bankr. M.D. Ga. 1983) ("This court is of the opinion that when Debtor converted her Chapter 13 to Chapter 7, she is deemed to have filed a *Chapter 7* case at the time her Chapter 13 case was filed.") (dictum). *In re Bullock*, 10 COLLIER BANKR. CAS. 2d (MB) 1292, 1295 (Bankr. E.D. Pa. 1984) ("under section 348 (a) the case is deemed filed under Chapter 7 as of the date the original petition under Chapter 13 was filed") (dictum).

<sup>14</sup>*Id.*

<sup>15</sup>See *supra* note 1 at 10 BANKR. CT. DEC. (CRR) 542.

<sup>16</sup>8 COLLIER BANKR. CAS. 2d (MB) 16 (Bankr. Or. 1982).

<sup>17</sup>8 COLLIER BANKR. CAS. 2d (MB), at 18.

<sup>18</sup>9 BANKR. CT. DEC. (CRR) 197 (Bankr. W.D. N.Y. 1982).

section 1327. Under section 1327(a), a confirmed plan is binding on the debtor and all creditors.<sup>19</sup> Judge Hayes reasoned from this:

The creditors of the debtor were given the interest in those wages provided by the plan and the order confirming the plan. Had these wages been paid to the creditors their interest would have vested. However, since the wages because of disputes as to claims were never paid to the creditors they became part of the Chapter 7 estate.<sup>20</sup>

In the very next paragraph of the opinion, the court reaches a very different conclusion with respect to the other debtors, Mr. and Mrs. Vasquez. The Vasquez plan had *not* been confirmed at the time of the conversion. The court thus looked solely at section 348(a) and summarily concluded that "When the Vasquez case converted, the conversion related the creation of the estate back to the original filing under Chapter 13. The *Chapter 7 case then created* (emphasis added) consisted only of the property set forth in section 541."<sup>21</sup> [Compare this language with the quotation from the *Tracy* case three paragraphs earlier. Arguably, the court in "*Vasquez*" is implying what *Tracy* is denying.]

There were other bankruptcy court decisions that the Eighth Circuit could have cited in *Lindberg* to support the conclusion that postpetition/preconversion earnings remain property of the estate even after conversion from chapter 13 to chapter 7. In January of 1984, for example, the bankruptcy court for the Western District of New York reached this result in *In re Wanderlich*<sup>22</sup> by looking to paragraphs (c) and (d) of section 348. Like Judge Goodman in *Tracy*, Judge McGuire reasoned that since the Code treated claims which occurred after the filing of the chapter 13 petition and before the conversion of the case as prepetition claims in the chapter 7 case, it was logical to treat the date of conversion to chapter 7 as the date for determining property of the estate. In *Wanderlich*, Judge McGuire also looked to section 548(c) which permits the assumption/rejection of postpetition/preconversion executory contracts—"an impossibility if those interests were not a part of the estate following confirmation."<sup>23</sup>

There is an earlier Eighth Circuit decision that the Eighth Circuit could have cited and discussed in *Lindberg*, *Resendez v. Lindquist*.<sup>24</sup> *Resendez*, like

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<sup>19</sup>See generally H. DRAKE & J. MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE § 11.10 (1983).

<sup>20</sup>9 BANKR. CT. DEC. (CRR), at 198. *But cf.* *In re Genova*, 43 Bankr. 108, 110 (Bankr. Colo. 1984) (upon conversion, section 1327 "became ineffective").

<sup>21</sup>*Id.*

<sup>22</sup>11 BANKR. CT. DEC. (CRR) 467 (Bankr. W.D. N.Y. 1984).

<sup>23</sup>11 BANKR. CT. DEC. (CRR), at 469.

<sup>24</sup>691 F.2d 397 (8th Cir. 1982).

*Lindberg*, dealt with a claim of exemptions; there the debtors, who converted from chapter 13 to chapter 7 after confirmation of their plan, tried to exempt funds paid to the chapter 13 trustee. The Eighth Circuit in *Resendez* held that the funds were part of the estate but not exemptible. This holding in *Resendez* seems consistent with the statement in *Lindberg* that property of the estate is to be determined as of the date of conversion and it has been so cited.<sup>25</sup>

Unlike *Lindberg* and the cases cited therein, the *Resendez* decision avoids any statement about the date of conversion as being the controlling date. Such language is disturbing for two reasons. First, there is no direct basis in the language of section 348 for it. Paragraph (a) of the section 348 expressly makes the date of the initial filing the relevant date for most purposes. Paragraphs (b) and (c) of section 348 specifically detail those situations in which the date of the conversion order is to be the relevant date. Second, a date of conversion test could produce bizarre results where a chapter 11 case involving a non-business debtor<sup>26</sup> is converted to a chapter 7 case. Neither chapter 11 nor chapter 7 generally include postpetition earnings of the debtor in property of the estate. Nevertheless, under a literal application of the language in cases like *Lindberg* and *Stinson*,<sup>27</sup> it could be argued that if Floyd Lawson filed a chapter 11 petition on January 15th and converted it to chapter 7 on April 5th, his earnings from January 15th to April 5th would be property of the estate.

A court can include postpetition/preconversion earnings in property of the estate without using a date of conversion test. It can instead simply conclude that where a debtor files a chapter 13 petition and then converts to chapter 7, the case will be treated as a chapter 13 case from the time of filing until the time of conversion. Dictum in *Tracy* suggests this approach.<sup>28</sup>

#### D. CASE LAW SUPPORTING THE POSITION THAT POSTPETITION/PRECONVERSION EARNINGS ARE NOT PROPERTY OF THE ESTATE

*Lindberg* et al represent the majority rule: postpetition/preconversion earnings are property of the chapter 7 estate. "*Vasquez*," however, is not the only case to the contrary.

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<sup>25</sup>E.g., *In re Wanderlich*, 11 BANKR. CT. DEC. (CRR) 467, 468 (Bankr. W.D. N.Y. 1984); *In re Peters*, 11 COLLIER BANKR. CAS. 2d (MB) 881, 885 et seq (Bankr. M.D. Tenn. 1984).

<sup>26</sup>In the typical business chapter 11 case, the vast majority of the postpetition/preconversion property will be generated from property of the estate and is thus property of the estate under section 541(a)(7). See *In re Ford*, BANKR. L. REP. (CCH) ¶ 71, 188, at page 89, 186 (Bankr. W.D. Wisc. 1986). Not all chapter 11 cases, however, are business cases. See *In re Fitzsimmons*, 11 BANKR. CT. DEC. (CRR) 799 (9th Cir. 1984) (attorney in chapter 11 entitled to earnings attributable to his personal services): see generally Herbert, *Consumer Chapter 11 Proceedings*, 91 COM. L. J. 234 (1986).

<sup>27</sup>See also *In re Winchester*, 12 COLLIER BANKR. CAS. 2d (MB) 293, 296-7 (Bankr. 9th Cir. 1984).

<sup>28</sup>See *op cit supra* note 12.

In one of the first reported cases on this question, *In re Hannan*,<sup>29</sup> the bankruptcy court for the Eastern District of New York relied on the language of section 348(a) to hold that property of the estate was determined as of the date of the original chapter 13 petition. There is also a brief discussion of policy in the *Hannan* opinion; Judge Goetz writes,

When a Chapter 13 plan does not work out, the debtor has the privilege of converting to Chapter 7, and, when he exercises that right, no reason of policy suggests itself why the creditors should not be put back in precisely the same position as they would have been had the debtor never sought to repay his debts by filing under Chapter 13.<sup>30</sup>

There is, of course, a problem with this statement from *Hannan*. Section 348(d) does not leave the creditors in "precisely the same position as they would have been had the debtor never sought to repay his debts by filing under Chapter 13." *In re Peters*,<sup>31</sup> a bankruptcy court decision for the Middle District of Tennessee, and *In re Lepper*,<sup>32</sup> a bankruptcy court decision from Maryland, deal with this problem directly.

