No. 05-996

IN THE
Supreme Court of the United States

ROBERT LOUIS MARRAMA,

Petitioner,

v.

CITIZENS BANK OF MASSACHUSETTS, and
MARK G. DeGIACOMO, CHAPTER 7 TRUSTEE,

Respondents.

**ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT**

BRIEF FOR RESPONDENT CITIZENS BANK OF MASSACHUSETTS

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QUESTION PRESENTED

Does a bankruptcy court have authority to deny, on grounds of bad faith or to prevent abuse of the bankruptcy system, a debtor's request made under section 706(a) of the Bankruptcy Code, 11 U.S.C. § 706(a), to convert a chapter 7 bankruptcy case to a proceeding under chapter 13.

RULE 29.6 STATEMENT AND PARTIES TO THE PROCEEDING

Respondent Citizens Bank of Massachusetts is owned by its directors (.01%) and by Citizens Financial Group, Inc. (99.99%). Citizens Financial Group Inc. is a wholly-owned subsidiary of RBSG International Holdings Limited. RBSG International Holdings Limited is a wholly-owned subsidiary of The Royal Bank of Scotland plc. The Royal Bank of Scotland plc is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc, which is a publicly traded company. There is no parent or publicly held company owning 10% or more of the stock of The Royal Bank of Scotland Group plc.

Respondent Mark G. DeGiacomo, is an individual serving as the court-appointed trustee of the chapter 7 bankruptcy estate of petitioner Robert Lewis Marrama, who is an individual.

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PRELIMINARY STATEMENT

This matter arises out of the chapter 7 bankruptcy case of Petitioner Robert Louis Marrama ("Marrama"). Respondent Citizens Bank of Massachusetts ("Citizens Bank") is Marrama's largest creditor. Respondent Mark DeGiacomo ("Trustee") is the chapter 7 trustee of Marrama's bankruptcy estate.

Several months before Marrama commenced his voluntary bankruptcy case under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq*., he refinanced real estate that he owned in Maine and transferred most of the proceeds of the refinancing to an account in the name of his girlfriend. He then transferred the real estate itself to a trust for his benefit and installed his girlfriend as trustee. After Marrama commenced his bankruptcy case, he failed to disclose these transactions (as well as his entitlement to a sizeable tax refund), and listed the real property in the trust as worthless (when in fact it had substantial value). When the Trustee questioned the transactions and indicated that he would recover the real estate for the benefit of creditors, Marrama responded by attempting to convert his chapter 7 case to a proceeding under chapter 13 to avoid the Trustee (who would be displaced automatically if the case were converted to chapter 13, *see* 11 U.S.C. § 348(e)). The bankruptcy court denied Marrama's attempt to convert on the ground that Marrama had acted in bad faith and to prevent abuse of the bankruptcy system.

Section 706 of the Bankruptcy Code provides that a debtor "may" convert his or her case from a proceeding under chapter 7 to one under chapter 13. 11 U.S.C. § 706. Marrama contends that, despite any bad faith on his part, he had the absolute right to convert his case and that the bankruptcy court lacked the authority to deny the conversion. Section 706, however, does not confer the absolute right that Marrama claims, nor does it otherwise abrogate a bankruptcy court's longstanding authority to deny relief for bad-faith conduct or to prevent abuse, and the bankruptcy court properly exercised its discretion in denying conversion in this instance. On appeal, the First Circuit properly affirmed the bankruptcy court, and this Court should likewise affirm.

STATEMENT

A. Events Preceding Marrama's Chapter 7 Case

Prior to commencing his chapter 7 case, Marrama owned and operated a business known as RLM Flooring ("RLM"). JA 20a, 37a.[1] Citizens Bank loaned funds to RLM, and Marrama guaranteed RLM's debt to the bank. *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 445 F.3d 518, 520 (1st Cir. 2006).[2] By June of 2002, RLM had defaulted on its obligations to the bank, and the bank demanded repayment of approximately $255,000 in outstanding indebtedness. *Id*., *see also Marrama III*, 331 B.R. at 12 (noting demand). Two weeks later, on July 10, 2002, the bank commenced a state court action to recover the debt (the "State Court Action"). *See Marrama IV*, 445 F.3d at 520; *Marrama III*, 331 B.R. at 12.

During this same period, Marrama refinanced a vacation home that he owned in York, Maine (the "Maine Property"), and obtained approximately $118,000 in cash as a result of the refinancing. *Marrama IV*, 445 F.3d at 520; *see* JA 23a, 56a-58a, 61a. Marrama initially deposited the proceeds of the refinancing transaction into an account held jointly with his girlfriend, Josephine Bolletiero ("Bolletiero"). *Marrama IV*, 445 B.R. at 520;

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[1] "JA" refers to the Joint Appendix. "SJA" refers to the Supplemental Joint Appendix.

[2] Reported decisions in Marrama's bankruptcy cases (other than the decisions of the Bankruptcy Appellate Panel and First Circuit contained in the Petition Appendix), and the manner in which they are referred to in this brief, are as follows: *In re Marrama*, 307 B.R. 332 (Bankr. D. Mass. 2004) ("*Marrama I*"); *Marrama v. DeGiacomo (In re Marrama)*, 316 B.R. 418 (1st. Cir. BAP 2004) ("*Marrama II*"); *Citizens Bank of Mass. v. Marrama (In re Marrama)*, 331 B.R. 10 (D. Mass. 2005) ("*Marrama III*"); *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 445 F.3d 518 (1st Cir. 2006) ("*Marrama IV*"); *In re Marrama*, 345 B.R. 458 (D. Mass. 2006) ("*Marrama V*").

Marrama III, 331 B.R. at 13 (noting transfer).[3] After using approximately $9,000 to pay some debts owed to creditors other than Citizens Bank, Marrama transferred the remaining amount of the funds - approximately $109,000.00 - into an account held in Bolletiero's name alone. *Marrama IV*, 445 F.3d at 520; *Marrama III*, 331 B.R. at 13. Marrama later testified "that he did this because [Bolletiero] asked him to and because there was 'no reason to have two accounts.'" *Marrama III*, 331 B.R. at 13 (citation omitted).

On August 9, 2002 - shortly after Citizens Bank commenced the State Court Action - Marrama created a revocable trust for his benefit known as the "Bo-Mar Realty Trust" (the "Trust"). JA 84a. Marrama hired an attorney to create the Trust. JA 52-53a. One week later, on August 16, 2002, the judge presiding over the State Court Action "enjoined Marrama from disposing of any assets except for normal living expenses and granted Citizens [Bank] authority to seize and liquidate all of [RLM's] assets." *Marrama III*, 331 B.R. at 12 (footnote omitted); *see also Marrama IV*, 445 F.3d at 520 (noting entry of order against Marrama). In spite of this injunction, "[i]n late August 2002 - after the [state] court ordered him not to transfer any assets - Marrama used the [Maine] Property to fund 'the [Trust.]'" *Marrama IV*, 445 F.3d at 520; *Marrama III*, 331 B.R. at 13 (noting transfer of Maine Property to the Trust). Marrama received no consideration in exchange for his transfer of the Maine Property to the Trust, or his cash transfer to Bolletiero, and he designated himself the sole beneficiary of the Trust with Bolletiero as the sole trustee. JA 52a, 74a-75a. Marrama later testified that he placed the Maine Property into the Trust "to try to protect it" from creditors. JA 75a; *Marrama IV*, 445 F.3d at 520; *Marrama III*, 331 B.R. at 13.

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[3] The details of this transfer to Bolletiero were set forth in *Marrama III*, 331 B.R. at 13, which the court of appeals cited in its decision below. Pet. App. 44 (citing *Citizens Bank of Mass. v. Marrama*, 2005 WL 1106919, at *5 (D. Mass. May 9, 2005), subsequently officially reported at *Marrama III*, 331 B.R. 10 (D. Mass. 2005)).

B. Marrama's Chapter 7 Filing

Approximately seven months later, on March 11, 2003, Marrama sought protection under chapter 7 of the Bankruptcy Code, 11 U.S.C. § 701 *et seq*., by filing a voluntary chapter 7 petition with the bankruptcy court. SJA 1. By operation of law, when Marrama commenced his bankruptcy case, a bankruptcy estate was created consisting of all of his property wherever located. 11 U.S.C. § 541. In addition, immediately following the commencement of Marrama's chapter 7 case, the office of the United States Trustee - a division of the Department of Justice with oversight authority in bankruptcy cases - appointed the Trustee to serve in Marrama's case and to take possession of and preside over Marrama's bankruptcy estate. 11 U.S.C. § 701(a)(1) (providing for the appointment of a trustee in every chapter 7 case); *see also* 11 U.S.C. § 702 (providing for the election by creditors of a trustee to serve in a chapter 7 case). The duties of a chapter 7 trustee include "collect[ing] and reduc[ing] to money the property of the estate" and "investigat[ing] the financial affairs of the debtor." 11 U.S.C. § 702.

In addition to prescribing the trustee's duties, the Bankruptcy Code vests a bankruptcy trustee with certain powers, including the authority to avoid various transfers that the debtor made prior to filing his or her bankruptcy petition. 11 U.S.C. § 548 (providing for the avoidance of fraudulent transfers made within one year before bankruptcy); *BFP v. Resolution Trust Corp*., 511 U.S. 531, 535 (1994) (discussing recovery of fraudulent transfers under section 548); *see also* 11 U.S.C. § 544 (trustee's avoidance powers); *Sears Petroleum & Transp. Corp. v. Burgess Constr. Svcs., Inc*., 417 F. Supp. 2d 212, 220 (D. Mass. 2006) (discussing application of Massachusetts Uniform Fraudulent Transfer Act under section 544). In addition, section 550 of the Bankruptcy

Code permits a trustee to recover transferred property for the benefit of the estate. 11 U.S.C. § 550(a).[4]

Under the Bankruptcy Code, a debtor's monetary obligations constitute "claims" against the debtor's estate, and a creditor holding a pre-petition claim is entitled to file a "proof of claim" with the bankruptcy court. 11 U.S.C. §§ 101(5), 101(10), 501(a), 502(b); Fed. Bankr. Rule P. 3001, 3002; *see Katchen v. Landy*, 382 U.S. 323, 336 (1966) ("bankruptcy . . . converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*").[5] After the trustee reduces property of the estate to money, he or she then distributes the funds to creditors on account of their filed claims as the Bankruptcy Code directs. 11 U.S.C. § 726.

Central to the administration of a chapter 7 case is the debtor's timely and candid disclosure of assets and financial dealings. 11 U.S.C. § 521 (requiring disclosures); Fed. R. Bankr. P. 1007 (same). Congress has determined that this disclosure is so important that a debtor who fails to comply risks losing his or her bankruptcy discharge. 11 U.S.C. § 727(a) (providing that the court may deny a discharge to a debtor who has concealed transfers of

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[4] Other sections of the Bankruptcy Code provide further assistance in the collection of property. Section 551 of the Code automatically preserves for the benefit of the estate any transfer that the trustee avoids. 11 U.S.C. § 551 ("Any transfer avoided under section . . . 544 . . . [or] 548 . . . is preserved for the benefit of the estate."). Pursuant to section 542, the recipient of property that may be administered as part of the estate also is obligated to return the property to the estate. 11 U.S.C. § 542(a) ("an entity . . . in possession, custody, or control . . . of property that the trustee may use . . . shall deliver to the trustee . . . such property").

[5] The Bankruptcy Code defines "creditor" as a person holding a claim that arises before the debtor commences a bankruptcy case. 11 U.S.C. § 101(10). The term "pre-petition" refers to claims or events arising or occurring *before* the debtor files a bankruptcy petition. Conversely, the term "post-petition" refers to claims of events arising or occurring *after* the debtor files.

property, or has concealed information regarding the debtor's transactions or financial affairs). To facilitate and standardize disclosures, the Bankruptcy Code and Rules require that debtors supply certain mandatory information on prescribed schedules and statements, including information regarding the debtor's ownership interests in property and transfers made by the debtor prior to filing for bankruptcy. *See* Official Form 6 (schedules); Official Form 7 (Statement of Financial Affairs).

