

The Supreme Court's Ruling in *Harris v. Viegelahn* Reaches Into Debtors' Attorneys Pockets

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The U.S. Supreme Court ruling in *Harris v. Viegelahn*, 2015 U.S. LEXIS 3203 (May 18, 2015) has had an appreciable and immediate impact on pending and future chapter 13 cases. As a standing trustee, I am in regular communication with chapter 13 trustees throughout the country and when the Supreme Court ruling in *Harris* came down, trustees nationwide were scurrying to revise their internal procedures to comply with the ruling. Essentially, the High Court decided to weigh in on what a chapter 13 trustee should do with the funds on hand upon the conversion of the chapter 13 case to a chapter 7 case. The court held that the debtor is entitled to the return of any post petition wages collected but not yet distributed by the chapter 13 trustee. In so finding, the court rejected the idea that the trustee's duty to "wind up" the affairs of the estate included a duty to distribute funds to the creditors. The Court found that the chapter 13 trustee's authority to provide services to the estate terminates at the moment of conversion. Because the bankruptcy code identifies the making of payments to creditors as one of the core "services", this service is terminated. In addition to the impact this ruling has on creditors and standing trustees, debtor attorney fees are an issue that will also be affected.

The chapter 13 trustee in *Harris*, argued that the creditor's interest in the funds vested when they came into the trust because the trust exists only for the benefit of the creditors. However, the Court was unimpressed with this argument and quoting one of the conflicting court of appeals decisions stated, "[N]o provision in the Bankruptcy Code classifies any property, including post-petition wages, as belonging to creditors." They further stated that "...wages may have been "property of the estate" while his case proceeded under chapter 13, but estate property does not become property of creditors until it is distributed to them."

Accordingly, the only conclusion I can reach is that any undistributed funds on hand at the time of conversion are not the property of any particular creditor, even an administrative claim. Thus, since the core services of the chapter 13 trustee have been terminated, I can only refund those funds to the debtor. The sole exception is when the funds on hand are traceable to the liquidation of a pre-petition asset. In that case, I believe Bankruptcy Rule 1019(4) would allow me to turn those funds over to the chapter 7 trustee. However, if the funds are traceable to the liquidation of a post-petition asset (e.g., post-petition inheritance or PI claim), then *Harris* prevents me from distributing those funds to creditors, absent a showing of bad faith or by application of Section 541(a)(5) which includes certain property acquired within 180 days of filing.

Under *Harris*, if chapter 13 trustees have no authority to make any determination as to how funds on hand are disbursed, other than to return said funds to the debtor, then all funds go back to the debtor if they are wages, absent a showing of bad faith. This is true regardless of whether or not the case is confirmed or unconfirmed, and also regardless of whether or not any debtor's attorney fees are due under the chapter 13 plan or other order of the court.

Therefore, the following are my determinations of where the balance on hand should be sent upon conversion of a chapter 13 case.

Confirmed or Unconfirmed cases that convert to chapter 7

- * Wages on hand - return to debtor absent finding of bad faith
- * Liquidated assets on hand of pre-petition asset- turnover to chapter 7 trustee
- * Liquidated assets on hand of post-petition asset - return to debtor. If there is a finding of bad faith or if Section 541(a)(5) applies, then turnover to chapter 7 trustee
- * Attorney fees due per confirmation order - cannot pay and funds are returned to the debtor
- * Adequate protection payments due per plan - cannot pay and return funds to the debtor

While I acknowledge that there may be further incarnations to consider, these are the procedures my office has currently implemented.

As is often the result of Supreme Court rulings in bankruptcy cases, many ripples of the decision are sure to follow. One of those ripples is the potential conflict of interest that a debtor's attorney may have when unpaid fees are provided in the plan and the debtor requests a conversion. Additionally, the question of whether the unpaid debtor attorney fees in a chapter 13 plan are considered a pre-petition debt or an administrative claim will give rise to new questions. Should these fees be paid from the chapter 7 estate? What priority do they enjoy? When the refund to the debtor from the chapter 13 trustee is received, can the debtor's attorney accept direct payment from the debtor while the chapter 7 case is still pending, or is that a violation of the automatic stay? These are only some of the issues that will arise in converted cases. The chapter 13 trustee's office shouldn't be the only office to consider changes to procedures when a chapter 13 case is converted.