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Conversion from 13 to 7 – The Allure, the Pitfalls, and the Perils.

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A. Conversion in General

Conversion of a case from one chapter to another constitutes an order for relief.¹ But conversion does not affect the dates of the filing of the petition, the commencement of the case or the order for relief, except as provided in subsections (b) and (c). This means that, aside from the exceptions listed in subsections (b) and (c), the sections of the Bankruptcy Code that are keyed to the dates of the filing of the petition, the commencement of the case or the entry of the order for relief are unaffected by conversion.²

Conversion does not commence a new bankruptcy case. Under the Bankruptcy Code, a case is commenced by the filing of a petition under section 301, 302 or 303 and a new petition is not filed when a case is converted to a different chapter.³

B. Good Faith Conversion and Property of the Estate

The property of a chapter 13 estate at the time of conversion is usually different from what the property of the estate would have been if the case had originally been filed under Chapter 7.⁴

Section 348(f)(1)(A) provides that “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 significance of Section 348(f)(1) is that Debtors spend money,⁵ relinquish property in divorce action pursuant to court order while in chapter 13 bankruptcy,⁶ or end up suffering decline in value of assets due to depreciation.⁷

¹ 11 U.S.C. § 348(a).

² 3 Collier on Bankruptcy ¶ 348.02 (16th 2022).

³ *Id.*

⁴ *Id.*

⁵ *Bogdanov v. Laflamme (In re Laflamme)*, 397 B.R. 194 (Bankr. D.N.H. 2008) (chapter 7 trustee had right to only the amount of insurance commissions that debtors had not spent for lawful expenses during chapter 13 case).

⁶ *Yoon v. Krick (In re Krick)*, 373 B.R. 593 (Bankr. N.D. Ind. 2007) (a debtor whose title to property was terminated by a divorce court order while her chapter 13 case was pending no longer had possession or control of the property when the case was converted to chapter 7).

⁷ *In re Lang*, 437 B.R. 70 (Bankr. W.D.N.Y. 2010) (if the value of property has declined due to depreciation, the estate includes only the property, and not the value the property had on the petition date, so the debtor has no responsibility to pay the trustee the difference in value).

Conversion from Chapter 13 to Chapter 7 and the application of Section 348(f) does not insulate a debtor from being subject to other applicable provisions of the Bankruptcy Code. For example, a debtor may not transfer property of the Chapter 13 estate with the intent to hinder, delay, or defraud creditors.⁸ Additionally, such course of action by debtor will likely be a basis for application of bad faith conversion to debtor under section 348(f)(2).

C. Bad Faith Conversion and Property of the Estate

Section 348(f)(2) contains the exception to the general rule.⁹ Conversion of a case from Chapter 13 to Chapter 7, “in bad faith,” leads to property of the Chapter 7 estate being determined as of conversion date.

The Bankruptcy Code does not define “bad faith.” Courts generally apply the totality of the circumstances test in determining bad faith.¹⁰ Once bad faith becomes an issue, under § 348(f)(2), the debtor has the burden of proving that they converted the Chapter 13 case to Chapter 7 in good faith.¹¹

According to Collier on Bankruptcy, the courts should not find bad faith if the debtor is unable to complete a plan due to a change in circumstances or financial hardship.¹² By the same token that converting non-exempt assets to exempt assets on eve of bankruptcy filing is not *per se* prohibited, simply taking advantage of the statute’s provisions by excluding property acquired during the Chapter 13 case from the Chapter 7 estate after conversion is not bad faith.¹³

⁸ *Pisculli v. T.S. Haulers, Inc. (In re Pisculli)*, 426 B.R. 52 (E.D.N.Y. 2010), *aff’d*, 2011 U.S. App. LEXIS 2271 (2d Cir. Feb. 4, 2011) (a Chapter 13 debtor who sold assets of a company and transferred the excess funds to his wife, and then converted to chapter 7, had his discharge denied pursuant to section 727(a)(2) despite section 348).

⁹ Section 348(f)(2) provides:

(f)(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

¹⁰ *Farrar v. Sandoval (In re Sandoval)*, 2005 Bankr. LEXIS 3383, 18* (9th Cir. BAP August 3, 2005); *Mullican v. Moser*, 417 B.R. 408 (E.D. Tex. 2009) (debtors who could easily have completed chapter 13 plan with money inherited post-petition, and who made false representations about their financial condition, found to have converted in bad faith); *In re Greene*, 2011 Bankr. LEXIS 162 (Bankr. M.D.N.C. Jan. 18, 2011) (Debtors disclosed expectation of a \$3,000 federal tax refund for 2008 and exempted it but ended up receiving a state tax refund of \$2,759 and a federal tax refund of \$8,435. Debtors did make a disclosure and spent the refunds while in Chapter 13. Later, Debtors converted to Chapter 7 and changed their exemptions to exempt 2009 tax refund instead of 2008 tax refunds because they had already spent the 2008 tax refunds. Debtors were found to have converted in bad faith).

¹¹ *Farrar v. Sandoval (In re Sandoval)*, 2005 Bankr. LEXIS 3383, 18* (9th Cir. BAP August 3, 2005).

¹² 3 Collier on Bankruptcy P 348.07[2] (16th 2022).

¹³ *In re Stillwaggon*, 2014 Bankr. LEXIS 1085 (Bankr. M.D. Fla. Mar. 19, 2014) (Debtor received \$57,300 in inheritance while in Chapter 13. Debtor’s decision to merely exercise her statutory right to convert her case under § 1307(a), in itself, did not constitute a bad faith conversion); *In re Wiczek-Spaulling*, 223 B.R. 538 (Bankr. D. Minn. 1998) (Debtor took advantage of a separation payment plan by converting her case to Chapter 7 before applying for

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