IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
LITTLE ROCK DIVISION

IN RE: CLAUDE LEROY SANDERS, JR. and **4:03-bk-24989 E**
TERRI ETTA SANDERS, Debtors **CHAPTER 13**

ORDER

Now before the Court is the Debtors' *Motion to Dismiss* filed on May 27, 2005; the Debtors' *Motion to Suspend Payments* filed on March 11, 2005; the *Motion to Convert Case to Chapter 7* filed by the Estate of Sara K. Brant (the "**Creditor**") on June 17, 2005; and the corresponding objections and responses. The Court heard these matters on July 1, 2005.[1] Keith Grayson and Melanie Grayson appeared on behalf of the Debtors; Maurice Rogers appeared on behalf of the Creditor; and Jeffrey Ellis appeared on behalf of the Chapter 13 Trustee, Joyce Bradley Babin (the "**Trustee**"). Although there is a pending motion to convert in addition to the Debtors' motion to dismiss, the parties agree that the case may be dismissed, and the only issue for the Court to decide is what should happen to certain funds held by the Chapter 13 Trustee upon dismissal.[2] For the

[1]Keith Grayson's *Application for Compensation*, an objection to such application filed by the Estate of Sara K. Brant, and the Court's *Order to Appear and Show Cause Why Attorney's Fees for Debtors' Counsel Should Not Be Reduced* were also set for hearing on July 1, 2005. Mr. Grayson filed an *Amended Application for Attorney Fee* on June 29, 2005; the Court orally ruled that the Amended Application satisfied its concerns and therefore cancelled the hearing on the Court's Order to Show Cause. No objections were filed in response to Mr. Grayson's amended application. Accordingly, Mr. Grayson is hereby directed to submit a proposed order to the Court granting his application.

[2]At the hearing on this matter, a dispute arose as to the scope of the evidence to be admitted with respect to the Debtors' *Motion to Dismiss* and the Creditor's *Motion to Convert Case to Chapter 7*. However, because the Creditor orally withdrew its objection to the Debtors' voluntary dismissal as well as its motion to convert the Debtors' case to chapter 7 during the hearing, it is not necessary for the Court to address Debtors' protest to certain evidence being introduced with respect to Debtors' motion to dismiss.

reasons explained herein, the Court finds that the case may be dismissed, and the Trustee should distribute the monies it holds on all allowed claims and hold the remaining funds in an interest bearing account until the Creditor's claim is resolved in Circuit Court.

The Court has reviewed the pleadings, briefs, and evidence submitted during the hearing, and makes the following findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052 (made applicable to contested matters by Federal Rule of Bankruptcy Procedure 9014). This is a core proceeding under 28 U.S.C. § 157(b)(2), and the Court has jurisdiction to enter a final judgment in this case.

FACTS

The Debtors' Bankruptcy Filing and Chapter 13 Plan

The Debtors filed bankruptcy on December 15, 2003. The Debtors' schedules listed assets of $789,264.46, and debts of $76,099.69. The Debtors testified that they filed bankruptcy under chapter 13 to prevent a foreclosure on their home which was threatened because they had fallen behind on their mortgage payments due to a lack of the income they had previously received from Mrs. Sanders' family. During the July hearing, Mrs. Sanders testified that she and her husband now have more income than they had at the time of filing because Mr. Sanders is employed, and they are no longer at risk of losing their home.

The Debtors' monthly plan payment is $744.52, which has so far paid the Debtor's regular monthly mortgage payment and the Trustee's fee (until the Debtors ceased making plan payments in March 2005). The Debtors' Chapter 13 Plan provided that certain distributions to be received by Debtor Terri Etta Sanders (as heir to her deceased parents) were to be paid into their plan, which would enable all claims to be paid. Specifically, the Debtors' plan provided that "[u]nsecured

creditors shall be paid a definite percentage of their claims as filed and allowed by the court. That percentage is 100%." The Debtors' plan further provided:

> The Debtor, Terri Sanders, is a beneficiary of a Trust that is to pay her approximately $400,000.00, although there is a dispute pending regarding distribution of these proceeds. In addition, she is entitled to proceeds from the sale of a car wash in the amount of approximately $86,000.00, payment of which is being wrongfully withheld by other parties. Creditors shall be paid in full upon distribution.

The Debtors filed a modified plan on March 15, 2004, providing, "All creditors will be paid in full when the proceeds from the carwash sale are distributed which shall be in less than five (5) years."[3] The Debtors' plan was confirmed on May 7, 2004.

