

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)	
)	
MICHAEL DO RAN,)	CASE NO. BK03-43437-TJM
)	
Debtor(s).)	CH. 7

ORDER

Three hearings were held in connection with the Chapter 7 trustee’s proposed distribution of funds in this case. At the hearing held on February 7, 2007, on the Chapter 7 trustee’s motion for court order regarding payment of funds (Fil. #238), objection by Stephanie Do Ran (Fil. # 242), and resistance by Home State Bank to the objection (Fil. # 247), Lea Wroblewski appeared for Stephanie Do Ran, and Roger Johnson appeared for Home State Bank. At the hearing held on February 21, 2007, on the Chapter 7 trustee’s notice and summary of filing of trustee’s final report and application for final compensation and reimbursement of expenses and proposed final distribution (Fil. #237), objection by Decision One Mortgage Company, L.L.C. (Fil. #240), and resistance by the debtor to the objection (Fil. #244), John Hahn appeared for the debtor, and Martin Pelster appeared for Decision One. At the hearing held on March 14, 2007, on Stephanie Do Ran’s motion to compel garnishment pursuant to a summons and order of garnishment for delinquent child support (Fil. #251), and objections by Decision One Mortgage Company, L.L.C. (Fil. #260) and the debtor (Fil. #262), Mr. Hahn appeared for the debtor, Ms. Wroblewski appeared for Stephanie Do Ran, and Mr. Pelster appeared for Decision One.

The trustee held \$104,752.31 in funds of the estate for distribution. After payment of trustee fees and expenses, \$91,813.52 remained for priority and general unsecured creditors. After distributions, the trustee reported a surplus of \$15,642.20 which he proposed to pay to the debtor. Two creditors objected and asserted claims to the surplus. The trustee also wanted guidance from the court regarding payment on a claim which had been assigned to another creditor. In the meantime, the trustee paid the undisputed distributions and transferred the amounts representing the assigned claim and the surplus to the clerk of the court pending further order.

By way of background, the debtor and Stephanie Do Ran were formerly married to each other. Home State Bank and Decision One Mortgage Company are two lenders involved in the case.

The Do Rans executed a promissory note in 2001 to Home State Bank for \$15,269.48. Mr. Do Ran filed his Chapter 13 bankruptcy petition on October 2, 2003. The case was converted to Chapter 7 on March 16, 2004. As of October 6, 2004, the balance due on the note, including interest, late fees, attorneys fees, and costs of liquidating collateral was \$13,179.81, plus daily interest of \$3.73861. On October 7, 2004, Ms. Do Ran assigned to the bank “an interest in whatever proceeds she receives from the bankruptcy estate sufficient to pay Home State Bank in full on the referenced indebtedness and based upon the amount, plus the per diem interest [set forth above].” Assignment, ¶ 8 (Fil. #238, Ex. 1). She further authorized the debtor’s bankruptcy trustee “to disburse directly

to Home State Bank said amount from any proceeds [Ms. Do Ran] may receive from said bankruptcy estate.” Id. The bank agreed to refrain from collection efforts against Ms. Do Ran until after funds from the bankruptcy estate are distributed, “so that to the extent possible the referenced debt will be paid by [the debtor.]” Id. at ¶ 9. With accrued interest, the current balance of the debt is almost \$16,000.

The trustee distributed \$8,133.20 from the bankruptcy estate to Home State Bank. He also proposes to pay the distribution of \$4,839.14 due to Ms. Do Ran for pre-petition unpaid child support directly to the bank pursuant to the terms of the assignment. Ms. Do Ran does not contest the validity of the assignment, but objects to the collection of the debt from her. She asserts that the current amount of the debt is due to interest accruing during these lengthy bankruptcy proceedings, and argues that she should not be penalized for delays which have not been caused by her or the bank.

While bankruptcy courts have some equitable power to adjust rights between creditors, Raleigh v. Illinois Dep’t of Revenue, 530 U.S. 15, 24 (2000), the application of an equitable remedy to relieve Ms. Do Ran of the unanticipated burdens of a valid agreement would not be an appropriate use of that power. The \$4,839.14 of estate funds that represent the payment on Ms. Do Ran’s claim may be paid to Home State Bank, as provided in the assignment.

Decision One Mortgage Company holds a non-dischargeable judgment against the debtor in the original amount of \$142,943.76. It filed an amended proof of unsecured claim for \$21,376.04, which represented the balance due after payments from various sources, including the mortgage payoff from Ms. Do Ran as ordered in the parties’ decree of marital dissolution. Interest and attorneys’ fees were not included in the amended proof of claim because the claim is unsecured or under-secured. The amended proof of claim included a reservation of rights to execute on the judgment and collect the balance due, if any, from the debtor. After distribution on the claim of \$22,225.96¹ from the Chapter 7 trustee, a balance of \$26,395.82 remains due on the judgment.

Decision One objects to the proposal to distribute the estate’s surplus to the debtor, asserting that because its judgment is non-dischargeable and it would have the right to recover from the debtor post-discharge, that surplus should be paid to Decision One instead. Decision One has served a garnishment on the Chapter 7 trustee. The debtor resists Decision One’s position, arguing that he relied upon its amended claim and that under 11 U.S.C. § 502(j), the court may disallow Decision One’s claim for equitable reasons. It is unclear what those equitable reasons might be, although delay in the case and the availability of alternative remedies for Decision One were mentioned in oral argument. This case has been on-going for some time, due at least in part to litigation concerning assets of the estate, exemptions, and dischargeability of certain debts. Such delay should not be to Decision One’s detriment, however. Likewise, Decision One’s state court action to foreclose on the property was enjoined at Ms. Do Ran’s request, so Decision One was unable to move forward with efforts to collect on the judgment.

¹This includes an additional payment of \$849.92 on an unsecured claim.

Ms. Do Ran did not object to the proposed distribution of surplus funds to the debtor, but she also obtained a garnishment order and served it on the trustee in an attempt to put a lien on the funds and prevent them from going to the debtor. She is owed more than \$13,000 in post-petition child support from the debtor.

Decision One objects to Ms. Do Ran's attempt to claim the surplus funds, asserting that its garnishment proceedings were initiated prior to Ms. Do Ran's, and arguing that Ms. Do Ran waived her right to collect any portion of the surplus by failing to object to the trustee's proposed distribution. Decision One also argues that Ms. Do Ran can set off the post-petition child support due her against her future payments to the debtor on a \$28,000 judgment entered as part of the dissolution decree. The debtor also objects to Ms. Do Ran's motion, joining in the set-off argument. The Do Rans accuse each other of delays and conduct that increased legal fees and interest charges to the other's detriment.

The trustee's position on the garnishments is that no funds are due the debtor until distribution to him is approved by the court, so there is nothing at this time to which the garnishments can attach.

Debts owed for domestic support have traditionally been given priority in the bankruptcy scheme, and after the Bankruptcy Code amendments of 2005, pre-petition domestic support obligations explicitly have first priority status under § 507(a)(1). Likewise, the reorganization chapters as amended require a debtor to stay current on post-petition domestic support obligations. See 11 U.S.C. §§ 1112(b)(4)(P); 1129(a)(14); 1208(c)(10); 1225(a)(7); 1228(a); 1307(a)(11); 1325(a)(8); 1328(a). However, this requirement is not part of Chapter 7 because the focus of a liquidation proceeding is different. The purpose of Chapter 7 is to collect and liquidate a debtor's non-exempt assets and distribute the proceeds to pre-petition creditors, discharging the debtor from most pre-petition debts and allowing him or her to move forward with a clean slate and a fresh start. Therefore, while the debtor certainly is obligated to pay his post-petition child support, the funds collected by the trustee are intended for pre-petition creditors.

Equality of distribution among creditors is a fundamental policy of the Bankruptcy Code. In re Swann, 149 B.R. 137, (Bankr. D.S.D. 1993). Available assets of a Chapter 7 estate are to be distributed according to the priority structure of § 726, where priority claims under § 501 are in the "tier" of claims to be paid first. Generally, timely filed allowed unsecured claims are in the second tier of claims; late-filed allowed unsecured claims are in the third tier; fines, penalties, and certain types of damage are in the fourth tier; and post-petition interest claims are in the fifth tier.

Because any available funds should be distributed among all of the unpaid creditors in a particular tier rather than being paid only to one creditor, the surplus estate funds should be distributed pro rata to holders of allowed unsecured claims who have not yet been paid in full.

IT IS ORDERED:

1. The Chapter 7 trustee's motion for court order regarding payment of funds (Fil. #238) is

granted. The Clerk of the Bankruptcy Court shall disburse \$4,839.14 to Home State Bank.

2. Decision One Mortgage Company's objection (Fil. #240) to the trustee's notice and summary of filing of trustee's final report and application for final compensation and reimbursement of expenses and proposed final distribution (Fil. #237) is sustained to the extent that the Clerk of the Bankruptcy Court shall disburse pro rata the balance of the funds held to those creditors with allowed unsecured claims which have not been fully paid, namely Decision One Mortgage Company, L.L.C., and Home State Bank. Counsel for those creditors shall consult with the deputy clerk financial officer and then submit a proposed order with the correct amounts to be distributed to each.

3. Stephanie Do Ran's motion to compel garnishment pursuant to a summons and order of garnishment for delinquent child support (Fil. #251) is denied.

DATED: April 9, 2007

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Rick Lange
Roger Johnson
*Lea Wroblewski
Martin Pelster
United States Trustee

Movant (*) is responsible for giving notice to other parties if required by rule or statute.