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JUDGE: M. A. Mahoney

PARTIES: Charles Franklin Woodruff, Jacqueline Elizabeth Woodruff, Lonnie L. Mixon,
Gayfers Department Store, Montgomery Ward & Co.

CHAPTER: 13

ATTORNEYS: J. J. Hartley, B. A. Friedman

DATE: 9/26/97

KEY WORDS:

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

Charles Franklin Woodruff
Jacqueline Elizabeth Woodruff

Case No. 96-12019-MAM-13

Debtors.

Lonnie L. Mixon, Trustee

Plaintiff,

v.

Adv. No. 96-1197

Gayfers Department Store

Defendant.

Lonnie L. Mixon, Trustee

Plaintiff,

v.

Adv. No. 96 -1212

Montgomery Ward & Co.

Defendant.

ORDER RE GARNISHMENT OF CERTAIN FUNDS
HELD BY CHAPTER 13 TRUSTEE

Jeffery J. Hartley, Mobile, Alabama, for J. C. McAleer, III, Chapter 13 Trustee.
Barry A. Friedman, Mobile, Alabama, for Lonnie L. Mixon, Chapter 7 Trustee.

This matter came before the Court on the Chapter 13 Trustee's objections to the issuance of garnishments that name the Trustee as garnishee. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). For the reasons indicated below, the Court

concludes that the garnishments may be issued to the Chapter 13 Trustee, subject to the limitations as to Montgomery Ward & Co. as explained below.

On August 20, 1996, Lonnie L. Mixon, the Chapter 7 Trustee of the Woodruffs' bankruptcy estate, filed a complaint to recover a \$700 preference paid to Gayfers Department Store ("Gayfers"). On January 27, 1997, this Court entered a judgment in the amount of \$700 plus costs of court in favor of Mr. Mixon and against Gayfers. On September 3, 1996, Mr. Mixon filed a complaint to recover a \$728 preference paid to Montgomery Ward & Co. ("Montgomery Ward"). On January 27, 1997, this Court entered a judgment in the amount of \$728 plus costs of court in favor of Mr. Mixon and against Montgomery Ward.

Barry A. Friedman, attorney for Mr. Mixon, filed affidavits attesting to the fact that J. C. McAleer, the Chapter 13 Trustee, was indebted to Gayfers and Montgomery Ward and had money under his custody and or control that belonged to Gayfers and Montgomery Ward. On May 23, 1997, writs of garnishment issued on Mr. McAleer. On June 17, 1997, Mr. McAleer filed objections to the issuance of the garnishments.

A hearing on the objections was held on September 2, 1997. Pursuant to § 1326(a)(2), a Chapter 13 Trustee holds all funds received from a debtor until confirmation of that debtor's plan, at which time the Trustee begins making disbursements to creditors under the plan. Mr. McAleer testified regarding the method of disbursement used by his office. On the third Tuesday of each month, the Chapter 13 Trustee's office disburses checks to creditors with the aid of a computer system. Each creditor is sent only one check per month. The check may contain the plan payments due to the creditor from numerous debtors. Mr. McAleer alleged that the garnishments would cause him to make payments in violation of 11 U.S.C. § 704 and 11 U.S.C. § 1302.

LAW

The issue presented is whether funds that are designated as disbursements to creditors in accordance with confirmed Chapter 13 plans are immune from garnishment. This issue raises two subissues which must be discussed. One, are the garnished funds property of a debtor's estate? Two, what is the status of a Trustee including a Chapter 13 Standing Trustee, when she (or he) performs her official duties?

A.

Chapter 13 confirmation orders in this district state:

Jurisdiction is retained during the pendency of this proceeding over . . . the debtor's property, including wages and earnings, wherever located.

This provision contradicts the "default" situation which occurs when a plan does not specify what happens to a debtor's property after plan confirmation. Section 1327(b) of the Bankruptcy Code, the default provision, states:

Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

When property is no longer property of the estate, the court does not have jurisdiction over it. Therefore, in this district, by the language of the confirmation order and the plan, the default provision of Section 1327(b) is overridden and debtors' property remains property of their estates as that term is defined in 11 U.S.C. § 541. The Court retains jurisdiction over the property.

