

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

ENTERED

MAY 28 2003

U.S. BANKRUPTCY COURT
MDNC - KWC

IN RE:)
)
Paul Boyd Gregson and) Case No. 02-12525C-7G
Althea Sylvia Gregson,)
)
Debtors.)
)

ORDER

This case came before the court on April 22, 2003, for hearing upon a motion by Charles M. Ivey, III as Chapter 7 Trustee to compel Anita Jo Kinlaw Troxler as Chapter 13 Trustee to turn over to the Chapter 7 Trustee funds received by the Chapter 13 Trustee while this case was proceeding under Chapter 13. Charles M. Ivey, III and Joshua N. Levy appeared on behalf of the Chapter 7 Trustee, Phillip E. Bolton appeared on behalf of the Debtors and Anita Jo Kinlaw Troxler appeared as Chapter 13 Trustee.

FACTS

This case was filed as a Chapter 13 case on August 21, 2002, and continued under Chapter 13 until it was converted to Chapter 7 on November 26, 2002. During the three months that the case remained under Chapter 13, the female Debtor operated a Paul Wylie Salon where spa services such as hair design, nail dressing and massages were offered. The business was operated by the female Debtor as a sole proprietorship. Although the female Debtor was active in the business, her efforts were not the sole source of the funds generated by the business. Instead, during a portion of the period that the business was operated under Chapter 13, the female

Debtor employed eight full time employees at the salon whose services generated much of the revenue received by the female Debtor. Also, in operating the business, the Debtor utilized various items of salon equipment such as chairs and massage tables which were owned by her when the Chapter 13 case was filed and which were used by her employees in performing services for customers. The female Debtor did not have a fixed salary and the only income received by her was whatever money was left over after paying operating expenses. From funds that were generated by the operation of the business, the female Debtor paid the sum of \$2,625.00 to the Chapter 13 Trustee which the Chapter 13 Trustee was holding when this case was converted from Chapter 13 to Chapter 7, which occurred prior to the confirmation of a plan. It is undisputed that the entire \$2,625.00 was generated after the filing of the Chapter 13 case and came from proceeds generated by the operation of the spa.

DISCUSSION

The status of the funds held by the Chapter 13 Trustee when this case was converted to Chapter 7 is controlled by § 348 of the Bankruptcy Code. Under § 348(f)(1)(A), "when a case under chapter 13 . . . is converted to a case under another chapter . . . 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" As reflected in the legislative history, this provision was intended to overrule the

holdings in cases such as Matter of Lybrook, 951 F.2d 136 (7th Cir. 1991), which held that property acquired after the filing of a chapter 13 case became property of the chapter 7 estate upon the conversion of the chapter 13 case to chapter 7. Thus, under § 348(f)(1)(A), when a chapter 13 case is converted to chapter 7, the property of the estate in the chapter 7 case consists of property that was held by the debtor when the chapter 13 case was filed and which remains in the possession or control of the debtor when the conversion occurs, unless the conversion was done in bad faith. In the present case, it is undisputed that the funds held by the Chapter 13 Trustee when this case was converted did not exist when the Chapter 13 case was filed and that such funds were acquired by the Debtor during the pendency of the Chapter 13 case. It follows that such funds did not become property of the estate in Debtors' Chapter 7 case, but instead should be paid to the Debtors. See Stamm v. Morton (In re Stamm), 222 F.3d 216 (5th Cir. 2000); In re Young, 66 F.3d 376 (1st Cir. 1995).

The Chapter 7 Trustee's argument that § 348(f)(1)(A) is not applicable unless the funds held by the Chapter 13 Trustee came from the wages or earnings of the Chapter 13 debtor is not accepted. Nothing in the language of § 348(f)(1)(A) or the legislative history supports such a limitation. Also, the Trustee's reliance upon cases such as Fitzsimmons v. Walsh (In re Fitzsimmons), 725 F.2d 1208 (9th Cir. 1984), involving conversions of chapter 11 cases to chapter 7 is misplaced because such cases do not involve § 348(f) which, by

its terms, is limited to conversions involving chapter 13 cases. Nor can the court disregard § 348(f)(1)(A) based upon the Trustee's argument that an unfair windfall may occur if a Chapter 13 debtor, following conversion to Chapter 7, receives proceeds from the Chapter 13 Trustee even though the debtor failed to pay debts incurred during the Chapter 13 case in operating the business that produced the funds. If it is believed that a chapter 13 debtor has acted improperly in connection with a conversion to chapter 7, then resort should be had to § 348(f)(2) which was enacted to deal with abuses of the right to convert. This provision gives the court discretion in a case in which a 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. No such objection was filed in the present case. Hence, § 348(f)(1)(A) is controlling with the result that the funds held by the Chapter 13 Trustee are not property of the Chapter 7 estate and, therefore, should be paid to the Debtors.

IT IS SO ORDERED.

This 23 day of May, 2003.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge