# In the United States Bankruptcy Court
# for the
# Southern District of Georgia
## Savannah Division

| | | |
|---|---|---|
| In the matter of: | ) | |
| | ) | Chapter 13 Case |
| RICHARD PRESCOTT HINELY | ) | |
| | ) | Number 03-40838 |
| *Debtor* | ) | |

**MEMORANDUM AND ORDER**
**ON DEBTOR'S MOTION FOR DISBURSEMENT OF FUNDS**
**AND TO MODIFY TRUSTEE'S RECORD OF CLAIMS**

This matter comes before the Court on Richard Prescott Hinely's (the "Debtor") Motion For Disbursement of Funds And To Modify Trustee's Record of Claims (the "Motion"). The Debtor filed a Chapter 7 case under the Bankruptcy Code (the "Code") on November 20, 2001, which was subsequently converted to a Chapter 13 case on March 11, 2003. A plan was confirmed on September 16, 2003, that required the Debtor to make monthly payments of $550.00 to the Chapter 13 Trustee (the "Trustee") for a period not to exceed five years (the "Chapter 13 Plan").

FINDINGS OF FACT

The Debtor owned an undivided one-half interest in real property at 5737 Colonial Drive, Savannah, Georgia, 31406 (the "real property"). The Debtor's wife owned the other one-half interest. On the Debtor's schedules, the value of the real property was listed as $125,000.00. Almost four years after filing, on June 8, 2005, the Debtor filed a motion to sell the real property for a proposed $240,000.00 sales price that, according to the Debtor, was reached upon arm's-length

negotiations with a purchaser unrelated to the Debtor. Debtor's Motion For Leave To Sell, p. 1 (June 8, 2005)(Dckt. No. 42). This Court ordered the sale of the real property after no party in interest filed an objection within fifteen days of the order's entry. Order On Debtor(s) Motion For Leave To Sell Real Estate, p. 1 (June 17, 2005)(Dckt. No. 43). The sale took place on or about July 14, 2005.

As a result of the sale, the Debtor's undivided one-half interest in the equity in the real property yielded a total of $69,057.19. The closing attorney paid $28,608.83 to the Georgia Department of Revenue in satisfaction of a tax lien on the real property. The remaining $40,448.36 of the sales proceeds was tendered to the Trustee, who disbursed $10,000.00 of these proceeds to the Debtor upon his claim of exemption. On July 19, 2005, the Debtor filed the Motion seeking disbursement of the remaining $30,448.36 of the net proceeds beyond his exemption. The Trustee and Electrolux Financial Corporation (a creditor of the Debtor) and filed objections to the Debtor's Motion.

## ARGUMENTS

In his Motion, the Debtor asserts that pursuant to Telfair v. First Union Mortgage Corp., 216 F.3d 1333 (11th Cir. 2000), his undivided one-half interest in the real property vested in him upon confirmation of the Chapter 13 Plan, which would entitle him to the net sales proceeds. Motion, p. 1 (July 19, 2005)(Dckt. No. 46). In her response to the Motion, the Trustee argues that the proceeds from the sale of the real estate are property of the estate and subject to the liquidation analysis set forth in 11 U.S.C. § 1325(a)(4)[1] and that the Debtor's post-confirmation reliance on the automatic stay to protect the real property is inconsistent with his current assertion that the real

[1]Hereinafter, all section references are to Title 11 of the United State Code.

property is not property of the estate. Trustee's Response To Debtor's Motion For Disbursement Of Funds And To Modify Trustee's Record Of Claims, p. 2-3 (September 16, 2005)(Dckt. No. 51). Furthermore, the Trustee contends that the proceeds from the sale of the real property constitute disposable income under Section 1325(b)(2), which should be devoted to the Chapter 13 Plan, and that the disbursement of the proceeds to the Debtor would be contrary to public policy and the requirement of good faith. Trustee's Letter Brief, p. 1-2 (October 3, 2005).

## CONCLUSIONS OF LAW

Resolution of this matter requires this Court to examine the Code's treatment of debtors and creditors upon the confirmation of Chapter 13 cases. Section 1327 governs the effects of confirmation on debtors and creditors. According to Section 1327(a), "[t]he provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." 11 U.S.C. § 1327(a). According to Section 1327(b), "[e]xcept 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." 11 U.S.C. § 1327(b). Finally, according to Section 1327(c), "[e]xcept as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan." 11 U.S.C. § 1327(c).

Section 1327(b)'s post-confirmation vesting of the property acquired either before or after the petition date in the debtor appears to be at odds with the language of Section 1306. In a Chapter 13 case, the property of the bankruptcy estate is determined by Section 1306, which states:

> (a) Property of the estate includes, in addition to the property specified in section 541 of this title–
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.
>
> (b) Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.
>
> 11 U.S.C. § 1306 (2005).

When read together, Sections 1306 and 1327(b) raise questions of what property remains in the bankruptcy estate after confirmation and what property vests in the debtor. McGlockling v. Chrysler Fin. Co., LLC (In re McGlockling), 296 B.R. 884, 887 (Bankr. S.D. Ga. 2003)(Davis, J.). The Eleventh Circuit Court of Appeals addressed this tension in Telfair v. First Union Mortgage Corp., 216 F.3d 1333 (11th Cir. 2000). According to Telfair, "after confirmation, only the amount required for the *plan payments* remain[s] property of the estate." 216 F.3d at 1340 (emphasis added). In adopting the "estate transformation approach," the Eleventh Circuit requires a debtor's Chapter 13 plan to return all property to the debtor that is not necessary to the fulfillment of the plan. Id.

District courts and bankruptcy courts in the Eleventh Circuit have consistently interpreted Telfair to require only the property necessary for making payments under a confirmed Chapter 13 plan to remain property of the bankruptcy estate. *See, e.g.,* Fleetwood Homes of Ga. v. Morrison, 263 B.R. 646, 651-52 (S.D. Ga. 2000)(Moore, J.)("In other words, money that does not go towards paying the plan is not property of the estate."); In re McGlockling, 296 B.R. at 887 ("I

conclude that the test is to examine the individual debtor to determine what is necessary, under the particular facts and circumstances, to complete a successful plan."); In re Ross, 278 B.R. 269, 275 (Bankr. M.D. Ga. 2001)(Walker, J.)("Debtor's plan payments of $238 per month were based on her disposable income. Therefore, only that amount of her future earnings was the property necessary to maintain the plan and, thus, property of the estate."); In re Brown, 260 B.R. 311, 313-14 (Bankr. M.D. Ga. 2001)(Walker, J.)("Since Debtor's payments under the plan are slightly less than the income Debtor has available to contribute to the estate for such payments, this income is all that is required to remain as part of the estate after confirmation of the plan.").

In EconoLube N' Tune, Inc. v. Frausto (In re Frausto), 259 B.R. 201 (Bankr. N.D. Ala. 2000), before the debtor filed a Chapter 13 case, he had commenced litigation in state court seeking a monetary judgment. After confirmation of the debtor's Chapter 13 plan but before its completion, the Chapter 13 trustee in the debtor's bankruptcy case settled the state court litigation for $100,000. Subsequently, one of the debtor's post-petition creditors filed a writ of garnishment seeking satisfaction of its claim from the $100,000. According to Judge Cohen, Telfair and Section 1327(b) required that all the debtor's property not necessary to the fulfillment of his Chapter 13 plan to be vested in him at confirmation and was not property of the estate. Id. at 208. This included the lawsuit, the proceeds from the settlement, and all other property of the debtor that was not necessary to make the required plan payments. Id. Since it was not a pre-petition creditor bound to the court's confirmation order by Section 1327(a), the post-petition creditor could freely pursue all assets that vested in the debtor at confirmation, including the proceeds from the settled state court litigation. Id. at 206.

In light of the foregoing, this Court concludes that the equity in the Debtor's residence and its proceeds from the sale of the real property are not property of the estate but rather property that vested in the Debtor upon confirmation. Under the terms of the confirmed Chapter 13 Plan, the Debtor is required to make monthly payments of $550.00 to the Trustee for a period not to exceed five years. The Plan did not contemplate liquidation of the real estate nor contain any other terms which subjected the real estate to post-confirmation scrutiny. Only the property required to make these payments remains property of the Debtor's bankruptcy estate. *See* Telfair, 216 F.3d at 1340. There is no evidence that the Debtor has defaulted such that he must make additional or greater payments above and beyond the $550.00 monthly payments required by the Chapter 13 Plan. Rather, the fact that the Debtor has not defaulted on his plan payments is further evidence that the proceeds from the sale of the real property are not necessary to the fulfillment of the Chapter 13 Plan. *See* Old Republic Ins. Co. v. Farmer (In re Farmer), 324 B.R. 918, 923 (Bankr. M.D. Ga. 2005)(Laney, J.)(concluding that personal injury claims acquired by the debtors post-confirmation were not necessary to the fulfillment of their Chapter 13 plan since the claims arose after completion of the bankruptcy case).

In the present case, the Debtor entered bankruptcy with an asset in the form of real property. After the confirmation of the Chapter 13 Plan but before its completion, the sale of the real property yielded the proceeds that are the subject of this dispute. Because only the Debtor's property that was necessary to satisfy his $550.00 monthly payments remained property of his bankruptcy estate, Telfair and Section 1327(b) also lead to the conclusion that the proceeds from the July 14, 2005 sale of the real property are not property of the estate but rather property that vested in the Debtor upon confirmation of his Chapter 13 Plan.

As for the Trustee's argument that the proceeds of the real property are subject to the liquidation analysis set forth in Section 1325(a)(4), satisfaction of the liquidation analysis is a condition to the confirmation of a plan or the modification of a previously confirmed plan. *See* 11 U.S.C. §§ 1325(a)(1) and 1329(b)(1). This analysis is to be conducted on the "effective date of the plan," which is widely interpreted to be a debtor's petition date. In re Green, 169 B.R. 480, 482 (Bankr. S.D. Ga. 1994)(Walker, J.)(citing Hollytex Carpet Mills v. Tedford, 691 F.2d 392, 393 (8th Cir. 1982)). As stated above, the Debtor is already obligated by his confirmed Chapter 13 Plan to make monthly payments of $550.00 to the Trustee. When the Chapter 13 Plan was proposed and then confirmed, the liquidation analysis of Section 1325(a)(4) was satisfied.

Applying the Trustee's rationale could potentially read out and/or make ineffective Section 1327(b) of the Code. In following the Trustee's argument, a post-confirmation debtor would face limitless liquidation challenges whenever his vested property increased in value. Debtors would have little incentive to choose reorganization under Chapter 13 instead of liquidation through Chapter 7 if they had to be constantly on guard for claims of Chapter 13 trustees whenever the property vested in them by Section 1327(b) appreciates in value. *See* McDonald v. Burgie (In re Burgie), 239 B.R. 406, 410 (9th Cir. B.A.P. 1999)("In place of liquidating non-exempt assets to pay creditors under chapter 7 of the Bankruptcy Code, Congress gave individuals with regular income the option of adjusting their debts pursuant to a plan under chapter 13. The chapter 13 deal permits a debtor to retain all prepetition property, including earnings, assets, money in the bank and real estate."); In re Meeks, 237 B.R. 856, 861-62 (Bankr. M.D. Fla. 1999)("A debtor who decides to retain collateral at a confirmation hearing is entitled to any later appreciation in value but also must suffer any resulting depreciation or loss.").

The Trustee contends that the Debtor is precluded from asserting that the real property is not part of the bankruptcy estate because he had previously relied on the automatic stay to protect the real property. This assertion disregards Section 362(a)(5), which applies the stay to "any act to create, perfect, or enforce against *property of the debtor* any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title." 11 U.S.C. § 362(a)(5) (emphasis added). Because of this section, the automatic stay "protects property vested in the debtor, pursuant to 11 U.S.C. § 1327(b), after confirmation of a Chapter 13 Plan." Davenport v. S.I. Sec. (In re Davenport), 268 B.R. 159, 165 (Bankr. N.D. Ill. 2001); In re Carona, 254 B.R. 364, 366-67 (Bankr. S.D. Tex. 2000)(stating that upon confirmation of a debtor's Chapter 13 plan, property vested in the debtor by Section 1327(b) becomes property of the debtor and remains subject to the automatic stay pursuant to Section 362(a)(5)); Cox v. Billy Pounds Motors, Inc. (In re Cox), 214 B.R. 635, 639 (Bankr. N.D. Ala. 1997)(concluding that since the debtor's Chapter 13 case had not yet been closed or dismissed, Section 362(a)(5) prohibited the repossession of the debtor's automobile since it became property of the debtor pursuant to Section 1327(b)).

Therefore, the Debtor was within his right to assert the automatic stay to protect the real property since it was his property. This fact does not preclude the Debtor from now arguing that the real property and the proceeds resulting from its sale are not property of his bankruptcy estate and subject to the Trustee's possession.

The Trustee also argues that the proceeds from the sale of the real property

constitute disposable income pursuant to Section 1325(b)(2)[2] that should be paid into the Debtor's Chapter 13 Plan. This Court is persuaded by the line of cases that conclude that the proceeds resulting from the post-confirmation sale of real property do not constitute disposable income. According to the Ninth Circuit's Bankruptcy Appellate Panel, "[p]ostpetition disposable income does not include prepetition property or its proceeds. This is the chapter 13 debtor's bargain. Creditors of a chapter 13 debtor have no claim to any of these assets." In re Burgie, 239 B.R. at 410 (citing Hagel v. Drummond (In re Hagel), 184 B.R. 793, 796, 798 (9th Cir. B.A.P. 1995) and 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §§ 1.7, 1.21, 1.44, 8.17 (2d ed. 1997)). The court in In re Burgie concluded that the debtors could not be compelled to treat the proceeds from the sale of their homestead as disposable income to be distributed under their Chapter 13 plan. 239 B.R. at 410.

This rationale has been adopted in several cases to preclude Chapter 13 trustees and pre-petition creditors from forcing debtors to turn over proceeds from the post-confirmation sales of homes and real property. *See, e.g.*, In re Ash'shadi, 2005 WL 1105039, *2 (Bankr. E.D. Mich. 2005)("Converting a debtor's prepetition capital asset (residence) into cash through a post-petition sale alters the form of the asset, but not its nature. Post-confirmation sales proceeds do not constitute disposable income."); In re Euler, 251 B.R. 740, 747-48 (Bankr. M.D. Fla. 2000)(agreeing with In re Burgie that the proceeds from the sale of a Chapter 13 debtor's pre-petition real property is not disposable income). The proceeds from the post-confirmation sale of the Debtor's real

[2] "Disposable income" is defined as "income which is received by the debtor and which is not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor. . . ." 11 U.S.C. § 1325(b)(2)(A).

property are proceeds from the sale of a capital asset that was not property of the estate, and therefore, they do not constitute disposable income.

Finally, the Trustee claims that public policy and the element of good faith prohibit the disbursement of proceeds from the sale of the real property to the Debtor. Section 1325(a)(3) requires as a condition to confirmation that a Chapter 13 plan be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). Similar to the Trustee's first argument concerning Section 1325(a)(4), this contention concerning good faith disregards the fact that an inquiry into the Debtor's good faith was made before the confirmation of his Chapter 13 Plan. The Trustee has provided no evidence that the Debtor misrepresented the value of the real property on his schedules or that the Debtor fraudulently hindered the Trustee's ability to discover the real property's true value at confirmation. *See* In re Jacobs, 263 B.R. 39, 49 (Bankr. N.D.N.Y. 2001)("The [finding that the Debtors satisfied the good faith test at confirmation] may very well be different if the Debtors had surreptitiously concealed the value or existence of an asset and the Trustee, through diligent inquiry and investigation, revealed the Debtors' ruse and was seeking modification to capture the hidden value for duped creditors.").

There was no evidence of any fraud, manipulation, or deception with regard to the vale of the property at confirmation. Although the increase in value of the real property is substantial, over four years have elapsed since the case was filed and market conditions may well explain the full amount of the increase. The Trustee or creditors dissatisfied with the value set in 2001 were required to raise that objection then, and they are now bound to the terms of the Chapter 13 Plan and the values then assigned to the real property. *See* 11 U.S.C. § 1327(a).

**O R D E R**

Pursuant to the foregoing, IT IS THE ORDER OF THIS COURT that Debtor's Motion For Disbursement of Funds And To Modify Trustee's Record of Claims be GRANTED. The Trustee shall disburse the remainder of the proceeds from the sale of the real property to the Debtor. Furthermore, the Trustee shall adjust her records to reflect the payment to the Georgia Department of Revenue to reduce its unpaid balance of the tax lien claim.

_____

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of November, 2005.