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# Negotiating Between Harris and Michael: Who is Entitled to Undistributed Payments upon a Chapter 13 to Chapter 7 Bankruptcy Conversion?

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# Negotiating Between *Harris* and *Michael*: Who is Entitled to Undistributed Payments upon a Chapter 13 to Chapter 7 Bankruptcy Conversion?

Robert J. Taylor*

**Abstract**

Conversion from a Chapter 13 to Chapter 7 bankruptcy is one of the most essential tools in a debtor's arsenal. However, over the past several decades, courts have clashed when applying the Bankruptcy Code to certain situations arising from such a conversion. Although Congress addressed one such disagreement in the Bankruptcy Reform Act of 1994, another hotly debated issue remained over whether debtors or creditors should receive undistributed funds held by Chapter 13 trustees upon conversion to a Chapter 7 bankruptcy. The issue led to a circuit split in 2014 when the Fifth Circuit, in *In re Harris*, ruled in favor of creditors, which contrasted with the Third Circuit's previous ruling in favor of debtors in *In re Michael*.

This Comment argues that Congress never intended for either debtors or creditors to have an absolute right to such undistributed funds upon conversion, which is supported through analyses of the Bankruptcy Code, legislative history, and policy. Rather, Congress intended the parties to negotiate for a term that would resolve the potential issue in their Chapter 13 bankruptcy repayment plan. The Comment proposes that Congress or the Supreme Court should clarify the matter by explicitly requiring the parties to provide such a provision in the plan.

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## I. INTRODUCTION

A vital mechanism in a Chapter 13 bankruptcy, which allows a debtor to repay creditors without liquidating existing assets,[1] is the debtor's ability to convert to a Chapter 7 bankruptcy to discharge debt through liquidation when that becomes the debtor's most prudent course of action.[2] However, this critical device has been undermined by uncertainty over whether a debtor or creditors receive undistributed funds held by a Chapter 13 trustee[3] after conversion to a Chapter 7 bankruptcy.[4] Disagreement over which party is entitled to such funds has tormented

1. *See* 11 U.S.C. § 1322*a)(1)(2012).

2. *See* Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 471 (5th Cir. 2014); Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 TEX. L. REV. 103, 132 (2011) (noting the importance of conversions from Chapter 13 to Chapter 7 bankruptcies because they often become the debtor's best option).

3. "[O]ne who, having legal title to property, holds it in trust for the benefit of another and owes a fiduciary duty to that beneficiary." *Trustee*, BLACK'S LAW DICTIONARY (9th ed. 2009).

4. *See, e.g.*, *In re Harris*, 757 F.3d at 471; *In re* Michael, 699 F.3d 307, 307 (3d Cir. 2012).

lower courts for decades.[5] While Congress addressed a similar question in the Bankruptcy Reform Act of 1994,[6] the quandary over which party is entitled to funds not yet distributed at the time of conversion remained.[7] In 2014, the Fifth Circuit, in *In re Harris* ("*Harris*"),[8] created a circuit split over the matter when the court found for creditors and rejected the Third Circuit's opinion, in *In re Michael* ("*Michael*"),[9] in favor of debtors.[10]

In this Comment's "background section," Part A will begin with a brief explanation of Chapter 13 and Chapter 7 bankruptcies, and the conversion from the former to the latter.[11] Part B will then discuss the prior pre-1994 circuit split that arose over the conversion and describe Congress's attempt to resolve the issue.[12] Part C will explain the recent developments that led to the new circuit split between the Third Circuit in *Michael* and the Fifth Circuit in *Harris*.[13]

In the "analysis section," Part A will examine the divergent opinions of those circuit courts as well as lower courts, which will show that the Bankruptcy Code ("Code"), legislative history, and policy are ambiguous with regard to the issue.[14] Part B will describe the vast number of pre-1994 cases that dealt with this issue to show that Congress was aware of this present matter in 1994 but deliberately chose to resolve only the issue surrounding the previous circuit split.[15] Part C will explain that analyzing the Code and legislative history reveals that Congress intended for the parties to negotiate for a term in the Chapter 13 bankruptcy repayment plan ("plan") that would resolve the matter, and a policy analysis will suggest that this is a prudent rule.[16] Lastly, Part D will recommend that either Congress or the Supreme Court clarify the rule by explicitly stating that the parties *must* negotiate for such a term in the plan.[17]

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5. *See, e.g.*, *In re* Peters, 44 B.R. 68, 73 (Bankr. M.D. Tenn. 1984); *In re* Rutenbeck, 78 B.R. 912, 913 (Bankr. E.D. Wis. 1987).

6. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-94, 108 Stat. 4106 (1994); 11 U.S.C. § 348(f).

7. *See In re Harris*, 757 F.3d at 471; *In re Michael*, 699 F.3d at 307.

8. Viegelahn v. Harris (*In re* Harris), 757 F.3d 468 (5th Cir. 2014).

9. *In re* Michael, 699 F.3d 307 (3d Cir. 2012).

10. *See In re Harris*, 757 F.3d at 471; *In re Michael*, 699 F.3d at 307.

11. *See infra* Part II.A.

12. *See infra* Part II.B; 11 U.S.C. § 1322(a)(1) (2012).

13. *See infra* Part II.C; *In re Harris*, 757 F.3d at 471; *In re Michael*, 699 F.3d at 307.

14. *See infra* Part III.A; *In re Harris*, 757 F.3d at 471; *In re Michael*, 699 F.3d at 307.

15. *See infra* Part III.B; 11 U.S.C. § 348(f).

16. *See infra* Part III.C.

17. *See infra* Part III.D.

## II. BACKGROUND

To better understand this Comment's topic, this section will focus on three separate matters to provide the necessary context surrounding the present circuit split's specific bankruptcy issue. First, the differences between Chapter 13 and Chapter 7 bankruptcies will be explained, followed by an explanation of the process of converting the former to the latter.[18] Then, the pre-1994 circuit split that arose over an issue related to such a conversion and the resolution of that split through the passage of 11 U.S.C. § 348(f)[19] of the Bankruptcy Code will be discussed.[20] Finally, the issue leading to the current circuit split that went unaddressed by § 348(f) will be explained.[21]

### *A. Conversion from a Chapter 13 to Chapter 7 Bankruptcy*

#### 1. Chapter 13 Bankruptcy

A Chapter 13 bankruptcy allows an individual debtor to repay both secured and unsecured claims[22] without liquidating the debtor's existing assets.[23] A debtor can commence a Chapter 13 bankruptcy by filing a petition with a bankruptcy court.[24] Filing the petition creates an estate composed of all the debtor's property at the time of the filing, and any property or income obtained after the filing "but before the case is closed, dismissed or converted."[25] The debtor ordinarily pays the creditors back through future income pursuant to a plan.[26]

