American Bankruptcy Institute

Did *Marrama* Change Anything? Conversion Issues – 7 to 13 and 13 to 7

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I. **Introduction**

The United States Supreme Court in *Marrama*[1] closely resolved a split in the circuits on the issue of whether a debtor has an absolute right to convert from a Chapter 7 to a Chapter 13. While the Court held that there is no absolute right in a 5-4 decision, the question still remains, does this decision really change anything?

II. **Prior to *Marrama***

The Court noted the split of authority[2] in its decision and discussed the relative merits of each position. The Sixth Circuit sided with those cases which held that a debtor's right to convert is not absolute, holding also that the court may deny conversion upon a showing of bad faith.[3] The Sixth Circuit has held further that in order to determine if the debtor has acted in bad faith for conversion purposes, the court will consider the totality of the circumstances, specifically

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[1] Marrama v. Citizens Bank of Mass., 549 U.S. 365, 127 S. Ct. 1105 (2007).

[2] *See In re* Martin, 880 F.2d 857, 859 (5th Cir. 1989); In re Croston, 313 B.R. 447 (9th Cir. BAP 2004); *In re* Miller, 303 B.R. 471 (10th Cir. BAP 2003), Pequeno v. Schmidt *(In re* Pequeno*)*, 307 B.R. 568, 579 (S.D.Tex.2004), *aff'd*, 126 Fed. Appx. 158, 2005 WL 513466 *4 (5th Cir. Mar. 4, 2005); *In re* Krishnaya, 263 B.R. 63, 69 (Bankr. S.D. N.Y.2001); *In re* Porras, 188 B.R. 375, 377 (Bankr.W.D.Tex.1995), all holding that the debtor has an absolute right to convert. *But see In re* Kuhn, 322 B.R. 377, 395 (Bank.N.D.Ind.2005); *In re* Sharkey, 179 B.R. 687, 699 (Bankr.N.D.Okla.1995) and cases cited infra note 3, holding that the debtor does not have an absolute right to convert.

[3] *See* Copper v. Copper *(In re* Copper*)*, 426 F.3d 810, 815 (6th Cir. 2005); Condon v. Smith *(In re* Condon*)*, 358 B.R. 317 (6th Cir. BAP 2007); Alt v. U.S. *(In re* Alt*)*, 305 F.3d 413, 418-19 (6th Cir. 2002).

looking at twelve factors.[4] Yet, the court has also stressed that conversion should be freely granted because a debtor should be permitted to repay his or her debts.[5]

Prior to *Marrama,* depending on the jurisdiction, the debtor largely maintained control over this aspect of the case. If, for example, the trustee uncovered an undisclosed asset, sued the debtor's family member for a preference, or filed a motion to dismiss the debtor's bankruptcy for means test abuse, failure to cooperate with the trustee or for some other equally good reason, in some jurisdictions, the debtor had the "absolute right" to convert his or her case and could avoid the negative implications of his or her conduct, converting to a Chapter 13 with a new and unsuspecting trustee, usually unfamiliar with the issues raised by the Chapter 7 trustee.[6] Consider this example: the debtor originally filed for Chapter 7, the trustee reviewed the debtor's schedules and noticed that the guns that had been disclosed on his schedules seemed to be undervalued. The trustee began investigating the value of the guns by sending the gun description to an appraiser and beginning to look into a sale of the guns. The debtor then files a notice of conversion and is permitted to convert. Even though there is potential bad faith, if the debtor had the absolute right to convert, the trustee's efforts have been useless.

