

Bankruptcy Blog Re: Debtor's Funds When Case Is Converted From Chapter 13 To Chapter 7

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The Supreme Court of the United States was recently asked 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 or distributed to creditors. On May 18, 2015, in *Harris v. Viegelaahn*, 575 U.S. _____ (2015), Justice Ginsberg delivered the opinion for a unanimous United States Supreme Court holding that a Chapter 13 Bankruptcy Trustee must return any undistributed, post-petition wages to a Debtor when a Debtor's Chapter 13 case is converted to a case under Chapter 7 of the United States Bankruptcy Code. The decision reverses the prior ruling from the United States Court of Appeals for the Fifth Circuit who held that the Chapter 13 Trustee could disperse the post-petition wages to creditors following the conversion of the Debtor's Chapter 13 case to a case under Chapter 7. Courts across the country have been split on who is entitled to post-petition wages held by a Chapter 13 Trustee following conversion of a Debtor's Chapter 13 case to a case under Chapter 7. Bankruptcy Courts in Missouri and Massachusetts agreed with the Fifth Circuit's ruling that Chapter 13 Trustees could distribute funds left over following conversion of a Debtor's Chapter 13 case to a case under Chapter 7, while the Third Circuit Courts, the Ninth Circuit Bankruptcy Appellate Panel, as well as Bankruptcy Courts in Alabama and Wisconsin, have held that money remaining with the Chapter 13 Trustee following conversion of the Debtor's Chapter 13 case to a case under Chapter 7 must be returned to the Debtor.

Justice Ginsburg noted that 11 U.S.C. §348(f)(2) provides that if a conversion to Chapter 7 case is made in bad faith, the converted Chapter 7 estate would consist of the property of the Chapter 13 estate as of the date of conversion and therefore post-petition wages and other assets acquired by the Debtor post-petition would be available for liquidation and distribution to creditors. The Supreme Court held, therefore, that when conversion to Chapter 7 is made in good faith, there is no penalty for conversion to Chapter 7 and thus the converted Chapter 7 estate would consist of the Debtor's assets as of the petition date and not include the undistributed post-petition wages paid to the Chapter 13 Trustee.

The Supreme Court also reasoned that, 11 U.S.C. §348(e) provides that conversion to Chapter 7 terminates the service of the Chapter 13 Trustee. One of the core services of the Chapter 13 Trustee is disbursements of payments to Creditors pursuant to the Debtor's Chapter 13 Plan 11 U.S.C. §1329(c). The moment a case is converted from Chapter 13 to Chapter 7, the Chapter 13 Trustee is stripped of any authority to provide that core service and thus is barred from making any further distributions to creditors or otherwise from accumulated funds paid by the Debtor pursuant to the Chapter 13 Plan. As a result of this ruling, creditors must insure that they are receiving timely payments, whether from the Chapter 13 Trustee or directly from the Debtor. This may include insuring that regular distributions are made by the Chapter 13 Trustee and/or requests for immediate adequate protection payments following the filing of a Chapter 13 bankruptcy case.