

UNITED STATES BANKRUPTCY COURT  
WESTERN DISTRICT OF NEW YORK

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In re:

CASE NO. 00-22684

KENNETH R. McFADDEN,

Debtor.

DECISION & ORDER

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**BACKGROUND**

On September 14, 2000, Kenneth R. McFadden (the "Debtor") filed a petition initiating a Chapter 13 case. On the Schedules and Statements required to be filed by Section 521 and Rule 1007, the Debtor indicated that: (1) he owned a residence at 5 Shafer Street, Rochester, New York ("Shafer Street"), which had a fair market value of \$60,000.00 and was subject to: (a) a first mortgage in favor of M&T Mortgage ("M&T") with a balance of \$43,049.00; (b) a second mortgage in favor of M&T with a balance of \$6,000; and (c) a third mortgage (the "Citi Mortgage") in favor of Citi National Bank of West Virginia with a balance of \$24,695.33; (2) on or about August 4, 2000, M&T commenced a State Court mortgage foreclosure proceeding (the "State Court Action"); (3) he had unsecured, nonpriority debts of \$15,244.03; and (4) he had \$1,600.00 on deposit in a savings account at ESL (the "Savings Account").

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The Debtor's Chapter 13 Plan (the "Plan"), dated September 11, 2000, proposed to pay: (1) \$260.00 biweekly to the Chapter 13 Trustee for a period of sixty (60) months; (2) approximately \$9,500.00 in pre-petition arrearages due on the three mortgages on Shafer Street; and (3) a one hundred percent (100%) distribution to the unsecured creditors who filed allowed claims.

On November 20, 2000, the Court orally confirmed the Plan and on January 11, 2001, an Order of Confirmation was entered. The Order of Confirmation provided, in part, that: (6) "All of the Debtor(s) wages and property, of whatever nature and kind and wherever located, shall remain under the exclusive jurisdiction of this Court; and title to all of the debtor's property, of whatever nature and kind and wherever located is hereby vested in the debtor during pendency of these Chapter 13 proceedings pursuant to the provisions of 11 U.S.C. § 1327."<sup>1</sup>

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<sup>1</sup> Section 1327. Effect of Confirmation.

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or in the order confirming the plan, the confirmation of a plan vests all of the property of estate in the debtor.

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On March 6, 2001, M&T filed a Motion for Relief from the Stay that: (1) alleged that Shafer Street had a value of \$46,000.00, based upon a current tax assessment; and (2) requested that M&T be permitted to continue the State Court Action. The Motion was settled by a Conditional Order entered on April 4, 2001.

On September 24, 2001, the Debtor filed an application which requested that his Chapter 13 case be converted to a Chapter 7 case, and on September 26, 2001, an Order of Conversion was entered.

On November 6, 2001, the Debtor's Chapter 7 trustee (the "Chapter 7 Trustee"), C. Bruce Lawrence, Esq., conducted a Section 341 Meeting of Creditors, and on November 20, 2001, he filed a Minute Report of the Meeting which indicated that there were assets in the estate consisting of non-exempt cash, tax refunds and an Eastman Kodak Company bonus (the "Bonus").

On January 16, 2002, an Order discharging the Debtor was entered.

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(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in any debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. § 1327 (2002).

On May 17, 2002, the Chapter 7 Trustee filed a Motion to Compel the Turnover of Property of the Estate (the "Turnover Motion"). The Motion alleged that: (1) on a number of occasions the Chapter 7 Trustee had demanded of the Debtor and his attorney that the Debtor turn over the non-exempt property of the estate that existed on the date of the filing of the petition, or its value,<sup>2</sup> which consisted of: (a) three-fourths of the Debtor's calendar year 2000 income tax refunds in the amount of \$3,635.00; (b) three-fourths of the Debtor's year 2000 Bonus in the amount of \$800.00; (c) the \$1,600.00 on deposit in the Savings Account;<sup>3</sup> (2) the Debtor had failed to turn over the amounts demanded; and (3) reasonable attorney's fees should be awarded to the Chapter 7 Trustee, since in his April 24, 2002 written demand, the Chapter 7 Trustee included a notice of the Court's Decision & Order in *In re Pacelli*, Ch. 7 Case No. 00-20281 (W.D.N.Y. 4/13/01) ("*Pacelli*").<sup>4</sup>

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<sup>2</sup> The \$3,535.00 value demanded by the Chapter 7 Trustee was net of an available \$2,500.00 cash exemption.

