

The Supreme Court Speaks in *Marrama*

The Plain Meaning Rule Isn't So Plain Anymore

By Eugene J. Geekie, Jr., Patricia J. Fokuo and L. Katie Mason

With its Feb. 21, 2007 holding in *Marrama v. Citizens Bank of Massachusetts*, 127 S. Ct. 1105 (2007), the Supreme Court stepped in to resolve a Circuit Court split concerning a debtor's right to convert a Chapter 7 case to a Chapter 13 case under the Bankruptcy Code, pursuant to § 706(a) of the Code. On its face, § 706(a) seems clear — a debtor has an absolute, one-time right to conversion. Such clarity is, in the Supreme Court's view, hazy at best.

In holding that a debtor does not, in fact, have an absolute right to convert from Chapter 7 to Chapter 13 under § 706(a), the Supreme Court resurrected the equitable power of § 105(a), and ignored the previously sacrosanct "plain meaning rule," see *U.S. v. Ron Pair Enterprises, Inc.*, 109 S. Ct. 1026, 1031 (1989), to reach a result at odds with not only the plain language of the statute, but also unequivocal statutory history. Although initially appearing to be limited only to a narrow consumer-case issue, *Marrama* has serious implications for all bankruptcy practitioners, due to its unexpected method of statutory interpretation, and thus its potential impact in the complicated process of deciphering and interpreting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").

CIRCUIT COURT SPLIT

Prior to *Marrama*, circuit court decisions addressing the issue of conversion of a Chapter 7 case to a case under Chapter 13 pursuant to § 706(a) revealed a clear split of authority. Many courts shared the

view that a court had no discretion to deny a Chapter 7 debtor the one-time, absolute right to convert an originally filed Chapter 7 case to a Chapter 13 case as long as the case has not been converted previously, and the debtor was eligible for relief under Chapter 13. See, e.g., *In re Martin*, 880 F. 2d 857 (5th Cir. 1989).

Other courts, however, held that a debtor had a qualified right to convert to Chapter 13, basing their decisions upon the statutory requirement found in § 706(d) that a Chapter 7 debtor be eligible for relief under the Code chapter to which conversion was sought. See 11 U.S.C. § 706(d); 11 U.S.C. § 109(e). These courts found only a qualified right to convert from Chapter 7 to Chapter 13, via three approaches: 1) the extreme circumstances approach, see, e.g., *In re Johnson*, 262 B.R. 75 (Bankr. E.D. Ark. 2001); 2) the equitable approach utilizing the bankruptcy courts' broad powers under § 105(a) of the Code, see, e.g., *Calder*, 93 B.R. 739, 740 (Bankr. D. Utah 1988); and 3) the totality of the particular facts and circumstances approach, see, e.g., *In re Gallagher*, 283 B.R. 604, 606 (M.D. Fla. 2002).

THE CASE

The debtor, Robert Marrama, filed a voluntary Chapter 7 petition in 2003, but the real story began before he sought bankruptcy relief. See *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 127 S. Ct. 1105 (2007). Prior to his bankruptcy filing, Marrama was sued by a bank for business debts that he guaranteed. See *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 445 F.3d 518, 520 (1st Cir. 2006) (affirming discharge denial). Around the same time that he was being sued by the bank, Marrama refinanced his vacation home and transferred a substantial portion of the proceeds to his girlfriend, then created a revocable trust for his own benefit and funded it with the vacation property. *Id.* Marrama filed his Chapter 7 petition seven months later. *Id.*

Further compounding his future problems, Marrama filed a statement of financial affairs containing several false statements. For instance, while

he disclosed that he was the beneficiary of the trust in which he placed his Maine vacation home, he listed the value of the trust's *res* as zero. *Id.* He also falsely denied making any property transfers within one year of filing the Chapter 7 petition, and made false statements regarding income tax refunds that he was owed. *Id.* After Marrama's misconduct came to light, and his trustee indicated his intent to recover and sell Marrama's vacation home, Marrama sought a Chapter 13 conversion, pursuant to § 706(a), in order to protect the property he had concealed. *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 430 F.3d 474, 476 (1st Cir. 2005), *aff'd*, 126 S. Ct. 1105 (2007). The bankruptcy court denied conversion to Chapter 13 because Marrama's conduct constituted "bad faith" sufficient to strip him of his right to convert to Chapter 13. *Id.*

On appeal the First Circuit affirmed, the holding that a debtor's right to a one-time conversion of a Chapter 7 case is not unlimited and that § 706(a) permits the bankruptcy court to deny conversion where the court determines that the debtor engaged in bad faith conduct. *Id.* at 481. The First Circuit based its decision, *inter alia*, on the bankruptcy court's equitable powers under § 105(a) to take reasonable action to prevent abuse of the bankruptcy process, as well as the language in § 706(d) that appears to limit § 706(a). *Id.* at 477-481.

SUPREME COURT RULING

The Supreme Court affirmed the lower court rulings and held that Marrama's § 706(a) right to convert to Chapter 13 is not automatic or unqualified, despite what Marrama argued was the clear, plain meaning of § 706(a). *Marrama*, 127 S. Ct. at 1109. Remarkably, the Court not only resisted all efforts to invoke the "plain meaning rule" previously articulated in *Ron Pair Enterprises*, 109 S.Ct. at 1031, it also found that § 706(a)'s "absolute right" of conversion is ... equivocal," *Id.* at 1110, despite the apparent seemingly unequivocal legislative history which

continued on page 4

Marrama

continued from page 3

stated that § 706(a) “gives the debtor the one-time *absolute right* of conversation.” S.Rep. No. 95-989, p. 94 (1978) (emphasis added).

