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JAN 27 1999

T.S. MCGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

IN RE

JOHN C. DOHERTY & IRENE
F. DOHERTY, husband and wife,

Debtors.

NO. 96-04391-R33

MEMORANDUM OPINION

I.

Procedural Posture & Jurisdictional Statement

A creditor attempted to seize funds held by the Chapter 13 Trustee following dismissal of the Debtor's case but prior to distribution of the funds held by the Chapter 13 Trustee. The Chapter 13 Trustee moved to quash the creditor's attempt to seize.

The issues in this matter involve the administration of a bankruptcy case filed under Title 11 of the United States Code. It is a core proceeding. 28 U.S.C. §157(b)(2).

II.

Facts

Debtors, John and Irene Doherty, filed a Chapter 13 petition October 7, 1996. The Dohertys were unable to confirm a plan. On February 19, 1998, the Court granted a creditor's motion to dismiss. The Order of dismissal was entered on February 26, 1998.

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1 The Washington State Department of Revenue wasted no time and on
2 February 27, 1998 pursuant to RCW 83.32.235 served the Chapter 13
3 Trustee with a Notice and Order to Withhold and Deliver the funds
4 being held on behalf of the Debtors. The Department of Revenue's
5 Notice and Order to Withhold and Deliver was based upon a pre-
6 petition tax warrant in the amount of \$11,310.27.

7 On April 10, 1998, the Trustee filed a motion seeking to quash
8 the Notice and Order to Withhold and Deliver. In the motion the
9 Trustee stated that he was holding \$9,330.00 received from or on
10 behalf of the Debtors and that under LBR 2083-1(1)(5) he was
11 entitled to deduct \$516.00 for administrative expenses.¹ The
12 Trustee seeks to pay the funds remaining after deduction of
13 administrative expenses to the Debtors.

14
15
16 ¹ Local Bankruptcy Rule for the Eastern District of Washington
2083-1 provides in pertinent part:

17 (1) Distributions and Payments by Chapter 13 Trustee

18 . . .

19 (5) Disposition of Funds on Conversion or Dismissal

20 (A) On the conversion or dismissal of a case, the
21 Chapter 13 trustee shall, as soon as
22 practicable, disburse any remaining funds in
23 according with 11 USC 1326. If a motion is
24 filed pursuant to 11 USC 348(f)(2) and the
trustee is served a copy thereof prior to
disbursement, then the Chapter 13 trustee
shall not further disburse until resolution of
the motion.

25 (B) If a case is dismissed or converted prior to
26 confirmation, then the Chapter 13 trustee
27 shall be entitled to deduct and retain as
reimbursement for set up and maintenance costs
an amount as established by the Court.

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1 III.

2 Issue

3 Are funds held by the Chapter 13 Trustee after dismissal of
4 the case prior to confirmation subject to a Notice and Order to
5 Withhold and Deliver issued by the Washington State Department of
6 Revenue or should the funds be returned to the Debtors?

7 IV.

8 Discussion

9 A. The Effect of Dismissal on the Estate and the Automatic Stay.

10 The commencement of a case under sections 301, 302 or 303
11 creates the Bankruptcy Estate. 11 U.S.C. §541(a). Likewise, upon
12 filing of a petition for relief, a stay of acts against the debtor
13 and property of the estate comes into existence under 11 U.S.C.
14 §362 (a). The definition of property of the estate in a Chapter 13
15 is broader than in other Chapters of the Bankruptcy Code. In a
16 Chapter 13 property of the estate includes all property described
17 in Section 541 acquired by the debtor post-petition and all post-
18 petition earnings of the debtor. 11 U.S.C. §1306(a)(1)-(2).
19 Therefore, prior to dismissal the funds held by the Trustee were
20 property of the estate and protected by the automatic stay.

21 Unfortunately the Bankruptcy Code is not specific as to when
22 the estate passes out of existence. The First Circuit in In re De
23 Jesus Saez, 721 F.2d 848 (1st Cir. 1983) held that the estate and
24 the automatic stay terminate upon dismissal of the bankruptcy
25 petition.

26 Section 362(c) provides that the stay continue as to
27 creditor conduct not directed against property of the

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1 estate, only until dismissal, and as to conduct directed
2 against such property, only so long as it remains in the
3 estate. It seems self evident that there is no "estate"
and hence no "property of the estate" unless there is an
existing petition.