*Peters* is a post-Lindberg case involving debtors who converted from chapter 13 to chapter 7 after their chapter 13 plan was confirmed. In concluding that the postpetition/preconversion earnings of the debtor were not property of the estate, Judge Paine discussed and disregarded the statutory symmetry arguments advanced in *Tracy* and *Wanderlich*. He concluded that these policy arguments were outweighed by the Congressional policy of encouraging debtors to try chapter 13:

Both the *Tracy* decision and the *Wanderlich* decision ignore the congressional policy to encourage debtors to file Chapter 13 plans and ignore the fact that certain benefits are provided to Chapter 13 creditors as an incentive. One such benefit, leaving the date of the filing of the petition unchanged by conversion, is provided by the Code as long as the debtor remains in bankruptcy. The *Wanderlich* court ignores the fact that the Code provides benefits to those who are in a Chapter 13 bankruptcy which it does not provide to

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<sup>29</sup>9 BANKR. CT. DEC. (CRR) 1151 (Bankr. E.D. N.Y. 1982).

<sup>30</sup>9 BANKR. CT. DEC. (CRR) at 1152.

<sup>31</sup>11 COLLIER BANKR. CAS. 2d (MB) 881 (Bankr. M.D. Tenn. 1984).

<sup>32</sup>58 Bankr. 896. *Lepper* involved a significant amount of property. There Dr. Lepper filed a chapter 13 petition in November of 1979. The case was converted to chapter 7 on April 5, 1984. At issue was the accounts receivable derived from services performed by Dr. Lepper during this four and a half year period. Judge Mannes looked to sections 541(a)(6), 1306, and 348(a) and concluded that they are "clear and unambiguous." Under the "plain meaning" of these provisions, Dr. Lepper's chapter 7 case is deemed to have commenced in November of 1979—accordingly, section 1306 is inapplicable—accordingly, the postpetition/preconversion accounts are not property of the estate.

other debtors. The *Tracy* decision ignores not only the congressional intent to encourage debtors to file a Chapter 13 petition, but it also ignores the statutory scheme of 11 U.S.C. section 348 and the specific language of both 11 U.S.C. section 348 and 11 U.S.C. section 541. It is true, that "[b]ecause the debtor converted to chapter 7, . . . creditors whose claims arose after the original chapter 13 filing, but before conversion to chapter 7, would share in the estate along with the pre-filing creditors, to the detriment of the latter." *Tracy* at 190-191 n.1. However, this detriment is contemplated by the Code in section 348 and may be viewed as an expense incurred by creditors in an attempt to encourage debtors to repay a greater portion of their debts than required under chapter 7 of the Code.<sup>33</sup>

In the *Lepper* opinion, Judge Mannes questions the present practical significance of section 348(d) after the addition of section 1325(b) and the amendment to section 1329 in 1984. Because section 1325(b) compels a chapter 13 debtor to commit all of his disposable income to the chapter 13 plan and because section 1329 now permits a trustee to request modification of a chapter 13 plan where the debtor's income increases, the Code now "effectively precludes payments outside the plan to postpetition creditors."<sup>34</sup> This leads Judge Mannes to conclude "The 1984 Amendments deal with the policy considerations expressed in *Wanderlich* and *Stinson* and result in the elimination of the abuses foreseen by those courts."<sup>35</sup>

I respectfully question this conclusion. While I cannot point to any federally funded empirical study on whether anyone has received credit after he has filed a chapter 13 petition, I believe that sellers and lenders are continuing to extend credit to chapter 13 debtors. If so, the abuses foreseen in *Wanderlich* have not been eliminated by the 1984 Amendments. The issue of symmetry between paragraphs (a) and (d) of section 348 has not been eliminated.

#### E. POLICY CONSIDERATIONS

The cases identify countervailing policy considerations. On the one hand, the Congressional policy of encouraging chapter 13 filings suggests that a debtor should realize no disadvantage because he first tried chapter 13 rather than filing under chapter 7 initially. On the other hand,<sup>36</sup> the policy of

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<sup>33</sup>11 COLLIER BANKR. CAS. 2d (MB), at 887.

<sup>34</sup>58 Bankr., at 898.

<sup>35</sup>*Id.*

<sup>36</sup>Cf. Randy Travis, "On the Other Hand" (1986).

symmetry suggests that postpetition earnings should be brought into the bankruptcy since postpetition claims are covered by the bankruptcy. Because it is not clear from the language of section 348 whether a case commenced under chapter 13 and then converted to chapter 7 should be treated as a chapter 7 case from the time of the first filing, these countervailing policy considerations are relevant.

### III. CONVERSION FROM CHAPTER 13 TO CHAPTER 7 AND EXEMPTIONS

There are obvious connections between the consequences of conversion on property of the estate and the consequences of conversion on exempt property. Obviously, here, again it is important to determine whether to focus on the date of the initial filing or the date of conversion. Obviously, a court that has concluded that property of the estate is to be determined as of the date of conversion is likely to conclude that exemptions are to be determined as of the date of conversion.<sup>37</sup> And, obviously, if a court has concluded that the debtor's postpetition/preconversion earnings are not property of the estate, it will not be necessary to determine if these earnings can be claimed as exempt—the debtor can keep these earnings without claiming an exemption.<sup>38</sup>

This part of the article considers some less obvious exemption questions raised by the conversion of a case from chapter 13 to chapter 7.

#### A. PROBLEMS

Assume, again, that Floyd Lawson files a chapter 13 petition on January 15th. He also files a chapter 13 statement identifying exempt property. On April 5th, Floyd files a motion to convert to chapter 7 and an order of conversion is entered. This conversion can create a number of different exemption issues. What if the exemption law in North Carolina<sup>39</sup> changed between January 15th and April 5th? What if the nature of or use of his property has changed so that it would no longer meet the requirements of the state exemption statute? What if the value of the property that Floyd identified as "exempt" has changed?

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<sup>37</sup>E.g., *In re Winchester*, 12 COLLIER BANKR. CAS. 2d (MB) 293 (Bankr. 9th Cir. 1984); *In re Wanderlich*, 11 BANKR. CT. DEC. (CRR) 467 (Bankr. W.D. N.Y. 1984).

<sup>38</sup>*In re Vasquez*, 9 BANKR. CT. DEC. (CRR) 197, 198 (Bankr. W.D. N.Y. 1982); *In re Lepper*, 58 Bankr. 896, 898 (Bankr. Md. 1986).

<sup>39</sup>Remember, Mayberry, North Carolina.

### B. POSTPETITION/PRECONVERSION CHANGES IN STATE EXEMPTION STATUTES

Between the date that the Stinsons filed their chapter 13 petition and the date that they converted to chapter 7, the Oregon law regarding exemptions changed; the Oregon legislature enacted a statute "opting out" of the federal exemptions. Thus, at the time that the Stinsons filed their original petition, debtors could choose either the federal exemption provided by section 522(d) or the state exemptions pursuant to section 522(b)(2). At the time of the conversion of their case to chapter 7, Oregon debtors then filing for chapter 7 relief could only claim the exemptions under section 522(b)(2). After the conversion, the Stinsons filed exemption schedules claiming exemptions under section 522(d). The bankruptcy court held that section 522(d) was no longer available to Oregon debtors and ordered the Stinsons to file an amended schedule of exemptions.<sup>40</sup> The reason for the holding was that: "(F)or purpose of claiming exemptions in the Chapter 7 case the law applicable to determine what property may be claimed exempt is the law in effect at the time of conversion to Chapter 7."<sup>41</sup> The reason for this statement was that the *Stinson* court earlier concluded that the date of conversion was the appropriate time for determining property of the estate.<sup>42</sup>

This bankruptcy court decision was overruled by the district court in an unreported decision.<sup>43</sup> The district court's opinion in *Stinson* emphasized the language of section 522(b)(2)(A) – "state or local law that is applicable on the date of the filing of the petition"<sup>44</sup> – and the language of section 348 – "does not effect a change in the date of the filing of the petition."<sup>45</sup>

Although the bankruptcy court's decision in *Stinson* was reversed by the federal district court, it has been expressly endorsed by the Eighth Circuit in its opinion in *In re Lindberg*.<sup>46</sup> Other courts that have adopted the date of conversion as the date for fixing property of the estate would also probably agree with the bankruptcy court in *Stinson*.

