

11 U.S.C. § 1326(a)(2)  
Garnishment  
O.R.S. 18.600-18.850  
Preemption  
Supremacy Clause  
U.S. Const. art. VI, cl.1.2

In re Bailey  
9/23/05

Case # 04-64719-aer13  
Radcliffe

Published

After confirmation of their plan was denied, Debtors' case was dismissed on their motion. At the time of dismissal, the Chapter 13 Trustee had collected \$4,800 in plan payments. Before he could distribute the funds to the Debtors, a pre-petition judgment lien creditor served a writ of garnishment under Oregon law on the Chapter 13 Trustee. The Trustee then moved the court for instructions.

Holding: The court followed the clear dictates of 11 U.S.C. § 1326(a)(2), and ordered that the funds be returned to the Debtors, holding that to the extent § 1326(a)(2) and Oregon's garnishment statutes conflict, the garnishment statutes must give way under the Constitution's Supremacy Clause and its related doctrine of preemption. The court also discussed the policy reasons behind § 1326(a)(2).

In a separate order, the court noted Debtor wife had filed a Chapter 7 petition subsequent to the dismissal of her Chapter 13 case, and that her Chapter 7 Trustee had filed a motion in the Chapter 13 case for intervention and for turnover of the funds at issue, as property of her Chapter 7 estate. The court stayed the effect of its ruling until the Chapter 7 Trustee's motion could be resolved.

**E05-13(5)**



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**ISSUE**

The issue presented is whether a Chapter 13 trustee who is holding debtor's plan payments, must honor a state law garnishment, post dismissal, after confirmation has been denied.

**DISCUSSION**

When a Chapter 13 case is dismissed without a confirmed plan, 11 U.S.C. § 1326(a)(2) provides in pertinent part as follows:

A payment made under this subsection shall be retained by the trustee until confirmation or denial of confirmation of a plan... If a plan is not confirmed, the trustee shall return any such payment to the debtor, after deducting any unpaid claim allowed under section 503(b) of this title. (emphasis added).<sup>1</sup>

There appears to be a split of authority on this issue. Cases holding that funds held by the trustee following dismissal of an unconfirmed chapter 13 case are subject to levy or other forced collection under state law include: Massachusetts v. Pappalardo (*In re Steenstra*), 307 B.R.732 (1st Cir. B.A.P. 2004); In re Doherty, 229 B.R. 461 (Bankr. E.D. Wash.1999); and Clark v. Commercial State Bank, 2001 WL 685529 (W.D. Tex. 2001). These courts reason that despite § 1326(a)(2), the bankruptcy estate terminates after dismissal and the automatic stay is no longer in force, leaving the funds held by the trustee unprotected from garnishing or levying creditors. Doherty, *supra* at 463; Pappalardo, *supra* (adopting Doherty).

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<sup>1</sup> Unless otherwise noted, all subsequent statutory references are to Title 11 of the United States Code.

1           On the other hand, courts holding that the funds must be  
2 returned to the debtor largely base their reasoning on the plain  
3 language of § 1326(a) (2) which mandates return of the funds to the  
4 debtor (after payment of administrative expense claims under  
5 § 503(b)).<sup>2</sup> See, In re Davis, 2004 WL 3310531, 2 (Bankr. M.D. Ala.  
6 2004); In re Oliver, 222 B.R. 272, 275 (Bankr. E.D. Va.1998); In re  
7 Walter, 199 B.R. 390, 392 (Bankr. C. D. Ill.1996).

8           This court agrees with the latter line of cases. Section  
9 1326(a) (2) is clear and unambiguous, therefore, its dictates must be  
10 followed. See United States v. Ron Pair Enterprises, Inc., 489 U.S.  
11 235, 242, 109 S. Ct. 1026, 1031, 103 L.Ed.2d 290, \_\_ (1989) (where  
12 the Supreme Court held that courts must follow a statute's plain  
13 language unless doing so would produce a result demonstrably at odds  
14 with the intentions of its drafters).<sup>3</sup>

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18           <sup>2</sup> Here, no § 503(b) claims have been asserted.

19           <sup>3</sup> In Beam v. I.R.S. (In re Beam), 192 F.3d 941 (9<sup>th</sup> Cir. 1999), the  
20 court required a Chapter 13 trustee, in similar circumstances, to honor an  
21 Internal Revenue Service levy. Beam, however, is easily distinguishable  
22 from the facts here, as it involved a conflict between two federal  
23 statutes (11 U.S.C. § 1326(a) (2) vs. IRS levy statutes, 26 USC §§ 6331 and  
24 6334(a) & (c)). The court held § 1326(a) (2) must give way, based on the  
25 levy statutes' language, which among other things, did not exempt funds  
26 held by a Chapter 13 trustee from levy. Id. at 944-45. Here,  
§ 1326(a) (2) is pitted against Oregon's garnishment scheme, codified at  
ORS 18.600-18.850. To the extent the two statutory schemes conflict, the  
Oregon statutes must give way based on the Supremacy Clause, U.S. Const.,  
art. VI, cl. 1.2, and its related doctrine of preemption. Davis, supra at  
2 (§1326(a) (2) preempts state garnishment statutes). See also, In Re  
Harris, 258 B.R. 8, 12-13 (Bankr. D. Id. 2000) (refusing to extend Beam to  
an attorney's state law charging lien).

1 In addition, sound policy reasons support returning the funds  
2 to the debtor. As ably put by the Davis court,

3 This disposition of the money [to the debtor]  
4 serves several purposes. First, it fosters the policy  
5 of encouraging debtors who are financially able to  
6 repay their debts to file chapter 13. It ensures that  
7 debtors who attempt chapter 13 will not be penalized  
8 for an unconfirmed attempt. Returning the money to  
9 the debtor ensures the orderly and efficient  
10 disposition of chapter 13 cases. Congress no doubt  
11 considered the possibility that creditors would like  
12 to participate in the money held by the trustee. By  
13 requiring the trustee to return the money to the  
14 debtor, Congress ensured that any attempts to reach  
15 the money would ensue outside the jurisdiction of the  
16 bankruptcy court. Therefore, unconfirmed cases may be  
17 closed as quickly as statutorily possible following  
18 dismissal. Holding to the contrary would create a  
19 "race to the trustee" and effectively ignore the  
20 statutory mandate to return the money to the debtor.

21 Davis, supra at 2.<sup>4</sup>

22 Based on the above, Trustee will be ordered to disburse the  
23 funds on hand to the Debtors forthwith. A separate order shall be  
24 entered. This opinion constitute the court's findings of fact and  
25 conclusions of law under FRBP 7052. They shall not be separately  
26 stated.

ALBERT E. RADCLIFFE  
Chief Bankruptcy Judge

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<sup>4</sup> The Davis court also noted that adhering to §1326(a)(2) was consistent with § 348(f), which, absent a showing of bad faith, returns to the debtor, upon conversion, post petition earnings held by the Ch. 13 Trustee, and with § 349(b), which, upon dismissal, reverts property of the estate in the entity in which such property was vested immediately before the commencement of the case. Id. at 2.