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Consumer Track

Who Gets What? Chapter 7 and 13 Conversions, Dismissal Considerations and More

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WHO GETS WHAT?

CHAPTER 7 AND CHAPTER 13 CONVERSIONS

DISMISSAL CONSIDERATIONS

AND MORE!

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I. WHERE DO THE ASSETS GO?

A. The Chapter 7 Estate

Upon filing a Chapter 7 bankruptcy petition all legal or equitable interests of the debtor in property as of the commencement of the case become property of the bankruptcy estate. 11 U.S.C. § 541(a).

Only property interests held as of the commencement of a Chapter 7 case are property of the bankruptcy estate. *Sharp v. Dery*, 253 B.R. 204 (E.D. Mich. 2000) (A bonus which is not earned as of the Chapter 7 petition date is not property of the Chapter 7 bankruptcy estate even if it is received by the debtor immediately after the commencement of the case.) See also *Blachy v. Butcher*, 35 F. Supp. 2d 554 (W.D. Mich. 1998) (If property is held jointly by a debtor and her spouse on the petition date a post-petition deed from the spouse to the debtor creates an interest that is not property of the estate).

1. Conversation from Chapter 7 to Chapter 13

A Chapter 7 debtor may convert a case to a case under Chapter 11, 12, or 13 at any time if the case has not been previously converted to Chapter 7 pursuant to Sections 1112, 1208, or 1307 of the Bankruptcy Code. 11 U.S.C. § 706(a).

Upon conversion to Chapter 13, the Chapter 7 trustee has no further standing to prosecute or settle proceedings filed prior to conversion. In *Cable v. Ivy Tech State College*, 200 F.3d 467 (7th Cir. 1999); overruled on other grounds by, *Hill v. Tangherlini*, 724 F.3d 965 (7th Cir. 2013), the Court ruled that a Chapter 13 debtor had standing to file, prosecute and appeal a chose in action belonging to the Chapter 13 estate. The Court noted: Upon conversion of a Chapter 7 case to a Chapter 13 case, all property of the Chapter 7 estate ". . . returns to the debtor under the guidance of the Chapter 13 trustee.") *Id.* at 475, citing 11 U.S.C. §§ 1302 and 1306. *See also In re Grossot*, 205 B.R. 341 (Bankr. M.D. Fla. 1997).

2. Dismissal of the Chapter 7

Unless the court for cause orders otherwise, upon dismissal of a Chapter 7 case, all property of the estate revests in the entity in which such property was vested immediately before the commencement of the case. 11 U.S.C. § 349(b)(2). This section applies to cases under Chapter 7, 11, 12, and 13 of the Bankruptcy Code. *See* 11 U.S.C. § 103(a). As a result, decisions addressing the status of property after dismissal of cases from other chapters of the Bankruptcy Code will be applicable to dismissed Chapter 7 cases. For cases addressing this issue, see cases cited in "Dismissal of Chapter 13" below.

B. The Chapter 13 Estate

In addition to the property specified in Section 541 of the Bankruptcy Code, a Chapter 13 estate includes all property of the kind specified in Section 541 that the debtor acquires after the Chapter 13 is commenced and before the case is closed, dismissed, or converted to a case under Chapter 7, 11, or 12. 11 U.S.C. § 1306(a)(1).

As a result, life insurance proceeds and inheritances received by a Chapter 13 debtor more than 180 days after the Chapter 13 petition date fall within the definition of property of the estate under Section 1306(a). *In re Murdock,* 547 B.R. 475 (Bankr. S.D. Ga. 2015) (re: life insurance proceeds). *In re Mizula*, 525 B.R. 569 (Bankr. D. NH 2015), citing *Carroll v. Logan (In re Carroll)*, 735 F.3d 147 (4th Cir. 2013) and *In re Lybrook*, 951 F.2d 136 (7th Cir. 1991) (re: inheritance).

The Chapter 13 estate also includes earnings from services performed by the debtor after commencement of the case but before the case is closed, dismissed, or converted. 11 U.S.C. § 1306(a)(2).

Property of the Chapter 13 estate includes property acquired before and after plan confirmation. *See In re Waldron*, 536 F.3d 1239 (11th Cir. 2008). The *Waldron* court, citing the plain meaning of 11 U.S.C. § 1306(a), held that debtor's claims for underinsured-motorist benefits which arose after confirmation of his Chapter 13 plan were property of the Chapter 13 bankruptcy estate. *Id*. at 1242.

Proceeds from the sale of exempt property, received during a Chapter 13 case are subject to distribution to the debtor's creditors if the proceeds are non-exempt or become non-exempt before the case is closed, dismissed, or converted. *In re Frost*, 744 F.3d 384 (5th Cir. 2014). *See also Garcia v. Bassel*, 507 B.R. 907 (D. N.D. TX 2014).

Income derived from exempt and non-exempt assets is considered property of a Chapter 13 estate. *In re Solomon*, 67 F.3d 1128, 1135 n.1 (4th Cir. 1995) and *In re Schnabel*, 153 B.R. 809, 818 (Bankr. N.D. Ill. 1993).

In Chapter 13 the debtor remains in possession of all estate property except as specified in the Chapter 13 plan or the order confirming the plan. 11 U.S.C. § 1306(b).

1. Conversion from Chapter 13 to Chapter 7

Estate property in a case converted from Chapter 13 to Chapter 7, consists of property belonging to the debtor as of the date the original Chapter 13 case was filed. 11 U.S.C. § 348(f)(1)(A). Hence, income and earnings acquired during a debtor's Chapter 13 case do not become property of the Chapter 7 estate upon conversion. *Harris v. Viegelahn*, __ U.S. __, 135 S. Ct 1829, 191 L. Ed. 2d 783 (2015). In *Harris*, the Supreme Court rejected arguments that the Chapter 13 trustee held undistributed post-petition earnings at the time of conversion in trust for the benefit of creditors.

However, if conversion from Chapter 13 is based on the debtor's bad faith, then property of the estate in the converted case includes all property of the estate as of the date of conversion. 11 U.S.C. § 348(f) (2), *In re Lien*, 527 B.R. 1 (Bankr. D. Minn. 2015) and *In re Bostick*, 400 B.R. 348 (Bankr. D. Conn. 2009) (Section 348(f)(2) does not apply to an involuntary conversion.). *See also In re Michael*, 699 F.3d 305 (3d Cir. 2012) (Undistributed funds held by the Chapter 13 trustee at conversion belonged to the debtor unless the conversion was in bad faith). A more detailed discussion of what constitutes property of the estate after conversion begins at page 6 below.

