Harris v. Viegelahn, No. 14-400 (previously described in the December 15, 2014, Docket Report)

Chapter 13 of the Bankruptcy Code allows debtors to keep certain assets (such as their home and car) and to repay their creditors in installments by turning over to a trustee a portion of the wages that they earn after filing their bankruptcy petition. At any time, however, a debtor may convert a Chapter 13 proceeding into a Chapter 7 proceeding—a common occurrence because debtors are often unsuccessful in getting Chapter 13 repayment plans approved and then meeting their obligations under those plans. Under Chapter 7, debtors do not retain any

prepetition assets but they get to keep all postpetition wages, making a “fresh start” as of the date of the petition.

Today, in *Harris v. Viegelahn*, No. 14-400, the Supreme Court held that “a debtor who converts to Chapter 7 is

entitled to return of any postpetition wages not yet distributed [to creditors] by the Chapter 13 trustee.”

Harris, the debtor, filed for relief under Chapter 13 and later converted to Chapter 7. At that point, the Chapter 13 trustee happened to be holding several thousand dollars of Harris's garnished postpetition wages that had not yet been distributed to Harris's creditors. The trustee went ahead and distributed most of that money to the creditors anyway. The bankruptcy court ordered the trustee to refund the money to Harris and the district court affirmed, but the Fifth Circuit reversed, acknowledging that its decision conflicted with the Third Circuit's ruling in *In re Michael*, 699 F.3d 305 (3d Cir. 2012).

Today, the Supreme Court reversed the Fifth Circuit. In an opinion by Justice Ginsburg, the Court unanimously held that the conversion from Chapter 13 to Chapter 7 “removes [postpetition] earnings from the pool of assets that may be liquidated and distributed to creditors” as long as the conversion is made in good faith. The Court explained that the service of the Chapter 13 trustee terminates immediately upon conversion, and therefore that distributing assets to creditors after conversion exceeds the trustee’s authority. Thus, how much creditors might receive from a

debtor’s postpetition wages in the event of conversion will depend on how quickly the Chapter 13 trustee

distributes those assets in accordance with the provisions of the approved plan.

Today’s decision is of interest to the business community because it provides greater certainty to creditors

regarding the scope of a debtor’s estate following conversion of a failed Chapter 13 plan. To minimize the risk of a

windfall to the debtor on possible conversion to Chapter 7, creditors may wish to consider a strategy,

recommended by the Court, of “seeking to include in a Chapter 13 plan a schedule for regular disbursement of funds the trustee collects." The Court's decision may also lead to increased litigation regarding the contours of the exception to return of postpetition wages when a debtor converts from Chapter 13 to Chapter 7 under circumstances that the challenging creditor or the Chapter 13 trustee believes to have been in bad faith.

Any questions about this case should be directed to Brian Trust (+1 212 506 2570) in our New York office, Thomas S. Kiriakos (+1 312 701 7275) in our Chicago office, or Richard B. Katskee (+1 202 263 3222) in our Washington office.