

Below is the Order of the Court.



Brian D. Lynch
U.S. Bankruptcy Judge
(Dated as of Entered on Docket date above)

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**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON AT TACOMA**

In re:

DAVID ALAN PERMAN and

MARY DEE PERMAN,

Debtors.

Case No. 13-43771-BDL

**MEMORANDUM DECISION
DENYING CHAPTER 13
CONFIRMATION**

The debtors David and Mary Dee Perman proposed a first amended chapter 13 plan dated July 23, 2013. It provided under paragraph IV "Distribution of Plan Payments," under the subheading "Attorney's Fees" that "[p]re-confirmation attorney fees and costs shall not exceed \$4000." Local Bankruptcy Rule 2016-1(e)(1) allows a

1 presumptive fee of \$3500 through confirmation without the necessity of an application
2 for compensation. It is referred to in the chapter 13 world as a "no-look" fee. If counsel
3 has contracted with the debtor to provide services on an hourly basis and the hourly fees
4 exceed the presumptive fee for work through confirmation, counsel may request fees in
5 excess of the presumptive fee by motion within 21 days of confirmation. This request
6 must be "accompanied by an itemized breakdown of time... in the form and manner
7 required by Local Bankruptcy Rule 2016-1(f)." Local Bankruptcy Rules 2016-1(e)(2) and
8 2016-1(i).

9 The trustee has objected not to the amount of fees, but how the debtors propose to
10 pay the fees. Following the provision concerning the amount of fees sought, there is a
11 form provision which spells out options for payment of those fees. The debtors chose
12 option d.: "Other: See paragraph XII(d)." Paragraph XII is titled "Additional Case-
13 Specific Provisions." Subparagraph d. provides:

14 After payments to vehicle creditors and on-going mortgage payments provided that
15 prior to disbursement of on-going mortgage payments, the trustee shall set aside at
16 least \$2,230 (the balance due on the presumptive attorney fee) to be paid to
17 Debtor's counsel upon confirmation or dismissal.

18 The Chapter 13 trustee objected to this provision and to paragraph XII(a), which
19 provides that "[a]ny refund to Debtor upon dismissal or discharge shall be disbursed
20 through Debtor's counsel." The trustee's concern was that the provisions violate 11
21 U.S.C. § 349(b)(3), which states that upon dismissal property of the estate reverts in the
22 entity in which such property was vested immediately prior to the commencement of the
23 case. The trustee in particular objects to the extent that the trustee is required to pay the
24 debtors' attorney a fee which has not been earned or awarded.

25 In the case of a preconfirmation dismissal, the simple answer is that since this is a
plan provision only operative if a plan is confirmed, the provision is not binding and the
statutory scheme under section 349 is not thwarted. But if the plan is confirmed, and the

1 case is dismissed before fees are awarded or disbursed, then this provision would conflict
2 with section 349(b)(3), because that section requires that funds be paid to the debtor upon
3 dismissal. *In re Nash*, 765 F.2d 1410, 1415 (9th Cir. 1985).

4 The Court has a broader concern with this provision, which it voiced at the hearing
5 on the objection. Specifically, paragraph XII(d) of this plan primes the payment of
6 postpetition ongoing mortgage payments in order to pay the debtors' counsel fees up to
7 the presumptive fee. It provides that payments to the ongoing mortgage do not commence
8 until the \$2230 is "set aside to be paid to Debtor's counsel upon confirmation"
9 Debtors, or to be more accurate, debtors' counsel, argue that no statutory provision
10 requires that ongoing postpetition mortgage payments on a residence be paid at or prior to
11 administrative claims.

12 There are two problems with this proposed plan provision. First, residential
13 mortgages have been subject to unique treatment in bankruptcy ever since 1978, when
14 sweeping changes were enacted to Chapter 13. 11 U.S.C. § 1322(b)(2) provides that a
15 plan may modify the rights of holders of secured claims, "other than a claim secured only
16 by a security interest in real property that is the debtor's principal residence...." This so-
17 called "anti-modification" language is subject to Section 1322(b)(5) which allows: "(5)
18 [the plan may] ... provide for the curing of any default within a reasonable time and
19 maintenance of payments while the case is pending on any unsecured or secured
20 claim...."