The distributions to be paid into the Debtors' plan included proceeds from the sale of the MacArthur Car Wash ("**MacArthur**"), a distribution from the Estate of Audrey Brant (the "**Estate**"), and a distribution from the Hersell C. Brant Revocable Trust (the "**Trust**"). In addition to the Debtors providing for these distributions to be included in their Chapter 13 plan, the Debtors also agreed to have these distributions paid directly to the Chapter 13 Trustee through their attorney's acknowledgment of a settlement with these entities by letter dated January 27, 2005 (accepted into evidence as Creditor's exhibit #6). As part of the Debtor's settlement with the Estate, MacArthur, the Trust and the Creditor, the claims filed by the Estate and MacArthur (and objected to by the Debtors) were to be disallowed and withdrawn, and the Trust's claim was to be allowed in the amount of $75,250, which is to be paid directly to the Trust out of Mrs. Sanders' share of the distribution from the Estate. The January 27, 2005 letter set forth exactly when those distributions were to be made. However, at the time of the July hearing, only Mrs. Sanders' share of the car wash

[3]Although this modification could be interpreted as providing that the estate or trust distributions would no longer be paid into the plan, no one interpreted the modification this way at trial, and the January 27, 2005 settlement letter discussed herein provides that these distributions were to be paid to the trustee.

proceeds, $86,060.71, had been paid into the plan. It was the Trustee's counsel's understanding that she was to hold the carwash proceeds for payment to all creditors pending the resolution of the claim held by the Creditor. An explanation of the Creditor's claim follows.[4]

Claims

Prior to filing bankruptcy, Mrs. Sanders had been appointed Guardian of the Creditor, the Estate of Sara K. Brant, Incompetent. She was later removed from that position by the Pulaski County Circuit Court (the "**Circuit Court**") in which the guardianship was and still is pending (the "**guardianship proceeding**"). The Creditor filed a claim for $36,000 in the Debtors' bankruptcy case, and the Debtors objected to that claim as contingent, disputed and unliquidated. On December 9, 2004, the Creditor filed a motion for relief from stay to enable the guardianship proceeding to continue. The Court granted that relief by Order dated January 27, 2005. That Order determined that any liability of Debtor Terri Sanders should be determined by the Circuit Court as part of the guardianship proceeding. On January 21, 2005, the Court indefinitely continued the hearing on Debtors' objection to the Creditor's claim, determining that such hearing should be continued until the guardianship proceeding was concluded.

In addition to this disputed claim, other unsecured claims have been filed totaling

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[4]In a letter from the Trustee's counsel to the parties' attorneys dated February 1, 2005 (conditionally accepted into evidence as Creditor's exhibit #3), the Trustee's counsel described her understanding of the parties' settlement, and how the Debtors' case would be administered in light of that settlement. The letter contains a statement that counsel for the Trustee believed that the purpose of Federal Rule of Evidence 408 was applicable to the letter and that the Trustee did not "expect the letter to be admissible at any trial or hearing related to the administration of the Debtors' Chapter 13 estate or any related State Court proceedings." At trial, the Trustee's counsel waived this restriction because she was there to explain what the letter meant. The Debtors, however, objected to the introduction of the letter into evidence for the purpose of proving a binding agreement on the Debtors' part. For these reasons and because the letter is not determinative of the outcome of this case, the Court accepts this letter only as evidence of the Trustee's understanding of how the Debtors' case would be administered.

$26,804.75, and there is a priority tax claim of $853.64, which was amended and allowed in the amount of $1,797.33 by order dated August 2, 2005. An additional $14,284.14 of unsecured claims were scheduled but not filed. The pre-petition mortgage arrearage equals $6,059.58; the post-petition mortgage arrearage at the time of hearing totaled $2,884.26. Counsel for the Trustee testified that after paying these sums out of the funds on hand and an estimated Trustee's fee, there would be approximately $31,769 remaining. Although the Trustee's calculation of this amount included payment of unfiled but scheduled claims of $14,282.14, those debts have not been allowed pursuant to the *Motion Combined With an Order Allowing Claims* entered on June 18, 2004, which lists the unfiled scheduled debts in question, but specifically provides that only filed claims are allowed by that order. Further, the *Order Confirming Chapter 13 Plan* provides in paragraph 4, in part: "Whenever the plan confirmed by this order refers to the debt, debts, claim or claims of creditors, such reference shall be construed to mean allowed claim or allowed claims." Accordingly, the Court finds that only allowed claims should be taken into account in calculating the approximate amount of funds which would remain after payment of all claims. Additionally, the Trustee's calculation did not take into account any attorneys' fees. The Debtors' attorneys' amended application for fees, which is still pending but ready for disposition (*see* footnote 1, *infra*), requests fees in the amount of $13,943.70. Accordingly, after adjusting for the amended tax claim of $1,797.33, removing the unfiled scheduled claims of $14,282.14 which are not allowed claims, and subtracting the attorneys' fees of $13,943.70, there should be approximately $31,163.75 available to pay Creditor's claim, if any, once it is liquidated.

The Debtors' Motion to Suspend Payments and Subsequent Pleadings Filed

The Debtors last made a payment to the Trustee on February 28, 2005, in the amount of

$744.52. On March 11, 2005, the Debtors filed their *Motion to Suspend Payments* in which they seek to suspend plan payments on the basis that they have allegedly paid in more than the amount to be paid through the plan. In this motion, they allege that "[t]here are disputed 'secured claims' that if allowed would be paid by way of an offset to funds owed to the Debtor." Presumably, this is a reference to the $75,250 to be withheld from the expected distribution from the Estate, discussed above. The motion does not mention the disputed claim of the Creditor, to which an outstanding objection remains. The hearing on the Debtor's *Motion to Suspend Payments* was continued several times, and consequently, it was not heard or ruled on when the Debtors moved to dismiss their case on May 27, 2005. The Creditor moved to convert the case to chapter 7 on June 17, 2005.

ANALYSIS

As stated earlier, despite the Creditor's pending motion to convert, the parties agree that the case may be dismissed, and that the only issue for the Court to decide is what should happen to the funds currently held by the Chapter 13 Trustee upon dismissal. The Creditor argues that the Court should order the Trustee to hold all or part of the funds until the Circuit Court liquidates its claim, or transfer the funds to the registry of the Circuit Court to be held pending the liquidation of Creditor's claim. In opposition, the Debtors argue that they have an absolute right to dismiss their case in the absence of bad faith (which they assert has not been proven) and that the funds held by the Trustee should be returned to them so that they may negotiate a full satisfaction with the unsecured creditors. At the hearing, counsel for the Debtors stated that the Debtors did not object to the Trustee paying the other unsecured creditors' filed claims now and refunding the remaining funds to the Debtors. In their post-trial brief, however, the Debtors assert that "if the Trustee simply pays over the money to the creditors in amounts sufficient to pay their claim amounts, the creditors

will still pursue the Debtors for interest and penalties accruing during the pendency of the bankruptcy."[5] Further, Debtors argue that transferring the funds to the Registry of the Circuit Court, as suggested by Creditor, amounts to pre-execution judgment which they argue is strictly prohibited by Arkansas law.

Both the Creditor and the Debtors cite law in favor of and against transferring the funds to the Debtor upon dismissal. Some courts hold that upon dismissal of a chapter 13 case, the chapter 13 trustee has a duty to make distributions to creditors in accordance with the confirmed plan pursuant to 11 U.S.C. § 1326(a)(2) (requiring the chapter 13 trustee to make distributions according to a confirmed plan). *See e.g., In re Parrish*, 275 B.R. 424 (Bankr. D.D.C. 2002). Other courts have held that once a case is dismissed, the funds should refunded to the Debtors pursuant to 11 U.S.C. § 349(b)(3) (providing that upon dismissal, property of the estate revests in the entity in which such property was vested immediately before the commencement of the case). *See e.g., In re Nash*, 765 F.2d 1410 (9th Cir. 1985). In this case, the Court need not reach this issue because the Debtors' case has not yet been dismissed (thereby triggering § 349(b)(3)'s automatic revesting). Rather, pursuant to § 349(b)(3), the Court may order, for cause, that property of the estate not revest in the Debtors upon dismissal. *See generally In re Torres*, 2000 WL 1515170 (Bankr. D. Idaho 2000). Therefore, this Court can determine how the funds held by the Trustee should be distributed prior to the case's dismissal, and in this case, the Court finds that cause exists to prevent the funds from being returned to the Debtors, and instead, such funds shall be used to pay allowed claims with the remainder to be held by the Trustee pending the liquidation of the Creditor's claim.

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[5]The Court notes that if Debtors preferred to discharge these debts, they could have chosen to stay in this chapter 13 until all payments are made (including the distributions due from the Estate) or until they otherwise qualify for an early discharge pursuant to 11 U.S.C. § 1328(b).