4 743 F.2d at 851. When a case is dismissed, the automatic stay
5 terminates immediately upon the docketing of the dismissal order.

6 In re Weston, 101 B.R. 202, 204-205, (Bankr. E.D. Cal 1989), aff'd
7 123 B.R. 466 (9 th Cir B.A.P. 1991) (table) aff'd , 967 F.2d 596
8 (9th Cir 1992) (table), cert. denied, 506 U.S. 1051, 113 S.Ct.973,
9 122 L.Ed.2d 128 (1993). In the instant case the bankruptcy estate
10 and the automatic stay terminated immediately upon the docketing of
11 the dismissal order. Immediately thereafter the State exercised
12 its collection procedures against the funds in the hands of the
13 Trustee.

14 B. The Effect of the Notice and Order to Withhold under State Law.

15 The Court must determine if and when the state obtained a
16 right in the funds in the trustee's possession.

17 The State of Washington is attempting to seize the funds in
18 the Chapter 13 Trustee's possession relying on the State's Notice
19 and Order to Withhold and Deliver procedure. The Department of
20 Revenue is proceeding under RCW 82.32.210 which allows it to file
21 a warrant for unpaid taxes with the Superior Court. Upon filing
22 the warrant is entered in the judgment docket. RCW 82.32.210(2).
23 The amount of the warrant docketed becomes a lien upon the
24 taxpayers real and personal property in the same fashion as a
25 judgment in a civil case. RCW 82.32.210(4). Once docketed the
26 warrant is sufficient to support issuance of a writ of garnishment
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1 pursuant to RCW 82.32.210(4) or a Notice and Order to Withhold and
2 Deliver pursuant to RCW 82.32.235. The lien created by a Notice
3 and Order to Withhold and Deliver is a continuing lien. RCW
4 82.32.237. In the State of Washington the judgment lien against
5 personal property arises only when the property is levied upon. RCW
6 4.56.10.

7 The Court recognizes that the State is not proceeding upon a
8 writ of garnishment issued by the Superior Court. RCW 82.32.235
9 allows the Department of Revenue to issue a Notice and Order to
10 Withhold and Deliver directly. However, the powers granted to the
11 State upon the filing of the warrant, the structure of the withhold
12 and deliver statute and the provision in the statute for entry of
13 a default judgment against the party holding the funds, leads this
14 court to conclude the withhold and deliver order is functionally
15 the equivalent of a writ of garnishment. The State's lien would
16 only come into existence when the Notice and Order to Withhold and
17 Deliver was served.

18 Before the Court can decide whether this imposition of a state
19 lien on the funds held by the Trustee is an improper interference
20 with the bankruptcy process, the Court must consider the Bankruptcy
21 Codes directions as to the disposition of property upon dismissal
22 of the case.

23 C. Disposition of Former Estate Property.

24 Once the bankruptcy petition is dismissed and the estate
25 terminates, the question becomes what happens to the former
26 property of the estate. The language of 11 U.S.C. §349(b)(3) is
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1 consistent with the conclusion that the estate terminates upon
2 dismissal. Section 349(b)(3) provides that upon dismissal property
3 of the estate reverts in the entity which held the property prior
4 to commencement of the case. Section 349 applies to all
5 bankruptcies and thus does not specifically address post-petition
6 funds paid to the Chapter 13 Trustee by the debtor or on behalf of
7 the debtor.

8 The disposition of post-petition funds received by the Chapter
9 13 Trustee is addressed in 11 U.S.C. §1326(a)(2). This section
10 directs that post-petition payments be returned to the debtor if
11 the case is dismissed prior to confirmation. There appears to be
12 no dispute that the funds at issue represent post-petition payments
13 to the Trustee by or on behalf of the Debtors. Therefore, upon
14 dismissal the funds reverted in the Debtors and they are no longer
15 protected by the automatic stay. While it is clear that the funds
16 at issue in this case revert in the Debtors upon dismissal, the
17 Chapter 13 Trustee must complete his administration of the case
18 before the funds can be returned to the Debtors. 11 U.S.C.
19 §1326(a)(2). In re Nash, 765 F.2d 1410 at 1413 (9th Cir. 1985).