<sup>3</sup> Under the various Decisions of this Court, these assets were Section 541 property of the estate.

<sup>4</sup> In *Pacelli*, this Court stated that Debtors may be required to pay reasonable attorney's fees if a trustee is required to bring a Turnover Motion because the Debtor failed to turn over fully or partially non-exempt assets or their value within the time set forth in a written notice from the trustee.

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On the June 19, 2002 return date of the Turnover Motion: (1) the Chapter 7 Trustee acknowledged that he would reduce his demand by \$1,258.00, the amount that was distributed to unsecured creditors in the Debtor's Chapter 13 case, plus the Chapter 13 Trustee's commission paid on that distribution; (2) the attorney for the Debtor advised the Chapter 7 Trustee and the Court that the Debtor had: (a) lost Shafer Street to foreclosure; and (b) spent the tax refunds, Bonus and amounts on deposit in the Savings Account in order to pay ordinary living expenses and his payments to the Chapter 13 Trustee under the Plan; and (3) the Court afforded the parties and the Chapter 13 Trustee an opportunity to make written submissions.

In a post-hearing submission, the attorney for the Debtor asserted that the Debtor was not required to turn over the value of the non-exempt assets that were property of the estate at the time of the filing of the petition, because: (1) the Debtor was no longer in possession of those assets, having spent them for ordinary living expenses and to make the payments under his Plan; (2) the Debtor's conversion to Chapter 7, after he lost Shafer Street to foreclosure, was not in bad faith; and (3) the assets demanded by the Chapter 7 Trustee were no longer property of the estate in the Debtor's converted Chapter 7 case,

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since Section 348(f)(1) provides that, in a case converted from Chapter 13 to Chapter 7, property of the estate consists only of that property of the estate which existed at the date of the filing of the petition that remains in the possession of or under the control of the Debtor on the date of conversion.<sup>5</sup>

## DISCUSSION

### **I. Equitable Considerations**

In order for the Debtor to receive a discharge in the case commenced on September 14, 2000: (1) he could have completed his Plan and received a discharge under Section 1328(a), which would

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<sup>5</sup> Section 348(f)(1) and (2) provide that:

(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; and

(B) valuations of property and of allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan.

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

11 U.S.C. § 348 (2002).

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have required him to pay a one hundred percent (100%) distribution to the unsecured creditors that filed allowed claims, unless the Plan were modified;<sup>6</sup> (2) he could have applied to obtain a hardship discharge under Section 1328(b), which would have required him to satisfy the best interest of creditors test by paying his unsecured creditors at least the amount demanded by the Chapter 7 Trustee; or (3) he could have converted his case, as he did, to a Chapter 7 case and receive a discharge under Section 727.

In a Chapter 7 consumer case, the honest but unfortunate debtor receives a discharge under Section 727 from all of his dischargeable debts in exchange for surrendering to the trustee any non-exempt assets, which are then administered and distributed to creditors.<sup>7</sup>

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<sup>6</sup> These claims filed in the Chapter 13 case exceeded the amount demanded by the Chapter 7 Trustee.

<sup>7</sup> Section 521(4) provides that the Debtor shall:

(4) if a trustee is serving in the case, surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under section 344 of this title[.]

11 U.S.C. § 521 (2002).

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Therefore, it would seem fair, equitable and consistent with the Bankruptcy Code that in order for the Debtor to have earned the discharge he received on January 16, 2002, he should be required to surrender, for administration and distribution, the value of the non-exempt assets that existed at the date of the filing of his Chapter 13 petition, less the amounts already paid to unsecured creditors.