The Court bases this finding of cause, in part, on equitable grounds, and the Court's power to prevent abuses of the bankruptcy system under 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."). Although the Debtors invoked the protection of the automatic stay and effectively stalled all of their creditors' collection efforts, they now wish to take all the money paid into the plan which was promised to their creditors, including the Creditor whose claim has not yet been liquidated, and settle their debts (other than the Creditor's) outside bankruptcy. This case has been pending more than two and a half years, and only the Debtors' mortgage creditor has been paid (in addition to the Trustee's fees). In addition to the mortgage creditor, who it appears has yet to be paid anything on its $6,059.58 pre-petition arrearage and the tax authorities, eight creditors have filed unsecured claims totaling $26,804.75. As stated by the Court in *Torres*, ". . . Debtors' creditors were held at bay, and without receiving any payments, for over ten months. It hardly seems appropriate those creditors should receive nothing on account of the delay, during which time they could take no action to otherwise assert or protect their rights." 2000 WL 1515170, *2.

Furthermore, not only were the Debtors' creditors not paid and their collection efforts stayed, the creditors were forced to file claims in the bankruptcy and in some cases, initiate litigation to protect their claims. Specifically, MacArthur, the Estate, and the Trust all filed claims which were objected to by the Debtors spawning negotiations which ultimately resulted in settlement. The Creditor was forced to move for relief from the automatic stay so that it could continue the ongoing guardianship proceedings in Circuit Court. Debtors objected to that relief, with no reasonable basis as noted by the Court in its June 17, 2005 Order, where it stated: "The Court is troubled by Mr. Grayson's failure to present either law or fact upon which the Court could rely to deny relief from

stay, other than his desire to have the Bankruptcy Court hear this uniquely probate issue because there were probate-related claims filed in the Sanders bankruptcy."

Finally, although the Debtors had sufficient funds to continue making plan payments, they unilaterally decided to simply cease making those payments in March 2005 without waiting for the Court to rule on their *Motion to Suspend Payments*. This decision provides evidence of the Debtors' manipulation of the bankruptcy system which they relied upon to retain possession of their home when they could not make the monthly payments, and which they seek to abandon now that they have funds exceeding liabilities. Further, the effect of their unilateral decision negatively impacts their creditors – specifically, Debtors' failure to make plan payments results in a post-petition mortgage arrearage which is required to be paid ahead of other creditors pursuant to their confirmed plan, according to the Trustee. Accordingly, if the plan payments are not brought current, there are less funds available with which to pay the outstanding claims of unsecured creditors (because the Trustee is required to catch up the post-petition mortgage arrearage with funds on hand). Although no one testified at the July hearing that the mortgage had been kept current after the Debtors ceased making plan payments, the Court was left with the impression that the Debtors were possibly paying the mortgage outside the plan since they were no longer concerned about the possibility of losing their home, their stated purpose in filing bankruptcy. For these reasons, the Debtors' *Motion to Suspend Payments* shall be granted on the condition that the Debtors provide the Trustee with evidence of post-petition payments made to their mortgage creditor outside their chapter 13 plan, and if the Debtors cannot provide such evidence and there is in fact a post-petition mortgage arrearage resulting from the Debtors' failure to make payments under the plan since February 2005, the Debtors are required to make a lump sum payment to the Trustee to bring these payments

current. Once these conditions are met, the Trustee may proceed with paying claims and dismissing the Debtors' case as described below.

CONCLUSION

The Debtors may dismiss their chapter 13 case prematurely, but the Court finds cause to condition such dismissal on the payment of all allowed claims and the Trustee's retention of remaining funds pending the outcome of pending state court litigation over the Creditor's outstanding disputed claim. Accordingly, once the conditions set forth herein regarding the Debtors' post-petition mortgage arrearage have been met, the Trustee shall pay all allowed claims in accordance with the Debtors' confirmed plan, and dismiss the case. The Trustee shall hold all remaining funds in an interest bearing account until the Creditor's claim has been liquidated in Circuit Court. The case shall remain open although dismissed pending resolution of the Creditor's claim.

For the reasons stated herein, it is hereby

ORDERED that the Debtors' *Motion to Suspend Payments* is **GRANTED** upon the conditions set forth in this Order; it is further

ORDERED that the Debtors' *Motion to Dismiss* is **GRANTED** upon the conditions set forth in this Order; and it is further

ORDERED that the Creditor's *Motion to Convert Case to Chapter 7* is **WITHDRAWN**.

IT IS SO ORDERED.

Audrey R Evans

HONORABLE AUDREY R. EVANS
UNITED STATES BANKRUPTCY JUDGE

DATE: September 21, 2005

cc: Keith L. Grayson, attorney for Debtors

David A. Grace
J. Maurice Rogers, attorney for Estate of Sara K. Brant
Chapter 13 Trustee
U.S. Trustee