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[4] These factors are set forth in *Condon,* 358 B.R. at 324-25 where the court held that the debtor could convert from a chapter 7 to a chapter 13 because he was not attempting to convert in bad faith. The twelve factors are the (1) debtor's income; (2) the debtor's living expenses; (3) the debtor's attorney's fees; (4) the expected duration of the Chapter 13 plan; (5) the sincerity with which the debtor has petitioned for relief under Chapter 13; (6) the debtor's potential for future earning; (7) any special circumstances, such as unusually high medical expenses; (8) the frequency with which the debtor has sought relief before in bankruptcy; (9) the circumstances under which the debt was incurred; (10) the amount of payment offered by [the] debtor as indicative of the debtor's sincerity to repay the debt; (11) the burden which administration would place on the trustee; and (12) the statutorily mandated policy that bankruptcy provisions be construed liberally in favor of the debtor. In this case, the court looked at the debtor's motive, attorney error in the schedules not attributable to the debtor, and the debtor's pre-petition and post-petition conduct in making its determination.

[5] *Copper,* 314 B.R. at 637.

[6] This raises the question whether there should be more established lines of communication between Chapter 7 and Chapter 13 trustees in cases in which the debtor successfully attempts to convert to a different chapter.

III. The *Marrama* decision

Marrama was decided on February 21, 2007.[7] In this case, the debtor filed a voluntary Chapter 7 petition and schedules. On his Schedule B, the debtor listed that he was "100% beneficiary of Bo-Mar Realty Trust the res of which is real property in Maine in which the debtor intended to live. The trust was a spendthrift trust," and the value was listed at 0.[8] On the debtor's Schedule C, the debtor indicated that the trust was not property of the estate. The debtor failed to disclose on his original schedules the transfer of real property in Maine for no consideration to a trust he had created listing his girlfriend as the beneficiary. The trustee discovered the transfer during the debtor's §341 meeting.

After discovering the transfer, the trustee informed the debtor that he intended to administer the Maine property, and the debtor filed a motion to convert his case to a Chapter 13 bankruptcy. The court treated the notice as a motion to convert, and the trustee and the bank filed objections to conversion.

Essentially, the debtor argued that he had the absolute right to convert his case for the following reasons:

1. The debtor asserted the "Oops" defense, arguing that the errors on his schedules were because of a scrivener's error not because of bad faith;
2. Under the plain language of §706(a),[9] he has an absolute right to covert;
3. The language of the House and Senate Reports regarding §706(a) state this provision gives the debtor an absolute, one-time right to convert;

[7] Marrama, 313 B.R. 525, 528 (B.A.P 1st Cir. 2004).
[8] *Id.* at 528.
[9] 11 U.S.C. § 706(a) states: "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."

4. Congress has specific, good faith requirements in other provisions of the Code, but this requirement does not appear in §706(a);
5. Even debtors who commit financial fraud or who acted in bad faith pre-petition can file a Chapter 13 petition, so why should a debtor who first filed for Chapter 7 be denied the right to convert;
6. Bad faith is a difficult concept to define and will have different interpretations in different jurisdictions--leading to increased judicial discretion and overall uncertainty when conversion cases are decided.

The Trustee and the bank argued, to the contrary, stating that

1. There are limitations on the debtor's right to convert. Section 706(d) states that the debtor may not convert "unless the debtor may be a debtor under such chapter." Under §109(e), a debtor filing for Chapter 13 is limited by the amount of his or her indebtedness;
2. The class of honest but unfortunate debtors does not include those that engage in pre-petition bad faith;[10]
3. Nothing in the language of §706 or §1307(c)[11] limits the court's authority to deny a motion to convert; rather, §105(a)[12] allows the court "broad authority" to "prevent an abuse of process";

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[10] The Court, however, did not articulate exactly what is meant by "bad faith." *Id.* at n 11.

[11] 11 U.S.C. § 1307(c) states: "Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including--

(1) unreasonable delay by the debtor that is prejudicial to creditors;
(2) nonpayment of any fees and charges required under chapter 123 of title 28;
(3) failure to file a plan timely under section 1321 of this title;
(4) failure to commence making timely payments under section 1326 of this title;
(5) denial of confirmation of a plan under section 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;

4. Even if §105 were not in effect, federal court's have the power to "sanction 'abusive litigation practices'";[13]

5. Section 706(a) states that a debtor *may* convert, which indicates a limitation on a debtor's right to convert;

6. Sections 706 and 1307 should be read together to require that conversion can be denied for cause;

7. There is a good faith requirement present in all bankruptcies, even if it is not specifically mentioned in section 706;

8. If a debtor has an absolute right to convert, the trustee will be less able to manage his or her caseload;

9. If a debtor has an absolute right to convert, it limits the power a trustee has and limits the trustee's ability to investigate fraud and protect creditor's assets.

The Court ultimately affirmed the Court of Appeal's decision, holding that the debtor did not have an absolute right to convert if bad faith exists. Specifically, the Court held that pursuant to §706(d), the debtor cannot convert unless he or she qualifies as a debtor under that chapter. Additionally, section 1307(c) states that a Chapter 13 case can be dismissed or converted for

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(6) material default by the debtor with respect to a term of a confirmed plan;
(7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of a modified plan under section 1329 of this title;
(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;
(9) only on request of the United States Trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521;
(10) only on request of the United States Trustee, failure to timely file the information required by paragraph (2) of section 521; or
(11) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition."

[12] 11 U.S.C § 105(a) says: "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."

[13] Marrama, at 1112. (quoting Roadway Express, Inc. v. Piper, 447 U.S. 752, 765 (1980)).

"cause," and one such cause is bad faith. Therefore, a Chapter 7 debtor who has engaged in bad faith and then attempts to convert is not eligible to be a debtor under Chapter 13 because his or her case is subject to dismissal or re-conversion for bad faith.

The Court also noted that, in the alternative, "[n]othing in the text of either §706 or § 1307(c) (or the legislative history of either provision) limits the authority of the court to take appropriate action in response to fraudulent conduct by the atypical litigant who has demonstrated that he is not entitled to the relief available to the typical debtor."[14] The Court went on to state that §105(a) of the Code was "surely adequate" to give the court power to deny conversion.[15]

IV. The aftermath of *Marrama* –the Trustee's Perspective

Shortly after the Supreme Court's decision, it was widely thought that a debtor could not convert his or her case when the debtor has engaged in bad faith regardless of jurisdiction. It seemed that this was a clear victory for the trustee, the estate, and its creditors.[16]

However, despite the seemingly straightforward ruling from the Court, the Court did not provide a definition of "bad faith," lending to the question, "What does it mean to say 'engaged in bad faith'"? While this apparent oversight may have taken the teeth out of the holding, it appears that the justices on the Supreme Court did not simply forget to tackle this question stating, "[w]e have no occasion here to articulate with precision what conduct qualifies as 'bad faith'."[17]

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[14] *Id.* at 1111-1112.
[15] *Id.* at 1112.
[16] This is especially true in Michigan given the dismal statistic that presently only 23% of Chapter 13 debtors are discharged in the Eastern District of Michigan. *See State of the Court Address,* September 16, 2008, http://www.mieb.uscourts.gov/notices/State%20of%20the%20Court%20-%202008.pdf
[17] *Marrama,* at n 11.

So, while the trustee may have more control of a case post-*Marrama*, it is arguable, especially in the Sixth Circuit and others with similar holdings that really not much has changed at all! Although the trustee is permitted to initially make his or her own decision in a case as to what constitutes bad faith and when to challenge conversion, it is solely within the court's discretion whether or not the trustee made the decision correctly. This is done just like the days before *Marrama* by considering the totality of the circumstances based on the twelve factors cited in footnote four.

The real decision is left to the bankruptcy court. It still remains clearly within the discretion of the judge to determine if the debtor engaged in bad faith. While Congress was attempting to limit judicial discretion with the passing of BAPCPA, the U.S. Supremes (at least five of them) voted to give some of it back.

V. <u>The aftermath of *Marrama*-the case law on what constitutes "bad faith"</u>

There have been over 300 opinions citing to *Marrama* since it was decided. Many of these decisions discuss what constitute "bad faith" for conversion purposes, and, much like the decisions that have arisen since BAPCPA determining what is meant by "abuse" under §707(b)(3), the cases will likely continue to multiply. The decisions to date demonstrate a spectrum with the really bad debtors at one end (conversion denied) and the debtors that just made a "mistake" or and "error" on the other end (conversion permitted).

The following decisions are representative post-*Marrama* cases in which the court held that a debtor did not engage in bad faith and could convert:

In re Bartelt, 2007 WL 2579949 (Bankr. D. Mont. Sept. 4, 2007)

1. Chapter 7 debtors filed a motion to convert citing that the debtor wife was terminally ill and the debtors wanted to pay these debts pursuant to plan, leaving something for the debtor husband if he should survive the debtor wife to negotiate and pay creditors.

2. The debtors argued that a Chapter 13 would likely be a quicker distribution than one in a Chapter 7.
3. The trustee's objection to the debtor's motion to convert alleged bad faith and that the debtors had no absolute right to convert under *Marrama*.
4. The court held that the debtors were justified in their efforts to convert, and the trustee had made no showing of bad faith. The court permitted the conversion.

In re Murray, 377 B.R. 464 (Bankr. D. Del. 2007).

1. The debtor voluntarily converted his petition from a Chapter 7 to a Chapter 13.
2. The trustee moved to set aside the conversion because he discovered a $200,000 license plate that had not been disclosed and was discovered by the trustee only after receipt of an anonymous letter.
3. The court looked at the totality of the circumstances to determine that the debtor had not converted his case in bad faith.
4. The court compared the facts of this case with those of *Marrama.* Specifically, the court held that the value of the license plate was not obvious to the debtor, the debtor had never tried to sell the license plate, the debtor had never treated the license plate as if it were valuable, there was no evidence that the debtor deliberately concealed the license plate.
5. Therefore, the court permitted conversion.

The following decisions are representative of post-*Marrama* cases in which the court held that the debtor could not convert from a Chapter 7 to a Chapter 13:

In re Splawn, 2008 WL 1914253 (Bankr. D. N.M. April 25, 2008)

1. The debtor filed a motion to convert from Chapter 7 to 13.
2. A creditor, who had successfully objected to debtors' discharge, objected citing bad faith.
3. The debtors had received $64,000 from sale of real property. The creditor held a mortgage on the property, although it was not recorded at the time of the sale. The debtors had signed the mortgage and note and knew that creditor had a secured interest in sale proceeds, but sold the property without paying the mortgage.
4. The court held that the debtors had acted in bad faith and were not eligible to be debtors under Chapter 13 under *Marrama.*
5. The court focused on the timing of the motion to convert-it was filed after the debtors had been denied their discharge. The court also looked at the debtor's actions to avoid the debt by selling the property.
6. The court held that "[b]ased on the totality of the circumstances, the . . .Debtors engaged in a consistent pattern of evading repayment of their debt to [the creditor] and have not proceeded in good faith."

In re Gabriel, 2008 WL 915789 (Bankr. D. S. C. March 27, 2008)

1. The trustee moved to compel the debtor to turnover undisclosed tax refund received post-petition.
2. The debtor filed motion to convert to a chapter 13.
3. The trustee argued that no conversion should be permitted because the debtor acted in bad faith when she spent her refund when it was property of the estate and failed to turn the money over to the estate.
4. Additionally, the trustee argued that the debtor's bank account contained not $250, as stated by the debtor on her schedules, but $7,219.16 as of the date of filing, and the debtor refused to turn the difference over to the trustee.
5. The court recognized that the 4th circuit, prior to *Marrama*, recognized the absolute right to convert to a Chapter 13.
6. The court held that debtor was not honest with the statements on her petition, and she did not cooperate with the trustee. The court denied the debtor's petition to convert.

