

No More Disbursements to Debtors' Attorneys or to Creditors When Cases Convert From Chapter 13 to Chapter 7:

The Impact of *Harris v. Viegelahn* on Cases in the Eastern District of Kentucky¹

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Summary: In *Harris v. Viegelahn*, 2015 WL 2340847 (May 18, 2015), the Supreme Court ruled that when a case is converted in good faith from chapter 13 to another chapter, all accumulated post-petition wages that the chapter 13 trustee has on hand at the date of conversion must be refunded to the debtor.

Existing Practice: Prior to the Supreme Court's ruling, this trustee's practice (pursuant to controlling case law) has been as follows: In cases converted prior to confirmation of a plan, the trustee held funds on hand for at least 14 days to allow debtors' attorneys to file fee applications pursuant to KYEB-LBR 2016-2(f). If the fee application was filed and approved, the trustee paid the debtor's attorney to the extent funds were available prior to refunding any remaining funds to the debtor. In cases converted after confirmation of a plan, the trustee disbursed funds on hand as of the day before conversion to creditors (including debtors' attorneys) pursuant to the plan.²

Changes as of May 2015: Based on the *Harris* opinion, effective with the May 2015 disbursement cycle, all funds on hand as of the date of conversion will be refunded to debtors, except in very limited circumstances discussed later.

This means that from now on, when a case converts from chapter 13, the chapter 13 trustee will not be able to disburse any funds:

- **to a debtor's attorney pre- or post-confirmation;**
- **to secured creditors for pre-confirmation adequate protection;**
- **to any creditor for any reason pre- or post-confirmation.**

Analysis: The Supreme Court based its ruling on two subsections of 11 U.S.C. § 348. Section 348(f)(1) provides:

(f)(1) . . . [W]hen 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 the filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion

11 U.S.C. § 348(f)(1)(A).

¹ This message generally reflects my interpretation today of the case and statutes discussed herein, is subject to change without notice, and may not be relied upon in any legal proceeding or administrative matter.

² In all cases, the trustee refunds to the debtor any monies received on or after the date of conversion. Nothing in the *Harris* opinion will change that.

A debtor's postpetition wages are property of the estate in the chapter 13 case pursuant to 11 U.S.C. § 1306, but of course are not property of the estate in a chapter 7 case as of the date of the original petition. Therefore, post-petition wages which the trustee has not yet disbursed³ cannot be considered property of the estate in a case converted to chapter 7 (or any other chapter). There is nothing new or remarkable about this holding, as this has been the status of the law since subsection (f) was added to section 348 in 1994.

More significantly, the Supreme Court went on to hold that at the moment of conversion, the chapter 13 trustee "is stripped of authority" to make payments to creditors by operation of 11 U.S.C. § 348(e), which provides: "Conversion of a case . . . terminates the service of any trustee . . . that is serving in the case before such conversion." *Harris* at *6-7. Once the case is converted, the chapter 13 plan, even if confirmed, is no longer binding. *Harris* at *7. The chapter 13 trustee has no option but to return the funds to the debtor.

There are two exceptions to this rule. The first exception is if the debtor converts the case from chapter 13 in bad faith. In such a scenario, the debtor is penalized, and all funds on hand as of the date of the conversion becomes property of the estate in the converted case. 11 U.S.C. § 348(f)(2); *Harris* at *6.

The second exception, not discussed in the *Harris* case, occurs if the debtor still has, at the time of conversion, possession or control of property that was property of the estate as of the petition date. For example, if the trustee is holding proceeds from the sale of property that was property of the estate at the time of the petition, those proceeds would continue to be property of the estate and would not be required to be refunded to the debtor upon conversion. No doubt there will be additional litigation regarding the scope and timing of 11 U.S.C. § 348(f)(1)(A).

Conclusion: Once the debtor files a notice of conversion in good faith, the trustee has no authority to do anything with funds on hand but return them to the debtor. **Debtors' attorneys will not be paid by the chapter 13 trustee.** There is no "unless the court orders otherwise" preamble in the relevant subsections of section 348, so not even the bankruptcy court can authorize the trustee to disburse funds to the debtor's attorney or to creditors in a converted case.

There might still be room to pay debtors' attorneys' fees and/or adequate protection payments in dismissed chapter 13 cases if the bankruptcy court so authorizes. See 11 U.S.C. § 349. However, further analysis is required to assess the impact of the *Harris* case on disbursements in dismissed chapter 13 cases.

³ Some examples of reasons why this trustee is holding funds that have not yet been disbursed to creditors are:

- Personal checks received after the 15th of the month are held by this trustee until the next month because of the risk of NSF's;
- An objection to a claim is pending, and funds are held to pay this claim should the objection be overruled;
- A secured creditor has obtained relief from stay but the deadline for filing a deficiency claim has not passed;
- A claim is on "reserve" pending the filing of a transfer or because the funds are to be remitted to the court's registry at the end of the case;
- There are no secured or administrative claims to pay but the bar date has not passed so disbursements to unsecured creditors cannot begin;
- The trustee receives funds from an unknown source and places the funds on hold pending further investigation.