21 If the plan provides for curing a default on a residential mortgage obligation, there
22 is the issue of whether payment of attorney's fees which interrupts the ongoing
23 postpetition mortgage payment violates §§ 1322(b)(2) and 1322(b)(5). *In re Perez*, 339
24 B.R. 385, 402 (Bankr. S.D. Tex. 2006); *In re Fernandez*, 2011 WL 1404891, at *10
25 (Bankr. S.D. Tex., Apr. 13, 2011); *In re Collins*, 2007 WL 2116416, at *12 (Bankr. E.D.
Tenn., July 19, 2007). However, inasmuch as the mortgagee did not raise this issue, the
Court will refrain from addressing it *sua sponte*.

1 The Court's greater concern has to do with the effect of this provision on debtors.
2 Irrespective of whether this plan provision violates the requirements of section 1322(b),
3 the fact is that this provision and others proposing to pay attorney's fees prior to
4 postpetition mortgage payments benefit the attorney for the debtors to the detriment of
5 the debtors themselves.

6 From the debtors' perspective, the practical effects of such a provision are (1) to
7 add postpetition mortgage payments to the mortgage delinquency which the debtors must
8 cure over the life of the plan; (2) to likely result in additional postpetition late charges
9 being assessed on the account until the trustee starts disbursing the payments; (3) to often
10 cause the mortgagee to object to the plan specifically because of this or similar
11 provisions, resulting in attorney's fees incurred by the mortgage creditor, ultimately
12 added to the mortgage arrearage the debtors must pay; and (4) to increase the risk of a
13 motion for relief from stay from the mortgagee due to defaults on postpetition mortgage
14 payments, which at the least results in more attorney's fees incurred by both creditor and
15 debtors, all of which are usually paid by the debtors.¹

16 Debtors' attorney argues that failure to pay the fees "early in the case will result in
17 debtors having less access to competent counsel and increase the burden on the
18 bankruptcy system." This assertion is unsupported by any evidence or empirical support.
19 And in fact, what empirical evidence there is, seems to contradict this assertion. While
20 BAPCPA accelerated a trend to having trustees administer ongoing mortgage payments
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24 ¹ See *In re Lynch*, 109 B.R. 792, 796 (Bankr. W.D.Tenn. 1989)(" the earlier plan
25 payments begin, the less opportunity for post-petition mortgage arrearages to arise and
the less opportunity for other defaults in secured plan payments to result").

1 on delinquent mortgages in chapter 13 plans, still something on the order of 34% of
2 trustees do not administer the ongoing mortgage payments.²

3 In those venues where trustees do not administer the ongoing mortgage payments,
4 the debtor is responsible for paying the ongoing mortgage payment directly from the
5 outset of the case. Even here in Western Washington, if the mortgage(s) is current at
6 filing, the debtor may and usually does make direct payments on the obligation from the
7 very outset of the case, effectively priming the debtor's attorney fees. Local Bankruptcy
8 Rule 3015-1(j). Paying postpetition ongoing mortgage payments from the outset of a
9 bankruptcy and ahead of attorney's fees has not seemed to have any effect on obtaining
10 competent counsel in cases where the mortgage payments are being paid directly by a
11 debtor.

12 Nationally, the amount distributed to pay debtors' attorney's fees has dramatically
13 increased over the last ten years. In fiscal year 2003, chapter 13 trustees disbursed to
14 debtors' attorneys \$347,487,639 of total disbursements of \$4,197,608,806 (8.3%). In
15 fiscal year 2012, the total disbursements by chapter 13 trustees to debtors' attorneys were
16 \$688,513,428, of a total of \$7,154,888,234 (9.6%) in disbursements.³

17 For the fiscal year ending September 30, 2012 in this district alone, chapter 13
18 trustees disbursed \$ 9,783,786 in debtor's attorney's fees on total disbursements of \$
19 160,710,118 (6.1%), an increase of 157% from the \$3,806,949 in attorney's fees
20 disbursed in 2003. There are many reasons for this increase in total amount of attorney's

21 ² According to Department of Justice Chapter 13 Trustee statistics for FY 2012, 53 out of
22 182 trustees made no disbursements and 9 made only de minimis disbursements toward
23 ongoing mortgage payments. The Court has defined "de minimis" for purposes here as
24 less than \$20,000 in annual disbursements to ongoing mortgage payments.
25 http://www.justice.gov/ust/eo/private_trustee/data_statistics/ch13.htm.

³ *Id.*

1 fees disbursed, including an increased number of pending cases and the increased
2 requirements BAPCPA imposed on chapter 13 cases. But given the amount of fees
3 awarded in those cases for work through confirmation and supplemental fees awarded
4 postconfirmation, it is disingenuous to suggest that the bar would somehow abandon
5 debtors if the fees of counsel are not allowed to prime the ongoing mortgage payment.

6 Counsel also argues that there is a “longstanding local practice” of “folding” two
7 postpetition mortgage payments into the prepetition mortgage arrears due to the delay in
8 the chapter 13 trustee making the original plan payments and disbursements. In this
9 Court’s experience, it is not true that there is a standard practice during that time frame
10 concerning payment of the debtor’s attorney’s fees from those plan payments. In fact,
11 many attorneys have filed and continue to file plans which do not seek to prime the
12 ongoing mortgage to pay their fees. When the plan proposes to pay the fees “prior to all
13 creditors,” the mortgage creditor often objects to such provisions, and the debtor’s
14 counsel then provides otherwise in an amended plan or makes some other agreement with
15 the residential mortgagee. Paragraph XII(d) is merely debtor’s counsel’s latest effort to
16 rebalance the interests of counsel and the ongoing mortgage as to those initial plan
17 payment proceeds. The Court is motivated to try to deal with this issue in a systematic
18 way given the lack of consistency among debtors and mortgagees, and given its concern
19 that the debtor is not really a party in this negotiation.

20 Counsel also argues that if payment of debtors’ attorney’s fees is delayed to pay
21 the ongoing mortgage, the likelihood of plan failure will increase because there will be
22 less postconfirmation legal help available to debtors trying to save a plan. Again, this
23 statement is unsupported by any hard evidence or empirical studies. Moreover, its logic is
24 suspect. The converse seems at least as likely, i.e., if debtor’s counsel has been paid in
25 full at the outset, there may be even less reason to fight off efforts to dismiss the case, if,
as is not uncommon, the debtor defaults at some point during the plan. As noted above,

1 counsel can and very often do apply for additional fees for services provided
2 postconfirmation.

3 Counsel also argues that the “mortgage modification debacle” and “foreclosure
4 crisis” have exacerbated the problem of getting retainers and emergency filings. This
5 argument, again unsupported by any evidence, empirical or otherwise, strikes the Court
6 as a red herring. The phenomenon of debtors filing chapter 13 cases right before
7 foreclosure sales goes back to the early 1980’s, when Chapter 13 became the stratagem of
8 choice for debtors delinquent on their mortgages. Similarly, the problem of getting
9 retainers to do chapter 13 work is not new, and in light of the increase in fees disbursed to
10 the debtors’ attorneys, does not appear to have adversely affected the volume of chapter
11 13 bankruptcy filings.

12 What has changed over time are the number of courts and trustees which pay the
13 ongoing mortgage payment “inside” the plan, i.e., through the trustee’s office. Less than
14 half of trustees in 2000 (36%)⁴ administered ongoing mortgage payments, and now more
15 than two-thirds of trustees (66%) administer them.⁵

16 While there are a number of benefits to having a trustee handle ongoing mortgage
17 payments, this scramble about who gets paid first from the plan payments, the debtor’s
18 attorney or the mortgagee, is not one of them. The facile answer to this problem is that
19 the debtor should pay both the fees incurred by counsel, which are administrative claims,

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21 ⁴ According to Department of Justice Chapter 13 Trustee statistics for FY 2000, 101 out
22 of 187 trustees made no disbursements and 18 made only de minimis disbursements
23 toward ongoing mortgage payments.

24 http://www.justice.gov/ust/eo/private_trustee/data_statistics/ch13.htm. Statistics for this
25 year are categorized ordering data in a slightly different manner than is the case for FY
2012, and so these results should not be considered an exact comparison.

⁵ See *supra*, note 2.

1 *and* the ongoing mortgage payments from the outset. In truth, however, only a minority
2 of debtors have the funds available to pay all the postpetition mortgage payments as they
3 accrue *and* the debtor's attorney's fees in full at confirmation.

4 If the trustee is required to pay the ongoing mortgage payment before paying the
5 debtor(s)' attorney, no doubt the risk increases somewhat that a certain percentage of
6 cases will be dismissed before counsel is paid in full. By the same token, even without a
7 provision such as paragraph XII(d), administrative claims, including claims for debtor
8 attorney fees, still enjoy priority over distributions to mortgage arrearage cure payments,
9 and priority and nonpriority unsecured claims.

10 What is required is a balancing of the interests of the attorney for the debtor, the
11 residential mortgagee and the debtor.

12 The problem with the proposed paragraph XII(d) is that it focuses on paying the
13 debtor's counsel to the detriment of the ongoing mortgage payment, placing the risk of
14 delayed payment or nonpayment on the residential mortgagee and the debtor. The
15 primary purpose of chapter 13 cases with delinquent mortgages is to save the home but
16 proposed paragraph XII(d) actually enhances the risk to the homeowner. The Court holds
17 that if an objection is raised to a provision such as paragraph XII(d) in a plan which
18 proposes to cure the debtor(s)' residential mortgage arrearage, a proper compromise
19 balancing the interests of the mortgagee, the debtor's counsel, and most importantly the
20 debtor, would provide as follows:

21 *From funds paid by the debtor in the first sixty days from the date of filing, the*
22 *trustee shall set aside the amount of one ongoing mortgage payment for any*
23 *mortgage on the debtor's residence which the debtor proposes to pay through the*
24 *trustee, and shall continue to do so each monthly plan payment thereafter until*
25 *confirmation or court order, at which point said reserved mortgage payments shall*
be disbursed. Except as provided otherwise in the plan, the original fees of
*debtor(s)' counsel will be paid up to the presumptive fee upon confirmation **after***

1 *the reserved funds are disbursed to the residential mortgagee, provided that the*
2 *payment of the fees not interrupt payment of the mortgage payments accruing*
3 *postconfirmation. If the debtor’s counsel seeks additional original fees, they may*
4 *be paid postconfirmation after said fees are approved by the Court from funds*
5 *available after paying the ongoing mortgage payments.*⁶

6 Regarding the objection of the chapter 13 trustee to the provisions in Paragraph
7 XII(d), the trustee shall not pay fees of counsel for the debtor if the case is dismissed
8 absent a further court order, although the refund to the debtor may be returned through
9 the attorney’s office.

10 Consistent with this ruling, confirmation of the debtors’ current plan is denied. The
11 debtors have fourteen (14) days to propose an amended plan. If no amended plan is filed
12 within that period, the Chapter 13 Trustee may present an order dismissing the case.

13 */// End of Order ///*

23 ⁶ This assumes that the plan does not provide for any other plan payments prior to or at
24 the same time as the debtor’s attorney fees. In the extant case, the plan proposes to pay
25 the “vehicle creditors” prior to the debtors’ fees, which would need to be incorporated
into this provision.