20 Dismissal of a Chapter 13 case does not automatically
21 terminate the Court's jurisdiction over the Chapter 13 Trustee or
22 former estate funds that he holds. The source of the Court's
23 continuing jurisdiction is implied rather than expressly stated in
24 the Bankruptcy Code. The court in In re Ethington, 150 B.R. 48
25 (Bankr.D.Idaho 1993) analyzed post dismissal jurisdiction in the

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1 context of a Chapter 12 proceeding.² The court concluded that it
2 had jurisdiction to hear and determine administrative expense
3 issues prior to payment of the funds held by the Chapter 12
4 Trustee. 150 B.R. at 51. The analysis of the court in Ethington is
5 persuasive.

6 The Trustee is a creature of the Bankruptcy Code and the
7 Court. The Court has a right and a duty to review the performance
8 of the Trustee. Even after a case is dismissed, the Trustee must
9 still deal with administrative claims pursuant to Sections 1326(a)
10 and 503. In addition the Trustee must file a final report. 11
11 U.S.C. §704(9). Until these matters are taken care of the case is
12 not fully administered and cannot be closed. The Bankruptcy Court
13 has jurisdiction to deal with these matters until the case is
14 closed. To conclude otherwise would severely limit the
15 effectiveness and intent of 11 U.S.C. §1326(a) and interfere with
16 the orderly administration and closing of the case.

17 Some courts have chosen to make the retention of jurisdiction
18 part of the order of dismissal. These courts cite 11 U.S.C. §
19 349(b) as the basis for including the language retaining
20 jurisdiction in the dismissal order. See, In re Ethington; In re
21 DeLuca, 142 B.R. 687 (Bankr. D. N.J. 1992). The order of dismissal
22 entered in this case contained no such language. Because
23 retention of jurisdiction is implied by the Bankruptcy Code, it is
24 not necessary that the court specifically retain jurisdiction in

25
26 ²The language of 11 U.S.C. §1226(a) is similar but not identical to 11 U.S.C. §1326(a).
27 However, the two sections operate in identical fashion. As a consequence, the reasoning in Ethington
applies equally to Section 1326(a).

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1 the dismissal order.

2 In the post dismissal period, the Court has jurisdiction to
3 deal with issues arising under 11 U.S.C. §1326(a) and the closing
4 of the case. While the Trustee does not have to immediately turn
5 the funds over to the debtor, the funds are not part of the
6 bankruptcy estate and are not protected by the automatic stay. This
7 does not mean that the funds in the hands of the Chapter 13 Trustee
8 are totally unprotected.

9 The United States Supreme Court discussed the long
10 recognized principal that where property is in the jurisdiction of
11 one court another court may not seek to remove the property from
12 the jurisdiction of the first court. Edward Murphy v. John Hofman
13 Company, 211 U.S. 562, 29 S.Ct. 154, 53 L. Ed. 327 (1909). Some
14 courts have chosen to identify this principal as *Custodia Legis*.

15 In Murphy v. Hofman, a creditor in a bankruptcy sought a writ
16 of replevin in state court against the bankruptcy receiver. The
17 Supreme Court held that seizure of the goods pursuant to a writ of
18 replevin was an improper invasion of the bankruptcy court's
19 possession of the property.

20 But, where the property in dispute is in the actual
21 possession of the court of bankruptcy, there comes into
22 play another principle, not peculiar to courts of
23 bankruptcy, but applicable to all courts., Federal or
24 state. Where a court of competent jurisdiction has taken
25 property into its possession through its officers, the
26 property is thereby withdrawn from the jurisdiction of
27 all other courts. The court, having possession of the
28 property, has an ancillary jurisdiction to hear and
determine all questions respecting the title, possession
or control of the property. In the courts of the United
States this ancillary jurisdiction may be exercised,
through it is not authorized by any statute. The
jurisdiction in such cases arises out of the possession

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1 of the property, and is exclusive of the jurisdiction of
2 all other courts, although otherwise the controversy
would be cognizable in them.

3 Murphy v. Hofman, 211 U.S. at 568-569; 29 S. Ct. at 156-157.

4 The policy behind the principle of *Custodia Legis* is to
5 prevent a clash between judicial jurisdictions as a result of a
6 court in one jurisdiction attempting to seize assets in the control
7 of another. In Re. Quakertown Shopping Center Inc., 366 F.2d 95
8 (3rd Cir. 1966).