Asset valuations established in Chapter 13 carry forward only for cases converted to Chapter 11 or 12, not for cases converted to Chapter 7. 11 U.S.C. § 348(f)(1)(B). *In re Airhart*, 473 B.R. 178 (Bankr. S.D. Tex. 2012). (In a Chapter 7 case which was converted from a Chapter 13, the value of property for redemption purposes is not determined by using the value established during the Chapter 13). In *Airhart*, the Court used the current commercially reasonable disposition approach to value debtor's used vehicle for purposes of redemption during her Chapter 7.

However, a secured creditor retains its lien to the extent recognized by applicable non-bankruptcy law until the earlier of the full payment of the underlying debt determined under applicable non-bankruptcy law or discharge. 11 U.S.C. § 1325(a)(5)(A)(i). *See In re Lewis*, 2010 W.L. 2025773 (Bankr. N.D. Ga. 2010) (Upon conversion of their case to a Chapter 7, the debtors were not permitted to redeem their vehicle for zero dollars because, although they had paid the amount of the creditor's secured claim through their Chapter 13 plan, they had not paid the full contractual interest rate and the creditor's claim continued to be secured by its lien on the vehicle). See these materials beginning at page 9 below for a more detailed discussion regarding the rights of secured creditors in converted cases.

2. Dismissal of Chapter 13

"Under 11 U.S.C. § 349(b), the pre-discharge dismissal of a bankruptcy case returns the parties to the positions they were in before the case was initiated." *In re Oparaji* 698 F.3d 231 at 238 (5th Cir. 2012), quoting *In re Sanitate* 415 B.R. 98, 104 (Bankr. E.D. Pa. 2009). "…the purpose of this section is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case." *Id*. (citations omitted)

As with a Chapter 7 dismissal, the dismissal of a Chapter 13 case causes the property of the estate to revert to the entity in which such property was vested immediately prior to the filing. 11 U.S.C. § 349(b)(3); *In re Groves*, 27 B.R. 866 (Bankr. D. Kan. 1983).

In Groves the Court held that a creditor's property right (a security interest) revested in creditor when debtor's Chapter 13 was dismissed before discharge. As a result the creditor held a valid, restored security interest when debtor filed a subsequent Chapter 13. Id at 868.

Also, see *In re Booth*, 289 B.R. 665 (Bankr. N.D. Ill. 2003) (Because the creditor's entire claim, both the secured and unsecured components, had not been fully paid at the time of Chapter 13 dismissal, the lien released during the Chapter 13 was reinstated and attached to the remaining indebtedness in a subsequently filed Chapter 7 case.) The Court in *Booth* granted a secured creditor relief from stay in the subsequently filed Chapter 7 to permit the creditor to enforce the reinstated lien.

In spite of the debtor's right to dismiss a Chapter 13 case, the Bankruptcy Court may retain jurisdiction to punish a Chapter 13 debtor for contempt and dismissal does not prevent the court from retaining jurisdiction over a related adversary proceeding. *In re Cusano*, 431 B.R. 726 (B.A.P. 6th Cir. 2010) (An order granting voluntary dismissal does not deprive the Bankruptcy Court from jurisdiction to modify the order to condition a dismissal). *See also In re Smart*, 212 B.R. 419 (Bankr. S.D. Ga. 1997) (Court retained contempt power to impose sanctions against debtor for her misconduct during the pendency of the case).

Dismissal of debtor's Chapter 13 case does not require dismissal of debtor's adversary proceeding against creditor for violation of the automatic stay which allegedly occurred while the Chapter 13 was pending. *In re Burgner* 218 B.R. 413 (Bankr. E.D. Tenn. 1998). In *In re Chapman*, 265 B.R. 796 (Bankr. N.D. Ill. 2001), order aff'd 2002 WL 818300 (N.D. Ill. 2002), the Court retained jurisdiction over a pending adversary proceeding after a debtor had voluntarily dismissed his Chapter 13 case based on judicial economy, the parties' convenience, fairness, and comity. But *see In re Harris*, 298 B.R. 897 (Bankr. M.D. Ala. 2003), aff'd, 306 B.R. 357 (M.D. Ala. 2004) (Following dismissal of the Chapter 13 case, there is no estate to be administered and the outcome of the adversary proceeding would not positively or negatively affect the bankruptcy estate; therefore, the court remanded a removed action to the state court).

C. Exemptions

Subject to the exceptions specified in 11 U.S.C. § 522(c) "Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such had arisen, before the commencement of the case…" *Id*.

Generally, a party in interest may file an objection to the debtor's list of property claimed as exempt within 30 days after conclusion of the meeting of creditors held under Section 341 of the Bankruptcy Code, or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. Fed. R. Bankr. Pro. 4003(b)(1).

Upon conversion of a case to Chapter 7, a new 30 day time period for a party in interest to file an objection to debtor's claim of exemptions commences unless:

- The case was converted to Chapter 7 more than a year after entry of the first order confirming a plan under Chapter 11, 12 or 13 or,
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- The case was previously pending in a Chapter 7 and the deadline to object to a claimed exemption had expired in the original Chapter 7 case.

  Fed. R. Bankr. P. 1019(2)(B).

Rule 1019(2)(B) was enacted in 2010 to resolve a disagreement among the courts as to whether a Chapter 7 trustee could object to a debtor's claim of exemptions after conversion from Chapter 13. *In re Golden*, 528 B.R. 803 (Bankr. D. Col. 2015).

Prior to the enactment of rule 1019(2)(B), a majority of the courts addressing the issue held that a Chapter 7 trustee was precluded from objecting to a debtor's claim of objections in a case which had been converted from Chapter 13. *Id.* at 811.

However, the terms of Fed. R. Bankr. P. 1019(2)(B) clearly do not apply in a case converted from Chapter 7 to Chapter 13. *In re Sharkey*, 560 B.R. 470, 475 n. 3. (Bankr. E.D. Mich. 2016). As a result, there is a continuing disagreement among courts regarding the Chapter 13 trustee's right to object to a debtor's claim of exemptions in a Chapter 13 which has been converted from a Chapter 7. *In re Kositphasaj*, 2006 WL 4854386 (Bankr. D. Mary. 2006).

For a discussion of the differing views on this issue and a collection of decisions addressing the issue, see *In re Fonke* 321 B.R. 199 (Bankr. S.D. Tex. 2005) which addresses the conflicting views in the context of a case converted from Chapter 13 to Chapter 7 prior to enactment of rule 1019(2)(B).

WHAT IS PROPERTY OF THE ESTATE POST-CONVERSION?

When a Chapter 13 Debtor converts to Chapter 7, are his post-petition assets (personal injury, contract claims, inheritance, tax refunds, business distributions, etc.) the Debtor's property or do those assets become property of the Chapter 7 estate? Answer: Yes, post-petition assets remain with the Debtor, unless the Debtor's conversion from Chapter 13 to Chapter 7 was done in bad faith.

Start with the Statute:

11 U.S.C. §348(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;

The analysis begins with an understanding of which date controls to create the property of the estate…. the Chapter 13 petition date or the conversion date? In the context of a case converting from Chapter 13 to Chapter 7, it is clear, the "petition date" controls in the creation of the property of the estate.

"Conversion of case from Chapter 13 to Chapter 7 does not change the date of filing of the petition; upon conversion, 11 USCS § 348(a) requires court to look back to date of filing of original Chapter 13 petition to determine creation of estate and what is included as property of Chapter 7 estate. *In re Gorski* (1988, BC MD Fla) 85 BR 155, CCH Bankr L Rptr P 72274". Lexis Nexus 11 USCS § 348 *17. Converted Chapter 13 cases*.

The rationale is that the Debtor should be no worse off for having tried and failed in chapter 13:

"…when a case is converted from a chapter 13 to one under Chapter 7, the Chapter 7 estate consists only of the property as of the original petition date that remains in the estate as of the conversion date, unless case converted as a result of Debtor's bad faith." *Ginsberg & Martin on Bankruptcy*, 5th Ed Vol 2 section 15.07[3].

For example, *In re Rosenberg* the chapter 13 Debtor had a post-petition claim for wrongful termination which arose post-petition. The court held that the Debtor's claim remained the Debtor's property and not property of the Chapter 7 estate. *Ginsberg & Martin on Bankruptcy*, 5th Ed Vol 2 section 15.07[3] citing *In re Rosenberg*, 303 B.R. 172(B.A.P 8th Cir.2004). "The idea is that absent bad faith, the estate should not be larger than if the Debtor had originally filed Chapter 7 instead of Chapter 13. In the circumstances of a finding of bad faith, the estate shall be comprised of all the assets of the Debtor at the time the case was converted". Id at 1507[c][3].

It is a simple three step analysis: Did the Debtor own or have an interest in the property on the Chapter 13 petition date? If so, did the property remain in the Debtor's possession or control until conversion to chapter 7? If so, the property remains property

of the case post-conversion. Conversely, if the Debtor did not own or have an interest in the property on the Chapter 13 petition date, i.e. an interest was acquired post-petition, then it is not property of the estate in the converted chapter 7, unless the conversion is undertaken by the Debtor in bad faith.

Post-petition loot remains the loot of the Debtor:

- Income received post-petition in the amount of $55,000 and $10,350 the Debtor received from a tax refund remained the Debtor's property upon conversion. *Shields v Adams (In re Adams)* (2011, BC ND Ala) 453 BR 774, 107 AFTR 2d 2304.
- Lottery winnings remain the Debtor's property. Adams v. Bostick (In re Bostick), 400 B.R. 348 (Bankr. D. Conn. 2009)
- Chapter 7 trustee could not avoid post-petition, pre-conversion transfer of proceeds from sale of Debtor's homestead to his former wife because when homestead revested in Debtor upon confirmation of his Chapter 13 plan, he acquired absolute ownership and control of property and was not required to remain in possession of it. Upon conversion to Chapter 7, only property of Chapter 13 estate that remained in possession of or under control of Debtor on date of conversion became property of Chapter 7 estate. *Sender v Golden* (*In re Golden*) (2015, BC DC Colo) 528 BR 803.

Like every good rule an exception can consume the rule. If the Debtor concealed assets, lied about the assets or timed the receipt of the assets to avoid their obligations under a chapter 13 plan Courts have carved out a bad faith exception and have held those actions, if done in bad faith, pull the concealed or conveniently timed receipt of assets into the case as if they had been in the estate since the petition date.

- "Because totality of circumstances revealed that main reason for Debtors' conversion from chapter 13 to chapter 7 was to avoid paying to chapter 13 trustee non-exempt inheritance received by Debtor husband during chapter 13 bankruptcy, Debtors' conversion from chapter 13 to chapter 7 was one done in bad faith." Lexis Nexus 11 USCS § 348 *17. Converted Chapter 13 cases* citing *In re Lien* (2015, BC DC Minn) 527 BR 1.
- "Congress recognized in 11 USCS § 348(f)(2) that, under certain circumstances, property of converted Chapter 7 estate should include property acquired after commencement of Chapter 13 case; where Debtor entered into state-court stipulation stating that Chapter 13 plan was expected to end on certain date and executed this stipulation with knowledge that he had not made payments to holder of deed of trust on real property, that he had filed motion to convert Chapter 13 case to Chapter 7, and that order of conversion would have been entered but for fact that required filing fee had not been paid, conversion was in bad faith as act that was intended to affect non-bankruptcy dissolution proceeding so that Debtor's full interest in real property as of date of conversion

would become property of estate and Debtor would not be entitled to claim homestead exemption in that property. Lexis Nexus 11 USCS § 348 *17. Converted Chapter 13 cases* citing *In re Hainz* (1999, BC ED Mo) 245 BR 347, 43 CBC2d 1083.

- Where conversion of chapter 13 case to chapter 7 was found to be in bad faith, property of Debtors as of date of conversion was property of chapter 7 bankruptcy estate, and non-exempt property thereof had to be turned over to Trustee, including husband's inheritance. In re Lien (2015, BC DC Minn) 527 BR 1.
- Debtor's post-confirmation inheritance became property of the Chapter 7 estate because Debtor's conversion was found to be in bad faith. Ginsberg & Martin on Bankruptcy, 5th Ed Vol 2 section 15.07[3] citing In re Salazar, 465 B.R. 875 1 (B.A.P. 9th Cir. 2012)

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WHO GETS WHAT?

(A CREDITOR'S PERSPECTIVE)

I. POST-PETITION APPRECIATION, DEPRECIATION, AND DIMINUTION

When property of the estate changes in value after the filing of the petition for bankruptcy protection, certain parties may dispute who is entitled to benefit from appreciation, who bears the risk of depreciation, or who is liable for diminution. Here are some cases that discuss these issues.

Post-Petition Appreciation and Lien Stripping/Cram Down

When there is post-petition appreciation in value of property secured by a claim which the debtor seeks to lien strip or cram down, the debtor will want to use the petition date to determine value while the secured creditor will want a date closer to the present moment. The Bankruptcy Code does not provide a specific date for valuing collateral when determine the status of a secured claim under 11 U.S.C. § 506(a).

The United States Supreme Court has indicated in dicta that secured creditors get the benefit of post-petition appreciation. In Dewsnup v. Timm , 502 U.S. 410 (1992), the Chapter 7 debtor filed an adversary proceeding seeking strip down the mortgagee's secured claim by reducing it to the value of the real property pursuant to 11 U.S.C. §506(d). The Supreme Court held §506(d) does not allow the debtor to strip down the lien because the creditor's claim is secured and has been fully allowed. The Supreme Court stated: "We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. The voidness language sensibly applies only to the security aspect of the lien and then only to the real deficiency in the security. Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain." (Emphasis added).

There do not appear to be any appellate decisions on the issue as to what date to use for determining value of property. The bankruptcy courts have used a variety of approaches.

The majority view uses the petition date as the proper date to determine valuation. *See* In re Montiel, 572 B.R. 758 (Bankr. W.D. Wash. 2017) and Putman v. AM Solutions, LLC (In re Putman), 519 B.R. 491 (Bankr. N.D. Miss. 2014).

In Montiel, the debtors' Chapter 13 plan proposed to strip a second lien on the principal residence for being wholly unsecured and therefore not entitled to the anti-modification

provisions under 11 U.S.C. §1322(b)(2). The creditor did not object to the plan which was confirmed without the court deciding the valuation issue. Post-confirmation, the debtors filed a motion to strip the second lien. The creditor objected by arguing there was equity to support its lien. The debtors' motion was filed approximately three years after the petition date. The property had appreciated in value. The debtors argued the petition date should be used to determine value. The creditor wanted a date closer to the hearing date. The court held that the petition date was the most logical date to use to determine the value of the property.

In Marsh v. United States Dep't of Hous. & Urban Dev. (In re Marsh), 929 F.Supp. 2d 852(N.D. Ill, 2013), the district court determined the petition date was the date to use for valuation by considering who bears the risk of post-petition depreciation. The court pointed out that the junior lienholder's risk of post-petition depreciation is eliminated as of the petition date through the mechanism of adequate protection. To allow the junior lienholder to use a post-petition date for valuation would allow the creditor to benefit from appreciation when it no longer bears the risk of depreciation during that post-petition period, which would constitute a windfall to the creditor compared to its non-bankruptcy remedies.

A different conclusion was reached by the court in In re Fuqua, 2015 Bankr. LEXIS 3244, case no. 12-52348, (Bankr. E.D. Mich. 2015). This case involved multiple conversions and a reopening. The time span between the petition date and the confirmation hearing date was over three years. In her Chapter 13 plan, the debtor sought to cram down two rental houses. The value of the properties had appreciated post-petition. The mortgagees objected to confirmation of the plan and argued the date for determining value should be the confirmation hearing date. Judge Walter Shapero recognized that some courts used the petition date, other courts used the confirmation date, and yet other courts took a "totality of the circumstances" approach. The court concluded that the valuation date ought presumptively be the petition date but that presumption is rebuttable under certain circumstances, primarily the following: (a) the amount of time that has passed between the petition date and the confirmation date; (b) the volatility of the market and the post-petition change in value; (c) whether the party materially benefitting from the delay is responsible for the delay or is perceived as trying to manipulate the process; and (d) the likelihood the property will be disposed or become useless during the life of the plan. Applying these principles, the court determined the proper valuation date is the confirmation hearing date.

Post-Petition Appreciation and Exemptions

In the context of exemptions, debtors say post-petition appreciation of property of the estate inures to them, but the trustees say it inures to the estate.

The case of In re Hyman, 967 F.2d 1316 (9th Cir. 1992) has been followed by many courts. In Hyman, the Chapter 7 trustee applied to employ a real estate broker to sell the debtor's principal residence. The debtors filed for declaratory judgment claiming their home is not an asset of the estate because of its exempt status including the post-petition appreciation which should inure to them. The bankruptcy court disagreed with the debtors' position. The 9th Circuit affirmed the bankruptcy court's ruling. Under California law, a forced sale of a homestead is permitted if the sale price exceeds the homestead exemption amount plus the amount of all liens. In determining whether a forced sale may be held, the law speaks only in terms of the exemption amount, not any appreciation or depreciation. The debtors' right to use the exemption comes into play not upon the filing of the petition but only if the trustee attempts to sell the property. Were the debtors to be entitled to post-petition appreciation, we would also have to hold that they are subject to post-petition depreciation whereby they could receive less than their exemption amount. This position is contrary to our case law. "The policies of both federal and state law (as well as the interest in simplifying bankruptcy estate administration) are best served if the debtor is guaranteed the full exemption amount on the date of sale, regardless of the vicissitudes of the real estate market or the timing of the sale."

In the Sixth Circuit there is no binding precedent as to who is entitled to post-petition appreciation in value of property of the estate, but some local courts have followed In re Hyman. *See* In re Heflin, 215 B.R. 530, 535 (Bankr. W.D. Mich. 1997). In Heflin, the debtor's exemptions and a lien exceeded the estimated value of real property as of the petition date. The Chapter 7 trustee (now Judge James Boyd) did not object to the exemptions because they were within the statutory limits. The property's value appreciated post-petition once a developer announced plans to purchase land near the subject property. The debtor moved to compel the trustee to abandon the property. The court denied the motion and rejected the debtor's argument that when the exemption amount exceeds the estimated value of the property (minus liens) this *ipso facto* means the entire value of the property is exempt even if the property subsequently appreciates in value. There was no indication the debtor had intended to exempt the entire property. Also, the trustee was not bound by the estimated value of the property stated in the schedules.

Also see In re Bregni, 215 B.R. 850, 854 (Bankr. E.D. Mich. 1997). In Bregni, the debtor jointly owned a condominium which she valued at $120,000 in her schedules. There was a lien of $90,000 on the property. The debtor claimed an exemption of $15,000. About eight months after the petition date, the condo sold for $158,000. The issue before the court was whether the debtor or the estate was entitled to the net sale proceeds. The court concluded that the debtor was limited to her $15,000 exemption and the net sale proceeds are property of the estate.

However, a court may be inclined to give the debtor the benefit of post-petition appreciation when it results from post-petition services performed by the debtor. *See* Coslow v. Reisz (In re Coslow), 573 B.R. 717 (Bankr. W.D. Kentucky. 2017). In Coslow, the debtor's principal residence had two liens as of the petition date. After the petition date, the second lien amount was substantially reduced with payments made by a third party (not the debtor) as a form of compensation for post-petition services performed by the debtor. The debtor filed an adversary proceeding to determine the estate's interest in the residence. The court ruled the equity which accrues as compensation for post-petition services belongs to the debtor to pursue for his own benefit.