### C. CHANGES IN THE USE, NATURE, OR VALUE OF PROPERTY

This choice between date of filing and date of conversion also becomes important where there is a change in the use, nature, or value of the property.

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<sup>40</sup>*In re Stinson*, 8 COLLIER BANKR. CAS. 2d (MB) 16 (Bankr. Or. 1982), reversed in an unreported decision that was printed as an appendix to *In re Kao*, 52 Bankr. 454 (Bankr. Or. 1985).

<sup>41</sup>8 COLLIER BANKR. CAS. 2d (MB), at 19.

<sup>42</sup>8 COLLIER BANKR. CAS. 2d (MB), at 18.

<sup>43</sup>While the federal district court decision in *Stinson* was not reported, it has been printed as an appendix to *In re Kao*, 52 Bankr. 452 (Bankr. Or. 1985).

<sup>44</sup>52 Bankr. at 455.

<sup>45</sup>*Id.*

<sup>46</sup>735 F.2d 1087 (8th Cir. 1984).

Recall that *In re Lindberg* involved such a change in use.<sup>47</sup> At the time of their chapter 13 petition, the Lindbergs lived in the home in New Town and claimed this house as their homestead. At the time of the conversion to chapter 7, they lived on their farm and wanted to claim the farm as their homestead. The Eighth Circuit held that the date of conversion is the important date in determining exemptions and allowed the change of exemptions.

In so ruling the Eighth Circuit relied more on three policy arguments than the particulars of statutory language. The court noted that if the date of the chapter 13 filing controlled exemption questions, the Lindbergs would be required to claim as homestead a house in which they no longer lived and this is contrary to both section 522 and state exemption laws.<sup>48</sup> Second, in other cases, a debtor might lose exemptions because he transferred property after his chapter 13 filing, and this is contrary to the Bankruptcy Code's policy of "fresh start,"<sup>49</sup> of "full use of exemption."<sup>50</sup> Finally, the court looked to the consequences of dismissal, implying that the debtor who converts from chapter 13 to chapter 7 should not be treated less favorably than the debtor who dismisses his chapter 13 case and then files a new chapter 7 petition.<sup>51</sup>

In a chapter 13 case, a debtor has a statutory right to have his case dismissed.<sup>52</sup> If the case is dismissed and the debtor later files a new chapter 7 case, exemptions in this new case will be determined as of the time of the chapter 7 filing. The *Lindberg* decision states that it would be "inequitable" to provide for a different result for the debtor who instead simply files a motion to convert.

*In re Winchester*<sup>53</sup> is, in some respects, the factual "mirror image" of *Lindberg*. In *Winchester*, the property in question was exempt as of the date of the chapter 13 filing but not as of the date of the order of conversion to chapter 7. In their Chapter 13 Statement, the Winchesters claimed their home as exempt. Later, they filed a chapter 13 plan that provided for the

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<sup>47</sup>*Id.*

<sup>48</sup>735 F.2d 1090.

<sup>49</sup>*Id.*

<sup>50</sup>*Id.*

<sup>51</sup>735 F.2d 1091. Remember that the consequences of conversion are very different from the consequences of dismissal and refiling. Consider, for example, the application of section 547 and the other avoidance provisions. If the debtor converts his case, the filing of the superseded case remains the relevant time for applying section 547's ninety day period and section 548's one year period. Similarly, only transfers that occurred prior to the filing of the superseded case can be challenged under section 544, 545, 547, and 548.