In re Piccoli, 2007 WL2822001 (E.D. Pa. Sept. 27, 2007)

1. The debtor filed a motion to convert her case from Chapter 7 to Chapter 13.
2. The trustee filed an objection to the motion, arguing that the debtor had filed her motion in bad faith because she drastically undervalued her home and did not disclose that she had transferred the home without consideration to her daughter and son-in-law sixteen months before filing.
3. Prior to the motion being filed, the trustee was in negotiations with the debtor to pay the estate to avoid the house being sold.
4. The court held that the debtor's behavior was "atypical" and she should not be permitted to covert to a Chapter 13 in accordance with *Marrama*.
5. The court used the same good faith analysis used to evaluate a Chapter 13 petition.
6. The court also looked at the debtor's purpose for converting in determining that her motion was filed in bad faith because it was only after the debtor learned that the trustee wanted to sell her house that she filed her motion to convert.
7. The court also held that the debtor was not forthright with the trustee in her valuation of the home, insisting that the value was lower despite the higher appraised value.
8. Finally, the court stated that the Chapter 13 plan proposed by the debtor was not feasible, and the creditors would be prejudiced if the conversion were permitted.

In re Grant, 385 B.R. 627 (Bankr. E.D Louisiana Feb. 27, 2008)

1. The debtor field a motion to convert his Chapter 7 case to a Chapter 13.
2. The trustee and a creditor objected, arguing that the debtor was attempting to convert in bad faith. The debtor had failed to disclose a $25,184.72 check he was holding, a bank account with $7,428, an outstanding receivable, and a closed bank account on his schedules.

3. The debtor also had two social security numbers which he used pre-petition to obtain credit, intentionally misleading his creditors.
4. Finally, even though he filed in Louisiana, the debtor took California exemptions, arguing that he was a resident of California, which was not accurate. When the trustee discovered these facts, the debtor amended his schedules, and, on the same day, filed a motion to convert.
5. The court, shifting the burden to the debtor to prove that his motion was filed in good faith, held that the debtor could not convert to a Chapter 13 and ordered that the matter be referred to the U.S. Attorney for a criminal investigation.

VI. Chapter 13 to 7

Marrama was a case involving a debtor who wanted to convert his Chapter 7 case to one under Chapter 13 to outwit an aggressive Chapter 7 trustee who might have been able to make a substantial distribution to creditors following the discovery of an undisclosed asset. Consequently, it directly affected the conversion from Chapter 7 to 13, not the reverse. The Court in *Marrama* interpreted 11 U.S.C. §706 in making its decision. That section seems limited to conversions to a Chapter 11, 12, or 13.[18] The Court did not take the next step and indicate whether a reconversion to a Chapter 7 could be denied upon a showing of bad faith Therefore, it is unclear what role the *Marrama* decision would play in determining whether a debtor has an absolute right to convert or re-convert to a Chapter 7 from a Chapter 13.

Unfortunately, there are very few reported cases post-*Marrama* discussing the effect of the decision on conversions or reconversions from Chapter 13 to Chapter 7.[19] Trustees or creditors in the Sixth Circuit who wished to oppose such conversion would be well advised to rely on the pre-*Marrama* cases for support.

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[18] Supra note 9 "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." 11 U.S.C. §706(d).

[19] *See In re* Garrett, 2008 WL 2206559, *3 (Bankr. E.D. Va. 2008 ("there is no absolute right to convert a case from chapter 13 to chapter 7.") *In re* Polly, 392 B.R. 236 (Bankr. N.D. Tex. 2008) (discussing *Marrama* as it applies to a motion to convert a Chapter 13 to a Chapter 7 filed by a creditor and a competing motion to dismiss the Chapter 13 petition filed by the debtor). The court in *In re* Polly ultimately held that the debtor had an absolute right to dismiss her Chapter 13 petition even if a motion to convert her case to a Chapter 7 was pending.

Although not binding, the dissent in *Marrama* did discuss the issue of re-conversion if a debtor had engaged in bad faith when converting from a Chapter 7 to a Chapter 13, indicating that re-conversion would not be just an empty exercise. The dissent indicated that if a court did find that a debtor converted his or her case in bad faith, the court could re-convert the case. The dissent chastised the Court of Appeals in the underlying case for stating that there would be no purpose served "by requiring the parties and the court to go through the process of conversion and prompt reconversion."[20]

VII. Did *Marrama* change anything?

No, at least not in the Sixth Circuit and in other circuits already following the *Marrama*-like rule. In other jurisdictions that adhered to the rule that a debtor has the absolute right to convert to a Chapter 13, it appears that there is a different rule in place. The trustee and estate creditors now have the ability to object to conversion on bad faith grounds. Yet, the court has the authority to decide what constitutes bad faith pursuant to its §105. It ultimately has the ability to fashion rulings related to bad faith to achieve the result it desires based on the facts of each case.

Additionally, what may be bad faith to one judge, may not be bad faith to another judge. *Marrama* did not set forth a legal test for determining bad faith. Bad faith is also not defined in the Code. The ruling in *Marrama* ultimately creates a vast gray area where judges could differ about what constitutes bad faith. It seems that despite the ruling in *Marrama,* each jurisdiction is left to fashion its own test.

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[20] *Marrama,* 549 U.S. at ***, 127 S. Ct. at 1115 (citations omitted). See *In re* Muth, 378 B.R. 302 (Bankr. D.Colo. 2007) (discussing the split in the courts over whether the debtor has a right to reconvert after already converting his or her case once). The court in *In re* Muth ultimately held that the debtor had a one-time right statutory right to convert.

DOES THE *MARRAMA* DECISION PLACE AN ADDITIONAL REQUIREMENT ON DEBTORS FOR CONVERSION FROM CHAPTER 7 TO 13?

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SUMMARY

On February 21, 2007, the Supreme Court of the United States decided the case of Robert Louis Marrama v. Citizens Bank of Massachusetts, et al.[21] The debtor in this case filed for bankruptcy protection under chapter 7, but did not disclose that he had transferred real property in Maine the year prior to the filing. The trustee indicated that he intended to recover the real property as an asset of the bankruptcy estate. The debtor attempted to convert his case to chapter 13. The trustee objected on the grounds of bad faith and that the conversion would be an abuse of the bankruptcy process. The Bankruptcy Judge denied the debtor's request to convert, finding bad faith. The First Circuit's BAP affirmed and the First Circuit Court also affirmed. The Supreme Court of the United States granted certiorari.

LEGAL ARGUMENTS OF THE PARTIES

The debtor argued that 11 U.S.C.S. §706(a) provides him with an absolute right to convert to chapter 13 and that a Debtor can not waive his right to convert a case. The debtor looked to the House and Senate Committee Reports on §706(a) which indicates:

> Subsection (a) of this section gives the debtor the one-time absolute right of conversion of a liquidation case to a reorganization or individual repayment plan

[21] 549 U.S. 365; 127 S. Ct. 1105, 166 L. Ed. 2d 956; 2007 U.S. LEXIS 2651; 75 U.S.L.W. 4133; Bank. L. Rep. (CCH) P80m 850; 57 Collier Bank. Cas. 2d (MB) 1; 47 Bankr. Ct. Dec. 221; 20 Fla. L. Weekly Fed. S 93

case. If the case has already once been converted from chapter 11 or 13 to chapter 7, then the debtor does not have that right. The policy of the provision is that the debtor should always be given the opportunity to repay his debts, and a waiver of the right to convert a case is unenforceable. S. Rep No. 95-989, p 94 (1978); see also H.R. Rep. No. 95-595, p 380, (1977).

The trustee argued that under 11 U.S.C.S. §706(d) conversion is not allowed if the debtor could not be a debtor under the chapter that he is attempting to convert to. Also that a chapter 13 case may be dismissed or converted to chapter 7 under 11 U.S.C.S. §1307(c) for cause and includes a non-exclusive list of causes that justifies relief including: unreasonable delay by the debtor that is prejudicial to creditors; nonpayment of any fees and charges required under chapter 123 of title 28; failure to file a pan timely under section 1321 of this title; on request by the United States trustee, failure to timely file the information required by paragraph 2 of section 521; failure of the debtor in chapter 7 to file a statement of intent indicating their intent as to secured property. 11 U.S.C.A. §521(a)(2).

Nothing in the above list specifies pre-petition bad faith by the debtor as a reason to disallow conversion; however, in practice bankruptcy courts routinely interpret "for cause" as bad faith.[22] By using this reasoning the Court is in effect pre-judging that the debtor does not qualify for chapter 13 because of pre-petition bad faith. The *Marrama* Court found that this bad faith includes fraudulent acts committed in an earlier chapter 7 proceeding, which means that a debtor would not qualify for chapter 13. The debtor must be honest but unfortunate in order to possess an absolute right to convert their case from chapter 7 to chapter 13.[23] The majority reasoned that neither 11 U.S.C.S. §706 or §1307(c) limits the Court's authority to sanction fraudulent conduct by a debtor, and 11 U.S.C.S. §105(a) provides broad authority to bankruptcy

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[22] *See, e.g., In re* Alt, 305 F.3d 413, 418-419 (6th Cir. 2002); *In re* Leavitt, 171 F.3d 1219, 1224 (9th Cir. 1999); *In re* Kestell, 99 F.3d 146, 148 (4th Cir. 1996); *In re* Molitor, 76 F.3d 218, 220 (8th Cir. 1996); *In re* Gier, 986 F.2d 1326, 1329-1330 (10th Cir. 1993); *In re* Love, 957 F.2d 1350, 1354 (7th Cir. 1992); *In re* Sullivan, 326 B.R. 204, 211 (B.A.P. 1st Cir. 2005).

[23] Grogan v. Garner, 498 U.S. 279, 287, 111 S. Ct. 654, 112 L. Ed. 2nd 755.

judges to prevent abuse of the bankruptcy process, including an immediate denial of a motion to convert.

FACTS OF MARRAMA

In his chapter 7 schedules the debtor disclosed that he was the sole beneficiary of a trust that owned real property in Maine and listed the value of the property at zero. Debtor also indicated that he had not transferred any property other than in the ordinary course of business during the one year prior to his filing. However, the real property did have substantial value and the debtor had transferred it into this newly created trust for $0 consideration within the year before filing his chapter 7 petition. Debtor admitted that the purpose of the transfer of the real property to the trust to protect it from his creditors. The trustee indicated that he was going to pursue the real property in Maine as an asset of the estate and debtor then filed a motion to convert his case to chapter 13. The trustee and a bank creditor objected to the conversion claiming bad faith on the part of the debtor pointing to the issue with the Maine property, but also that the debtor had claimed a homestead exemption for real property in Gloucester, Mass. that the debtor did not reside in and was receiving rental income from. Further, the debtor also claimed no right to a tax refund on Schedule B, but debtor had filed an amended tax return which entitled him to a $8,745.86 tax refund.

At the conversion hearing debtor's attorney tried to place the blame on himself and indicated that the "misstatements" about the Maine real property were due to his error. Additionally, the petition was filed as a chapter 7 when the debtor was unemployed, but now that the debtor had employment the debtor's attorney presented that he wished proceed under chapter 13.

The BAP concluded that 11 U.S.C.S. §706(a) grants debtors an absolute right to convert unless there are extreme circumstances and that those circumstances exist is this case.[24] And although debtor may now qualify as a debtor under chapter 13 because of an increase in income, his concealment of assets established bad faith to deny the conversion. The United States Court of Appeals for the First Circuit agreed and affirmed.[25] The Supreme Court in a 5 to 4 decision held that a debtor does not have an absolute right to convert and, in fact, forfeits their right to convert when the debtor has acted in bad faith. The Supreme Court cited §706(d), which allows for denial of the conversion when it is found under §1307(c) that a chapter 13 case should be dismissed or converted "for cause" when there is bad faith. The Court found bad faith to include fraudulent acts committed in a previously filed chapter 7 case, which would disqualify them as a chapter 13 debtor. The Court also ruled that neither of these code sections limited the Court's authority to take whatever action was necessary to prevent abuse of the bankruptcy process, and that §105(a) allows an immediate denial of a motion to convert.

