

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
KENNETH THOMAS MAREK,) CASE NO. BK93-81296
DEBRA MARIE MAREK,) CH. 13
)
)
DEBTOR(S))

MEMORANDUM

This matter is before the Court on a Motion to Convert to Chapter 13 Bankruptcy; Order for Relief Under Chapter 13; Motion to Determine Proper Payee; and Order dated December 20, 1994. Appearing on behalf of debtor is Howard Duncan of Omaha, Nebraska. Appearing as Chapter 7 Trustee is James Stumpf of Omaha, Nebraska. Appearing as Chapter 13 Trustee is Kathleen Laughlin of Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

Background

The debtors, Kenneth T. and Debra M. Marek, filed a petition for Chapter 7 bankruptcy relief on August 10, 1993. The bankruptcy estate was entirely abandoned by the Chapter 7 Trustee for lack of value to creditor, except for Kenneth Marek's potential inheritance from the estate of Julia E. Marek, Kenneth Marek's aunt.

The debtors did not list the inheritance as an asset in their bankruptcy schedules. However, it does not appear that the debtors had knowledge of the inheritance at that time. Since the issue as to whether the inheritance is part of the bankruptcy estate was not raised by the parties, the Court is presuming that the inheritance arose within 180 days after the petition date and is, therefore, property of the estate under 11 U.S.C. § 541(a)(5)(A).

The Chapter 7 Trustee discovered that Kenneth Marek was entitled to receive an inheritance at the § 341 meeting. After the probate of Julia Marek's estate was completed, the inheritance totaled \$5,452.75. On February 1, 1994, which occurred at some point during or after the probate proceedings, the debtors received a discharge of all of their dischargeable debts in the Chapter 7 bankruptcy case.

The debtors moved this Court to convert the Chapter 7 case to one under Chapter 13 on September 29, 1994. Receiving no resistances to the motion, the Court ordered that the Chapter 7 case should be converted to one under Chapter 13 on October 28, 1994.

The Chapter 7 Trustee filed a motion in the Chapter 13 case to determine whether the proper payee for the funds collected by the trustee during the Chapter 7 case is the debtor or the Chapter 13 Trustee. After the Chapter 7 administrative expenses for the Chapter 7 case were paid, \$ 3,900.00 remained in the bankruptcy estate.

Initially, the Court ordered the Chapter 7 Trustee to distribute the funds to the debtor. However, after the Court entered the order, the Court learned that the debtors had received a discharge in the Chapter 7 case and that said discharge had not been revoked. The Court vacated its prior order directing the trustee to distribute the funds to the debtor. In addition, the Court ordered that the court order approving the conversion of the case from Chapter 7 to one under Chapter 13 should be vacated, but before vacating the order, the Chapter 7 Trustee, the Chapter 13 Trustee, and the debtor were granted the opportunity to present written legal arguments as to why the vacation should not occur.

Discussion

A Chapter 7 case may be converted to a Chapter 13 case pursuant to Section 706(a) of the Bankruptcy Code, which provides:

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.

11 U.S.C. § 706(a) (1995). This Court previously discussed the right of the debtor to convert a case from one under Chapter 7 to one under Chapter 13 in In re Fridrich, Neb. Bkr. 94-357 (Bankr. D. Neb. June 17, 1994). In Fridrich, this Court followed the Fifth Circuit case In re Martin, 880 F.2d 857 (5th Cir. 1989), and held that a debtor has an absolute right to convert a Chapter 7 case to one under Chapter 13, even after a discharge has been granted in the Chapter 7 case, but that the absolute right to conversion does not preclude a court from denying the conversion on other grounds. Fridrich, Neb. Bkr. 94:357 at 358.

Fridrich also held that conversion does not revoke the discharge granted to the debtor in the Chapter 7 case and that only the nondischargeable debts or those debts which arose post-petition in the Chapter 7 case are reorganized in the Chapter 13 case because the debtor lacks standing under 11 U.S.C. § 727(d) to request a revocation of the discharge. Neb. Bkr. 94:357 at 359 (discussing and following other bankruptcy court opinions within the Eight Circuit).

Fridrich noted that other bankruptcy courts in the Eighth Circuit have evaluated a motion to convert from a Chapter 7 case to a Chapter 13 case by considering the standards for good faith established by the Eighth Circuit in Handeen v. LeMaire (In re LeMaire), 898 F.2d 1346 (1990) (en banc). Fridrich, 357 (citing to In re Sieg, 120 B.R. 533 (Bankr. D.N.D. 1990); In re Kilker, 155 B.R. 201 (Bankr. W.D. Ark. 1993)). Under LeMaire, this Court is required to consider the "totality of the circumstances" to determine whether the debtor is seeking to have the case converted in good faith or is manipulating the Bankruptcy Code. Id.

There is very little evidence in this case to determine the debtors' good faith. The debtors' behavior with regard to the timing of the conversion suggests that the inheritance was a factor in causing the debtors to convert, but this reason alone, without other evidence of wrongdoing by the debtors, is not enough to cause the Court to deny the conversion.

The Chapter 7 Trustee, however, has raised another point, which if true, would cause the debtors' proposed Chapter 13 plan to be unfeasible. The Chapter 7 Trustee takes the position that the debtors have improperly claimed exemptions in the Chapter 13 case. Kenneth Marek has taken a homestead exemption as the head of household pursuant to NEB. REV. STAT. § 44-101, and Debra Marek has claimed approximately \$2,450 of the inheritance proceeds as exempt under the "in lieu of homestead exemption" pursuant to NEB. REV. STAT. § 25-1552.

As a general rule, married debtors are entitled to take both exemptions. In re Coonrod, 135 B.R. 375, 377 (Bankr. D. Neb. 1991). However, the Chapter 7 Trustee is arguing that Debra Marek may not claim an interest in the inheritance as exempt because only Kenneth Marek inherited the interest, and he has already claimed the homestead exemption.

If the trustee is correct, then none of the inheritance may be claimed as exempt. Therefore, in a Chapter 7 case, almost \$3,000 would be distributed to general unsecured creditors on a pro rata basis after priority claims were paid.

In contrast, the Chapter 13 plan proposed by the debtors will not pay any dividend to the unsecured creditors. Therefore, the Chapter 13 plan violates 11 U.S.C. § 1325(a)(4) by paying general unsecured creditors less than they would receive under a Chapter 7 liquidation proceeding.

The Chapter 13 Trustee and the debtor, however, take the position that the unsecured creditors will receive approximately the same amount as they would receive in a Chapter 7 liquidation. The Chapter 13 Trustee, who takes no official position on the conversion issue, did provide calculations to the Court that were based on the presumption that the debtors could claim an additional

\$ 2,450 as exempt pursuant to NEB. REV. STAT. § 25-1552 because the debtors only claimed \$50.00 as exempt under that provision in the original Chapter 7 case.

The Chapter 13 Trustee calculates that after this exemption is taken, and priority claims are paid, the final amount available for distribution to unsecured creditors in a liquidation case will be approximately \$581.00. The Chapter 13 Trustee deems this amount as insufficient because the unsecured creditors' claims totaled \$25,131.71 in the schedules. Therefore, she concludes that the unsecured creditors in the Chapter 7 case are not injured by the conversion to the Chapter 13 case, where they will also receive nothing under the debtor's proposed plan.

The debtor adopts the position of the Chapter 13 Trustee and argues that the net effect of permitting the conversion is not relevant because the debtor can refile a Chapter 13 case and propose the same plan if conversion is denied. The debtor also points out that no unsecured creditors have objected to the conversion and that all unsecured creditors did receive notice that assets may be available for distribution.

Decision

The order to convert the case from one under Chapter 7 to one under Chapter 13 of the Bankruptcy Code is reinstated. The order directing the Chapter 7 trustee to turnover the remaining proceeds from the Chapter 7 case to the debtor is reinstated.

Discussion

The debtors are entitled to convert their Chapter 7 case to one under Chapter 13 if there is no evidence of bad faith. The issue raised by the Chapter 7 Trustee, that the unsecured creditors would receive more in a Chapter 7 distribution than under the Chapter 13 plan proposed by the debtors, is not a good faith issue in this particular case because the success of the Chapter 7 Trustee's position is based on how the Court would interpret Nebraska's exemption statutes. If the Chapter 7 Trustee is correct that Debra Marek may not claim \$2,450 of the inheritance as exempt, the proposed Chapter 13 plan violates the best interests of the creditors rule. However, if the Chapter 13 Trustee and the debtor are correct, the proposed Chapter 13 plan is confirmable.

Under certain circumstances, the issue as to whether the Chapter 13 plan is confirmable is a good faith issue, e.g. if the debtor is proposing the plan to delay the bankruptcy case and frustrate creditors. However, in this case, there is no allegation of any wrongdoing on the part of the debtors, and no unsecured creditors have objected to the conversion of the bankruptcy case. Therefore, as for those creditors whose claims were discharged in the Chapter 7 case, they are not prejudiced by the conversion. It

appears that the Chapter 7 unsecured creditors received notice of the conversion and of the potential availability of an asset, but none of these creditors have sought to have the discharge of their claims revoked or to object to the conversion.

The issue as to whether Debra Marek may claim the inheritance proceeds as exempt is not contingent upon or the result of the proposed conversion of the case. This issue would exist whether the debtors converted the case, closed the Chapter 7 case and refiled a Chapter 13 case, or remained in Chapter 7. Assuming, for a moment, that the Court agrees with the Chapter 7 Trustee and finds that the debtors are not entitled to claim the inheritance proceeds as exempt, the more appropriate remedy would be to cause the debtors to amend their proposed Chapter 13 plan to satisfy the best interest of creditors test. The Chapter 13 Trustee is obligated to object if she finds that the proposed Chapter 13 plan violates the standards for confirmation under the Bankruptcy Code. The issue of confirmation of a proposed plan that may be flawed because of a question concerning the right to an exemption is not the same as a question of good faith concerning the conversion of the case.

The motion to convert to Chapter 13 is granted.

Separate journal entry shall be filed.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

STUMPF, JAMES	397-1201
DUNCAN, HOWARD T.	342-8134

Copies mailed by the Court to:

Kathleen Laughlin, Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
KENNETH THOMAS MAREK,)	
DEBRA MARIE MAREK,)	CASE NO. BK93-81296
)	A
<u>DEBTOR(S)</u>)	
)	CH. 13
)	Filing No.
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	DATE: March 7, 1995
<u>Defendant(s)</u>)	

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Convert to Chapter 13 Bankruptcy; Order for Relief Under Chapter 13; Motion to Determine Proper Payee; and Order dated December 20, 1994.

APPEARANCES

Howard Duncan, Attorney for debtor
James Stumpf, Chapter 7 Trustee
Kathleen Laughlin, Chapter 13 Trustee

IT IS ORDERED:

The motion to convert to Chapter 13 granted. See memorandum entered this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:
STUMPF, JAMES 397-1201
DUNCAN, HOWARD T. 342-8134

Copies mailed by the Court to:
Kathleen Laughlin, Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.