

# LAW CURRENTS An informational newsletter from Richard A. Klass, Esq.

## When is the best time to sell a house? Right Away!

The divorce case had been pending since 2015. Throughout those eight years of litigation, there were more than 35 motions made, including numerous motions for contempt — a hotly contested divorce case!

The couple's only significant assets were two houses, one in New York and another in Florida. Early on, the judge had granted the wife exclusive occupancy of the New York house and the husband was directed to pay the carrying charges during the pendency of the case. However, after many years of battling it out in the divorce case, the judge directed that the houses be immediately sold and suspended the requirement that the husband pay the carrying charges.

### **Wife files Chapter 11 Bankruptcy to Stop Contempt**

Then, the divorce trial started. The wife originally had one attorney, then another, and then began representing herself *pro se*.<sup>1</sup> The judge found the wife in contempt of court for transferring away her ownership interest in a business and required her to purge her contempt by posting a bond or she would be subject to arrest and

<sup>1</sup> A typically bad idea, bringing to mind the oft-quoted expression attributed to Abraham Lincoln, "The man who represents himself has a fool for a client."

<sup>2</sup> Except as provided in paragraph (2) of this subsection, subsection (c) of this section, and section 1104(a)(3), on request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall convert a case under this

chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause." 11 U.S.C. § 1112 (b)(1). Under Bankruptcy Code Section 1112(b)(1), a court shall convert or dismiss a Chapter 11 case if any of the following grounds is present:

### **Sufficient "Cause" to Convert Case to Chapter 7**

Given the wife's bankruptcy case was lingering, the husband retained **Richard A.**

**Klass, Esq.**, *Your Court Street Lawyer*, to obtain relief. The novel approach was to seek "conversion" of the case from Chapter 11 (reorganization — in which a debtor operates as her own trustee) to Chapter 7 (liquidation — in which a trustee is appointed to sell a debtor's assets and administer the case). Accordingly, the motion was made pursuant to Bankruptcy Code Section 1112(b)(1).<sup>2</sup> based on:

"(4) For purposes of this subsection, the term "cause" includes--  
(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;



**A: Continuing loss and diminution of the estate and absence of likelihood of rehabilitation.**

The Debtor stated that she was a “housewife” with no source of income. Since the bankruptcy filing, she filed four monthly operating reports indicating that she was not maintaining insurance coverage on the properties, not paying real estate taxes or paying any of the carrying costs associated with the properties. Despite the Debtor’s stated purpose for filing Chapter 11 was to sell the houses, for many months she failed to retain real estate brokers and find buyers for them. During the case’s pendency, the administrative expenses continued to grow, eroding the net equity in the jointly held assets.

It was urged by the husband that there was no likelihood of the Debtor’s rehabilitation by remaining in Chapter 11 bankruptcy. Since the Debtor’s operating reports reflected no income which could offset the heavy continuing losses and the Debtor’s stated intention to liquidate the assets, it was established that there would be no likelihood of rehabilitation.<sup>3</sup>

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- (B) gross mismanagement of the estate;
  - (C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;
  - (D) unauthorized use of cash collateral substantially harmful to 1 or more creditors;
  - (E) failure to comply with an order of the court;
  - (F) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;
  - (G) failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;
  - (H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);
  - (I) failure timely to pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;
  - (J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;
  - (K) failure to pay any fees or charges required under chapter 123 of title 28;
  - (L) revocation of an order of confirmation under section 1144;
  - (M) inability to effectuate substantial consummation of a confirmed plan;
  - (N) material default by the debtor with respect to a confirmed plan;
  - (O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and
  - (P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

**B: Post-petition “negative cash flow.”**

The wife could not deny that she had negative cashflow and an inability to pay current expenses as they came due since the filing date. Courts have held that a negative cash flow post-petition and an inability to pay current expenses satisfy the elements of Section 1112(b)(1).<sup>4</sup> Aside from the Debtor’s speculative intention to file a liquidating plan, the Debtor does not have any plans for generating an income. A liquidating plan is evidence of no likelihood of rehabilitation in this case.

**C: Failure to maintain insurance coverage.**

It was alleged that the Debtor was unable to continue insurance coverage on the New York house and the insurance policy on the Florida house would soon lapse and then no longer be insurable due to the inability to obtain flood insurance. This would pose a risk to the bankruptcy estate and the public.

**D: Inability to effectuate a plan.**

Based on the filed unsecured claims in the case, the husband claimed that the Debtor would be unable to

These grounds are ‘illustrative, not exhaustive.’ *In re Babayoff*, 445 B.R. 64 (Bankr. E.D.N.Y. 2011) (citing *C-TC 9th Ave. P’ship v. Norton Co.*, 113 F.3d 1304, 1311 (2d Cir.1997)).

<sup>3</sup> See, *In re Kanterman*, 88 B.R. 26, 28–29 (S.D.N.Y. 1988) (No likelihood of rehabilitation and continuing loss to estate constituted cause where Debtor was a housewife with no regular income). Even if the Debtor were to file a liquidating plan, the Debtor’s failure to meet her post-petition obligations, the costs associated with filing and confirming a plan, and the delay occasioned thereby, would not be beneficial to the Debtor’s estate. On the contrary, this case was only digging the Debtor deeper into debt.

Conversion would permit a Chapter 7 Trustee to liquidate the Debtor’s properties in an orderly fashion and use the proceeds to pay creditors, ensuring “the largest number of [creditors] being paid the largest amount of money in the shortest amount of time.” *In re Francis*, 2019 WL 1265316, at 7 (B.A.P. 1st Cir. Mar. 14, 2019).

<sup>4</sup> See, *In re AdBrite Corp.*, 290 B.R. 209, 215 (Bankr. S.D.N.Y. 2003) (citing *In re Route 202 Corp. t/a Lioni’s Villa*, 37 B.R. 367, 374 (Bankr.E.D.Pa.1984) (“Obviously, if the debtor has negative cash flow after entry of the order for relief in the chapter 11 case, the first of two elements of 1112(b)(1) is satisfied.”); see also *In re Galvin*, 49 B.R. 665, 669 (Bankr.D.N.D.1985) (“Post-petition negative cash flow is considered by courts to be evidence of continuing losses required by section 1112(b)(1)”). “With respect to the second prong of § 1112(b)(1), rehabilitation does not mean the same thing as reorganization for purposes of Chapter 11.” *Adbrite*, 290 B.R. at 215; see *In re Rundlett*, 136 B.R. 376, 380 (Bankr.S.D.N.Y.1992). In this context, rehabilitation means to put back in good condition and reestablish on a sound basis. See *Andover Covered Bridge, LLC*, 553 B.R. 162, 175 (B.A.P. 1st Cir. 2016) “Whereas, confirmation of a plan could include a liquidation plan, rehabilitation does not include liquidation.” *Id.* at 175; see also *In re Kanterman*, 88 B.R. 26, 29 (S.D.N.Y.1988).

effectuate substantial consummation of a confirmed plan because she would be unable to obtain the requisite consents from creditors. A debtor's ability to effectuate a plan may well turn on practical considerations, including whether confirmation could be achieved.<sup>5</sup> Given the positions that the unsecured creditors have taken against this Debtor, it seemed to be unlikely, if not highly unlikely, that this Debtor could ever obtain the necessary consents for a plan. Based on the claims, the Debtor would be unable to effectuate any proposed plan.

#### **E: Post-petition utilities not being paid.**

The Debtor could not refute the fact that she had not paid utility bills as they came due on the houses since the filing date.

#### **Motion Granted!**

Based on the above grounds, the Bankruptcy Judge granted the husband's motion and converted the case to a Chapter 7 bankruptcy case.

#### **Round Two — Debtor's Motion for "Re-Conversion" to Chapter 11**

Immediately after the Bankruptcy Judge granted the motion to convert the case to Chapter 7, the Debtor moved for reconsideration and requested that the judge allow the case to be reconverted back to a Chapter 11 case; the Debtor further presented contracts of sale for each of the properties for the Court's approval as part of the motion.

#### **A: Reconversion is preclusion by Section 706(a).**

The wife made her motion to reconvert her Chapter 7 case to Chapter 11 pursuant to 11 U.S.C. § 706(b). However, she failed to acknowledge that section 706(a) specifically excepts a debtor from converting a case if it had been previously converted pursuant to Section 1112 (as happened in this case). Section 706(a) states: "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.**" 11 U.S.C.A. § 706(a) (*emphasis added*).<sup>6</sup> Since the Debtor's case had been converted pursuant to Section 1112(b), it was argued that she was precluded from reconverting the case.

#### **B: Immediate grounds for conversion still existed.**

Even if the court could have found that reconversion was permissible, it was still within the court's discretion to deny the motion. Some courts review the factors identified in 11 U.S.C. § 1112(b) in deciding whether to convert because "[i]f cause exists to reconvert from Chapter 11 under § 1112(b), conversion from Chapter 7 under section 706(b) would be a futile and wasted act." In this case, it was argued that the court properly found that "cause" existed for conversion under section 1112(b) for multiple reasons, including: (a) first, the Debtor caused delay and gross mismanagement of the estate, which was detrimental to the estate by failing to retain real estate brokers and sell the Debtor's properties in a timely manner; (b) the Debtor failed to file timely operating reports, and when the reports were filed, they failed to show any payment of post-petition carrying costs, causing continuing losses and diminution of the estate; (c) Post-petition taxes are accruing and unpaid by the Debtor; and (d) finally, the Debtor's filed her Combined Plan and Disclosure Statement that failed to contain "adequate information" pursuant to 11 U.S.C. 1129. The Plan was argued to be facially unconfirmable, as it provided unfair treatment among the same priority levels; there was disparate treatment of the general unsecured creditors; some unsecured creditors were to be paid 85% of their claim's, whereas others were to be paid 95% and the husband would seemingly get nothing under the plan. There was also scandalous language and

<sup>5</sup> A debtor is unable to effectuate a plan where it "lacks the ability to formulate a plan or to carry one out." *Hall v. Vance*, 887 F.2d 1041, 1044 (10th Cir.1989). However, to effectuate a plan, the proponent must obtain the requisite consents of two-thirds in amount and more than one-half in number, as stated in 11 U.S.C. § 1126(c), of at least one class of impaired claims in accordance with 11 U.S.C. § 1129(a)(10). *In re Rundlett*, 136 B.R. 376 (Bankr. S.D.N.Y. 1992). In this case, the husband, who holds the vast majority of the unsecured debt, could prevent confirmation of a proposed plan. *See In re Local Union 722 Int'l Bhd. of Teamsters*, 414 B.R. 443 (Bankr.N.D.Ill.2009) (the court found that cause under Section 1112(b) was present where a single creditor held seventy-eight percent of the unsecured debt and objected to the plan because his

claim was impaired so that confirmation of a plan was impossible.) *See In re B & B West 164th Street Corp.*, 147 B.R. 832, (Bankr.E.D.N.Y.1992) (cause under Section 1112(b) present where plan confirmation impossible over objection of creditor who controlled over one-third of a class).

<sup>6</sup> There are several courts that have interpreted this language as barring a debtor from seeking reconversion outright. *See In re First Connecticut Consulting Group, Inc.*, 579 B.R. 673, 682 (Bankr. D. Conn. 2018) (*citing In re Muth*, 378 B.R. 302 (Bankr. D. Colo. 2007); *In re Hardin*, 301 B.R. 298 (Bankr. C.D. Ill. 2003); *In re Banks*, 252 B.R. 399 (Bankr. E.D. Mich. 2000); *In re Vitti*, 132 B.R. 229 (Bankr. D. Conn. 1991)).

unsubstantiated accusations of fraud, having no place in a Chapter 11 Plan. The Debtor's filed Plan was evidence that the expense of the plan process would be highly contested and be an unnecessary waste of estate resources.

**C: Claim that the “highest and best offer” was not presented.**

The Debtor improperly sought the approval of a “no-bid” contract of sale of the New York house, which the husband learned was not even the highest and best offer! No real estate broker was formally retained in the case, nor has a real estate attorney been retained as special counsel by the Debtor. The husband urged that a Chapter 7 Trustee would serve the best interest of creditors and sell the houses in an expeditious manner with full transparency so as to maximize recovery for the estate.

***Motion Denied.***

Once again, the Bankruptcy Judge denied the wife's motion and left the Order converting the case to Chapter 7 intact. The next step was the appointment of a Chapter 7 Trustee authorized to sell the properties as expeditiously as possible.

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