

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

IN RE:

ARLEN CECIL KIPER, II,

CASE NO. 98-14655-WSS

Debtor.

Chapter 13

ORDER ON TRUSTEE'S MOTION FOR INSTRUCTIONS AND
FRANKLIN V. ANDERSON'S MOTION TO IMPOSE
ATTORNEY FEE LIEN

This matter came before the Court on the Trustee's motion for instructions, the Debtor's objection to the Trustee's motion, and the motion of Franklin V. Anderson, counsel for the Debtor, to impose lien for the Debtor's attorney fees. J.C. McAleer, the Chapter 13 Trustee (hereinafter "the Trustee"), was represented by Jeffrey Hartley; Franklin V. Anderson appeared for the Debtor; and Russell Watson appeared for Rolland and Sylvia Novack (hereinafter referred to as "the Novacks"). After due consideration of the testimony, evidence, arguments of counsel and briefs submitted by counsel, the Court makes the following findings of fact and conclusions of law:

The Debtor, Arlen Cecil Kiper II (hereinafter "Kiper"), filed a chapter 13 petition in this Court on December 23, 1998. In his petition, Kiper listed a judgment in favor of Rolland and Sylvia Novacks (hereinafter "the Novacks") for \$67,499.00 and debt to the Internal Revenue Service (hereinafter "the IRS") for \$26,375.00. The State of Alabama was not listed in Kiper's petition. On January 18, 2000, the Court sustained an objection to Kiper's plan, and dismissed his case with a 180-day injunction. The dismissal order instructed the Trustee to refund any funds being held to the Debtor in care of his attorney, Franklin V. Anderson (hereinafter "Anderson"). The Trustee is currently holding \$6,428.59.

On January 19, 2000, the Novacks filed a process of garnishment with the Circuit Court of Baldwin County, Alabama (hereinafter “the state court”). The state court issued a writ of garnishment to the Trustee on January 21, 2000. The Trustee was served with the garnishment on January 24, 2000, and filed the present motion for instructions on January 27, 2000.¹ Kiper objected to the Trustee’s motion. Anderson, Kiper’s attorney, filed a motion to impose lien for the Debtor’s attorney fees on January 27, 2000. On February 3, 2000, the State of Alabama Department of Revenue (hereinafter “the State”) issued a writ of garnishment to the Trustee pursuant to Alabama Code (1975) §40-2-11(16).² Kiper owes the State approximately \$3,756.13.

Kiper objects to the Novacks’ garnishment on two grounds. First, Kiper maintains that the state court had no jurisdiction to assert control over funds held by an officer of a federal court, the Trustee, and that this Court has exclusive control of all matters before it. Secondly, Kiper asserts that the Novacks are attempting to assert a junior claim over administrative claims and tax claims without the notice and due process protections of an adversary proceeding.

Bankruptcy courts have considered the issue of whether funds held by a chapter 13 trustee after dismissal are subject to levy. In In re Schlapper, 195 B.R. 805 (Bankr. M.D. Fla. 1996), the court dismissed the debtor’s chapter 13 case, ordering the trustee to pay the administrative expenses and refund the balance to the debtor. The IRS served a notice of levy upon the chapter 13 Trustee after the dismissal. Schlapper, 195 B.R. at 805. Finding in favor of

¹The Trustee also filed a motion to expedite his motion for instructions on January 27, 2000, which the Court granted.

²The State did not participate in the hearing on this matter, and did not file a response to the motions at issue.

the IRS, the bankruptcy court held:

While this Court has jurisdiction to enforce its order, the Court finds that, once the order of dismissal is entered, and the stay has been lifted, and the Trustee has been ordered to turn over the funds to the Debtor, she becomes a debtor of the Debtor to that extent. The funds held by the Trustee are subject to levy or garnishment by creditors of the Debtor, pursuant to applicable law. The Trustee is bound to accept the levy if she has any money that belongs to the Debtor.

Schlapper, 195 B.R. at 806. The bankruptcy court in In re Mishler, 223 B.R. 17 (Bankr. M.D. Fla. 1998) denied a debtor's motion to enforce its dismissal order, which required the trustee to return funds to the debtor. As in Schlapper, the IRS served the trustee with notice of a tax levy. The court declined to enforce its order in light of the tax levy, concurring with the Schlapper court's reasoning. Mishler, 223 B.R. at 20.

Kiper would distinguish the holdings in Schlapper and Mishler on grounds that the IRS's authority to levy on the funds is derived from a federal statute, a source that is at least on equal footing with an order from a federal court. Kiper argues that the garnishment at issue in this case is based on a state court order, which is superceded by this Court's order. However, Kiper recognizes the holding in In re Doherty, 229 B.R. 461 (Bankr. E.D. Wash. 1999). In Doherty, the court dismissed the debtors' chapter 13 case without confirming a plan. The state department of revenue subsequently served the chapter 13 trustee with a notice and order to withhold funds being held on behalf of the debtors. The trustee filed a motion to quash the notice and order from the state department of revenue. Doherty, 229 B.R. at 462. The bankruptcy court denied the trustee's motion to quash the order, holding that the funds owed to the debtors after administrative expenses were deducted were subject to the notice and order. Doherty, 229 B.R. at 466-67.

The Doherty court reasoned that all property of the bankruptcy estate is protected by the

automatic stay imposed by 11 U.S.C. §362(a). Because the dismissal order terminates the automatic stay, there was no stay to protect the funds held by the trustee after the court entered the dismissal order. Doherty, 229 B.R. at 463. Under §349(b)(3), property of the estate reverts to the entity which held it prior to filing upon dismissal of the case. Section 1326 of the Bankruptcy Code provides that if a plan is not confirmed, the trustee must return any plan payments to the debtor, after deducting certain claims allowed under 11 U.S.C. §503(b). The Doherty court concluded that the funds were subject to the state's levy, finding:

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

Doherty, 229 B.R. at 466. See also In re Clifford, 182 B.R. 229 (Bankr. N.D. Ill. 1995) (The bankruptcy court ruled funds held by a chapter 13 trustee following the dismissal of the debtor's case were subject to levy by the state department of revenue; however, the court ordered the trustee to return the funds to the debtor subject to the levy.)

Kiper distinguishes the holding in Doherty on grounds that the case involves a levy on property under state taxing provisions rather than a writ of garnishment issued by a state court. However, the Doherty court noted that the notice and order to withhold funds allowed by the state statute was "functionally the equivalent of a writ of garnishment." Doherty, 229 B.R. at 461. Similarly, the Schlapper court made no distinction between a federal tax levy when it held that "[t]he funds held by the Trustee are subject to levy or garnishment by creditors of the Debtor, pursuant to applicable law." Schlapper, 195 B.R. at 806. This Court sees no compelling difference between the state tax levy in Doherty or the federal tax levy in Schlapper, and the

Novacks' writ of garnishment in the present case. The Court concurs with the reasoning of the Doherty and Schlapper courts. Once the order dismissing Kiper's case was entered, the automatic stay lifted. The funds, previously property of the estate, became Kiper's property and subject to garnishment. Counsel for the Novacks conceded in his oral argument that the Trustee is entitled to deduct any administrative expenses before paying over the funds on the garnishment. The Court finds that the Trustee is entitled to deduct from the funds held any administrative expenses in accordance with 11 U.S.C. §1326(a), and any remaining funds are subject to garnishment.

The existence of the State of Alabama's garnishment and the potential interest of the IRS are important differences between the present case and the Doherty and Schlapper cases. The priority of the competing garnishments is solely a matter of state law, and therefore should be decided by the state court. The Court instructs the Trustee to interplead the remaining funds (after the Trustee's administrative expenses are deducted) into the Circuit Court of Baldwin County, Alabama to determine the priority of the Novacks' garnishment and the State of Alabama's garnishment, and whether the IRS has an interest in said funds.

Anderson, counsel for Kiper, asks the Court to impose a lien for the Debtor's attorney fees based on either the Court's dismissal order or Alabama Code §34-4-60, 61 (1975). In his motion for instructions, the Trustee noted that the usual procedure in this Court is to return the funds to the debtor through his attorney. The Court's direction to the Trustee to return the funds to the debtor through his attorney was merely a procedural provision and did not create an attorney's lien on the funds. Section 34-4-61(a) of the Code of Alabama provides that "[a]ttorneys-at-law shall have a lien on all papers and money of their clients in their possession

for services rendered to them . . .” (Emphasis added). Clearly the statute is inapplicable in the present case because it only creates an attorney fee lien on papers and money in the attorney’s possession. Based on the foregoing, the Court finds that Anderson’s motion to impose lien for the Debtor’s attorney fees is due to be denied. It is hereby

ORDERED that the Trustee’s motion for instructions is **GRANTED**; and it is further

ORDERED that the Trustee shall deduct from the funds held any administrative expenses in accordance with 11 U.S.C. §1326(a), and shall interplead any remaining funds into the Circuit Court of Baldwin County, Alabama to determine the priority of the Novacks’ garnishment and the State of Alabama’s garnishment, and the interest, if any, of the IRS in said funds; and it is further

ORDERED that the motion of Franklin V. Anderson, counsel for the Debtor, to impose lien for the Debtor’s attorney fees is **DENIED**.

DATED: April ____, 2000

WILLIAM S. SHULMAN
U.S. BANKRUPTCY JUDGE