On the other hand: (1) perhaps because the Plan proposed to pay a 100% distribution to unsecured creditors, the Chapter 13 Trustee's Report presented to the Court at the time of confirmation did not include a best interest test analysis based upon the non-exempt assets in existence at the time the Debtor filed his petition that are now being demanded by the Chapter 7 Trustee; (2) there is no evidence that, at the time of the filing of his petition or when his Plan was confirmed, the Debtor was advised that: (a) he could not use the non-exempt assets in existence at the date the Debtor filed his petition that are now being demanded by the Chapter 7 Trustee for living expenses or Plan payments; or (b) notwithstanding Section 348(f)(1), if he were to convert his case to a Chapter 7 case, he would be responsible to the Chapter 7 Trustee and the bankruptcy estate for the value of those assets, less any credit

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for payments to unsecured creditors in his Chapter 13 case; (3) no request was made of the Court that the Confirmation Order: (a) direct that the non-exempt assets when received by the Debtor be immediately turned over to the Chapter 13 Trustee for distribution to unsecured creditors; (b) direct that the value of the Debtor's non-exempt assets be distributed to unsecured creditors from the Debtor's Plan payments prior to or simultaneously with distributions to secured and priority creditors; or (c) as an exception to Section 1327, direct that title to the non-exempt assets remain with the bankruptcy estate and that they, or their values, be turned over to the Chapter 13 Trustee for distribution in the event of a dismissal or to the Chapter 7 Trustee in the event of a conversion; and (4) it could be argued that the Citi Mortgage, even though it was treated in the Plan as secured, based upon the Shafer Street tax assessment, was in fact unsecured, so that the \$4,115.00 paid on the mortgage arrearages through the Plan should also be treated as a credit against the amount necessary to satisfy the best interest of creditors test.

In this case, where the Debtor was not given any specific direction as to the assets now being demanded and he used them for living expenses and plan payments, the balance of the equities favors the Debtor.

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**II. Section 348**

Prior to its amendment in 1994 (the "1994 Amendment"), Section 348(a) provided that the conversion of a Chapter 13 case to a Chapter 7 case constituted an order for relief under Chapter 7 as of the date of the filing of the original petition. Therefore, prior to the 1994 Amendment, although there was disagreement,<sup>8</sup> many courts would have found that the property of the estate in the Debtor's converted Chapter 7 case would be the property of the estate that existed on the date the Debtor filed his petition, which would include the assets demanded by the Chapter 7 Trustee, or their value.

However, as correctly asserted by the attorney for the Debtor, Section 348(f)(1), by its plain language, eliminates the property being demanded by the Chapter 7 Trustee as property of the estate in the converted Chapter 7 case because it is no longer in the possession of or under the control of the Debtor.

It appears from the legislative history that the 1994 Amendment was not intended to address the cash and cash-type equivalent property of the estate in existence at the filing of a Chapter 13 at issue in this case, but was intended to address a disagreement among courts as to whether: (1) post-petition

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<sup>8</sup> For an excellent and thorough discussion of this disagreement, and the interplay between Sections 1306, 1327 and 348, See In re Fisher, 198 B.R. 721 (Bankr. N.D.Illinois 1996).

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assets acquired by a Chapter 13 debtor; and (2) appreciation in assets in existence when the Chapter 13 petition was filed due to increases in value or the pay down of secured debt in the Chapter 13 case, are property of the estate when a Chapter 13 case is converted to a Chapter 7 case. Nevertheless, the unambiguous language of the Amendment prevents this Court from looking behind the statute to determine that the assets being demanded by the Chapter 7 Trustee, which existed at the time of the filing of the petition, are property of the estate in the converted Chapter 7 case because of the legislative intent when it enacted the Amendment.

**CONCLUSION**

The Turnover Motion is denied.

**IT IS SO ORDERED.**

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**HON. JOHN C. NINFO, II  
CHIEF U.S. BANKRUPTCY JUDGE**

**Dated: September 12, 2002**