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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.<sup>1</sup> The  
12 Trustee seeks to pay the funds remaining after deduction of  
13 administrative expenses to the Debtors.

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16 <sup>1</sup> 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 (1<sup>st</sup> 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 (9<sup>th</sup> 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.<sup>2</sup> 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

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25  
26 <sup>2</sup>The 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  
28 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 (9<sup>th</sup> 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

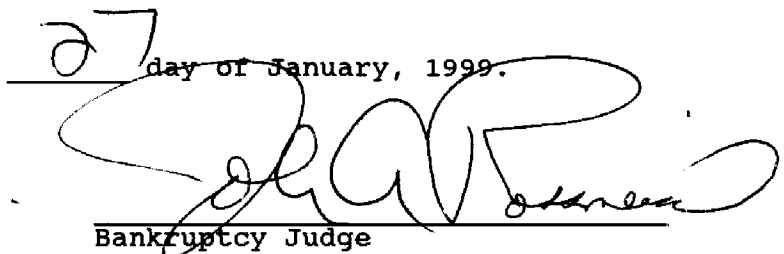
24 The Court finds that the Trustee is authorized and entitled to  
25 deduct from the funds held the sum of \$516.00 for administrative  
26 expenses. After deduction of this amount, the remaining funds are  
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1 subject to the Department of Revenue's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

4  
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