On schedule A to his chapter 7 petition, Marrama declared that he owned and resided in a home in Gloucester, Massachusetts (the "Massachusetts Property"). SJA 4. On schedule C, Marrama claimed a homestead exemption for the Massachusetts Property. SJA 7, 18, 21; Pet. App. 10-11. Marrama, however, did not list or identify the Maine Property on schedule A. Rather, on schedule B, Marrama indicated that he was the beneficiary of the Trust, but listed the value of the Trust *res* as zero. SJA 6. In fact, the Trust *res* - the Maine Property - had considerable value, which Marrama would later estimate to be approximately $220,000, JA 59a, and which would later be sold for an even higher amount.

In Marrama's Statement of Financial Affairs filed with his bankruptcy petition, Marrama stated (in response to question 10) that he had not made any transfers of property "other than . . . in the ordinary course of [] business or financial affairs" within one year preceding the filing of the chapter 7 petition. SJA 23. Marrama failed to disclose either the transfer of the Maine Property to the Trust, or the transfer of approximately $109,000 to Bolletiero. *Marrama IV*, 445 F.3d at 520. Separately, Marrama stated that the IRS did not owe him any tax refunds.[6] SJA 6. In fact, Marrama was entitled to a significant refund, which the Trustee later collected. *Marrama III*, 331 B.R. at 13; *see* JA 31a.

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[6] Item 17 on schedule B directs the debtor to "identify other liquidated debts owing debtor including tax refunds." Marrama's response to Item 17 was "none." SJA 6.

In addition to requiring certain disclosures, the Bankruptcy Code and Rules provide creditors an opportunity to meet with the debtor early in the case to conduct a limited examination of the debtor under oath (a "Section 341 Meeting"). 11 U.S.C. § 341; Fed. R. Bankr. P. 2003. Marrama's Section 341 Meeting was adjourned several times, but was eventually held on April 24, 2003. *See* JA 36a; Pet. App. 11.[7] During the course of the meeting, it became clear that certain of Marrama's representations in his chapter 7 petition, schedules, and Statement of Financial Affairs were materially incomplete and inaccurate. For example, when asked if he owned any real estate other than the Massachusetts Property, JA 40a; *see also* SJA 4, Marrama responded: "I have a piece of property in Maine." JA 40a. His attorney then corrected him, explaining, "[t]hat's actually owned by [the] trust, right?" *Id.* Marrama responded: "Right. That's owned by [the] trust." *Id*.

During his testimony, Marrama admitted to refinancing the Maine Property with a loan from Bank One, N.A. ("Bank One") in the amount of $135,000. JA 56a-57a; SJA 9.[8] Marrama further

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[7] Separately, the bankruptcy court required that Marrama appear for an examination to be conducted by Citizens Bank pursuant to Rule 2004 of the Federal Rules of Bankruptcy Procedure. *See Marrama III*, 331 B.R. at 14. Marrama failed to appear at scheduled Rule 2004 examinations on May 13, 2003 and September 10, 2003. *Id*. He did appear for an examination on September 29, 2003, but did not produce the documents requested by Citizens Bank. *Id*. Moreover, while he answered questions posed by the Trustee on September 29, 2003, Marrama refused to answer questions posed by Citizens Bank, invoking his Fifth Amendment right against self-incrimination. *Id*.; *see also id*. at n.4.

[8] Marrama testified that he purchased the Maine Property for $40,000.00 in 1998. JA 54a-55a. He explained that he paid for the Maine Property by transferring $4,000.00 in cash to the seller and executing a $36,000.00 promissory note in the seller's favor. JA 55a. Marrama used a portion of the proceeds from the refinancing with Bank One to pay off the balance due on the seller's note and, as noted, deposited approximately $109,000

admitted that he transferred the Maine Property to the Trust for no consideration. JA 74a-75a. He also admitted that he designated Bolletiero as the trustee of the Trust, and that he is the sole beneficiary of the Trust. JA 52a. Finally, Marrama admitted that he transferred the Maine Property to the Trust seven months prior to commencing his chapter 7 bankruptcy case to "try to protect it" from his creditors. JA 75a; *see also Marrama IV*, 445 F.3d at 523.

Although Marrama listed the value of the Maine Property as zero in his schedules, SJA 6, during the Section 341 Meeting Marrama estimated the value of the property to be approximately $220,000.00 and explained that the Bank One mortgage - the only encumbrance on the Maine Property - secured an outstanding balance of no more than $135,000.00. JA 56a, 59a. Subsequently, after recovering the Maine Property for the benefit of creditors, the Trustee sold it on July 21, 2004 at auction for $258,000.00.

In addition, Marrama admitted during the Section 341 Meeting that he had actually been living in the Maine Property (rather than the Massachusetts Property claimed as his homestead) for two months. JA 71a; *see also Marrama I*, 307 B.R. at 335 (noting testimony). He also admitted that he was renting the Massachusetts Property to two tenants, and was deriving $2,150 in income as a result. JA 71a, 72a; SJA 21. Yet, on schedule I he declared that he received no income generated by sources other than his employment. SJA 7, 18, 21; Pet. App. 10-11.[9] Marrama did not amend his schedules to reflect this additional income until August 11, 2003 - well after the Trustee had voiced his concern over Marrama's less than candid disclosures. *See* SJA 30-31; Pet. App. 13.

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of the proceeds in August of 2002 into an account held by Bollettiero. *Marrama IV*, 445 F.3d at 520; *Marrama III*, 331 B.R. at 13.

[9] Marrama stated on schedule I that he generated monthly income of $5,762 (on a salary of $8,600) and had monthly expenses of $4,925.95. SJA 18; Pet. App. 11.

C. Marrama's Motion To Convert To Chapter 13

Following the Section 341 Meeting, the Trustee advised Marrama that he intended to recover the Maine Property for the benefit of the bankruptcy estate and Marrama's creditors. JA 15a. In response, Marrama filed a Verified Notice Of Conversion To Chapter 13 (the "Motion to Convert") in the bankruptcy court, seeking under section 706(a) of the Bankruptcy Code to convert his chapter 7 case to a proceeding under chapter 13. JA 11a. The Motion to Convert was a one paragraph document in which Marrama stated "that the case has not been converted from another chapter previously, and that [he was] qualified to be a debtor under Chapter 13." JA 11a.

Proceedings in chapter 13 differ materially from those under chapter 7. In chapter 7, the debtor surrenders his or her nonexempt assets to the trustee who liquidates the assets for the benefit of creditors. 11 U.S.C. § 704(a)(1); *see also* 11 U.S.C. § 522 (governing exemptions). In exchange, the debtor typically receives a discharge of most prior indebtedness. 11 U.S.C. § 727; *see also* 11 U.S.C. §§ 523 (prescribing exceptions to discharge), 524 (prescribing effect of a bankruptcy discharge). In contrast, in chapter 13 the debtor typically retains his or her property, and receives a discharge only after completing (or substantially completing) payments to creditors in accordance with a confirmed chapter 13 repayment plan. 11 U.S.C. §§ 1322 (providing for contents of chapter 13 repayment plan), 1327(b) (providing for vesting of property of the estate in the debtor upon confirmation of the debtor's chapter 13 plan), 1328 (providing for discharge after completion, or substantial completion, of payments under the plan). Whereas any individual may commence a chapter 7 case, *see* 11 U.S.C. § 109(b), only an individual with regular income and debts below certain levels may be a debtor under chapter 13, *see* 11 U.S.C. § 109(e). Critically, when a case is converted from chapter 7 to chapter 13, the services of the chapter 7 trustee are terminated. 11 U.S.C. § 348(e). Although a standing chapter 13 trustee presides generally over chapter 13 cases, the duties of the chapter 13 trustee do not include collecting and reducing the debtor's

property to money for the benefit of creditors. 11 U.S.C. § 1302(b).

Bankruptcy Rule 1017(f)(2) requires that a request for conversion under section 706(a) must be made by motion served on all parties in interest as required by Bankruptcy Rules 9013 and 2002(a)(4). Fed. R. Bankr. P. 1017(f)(2), 2002(a)(4). This procedure affords creditors and the chapter 7 trustee the opportunity to object to the conversion. Here, the Trustee opposed Marrama's conversion to chapter 13 on the ground that Marrama had intentionally failed to disclose the transfer of the Maine Property to the Trust some seven months prior to filing his chapter 7 petition, and that Marrama had sought conversion to frustrate the Trustee's efforts to recover assets for the benefit of creditors. JA 13a-18a, 29a-31a; *see also* JA 61a ("I want to know [] how this gentleman spent $100,000 dollars since last spring, approximately."). Citizens Bank also opposed the conversion. JA 19a-27a, 31a-32a.

Shortly after the Trustee and the bank filed their oppositions to the motion, but before the hearing on the motion, the IRS advised the Trustee that, prior to filing for bankruptcy, Marrama had claimed a tax refund of $11,194.00 in an amended tax return filed in July 2002. JA 30a-31a. As noted, Marrama did not disclose his entitlement to a tax refund in his schedules. SJA 6. Subsequently, on September 5, 2003, the Trustee learned that Marrama was entitled to a tax refund from the IRS in the amount of $8,745.86. *Marrama III*, 331 B.R. at 13; *see* JA 31a.

D. The Bankruptcy Court's Denial Of Conversion

On August 27, 2003, the bankruptcy court held a hearing on the Motion to Convert. JA 28a. Prior to the hearing, Marrama contended in response to the Trustee's and the bank's oppositions to his motion that his various misstatements and omissions were inadvertent. JA 33a.[10] Marrama's attorney claimed that the failure

[10] Responding to the Trustee's objection, Marrama also indicated that he was "Treating the objection as a motion to reconsider conversion, *see In*

to disclose the transfer of the Maine Property to the Trust was a drafting error on his part. JA 33a. With respect to the tax refund, he claimed that "we found out about that the same time the Trustee did." *Id.* Yet, as noted, Marrama had actually filed the amended tax return seeking the refund in July of 2002 - some eight months *before* commencing his chapter 7 case. *Marrama III*, 331 B.R. at 13.

At the hearing on the motion, Marrama argued that "the only reason he filed a Chapter 7 instead of a 13, [] was because he was unemployed and unqualified for Chapter 13" on the petition date. JA 33a; *see also* Pet. at 3 Yet, in schedule I to his petition, Marrama affirmatively represented that he was in fact employed on the petition date, earning a monthly salary of $8,600. SJA 18; JA 64a (on April 24, 2003, Marrama also testified that he was employed); *see also Marrama V*, 345 B.R. at 462 n.5 (noting Marrama's claim of unemployment is flatly contradicted by Marrama's own sworn statements). At the hearing, the standing chapter 13 trustee for the Eastern District of Massachusetts appeared and stated that, on the facts presented, Marrama would not be able to confirm a chapter 13 plan. JA 28a-35a; *see also* 11 U.S.C. § 1325(a)(7) (as amended in 2005, requiring that, in order to confirm a chapter 13 plan, the debtor's filing of the bankruptcy petition was in good faith). Marrama's failure to disclose his tax refund was also addressed. JA 31a.

Following argument, the bankruptcy court denied conversion based on Marrama's bad faith. JA 35a, SJA 33. The court stated: "I don't think there's an 'Oops' defense to the concealment of assets." JA 34a. The court emphasized the debtor's disclosure

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re Cabral, 285 B.R. 563 (1st Cir. BAP 2002)" - in other words, he was treating the Trustee's objection as though conversion had been granted and the court were considering whether to reconvert the case back to chapter 7. JA 2a; Case No. 03-11987 (Bankruptcy Court, District of Mass.), Docket Entry No. 73 (Aug. 11, 2003) (Debtor's Response To Chapter 7 Trustee's Objection To Conversion To Chapter 13) (hereinafter, the "Reply on Conversion").

obligations in bankruptcy, stating: "I believe that there is an obligation on the part of people who file schedules in bankruptcy cases to get it right." *Id*. The court also noted Marrama's undisclosed pre-petition transfers of property, stating: "certainly in my mind there is a major presumption of bad faith when you have a grantor trust within a year of bankruptcy and the property is not disclosed." *Id*.

