UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

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IN RE: CARY M. McCOY
WILLIAM A. McCOY,

Debtors.

Case No. 09-24543-pp

Chapter 13

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TERRA DEV CO.,

Plaintiff,

v.

WILLIAM A. McCOY and
CARY M. McCOY,

Defendants.

Adv. Case No. 09-2433

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**ORDER DENYING WITHOUT PREJUDICE THE PLAINTIFF'S MOTION FOR DEFAULT JUDGMENT, STAYING ALL PROCEEDINGS IN THE ADVERSARY CASE, AND CLOSING THE ADVERSARY CASE UNTIL AND UNLESS THE UNDERLYING CASE RECONVERTS TO ONE UNDER CHAPTER 7**

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On April 8, 2009, the debtors/defendants filed a Chapter 7 petition. The creditor/plaintiff filed its adversary complaint on November 11, 2009, alleging that the Court should deny the debtors/defendants a Chapter 7 discharge

pursuant to 11 U.S.C. §§727(c), (d) and (e). The deadline for the debtors/defendants to file their answer to this complaint was December 14, 2009.

On December 4, 2009, ten days before the deadline for the debtors/defendants to file an answer in the adversary proceeding, they converted their case to one under Chapter 13. Accordingly, they no longer were seeking a Chapter 7 discharge. They did not file an answer to the §727 complaint.

On January 19, 2010, the creditor/plaintiff filed a motion for default judgment in the adversary, arguing that because the debtors/defendants had not timely answered the adversary complaint, the creditor/plaintiff was entitled to default judgment. The Court held a hearing on January 20, 2010. At the hearing, counsel for the debtors/defendants stated that the only reason his clients had not answered the adversary complaint was because they had converted to a case under Chapter 13, and argued that the conversion mooted the §727 action. Counsel for the creditor/plaintiff disagreed, arguing that the conversion did not moot the §727 action because the debtors/defendants could reconvert back to a Chapter 7 case. Counsel further argued that if the Court did not feel comfortable granting the creditor/plaintiff's motion for default judgment, the appropriate thing for the Court to do would be to leave the adversary action open until the debtors either completed their Chapter 13 case or reconverted. Counsel for the creditor/plaintiff argued that this was the

procedure "other courts" followed. The Court took the question under advisement.

The Court has found three cases from other districts involving similar facts. In Lunsford v. Vent (In re Vent), 188 B.R. 396, 398 (Bankr. E.D. Ark. 1995), the bankruptcy court found that the debtor's conversion from Chapter 7 to Chapter 13 mooted the pending §523(a) nondischargeability adversary. Noting, however, that a subsequent reconversion to Chapter 7 "would resurrect the viability of the complaint," the court denied the plaintiff's motion to dismiss the adversary, and suspended the adversary litigation pending completion of the Chapter 13 case. Id.

In Searles v. Riley (In re Searles), 317 B.R. 368, 374 (B.A.P. 9th Cir. 2004), the Ninth Circuit Bankruptcy Appellate Panel found that converting a case from Chapter 7 to Chapter 13 did not render a §727 action moot. The facts in Searles differ from those in the case at bar in several important ways. Like the debtors here, Ms. Searles converted her case after the filing of the adversary complaint but before the deadline for filing an answer to that complaint. Id. at 372. Unlike the debtors in this case, however, Ms. Searles filed an answer to the complaint, asserting that because of the conversion of her underlying case to one under Chapter 13, the adversary plaintiff–the Chapter 7 trustee, in that case–no longer had standing to pursue the §727 objection to discharge. The bankruptcy court substituted the Chapter 13 trustee for the Chapter 7 trustee as plaintiff, and proceeded to trial and

judgment on one prong of the complaint. The court then reconverted the case to one under Chapter 7 and tried the remaining §727 issues to judgment. Id.

In reviewing the bankruptcy court's actions on appeal, the Ninth Circuit BAP first noted that because "a case converted from chapter 7 to chapter 13 cannot be dismissed as of right under §1307(b), every such conversion carries with it the possibility of reconversion to chapter 7." Id. at 374. The BAP reasoned that the logical extension of this fact was that "pending litigation addressed to issues specific to chapter 7 may recede into the background while the case is in chapter 13 but may later re-emerge." Id. For this reason, the Searles court concluded that conversion from Chapter 7 to Chapter 13 did not render the §727 issues "moot." Id. Given the definition of a moot case–"[a] matter in which a controversy no longer exists; a case that presents only an abstract question that does not arise from existing facts or rights," BLACK'S LAW DICTIONARY 1029 (8th ed. 2004)–this makes sense. Rather, the Searles court indicated that the conversion rendered the §727 action "dormant," Searles, 317 B.R. at 374–"[i]nactive; suspended; latent," BLACK'S LAW DICTIONARY 527 (8th ed. 2004).

Accordingly, the Searles court held that the debtor's conversion of the underlying case to one under Chapter 13 did not moot the §727 adversary, and that the bankruptcy court did not err in deciding a portion of that adversary in the Chapter 13 case (after substituting the Chapter 13 trustee for the Chapter 7 trustee who'd been the original plaintiff). Searles, 317 B.R. at 374.

A couple of years later, the bankruptcy court for the Eastern District of California had occasion to consider the question under facts somewhat similar to the facts at bar. In Kistler v. Cleveland (In re Cleveland), 353 B.R. 254 (Bankr. E.D. Cal. 2006), the Chapter 7 trustee filed a §727 complaint objecting to discharge. The debtor did not file an answer to the complaint, and the trustee asked for a default judgment. Before the court had an opportunity to enter the default judgment, the debtor converted the case to one under Chapter 13. Id at 256. Unlike the debtors here, however, the debtor in Cleveland clearly stated that he did not intend to defend the §727 action, so the facts demonstrated that the debtor deliberately allowed the default to occur. Id. at 257. Some two months after the U.S. Trustee filed an application for judgment in the §727 action, the debtor filed a motion asking the bankruptcy court to set aside the default judgment. Id.

The Cleveland court noted that the Ninth Circuit BAP had confronted the question of how conversion impacts a §727 action in its decision in Searles. Id. at 257-258. It observed, however, that "the *Searles* decision stopped short of instructing trial courts what to do with a chapter 7 discharge complaint while the case is still in chapter 13." Id. Accordingly, the Cleveland court conducted a further analysis.

The Cleveland court clearly and simply articulated the impact of the conversion on the §727 cause of action:

> . . . The voluntary conversion to chapter 13 terminated the

> application of chapter 7 before the hearing on the UST's Application [for an order denying the debtor a Chapter 7 discharge]. The Complaint arises under §§727 and 727 of the Bankruptcy Code, which are found in subchapters I and II of chapter 7. Under §103(b), "Subchapters I and II of chapter 7 of this title apply only in a case under such chapter." By the plain meaning of the Bankruptcy Code, §§707 & 727 do not apply so long as the case is in chapter 13. A ruling under those Code sections is unnecessary and would be inappropriate at this time.

Id. at 258.

The court went on to say that by asking the court to issue a ruling in the §727 action in spite of the conversion,

> the UST [was] essentially asking the court to issue an advisory opinion because the question of a chapter 7 discharge has no meaning so long as the Debtor is in chapter 13. The court is being asked to make a ruling based on a hypothetical set of facts; i.e., "would the Debtor be entitled to a discharge if he were in chapter 7?" The entry of a judgment against the Debtor cannot affect the rights of the debtor so long as he remains in chapter 13.

Id. at 259.

Accordingly, in spite of the fact that the debtor clearly indicated that he did not intend to defend the complaint on its merits, id. at 259-260, the Cleveland court denied the motion for entry of judgment without prejudice, id. at 261. The court did conclude, however–as had the Vent court eleven years earlier–that the appropriate way to treat the adversary proceeding would be to stay it "unless and until" the case was reconverted to one under Chapter 7. Id. at 260. In reaching this conclusion, the court reiterated that ruling on the motion for entry of judgment on its merits was not appropriate, because the motion presented no justiciable issues. The court opined that "[d]ismissal of

the adversary proceeding is not the fairest course of action because that would essentially nullify much of the UST's efforts up to this point." Id. at 260. The court agreed with the Searles court that the adversary proceeding was not moot, because the debtor could reconvert. Finally, the court stated that "multiple 'wait and see' status conferences would be an administrative burden on the court and an unfair burden and expense to the litigants." Id.

The Cleveland court summed up its conclusion thus:

> The Debtor is entitled to the presumption that he will successfully complete his chapter 13 plan, and receive his chapter 13 discharge. Until then, the UST retains her right to move for entry of a judgment should the chapter 13 prove unsuccessful. In the interest of fairness to the litigants and judicial economy, the adversary proceeding must be stayed until and unless the case is reconverted to chapter 7.

Id. at 260-261.

In the case at bar, the creditor/plaintiff argues that because the debtors/defendants could, at some future point, convert their case back to one under Chapter 7, the §727 action is not moot. He urges the Court either to grant his motion for default judgment, or in the alternative, to hold this adversary proceeding open until the debtor/defendants either complete their Chapter 13 case, or suffer its dismissal, or re-convert to a case under Chapter 7.

First, this Court is unwilling to grant the creditor/plaintiff's motion for default judgment. True, the debtors/defendants did not timely answer the complaint, but, in contrast to the situation in Cleveland, the reason these

debtors did not answer was not because they did not wish to defend against it. Rather, they believed–correctly or not–that converting the underlying case made it unnecessary for them to answer. The Court will not award judgment on the merits to the creditor/plaintiff based on a procedural error (if, in fact, it was a procedural error), when the debtors/defendants did appear through counsel at the January 20, 2010 hearing and expressed their desire to defend against the §727 action to the extent that it remained a live controversy. Further, as the Cleveland court so clearly articulated, it is not appropriate for this Court to rule on the §727 issue as long as the underlying case is pending under Chapter 13. For these reasons, the Court will deny the plaintiff's motion for default judgment without prejudice.

Second, this Court agrees with the Searles and Cleveland courts that conversion renders a §727 cause of action "dormant," rather than moot. While there is no reason for this Court to proceed further on that cause of action as long as the underlying case remains a Chapter 13 (and thus, as long as the debtors/defendants are not seeking a Chapter 7 discharge), it is true that the facts supporting the §727 action may very well re-surface if the debtors/defendants reconvert to a case under Chapter 7.

The remaining question, then, is what to do with that "dormant" case of action during the pendency of the Chapter 13 case. The Cleveland court's solution makes the most sense to this Court. Rather than dismissing the adversary complaint–which would require the creditor/plaintiff to re-file it in

the event of a reconversion–it makes sense for the Court to order the clerk's office to close the adversary case "until and unless the case is reconverted to chapter 7." Cleveland, 353 B.R. at 261. If the case is reconverted, either party may file a motion asking to reopen the adversary proceeding, giving all interested parties fourteen (14) days' notice of the opportunity to object. This procedure will avoid a situation in which the creditor/plaintiff would have to pay another adversary filing fee upon reconversion.

WHEREFORE, the Court hereby **DENIES WITHOUT PREJUDICE** the plaintiff's motion for default judgment. The Court further **ORDERS** that the proceedings in the above-captioned adversary are **STAYED**, and **ORDERS** that the above-captioned adversary case be **CLOSED** effective immediately. In the event that the case reconverts to Chapter 7 in the future, either party may file a motion asking the Court to reopen the adversary case. The party filing such a motion may do so on negative notice; if the movant chooses to proceed by negative notice, the movant must give interested parties fourteen (14) days to object to the motion to reopen. If the Court grants the motion to reopen the case, the Court will modify its order staying the adversary proceedings accordingly.

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