9 The State of Washington is relying upon its status as holder
10 of a "judgment lien" to seize property in the custody of the
11 Chapter 13 Trustee, an officer of the bankruptcy court. The State
12 of Washington cannot compel the Chapter 13 Trustee to turnover the
13 funds which are subject to a Section 503(b) administrative claim
14 or payment of the Trustees fees and expenses. The last sentence of
15 11 U.S.C. §1326(a)(2) provides:

16 If a plan is not confirmed, the trustee shall return any
17 such payment to the debtor, after deducting any unpaid
claim allowed under section 503(b) of this title.

18 This is a clear statutory mandate to the Trustee. The Court cannot
19 permit the State's levy to interfere with the accomplishment of the
20 Trustee's duties to determine and pay costs of administration.
21 Those statutory duties are preemptive both under the Supremacy
22 Clause of the United States Constitution and the doctrine of
23 *Custodia Legis*. The Trustee in this case has accomplished these
24 duties and the only matter remaining is distribution of the
25 remainder of the funds to the debtor after paying costs of
26 administration.

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1 The question then becomes whether the State's levy upon the
2 funds not necessary to pay the administrative and trustee costs
3 primes the Debtors' claim to the funds.

4 The Trustee and Debtors' have cited In re Nash, 765 F.2d 1410
5 (9th Cir 1985) for the proposition that funds should be returned
6 only to the Debtors. Nash does not have any bearing on the current
7 situation. It involved dismissal of a Chapter 13 after the plan
8 was confirmed and thus the last sentence of 11 U.S.C. §1326(a) is
9 not applicable. The question before the Nash court was whether the
10 funds in the trustee's hands should be distributed to the creditors
11 pursuant to the terms of the confirmed plan or to the debtors.
12 The Ninth Circuit Court of Appeals rejected the contention that the
13 debtors continued to be bound by terms of their confirmed plan
14 after dismissal and found the funds should be paid to the debtors.

15 There was no discussion of whether the funds in the hands of the
16 trustee were subject to a levy by the debtors' creditors. Nash is
17 not determinative as to the issue before this court.

18 There is some authority at the bankruptcy court level on this
19 issue. A number of these cases involve the effect of an IRS levy.
20 On facts remarkably similar to those in this case the bankruptcy
21 courts in In re Pendrick, 20 B.R. 972 (Bankr. N.D. Ohio 1982) and
22 In re Schlapper, 195 B.R. 805 (Bankr. M.D. Fla 1996) have held the
23 funds in the trustee's control post dismissal are subject to levy.
24 But See In re DeLuca, 142 B.R. 687 (Bankr. N.J. 1992) (where the
25 bankruptcy court's retention of jurisdiction in the dismissal order
26 pursuant to 11 U.S.C. §349(b)(3) kept the property in the estate
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1 and protected by the automatic stay provision. 11 U.S.C.
2 §362(a)(4).)

3 The only instance the Court can find of an entity other than
4 the Internal Revenue Service attempting to attach or levy on funds
5 held by the Chapter 13 Trustee post dismissal is an attempted levy
6 by the Illinois Department of Revenue in In re Clifford, 182 B.R.
7 229 (Bankr. N.D.Ill.1995). The court in Clifford recognized the
8 attachment of the lien but did not order the funds be turned over
9 to the Illinois Department of Revenue. Rather, the court directed
10 that the funds be disbursed to the debtor subject to the lien.
11 The Department of Revenue was left to complete its pursuit of the
12 funds in state court. This solution is not attractive to this
13 court. Judicial economy suggests that any issues regarding the
14 funds should be resolved in the bankruptcy court.

15 The court in In re Walter, 199 B.R. 390 (Bankr. C.D. Ill.
16 1996) suggests that funds held by the trustee post dismissal might
17 be subject to "state law proceedings". However that issue was not
18 before the Walter court in that it had declined to issue a written
19 order of dismissal until the issue of rights to the funds was
20 determined. The funds presumably still remained property of the
21 estate and protected by the automatic stay.

22 Does the statutory direction to pay to the debtor mean pay
23 exclusively to the debtor or are the funds subject to execution by
24 creditors? The language of Section 1326(a)(2) does not directly
25 answer this question.