E. The Bankruptcy Appellate Panel's Affirmance

Marrama appealed to the bankruptcy appellate panel for the First Circuit (the "BAP"), which affirmed. Pet. App. 10. The BAP determined that a debtor's request for conversion under section 706(a) could be denied where "extreme circumstances" exist. Pet. App. 22. The court explained:

> [t]he extreme circumstances approach requires the bankruptcy court to make a factual determination as to the existence of extreme circumstances, such as bad faith, abuse of process, or other gross inequity, and such cases typically involve egregious conduct on the part of the debtor, who is seeking to use the bankruptcy process abusively and selfishly rather than for its intended purpose.

Pet. App. 19 (citations omitted); *see also id*. at 22 (finding presumption in favor of conversion). The BAP also explained that "a bankruptcy court may use the totality of the circumstances approach to determine whether the same are extreme and warrant denial of a Chapter 7 debtor's motion to convert to Chapter 13 under [section] 706(a)." Pet. App. 22.

Turning to the facts, the BAP found that the bankruptcy court's denial of conversion was warranted in light of Marrama's bad faith. Pet. App. 23-28. The BAP found that Marrama's failure to disclose the transfer of the Maine Property was consistent with his stated intent of protecting it from creditors, rather than being a mistake. Pet. App. 25-26. The BAP also noted that Marrama did not seek to amend his schedules or statements to cure material

misstatements and omissions until *after* the bankruptcy court had denied conversion. Pet. App. 26.[11]

The court noted that Marrama did not disclose his expected tax return, and that his alleged lack of awareness of the tax refund was not credible given that he had applied to the IRS for the refund in July of 2002. Pet. App. 26-27. The BAP reasoned:

> [Marrama] appears to have taken affirmative attempts to conceal assets from creditors, beginning with the pre-petition transfer of the Maine Property into a revocable trust. Then, [he] made affirmative misrepresentations on his schedules regarding his homestead exemption, the value of his interest in the Trust, and the rental income generated by the Massachusetts Property. Additionally, [he] did not initiate disclosure of the assets, and only did so when asked direct questions at the § 341 meeting. Thus, [Marrama] did not take steps to preserve his assets for the benefit of his creditors . . .; instead, the intent behind [Marrama's] transfer of the Maine Property for no consideration was to preserve the asset for his personal benefit, and place it beyond the reach of his creditors. . . . Furthermore, . . . there seems to have been a pattern of attempts to conceal assets . . . .

Pet. App. 27-28. The court concluded: "The bankruptcy court was correct in denying [Marrama's] request for conversion because of

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[11] On August 11, 2003 (shortly before the hearing on the Motion to Convert), Marrama filed amended schedules I and J to reflect an increase in monthly "take-home" pay of approximately $1,400, in large part due to Marrama's recognition of $1,500 in income from real property. *See* SJA 30-31; Pet. App. 13. Marrama testified, however, that his income from real property rental was $2,150. JA 72a. Marrama also claimed an increase in monthly expenses of approximately $900, which absorbed some of his increased income. *Compare* SJA 18-19 *with* SJA 30-31. Marrama did not at this time amend schedule B or his Statement of Financial Affairs.

the existence of 'extreme circumstances' constituting bad faith." Pet. App. 28.

F. The First Circuit's Affirmance

Marrama next appealed to the First Circuit, which also affirmed. Pet. App. 29. The court concluded that conversion under section 706(a) from chapter 7 to 13 is not a matter of absolute right, but that a bankruptcy court could deny conversion upon a determination that the debtor acted in bad faith. Pet. App. 40; *see also id*. at 34 (noting presumption in favor of conversion). The court stated:

> [S]ubsection 706(a) is to be viewed in light of a fundamental canon of the Bankruptcy Code: a bankruptcy court sitting in equity is duty bound to take all reasonable steps to prevent a debtor from abusing or manipulating the bankruptcy process to undermine the essential purposes of the Bankruptcy Code, including the principle that all the debtor's assets are to be gathered and deployed in a bona fide effort to satisfy valid claims.

Pet. App. 32 (citation omitted).

Analyzing section 706(a), the court looked not only to the text of the provision, but also compared it to different sections of the Bankruptcy Code, with particular focus on sections 105(a), 109(e), 706(d), 1112, 1208 and 1307(b), as well as Bankruptcy Rules 1017(f) and 2002(a)(4). Pet. App. 31-40. The court reasoned that if Congress had intended to eliminate or restrict the bankruptcy court's discretion in denying conversion on grounds of bad faith, it could easily have done so, as it has limited the bankruptcy court's discretion in other sections of the Code, but has not in section 706(a). *Id*.

The court also considered it "important to bear in mind that the bankruptcy court has unquestioned authority to dismiss a chapter 13 petition . . . based upon a showing of 'bad faith' on the part of the debtor." Pet. App. 36 (citations omitted); *see* 11 U.S.C. § 1307 (authorizing dismissal of a chapter 13 case for "cause," including bad faith). The court stated that it could discern no reason why Congress would authorize a bankruptcy court to turn down a

bankruptcy case filed initially under chapter 13 on grounds of bad faith, but deny a bankruptcy court from turning down a case commenced initially under chapter 7 and then converted to chapter 13. *Id*.

The court further analyzed the legislative history behind section 706(a), as well as the essential policies underlying the chapter 13 repayment plan process. Pet. App. 36-38. The court reasoned that none of the purposes and policies of chapter 13 would be served by allowing a debtor who engages in bad-faith conduct to convert his or her case to avoid a trustee's investigation and recovery of concealed property. *Id*. at 39 ("A legislative policy aimed at encouraging able debtors to undertake the voluntary repayment of their lawful credit obligations plainly is not served where the bankruptcy court has determined, as a threshold finding of fact, that the debtor is utilizing his subsection 706(a) conversion rights to advance an ongoing scheme to retain his non-exempt assets from bona fide creditors.").

The court also considered the efficient operation of bankruptcy proceedings, and the bankruptcy court's clear discretionary authority under section 1307 of the Code "to reconvert a chapter 13 case to chapter 7 at a subsequent stage of the proceedings where the debtor has acted in 'bad faith.'" Pet. App. 39. The court observed:

> [I]t would ill serve general policies aimed at promoting the efficient administration of bankruptcy cases to insist that a bankruptcy court - already confronted with clear evidence of a debtor's bad faith - must indulge in the technical formality of converting the chapter 7 case to chapter 13, knowing full well that eventually the case must be reconverted by reason of the same bad faith. Absent some plausible policy justification for such pointless spinning of the judicial wheels, we cannot construe subsection 706(a) as requiring it. . . . Congress may well have envisioned - altogether reasonably - that the bankruptcy court could nip in the bud manipulative conduct on the part of a 'bad faith' debtor at the moment of conversion, pursuant to subsection 706(a), rather than only after the case has been converted.

Pet. App. 39-40.

Reviewing the facts of the case, the court found that the bankruptcy court's "determination that Marrama engaged in 'bad faith' conduct is amply supported by the record." Pet. App. 41. The court noted:

> The instant case comports in all material respects with the classic profile of playing fast and loose with the bankruptcy process. First, Marrama engaged in prepetition transfers of valuable property with the acknowledged intention of insulating the transfers from creditors, submitted a chapter 7 petition, then omitted to mention these same assets and transfers in the bankruptcy schedules, presumably in the expectation that the chapter 7 trustee would not discover their concealment. As the effort at camouflage failed, Marrama moved to convert the case to chapter 13, predicated upon the uncorroborated assertion that he was receiving regular income sufficient to entitle him to protection under chapter 13. Conveniently, the instant conversion (which Marrama characterizes as an "absolute" matter of right impregnable to challenge either by the trustee or the bankruptcy court) would divest the chapter 7 trustee of any authority to act [on] behalf of the estate to safeguard its assets. Thus, in the event the debtor were to succeed in securing confirmation of a chapter 13 plan, he could reacquire his interest in "property of the estate," *as well as the concealed property*.

Pet. App. 42 (citations omitted) (emphasis in original). Concluding that Marrama's disclosures "demonstrated abundant indicia of intentional concealment," and that Marrama's explanations for his conduct "strain[ed] credulity," the court affirmed the decisions below. Pet. App. 42-44.

G. Further Proceedings

During the pendency of Marrama's various appeals of the bankruptcy court's order denying his Motion to Convert, his chapter 7 case continued. In a separate adversary proceeding, Citizens Bank argued that Marrama should be denied a chapter 7 discharge under section 727(a)(2)(A) of the Code, 11 U.S.C.

§ 727(a)(2)(A). *See Marrama III*, 331 B.R. 10 (D. Mass. 2005). Citizens Bank contended that Marrama made transfers of property, within one year of the commencement of his bankruptcy case, with the actual intent of hindering, delaying, or defrauding a creditor. *Id*. at 15. Agreeing, the bankruptcy court denied Marrama a chapter 7 discharge. *See id*. at 10. On appeal, the district court affirmed, s*ee id.*, as did the court of appeals, *Marrama IV*, 445 F.3d at 524 (concluding that "an array of undisputed facts support nearly every indication of fraudulent intent that we have recognized," and holding that "[t]here is only one reasonable inference that can be drawn from this record: that Marrama transferred valuable assets belonging to him, less than a year before he petitioned for bankruptcy protection, with the actual intent to defraud his creditors.").

On June 13, 2006, the day after this Court granted certiorari in this case, and while Marrama's chapter 7 case remained pending, Marrama commenced a separate chapter 13 bankruptcy case in the bankruptcy court. *See Marrama V*, 345 B.R. at 461-62. In his schedules filed with his chapter 13 petition, Marrama provided information that the bankruptcy court found to be inconsistent with the information provided in his chapter 7 case. *See id*. at 470-72 ("While the debtor seeks mightily to describe the Chapter 7 as his previous case and irrelevant, the Chapter 7 is, in fact, a pending case wherein the docket and claims register contain a wealth of information. The debtor could and should have consulted this information when he filed the Chapter 13."). Marrama also filed a chapter 13 plan that provided for a $0.00 payment to creditors. *Id*. at 463. The bankruptcy court dismissed his chapter 13 case. *Id.* at 460.

SUMMARY OF ARGUMENT

The court of appeals properly concluded that the bankruptcy court had the necessary authority to deny the conversion of Marrama's chapter 7 case to a proceeding under chapter 13, and that the bankruptcy court properly exercised its authority in doing so. First, bankruptcy courts, like other federal courts, have "inherent power" to "fashion an appropriate sanction for conduct which abuses the judicial process." *Chambers v. NASCO, Inc.*, 501

U.S. 32, 49 (1991). In this case, the bankruptcy court properly viewed Marrama's effort to convert his case as part of a bad faith scheme to abuse the bankruptcy system - among other things, to avoid a chapter 7 trustee seeking to recover concealed property. *See* 11 U.S.C. § 348(e) (services of a trustee are terminated upon conversion of a case). As this Court has explained, "'we do not lightly assume that Congress has intended to depart from established principles,' such as the scope of a court's inherent power," *id*. (quoting *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 313 (1982)), and nothing in section 706(a) of the Bankruptcy Code authorizing conversion of a bankruptcy case from chapter 7 to chapter 13 even remotely displaces the bankruptcy court's inherent authority to deny conversion on grounds of bad faith or to prevent abuse. By its terms, section 706(a) is conditional, not absolute. If Congress had intended to confer an absolute right to convert displacing a bankruptcy court's discretionary authority, it could easily have done so. The fact that Congress did not do so demonstrates that no absolute right of conversion exists, and certainly no right exists sufficient to displace the bankruptcy court's inherent power to deny relief on grounds of bad faith or to prevent abuse.

Second, section 706(a) must be construed in context with other provisions of the Code, as well as in harmony with the Code's overall structure. In contrast to section 706(a), other provisions of the Code direct mandatory action or relief in unmistakably clear terms. In contrast, Congress crafted section 706(a) using language that it uses when it grants permissive authority. Likewise, reference to other provisions of the Code demonstrates that Congress did not provide for unfettered access to chapter 13 relief, either directly by filing a chapter 13 petition, or on conversion of a case commenced under some other chapter to one under chapter 13. Read in context with other provisions, section 706 cannot be construed as conferring an absolute right on Marrama to have his case converted to a proceeding under chapter 13, and the bankruptcy court was plainly authorized to deny his conversion attempt on grounds of bad faith or to prevent abuse.

Third, this Court has long recognized the bankruptcy courts' inherent authority to take action to remedy bad faith conduct or prevent abuse of the bankruptcy system. Prior to the enactment of the current Bankruptcy Code, this Court endorsed this long-standing practice. There is no evidence that Congress intended to alter this critical aspect of bankruptcy administration in the enactment of the Code or section 706(a), and, accordingly, the Court should conclude that it endures.

Fourth, withdrawing from the bankruptcy courts the authority to take the steps that the court below took in this case would be disastrous for the administration of bankruptcy proceedings. Fifth, recognizing the bankruptcy court's authority is essential to fulfill the salient bankruptcy policy of preserving bankruptcy relief for the "honest but unfortunate" debtor. Finally, allowing Marrama an absolute right to convert would be manifestly inequitable. For these reasons, the Court should affirm the judgment of the court of appeals.

ARGUMENT

A. Bankruptcy Courts Have Inherent Authority To Deny Conversion On Grounds Of Bad Faith And To Prevent Abuse, And Nothing In Section 706(a) Supplants That Authority.

As this Court has long recognized, federal courts have certain inherent powers arising from "the nature of their institution" that must exist "because they are necessary to the exercise of all other [powers]." *United States v. Hudson*, 11 U.S. 32, 34 (1812). These include the inherent authority to "punish for contempts," *Ex parte Robinson*, 86 U.S. 505, 510 (1834); to "impose silence, respect and decorum, in their presence, and submission to their lawful mandates," *Anderson v. Dunn*, 19 U.S. 204, 227 (1821); to discipline attorneys appearing before the court, *Ex parte Burr*, 22 U.S. 529, 530-31 (1824); to vacate a prior judgment upon proof that it was procured by fraud, *Universal Oil Prods Co. v. Root Ref. Co.*, 328 U.S. 575, 580 (1946); *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238, 249-50 (1944); to dismiss a case outright to avoid abuse of the judicial system, *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 765 (1980); *Link v. Wabash R. Co.*,

370 U.S. 626, 630-32 (1962); and otherwise "to fashion an appropriate sanction for conduct which abuses the judicial process," including imposing attorneys' fees not otherwise authorized by statute for bad-faith conduct, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 44-45, 49 (1991). As the Court explained in *Chambers*:

> The imposition of sanctions [for bad-faith conduct] transcends a court's equitable power concerning relations between the parties and reaches a court's inherent power to police itself, thus serving the dual purpose of vindicat[ing] judicial authority without resort to the more drastic sanctions available for contempt of court and mak[ing] the prevailing party whole for expenses caused by his opponent's obstinacy.

Chambers, 501 U.S. at 46 (citations and internal quotation marks omitted).

Even where Congress has prescribed specific mechanisms for deterring bad faith and abuse of the judicial system, the presumption of the ongoing vitality of a court's inherent authority is strong. Although "[i]t is true that the exercise of the inherent power of lower federal courts can be limited by statute and rule . . . 'we do not lightly assume that Congress has intended to depart from established principles' such as the scope of a court's inherent power." *Id*. at 47 (quoting *Weinberger v. Romero-Barcelo*, 456 U.S. 305, 313 (1982)). This is especially true if any Congressionally prescribed mechanisms for combating bad faith and abuse are less than comprehensive. As the Court held in *Chambers*:

> We discern no basis for holding that the sanctioning scheme of the statute and rules displaces the inherent power to impose sanctions for the bad-faith conduct described above. These other mechanisms, taken alone or together, are not substitutes for the inherent power, for that power is both broader and narrower than other means of imposing sanctions. . . . At the very least, the inherent power must continue to fill in the interstices.

Chambers, 501 U.S. at 46.

Recognition of a court's inherent authority to sanction bad-faith conduct and prevent abuse of the judicial system is all the more imperative in the bankruptcy context. As this Court has explained, bankruptcy courts "are courts of equity and 'appl[y] the principles and rules of equity jurisprudence.'" *Young v. United States*, 535 U.S. 43, 50 (2002) (quoting *Pepper v. Litton*, 308 U.S. 295, 304 (1939)); *see also Bank of Marin v. England*, 385 U.S. 99, 103 (1966) ("There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."); *SEC v. United States Realty & Improvement Co.*, 310 U.S. 434, 457 (1940) ("Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part."). Chief among these equitable principles and rules is the concept that a debtor who seeks relief under the Bankruptcy Code must act in good faith and not for any improper purpose. As this Court has explained, "[o]nly exemplary motives and scrupulous good faith" can stir a court of equity to grant relief in bankruptcy. *Shapiro v. Wilgus*, 287 U.S. 348, 356-57 (1932); *see also Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1072 (5th Cir. 1986) (noting that the good faith standard "protects the jurisdictional integrity of the bankruptcy courts by rendering their powerful equitable weapons (i.e., avoidance of liens, discharge of debts, marshalling and turnover of assets) available only to those debtors and creditors with 'clean hands.'"); *In re Wiggles*, 7 B.R. 373, 375 (Bankr. N.D. Ga. 1980) (tracing the origins of the concept of good faith in the bankruptcy context to *Shapiro*).

This Court has similarly recognized that bankruptcy courts have long relied upon their inherent equitable powers in passing on and preventing "a wide range of problems arising out of the administration of bankrupt estates." *Pepper*, 308 U.S. at 304. Notably, bankruptcy courts have invoked their inherent equitable authority "to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Id*. at 304-05; *see also Birkett v. Columbia Bank*, 195 U.S. 345, 350-51 (1904) (observing that the

law would "be defective if it permitted the bankrupt to experiment with it - to so manage and use its provisions as to conceal his estate . . . without penalty to him. It is easy to see what results such looseness would permit"); *In re Victory Constr. Co., Inc.*, 9 B.R. 549, 558 (Bankr. C.D. Cal. 1981) (observing that the "borderline" between "fulfillment and perversion" of the provisions of the bankruptcy laws "is patrolled by courts of equity, armed with the doctrine of good faith").

Consistent with these principles, there is no basis for concluding that section 706(a) of the Bankruptcy Code displaces the inherent power of a bankruptcy court to deny conversion as a sanction for a debtor's bad-faith conduct, or to prevent ongoing abuse of the bankruptcy system. Section 706(a) provides:

> 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. Any waiver of the right to convert a case under this subsection is unenforceable.

11 U.S.C. § 706(a). Plainly, nothing in this provision confers upon the debtor an absolute right to convert a case, or otherwise supplants a bankruptcy court's inherent authority to deny conversion in cases (such as this one) involving bad faith or abuse.

To begin with, section 706(a) merely directs that a debtor "may" convert a case from chapter 7 to 13, not that a debtor has an absolute, unqualified right to do so. Use of the term "may" signals both discretion in seeking relief and the full preservation of the court's inherent authority to deny relief in appropriate circumstances. *See United States v. Rodgers*, 461 U.S. 677, 708 (1983) (observing that "reading 'may' as either conferring or confirming a degree of equitable discretion conforms to the even more important principle of statutory construction that Congress should not lightly be assumed to have enacted a statutory scheme foreclosing a court of equity from the exercise of its traditional discretion."); *see also Jama v. Immigration & Customs Enforcement*, 543 U.S. 335, 346 (2005) ("The word 'may' customarily connotes discretion."); *Anderson v. Yungkau*, 329 U.S. 482, 485 (1947) (construing the terms "may" and "shall" in their

"usual sense - the one act being permissive, the other mandatory."). *Cf. Miller v. French*, 530 U.S. 327, 337-38 (2000) (stating that statute providing for a stay using the mandatory term "shall" should not be read as permissive because to do so would undercut the mandatory command of the statute and that "[i]f Congress had intended to accomplish nothing more [than permissive relief], the language of [the statute] is, at best, an awkward and indirect means to achieve that result.").

Further, although section 706(a) mentions only "the debtor" as the party who may convert a case from chapter 7 to 13, the statutory reference to "the debtor" cannot be construed as limiting the authority of *the court* to deny relief in instances involving bad faith or to prevent abuse. Section 105(a) of the Bankruptcy Code provides expressly: "No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a); *see also* 11 U.S.C. § 1109 (defining the phrase "party in interest" to include a "debtor").[12] Plainly, under section 105(a), the court retains the authority to take steps, on its own if necessary, to prevent abusive practices notwithstanding that some other section of the Bankruptcy Code authorizes a party other than the court to take some particular action or seek some particular relief. Moreover, the wording of section 105(a) - that nothing in the Code "shall be construed" to prevent the court from taking

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[12] The above-quoted language of section 105(a) was added to the Code by amendment in 1986. In hearings leading up to the amendment, the Hon. T. Glover Roberts explained: "'Section 105 would be amended [to add the above-quoted text] to recognize judges' inherent authority to control their dockets and manage cases pending before them. This recognition clarifies an area of uncertainty in existing law and thus will eliminate a cause for some needless and wasteful litigation.'" 2 COLLIER ON BANKRUPTCY, ¶ 105.LH[4] at 105-108 n.12. (15th ed. 1998) (quoting statement of the Hon. T. Glover Roberts).

steps to prevent abuse - recognizes implicitly the court's longstanding, inherent authority to do so as a background principle of judicial administration that Congress did not intend to abridge by its general wording of specific sections of the Bankruptcy Code that authorize certain parties to perform specific tasks.

The reference in section 706(a) to "the debtor" as the person who may seek conversion merely recognizes that persons other than the debtor are not authorized to *ask for* the conversion of the debtor's chapter 7 case to a repayment plan or reorganization proceeding under chapters 11, 12 or 13. The reference to "the debtor" as the party who may ask for conversion does not address whether the court *may deny* the debtor's request to convert in appropriate instances. Marrama's construction of section 706(a), which focuses on the fact that debtors alone are identified in the text, merely confuses the question *who can seek conversion* with the question whether conversion *must be granted* at the debtor's sole election. *See* Pet. Br. at 10, 18. As section 105(a) clarifies, the fact that the debtor alone can ask for relief cannot prevent the court from taking action to prevent abuse. On the contrary, the fact that a debtor alone can seek conversion of the case from chapter 7 to chapter 13 simply recognizes that relief under chapter 13 is purely voluntary for compelling constitutional and policy reasons:

> [C]hapter 13 is completely voluntary. This Committee firmly rejected the idea of mandatory or involuntary chapter XIII in the 90th Congress. The thirteenth amendment prohibits involuntary servitude. Though it has never been tested in the wage earner plan context, it has been suggested that a mandatory chapter 13, by forcing an individual to work for creditors, would violate this prohibition. On policy grounds, it would be unwise to allow creditors to force a debtor into a repayment plan. An unwilling debtor is less likely to retain his job or to cooperate in the repayment plan, and more often than not, the plan would be preordained to fail. Therefore, the bill prohibits involuntary cases under chapter 13, and forbids the conversion of a case from chapter 7, liquidation, to chapter 13, unless the debtor requests.

H. Rep. No. 95-595, p. 120, reprinted in 1978 U.S.C.C.A.N. 5963 (footnotes and citations contained therein omitted).

Amicus Curiae, the National Association of Consumer Bankruptcy Attorneys ("Amicus" or "NACBA"), advances the same erroneous proposition as Marrama, arguing that section 706(a) gives the debtor "permission to convert his bankruptcy case, at his sole discretion." *See* NACBA Br. at 8. Section 706(a), however, in no way provides that a debtor's motion to convert must be allowed at the debtor's whim. Indeed, section 706(a) in and of itself imposes textual restrictions on the debtor's ability to convert, providing that the debtor may convert "if the case has not been converted [previously to chapter 7 from some other chapter] under section 1112, 1208, or 1307 of this title." 11 U.S.C. § 706(a). In addition, other sections of the Code impose limitations on conversion under section 706(a), most notably section 706(d): "Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter." 11 U.S.C. § 706(d); *see also* 11 U.S.C. § 109 (prescribing who may be a debtor under the different chapters of the Code). Critically, these restrictions say nothing about whether the bankruptcy court may deny conversion on grounds of bad faith or to prevent abuse. Where (as here) the statute at issue imposes *some* statutory restrictions on discretionary relief, but does not specifically address situations of bad faith or other abuse, or mandate an exclusive remedy directed at bad faith or abuse, the court's inherent authority to act is presumptively preserved. *See Chambers*, 501 U.S. at 46.

Invoking the canon "*expressio unius est exclusion alterius*" - the expression of one thing excludes others - NACBA argues that the fact that Congress imposed some express limitations on conversion (e.g., the requirement in section 706(d) that a debtor must be eligible for relief under chapter 13 as a condition for conversion), but not an express restriction for a conversion sought in bad faith, means that Congress did not intend a court to have the authority to deny conversion on grounds of bad faith. NACBA Br. at 13-14. In other words, NACBA contends that, no matter how egregious or abusive the debtor's conduct in seeking conversion, a

bankruptcy court is duty bound to permit the conversion even if it furthers a clear abuse of the bankruptcy system. NACBA's invocation of the *expressio* canon in this context is plainly wide of the mark.

The central point of *Chambers* acknowledging the inherent powers of a court to address bad faith and abuse is to recognize those powers *especially* where Congress has not provided a specific remedy. This follows from the very nature of the courts' powers as *inherent*. If the *expressio* canon applied in the manner that NACBA suggests, then *Chambers* would be a nullity because inherent powers could never exist if some remedy for abusive conduct (however inapplicable, inadequate, or incomplete) were specified somewhere in the relevant judicial system. Moreover, contrary to NACBA's position, this case lends particular credence to the Court's warning that, while "often a valuable servant," the *expressio* canon is "a dangerous master to follow in the construction of statutes." *Ford v. United States*, 273 U.S. 593, 612 (1927) (citation omitted). As the Court has indicated, the canon "ought not to be applied, when its application, having regard to the subject-matter to which it is to be applied, leads to inconsistency or injustice." *Id*. (citation omitted). The very point of a court's inherent powers it to *prevent* injustice by allowing the court to address abusive conduct as it arises. Application of the *expressio* rule to eliminate a court's inherent powers on the theory that they have not been expressly established by statute in a particular context would deny the courts in every instance access to their inherent powers precisely when they are most needed - when no adequate, express remedy exists.

Similarly defective is NACBA's argument that courts lack the authority to deny a debtor's request for conversion in cases involving bad faith or abuse on the theory that, if Congress had intended a good faith requirement in section 706(a), it would have provided for one explicitly in that section, as it has in other sections of the Code that do not involve conversions. NACBA Br. at 15. NACBA's argument, however, serves only to illustrate why the bankruptcy court's resort to its inherent authority was appropriate in this case - because other sections of the Code that

contain good faith requirements (e.g., section 1325(a)(3) governing confirmation of a chapter 13 plan) do not apply to conversion motions under section 706(a) and are thus insufficient to address the particular bad faith and abuse at issue in the context of Marrama's Motion to Convert. Moreover, the Court has previously rejected in the bankruptcy context the very argument that NACBA advances in its brief. As discussed in Part C *infra*, the Court in *SEC v. U.S. Realty & Improvement Co.*, 310 U.S. 434, 456-57 (1940), expressly endorsed a court's inherent authority to refuse bankruptcy relief to protect "its own jurisdiction from misuse" in a context in which the particular bankruptcy procedure at issue (former Chapter XI of the Bankruptcy Act) had no express good faith requirement, in contrast to other bankruptcy procedures that did (e.g., former Chapter X of the Bankruptcy Act). As further discussed in Part C *infra*, NACBA's argument is also contrary to this Court's recognition in *Perry v. Commerce Loan Co.*, 383 U.S. 392, 404 (1966), made in the context of discussing former Chapter XIII of the Bankruptcy Act (the predecessor to the current chapter 13) of the inherent "power of the court to make certain that the provisions of the chapter are not abused." These and similar precedents recognizing a court's inherent power to deny relief on grounds of bad faith or abuse are fully consistent with the rationale of *Chambers*, and confirm the bankruptcy court's authority in this case.[13]

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[13] The example that NACBA offers of a hypothetical conversation between two neighbors where one says to the other "[y]ou may use my rake at any time," also misses the point. NACBA Br. at 9-10. It would hardly be reasonable to assume from an authorization of this kind that, if the rake were kept in a locked garage, the neighbor could permissibly break down the garage door to take it. Nor would it be reasonable to assume that the permission could not be revoked if, for example, the neighbor were going to use the rake to harm a third party. Here, there is nothing in the text of section 706(a) that strips the bankruptcy court of its authority - indeed, its duty - to prevent abuse of the bankruptcy system,

Further, the provision in section 706(a) authorizing a debtor to convert a case "at any time" lends no support to the conclusion that section 706(a) limits the court's discretion to deny conversion on grounds of bad faith or to prevent abuse. The plain import of this phrase is purely temporal - a debtor may seek conversion at any time during the bankruptcy case. *See In re Starkey*, 179 B.R. 687, 691-92 (Bankr. N.D. Okla. 1995). The statutory term "at any time" cannot be transformed into a requirement that bankruptcy courts must grant conversion "regardless of the circumstances." *See In re Copper*, 426 F.3d 810, 816 (6th Cir. 2005) ("We agree with the cases finding that the phrase in § 706(a) providing that the debtor may convert 'at any time' refers to a time frame. The phrase does not mean 'regardless of circumstances.'") (citation omitted); *In re Ponzini*, 277 B.R. at 404 (noting that "at any time" does not mean "regardless of circumstances"); *In re Young*, 269 B.R. 816, 822 (Bankr. W.D. Mo. 2001) (same); *In re Starkey*, 179 B.R. at 692 ("The words 'at any time' refer literally to any stage in the progress of a case, not to any conditions which may develop during that progress, especially in an abnormal and abusive case.").

Finally, the fact that section 706(a) states that "[a]ny waiver of the right to convert a case under this subsection is unenforceable" also says nothing about the court's inherent discretion to deny conversion in cases involving bad faith or abuse. The provision directs merely that the debtor's ability to convert is not waivable; it does not define the scope of the debtor's ability to convert in the first instance. The principle evil that the provision aims to resolve is straightforward: if the debtor's execution of a waiver of the ability to convert were enforceable, a creditor (or group of creditors) could commence an involuntary chapter 7 liquidation case against the debtor without the debtor being able to convert the case to some other proceeding - even if doing so would be more advantageous to the debtor and other creditors because, under some other chapter, the debtor may be able to repay more of his or

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and nothing that prevents a bankruptcy court from denying a debtor's motion to convert a chapter 7 case to chapter 13 for bad faith.

her debts through a repayment plan or reorganization proceeding. *See In re Copper*, 426 F.3d at 637. *Cf.* 11 U.S.C. § 522(e) (overriding a waiver of the debtor's ability to exempt property). The anti-waiver provision - directed at a potentially abusive practice by creditors - says nothing about whether the bankruptcy court may prevent *the debtor* from converting from chapter 7 to 13 in cases involving the debtor's bad faith or abuse.

B. Consideration Of The Structure And Text Of The Bankruptcy Code As A Whole Demonstrates That Bankruptcy Courts Retain Inherent Authority To Deny Conversion In Cases Involving Bad Faith Or To Prevent Abuse.

As this Court has instructed, the provisions of the Bankruptcy Code must be construed "holistically," taking into account the structure of the Code as a whole, the relationship between its various provisions, and Congress' collective and systematic choice of words. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369-71 (1988) (construing several sections of the Bankruptcy Code together and observing that "[s]tatutory construction is a holistic endeavor."); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law.") (citations omitted); *see also Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 60 (2004) (noting same principles). Reference to the text and structure of the Code as a whole further demonstrates that Congress did not in section 706(a) limit a bankruptcy court's inherent authority to deny conversion of a case from chapter 7 to 13 for bad faith or to prevent abuse.

If Congress had intended to strip the bankruptcy courts of discretion in determining whether to convert a chapter 7 case to chapter 13 on a debtor's request under section 706(a), it could easily have done so. Using unmistakably clear terms, Congress specifically crafted other provisions of the Code to limit the bankruptcy court's discretion to grant or deny relief in the face of a particular request. For example, section 1307(b) - governing dismissal of a chapter 13 case - provides in relevant part that "[o]n

request of the debtor at any time . . . the court *shall* dismiss a case under this chapter." 11 U.S.C. § 1307(b) (emphasis supplied). If Congress had intended the same mandatory direction under section 706(a), it could easily have drafted the provision to provide that "on request of the debtor at any time, the court *shall* convert a case under this chapter to one under chapter 13." Instead, Congress used quite different terms: "The debtor may convert a case under this chapter to a case under chapter . . . 13 of this title at any time . . . ." 11 U.S.C. § 706(a).

The contrast between how Congress could have crafted section 706(a) if Congress had intended it to be mandatory, and how Congress actually crafted section 706(a) as a permissive provision, is all the more starkly illustrated by reference to section 1208 of the Code governing the conversion or dismissal of reorganization proceedings involving family farmers. 11 U.S.C. § 1208. Like section 706(a), section 1208(a) provides that "[t]he debtor *may* convert a case under this chapter to a case under chapter 7 of this title at any time." 11 U.S.C. § 1208(a) (emphasis supplied). In contrast, in the very next subsection of section 1208, Congress provided in relevant part "[o]n request of the debtor at any time, . . . the court *shall dismiss* a case under this title." 11 U.S.C. § 1208(b) (emphasis supplied). Clearly, Congress knew how to direct mandatory relief on the request of the debtor (as expressly provided in section 1208(b)), and how to direct discretionary relief on the debtor's request (as expressly provided in sections 1208(a) and 706(a)).

When Congress employs particular language in a provision of the Bankruptcy Code, it is presumed to act deliberately, and Congress's use of different terms in different provisions also is presumed to be deliberate. *FCC v. NextWave Personal Commc'ns, Inc.*, 537 U.S. 293, 302 (2003) (provision appearing in one section of the Code, but not another, demonstrates that Congress did not intend the provision where it does not appear); *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 560-61 (1990) (exception appearing in one section of the Bankruptcy Code, but not another, demonstrates that Congress did not intend exception where it was not included); *see Bates v. United States*, 522 U.S. 23,

29-30 (1997) (it is "generally presumed that Congress acts intentionally" in the "disparate inclusion or exclusion" of particular language). If Congress had intended to confer an absolute right of conversion in section 706(a), it would have used the mandatory phraseology that is used elsewhere in the Code, such as in sections 1307(b) and 1208(b). The fact that Congress did not, demonstrates only that Congress did not intend to confer an absolute right of conversion in section 706(a).

Congress otherwise consistently uses the term "shall" in sections of the Bankruptcy Code where Congress intends to convey a mandatory direction, and the term "may" where Congress intends the court to exercise discretion. For example, section 1321 provides that the debtor "*shall* file a plan" in a chapter 13 case, directing plainly that the chapter 13 debtor is to file a plan in all chapter 13 cases. 11 U.S.C. § 1321 (emphasis supplied). In contrast, section 1121 provides that "the debtor *may* file a plan" in a chapter 11 case, recognizing that debtors do not always file chapter 11 plans, but that others file chapter 11 plans under some circumstances. 11 U.S.C. § 1121(a) (emphasis supplied); *see* 11 U.S.C. § 1121(c) (providing that creditors may file a plan in some chapter 11 cases). Similarly, section 1128(a) provides that, in a chapter 11 case, "the court *shall* hold a hearing on confirmation of a plan," directing that a confirmation hearing is mandatory. 11 U.S.C. § 1128(a) (emphasis supplied). In contrast, section 1128(b) provides that "[a] party in interest *may* object to confirmation of a plan," recognizing that a party in interest will object to confirmation only if the party in interest has some reason for doing so. 11 U.S.C. § 1128(b) (emphasis supplied).

As the Court has observed, although the term "may" is sometimes construed to mean "shall," this occurs only where the context "compels such a construction." *Farmers' & Merchants' Bank of Monroe, N.C. v. Federal Reserve Bank of Richmond*, 262 U.S. 649, 662-63 (1923) (citation omitted). Where, as here, "the statute appears to have been drawn with great care," and "throughout the act the distinction is clearly made between what [the parties] 'shall' do and what they 'may' do," the ordinary distinction between the meaning of the terms "may" and "shall"

will be respected. *Id*.; *see also In re Copper*, 426 F.3d at 816 ("[I]t is also relevant that § 706(a) uses the word 'may' meaning 'might' or 'used to express possibility' or 'used to express opportunity or permission.' If Congress had intended to leave the bankruptcy courts with absolutely no discretion in the matter, it would have used the more mandatory phrase of 'shall be able to convert.'") (citations omitted); *In re Ponzini*, 277 B.R. 399, 404 (Bankr. E.D. Ark. 2002) ("Section 706(a) does not contain the word 'absolute' or any other word or phrase indicating that the right to convert is unequivocal.").[14]

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[14] Consistent with Congress's choice of permissive language, many courts interpreting section 706(a) have found that the section creates a presumption in favor of granting conversion, but that the ultimate question of whether conversion is appropriate is left to the bankruptcy court's discretion. *See* Pet. App. 22, 34; *Neely v. Smith (In re Neely)*, 334 B.R. 863, 871-72 (S.D. Tx. 2005) ("The court concludes that § 706(a) is not that absolute. By using 'may' rather than more mandatory language, such as 'shall,' the statute creates a strong presumption in favor of conversion."); *In re Wampler*, 302 B.R. 601, 605 (Bankr. S.D. Ind. 2003) ("The Court emphasizes that motions filed pursuant to § 706(a) should be granted liberally and with the presumption that they are filed in good faith. Accordingly, the party challenging conversion bears the burden of establishing bad faith by a preponderance of the evidence."); *In re Ponzini*, 277 B.R. 399, 405 (Bankr. E.D. Ark. 2002) ("Clearly, the plain language of § 706(a), especially when read in context with other sections of the Bankruptcy Code and Rules, does not grant a debtor an absolute right to convert a chapter 7 case. Rather, a debtor's right to convert is presumptive and should be granted if the court finds it appropriate under the Bankruptcy Code."); *In re Young*, 269 B.R. 816, 823 (Bankr W.D. Mo. 2001) ("In this Court's view, a debtor has a presumptive right to convert a Chapter 7 case to a reorganization case, but that right is not absolute."); *In re Krishnaya*, 263 B.R. 63, 69 (Bankr. S.D.N.Y. 2001) ("[W]hile the right to convert is presumptive and nearly absolute, a bankruptcy court, as the *Marcakis* court observed, still 'must determine if the conversion is appropriate pursuant to the overall purpose and policy of the Bankruptcy Code.'") (citing *In re Marcakis*, 254 B.R. 77, 82 (Bankr. E.D.N.Y. 2000)).

In addition, review of the Bankruptcy Code amply demonstrates that Congress did not intend a debtor to have an absolute right to resort to relief under chapter 13, further defeating the argument that section 706(a) should be construed to confer an absolute right of conversion. To begin with, section 1307(c) expressly provides that "on request of a party in interest [including the debtor or any creditor] or the United States trustee . . . the court . . . may dismiss a case under this chapter . . . for cause." 11 U.S.C. § 1307(c). Although the Code does not define the term "cause," it is widely recognized to include a debtor's bad faith. *See Badalyan v. Holub (In re Badalyan)*, 221 F.3d 1333, Case No. 99-4120, 2000 WL 924591 at *2 (6th Cir. June 26, 2000) (unpublished) ("failure to comply with the bankruptcy court's show cause order was indicative of bad faith and constituted cause to dismiss the case under [section] 1307(c)"); *Harker v. United States*, 112 F.3d 513, Case No. 96-3620, 1997 WL 199507 at *1 (8th Cir. April 25, 1997) (unpublished) ("[A] Chapter 13 petition filed in bad faith may be dismissed . . . 'for cause' under 11 U.S.C. § 1307(c)."") (citation omitted); *In re Lilley*, 91 F.3d 491, 496 (3d Cir. 1996) (bad faith constitutes "cause" for purposes of analysis under section 1307(c)); *Molitor v. Eidson (In re Molitor)*, 76 F.3d 218, 220 (8th Cir. 1996) ("[A] Chapter 13 petition filed in bad faith may be dismissed . . . 'for cause' under 11 U.S.C. § 1307(c). Such cause includes filing a bankruptcy petition in bad faith.") (citing *In re Eisen*, *infra*); *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994) ("[C]ourts have overwhelmingly held that a lack of good faith in filing a Chapter 11 petition establishes cause for dismissal."); *Eisen v. Curry (In re Eisen)*, 14 F.3d 469, 470 (9th Cir. 1994) (per curiam) ("A Chapter 13 petition filed in bad faith may be dismissed 'for cause' pursuant to [section] 1307(c)."); *Gier v. Farmers State Bank of Lucas, Kansas (In re Gier)*, 986 F.2d 1326, 1329-30 (10th Cir. 1993) (affirming dismissal of chapter 13 petition for bad faith); *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992) (noting good faith requirement in seeking chapter 13 relief and that "lack of good faith is sufficient cause" for relief under section 1307(c)); *In re Cabral*, 285 B.R. 563, 572 (1st Cir. B.A.P. 2002) (concluding that "lack of good faith (or bad faith) is 'cause' for dismissal . . . of a Chapter 13 case under [section] 1307(c)");

see also NACBA Br. at 15 (conceding that the phrase "for cause" has "uniformly been construed to include bad faith"), 18 (same); 7 COLLIER ON BANKRUPTCY, ¶ 1112.07[2] & [3] at 1112-64.8 - 1112-70 (15th ed. 2000) (discussing doctrine of good faith in the context of section 1112 of the Bankruptcy Code).

Given the bankruptcy court's recognized authority to dismiss a case commenced originally as a chapter 13 case on grounds of bad faith, it is difficult to understand why a bankruptcy court cannot also prevent the conversion of a chapter 7 case to a case under chapter 13 likewise on grounds of bad faith. This analysis is bolstered by the fact that, in addition to authorizing dismissal of a chapter 13 case for cause (including bad faith), section 1307(c) also authorizes in the alternative the conversion of a chapter 13 case to a proceeding under chapter 7 for cause (including bad faith): "on request of a party in interest or the United States trustee . . . the court may convert a case under this chapter to a case under chapter 7 . . . for cause . . . ." 11 U.S.C. § 1307(c). *Molitor v. Eidson (In re Molitor)*, 76 F.3d 218, 220 (8th Cir. 1996) (converting case pursuant to section 1307(c) upon finding of bad faith that constituted "cause" for conversion); *see also* Pet. Br. at 23-24 (conceding authority to reconvert for cause under section 1307); Reply on Conversion (discussed at n.10, *supra*); NACBA Br. at 18 (conceding that a court may convert a case from chapter 13 to chapter 7 for cause, including bad faith).

The fact that section 1307(c) expressly authorizes a bankruptcy court to convert a chapter 13 case to one under chapter 7 for bad faith demonstrates that Marrama has no entitlement to chapter 13 relief. Indeed, under the facts presented, conversion of his chapter 7 case to chapter 13 would simply have resulted in the reconversion of his chapter 13 case back to chapter 7.

Marrama suggests that this is how matters should have played out: that he had an absolute right to convert to chapter 13, and then was entitled to defend a motion brought under section 1307(c) to send his case back to chapter 7 with whatever defenses he could come up with. Pet. Br. at 24-25; *see also* NACBA Br. at 18-19. But there is no reason why, in considering Marrama's motion to convert under section 706(a) in the first instance, the bankruptcy

court was required to cast a blind eye on Marrama's bad faith or the provisions of chapter 13 that would have required sending Marrama's case back to chapter 7, rendering his conversion entirely futile. This is especially true given that, pursuant to the express terms of section 105(a), the bankruptcy court is not required to wait for a party in interest to file a motion under section 1307(c) before reconverting a chapter 13 case back to chapter 7, but may act *sua sponte*. Marrama's argument is the epitome of form over substance and would simply clog the machinery of bankruptcy with unnecessary, and unwarranted, debris.

More important, the existence of section 1307(c) (permitting dismissal or conversion of a chapter 13 case for cause including bad faith) plainly demonstrates that Congress did not intend unfettered resort to relief under chapter 13. This undercuts dramatically Marrama's contention that he must have a right to convert under section 706(a) on the theory that Congress intended to promote chapter 13 repayment plans. Because the grounds for denial of conversion in this case (i.e., Marrama's bad faith) also suffice to deny access to chapter 13 relief under section 1307(c), construing the permissive language of section 706(a) to deny conversion for bad faith is perfectly consistent with Congress's overall statutory scheme.[15]

Finally, the bankruptcy court's denial of Marrama's Motion to Convert is also perfectly consistent with - and authorized by -

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[15] Marrama's argument that he was deprived of due process, Pet. Br. at 23-26, rings hollow. In his reply papers filed with the bankruptcy court, Marrama treated the Trustee's opposition to his Motion to Convert "as a motion to reconsider conversion," and cited *In re Cabral*, *supra*, as illustrative of that concept. *See* JA 2a; Reply on Conversion (*see* n.10, *supra*). Marrama thus effectively treated the hearing as though it were a motion to reconvert under section 1307(c). In addition, as the court of appeals observed, Marrama never requested an evidentiary hearing, nor has he ever identified what additional evidentiary materials he would have introduced or how an evidentiary (or other) hearing would make any difference in the outcome. Pet App. 43.

section 105(a) of the Bankruptcy Code. In addition to directing that no provision of the Code providing that a particular party in interest may take some particular action shall be construed to preclude the bankruptcy court from acting to prevent abuse, section 105(a) also provides that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a).[16] As noted, one of the obligations imposed by the Code is the debtor's duty to timely disclose his or her assets and financial dealings. 11 U.S.C. § 521. Further, the duties of the Trustee included collecting Marrama's assets and investigating his financial affairs. 11 U.S.C. § 704(a)(1) & (4). Here, Marrama sought to convert his case as part of a scheme to conceal assets and avoid the Trustee, who would be disenfranchised if the case were converted. 11 U.S.C. § 348(e). Pursuant to section 105(a), the bankruptcy court was perfectly justified in denying Marrama's motion in order to vindicate the requirements of section 521 and enable the Trustee to carry out his responsibilities in the face of the debtor's bad-faith effort to prevent him from doing so. Because section 706(a) does not confer an absolute right to convert, the bankruptcy court's denial of

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[16] The above-quoted language of section 105(a) was derived from former section 2a(15) of the Bankruptcy Act of 1898, 11 U.S.C. § 11(a)(15) (repealed 1979). Section 2a(15) authorized the bankruptcy courts to "[m]ake such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this Act." As noted in the *Collier*, Treatise "current section 105(a) is much broader than former Section 2a(15) . . . . Unlike the restriction under prior law that an order of a bankruptcy court must be 'necessary for the enforcement of the provisions of this title,' section 105 authorizes the bankruptcy court to also issue orders "appropriate to carry out the provisions of this title." This change evidenced Congress's intent that bankruptcy courts would, under the Bankruptcy Code, deal with all phases and aspects of a bankruptcy case." 2 COLLIER ON BANKRUPTCY, ¶ 105LH[2] at 105-106 (15th ed. 1998).

Marrama's motion was fully warranted and authorized under section 105(a).

C. Historical Practice And Interpretation Of The Bankruptcy Laws, Presumed To Endure, Demonstrate That Bankruptcy Courts Retain Their Inherent Authority To Deny Conversion In Cases Involving Bad Faith Or To Prevent Abuse.

This Court has explained that, "[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate." *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (internal quotation marks and citation omitted). As the Court has further stated: "We . . . 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" *Cohen v. De La Cruz*, 523 U.S. 213, 221 (1998) (quoting *Davenport*, 495 U.S. at 563); *see United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 221 (1996); *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 500-02 (1986); *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 218 (1936) ("To fix the meaning of these provisions [of the Bankruptcy Act] there is need to keep in view the background of their history."). For well over a century, bankruptcy courts have exercised the authority to deny bankruptcy relief on grounds of bad faith and to prevent abuse. There is no indication that Congress intended to abrogate this practice in enacting the provisions of the Bankruptcy Code generally, or section 706(a) specifically. Accordingly, the Court should conclude that this longstanding practice endures.

The requirement of good faith as a prerequisite to bankruptcy relief has ancient roots. As the Securities and Exchange Commission explained in discussing the concept of good faith in its report to Congress on corporate reorganization practices in the 1930's and 1940's: "When a corporation avails itself of the protection of the bankruptcy court, it is enabled to stave off its creditors. The court protects its property from dismemberment by executions and attachments. It has the benefit of what in equity was called the 'chancellor's umbrella.'" Securities and Exchange Commission, REPORT ON THE STUDY AND INVESTIGATION OF THE

WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, Pt. VIII, p. 107 (1940) ("SEC Report") (citation omitted). But it has long been held that resort to the chancellor's umbrella is available only to debtors in bankruptcy who show "exemplary motives and scrupulous good faith." *Shapiro*, 287 U.S. at 356-57. In some of the bankruptcy provisions that Congress has enacted over the past century it has specifically incorporated a good faith requirement as a precondition for certain relief. In others, however, it has not. And where Congress has not incorporated an express good faith requirement, this Court has directed nonetheless that one exists as an inherent precondition and that bankruptcy courts have inherent authority to remedy bad faith conduct and prevent abuse. *SEC v. US Realty & Improvement Co*., 310 U.S. at 457-58 (1940) (discussed below); *see Little Creek Dev. Co*., 779 F.2d at 1071-72 (reviewing the relevant history and stating that "[e]very bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings").

In defining more precisely the boundaries of legitimate resort to bankruptcy relief, this Court has made it clear from the outset that abusive practices will not be tolerated. *First Nat'l Bank of Cincinnati v. Flershem,* 290 U.S. 504, 517 (1934). Condemning a bankruptcy proceeding on the ground that the debtor did not actually require bankruptcy relief and had staged its defaults needlessly, the Court stated:

> The substantive law affords no warrant for so abridging the rights of individual creditors. . . . The power of the District Court was invoked, not to enforce the rights of creditors, but to defeat them. The fact that the [district court approved the proceeding] does not remove the taint of illegality.

Id. at 518-19.

Although *Flershem* arose out of an equity receivership proceeding, the case is significant for two reasons. First, as a general matter, the doctrine of good faith derives in significant part from equity receivership practice. *See Shapiro*, 287 U.S. at 356-57

(requiring good faith as condition of relief in equity receivership case); 6 COLLIER ON BANKRUPTCY, ¶ 6.07 at 1042 (14th ed. 1988) ("The idea that reorganization cases should be founded on [good faith] undoubtedly was an outgrowth of the equity receivership background of § 77B."). Second, as the relevant history reveals, the basic principles of *Flershem* have survived each subsequent iteration of the nation's bankruptcy laws and have endured as an integral part of contemporary jurisprudence.

In 1933, Congress largely codified existing equity receivership practice with the enactment of Section 77B of the former Bankruptcy Act. Consistent with *Flershem*, Section 77B limited reorganization relief to firms that demonstrated a "need for relief." 11 U.S.C. § 207 (repealed 1938). Likewise, Section 77B instructed courts to accept a bankruptcy petition only if filed "in good faith." *Id*.

As the SEC - and later this Court - explained, courts reviewing bankruptcy petitions under Section 77B properly concluded that a corporation that failed to demonstrate a genuine need for relief lacked good faith. *See* SEC Report at 94 (under Section 77B, "the 'need for relief' which a debtor was obliged to show was a need for the machinery of 77B as an essential in accomplishing a reorganization . . . [i]n the cases cited, it was the debtor's inability to show this . . . that led the courts to find an absence of good faith."); *Marine Harbor Props., Inc. v. Manufacturer's Trust Co*., 317 U.S. 78, 84 (1942) (quoting SEC Report and dismissing case for lack of good faith).

In 1938, Congress replaced Section 77B with Chapters X (reorganization) and XI (reorganization) as part of the Chandler Act amendments. Like Section 77B, Chapter X applied only to corporations that demonstrated a "need for relief." 11 U.S.C. § 530 (repealed 1979). In addition, section 141 required dismissal if the petition had not been filed "in good faith." 11 U.S.C. § 541 (repealed 1979). In turn, section 146 provided examples of the absence of good faith. 11 U.S.C. § 546 (repealed 1979). As the legislative history explained, however, the examples were not intended to be exhaustive, and the courts treated them as illustrative only. *See* Hearing on H.R. 6439, 75th Cong., 1st Sess.

40-41 (1937) ("although we have set up standards, we have not made an inflexible meaning of the phrase 'good faith' . . . [s]o that, in case it shall appear under peculiar circumstances that good faith was not used in connection with the filing of the petition, the court may nevertheless dismiss it"); *In re Julius Roehrs Co*., 115 F.2d 723, 724 (3d Cir. 1940) ("[T]he petition may not be found to be filed in good faith if it is within any of the prohibitions set forth by Section 146, though it must also be borne in mind that the generality of the meaning of the term 'good faith' is not to be limited by the specific provisions of the section."); 6 COLLIER ON BANKRUPTCY, ¶ 6.07 at 1045 (14th ed. 1988) ("the statutory enumeration, while inclusive, is not exclusive."). As this Court observed, section 146 "represents a codification of some of the interpretations which the courts had given the words 'good faith' in proceedings under § 77B." *Marine Harbor*, 317 U.S. at 84.

Like Chapter X, relief under Chapter XI of the Act of 1898 was also limited to debtors in need of relief. 11 U.S.C. § 723 (repealed 1979). Unlike section 141 of Chapter X, however, Chapter XI contained *no express authorization* for dismissal of a petition for lack of good faith. In 1940, legislation was introduced in Congress to add a new provision to Chapter XI that would have mirrored the express "good faith" requirement under Chapter X. But as explained in the legislative materials, the provision was dropped as unnecessary after this Court's decision in *US Realty*, which recognized the bankruptcy court's inherent authority to dismiss a Chapter XI case to avoid misuse of the proceeding. *See* 8 COLLIER ON BANKRUPTCY, ¶ 4.11 at 413 n. 7 (14th ed. 1988) (citing and discussing the history of the proposed amendment).

In *US Realty*, a debtor filed for relief under Chapter XI seeking to adjust its unsecured liability as the guarantor of certain debts of its affiliate. Significantly, the debtor proposed to adjust *only* its unsecured guaranty liability, leaving unaffected its other secured and unsecured obligations, and likewise leaving undisturbed the interests of its stockholders. Recognizing that the debtor met the technical requirements for a petition for relief under Chapter XI, the Court nevertheless inquired as to "the propriety, in the circumstances, of [the bankruptcy court's] order retaining

jurisdiction, and of the extent of its duty to go forward with the proceeding under Chapter XI . . . ." *US Realty*, 310 U.S. at 447. Addressing the question of propriety, the Court focused on "the authority of the court clothed with equity powers and sitting in bankruptcy . . . to withhold relief . . . ." *Id.* at 448.

As the Court explained, Chapter XI proscribed the alteration of shareholder interests and secured obligations, permitting only the adjustment of unsecured debt. *Id*. at 452-53. At the same time, Chapter XI also required adherence to absolute priority. *Id*. Consistent with the absolute priority doctrine, the shareholders could not retain their interests without a new value contribution if the rights of unsecured creditors were diminished, and the Court found the debtor's proposal to be objectionable on this ground. The Court then concluded that the petition had to be dismissed in favor of relief under Chapter X because the Court found Chapter X to offer a better means to accommodate the debtor's circumstances and likewise protect the interests of the debtor's unsecured creditors. *Id.* at 456-57.

In reaching this conclusion, the Court remarked that "[a] bankruptcy court is a court of equity . . . and is guided by equitable doctrines and principles except in so far as they are inconsistent with the Act." *Id*. at 454. The Court continued:

> [W]e cannot assume that Congress has disregarded well settled principles of equity [in its enactment of bankruptcy legislation]. Good sense and legal tradition alike enjoin that an enactment of Congress dealing with bankruptcy should be read in harmony with the existing system of equity jurisprudence of which it is a part. If respondent had sought relief by way of an equity receivership such would have been the duty of the Court. We think it is no less so here. . . . [I]t has long been the practice of bankruptcy courts to permit creditors or others not entitled to file pleadings or otherwise contest the allegations of a petition to move for the vacation of an adjudication or the dismissal of a petition on grounds, whether strictly jurisdictional or not, that the proceeding ought not to be allowed to proceed.

Id. at 457-58; *see also Am. United Mut. Life Ins. Co. v. City of Avon Park*, 311 U.S. 138, 145 (1940) (quoting *US Realty* and recognizing equitable power of bankruptcy court to prevent misuse of bankruptcy law).

In applying the doctrine of good faith under the current Bankruptcy Code, courts have recognized that its contours are not a modern invention. Rather, in applying the doctrine, courts have drawn upon the experience and conclusions of their predecessors reviewing petitions under equity receivership practice, Section 77B, Chapter X, and Chapter XI. *See, e.g., Little Creek Dev. Co*., 779 F.2d at 1071-72. This is entirely appropriate. As this Court has held repeatedly: "'[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific.'" *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) (quoting *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986)); *see also Archer v. Warner*, 538 U.S. 314, 319 (2003) (following prior precedent in interpreting scope of debtor's discharge); *Kelly*, 479 U.S. at 47 (stating that the Court follows its interpretative approach of presuming the continuation of prior practice "with particular care in construing the scope of bankruptcy codifications"); *United States v. Reorganized CF&I Fabricators, Inc*., 518 U.S. 213, 220-21 (1996) (adhering to the traditional bankruptcy interpretation of the concept of an excise tax); *United States v. Noland*, 517 U.S. 535, 539 (1996) (following *Midlantic*); *Case v. Los Angeles Lumber Prods. Co*., 308 U.S. 106, 115 (1939) (interpreting the phrase "fair and equitable" as used in Section 77B as having acquired a "fixed meaning" through judicial interpretation in the field of equity receiverships).

To the extent that it permits conversion of a chapter 7 case to one under chapter 13, section 706(a) of the Bankruptcy Code derives from former section 621 of the Bankruptcy Act of 1898, 11 U.S.C. § 1021 (repealed 1979). In order to convert from a liquidation case to a repayment plan proceeding under former Chapter XIII, section 621 specified that the debtor was required to file a new Chapter XIII petition in the pending liquidation case. All the requirements of good faith for the filing of a petition applied, and the bankruptcy court had inherent authority to deny

Chapter XIII relief to prevent abuse. *See Perry v. Commerce Loan Co.*, 383 U.S. 392, 404 (1966) (discussing Chapter XIII and recognizing the inherent "power of the court to make certain that the provisions of the chapter are not abused"). As explained in Collier:

> [I]n a proper case, the petition can be dismissed. If the court lacks jurisdiction, or if the jurisdiction of the court has been imposed upon, and the proceeding ought not to be allowed to proceed, either . . . because of fraud or other adequate ground, there is undoubtedly power in the Chapter XIII court to dismiss the petition for relief under Chapter XIII.