The dissent argued that if a debtor filed a case under chapter 7 it could be converted to another chapter that the debtor was eligible for and interpreted the majority's ruling as placing an additional requirement on the debtor, that being that the bankruptcy judge must make a finding of good faith, and this is inconsistent with the Code. The only requirements to be a chapter 13 debtor are: that the debtor must be an individual or married individuals with regular income, and they must be under the debt limits (11 U.S.C.S. §109(e)). Further, the minority points out that Congress did provide remedies for conduct like this by debtors including a denial of discharge for concealment of records and papers regarding the debtor's financial condition (11 U.S.C.S.

[24] *In re* Marrama, 313 B.R 525; 2004 Bankr. LEXIS 1317 (1st Cir. B.A.P. 2004).
[25] *In re* Marrama, 430 F.3d 474, 2005 U.S. App. LEXIS 23512 (1st Cir. 2005).

§727(a)(3)) or making a false oath or presenting a false claim (11 U.S.C.S. §727(a)(4)). Congress could have made this conduct a bar to conversion, but did not specifically do so. The dissent concludes that the Code does not give bankruptcy courts the power to deny conversion based on a finding of bad faith.

THE DEFINITION OF BAD FAITH FROM THE DEBTOR'S VIEW

The debtor's attorney in *Marrama* apparently did not question the debtor regarding the trust or the transfer of the real property, or the debtor intentionally did not disclose it. If a debtor attorney discovers that either one of these situations have happened, the best they can hope for is that the client's financial situation has changed so that there is an arguable reason to convert the case to chapter 13. Any debtor attorney that heard this story would advise him of a potential problem and advise the debtor to file a chapter 13.

From the debtor's point of view, "bad faith" is one of those ubiquitous concepts that creditors and trustees fall back on when there is not a specific bankruptcy code section to use to object to a debtor's discharge. This is much like the "totality of the circumstances" standard in 11 U.S.C.S. §707(b)(3), that allows objection to discharge based on an undefined standard. The definition changes from case to case and I am convinced that it is decided much like the Supreme Court's ruling on pornography -- they know it when they see it.

THE ROLE OF THE DEBTOR ATTORNEY

Every debtor attorney has had a client that you know was not being totally candid and you either call them out or go along with the story. But in those cases where the debtor attorney does not inquire of the debtor as thoroughly as they should but the debtor is not actively hiding any facts, is it fair to hold the debtor responsible for their attorney's mistake? If the debtor in *Marrama* had a different attorney that had discovered these facts he may have been advised to

file a chapter 13 or not file at all. Debtor attorneys are required to do some independent investigation of the facts pursuant to Rule 9011, and given the holding in *Marrama* there is more of an incentive be diligent in questioning the client.

In the Eastern District of Michigan Local Rule 9014-1 indicates the procedure for motions. A motion must be filed for conversion from chapter 7 to chapter 13 to put creditors and the panel trustee on notice that the debtor wishes to convert the case. This gives the panel trustee opportunity to object if there are assets that should be recovered for the estate.

Debtor attorneys can complain that the "bad faith" standard in *Marrama* is vague and unfairly applied, but this has always been the standard in the Sixth Circuit and the Eastern District of Michigan. If we are honest with ourselves, we know when a case should be a 13 or when it is filed as a 7 hoping that the trustee does not ask too many questions about the assets. If the debtor attorney is wrong and assets are discovered they are putting those assets at risk for the client. *Marrama* makes clear that there is no an absolute right to convert from chapter 7 to chapter 13 so cases should be filed under the correct chapter from the beginning.