However, property of a debtor's estate loses that character at some point in the continuum from payment to the Chapter 13 Trustee to payment to the creditor. At what point does the right to the money clearly vest in Gayfers or Montgomery Ward? No case the Court could find discusses this issue. The Court concludes the change from "property of the estate" of the debtor to property of the creditor occurs when the Chapter 13 Trustee has determined the amount owed to each of a

debtor's creditors and allocated the appropriate sum to the creditors. At that point, the sum is held by the Chapter 13 Trustee for the benefit of the creditor and not the debtor.

Therefore, the garnishment does not violate the stay imposed in any debtors' cases when it attaches to these funds of a creditor. *Laughlin v. United States I.R.S.*, 912 F.2d 197 (8th Cir. 1990). The garnishment, to the extent it targets only funds already allocated to the party liable to the garnishor, is not a garnishment of any debtor's funds or property.

The Chapter 13 Trustee argued that subjecting the trustee to garnishment would force him to violate his duties under 11 U.S.C. §§ 704 and 1302. However, once the funds are not property of a debtor's estate and have been allocated to the benefit of the correct creditor, payment of the sum to a garnishor does not violate any duties. The monies are still allocated to the proper creditor and the debtors receive credit for proper payment. As discussed below, the trustee is also fulfilling his duties under 28 U.S.C. § 959 when he responds to valid federal or state law garnishments and levies.

B.

The Chapter 13 Trustee is a person appointed by the Court to handle the administration of some or all Chapter 13 cases in a particular district. The duties and rights of all trustees in bankruptcy cases is governed, in part, by Bankruptcy Code mandated duties, e.g., 11 U.S.C. § 404 and 1302, and, in part, by 28 U.S.C. § 959 entitled, "Trustees and receivers suable; management; state laws." Section (b) of Section 959 states:

[A] trustee, receiver or manager appointed in any cause pending in any court of the United States . . . shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the state in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.

This section of title 28 applies to bankruptcy cases. *Clancy v. Goldberg*, 183 B.R. 672 (N.D.N.Y. 1995); *Fazio v. Growth Development Corp. (Matter of Growth Development Corp.)*, 168 B.R. 1009, 1020 (Bankr. N.D. Ga. 1994) (“Answering a continuing garnishment perhaps does not fall within the literal meaning of 28 U.S.C. § 959(b) requiring a debtor in possession to ‘operate and manage’ its property in accordance with state law. Nevertheless, both 28 U.S.C. § 959(b) and *N.P. Mining [In re N.P. Mining Co.]*, 963 F.2d 1449 (11th Cir. 1992)] support the general proposition that debtors in possession are expected to comply with state law while they are operating their businesses.”) This section applies to all trustees. There is no differentiation among Chapter 7, 11, 12 or 13 trustees. Pursuant to 11 U.S.C. § 1302, Chapter 13 trustees perform duties similar in most respects important to this case to the duties of Chapter 7 trustees.

Section 959(b) states that a trustee shall manage property according to the requirements of state law. Therefore, once the funds the trustee holds belong to the creditor and are no longer subject to Bankruptcy Code requirements, state law controls.

Under the Alabama garnishment statutes, monies held by any party are garnishable with limited exceptions. None of the exceptions apply to this case. Section 6-6-413(a) of the Alabama Code excepts monies held in trust. This does not apply as there is no trust agreement to which funds allocated to a creditor are subject. Section 6-6-413(b) excepts “personal property in the custody of a Trustee in bankruptcy, exempt to the bankrupt . . .” The funds held for Gayfers and Montgomery Ward are not any debtor’s exempt assets.

C.