The debtor may either file the plan with the Chapter 13 petition, or within 14 days thereafter.[27] Failure to file the plan within the required time is a ground for either dismissing the case or for converting the case from a Chapter 13 to Chapter 7 bankruptcy.[28] Under § 1322(a), the debtor must disclose several elements of the plan.[29] For instance, §

18. *See infra* Part II.A.
19. 11 U.S.C. § 348(f)(2012).
20. *See infra* Part II.B.
21. *See infra* Part II.C.
22. An unsecured claim means that a creditor "does not have a lien or right of set-off against the debtor's property," which is contrary to a secured claim when a creditor does have such a lien or right. *Claim*, BLACK'S LAW DICTIONARY (9th ed. 2009).
23. *See* 11 U.S.C. § 1322(a)(1).
24. *Id.* § 301(a).
25. *Id.* § 1306(a)(2).
26. 8 COLLIER ON BANKRUPTCY ¶ 1322.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012) ("Chapter 13 . . . plans [are] funded primarily from future income.").
27. FED. R. BANKR. P. 3015(b).
28. 11 U.S.C. § 1307(c)(3).
29. *See id.* § 1322(a).

1322(a)(1) requires the debtor to submit that the future income necessary to the plan's execution is under the trustee's control.[30] Courts have interpreted this provision in a manner that allows, in some instances, the debtor to bypass the trustee in order to directly pay certain creditors outside the plan, such as mortgage companies.[31] In another example, § 1322(a) also requires the debtor to state that certain claims will be paid in full, unless the holder of such a claim agrees otherwise.[32]

In addition to the disclosures mandated by § 1322(a), § 1322(b) lists provisions the plan "may" include.[33] For example, the plan may modify either unsecured or secured creditors' rights.[34] The plan may also include a provision indicating whether the Chapter 13 estate vests[35] in the debtor or in another entity, and at what stage of the bankruptcy proceeding that vesting occurs.[36] Furthermore, "any other appropriate provision not inconsistent"[37] with the Code may also be included in the plan.[38]

After all parties in interest are notified of the impending Chapter 13 bankruptcy, the bankruptcy court will hold a confirmation hearing on the proposed plan.[39] Although the interested parties lack the authority to accept the proposed plan, the hearing is held to give them an opportunity to object to the proposed plan.[40] These objections often lead to negotiations between the parties and modifications to the initial plan by the debtor.[41] If the parties do not come to an agreement, the objecting party can then attempt to meet the initial burden of production by producing evidence that the plan does not meet the Code's requirements established in § 1325.[42] If the burden of production is satisfied, the debtor then has a

30. *Id.* § 1322(a)(1).

31. *See, e.g.*, *In re* Aberegg, 961 F.2d 1307, 1308 (7th Cir. 1992) ("We conclude that Chapter 13 authorizes confirmation of plans including . . . direct-payment provisions.").

32. 11 U.S.C. § 1322(a)(2) (stating that, in the plan, the debtor "shall provide for the full payment, in deferred cash payments, of all claims entitled to priority . . . , unless the holder of a particular claim agrees to a different treatment of such claim").

33. *Id.* § 1322(b).

34. *Id.* § 1322(b)(2).

35. Vesting occurs when an entity is "confer[red] ownership (of property)." *Vest*, BLACK'S LAW DICTIONARY (9th ed. 2009).

36. *See* 11 U.S.C. § 1322(b)(9).

37. *Id.* § 1322(b)(11).

38. *Id.*

39. *See id.* § 1324(a).

40. *Id.* ("The court shall hold a hearing on confirmation of the plan. A party in interest may object to confirmation of the plan.").

41. *See, e.g.*, Nielsen v. DLC Inv. (*In re* Nielsen), 211 B.R. 19, 20 (B.A.P. 8th Cir. 1997).

42. *See* 11 U.S.C. § 1325; Shortridge v. Ruskin (*In re* Shortridge), 65 F.3d 169, 170 (6th Cir. 1995); *In re* Mendenhall, 54 B.R. 44, 45-46 (Bankr. W.D. Ark. 1985).

burden of proof to show the requirements of § 1325 are met in their plan.[43] Thus, after the confirmation hearing, the court will confirm the plan if the debtor has met the conditions specified in § 1325.[44]

The bankruptcy court's confirmation of a plan binds the debtor and all creditors regardless of whether a creditor accepted or objected to the plan.[45] Additionally, unless the plan or order confirming the plan provides otherwise, the property of the estate is vested in the debtor[46] "free and clear" of any creditor's claim provided for in the plan.[47]

After confirmation, the trustee is required to distribute payments to the creditors pursuant to the plan,[48] absent court approval directing otherwise.[49] Once the debtor has made all payments required by the plan, the court must grant the debtor discharge.[50] The act of discharge releases the debtor from all debt obligations provided for in the plan, subject to exceptions specified in § 1328.[51] Thus, Chapter 13 bankruptcies are often appealing because of the opportunity they provide debtors to dis-

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43. *See* 11 U.S.C. § 1325; *In re* Lofty, 437 B.R. 578, 584 (Bankr. S.D. Ohio 2010).

44. The relevant provisions in § 1325 include:

> (a)(1) the plan complies with the provisions of [the Code];
> (5) with respect to each allowed secured claim provided for by the plan—
> (A) the holder of such claim has accepted the plan;
> (B)(i) the plan provides that—
> (II) if the case . . . is dismissed or converted without completion of the plan, such lien shall [] be retained by such holder . . .;
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and
> (C) the debtor surrenders the property securing such claim to such holder;
> (6) the debtor will be able to . . . comply with the plan;
> (b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
> (A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
> (B) the plan provides that all of the debtor's projected disposable income to be received . . . under the plan will be applied to make payments to unsecured creditors under the plan.

11 U.S.C. § 1325.

45. *Id.* § 1327(a).

46. *Id.* § 1327(b).

47. *Id.* § 1327(c).

48. *Id.* § 1326(c).

49. 11 U.S.C. § 1326(c); *see* Mendoza v. Temple-Inland Mortg. Corp. (*In re* Mendoza), 111 F.3d 1264, 1265 (5th Cir. 1997) (finding that the court can order the debtor to make post-petition mortgage payments directly to the creditor); *In re* Aberegg, 961 F.2d 1307, 1310 (7th Cir. 1992) (finding that the court can approve plans under which the debtor distributes certain payments directly to creditors).

50. *Id.* § 1328(a).

51. *See id.* § 1328.

charge debt without liquidating their estate, which is not an opportunity provided by Chapter 7 bankruptcies.

2. Chapter 7 Bankruptcy

In contrast to Chapter 13 bankruptcies, Chapter 7 bankruptcies are funded through liquidating the debtor's estate.[52] Thus, the proceeds from the sale of the debtor's assets are put toward the Chapter 7 bankruptcy.[53] The debtor's estate is comprised of all the debtor's property at the time of the Chapter 7 bankruptcy filing.[54] Subject to exceptions, the liquidated estate is used to pay creditors, and any remaining debt is discharged.[55] Debtors often turn to Chapter 7 bankruptcies to discharge their debt after the debtors realize that adherence to their Chapter 13 plans is no longer monetarily feasible.[56] Debtors are able to fall back on Chapter 7 bankruptcies through a process known as conversion.[57]

3. Conversion

A debtor who enters into a Chapter 13 bankruptcy, but is not able to comply with the confirmed plan, is permitted to convert his case to a Chapter 7 bankruptcy at any time.[58] This is often a crucial tool for a debtor, evidenced by the fact that Chapter 13 bankruptcies are completed in only approximately one-third of all cases.[59] While the Chapter 13 trustee's services are terminated upon conversion,[60] the trustee must account for any funds that came into the trustee's possession in a final report.[61] Despite the frequency and importance of conversions, certain details of the process have been murky for decades because of disagreements among courts.[62] In addition to the present circuit split,

52. *See* Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 471 (5th Cir. 2014).
53. *See* HON. W. HOMER DRAKE, JR. & KAREN D. VISSER, BANKRUPTCY PRACTICE FOR THE GENERAL PRACTITIONER § 11:1 (2014).
54. 11 U.S.C. § 541.
55. *See In re Harris*, 757 F.3d at 471.
56. *See* Porter, *supra* note 2, at 132.
57. *See* 11 U.S.C. § 1307(a).
58. *Id.*
59. *See* Porter, *supra* note 2, at 107–11 (using studies to support position that only 1/3 of Chapter 13 bankruptcies are successfully completed, and noting that this trend has existed for "more than thirty years").
60. 11 U.S.C. § 348(e).
61. FED. R. BANKR. P. 1019(5)(B)(ii).
62. *See infra* Part II.B.

these judicial divergences arising from conversions led to a circuit split in 1991.[63]

### B. *Resolution of the Pre-1994 Circuit Split*

Given the dynamics of a Chapter 13 to Chapter 7 bankruptcy conversion, an inevitable question arose over whether the converted estate included the property acquired during the Chapter 13 proceeding but before the conversion, or instead was limited to the debtor's property held at the time the Chapter 13 petition was filed.[64] In fact, before the Bankruptcy Reform Act of 1994, there was a circuit split on this issue.[65]

In 1985, in *In re Bobroff*,[66] the Third Circuit held that the debtor's tort claims brought after the Chapter 13 petition would not be included in the Chapter 7 bankruptcy.[67] The *Bobroff* court found that Congress intended the Code to be interpreted in a way that Chapter 13 repayment plans were encouraged over Chapter 7 liquidations and that ruling in favor of the debtor would further that purpose.[68] The court reasoned that debtors would be disincentivized to enter into Chapter 13 bankruptcies if property acquired after the beginning of the proceeding was at risk of being liquidated.[69]

Six years after the *Bobroff* decision, the Seventh Circuit created the circuit split in *In re Lybrook*.[70] The *Lybrook* court held that farmland inherited by the debtor during the Chapter 13 proceeding became part of the Chapter 7 estate upon conversion.[71] Writing for the majority, Judge Posner reasoned that holding otherwise would not promote any legitimate interests of the debtor and would, instead, encourage opportunistic behavior that would ultimately hurt creditors.[72]

In addition to *Bobroff* and *Lybrook*, other circuit court decisions contributed to the split, all of which favored an interpretation similar to the Third Circuit's in *Lybrook*. A year before *Bobroff*, the Eighth Circuit found that, upon conversion, the debtor's estate was determined by the

63. *See In re* Lybrook, 951 F.2d 136, 136 (7th Cir. 1991); *In re* Bobroff, 766 F.2d 797, 797 (3d Cir. 1985).
64. *See, e.g.*, *In re Lybrook*, 951 F.2d at 136; *In re Bobroff*, 766 F.2d at 797.
65. *See, e.g.*, *In re Lybrook*, 951 F.2d at 136; *In re Bobroff*, 766 F.2d at 797.
66. *In re* Bobroff, 766 F.2d 797 (3d Cir. 1985).
67. *Id.*
68. *Id.* at 803.
69. *Id.*
70. *In re* Lybrook, 951 F.2d 136 (7th Cir. 1991).
71. *Id.* at 138.
72. *Id.* ("[A] rule of once in, always in is necessary to discourage strategic, opportunistic behavior that hurts creditors without advancing any legitimate interest of debtors.").

date of conversion rather than the date the debtor initially filed for the Chapter 13 bankruptcy.[73] Similarly, in 1992, the Tenth Circuit held that a debtor's funds acquired after the Chapter 13 petition became part of the Chapter 7 estate upon conversion.[74] The court explicitly stated that it agreed with Judge Posner's statutory interpretation and policy analysis in *Lybrook*.[75]

Resolution of the circuit split ultimately came when Congress passed the Bankruptcy Reform Act of 1994, which included § 348(f).[76] This provision provides that:

> when a case under chapter 13 of this title is converted . . . 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.[77]

The accompanying House Report noted that the provision was included to resolve the circuit split over "what property is in the bankruptcy estate when a debtor converts from chapter 13 to chapter 7."[78] The Report further states that the amendment "overrules the holding in cases such as . . . *Lybrook* . . . and adopts the reasoning of *Bobroff* . . . ."[79] The Report also notes the discretion given to courts in the case of a bad faith conversion.[80] This exception states that if the conversion is executed 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."[81] Although Congress met this circuit split issue head on in the Bankruptcy Reform Act of 1994, there was another key disagreement over the details of conversions that was left unresolved.[82]

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73. *In re* Lindberg, 735 F.2d 1087, 1088-99 (8th Cir. 1984) (holding that, at the time of conversion, a debtor could claim a different homestead exemption than the one chosen at the beginning of the Chapter 13 proceeding).

74. *In re* Calder, 973 F.2d 862, 865–66 (10th Cir. 1992).

75. *See id.* at 866.

76. *See* 11 U.S.C. § 348(f)(2012); Bankruptcy Reform Act of 1994, Pub. L. No. 103-94, 108 Stat. 4106 (1994); Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 473 (5th Cir. 2014) ("In 1994, Congress resolved the circuit split by enacting 11 U.S.C. § 348(f) . . . .").

77. *Id.* § 348(f)(1)(A).

78. H.R. REP. NO. 103–835, at 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366 (citations omitted).

79. *Id.*

80. *Id.* ("[Section 348(f)] also gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case.").

81. 11. U.S.C. § 348(f)(2).

82. *See infra* Part II.C.