<sup>52</sup>Section 1307; see *In re Benediktsson*, 11 BANKR. CT. DEC. (CRR) 209 (Bankr. W.D. Wash. 1983); H. DRAKE & J. MORRIS, CHAPTER 13 PRACTICE AND PROCEDURE § 13.02 (1983); but cf. *In re Gillion*, 10 BANKR. CT. DEC. (CRR) 1354 (Bankr. E.D. Ark. 1983).

<sup>53</sup>12 COLLIER BANKR. CAS. 2d (MB) 293 (Bankr. 9th Cir. 1983).

sale of the house. The plan was confirmed, and the house was sold. The Winchesters failed to reinvest the proceeds from this sale within one year as required by state exemption law. Later, they converted the case to chapter 7. In concluding that the proceeds from the sale were not exempt in this chapter 7 case, the Bankruptcy Appeals Panel for the Ninth Circuit stated "logic dictates that the date of conversion is the controlling date on which to determine the debtor's exemptions, and property of the Chapter 7 estate."<sup>54</sup>

The "logic" can be found in the facts of *Winchester*. More than two years elapsed between the filing of the chapter 13 petition and the conversion to chapter 7. A debtor who converts to chapter 7 two or three years after originally filing a chapter 13 case may at the time of conversion have completely different property from what he owned at the time of the commencement of the chapter 13 case.

Even if the debtor has the same property at both filing and conversion, the property will have a different value. The question then arises at what point in time should the value of the debtor's property and consequently his equity be measured. This question affects the determination not only of exemption, but also lien avoidance.

Section 522(f) permits the avoidance of certain liens on an interest of the debtor in property to the extent that the lien impairs a debtor's exemption. In order to determine whether a lien impairs a debtor's exemption, the court must determine the value of the debtor's equity in the property as of some point in time. A debtor's exemption is impaired only to the extent that there is insufficient equity to cover both the debtor's exemption and the lien.

A court that considers the date of conversion as the relevant date of fixing property of the estate will probably also look to that date for valuing the debtor's equity in exempt property.<sup>55</sup> Similarly, a court that considers the date of filing as the relevant date for fixing property of the estate will probably also look to that date of valuing the debtor's equity in exempt property.<sup>56</sup>

#### D. POLICY CONSIDERATIONS

In dealing with these exemption questions, it is more difficult to find a statutory basis for considering post-filing occurrences. Remember, paragraph (a) of section 348 makes the date of the initial bankruptcy filing the critical date for most purposes. In exemption questions, unlike property of the estate questions, it is not at all helpful to argue that the case should be treated as a chapter 13 case from the time of filing until the time of conversion.

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<sup>54</sup>12 COLLIER BANKR. CAS. 2d (MB), at 296.

<sup>55</sup>See *In re Salamone*, 12 COLLIER BANKR. CAS. 2d (MB) 517 (Bankr. E.D. N.Y. 1984).

<sup>56</sup>Cf. *In re Dennis*, 10 BANKR. CT. DEC. (CRR) 930 (Bankr. M.D. Ga. 1983).

While property of the estate in chapter 13 cases is different from property of the estate in chapter 7 cases, "exempt property" in chapter 13 cases is *not* different from exempt property in chapter 7 cases. In both chapter 13 cases and chapter 7 cases, section 522 determines what property is exempt.

On the other hand, the policy arguments for considering exemptions issues as of the date of conversion are stronger than the policy arguments for determining property of the estate as of the time of conversion. As noted in the cases discussed above, the debtor might have completely different property at the time of conversion, he might have different needs, and the value of the property might have changed.

### III. CONVERSION FROM CHAPTER 11 TO CHAPTER 7 AND PROOF OF CLAIM

Creditors are generally required to file proofs of claims. Section 1111(a) creates a significant exception to this requirement for creditors in a chapter 11 case. Under section 1111(a), creditors whose claims are scheduled by the debtor in possession or trustee can participate in the chapter 11 case without filing a proof of claim; such claims are "deemed filed under section 501." What if the case is later converted from chapter 11 to chapter 7? Will the claims be "deemed filed" in the chapter 7 case? The Third Circuit recently provided an affirmative answer to this question in *In re Crouthamel Potato Chip Co.*<sup>57</sup>

In 1979, Crouthamel filed a chapter 11 petition. It included all of its employees' wage claims in its schedule of debts, and the employees did not file proofs of claim. In 1982, the case was converted to chapter 7 and notice was mailed to all creditors, including employees, establishing a six month bar date for the filing of claims in the chapter 7 case. Again, the employees did not file proofs of claim. The chapter 7 trustee filed an objection to the allowance of claims on the ground that they had not been timely filed. The bankruptcy court and the district court upheld this objection. The Third Circuit reversed.