In the Seventh Circuit there is binding precedent which says the debtor may benefit when an exempt asset appreciates in value post-petition. In Polis v. Getaways, Inc. (In re Polis), 217 F.3d 899 (7th Cir. 2000), the Chapter 7 debtor had a pre-petition potential cause of action against Getaways, which she exempted for $900 and assigned it a value of zero. After entry of the discharge, the debtor filed a class action lawsuit against Getaways in federal district court while the bankruptcy case was still open. A week later the bankruptcy case was closed. Soon thereafter Getaways and the trustee moved to reopen the bankruptcy case on the ground that the value of the cause of action exceeded the $900 exemption and therefore had been improperly exempted from the estate. Getaways also moved to dismiss the class action on the ground that the debtor lacked standing. The lower courts agreed that the debtor did not properly exempt the cause of action. Therefore, the district court dismissed the class action and the bankruptcy court revoked the exemption. On appeal, the Seventh Circuit reversed these decisions. Under 11 U.S.C. § 522(a)(2), the value of exempt property means fair market value on the petition date, regardless of the possibility that the asset's value may later appreciate. Here, the evidence was insufficient to show the cause of action had a value greater than $900 as of the petition date.

A similar ruling was reached in In re Wick, 256 B.R. 618 (Minn. 2001). In Wick, the debtor's employer "TTI" agreed to provide the debtor with a contingent stock option that allowed her to receive shares of TTI's stock if she remained employed for one year following the date of the agreement. After four months of employment, the debtor filed for bankruptcy relief under Chapter 7. She listed the stock as an asset of unknown value and exempted $3,925 of the stock. After the bankruptcy case was closed, the debtor completed the year of employment with TTI and began negotiations to exercise her stock options. When the debtor was terminated from employment and did not receive her stock options, she sued in state court and eventually obtained a judgment of $97,200 for her stock. The Chapter 7 trustee successfully moved to reopen the bankruptcy case and commenced an adversary proceeding for turnover of the cash the debtor had received for the stock in excess of the exemption amount. The bankruptcy

court ruled in favor of the trustee and held that the estate had an interest in the asset to the extent the assets value and any post-petition appreciation exceeded the value of the debtor's exemption. On appeal, the district court reversed the bankruptcy court's ruling. The value of the asset and the exemption were determined as of the petition date. The estate's interest in the contingent stock option was $1,605 as of the petition date, which was less than the $3,925 of the available exemption amount. Because debtor exempted all the value of the contingent stock option, the stock option was removed from the estate and re-vested in the debtor. The estate had no interest in the amount eventually received by the debtor. The court also agreed with the debtor's alternative agreement that the holding of Taylor v. Freeland & Kronz, 503 U.S. 638 (1992) applied. The estate was not entitled to the contingent stock option, even if the asset's value had exceeded the exemption amount as of the petition date, because the trustee did not timely object to the exemption.

Post-Petition Appreciation and Conversion

When there is a conversion, it is no surprise that debtors say any post-petition/pre-conversion appreciation belongs to them while the trustees say it belongs to the estate.

In Kakos v. Stevenson (In re Kakos), 2015 U.S. Dist. LEXIS 118243, case no. 14-CV-13736 (E.D. Mi. 2015) , the debtor initially filed a petition for bankruptcy relief under Chapter 13 and a few months later converted to Chapter 7. No plan was confirmed. The debtor's residence had two mortgages. As of the petition date, the second mortgagee had foreclosed and the debtor was in the redemption period. While the case was in Chapter 13, a third party paid the redemption amount on the second mortgage as a "gift" to the debtor. So at the time the Chapter 7 trustee was appointed the value of the debtor's interest in the residence was much greater than it was as of the petition date. The debtor moved to compel the trustee to abandon the residence. The district court affirmed the bankruptcy court's decision to deny the debtor's motion. Although payments made to a secured creditor pursuant to a confirmed Chapter 13 plan are not included in the estate post-conversion, the redemption payment in this case was not made pursuant to a confirmed plan, or even a proposed plan. Therefore the increase in equity caused by the redemption payment is part of the Chapter 7 estate.

In In re Hodges, 518 B.R. 445 (E.D. Tenn 2014), the debtors filed a petition for relief under Chapter 7. Their amended schedules valued their real property at $173,000 subject to a first and second mortgages totaling $143,593.32. They converted to Chapter 13 and made payments on the mortgages totaling $54,316.81 pursuant to a confirmed plan. At the end of their plan, the Chapter 13 trustee successfully moved to reconvert to Chapter 7 for the debtors' failure to submit tax refunds. The Chapter 7 trustee listed the property for sale. The debtors moved to compel the trustee to abandon the property. The bankruptcy court concluded that the increase in equity occurring during the Chapter 13 period is not property of the estate upon conversion to Chapter 7. The district court affirmed this ruling on appeal. Title 11 U.S.C. §348(f) establishes what property is included as property of the estate when a case converts from Chapter 13. Under

§348(f)(1)(A), property of the estate in the converted case shall consist of property as of the petition date that remains in the debtor's possession or control on the conversion date. Under §348(f)(1)(B), valuations of property and of allowed secured claims in the Chapter 13 case shall apply only in a case converted to Chapters 11 or 12 but not in a case converted to Chapter 7. The court ruled that 11 U.S.C. §541 (a) (7)(property of the estate is comprised of any interest in property the estate acquires after the commencement of the case), and 11 U.S.C. §1306(a)(1)(property of the estate includes all property the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted) do not apply in this context involving a conversion.

Post-Petition Diminution and the Trustee's Duties

New Products Corporation v. Tibble (In re Modern Plastics Corp.), 543 B.R. 819 (Bankr. W.D. Mich. 2016), aff'd 732 Fed. Appx. 379 (6th Cir. 2018) – The plaintiff ("NPC") was initially an unsecured creditor as of the petition date and later became a secured creditor pursuant to a post-petition assignment of the loan documents from Bank of America ("BOA"). Neither BOA nor NPC moved for relief from stay or to compel abandonment. BOA allowed insurance to lapse. As a secured creditor, NPC sued the Chapter 7 trustee for damages based on diminution in value of its collateral (real property) allegedly caused by the trustee's breach of fiduciary duties owed to the estate and the secured creditor. NPC asserted that the trustee failed to protect the property against vandals and scrappers who stripped the building over time. After conducting a trial, the bankruptcy court dismissed the claims brought against the trustee. The district court and Sixth Circuit affirmed the bankruptcy court's ruling. A Ch. 7 trustee represents secured creditors only in the capacity of a custodian of the collateral. The trustee's duty to "account for all property received, " 11 U.S.C. §704(a)(2), does not constitute an unqualified duty to protect or manage assets for the benefit of secured creditors at the expense of the estate. Rather, the trustee is required to exercise the care, diligence and skill as that of an ordinary prudent person conducting his or her own private affairs under similar circumstances and of a similar object in view. Here, the liens on the property exceeded its value by more than $950,000 as of the petition date. The property's value was due more to its location than its structures. The scrapping was "shocking" but BOA and the trustee had agreed expressly or impliedly to neglect the building because it was not economical to protect it. The bankruptcy court found the trustee behaved as an ordinary prudent person in the conduct of his private affairs under similar circumstances and with a similar object in view would have behaved. The Sixth Circuit saw no clear error in these findings.

II. REIMPOSING THE AUTOMATIC STAY

The filing of a petition for bankruptcy relief imposes the automatic stay under 11 U.S.C. §362(a). An interested party may request relief from the automatic stay under 11 U.S.C. §362(d).

The issue of whether the automatic stay may be re-imposed often arises when the case converts. Conversion from one chapter to another is governed by 11 U.S.C. §348 which provides:

> (a) Conversion of a case from a case under one chapter of this title to a case under another chapter of this title *constitutes an order for relief* under the chapter to which the case is converted, but, except as provided in subsections (b) and (c) of this section, *does not effect a change in the date of the filing of the petition,* the commencement of the case, or the order for relief.
>
> (b) Unless the court for cause orders otherwise, in [various sections] of this title, "the order for relief under this chapter" in a chapter to which a case has been converted . . . means the conversion of such case in such chapter.
>
> (c) Sections 342 and 365(d) of this title apply in a case that has been converted under section 706, 1112, 1307, or 1208 of this title, as if the conversion order were the order for relief.
>
> (d) A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section 1112, 1307, or 1208 of this title, other than a claim specified in section 503(b) of this title, shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.
>
> (e) Conversion of a case under section 706, 1112, 1307, or 1208 of this title terminates the service of any trustee or examiner that is serving in the case before such conversion. (Emphasis supplied)

In re State Airlines, Inc., 873 F2d 264 (11th Cir. 1989). The appellants sued the debtor for injuries sustained in a plane crash. The debtor's insurer brought an action for a declaratory judgment claiming that is coverage did not include the subject plane. The appellants and the insurer obtained relief from the automatic stay in the Chapter 11 case to pursue their respective actions. The bankruptcy court's order stated "any recovery resulting from a Judgment against State Airlines, Inc. shall be limited to insurance proceeds, if any." The appellants obtained default judgments and were awarded damages, but prior to entry of the judgments the debtor converted to Chapter 7. The insurer moved to intervene in the state court to stay entry of the final judgments on the grounds that the conversion re-imposed the automatic stay. The parties obtained conflicting rulings in the lower courts. The Eleventh Circuit ruled the filing of a petition triggers the stay under 11 U.S.C. §362. A conversion under 11 U.S.C. §348 does not.

In re Parker, 154 B.R. 240 (Bankr. S.D. Ohio 1993). The debtors filed a Chapter 7 case. The secured creditor moved for relief from the automatic stay to allow it to sell two

vehicles. The debtors did not respond to the motion. The court entered an order lifting the stay. A week later, the debtors converted to Chapter 13 and moved to determine the status of the stay. The debtors contended that the creditor was required to obtained relief from stay under the provisions of Chapter 13. The creditor returned the vehicles pending the outcome of the motion. The bankruptcy court ruled that conversion from Chapter 7 to Chapter 13 did not cause the stay to be re-imposed and did not affect the order granting relief from stay. Nonetheless, the court ruled that under certain circumstances and on a case-by-case basis, the court may exercise discretion under 11 U.S.C. §105 to reinstate the stay. To pursue this approach, the debtors must file an adversary proceeding to request injunctive relief.

In re Twenver, Inc., 149 B.R. 950 (D. Colo 1993). The Chapter 11 debtor owned and operated a television station. The primary creditor had a lien on almost all of the debtor's property. The creditor moved for relief from the stay as to its security interests, particularly cash collateral, for not being adequately protected or necessary for reorganization. The unsecured creditors committee opposed the motion. After notice and hearing, the court granted the creditor's motion for relief from the stay. About two weeks later, the committee moved to vacate the order under Fed.R.Civ.P. 59 and 60, applicable under Bankr. R. 9023 and 9024. The committee argued it had been unaware of a pending offer to buy the station which would be more favorable to the unsecured creditors. The secured creditor adamantly opposed the committee's motion. The bankruptcy court held that Rules 59 and 60 do not apply, but agreed to vacate the order lifting the stay pursuant to 11 U.S.C. §105. On appeal, the district court held that the bankruptcy court did not abuse it power under §105 by reimposing the stay. The analysis involves applying the basic test for injunctive relief: (1) a substantial likelihood of success on the merits; (2) irreparable harm; (3) less harm to the opposing party; and (4) no violation of the public interest.

In re Bryant, 296 B.R. 516 (Bankr. D. Colo. 2003). The debtors converted from Chapter 13 to Chapter 7. The mortgagee obtained relief from the automatic stay. The debtors realized a prior discharge prevented a Chapter 7 discharge and reconverted to Chapter 13. They moved under 11 U.S.C. §105 to reimpose the stay. The bankruptcy court held that the debtors must file an adversary proceeding for injunctive relief under Fed.R.Bankr.P. 7001(7), rather than a contested matter under §105. The debtor's only real basis to re-impose the stay was to forestall the mortgagee, which was not a proper ground for injunctive relief. Most importantly, the public interest would be violated if the injunction is granted. A court should not neutralize and/or vitiate a final order barring extraordinary circumstances.

Casner v. Chase Manhattan Mortg. Corp. (In re Casner), 302 B.R. 695 (Bankr. E.D. Cal. 2003). The Chapter 13 debtors sought a temporary injunction to prevent the mortgagee from foreclosing on their residence. After two motions for relief from stay, the mortgagee obtained an order modifying the stay to allow the foreclosure. The debtors wanted additional time to refinance to payoff the mortgage and the plan. The court ruled the debtors were likely to prevail on the merits because they struggled to make their payments and they needed to refinance or sell to complete their plan. Also, there was equity in the property.

COMMON FEE ISSUES UPON CONVERSION OR DISMISSAL

1. Conversion from Chapter 13 to Chapter 7

a. Debtor's attorney fees cannot be paid from postpetition wages on hand with the Chapter 13 trustee.

If the Chapter 13 trustee is holding plan payments made by a debtor from postpetition wages upon conversion from Chapter 13 to Chapter 7, can debtor's counsel be paid from those funds? Or does the Code require return of the funds to the debtor?

The U.S. Supreme Court addressed this issue in *Harris v. Viegelahn* and held that, upon conversion, "postpetition wages must be returned to the debtor." *Harris v. Viegelahn*, __ U.S. __, 135 S. Ct. 1829, 1837 (2015). The Court began its analysis by citing § 348(f), which provides that a debtor's postpetition earnings do not become property of the estate upon conversion from Chapter 13 to Chapter 7. *See* 11 U.S.C. § 348(f)(1)(A); *cf*. § 348(f)(2) (which creates an exception to this general rule for cases converted in bad faith). It then explained:

> By excluding postpetition wages from the converted Chapter 7 estate, § 348(f)(1)(A) removes those earnings from the pool of assets that may be liquidated and distributed to creditors. Allowing a terminated Chapter 13 trustee to disburse the very same earnings to the very same creditors is incompatible with that statutory design. We resist attributing to Congress, after explicitly exempting from Chapter 7's liquidation-and-distribution process a debtor's postpetition wages, a plan to place those wages in creditors' hands another way.

Harris, 135 S. Ct. at 1837.

b. Is the answer different if conversion occurred prior to confirmation?

A majority of courts say "no" and require that the funds must still be returned to the debtor:

> This Court agrees with the growing majority that *Harris* applies equally to cases converted from Chapter 13 to Chapter 7 after confirmation and prior to confirmation. To adopt the reasoning of *[In re Brandon*, 537 B.R. 231 (Bankr. D. Md. 2015)] and rely on § 1326(a)(2) to allow payment of fees in a preconfirmation converted case would ignore the *Harris* court's sweeping statement that "no chapter 13 provision holds sway" after conversion.

In re Lettie, No. 18-24510-BEH, 2019 WL 960157, at *7 (Bankr. E.D. Wis. Feb. 22, 2019) (quoting *Harris*, 135 S. Ct. at 1838).

c. Debtor's attorney fees may be allowed as a second priority in the converted Chapter 7 case.

2.

If Chapter 13 debtor's counsel is not paid by the Chapter 13 trustee, his or her fees may be allowed as an administrative claim in the converted Chapter 7 case:

> As noted during the hearing, and as Debtor's attorney all-but-concedes in his brief, § 726(b) expressly anticipates, and governs, the situation in which a case is converted under § 1307 to Chapter 7 after the estate incurs the obligation to pay administrative claims, but before such claims have been paid. In such a case, the Chapter 13 administrative claims are entitled to payment before most other claims, but not before payment of administrative claims incurred under Chapter 7. *See* 11 U.S.C. § 726(b).

In re Post, 572 B.R. 678, 680 (Bankr. W.D. Mich. 2017).

3. Chapter 13 Dismissal

a. Debtor's attorney fees when case is dismissed **after confirmation**.

If a Chapter 13 case is dismissed post-confirmation, the funds on hand with the Chapter 13 trustee generally must be returned to the debtor.

Upon dismissal, 11 U.S.C. § 349(b)(3) provides that property of the estate revests in the entity in which such property was vested prepetition, unless the court, for cause, orders otherwise.

The Bankruptcy Court for the Eastern District of Michigan has held that *Harris* governs not only when a Chapter 13 case is converted post-confirmation, but also when the case is dismissed post-confirmation:

> The application of *Harris* [in such instances is] consistent with Congress' intention in § 349(b) to basically unwind the entire case as if it never happened. Section 349(b) "serves to undo the bankruptcy case to the extent possible – to put all parties in the position they were in before the case was filed." *In re Hamilton,* 493 B.R. 31, 38 (Bankr. M.D. Tenn. 2013) (citing S. Rep. No. 95–989, 49, reprinted in 1978 U.S.C.C.A.N. 5787, 5835). "[A]fter a bankruptcy case is dismissed, the debtor returns to the status he or she was in before the petition was filed." *Bli v. Greenstone Farm Credit Services, FCLA (In re Bli Farms),* 312 B.R. 606, 622 (E.D. Mich. 2004) (citations omitted). That means that any funds paid by a debtor to a Chapter 13 trustee that are still held by the trustee on dismissal must be returned to the debtor under § 349(b)(3).

In re Bateson, 551 B.R. 807, 813 (Bankr. E.D. Mich. 2016).

Notwithstanding this general rule, could debtor's counsel establish cause upon conversion such that the court would order the property to not revest in the debtor and instead be paid to the attorney? Maybe.

In *Bateson*, Judge Shefferly determined that cause under § 349 did not exist, given the garden-variety reasons alleged by the trustee, such as the case having been pending for 30 months, unsecured creditors not being paid pursuant to the plan, and the debtor's ability to control the timing of dismissal. However, the court said that under different facts, it might find cause to "order otherwise," particularly if those facts established "dishonesty," "gamesmanship," or "bad faith" on the part of the debtor. *In re Bateson*, 551 B.R. at 814.

On the other hand, Judge Dales held that when a case ends, it ends, and that the funds must be returned to the debtor:

> When dismissal brings a case to an end, "courts should limit the effects of the case and their previously exclusive *in rem* jurisdiction over property formerly within the estate, returning the parties to their prior positions as far as possible, governed by applicable non-bankruptcy law." [*In re Gonzales*], 578 B.R. at 632. Here, to avoid giving the [law firm that represented the Debtor] any bankruptcy-related advantage over the Debtor's other creditors, the court will hew to its opinion in *Gonzales* and deny the Motion for the reasons set forth above and in that opinion."

In re Reilly, No. DG 17-02411, 2018 WL 6584776, at *1 (Bankr. W.D. Mich. Dec. 12, 2018); *see also In re Gonzales*, 578 B.R. 627, 633 (Bankr. W.D. Mich. 2017) (holding that § 349(b)(3) does not apply to plan payments made from a debtor's postpetition wages because those wages "were not in existence at the time the case was commenced, let alone vested in anyone at that time"; accordingly, § 349(b)(3) "does not provide grounds" for the court to order the Chapter 13 trustee to return the funds to the debtor's attorney, rather than to the debtor herself).

b. Debtor's attorney fees when case is dismissed **prior to confirmation**.

Most courts hold that if a case is dismissed prior to confirmation, 11 U.S.C. § 1326(a)(2) provides a mechanism to pay outstanding administrative expenses, including attorney fees:

> [B]y the plain language of § 1326(a)(2), when a Chapter 13 case is dismissed before confirmation, the trustee must first pay allowed administrative expenses, including any allowed fees and expenses of the debtor's counsel, before returning any funds on hand to the debtor.

In re Fairnot, 571 B.R. 767, 769 (Bankr. E.D. Mich. 2017).

4. Conversion from Chapter 7 to Chapter 13

a. Unpaid Debtor's attorney fees from the Chapter 7 estate can be allowed and paid from the Chapter 13 estate.

Some courts allow the unpaid fees of debtor's counsel to be paid from the Chapter 13 estate upon conversion:

> [Section] 330(a)(4)(B) permits counsel for a chapter 13 debtor to seek an award of fees and expenses "for representing the interests of the debtor in connection with the bankruptcy case" even when a portion of the fees and expenses were incurred when the case was previously pending in chapter 7.

In re Genatossio, 538 B.R. 615, 617 (Bankr. D. Mass. 2015).

Other courts do not allow such unpaid fees to be paid upon conversion to Chapter 13, citing *Lamie v U.S. Trustee*, 540 U.S. 526, 124 S. Ct. 1023 (2004), which held that debtor's counsel could not be paid from the Chapter 7 estate if the attorney was not employed by the Chapter 7 trustee:

> Here, the Debtors' case began as a chapter 7 proceeding and then converted to chapter 13. While Attorney Feinman [(the Debtors' attorney)] attempts to distinguish these facts and argues that he is entitled to compensation from the estate because, upon conversion of the case to chapter 13, he became a professional person employed under section 327 and a new bankruptcy estate, from which his fees and expenses can be paid, was created. The Court is convinced, nonetheless, that *Lamie* dictates that Attorney Feinman not be compensated from the Debtors' bankruptcy estate for services undertaken during the chapter 7 proceeding as Attorney Feinman did not come within the terms of section 330(a)(1) as he was not employed as a professional person by the chapter 7 trustee pursuant to section 327.

In re Carey, No. 04-11133-JMD, 2006 WL 288226, at *2 (Bankr. D.N.H. Feb. 1, 2006); *see also In re Miller*, Case No. 07-48297 (Bankr. E.D. Mich. Mar. 19, 2008) (unpublished order), *aff'd, Miller v. Rushkin (In re Miller)*, Civil Case No. 08-11384 (E.D. Mich. Aug. 1, 2008) (unpublished order) ("The Supreme Court's directive [under *Lamie*] is clear: under the bankruptcy code, a debtor's attorney can not receive compensation for work done on a chapter 7 case without being authorized under § 327.").

b. Unpaid trustee fees and trustee's attorney fees from Chapter 7 can be an administrative expense in the converted Chapter 13 case.

Sec. 1326(b)(3) provides that if a case is converted or dismissed pursuant to 11 USC 707(b), if a Ch. 7 trustee has been allowed compensation due to the conversion or

dismissal, the compensation must be paid over the life of the Ch. 13 plan, and in an amount not to exceed the monthly amount of the greater of $25, or 5% of the amount paid to unsecured creditors prorated over the life of the plan.

Of course, most cases are not dismissed or converted based on Sec. 707(b). Often, if a Chapter 7 trustee is pursuing assets and, as a result, the debtor voluntarily converts the case to Chapter 13 pursuant to Sec. 706(a), the Chapter 7 trustee can be paid for his or services.

The Bankruptcy Court for the District of Massachusetts recently concluded that the Chapter 7 trustee can be compensated from the Chapter 13 estate even if conversion occurs before the Chapter 7 trustee collects assets or makes distributions:

> [T]he Court does not read the plain language of § 326(a) as precluding Chapter 7 trustee fees in converted cases where the trustee has not disbursed any funds. Section 326(a) is explicitly reserved for limiting trustee compensation *"[i]n a case under chapter 7 or 11."* 11 U.S.C. § 326(a) (emphasis supplied). This case is no longer a case under Chapter 7. Accordingly, "by its terms, read literally, § 326(a) simply does not apply to preclude trustee compensation." *In re Colburn,* 231 B.R. 778, 782 (Bankr. D. Or. 1999); *see also Scott,* 2006 WL 566441 at *2 ("Section 326(a) limits compensation to the trustee in a chapter 7 case, true enough, but the provision becomes irrelevant once the case is converted" to one under chapter 13).

In re Bartlett, 590 B.R. 175, 178 (Bankr. D. Mass. 2018).

Similarly, the District Court for the Eastern District of Michigan recently affirmed the Bankruptcy Court's award of the Chapter 7 trustee's attorney fees based upon making a substantial contribution in accordance with 11 U.S.C. § 503(b)(3)(D):

> Further guidance on when § 503(b)(3)(D) administrative expenses can be awarded in cases outside of the Chapter 9 or Chapter 11 contexts can be drawn from the closing discussion of the [Sixth Circuit's opinion in *In re Connolly North America, LLC*, 802 F.3d 810 (6th Cir. 2015)]. Noting the consistency of its holding with the general purposes of the Bankruptcy Code, the *Connolly* court stated:
>
> > Failing to award administrative expenses to the rare Chapter 7 creditors who are forced by circumstances to take action that benefits the bankruptcy estate when no other party is willing or able to do so would deter them from participating in bankruptcy cases and proceedings, which is plainly inconsistent with the purposes of the Act. This militates in favor of interpreting § 503(b) to embrace reimbursement of administrative expenses in cases such as this one and

> § 503(b)(3)(D) as not divesting the bankruptcy courts of the authority to do so.

Connolly, 802 F.3d at 818 (quotation marks and alterations omitted).

> This Court concludes that in successfully objecting to the exemptions that [the debtors] claimed in the annuities, [the creditor law firm, which had represented the Chapter 7 trustee prior to conversion] was "forced by circumstances to take action that benefit[ted] the bankruptcy estate when no other party [was] willing or able to do so," *id.*, and thus deserved reimbursement through an administrative expense under *Connolly*'s interpretation of 11 U.S.C. § 503(b).

In re Sharkey, No. 17-11237, 2017 WL 5476486, at *8 (E.D. Mich. Nov. 15, 2017).

c. Priority of Ch. 7 administrative claims when the case is converted to Ch. 13.

Unlike Ch. 7, for which Sec. 726(b) provides that it in a Ch. 7 case administrative claims from a prior chapter have second priority status, Chapter 13 has no such corollary. See 11 USC 1322(a)(2), which requires that a plan provided for full payment of all claims entitled to priority under Sec. 507.

5. Can Chapter 7 Trustee and Attorney Fees Be Paid on Dismissal under 11 U.S.C § 707?

There are few reported decisions on the topic, but it appears that the trustee and his or her attorney can be paid if a Chapter 7 case is dismissed pursuant to 11 U.S.C. § 707.

For example, in *In re Kaur*, the Bankruptcy Court for the Eastern District of California held that the debtor failed to establish "cause" under § 707(a) because immediate dismissal would have prejudiced administrative claimants (i.e., the trustee and his law firm) who would only be paid upon successful completion of a pending fraudulent transfer adversary proceeding. The court then stated:

> Although an outright dismissal of the chapter 7 case would be inappropriate, the court can conditionally grant the Debtor's Motion while also sustaining the Trustee's objection to the Motion. Under similar circumstances, some bankruptcy courts have dismissed chapter 7 cases conditioned on the debtor paying the outstanding administrative expenses. *See, e.g., In re Aupperle,* 352 B.R. 43, 48 (Bankr. D.N.J. 2005); *In re Jackson,* 7 B.R. 616, 617-18 (Bankr. E.D. Tenn. 1980); *In re Gallman,* 6 B.R. 1, 2 (Bankr. N.D. Ga. 1980). The court agrees with the approach taken by those courts.

In re Kaur, 510 B.R. 281, 289 (Bankr. E.D. Cal. 2014).