

**PRESENTED AT**

12<sup>th</sup> Annual Consumer Bankruptcy Practice

July 14-15, 2016  
Galveston, Texas

## **Conversion and Dismissals under Sections 706 and 707: Recent Case Developments**

Presentation by:

**Hon. Tony M. Davis**  
**J. Hector Duran Jr.**  
**Joshua P. Searcy**

Written materials by:

**Robert J. Shannon**

Author Contact Information:

Law Clerk to Hon. Tony M. Davis  
903 San Jacinto Blvd. STE 322  
Austin, TX 78701

512.916.5875

## I. SECTION 706

### A. Code Provision

Section 706 governs conversion of a case from chapter 7 to chapter 11, 12, or 13. The provision states:

(a) The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable

(b) On request of a party in interest and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 11 at any time.

(c) The court may not convert a case under this chapter to a case under chapter 12 or 13 of this title unless the debtor requests or consents to such conversion.

(d) Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter.

### B. Decisions

#### 1. *Foster v. Holder (In re Foster)*, 530 B.R. 650 (N.D. Tex. 2015).

In *Foster*, the U.S. Bankruptcy Court for the Northern District of Texas (Judge Nelms) orally denied the debtor's motion to convert her chapter 7 case to chapter 11. The bankruptcy court arrived at its decision by applying *Marrama v. Citizens Bank of Massachusetts*,<sup>1</sup> in which the Supreme Court held that a court could deny conversion from chapter 7 to chapter 13 when the debtor had engaged in bad faith conduct. The U.S. District Court for the Northern District of Texas and the Fifth Circuit affirmed.

To support its bad faith determination, the bankruptcy court found:

- The debtor's purpose in filing the bankruptcy case was to prevent a foreclosure on her homestead;
- The debtor was not seeking conversion to pay unsecured debt or non-dischargeable education debt, but rather to pay her mortgage debt;
- Throughout the chapter 7 case, the debtor's actions and inconsistent positions were not compatible with the fiduciary obligations of a chapter 11 debtor in possession;

---

<sup>1</sup> *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007).

- The debtor had no ability to fund a feasible plan;
- If a chapter 11 trustee, was appointed, he or she would likely come to exactly the same conclusions and take the same actions as the chapter 7 trustee;
- The debtor’s actions in the case suggested an abuse of process in the case;
- The debtor had used bankruptcy for an improper purpose; and
- Achieving confirmation of a chapter 11 plan would be impossible.

Based on these findings, the bankruptcy court concluded that it had discretion to deny the debtor’s motion and decided to do so.

The Debtor appealed to district court and argued that *Marrama* was not controlling authority in light of the Supreme Court’s subsequent decision in *Law v. Segal*.<sup>2</sup> *Law* is widely seen as limiting the scope of *Marrama*’s dicta. According to the district court, however, the basis for the bankruptcy court’s relief was section 706(d)’s express requirement that the debtor be eligible under the chapter to which the case would be converted, which could be seen as the basis for the holding in *Marrama*.<sup>3</sup> The bankruptcy court’s denial of the motion to convert merely “dispensed ‘with futile procedural niceties in order to reach more expeditiously an end result required by the Code[,]’” which *Law* expressly authorized.<sup>4</sup>

On further appeal, the Fifth Circuit affirmed the district court in an unpublished opinion and later denied a request for a rehearing *en banc*.<sup>5</sup>

The Fifth Circuit has held that the right to dismiss a chapter 13 case is likewise subject to a good faith requirement.<sup>6</sup> However, it is clear that a debtor’s right to convert from chapter 13 to chapter 7 is absolute.<sup>7</sup>

## 2. *In re Karlinger-Smith*, 544 B.R. 126 (Bankr. W.D. Tex. 2016).

In *Karlinger-Smith*, the U.S. Bankruptcy Court for the Western District of Texas (Judge Davis) denied the U.S. Trustee’s motion to convert the debtor’s case to chapter 11 pursuant to section 706(b). The bankruptcy court’s decision was not appealed.

Although section 706(b) provided no express standard by which courts are to decide motions under section 706(b), the bankruptcy court held that the appropriate standard to guide its discretion was the one used by the Fifth Circuit in *Pickens v.*

---

<sup>2</sup> *Law v. Siegel*, 134 S. Ct. 1188 (2014).

<sup>3</sup> *Marrama* 549 U.S. at 373-74.

<sup>4</sup> *In re Foster*, 530 B.R. 650, 654 (N.D. Tex. 2015) (quoting *Law*, 134 S.Ct. at 1197).

<sup>5</sup> *Foster v. Holder*, No. 15-10449 (5th Cir. 2015).

<sup>6</sup> *Jacobson v. Moser (In re Jacobson)*, 609 F.3d 647, 660-61 (5th Cir. 2010).

<sup>7</sup> See Fed. R. Bankr. P. 1017(f)(3); *Harris v. Viegelahn*, 135 S.Ct. 1829, 1835-1836 (2014); *In re Fonke*, 310 B.R. 809, 814 (Bankr. S.D. Tex. 2004). Compare 11 U.S.C. § 1307(a) (2014) (“The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.”), with 11 U.S.C. § 1307(b) (2014) (“On request of a debtor at any time, if the case has not been converted under section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter. Any waiver of the right to dismiss under this subsection is unenforceable”).

Find the full text of this and thousands of other resources from leading experts in dozens of legal practice areas in the [UT Law CLE eLibrary \(utcle.org/elibrary\)](http://utcle.org/elibrary)

## Title search: Conversions and Dismissals under Sections 706 and 707: Recent Case Developments

Also available as part of the eCourse

[2016 Consumer Bankruptcy Practice eConference](#)

First appeared as part of the conference materials for the  
12<sup>th</sup> Annual Consumer Bankruptcy Practice session  
"Conversions and Dismissals under Sections 706 and 707"