None of the cases pertaining to funds held by a trustee discuss 28 U.S.C. § 959 which this Court concludes controls. The *Laughlin* case directly upholds the right of the IRS to garnish funds held by a Chapter 13 Trustee. The Eleventh Circuit Court of Appeals and the Ninth Circuit

Court of Appeals implicitly uphold the right of the IRS to levy against a Chapter 7 Trustee. *United States v. Ruff*, 99 F.3d 1559 (11th Cir. 1996); *United States v. Hemmen*, 51 F.3d 883 (9th Cir. 1994). Under the Bankruptcy Act, which preceded the Bankruptcy Code, two other circuit courts uphold IRS levies on trustees. *In re Quakertown Shopping Center, Inc.*, 366 F.2d 95 (3d Cir. 1966); *In re Meter Maid Indus., Inc.*, 462 F.2d 436 (5th Cir. 1972).

The IRS levies were held appropriate pursuant to the rights given to the IRS in 26 U.S.C. §§ 6331 and 7421. Although these statutes are certainly not the same as the Alabama garnishment law, this Court sees no reason why the different language would make a levy pursuant to federal law valid and one pursuant to state law invalid.

Some older cases hold that funds *in custodia legis*, or “in the custody or keeping of the law,” are not attachable by garnishment. Courts held that funds held by a Trustee were held *in custodia legis*. *E.g.*, *In re Chakos*, 36 F.2d 776 (W.D. Wisconsin 1930); *Brown Shoe Co. v. Schaefer*, 242 Ala. 310, 6 So. 2d 405 (Ala. 1942); *Callaway v. Security Loan Corp.*, 249 Ala. 81, 29 So. 2d 567 (Ala. 1947). The courts reasoned that garnishment of funds from a Trustee could “cause endless embarrassment and interferences with the administration of estates and the court’s administration of its functions.” *Chakos*, 36 F.2d at 776. The Trustee in this case also argued that garnishment would subject him to increased administrative functions. This is no doubt true. However, the mandate in 28 U.S.C. § 959 to follow state law overrides this concern. There is no applicable statutory exception. The procedure is inconvenient for any garnishee, but still must be followed.

A review of the other Chapter 13 Trustees in the State of Alabama shows that some of them have been subject to garnishments. All have complied. There are eight Chapter 13 Trustees in Alabama. Phillip A. Geddes, the Chapter 13 Trustee in Decatur, and W. Newt Pitts, the Chapter 13 Trustee in Sheffield, do not recall any instances when there was an attempt to garnish funds in their

possession. Curtis Cleve Redding, the Chapter 13 Trustee in Montgomery, has had one instance in which the IRS levied against an attorney's fees. Mr. Redding did not object to the levy. C. David Cottingham, the Chapter 13 Trustee in Tuscaloosa, and David P. Rogers, the Chapter 13 Trustee in Birmingham, have each had one instance in which an attorney's fees were garnished. The Trustees did not object to the garnishments. Linda Gore, the standing Chapter 13 Trustee in Gadsden, and Mavis Willingham, the Chapter 13 Trustee in Anniston, are the only Trustees who have had creditor funds subjected to garnishment. Both Trustees can recall only two occasions when such garnishments took place. Neither Trustee objected to the garnishments.

D.

The Court will allow the garnishment to remain in effect as to Gayfers. However, the Montgomery Ward garnishment is ineffective unless Mr. Friedman can show the Chapter 13 Trustee proof that he has obtained relief from the stay in Montgomery Ward's pending Chapter 11 case.

The Court will set this matter for further hearing as to how the garnishment procedure should be completed.

THEREFORE, IT IS ORDERED:

1. The objection of the Chapter 13 Trustee to the garnishment by Lonnie L. Mixon of funds owed to Gayfers Department Store is OVERRULED.
2. The objection of the Chapter 13 Trustee to the garnishment by Lonnie L. Mixon of funds owed to Montgomery Ward & Co. is OVERRULED to the extent that Lonnie L. Mixon offers proof to the Trustee within five business days of an order granting Mr. Mixon relief from stay in Montgomery Ward's bankruptcy case.
3. A further status hearing on this matter is set on **October 8, 1997 at 10:00 a.m.** to determine appropriate procedures to be followed by the Chapter 13 Trustee.

Dated: September 26, 1997

MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE