

Post-Harris Attorney Fee Review

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Since the Supreme Court's decision in *Harris v. Viegelaahn*, 135 S. Ct. 1829 (2015), the issue of payment of the debtor's chapter 13 attorney's fees out of undisbursed funds held by the chapter 13 trustee upon conversion to chapter 7 has split the courts. In *Harris*, the Court found that upon conversion all funds currently in the hands of the chapter 13 trustee must be returned to the debtor. The decision rested on interpretation of section 348(f) which provides that, upon conversion, the chapter 7 estate consists of the debtor's property as of the original chapter 13 petition date unless the case is converted in bad faith. Under this provision, post-petition wages that the debtor has paid into the plan would not be property of the new chapter 7 estate. Additionally, because section 348(e) acts to terminate the services of the chapter 13 trustee upon conversion, the Court found that the trustee was divested of the power to distribute such funds to creditors. Specifically, the Court found that section 1326(a)(2)'s directive to the trustee to distribute funds according to the plan once the plan is confirmed, did not apply upon conversion.

Prior to *Harris*, many courts had established procedures whereby upon conversion the trustee would use the undisbursed funds to pay attorney's fees and administrative costs (and in some cases creditors). *Harris* has caused courts to take another look at that process. The impact of these cases on the chapter 13 Bankruptcy Bar is potentially serious. Because chapter 13 attorneys typically are paid through the bankruptcy plan, when the case is converted to chapter 7 that avenue of payment is foreclosed if the courts find that *Harris* precludes payment of fees using undisbursed funds. As a result, representing clients in chapter 13 may carry a substantial risk of non-payment.

Addressing this issue, a bankruptcy court in the District of Maryland distinguished *Harris* to find that the debtor's attorney could be paid for services rendered out of funds in the hands of the trustee at the time of conversion. *In re Everest*, No. 14-29084 (Sept. 10, 2015). Noting that *Harris* involved conversion after confirmation of the debtor's chapter 13 plan, the *Everest* court found that a different result was dictated when the conversion took place pre-confirmation. The court relied on analysis of section 1326(a)(2) which provides:

A payment made under paragraph (1)(A) [in accordance with a plan not yet confirmed] 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 concluding that the chapter 13 trustee is divested of all power to distribute funds, the Court in *Harris*, faced with a confirmed plan, applied section 348(e) to the first two sentences of section 1326(a)(2) finding that the former section cancelled out the directive in the latter. In contrast, because the conversion in *Everest* took place prior to confirmation, the first two sentences of section 1326(a)(2) were inapplicable. The court therefore turned to the third sentence of section 1326(a)(2) to determine the chapter 13 trustee's responsibilities. The *Everest* court found that "[t]he third sentence of § 1326(a)(2) . . . specifically deals with disposition of plan payments if 'a plan is not confirmed.' It does not follow that after *Harris* a Chapter 13 trustee must comply with a portion of this sentence (return pre-confirmation plan payments to the debtor), but

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ignore another portion of that same sentence (after deducting funds needed for payment of allowed administrative expense claims).”

Cases finding that the debtor’s attorney may not be paid with undisbursed funds upon conversion prior to plan confirmation are simply wrongly decided and have applied *Harris* without adequate analysis.

In two cases involving the courts’ practice of permitting the chapter 13 trustee to distribute undisbursed funds to creditors upon conversion to chapter 7, the courts found that *Harris* dictated a different result without regard to whether the case was converted prior to confirmation of the plan. *In re Beauregard*, 533 B.R. 826 (Bankr. D. N.M. 2015) (post-confirmation conversion), consolidated with, *In re Rule-Osburn*, No. 14-13624, and *In re Montano*, No. 14-12950 (Bankr. N. M. July 10, 2015) (both dealing with pre-confirmation conversion).

The court in *Beauregard* discussed *Harris* and its finding that under section 348(e), upon conversion, the chapter 13 trustee may not exercise the powers of trustee with respect to distributions. The *Beauregard* court concluded that there was “no principled basis upon which to continue to give effect to the third but not the second sentence of § 1326(a)(2) after conversion.” Likewise, the court in *In re Sowell*, 2015 WL 4718588 (Bankr. D. Minn. Aug. 7, 2015), extrapolated from *Harris* that conversion pre-confirmation had the same effect as post-confirmation conversion. See also *In re Beckman*, No. 14-7656 (Bankr. S.D. Cal. Sept. 8, 2015); *In re Spraggins*, 2015 WL 5227836 (Bankr. D. N.J. Sept. 3, 2015) (relying on *Beauregard* and *Sowell* for the same finding).

The *Everest* court acknowledged these contrary decisions but found them incorrectly reasoned. *Everest* was persuaded by the fact that, in reversing the case before it, *Harris* resolved the circuit split in favor of the third circuit decision in *In re Michael*, 699 F.3d 305 (2012). In *Michael* the court applied the third sentence of section 1326(a)(2) after conversion explaining that while conversion terminates the services of the chapter 13 trustee under section 348(e):

[T]he trustee is required to account for the funds that came into his possession by filing a final report under Federal Rule of Bankruptcy Procedure 1019(5)(B)(ii). In addition, if the case is converted prior to confirmation of a plan, the trustee must return any payments held by him to the debtor after deducting adequate funds for him to pay allowed administrative expense claims [under section 1326(a)(2)].

In the emerging line of cases represented by *Beauregard* and *Everest*, the *Everest* decision is the better reasoned. That case properly applies the specific text of section 1326(a)(2), as it pertains to pre-confirmation plans, before the more general provisions of section 348. See *Michael*, 699 F.3d 314 n. 7 (“In the pre-confirmation context, the trustee is obligated to pay allowed administrative expenses from accumulated payments he is holding. *Id.* § 1326(a)(2). Though this creates the anomalous outcome that if a Chapter 13 proceeding is converted pre-confirmation administrative expense claims will be paid from undistributed plan payments, but if the proceeding is converted post-confirmation no administrative expense claims can be paid from undistributed plan payments, this inconsistency is addressed by the Federal Rules of Bankruptcy Procedure. Rule 1019(6) provides for the filing after conversion of pre-conversion administrative expense claims.”)

In any case, many bankruptcy attorneys take a pro-active approach to this issue, by including in their fee agreements an assignment of and security interest in the debtor’s post-petition wages held by the trustee on the date of conversion, to pay allowed unpaid attorney fees and costs incurred during the Chapter 13 case.

[Everest Bankr Md opinion](#)

[Beauregard Bankr. NM opinion](#)

[Harris v. Viegelahn opinion](#)

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