26 The Debtors argue that the language of §1326(a)(2) directs
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1 that the funds held by the Trustee after payments of the
2 appropriate costs of administration are to be paid only to the
3 Debtors. In essence, they argue Congress intended a kind of
4 exemption from creditors' claims granted for funds paid by the
5 debtors in the hands of the Chapter 13 trustee until repaid to the
6 debtors. This argument is not persuasive.

7 The Bankruptcy Code grants protection to debtors and their
8 property in quite specific provisions. The automatic stay
9 provision of §362 protects both the debtors and the property of
10 their estates. Those protections terminate upon the dismissal of
11 the case. The language of §1326(a)(2) does not clearly extend
12 those protections beyond the entry of the order of dismissal. Nor
13 is it clear what the purpose such an extension would serve.

14 The Debtors might argue that this was another incentive
15 offered by Congress to make Chapter 13 a more attractive
16 alternative for debtors as compared to relief under other chapters
17 of the Code. Certainly the ability to set aside funds protected
18 from the claims of creditors would be a great incentive to debtors
19 but it is unlikely that Congress would supply that incentive to one
20 who may have decided to forego the responsibilities to one's
21 creditors contained in the Bankruptcy Code.

22 Congress has specifically provided safeguards to protect
23 debtors from the adverse consequences to them of choosing Chapter
24 13 relief as opposed to Chapter 7 relief. If the Chapter 13 fails,
25 the debtors in good faith may convert their case to one under
26 Chapter 7. In such cases the property of the estate and valuation
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1 of secured claims is determined as of the date of the original
2 filing as opposed to the conversion date. 11 U.S.C. §548(f).
3 These provisions are a significant benefit and protect the debtor
4 from a choice which time has shown did not work out.

5 The interpretation suggested by the Debtors would give more
6 incentive to dismiss the case than to remain within the constraints
7 of the Code provisions by converting case to one under Chapter 7.
8 The court fails to see why Congress would intentionally encourage
9 dismissal rather than conversion in these circumstances by giving
10 debtors a head start in disposing of the funds in the race with
11 their creditors.

12 The Trustee argues that allowing creditors to levy would be
13 unduly burdensome to his office. The Trustee is merely a
14 stakeholder. The levy does not interfere with the administration
15 of this case. That work is completed. There is not a compelling
16 argument for why the Chapter 13 Trustee should be treated
17 differently from any other person or entity who holds funds of the
18 debtor. There is always a burden in responding to garnishments and
19 levies but the Court questions whether it is any greater burden for
20 the Trustee than for any other respondent to a Notice and Order to
21 Withhold and Deliver. This argument is not persuasive.

22 IV.

23 Conclusion

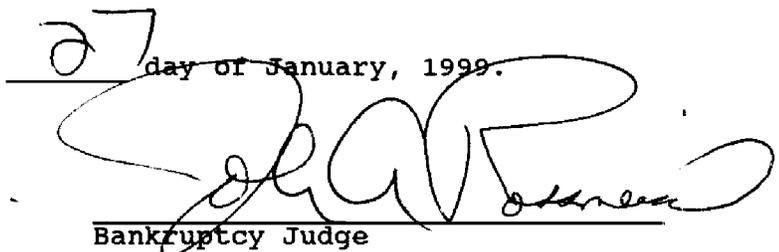
24 The Court finds that the Trustee is authorized and entitled to
25 deduct from the funds held the sum of \$516.00 for administrative
26 expenses. After deduction of this amount, the remaining funds are
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1 subject to the Department of Revenue's Notice and Order to Withhold
2 and Deliver. The motion to quash the Notice and Order to Withhold
3 and Deliver is denied.

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5 DONE THIS 27 day of January, 1999.

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28 Bankruptcy Judge

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CERTIFICATE OF MAILING

The undersigned Clerk of the U.S. Bankruptcy Court for the Eastern District of Washington hereby certifies that a copy of the document on which this stamp appears was mailed this date to the following parties as required by the Bankruptcy code and rules of Bankruptcy.

~~REUNION / TRUSTEE~~
~~YUNKER / WA STATE~~
~~MICBRIDE / DEBTORS~~

T.S. McGregor, Clerk

By: SARAH Deputy Clerk Date 1-28-99