

**TO BE THE AGENT, OR NOT TO BE:
THE TRUSTEE VERSUS THE DEBTOR AS DISBURSING AGENT**

By

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I. STATUTORY BACKGROUND & INTRODUCTION TO DISBURSING AUTHORITY

11 U.S.C. § 1326(c):

Except as otherwise provided in the plan or the order confirming the plan, the trustee shall make payments to creditors under the plan.

In the 1978 Bankruptcy Code, this subsection was designated subsection (b), but an amendment to § 1326 in 1984 brought about the current version of subsection (a), thereby re-designating subsections (a) and (b) at the time as (b) and (c), respectively. When examining the legislative history, it must be observed that our current version of subsection (c) was designated subsection (b) when the Bankruptcy Code was enacted in 1978. In the 1978 legislative history Congress noted: “Subsection (b) makes it clear that the Chapter 13 trustee is normally to make distribution to creditors of the payments made under the plan by the debtor.” S. Rep. 95-989, 95th Cong., 2nd Sess. (1978).

11 U.S.C. § 1322(a)(1):

The plan[:] shall provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan[.]

11 U.S.C. § 1326(a)(2):

A payment made under paragraph (1)(A) shall be retained by the trustee until confirmation or denial of confirmation. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan as soon as is practicable. If a plan is not confirmed, the trustee shall return any such payments not previously paid and not yet due and owing to creditors pursuant to paragraph (3) to the debtor, after deducting any unpaid claim allowed under section 503(b).

In Chapter 13 cases, a frequent point of debate involves the determination of the better party to disburse payments to creditors provided for under a Chapter 13 plan: the trustee or the debtor(s). However, in the absence of Congressional intent providing a clear statutory mandate or a list of criteria to consider, the question often resolves itself based on ideological grounds. Ask a trustee the question and one would be lying if part of the consideration is not based on the financial

support of the trusteeship. *See* 28 U.S.C. § 586(e)(1). Ask a debtor’s attorney and one would be lying if part of the consideration is not the cost to the debtor. Ask a judge or a United States Trustee and part of the consideration is likely the systemic impact to the unsecured creditors.

II. COMMENTARY ON DISBURSING AUTHORITY

Bankruptcy Judge Keith Lundin observes that the Chapter 13 trustee has “primary responsibility” for making payments to creditors. *See* 1 Keith M. Lundin, *Chapter 13 Bankruptcy* § 59.1, p. 59-1 (3d ed. 2000). However, although “[d]irect payment has always been allowed by the Bankruptcy Code in Chapter 13 cases, . . . the practice is disfavored.” *See* 5 Keith M. Lundin, *Chapter 13 Bankruptcy* § 401.1, p. 401-1 (3d. 2000).

Nevertheless, Lundin refers to a possible trend emerging in case law that emphasizes factors to be considered in determining whether to allow a debtor to assume disbursement authority. Among the factors Lundin directly references, the one receiving considerable attention is whether an arrearage exists with respect to a secured claim when a debtor enters Chapter 13.

III. SUBSTANTIVE CONSIDERATIONS OBSERVED IN CASE LAW

A. Most Cases Start With the Presumption Against Debtor Disbursements

“The duties of a Chapter 13 trustee include serving as the disbursing agent. . . . The general rule is that debtors make monthly payments to the trustee, who then disburses the monies to holders of allowed claims.” *In re Perez*, 339 B.R. 385, 389 (Bankr. S.D. Tex. 2006).

See also In re Glenn, 173 F.3d 428, 1999 WL 68570 at *2 (6th Cir. 1999) (“Although there is a presumption that the trustee will handle payments under the plan . . .”).

B. However, Most Courts Also Recognize that Trustee Disbursement is not Absolute

1. The Plain Reading of the Statute Embodies The Exception

11 U.S.C. § 1326(c): “Except as otherwise provided . . .”

See also In re Vigil, 344 B.R. 624, 629 (Bankr. D.N.M. 2006) (“Because the language in 11 U.S.C. § 1326(c) clearly contemplates that some payments will not be made by the trustee . . .”).

2. Section 1326(c)’s Exception is Supported in § 1322(a)(1)

11 U.S.C. § 1322(a)(1): “The plan[:] shall provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan[.]”

See also In re Aberegg, 961 F.2d 1307, 1309 (7th Cir. 1992) (“The Bankruptcy Code contemplates that the debtor and/or his employer will typically transmit the specified portion of the debtor’s future income to a Chapter 13 trustee charged with disbursing the monies to creditors pursuant to the plan. . . . This method of disbursement is not exclusive, however, because section 1322(a)(1) requires only that the plan provide for the submission to the trustee of ‘all or such portion of future earnings or other future income of the debtor . . . as is necessary for the execution of the plan.’ . . . This language has been uniformly interpreted as giving bankruptcy courts the discretion to permit debtors to make payment directly to some secured creditors, provided that the plan meets all the confirmability requirements set forth in §1325(a).”).

C. Where Discretion Is Exercised on a Case-By-Case Basis, Factors Have Emerged

In the Eastern District of Pennsylvania, Eight (8) Factors Are Considered:

- (1) [T]he ability of the trustee and the court to monitor future direct payments;
- (2) the potential burden on the trustee;
- (3) the possible effect upon the trustee's salary or funding the U.S. Trustee system;
- (4) the potential for abuse of the bankruptcy system;
- (5) the number of payments proposed to pay the targeted claim;
- (6) the plan treatment of each creditor to which a direct payment is proposed to be made;
- (7) the consent, or lack thereof, by the affected creditor to the proposed plan treatment; and,
- (8) the ability of the debtor to reorganize absent direct payments and the good faith of the debtor in proposing direct payments.

In re Miles, 415 B.R. 108, 116 (Bankr. E.D. Penn. 2009).

A similar list has developed in the Southern District of Texas, but specifically for ongoing mortgages:

- (1) [T]he degree of responsibility of the debtor, as evidenced by his past dealing with his creditors;
- (2) the reasons contributing to the debtor's need for filing a Chapter 13 petition and plan;
- (3) any delays that the trustee might make in remitting the monthly payment to the targeted creditor;
- (4) whether the proposed plan modifies the debt;

- (5) the sophistication of the targeted creditor;
- (6) the ability and incentive of the creditor to monitor payments;
- (7) whether the debt is a commercial or consumer debt;
- (8) the ability of the debtor to reorganize absent direct payments;
- (9) whether the payment can be delayed;
- (10) the number of payments proposed to pay the targeted claim;
- (11) whether a direct payment by the debtor under the proposed plan will impair the trustee's ability to perform his standing trustee duties;
- (12) unique or special circumstances of a particular case;
- (13) the business acumen of the debtor;
- (14) the debtor's post-filing compliance with statutory and court-imposed duties;
- (15) the good faith of the debtor;
- (16) the plan treatment of each creditor to which a direct payment is proposed to be made;
- (17) the consent, or lack thereof, by the affected creditor to the proposed plan treatment;
- (18) the ability of the trustee and the court to monitor future direct payments;
- (19) the potential burden on the trustee;
- (20) the possible effect upon the trustee's salary or funding the U.S. Trustee system; and,
- (21) the potential for abuse of the bankruptcy system.

In re Perez, 339 B.R. 385, 409 (Bankr. S.D. Texas 2006).

See also In re Pianowski, 92 B.R. 225, 233-34 (Bankr. W.D. Mich. 1988) (enumerating thirteen similar factors under related Chapter 12 provision).

D. Failure to Balance Factors Could Be Reversible Error

In re Giesbrecht, 429 B.R. 682, 690-91 (9th Cir. B.A.P. 2010).

1. Bankruptcy courts have discretion under § 1322(a)(1) to determine when it is appropriate for debtors to make payments directly to some secured creditors.
2. The basis usually lies upon policy reasons and factors set forth in case law, local rules or guidelines.

3. In the case decided the court recognized some factors include: (a) the ability of the trustee to monitor future direct payments, (b) the burden on trustee to monitor direct payments and (c) the effect on the funding of the trustee's office.

4. However, because bankruptcy court did not set forth the factors on which it considered in making the determination, the appellate court reversed the order confirming the plan, vacated the order which denied the first plan which proposed direct payments and remanded to the bankruptcy court.

IV. SPECIFIC EXAMPLES IN CASE LAW

In re Kalfayan, 415 B.R. 907, 911 (Bankr. S.D. Fla. 2009)

1. The court allowed the debtor to separately classify the student loan claim where default under the student loan could result in loss of the debtor's professional license.

2. Because remaining current on the student loans was so important to the debtor, the court required the payment to be paid by the Chapter 13 trustee even if it meant a reduced dividend to other unsecured creditors because loss of the debtor's professional license and job would be a worse impact.

In re Carey, 402 B.R. 327 (Bankr. W.D. Mo. 2009)

1. Acknowledging debtors have right to make direct payments, but it is not an unfettered right and § 1326(c) creates a presumption in favor of the trustee acting as the disbursing agent.

2. Ultimately the court denied confirmation of Chapter 13 plans proposing the debtors would make the ongoing mortgage payments directly.

3. The debtors advanced two primary arguments: the cost of the trustee's fee and loss of flexibility needed to administer the plans.

a. The court found that the cost of the trustee's fee did not weigh in their favor because the debtors habitually incurred late fees which were no greater than the average trustee's fee.

b. The court accepted the trustee's testimony which recounted stories where debtors who make mortgage payments directly often fall behind on one to catch up the other and fail to advise their attorney before this situation happens causing motions for relief or motions to dismiss to be filed. Once the motions are filed the debtors actually lose flexibility to resolve these matters.

V. PRACTICAL CONSIDERATIONS

A. Attorneys' Fees

1. Debtor's Counsel's Fee:

In re Green, Case No. 13-50343 (Bankr. W.D. Va.) (Connelly, J.): No published or written opinion but court denied counsel's request for attorney's fees for defense of motion to dismiss where the claim was paid directly.

2. Creditor's Counsel's Fee:

In re Hairston, Case No. 13-60727 (Bankr. W.D. Va.) (Connelly, J.): Creditor did not charge presumptive amount for motion for relief but rather submitted actual time records and obtained a fee of \$4,000.

B. Analysis of Actual Cost in Paying a Secured Claim Through Chapter 13 Trustee

1. *In re Green* Demonstrates Potential Savings to Debtor

- (i) Debtor purchased 2010 Toyota Corolla with an amount financed of \$14,855.47 at 13.99% interest. The vehicle was purchased on 7/24/2010. If the note was paid according to schedule, the total amount paid for the vehicle would be \$22,152.24 which means the interest cost would be \$7,296.77.
- (ii) The debtor filed Chapter 13 on March 20, 2013. Based on the original amortization schedule, the principal should have been reduced to \$9,929.13. The creditor's claim was filed for \$10,413.62.
- (iii) The debtor proposed to pay the claim directly. Based on contract terms, the debtor will need to pay a total of \$13,321.73 to pay the debt, including interest.
- (iv) What would happen if paid through the Plan? Would it cost the debtor more because of trustee's fee?
- (v) If paid through the Plan and the interest rate could be crammed down to 4.75%, the amount paid would be \$13,021.82, including 10% trustee's fee.

2. Creditors' Fees Across the Board Could be Mitigated

What were total attorneys' fees paid for motions for relief in 2013?

In 2013, in Roanoke, Abingdon, Big Stone Gap and Danville cases, approximately 625 motions for relief were filed. If each motion incurred presumptive attorneys' fees and costs (i.e., \$676.00), in 2013 alone Chapter 13 cases in said divisions had \$422,500.00 in creditors' attorneys' fees and costs. Note: This amount does not include any amounts charged by debtors' attorneys to defend against these motions.

3. Chapter 13 Trustee's Fees

- (i) For funding purposes at confirmation time, trustee's fees are calculated at 10%.

- (ii) The more claims paid by the trustee results in more fees paid to the trustee. However, the trustee's fees cannot exceed the fees approved by the United States Trustee.
- (iii) If the fees collected consistently exceed the fees approved, trustees will often decrease the amount needed to calculate for funding purposes (e.g., 10% to 8.5%).

C. Record Keeping by the Trustee Rather Than the Debtor

Example: When proof of payment was requested of a debtor, the debtor emailed pictures of four money orders, two of which were duplicates of the two valid payments.

D. Unsecured Creditors Benefit in the System

1. Conventional wisdom dictates that if an ongoing mortgage is paid through case administration, the cost of the trustee's commission will drive down the dividend.
2. About five years ago Kansas implemented mandatory ongoing mortgages through case administration. What happened to unsecured creditors?
3. Over the last five year period the distribution to unsecured creditors almost doubled, increasing from \$3,434,155 in 2009 to \$6,657,446 in 2013. This represents an average distribution in 2009 of \$1,809 per case to unsecured creditors to \$2,258 per case in 2013.
4. This is not meant to be a precise statistical study but a demonstration that conventional wisdom may not be correct. Many factors, like rate of dismissal/conversion to completion, case filing increases/decreases and district specific factors would need to be analyzed for a complete understanding.

E. Mortgage Morass

In re Reece, Case No. 09-72641 (Bankr. W.D. Va.): First and second deed of trust serviced by the same mortgage servicer. The ongoing mortgage payments are paid through case administration. Four years into the case, the second deed of trust is transferred to a new servicer. Six months later the first deed of trust servicer sends \$5,236.10 back stating they misapplied funds between the first and second deed of trust. However, in the voucher attached to the check are payments that clearly belong to the first deed of trust servicer. At the same time the first deed of trust servicer increases the mortgage payment for escrow shortage. How do you begin to unravel this? Can your client afford to pay you to unravel this? Can you afford to provide this work on a pro bono basis?