10 COLLIER ON BANKRUPTCY, ¶ 24.12 at 152 (14th ed. 1974) (emphasis supplied); *see, e.g., In re Herndon Executive Center, Inc.*, 36 B.R. 803, 805 (Bankr. M.D. Fla. 1984) (observing that, although former Chapter XIII did not contain an express requirement of good faith, "[n]evertheless, the courts were not hesitant to use the concept of good faith as an implied requirement for filing and maintaining a case under [Chapter XIII] in spite of the absence of a specific requirement to show good faith . . . as an effective means to prevent abusive filings"); *see also In re Webb*, 253 F. Supp. 757, 758 (E.D. Va. 1966) (dismissing Chapter XIII case as abusive). There is no reason to conclude that, when Congress enacted the Bankruptcy Code it intended to abrogate the requirements of good faith developed under its predecessor statutes, or the bankruptcy court's longstanding, inherent authority to deny relief on grounds of bad faith or abuse acknowledged by this Court in the Chapter XIII context in *Perry*.

Ignoring the weight of history, Marrama argues that reference to a passage in the legislative history to section 706(a) undercuts the bankruptcy court's inherent authority. Marrama is mistaken. The legislative history to section 706(a) states that "[s]ubsection (a) of this section gives the debtor the one-time absolute right of conversion of a liquidation case to a reorganization or individual repayment plan case." S.Rep. No. 95-989, at 94, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5880. A key problem with this statement, however, is that, taken literally, it does not square with the statute.

The term "absolute" cannot actually mean "absolute" because, as noted, sections 706(a), 706(d), and 109(e) prescribe statutory restrictions on a debtor's ability to convert from chapter 7 to 13. 11 U.S.C. § 706(a) (restricting conversion if the case had already been converted to chapter 7 from some other chapter), 706(d) (denying conversion if the debtor is ineligible to be a debtor under chapter 13), 109(e) (detailing eligibility requirements for resort to chapter 13). More reasonably, the reference in the legislative history to a "one-time absolute right" to convert means what section 706(a) actually says - that the debtor's ability to convert is "absolute" in the sense that it cannot be waived by contract, and the debtor has "one" chance to convert to some other chapter, and may not engage in multiple conversions. 11 U.S.C. § 706(a) (providing that "[a]ny waiver of the right to convert a case under this subsection is unenforceable" and that the debtor may convert to chapter 13 under the section unless the case has already been converted to chapter 7 from some other chapter).

In any event, there is no indication that the ambiguous reference in the legislative history to a "one-time absolute right" reflects any deliberate intention to abandon or diminish the bankruptcy court's longstanding, inherent power to deny bankruptcy relief on grounds of bad faith or to prevent abuse. More important, because the reference in the legislative history is, at best, ambiguous, it is insufficient to overcome the strong presumption of the preservation of a court's inherent authority backed in the bankruptcy context by a century of precedent and practice and the literal text of the governing statutory scheme. *See In re Young*, 269 B.R. 816, 823 (Bankr. W.D. Mo. 2001) ("The notion that a debtor has an 'absolute right' to convert arises from the use of that phrase in the legislative history . . . rather than from the language of the statute itself. This Court will not read that phrase literally into the statute; it is not warranted and leads to an erroneous conclusion."); *In re Starkey*, 179 B.R. 687, 692 (Bankr. N.D. Okl. 1995) ("The phrase 'absolute right' comes not from the statute, but from the statute's legislative history. . . . The Court is not asked to apply the statute literally; the Court is asked to read

these committee comments into the statute and apply *these comments* literally.").

D. Recognizing The Bankruptcy Court's Inherent Authority To Deny Conversion In Cases Involving Bad Faith Or To Prevent Abuse Is Necessary To Fulfill The Policies And Purposes Of The Bankruptcy Code.

The shelter of bankruptcy law is intended to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (internal quotation marks and citation omitted). As the Court continued in *Hunt*:

> This purpose of the Act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt. The various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the [A]ct.

Id., at 244-45 (1934) (citations omitted); *see Perry*, 383 U.S. at 396 ("[C]hapter XIII [of the former Bankruptcy Act] . . . creates an equitable and feasible way for the honest and conscientious debtor to pay off his debts rather than having them discharged in bankruptcy."); *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 514 (1938) ("The development of bankruptcy legislation has been towards relieving the honest debtor from oppressive indebtedness and permitting him to start afresh."); *Cont'l Ill. Nat'l Bank & Trust Co. of Chicago v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 670-71 (1935) (relief for honest debtors was "[o]ne of the primary purposes of [the bankruptcy acts]"); *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918) ("Our decisions lay great stress upon this feature of the law - as one not only of private but of great public interest in

that it secures to the unfortunate debtor, who surrenders his property for distribution, a new opportunity in life.").

Conversely, the Court has also reiterated time and again that bankruptcy relief is also properly *limited* to debtors who are actually honest, and that the bankruptcy laws should be construed accordingly. *Grogan v. Garner*, 498 U.S. 279, 286 (1991) ("[I]n the same breath that we have invoked this 'fresh start' policy, we have been careful to explain that the Act limits the opportunity for a completely unencumbered new beginning to the 'honest but unfortunate debtor'" and stating that, regarding provisions governing the nondischargeability of certain debts, "[w]e think it unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud."); *Brown v. Felsen*, 442 U.S. 127, 128 (1979) (observing that "[b]y seeking discharge, however, respondent placed the rectitude of his prior dealings squarely in issue, for, as the Court has noted, the Act limits that opportunity to the 'honest but unfortunate debtor'"); *Tinker v. Colwell*, 193 U.S. 473, 488 (1904) ("We are not inclined to place such a narrow construction upon the language of the section. We do not think the language used was intended to limit the exception in any such way. It was an honest debtor, and not a malicious wrongdoer, that was to be discharged.").

In this case, the court of appeals was properly mindful of these guiding principles, and interpreted section 706(a) consistently with the "fundamental canon of the Bankruptcy Code: [that] a bankruptcy court sitting in equity is duty bound to take all reasonable steps to prevent a debtor from abusing or manipulating the bankruptcy process to undermine the essential purposes of the Bankruptcy Code . . . ." Pet. App. 32 (citation omitted). The court also recognized that this fundamental policy finds expression in section 105(a) of the Code, stating:

> Whether or not the Bankruptcy Code § 105(a) anti-abuse provision alone would warrant the bankruptcy court's decision to deny Marrama a subsection 706(a) conversion, that provision indeed looms large in determining whether

> Congress envisioned that subsection 706(a) be construed as withholding all discretion where the bankruptcy court is confronted by a patently abusive motion to convert . . . .

Pet. App. 33.

In this case, the debtor engaged in a demonstrated pattern of bad faith conduct and abuse. Permitting him unfettered access to chapter 13 relief would simply have furthered his abusive scheme by disenfranchising the Trustee, who was hot on his trail. *See* 11 U.S.C. § 348(e) (providing that "[c]onversion of a case under section 706 . . . of this title terminates the service of any trustee . . . that is serving in the case before such conversion."). Denial of conversion was essential to promote the essential policy that bankruptcy relief is properly available only to debtors who are actually honest.

Marrama suggests that a countervailing policy warrants permitting him unfettered access to chapter 13 - that of affording him the opportunity to pay his debts through a chapter 13 repayment plan. Pet. Br. at 20; *see also* NACBA Br. at 23. But given Marrama's demonstrated pattern of concealing assets and thwarting creditor repayment, it is doubtful (at best) that conversion would have served this purpose. More important, because Marrama's conduct would have constituted grounds to reconvert his chapter 13 case back to chapter 7, the policy that he invokes would not have been assisted in any event.

As the Court has explained, the taint of misconduct and bad faith occurring at one phase of a bankruptcy case permeates the entirety of the case. *See Flershem*, 290 U.S. at 518-19 ("The fact that the [district court approved the proceeding] does not remove the taint of illegality. . . . Nor is it material that the corporation became insolvent later . . . . The lack of equity in the bill when filed is not cured by the insolvency later occurring."). And there is good reason for this view. Successful bankruptcy administration turns on the good faith of all parties to the proceeding, and where (as here) the debtor's good faith has once been shown to be seriously wanting, a court is justified in doubting whether the debtor will adhere to necessary procedures going forward and may,

if the transgression warrants it (as in this case), deny relief to which an honest debtor would undoubtedly be entitled.

E. Failure To Recognize The Bankruptcy Court's Inherent Authority To Deny Conversion In Cases Involving Bad Faith Or To Prevent Abuse Would Be Disastrous To The Administration Of Bankruptcy Cases.

Like any system of law, the chapter 7 process is susceptible to bad faith manipulation and abuse. An important safeguard to protect against misconduct is the office of the chapter 7 trustee. In this case, that office functioned as it should. The Trustee uncovered Marrama's transfers and disclosure discrepancies and began to take action to remedy them. In an effort to avoid the Trustee, Marrama sought to convert his chapter 7 case to a proceeding under chapter 13 because doing so would have immediately disenfranchised the Trustee. *See* 11 U.S.C. § 348(e) (providing that "[c]onversion of a case under section 706 . . . of this title terminates the service of any trustee . . . that is serving in the case before such conversion"). The bankruptcy court properly denied conversion to prevent this from occurring. Removing the bankruptcy court's discretion to take the action that it took would serve only to facilitate the misconduct that Marrama attempted here. This would obviously be disastrous for the administration of bankruptcy cases, particularly because, in many cases, creditors hold claims too small to justify their careful scrutiny of the process and reliance on the office of the trustee assumes paramount importance.

Marrama argues that, rather than deny conversion from chapter 7 to 13 under section 706(a) on grounds of bad faith, courts should postpone any good faith inquiry until much later in the process - specifically, the time the debtor proposes to confirm a chapter 13 plan. Marrama observes that one of the requirements of confirmation of a chapter 13 plan is that the plan has been proposed in good faith. 11 U.S.C. § 1325(a)(3) (requiring as a condition of confirmation of a chapter 13 plan that "the plan has been proposed in good faith"). Marrama contends that permitting denial of conversion from chapter 7 to 13 for bad faith would essentially predetermine an inquiry that Congress designated for

the chapter 13 plan confirmation process. Pet. Br. at 23-24; *see also* NACBA Br. at 15. This argument, however, fails.

To begin with, section 1325(a)(3) is directed only to the debtor's good faith in proposing a plan. It says nothing about good faith in commencing a bankruptcy case, or converting from chapter 7 to 13. Reference to section 1325(a)(3) is thus a classic example of an inadequate remedy to address bad faith or prevent abuse prior to the plan confirmation process.

More important, as the court of appeals explained, there is no point in putting off the inevitable and wasting judicial and other resources in the process. Pet. App. 39. Confronted with clear evidence of the debtor's bad faith, a court may take action, and need not wait for the bad faith to generate the additional burden of fruitless administrative deadweight.

F. Permitting Marrama To Convert His Chapter 7 Case To Chapter 13 Would Be Manifestly Inequitable.

In presenting his Motion to Convert to the bankruptcy court, Marrama did not seek relief with the requisite "clean hands" that a court of equity demands. Scrutinizing Marrama's conduct and motives carefully, the bankruptcy court concluded that Marrama should not be able to take advantage of the conversion process to oust the Trustee and retain his property. Conversely, permitting Marrama to convert his case would have been inequitable precisely because it would allow a perversion of Congress's equitable system of bankruptcy law.

There is no injustice in denying Marrama access to the procedures of the chapter 13 process. Because the Bankruptcy Code is an equitable regime, denying Marrama's Motion to Convert in this case was fully consistent with the equitable underpinnings of the statutory scheme.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the court of appeals in this case.

Respectfully submitted,

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