Rather than follow the apparent plain meaning of the statute, the Supreme Court instead affirmed the denial of debtor’s conversion on two grounds. First, the Court held that § 706(d) of the Code, which provided that a case may not be converted to a case under another chapter unless the debtor is qualified to be a debtor under such chapter, was adequate authority for the denial of Marrama’s effort to convert his case to Chapter 13. 127 S. Ct. at 1111. Here the Court appeared to be particularly concerned that, although a case like *Marrama* would likely be reconverted to Chapter 7 (in the event that § 706(a) conversion was actually allowed), there would be too much “opportunity” for debtor mischief with assets before reversion. See *id.* at 1112, n. 13. For this reason, § 706(a) conversion was available only for the “class of honest but unfortunate debtors.” *Id.* at 1111.

Second, although its affirmance based on § 706(d) would have been sufficient, the Court reached deep into its bag of tricks to pull out the largely forgotten § 105(a) of the Code to also hold that bankruptcy judges may use the broad authority “to prevent an abuse of process” under § 105(a) of the Bankruptcy Code to immediately deny a motion to convert filed under § 706 where the debtor acted in bad faith instead of allowing the conversion to take place and reconvert the case back to Chapter 7. *Id.* at 1111-12.

The dissent, led by Justice Alito, advocated an approach similar to the “plain meaning rule,” asserting that § 706 “unambiguously provides that a debtor who has filed a bankruptcy petition under Chapter 7 has a broad right to convert the case to another chapter.” *Id.* at 1112. The dissent further noted that ignoring the debtor’s obvious right to convert under § 706(a) was unnecessary because the Bankruptcy Code provides for

several express ways of dealing with bad faith conduct, including denial of discharge under § 727, conversion or reversion, denial of a Chapter 13 plan not proposed in good faith, and perjury penalties, among other things. *Id.* at 1113-14. Importantly though, the dissent acknowledged that “§ 105(a) and a bankruptcy court’s inherent powers may have a role to play”, *Id.* at 1116, but noted that such equitable powers “must and can only be exercised within the confines of the Bankruptcy Code.” *Id.* (quoting *Norwest Bank Worthington v. Ahlers*, 108 S. Ct. 963 (1988)).

STATUTORY INTERPRETATION IN LIGHT OF BAPCPA AND MARRAMA

Though possibly precipitated by one debtor’s flagrant attempt to abuse the bankruptcy process, the Supreme Court’s *Marrama* ruling and apparent departure from the “plain meaning rule” is likely to have an impact far beyond the confines of the case. Not only will it impact future debtors’ rights to conversion under § 706(a), it may also affect court interpretations of other Bankruptcy Code sections, which is particularly important in light of BAPCPA’s recent amendments to the Code.

Under BAPCPA, Congress sought to limit judicial discretion in many areas and instead impose hard-and-fast rules that eliminated much of a bankruptcy court’s judgment, flexibility, and discretion. Bankruptcy courts have chafed under BAPCPA’s restrictions and attempts to make them more administrators than judges. And quite frankly, much of BAPCPA is not well-written, thereby creating confusion in place of the certainty and structure that Congress apparently believed BAPCPA would install.

Marrama might be the medicine to cure these ills. First, with respect to the handcuffs apparently imposed on bankruptcy courts by BAPCPA, the *Marrama* Court’s reanimation of § 105(a) — especially in light of the seemingly clear language of and legislative history regarding, § 706(a) — will give courts greater leeway in interpreting the Code and applying it to cases. Not only will the courts

again be able to “take any action ... to prevent an abuse of process,” they can apply BAPCPA in a way “that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code].” *Marrama*, 127 S. Ct. at 1112.

Furthermore, in interpreting BAPCPA, *Marrama* makes clear that nothing is clear, and that the “plain meaning rule” is no longer the singular guide to statutory interpretation. With *Marrama* as their guide, bankruptcy courts can look to the effects and consequences of their interpretation of the Code, even when the language of the Code is apparently clear and unequivocal, and they can consider the goals of the Code — be it a “fresh start,” equitable treatment of creditors, or one of the other perceived goals of the Bankruptcy Code — in reaching their decision.

These results cannot be lost on bankruptcy practitioners either. It is once again permissible, indeed advisable, to argue equity under § 105(a), and opponents of attorneys citing *Marrama* must be prepared to address why equity under § 105(a) is inappropriate (beyond just invoking the strictures of *Ahlers* and its progeny). Similarly, bankruptcy attorneys may now look beyond the apparent “plain meaning” of the Code to argue an interpretation that fits within the overall statutory scheme that they believe exists, or that their respective bankruptcy judge might follow.

CONCLUSION

Ultimately, *Marrama* reopened a door that many thought BAPCPA closed — the ability of bankruptcy courts to use their equitable powers to enforce just results and underlying purposes of the Bankruptcy Code. In light of *Marrama*, bankruptcy judges and attorneys can again play a role in reaching just and equitable results that BAPCPA might have otherwise foreclosed.



The publisher of this newsletter is not engaged in rendering legal, accounting, financial, investment advisory or other professional services, and this publication is not meant to constitute legal, accounting, financial, investment advisory or other professional advice. If legal, financial, investment advisory or other professional assistance is required, the services of a competent professional person should be sought.