The five page opinion dismisses the trustee's strong arguments based on the language of (1) section 103(f),<sup>58</sup> (2) Rule 3002(a),<sup>59</sup> and (3) Rule 1009<sup>60</sup> with the statement in a footnote, "Impressive authorities have warned us not to depend too much on the literal interpretation of words of law."<sup>61</sup>

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<sup>57</sup>786 F.2d 141 (3d Cir. 1986).

<sup>58</sup>786 F.2d at 144.

<sup>59</sup>*Id.*

<sup>60</sup>*Id.*

<sup>61</sup>786 F.2d at 145, n.5.

Judge Aldisert<sup>62</sup> instead relies on "what actually takes place in the real world of bankruptcy practice".<sup>63</sup> "Requiring a second [second?] filing serves little purpose. No person interested in the proceeding will be injured or inconvenienced, no guarantee diluted if the original claim is recognized in the chapter 7 proceeding."<sup>64</sup>

Arguably, Crouthamel's employees are no different from any other creditors of a chapter 7 debtor. Arguably, requiring the employees in the *Crouthamel* case to file a proof of claim serves the same purposes as requiring any holder of a scheduled claim in a chapter 7 case to file a proof of claim. Arguably, the Crouthamel case raises the same question as the cases considered in the "property of the estate" part of this article: When a case is converted from chapter 11 to chapter 13 to chapter 7, is it necessary to treat it as if it were a chapter 7 case from the time of initial filing?

#### IV. SOME CONCLUDING COMMENTS

Obviously, section 348 does not expressly provide for all of the consequences of converting a bankruptcy case. Numerous conversion questions have not been specifically dealt with by Congress—are left for the courts to resolve.

In resolving these question, the courts should give great weight to the principle of finality. Actions taken, decisions made, should not be undone. For example, no court has suggested that payments made in a superseded chapter 11 or chapter 13 case should be recoverable by the chapter 7 trustee or by the debtor. Payments pursuant to a confirmed plan constitute payments authorized "under this title or by the court" and thus are protected by section 549(a)(2)(B). In *In re Ford*,<sup>65</sup> Judge Martin held that section 1107's authorization of continuation of business operations prevented a chapter 7 trustee from recovering payments made prior to confirmation in the superseded chapter 11 case.

It can be argued that when a chapter 13 petition is filed, a decision is made with respect to property of the estate. The debtor's postpetition earnings are automatically made property of the estate and protected from the reach of creditors by the automatic stay. Under the principle of finality, this action should not be undone.

It can also be argued that when a chapter 13 petition is filed, a decision is made with respect to exemptions. Exemptions are listed in chapter 13 statements. This argument for exemptions is less persuasive than the above argument regarding property of the estate. The exemptions claimed by chap-

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<sup>62</sup>Judge Aldisert served as Chairman of the Advisory Committee on Bankruptcy Rules.

<sup>63</sup>786 F.2d at 145.

<sup>64</sup>*Id.*

<sup>65</sup>BANKR. L. REP. (CCH) ¶ 71,188 (Bankr. W.D. Wisc. 1986).

ter 13 debtors are of very limited practical significance. As noted by the court in *In re Winchester*, "The exemptions claimed by the debtor upon the filing of their Chapter 13 petition are not really exemptions at all. They are merely statements used to show what the debtors would claim as exempt if their case were a liquidation case." Accordingly, permitting a debtor to choose his exempt property from his property as of the time of conversion to chapter 7 does not undo actions taken or decisions made.

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