### C. *The Current Circuit Split*

Congress's success in resolving the pre-1994 circuit split is unquestioned, as it is now well-established that any property acquired during the Chapter 13 bankruptcy proceeding does not become part of the Chapter 7 estate.[83] Section 348 failed, however, to address another important question: who receives undistributed payments, made pursuant to the plan, upon conversion?[84] Courts have since reached opposite answers to the question, including the Third and Fifth Circuits.[85]

Although the circuit split arose only recently, lower courts have been grappling over this issue for decades.[86] During that time, courts have answered the question in three different ways.[87] First, some courts have held that the undistributed payments held by the Chapter 13 trustee should be handed over to the Chapter 7 trustee.[88] However, as noted above, § 348(f) abrogated this option by explicitly stating that Chapter 13 property cannot become part of the Chapter 7 estate.[89] A second option, adopted by some lower courts, requires the undistributed payments be returned to the debtor upon conversion.[90] Lastly, other courts determined that the Chapter 13 trustee should distribute the funds to creditors, pursuant to the Chapter 13 plan.[91] These last two contrasting solutions were the answers provided by the Third Circuit in *Michael* and the Fifth Circuit in *Harris*, causing the current circuit split.[92] The facts of these two

83. Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 473 (5th Cir. 2014) ("After the passage of § 348(f), it is clear that property acquired after the filing of a Chapter 13 petition, including wages, does not become part of the Chapter 7 estate upon conversion (absent bad faith).").

84. *See, e.g.*, *In re Harris*, 757 F.3d at 471; *In re* Michael, 699 F.3d 307, 307 (3d Cir. 2012).

85. *Compare In re Harris*, 757 F.3d at 471, *with In re Michael*, 699 F.3d at 307.

86. *See, e.g.*, *In re* Peters, 44 B.R. 68, 73 (Bankr. M.D. Tenn. 1984); *In re* Rutenbeck, 78 B.R. 912, 913 (Bankr. E.D. Wis. 1987).

87. *In re Michael*, 699 F.3d at 308 (noting that "courts considering the disposition of funds held by a Chapter 13 trustee at the time of conversion reached three different results").

88. *See, e.g.*, *In re* Tracy, 28 B.R. 189, 190 (Bankr. D. Me. 1983) (holding that the undistributed payments became part of the Chapter 7 estate).

89. *See* 11 U.S.C. § 348(f)(2012).

90. *See, e.g.*, *In re* Boggs, 137 B.R. 408, 411 (Bankr. W.D. Wash. 1992) (finding that the undistributed funds held by the Chapter 13 trustee should be returned to the debtor upon conversion to a Chapter 7).

91. *See, e.g.*, *In re* Waugh, 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) (holding that undistributed payments should be distributed to the creditors as provided by the Chapter 13 plan).

92. *See, e.g.*, Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 471 (5th Cir. 2014); *In re Michael*, 699 F.3d at 307.

cases are essential to understand the current problem and the importance of resolving it.

1. Overview of *In re* Michael

In 2012, the Third Circuit, in *Michael*, became the first circuit to address which party is entitled to undistributed payments when a Chapter 13 bankruptcy is converted to a Chapter 7 bankruptcy.[93] In *Michael*, the debtor's Chapter 13 plan required him to pay $277 per month to the trustee for 53 months.[94] Pursuant to the plan, the trustee then distributed those funds to secured creditors and, if any funds remained, to unsecured creditors.[95] Additionally, outside of the plan, the debtor agreed to make his regular mortgage payments to his mortgage company, which was also a secured creditor under the plan.[96] The debtor's wages were attached to fund the plan, and were sent directly to the trustee.[97] The debtor, however, defaulted on his regular mortgage payments, causing the court to grant the mortgage company permission to lift the automatic stay to foreclose upon the debtor's residence.[98]

After foreclosure, the debtor did not modify his plan and continued to make payments pursuant to the original plan.[99] However, to avoid creating possible defenses to its mortgage foreclosure, such as estoppel, the mortgage company refused to accept any further payments that the company was entitled to under that plan.[100] The trustee then accumulated those funds, which totaled $9,181.62, until the debtor converted his case to a Chapter 7 bankruptcy.[101] Ultimately, the Third Circuit found that the undistributed funds should be returned to the debtor.[102] In the following section, an analysis of the court's decision will be provided and compared to that of the court in *Harris* to shed light on the Code's ambiguity in regard to the current circuit split issue.

93. *See In re Michael*, 699 F.3d at 307.
94. *Id.*
95. *Id.*
96. *See id.*
97. *Id.*
98. *In re Michael*, 699 F.3d at 307.
99. *Id.*
100. *See id.*
101. *Id.*
102. *See id.*

2. Overview of *In re* Harris

Two years after *Michael*, the Fifth Circuit created the existing circuit split with *Harris*.[103] In that case, the debtor's Chapter 13 plan required him to make monthly payments of $530 to the trustee for 60 months.[104] These payments were then to be distributed by the trustee to the secured creditors, then to the debtor's attorneys, and lastly to the unsecured creditors.[105] The plan also required the debtor to make payments directly to his mortgage company, which was also a secured creditor.[106] The debtor, however, failed to make the direct payments to the mortgage company, and therefore the automatic stay was lifted on the debtor's home so that the mortgage company could proceed with foreclosure.[107]

After foreclosure, the trustee placed a hold on the funds that were supposed to go to the mortgage company.[108] Those funds began to accumulate with the trustee, amounting to $4,319.22, because the debtor continued to make his monthly payments according to the plan.[109] In the end, the Fifth Circuit held that those funds should be distributed to the creditors pursuant to the plan.[110] The Fifth Circuit's rationale will be analyzed and compared to the Third Circuit's rationale in the next section to demonstrate that the Code does not resolve the question posed by the present circuit split.

## III. ANALYSIS

### *A. Analysis of the Bankruptcy Code through In re Michael and In re Harris*

Determining whether debtors or creditors have an absolute right to the undistributed funds through analyses of the Code's text, relevant legislative history and policy leads to the conclusion that the Code provides no certain answer.[111] Nowhere is this more apparent than through a comparison of the Third Circuit's interpretation in *Michael* and the Fifth Circuit's interpretation in *Harris*.[112] The ultimate stalemate on each ar-

103. *See* Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 471 (5th Cir. 2014).
104. *Id.*
105. *See id.*
106. *Id.*
107. *See id.*
108. *In re Harris*, 757 F.3d at 471.
109. *Id.*
110. *Id.*
111. *See infra* Part III.A.
112. *See In re Harris*, 757 F.3d at 478; *In re* Michael, 699 F.3d 307, 313-14 (3d Cir. 2012).

gument between those circuit courts shows that there is no clear answer to whether debtors or creditors have an absolute right to undistributed funds upon conversion.[113] In fact, Congress deliberately chose not to give either party an absolute right to the undistributed funds.[114] Congress made that decision in order to give the parties the discretion to provide a resolution in the plan.[115] However, Congress or the Supreme Court must resolve the issue once and for all by explicitly requiring the parties to negotiate for such a term in the plan.[116]

1. Text of the Bankruptcy Code

Analyzing the Third and Fifth Circuit's respective statutory interpretations in *Michael* and *Harris* highlights the Code's failure to address the present issue. To begin this analysis, § 348(f)(2) must be examined, which is a provision both circuit courts combed for an indication that Congress intended to address this issue while resolving the pre-1994 circuit split.[117] Section 348(f)(2) stands for the proposition that if a debtor converts a Chapter 13 case in bad faith then he or she is not entitled to property acquired post-petition, such as wages.[118] Following that logic, the Third Circuit majority in *Michael* found that it is therefore implied that the debtor should *receive* the post-petition property if he or she acts in *good faith*.[119] The *Michael* opinion further noted that the penalty for converting in bad faith would be "diminished significantly" if the post-petition property were to go to creditors in good faith conversions as well.[120]

However, the Fifth Circuit took a contrary position in *Harris*. The *Harris* court noted that undistributed post-petition funds make up *only a portion* of a debtor's post-petition property and, upon a bad faith conversion, a debtor would have to give up *all* post-petition property.[121] Thus, distributing the funds held by the trustee to the creditors upon conversion "neither renders [§] 348(f)(2) superfluous nor removes the disincentive for bad faith . . . ."[122]

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113. *See infra* Part III.A.
114. *See infra* Part III.B.
115. *See infra* Part III.C.
116. *See infra* Part III.D.
117. *See In re Harris*, 757 F.3d at 478; *In re Michael*, 699 F.3d at 313-14.
118. 11 U.S.C. § 348(f)(2)(2012) ("If the debtor converts a case under chapter 13 . . . 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.").
119. *In re Michael*, 699 F.3d at 313–14.
120. *Id.* at 315.
121. *In re Harris*, 757 F.3d at 478.
122. *Id.*

A provision of the Code that superficially appears to explicitly address the present issue, § 1327(b), also ultimately ends up being a bridge to a murky answer. Section 1327(b) states, "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."[123] The Third Circuit majority in *Michael* relied heavily on this provision in its opinion, finding it to mean that the debtor has a vested right in the property of the Chapter 13 estate until the funds are actually transferred by the trustee to the creditors.[124]

In response, the Fifth Circuit in *Harris* noted that such a finding ignores the exception segment of the provision that states, "except as otherwise provided in the plan or the order confirming the plan."[125] With that exception in mind, the *Harris* court noted that a debtor clearly does not retain possession of payments that are *provided in the plan* and made to the trustee.[126] Furthermore, the court found that the statute, as a whole, actually seems to "divest[] the debtor of any interest he may have in the payments made to the trustee," in such a situation.[127]

In fact, some courts and individuals, including the trustee in *Harris*, have found that, under § 1326(a)(2), creditors actually have a vested right to the funds pursuant to the plan once the trustee receives the funds from the debtor.[128] That provision reads, "[i]f a [Chapter 13] plan is confirmed, the trustee shall distribute any such payment in accordance with the plan as soon as is practicable."[129] As can be observed in *Harris*, some courts have found that the word "shall" in that provision creates a trust fund for the creditors.[130] To further support that position, those courts and others[131] quote another portion of § 1326(a)(2) that provides, "[i]f a plan is not confirmed, the trustee shall return [all] payments . . .

123. 11 U.S.C. § 1327(b).

124. See *In re Michael*, 699 F.3d at 313; see also Resendez v. Lindquist, 691 F.2d 397, 399–400 (8th Cir. 1982) (Bright, J., dissenting).

125. 11 U.S.C. § 1327(b).

126. *In re Harris*, 757 F.3d at 477.

127. *Id.* at 478; *see also In re* Lennon, 65 B.R. 130, 136 (Bankr. N.D. Ga. 1986).

128. *See In re Harris*, 757 F.3d at 475; *In re* Galloway, 134 B.R. 602, 603 (Bankr. W.D. Ky. 1991) (holding that after a debtor delivers the funds to the trustee in accord with the Chapter 13 plan, "the creditors have a vested right to receive those payments pursuant to the plan").

129. 11 U.S.C. § 1326(a)(2).

130. *See In re Harris*, 757 F.3d at 475-76 (quoting *In re* Waugh, 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988)) ("The word 'shall' in § 1326(a)(2) creates the condition of a trust. [Thus,] [c]reditors have the right to the funds in an active confirmed chapter 13 plan upon payment by the debtor.").

131. *See, e.g.*, *In re Galloway*, 134 B.R. at 603; *In re* Burns, 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988).

."[132] These courts have found that the lack of a similar provision regarding undistributed *post-confirmation* funds shows that the debtor is not entitled to have such funds returned.[133]

However, other courts, including the Third Circuit, have rejected those arguments.[134] These courts emphasized that § 1326(a)(2) does not cover funds received by a trustee post-confirmation of a Chapter 13 plan.[135] Moreover, they have noted that courts that have found that creditors have a vested right impliedly through § 1326(a)(2) have never cited any legislative history to support that position.[136] In plain terms, these courts found that "[§] 1326(a)(2) only address[es] the obligation of the trustee to distribute payments in accordance with a confirmed plan; [it] do[es] not vest creditors with any property rights."[137]

Another key provision that the Third and Fifth Circuits disagree over is § 348(e), which states that "[c]onversion of a case . . . terminates the service of any trustee or examiner that is serving in the case before such conversion."[138] The Third Circuit's majority opinion in *Michael* found this provision suggests that the trustee has no authority to pay the undistributed funds to creditors post-conversion.[139] While the majority in *Michael* did acknowledge that the trustee has some "limited duties post-conversion,"[140] such as filing a final report that accounts for all of the funds that came into his or her possession,[141] the court found it illogical to include the duty of distributing "funds under a plan that is no longer operative."[142] However, in rebutting that argument, the Fifth Circuit in *Harris* noted that if the trustee lacks the power to distribute funds post-conversion, then the debtor will not be able to receive the funds from the trustee either because such an act would require the trustee to have that same power.[143] The dissent in *Michael* supported that position, finding that there is no reason to conclude that Congress did not intend to include

132. 11 U.S.C. § 1326(a)(2).
133. *See, e.g.*, *In re Galloway*, 134 B.R. at 603; *In re Burns*, 90 B.R. at 304.
134. *See, e.g.*, *In re* Michael, 699 F.3d 307, 313 (3d Cir. 2012).
135. *See In re Harris*, 757 F.3d at 475 (citing *In re* Boggs, 137 B.R. 408, 410 (Bankr. W.D. Wash. 1992)).
136. *Id.* (citing *In re Boggs*, 137 B.R. at 410).
137. *In re Michael*, 699 F.3d at 313.
138. 11 U.S.C. § 348(e)(2012).
139. *See In re Michael*, 699 F.3d at 314.
140. *Id.*
141. *Id.* (speaking of a duty established by FED. R. BANKR. P. 1019(5)(b)(ii)).
142. *Id.*
143. Viegelahn v. Harris (*In re* Harris), 757 F.3d 468, 474 (5th Cir. 2014).

the distribution of funds under the plan as another one of the trustee's duties he or she must perform in finalizing the estate.[144]

The two circuits also disagree over whether conversion vacates the Chapter 13 plan and, subsequently, the trustee's authority to pay creditors pursuant to the plan. While the majority in *Michael* found that conversion entirely vacates the plan because "Chapter 13 plan[s] ha[ve] no relevance in a [Chapter 7] case,"[145] the *Harris* court noted that there is no "statutory argument to support such an interpretation."[146] Again, the *Harris* court suggested that the duties of the trustee to finalize the Chapter 13 estate show that Congress intended the trustee to have the power to distribute funds, especially because the payments were made while the plan was still in effect.[147] Moreover, as the majority in *Michael* conceded, courts noted that, under § 1327(a),[148] a confirmed plan creates a new relationship between the debtor and the creditors that requires creditors to forego certain rights in exchange for the debtor's promise to make payments under the plan.[149] These courts have found that this bargained-for agreement, confirmed by the Bankruptcy Court, "should not be made a nullity by a later failure of the debtor to observe a confirmed plan."[150]

These diverging opinions about the Code's application to the question of which party should receive the undistributed funds upon conversion further suggests that Congress did not intend to provide a definite answer. The lack of clarity provided by the Code's text demonstrates that Congress intended the parties to provide a term in the plan that would resolve such a situation, and Congress or the Supreme Court must make that clear. The next logical source to analyze for guidance, the Code's legislative history, further supports those conclusions.

144. *In re Michael*, 699 F.3d at 320 n.8 (Roth, J., dissenting) ("Since Congress intended for the trustee to perform several ancillary duties to clean-up and finalize the administration of the estate, . . . there is no logical reason why distribution of funds pursuant to the previously confirmed reorganization plan cannot be included as one of those administrative duties.").

145. *Id.* at 312.

146. *In re Harris*, 757 F.3d at 475.

147. *Id.*

148. 11 U.S.C. § 1327(a)(2012) ("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.").

149. *In re Michael*, 699 F.3d at 311 (citing *In re* Burns, 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988)); *see id.* at 320 (Roth, J., dissenting).

150. *Id.* at 311 (quoting Spero v. Porreco (*In re* Porreco), 426 B.R. 529, 537 (Bankr. W.D. Pa. 2010)).

2. Legislative History

As demonstrated through the above analysis, the Code's plain text is unclear in regard to resolving this issue. Similarly, the relevant legislative history does not provide the guidance needed to reach a more definite interpretation. Because of the relevance to the present issue, the legislative history surrounding § 348(f)'s enactment of the Bankruptcy Reform Act of 1994 will be the primary focus in this section.

Again, § 348(f) was passed to resolve the pre-1994 circuit split and to make clear that post-petition property in a Chapter 13 case would not become part of the Chapter 7 estate upon conversion, absent bad faith.[151] A House Report noted that reaching a different conclusion "would create a serious disincentive to chapter 13 filings."[152] Courts have implied from the legislative history that Congress's intent is to provide incentives for filing Chapter 13 bankruptcies.[153] Applying that philosophy to the current issues, the Third Circuit in *Michael* and other lower courts have found that distributing funds to creditors upon conversion runs counter to that congressional intent because doing so establishes a disincentive for Chapter 13 filings.[154]

Contrary to that reasoning, the Fifth Circuit in *Harris* and other lower courts have found that a debtor will not be "meaningfully deterred"[155] by knowing that their payments will not be returned if the debtor decides to convert to Chapter 7.[156] These courts reasoned that "such a rule . . . simply requires them to fully honor their obligation under a confirmed plan up to the point when they voluntarily wish to terminate the provisions of the plan and have their case dismissed or converted to a Chapter 7 case."[157] After all, the courts reasoned, the debtor proposes the plan with full knowledge that the payments made to the Chapter 13 trustee will be distributed to the creditors.[158] Whether those completed payments are still in the hands of the trustee at the time of the conver-

151. *See In re Harris*, 757 F.3d at 478-79.

152. H.R. REP. NO. 103–835, at 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366.

153. *In re Harris*, 757 F.3d at 479 (referring to the lower court's opinion and the majority's opinion in *In re Michael*, 699 F.3d at 314–16).

154. *Id.* at 479 (referring to the lower court's opinion and the majority's opinion in *In re Michael*, 699 F.3d at 314–16).

155. *Id.*

156. *Id.*; *see also In re* Bell, 248 B.R. 236, 240 (Bankr. W.D.N.Y. 2000).

157. *In re Harris*, 757 F.3d at 479 (quoting *In re Bell*, 248 B.R. at 240).

158. *Id.*

sion is "essentially fortuitous,"[159] depending solely upon the trustee's speed in distributing those funds.[160]

Moreover, these opinions also reasoned that the attached wages used to make these payments are part of the "quid pro quo" that allows the debtor "to stave off foreclosure and cure the mortgage default, retain the use of his automobile, and enjoy the automatic stay."[161] Additionally, at any time, the debtor can avoid further wages from being allocated to the creditors, in accordance with the plan, by converting to a Chapter 7.[162] Thus, based on the extensiveness of the debtor's rights, these opinions reasoned that taking away the additional right to undistributed funds would have little effect on the willingness of the debtor to file for Chapter 13.[163] Furthermore, these opinions found that if the debtor had the additional right to undistributed funds, then the debtor would be in a better position than if he had just filed for a Chapter 7 and would receive a "windfall."[164]

The difference in opinions about § 348's legislative history reinforces the belief that Congress intended to leave it up to the parties to determine which party would receive the undistributed funds upon conversion. Either Congress or the Supreme Court could have clarified if this was not Congress's original intention, but neither have done so yet. Additionally, an analysis of the relevant policy bolsters the view that Congress intended to allow the parties to determine who would receive the undistributed funds upon conversion because there is no equitable reason to give either party an absolute right to such funds.

3. Policy

Just as analyzing the Code's plain text and legislative history fails to result in a clear indication of how Congress intended to resolve the matter, a policy analysis similarly shows there is no logical reason to favor debtors over creditors in this situation, or vice versa. Some courts, such as the Third Circuit in *Michael*, found that policy considerations support creating a rule favoring debtors.[165] These courts reasoned that even if the funds are returned to the debtor, the creditors are still in a better position

159. *Id.*
160. *Id.* at 479; *see In re* Waugh, 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988).
161. *In re* Michael, 699 F.3d 307, 319 (3d Cir. 2012) (Roth, J., dissenting).
162. *In re Harris*, 757 F.3d at 480.
163. *See In re Harris*, 757 F.3d at 479; *In re Michael*, 699 F.3d at 320 (Roth, J., dissenting).
164. *See In re Harris*, 757 F.3d at 479; *In re Michael*, 699 F.3d at 320 (Roth, J., dissenting).
165. *See In re Michael*, 699 F.3d at 314-17.

than would otherwise be the case if a Chapter 7 bankruptcy petition was initially filed. After all, the creditors will receive wage contributions that they would not have received.[166] Therefore, these courts found that there is "no inherent inequity in refunding undisbursed wage contributions to debtors on conversion."[167]

Conversely, other courts, such as the Fifth Circuit in *Harris*, have found that equity weighs heavily in favor of distributing the funds to creditors.[168] These arguments are the same as those put forth with regards to the legislative history to counter the position that distributing the funds to creditors would serve as a disincentive to debtors contemplating filing a Chapter 13 bankruptcy. These courts found that the debtor's attached wages are the "quid pro quo" exchanged for the benefits of the Chapter 13 bankruptcy, the debtor has voluntarily proposed these payments, and the debtor is free to end these payments at any time through conversion.[169] Moreover, these courts also noted that returning the funds to the debtor is inequitable to the creditors because the depreciation of the secured property used by the debtor injures creditors, and those creditors are not reimbursed for the losses due to depreciation, upon conversion.[170]

Thus, similar to the textual and legislative history analyses, a policy analysis suggests there is no clear answer to which party should receive the undistributed funds upon conversion. The three analyses all support the position that Congress wanted the parties to resolve the issue on a case-by-case basis in the plan. Additionally, the high number of pre-1994 cases that dealt with the present circuit split's exact issue strengthen that conclusion because the cases demonstrate that Congress was aware of the issue in 1994 and intentionally chose not to enact a statute that would give one party an absolute right to the funds.

166. *Id.* at 312 (citing *In re* Boggs, 137 B.R. 408, 410 (Bankr. W.D. Wash. 1992)).

167. *Id.* (quoting *In re Boggs*, 137 B.R. at 410).

168. *In re Harris*, 757 F.3d at 480 ("[D]istribution of the funds to creditors is supported by strong considerations of fairness.").

169. *See id.*; *In re Michael*, 699 F.3d at 320 (Roth, J., dissenting); *In re* Bell, 248 B.R. 236, 239 n.3 (Bankr. W.D.N.Y. 2000).

170. *See In re Harris*, 757 F.3d at 480 ("[C]onversion does not undo the disadvantages that creditors may have suffered as a result of the plan, such as depreciation of secured property."); O'Quinn v. Brewer (*In re* O'Quinn), 143 B.R. 408, 413 (Bankr. S.D. Miss. 1992) ("[It's] unfair to allow a debtor to drive and depreciate an automobile, occupy a home or use household goods . . . [and] then snatch away the monies which the trustee is holding to make the payments, but has not yet disbursed.").

### B. *Congress's Intentional Failure to Resolve the Issue in the Bankruptcy Reform Act of 1994*

As the above sections demonstrate, examining the relevant Code provisions, legislative history of § 348(f), and policy establishes that no logical conclusion can be reached with regard to which party should have the absolute right to receive the undistributed funds. However, this section will outline the large number of pre-1994 cases that are analogous to *Michael* and *Harris* to demonstrate that Congress was well aware of the present matter in 1994 when they chose only to resolve the previous circuit split with the enactment of § 348(f). Thus, in combination with the sections above, this section will demonstrate that Congress purposely failed to address the issue to allow the parties to resolve the matter in the plan.

Prior to the Bankruptcy Reform Act of 1994, there were numerous analogous cases to *Michael* and *Harris*, but there was no consensus among courts regarding whether the debtor or creditors should receive the undistributed funds. A chronological list of pre-1994 analogous cases in favor of the debtor will first be provided, followed by a list of those cases finding for creditors. To start, in 1984, in *In re Peters*,[171] the bankruptcy court found that the undistributed funds held by the Chapter 13 trustee should be returned to the debtor upon a conversion to a Chapter 7.[172] Two years later, the bankruptcy court in *In re Shattuck*[173] found that the funds collected by the Chapter 13 trustee pursuant to the plan must be returned to the debtor at the time of conversion.[174] In 1987, the federal district courts in both *In re Luna*[175] and *In re de Vos*[176] ordered the Chapter 13 trustee to repay the debtor the funds held by the trustee that were undistributed at the time of conversion.[177] Furthermore, in 1992, another bankruptcy court, in *In re Boggs*,[178] found that the Chapter 13 trustee must return the payments made by the debtor that were not yet distributed.[179]

Conversely, there are even more cases finding that the undistributed payments belonged to the creditors pursuant to the plan. In 1987, the

171. *In re* Peters, 44 B.R. 68 (Bankr. M.D. Tenn. 1984).
172. *See id.* at 73.
173. *In re* Shattuck, 62 B.R. 14 (Bankr. D.N.H 1986).
174. *See id.* at 16.
175. *In re* Luna, 73 B.R. 999 (N.D. Ill. 1987).
176. *In re* de Vos, 76 B.R. 157 (N.D. Cal. 1987).
177. *See In re Luna*, 73 B.R. at 1000; *In re de Vos*, 76 B.R. at 160.
178. *In re* Boggs, 137 B.R. 408 (Bankr. W.D. Wash. 1992).
179. *See id.* at 411.

bankruptcy court in *In re Rutenbeck*[180] noted that when a debtor makes payments pursuant to a confirmed plan and some of those funds are undistributed at the time of conversion, the Chapter 13 trustee should distribute those funds to the creditors.[181] In that same year, another bankruptcy court, in *In re Redick*,[182] ruled that the undistributed funds held by a Chapter 13 trustee belonged to the creditors in accordance with the plan.[183] In 1988, three more bankruptcy courts, in *In re Waugh*,[184] *In re Burns*,[185] and *In re Milledge*[186] held that the payments in the trustee's possession were to be given to the creditors at the time of conversion.[187] In 1991, both bankruptcy courts in *In re Halpenny*[188] and *In re Galloway*[189] respectively held that the funds belonged to the creditors because they had a vested right to the funds once the debtor paid the trustee in accordance with the confirmed plan.[190] Lastly, one year later, in *In re O'Quinn*,[191] the bankruptcy court also held that the trustee must allocate all undistributed funds to the creditors at the time of the conversion.[192]

Listing these cases emphasizes the large number of pre-1994 cases dealing with the exact issue that is now the cause of the present circuit split. These cases demonstrate that there was an obvious disagreement between the lower courts that Congress had to be aware of pre-1994, and which should have foreshadowed the current dispute at the circuit level. Thus, this plethora of cases further bolsters the idea that Congress chose not to resolve the matter in the Bankruptcy Reform Act of 1994 so that the parties could negotiate for a resolution on their own terms in the plan.

### *C. Congress's Intent to have the Parties Resolve the Issue in the Plan*

As can be seen through the previous sections, Congress deliberately chose not to establish a rule that would require the undistributed funds to go to either the debtor or creditors. Instead, Congress decided to give

180. *In re* Rutenbeck, 78 B.R. 912 (Bankr. E.D. Wis. 1987).
181. *See id.* at 913 ("[T]he undistributed funds ought to be treated as trust funds for the benefit of the creditors under the confirmed plan and distributed to those creditors in accordance with the terms of the plan.").
182. *In re* Redick, 81 B.R. 881 (Bankr. E.D. Mich. 1987).
183. *See id.* at 887.
184. *In re* Waugh, 82 B.R. 394 (Bankr. W.D. Pa. 1988).
185. *In re* Burns, 90 B.R. 301 (Bankr. S.D. Ohio 1988).
186. *In re* Milledge, 94 B.R. 218 (Bankr. M.D. Ga. 1988).
187. *See In re Waugh*, 82 B.R. at 400; *In re Burns*, 90 B.R. at 305; *In re Milledge*, 94 B.R. at 220.
188. *In re* Halpenny, 125 B.R. 814 (Bankr. D. Haw. 1991).
189. *In re* Galloway, 134 B.R. 602 (Bankr. W.D. Ky. 1991).
190. *See In re Halpenny*, 125 B.R. at 816; *In re Galloway*, 134 B.R. at 604.
191. *In re* O'Quinn, 143 B.R. 408 (Bankr. S.D. Miss. 1992).
192. *See id.* at 409.

debtors and creditors the discretion to negotiate for a resolution of the issue in the plan. The Code and legislative history strongly support that position, and policy considerations suggests that allowing the parties to determine who has the right to undistributed funds upon conversion is the ideal rule.

1. Support from Bankruptcy Code

Several relevant provisions of the Code support the notion that Congress intended for the parties to negotiate for a term in the plan that would resolve the current issue should such a situation arise in their case. As a threshold matter, there are no Code provisions that would prevent the parties from explicitly stating which party has the right to the undistributed payments upon conversion to a Chapter 7 case. In fact, the Code explicitly supports this position through § 1322(b).[193] As aforementioned, § 1322(b) explicitly permits certain provisions that the plan "may" include.[194] Again, examples of what § 1322(b) explicitly allows for include: (1) the modification of the rights of either unsecured or secured creditors,[195] (2) the determination of whether the Chapter 13 estate vests in the debtor or in another entity,[196] and (3) the inclusion of "any other appropriate provision not inconsistent"[197] with the Code. These § 1322(b) provisions taken together are sufficient evidence that Congress's intent was for the parties to resolve this issue in the plan. Furthermore, § 1327(b) states that *"[e]xcept as otherwise provided in the plan or the order confirming the plan*, the confirmation of a plan vests all of the property of the estate in the debtor."[198] The italicized portion of that provision strongly suggests that Congress placed a large deal of importance on the parties' ability to resolve issues in the plan. Additional support for the belief that Congress intended the parties to negotiate for a provision in the plan that would address the matter is provided through the relevant legislative history.

2. Support from Legislative History

Legislative history further supports the position that Congress intended for the parties to resolve the potential problem in the plan. As made clear by the House Report previously discussed, Congress strives

193. 11 U.S.C. § 1322(b)(2012).
194. *Id.*
195. *Id.* § 1322(b)(2).
196. *Id.* § 1322(b)(9).
197. *Id.* § 1322(b)(11).
198. 11 U.S.C. § 1327(b) (emphasis added).

to provide incentives for Chapter 13 bankruptcies.[199] Allowing the parties to settle the present issue in the plan adheres to that legislative intent for various reasons.

First, by allowing the parties to resolve the issue in the plan, the debtor will be more informed and will be able to make better decisions throughout the case. The debtor's risk of losing undistributed funds because of a lack of knowledge will also decrease, which will thus increase the attractiveness of Chapter 13 bankruptcies to the debtor. With this knowledge and the debtor's power to convert at any time,[200] the debtor should have no hesitation about filing a Chapter 13 plan for fear of unnecessarily funding a plan that is doomed to fail. Moreover, such a rule will promote the debtor's freedom to contract and will allow the debtor to use such a term as a negotiating chip to gain other debtor-favorable provisions. Thus, giving the parties discretion to choose who receives the undistributed funds increases the odds that an optimal deal is struck. The benefits of empowering the parties with such discretion is further demonstrated through a policy analysis.

3. Support from Policy

Policy considerations suggest that Congress's decision to leave the resolution of the issue up to the parties was a prudent one. Aside from the policy of creating incentives for the debtor to file a Chapter 13 bankruptcy, discussed above, the creditors also receive benefits from such a rule. First, the creditors will also benefit from the predictability that will ensue if the parties resolve the issue in the plan, such as being able to make more beneficial and informed decisions throughout the remainder of the case. Again, such a rule will promote the creditors' rights to freely contract and will allow them to use the term as a bargaining chip. The increase in contractual rights will correspondingly increase the potential for the creation of an optimal deal for all creditors as well. Moreover, if the debtor has the right to receive undistributed funds from the trustee upon conversion, this will afford the creditors the opportunity to lobby the trustee for quicker distributions of the funds held by the trustee. Given all the benefits of a rule that leaves the parties to determine who has a right to undistributed funds upon conversion, action must be taken that will explicitly make that the rule.

*D. Congress or the Supreme Court should Explicitly Require the Parties*

199. *See* H.R. REP. NO. 103–835, at 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366.

200. *See* 11 U.S.C. § 1307(a).

*to Resolve the Issue in the Plan*

Through the above analyses, Congress clearly intended for the parties to negotiate for the term in the plan. However, for the sake of clarity, Congress should resolve the circuit split by requiring the parties to include a term in their plan that would resolve the issue if it should arise in their case. Congress can do this by amending § 1322(a), which is the provision that states which terms *must* be included in the plan, to require the selection of the party that would receive the undistributed funds.

If Congress fails to require the parties to address the issue in the plan by amending § 1322(a), the Supreme Court should grant certiorari to address the issue. The Court can then resolve the current circuit split by finding that the parties are implicitly required by the Code, legislative history, and policy considerations to negotiate for the term in their plan. As long as either Congress or the Supreme Court clearly states that the parties are to establish a term that will resolve the issue should such a situation arise, then all parties involved will benefit.

## IV. CONCLUSION

As can be seen through the divergent opinions of the Third Circuit in *Michael,* the Fifth Circuit in *Harris*, and the lower courts, analyses of the Code, legislative history, and policy do not lead to a clear answer as to whether a debtor or creditors should receive undistributed funds held by a Chapter 13 trustee upon conversion. Additionally, the high number of conflicting pre-1994 cases involving the same issue makes clear that Congress deliberately chose not to address this matter when Congress resolved the previous circuit split in 1994. Moreover, the Code and legislative history indicate that Congress intended the parties to negotiate for a term in the plan that would resolve such an issue, and policy considerations favor such a rule. Lastly, to clarify the rule, Congress should add to § 1322(a) a provision that requires the parties to establish a term in their plan that would resolve such an issue, or the Supreme Court should grant certiorari to explicitly state that such a term is required in the plan.