

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

STEVEN R. SMITH and
ANGELA L. SMITH

Bankruptcy No. 96-51298XS

Debtor(s).

Chapter 7

OBJECTION TO FINAL DISTRIBUTION

The matter before the court is an *Objection to Final Distribution* filed by the Iowa Child Support Recovery Unit for the State of Washington (docket no. 33). The trustee, Donald H. Molstad, filed a response (docket no. 35), and the matter came on for hearing on May 5, 1998 in Sioux City. The trustee appeared on his own behalf. Robert R. Huibregtse appeared for the State of Washington. This is a core proceeding under 28 U.S.C. § 157(b)(2)(B).

Steven and Angela Smith filed their joint chapter 7 petition on May 24, 1996. Angela Smith's estate included real property in Sheldon, Iowa. Steven Smith had had a pre-bankruptcy interest in the property, but he had transferred it to his spouse. Prior to the transfer, a lien against his interest in the property had attached in favor of the State of Washington for a child support obligation to a former spouse.

Steven Smith did not schedule any debt owing to the State of Washington, and the State was not included in the mailing matrix. Child support debts were scheduled for the State of South Dakota and the Iowa Department of Human Services.

The trustee asked to sell the Sheldon property free and clear of liens (docket no. 12). No lienholders were described in the motion. The motion and notice of the motion were served on all scheduled creditors and on those parties listed in the mailing matrix. This did not include the State of Washington. The trustee proposed to sell the property for \$7,500.00.

No one objected to the motion, and on March 18, 1997, the court issued an order authoring the sale (docket no. 17). On May 13, 1997, the trustee obtained court permission to retain himself as counsel to correct title problems that came to light during the sales transaction (docket no. 19). The legal description of the property in the schedules was corrected as was the description of the property in the order authorizing the sale (docket nos. 22 and 21). The buyers' attorney objected to the quality of title because he learned of Washington's lien. When the objection was raised, the trustee contacted Robert Huibregtse concerning the title problem (Exhibit A). Huibregtse was with the Iowa Child Support Recovery Unit. The trustee asked him for his help in obtaining a release of the lien. He wrote:

I would appreciate it if you would check into this matter and check with the State of Washington to see if they would voluntarily release their lien in consideration of a lien attaching to the proceeds [of sale] here in Bankruptcy Court in the Northern District of Iowa. In furtherance of that, I have prepared a partial satisfaction and release of lien for them to sign.

Exhibit A. The trustee also wrote that it was his position that "one-half of the net proceeds would be divided among the various state agencies who have a lien on the property subject to sales expenses, etc." Id.

Huibregtse wrote to Washington's Office of Support Enforcement and recommended, based on the trustee's assurance that the lien would continue in the proceeds, that it execute the release (Exhibit B). The State of Washington released its lien. It was never added to the mailing matrix or the schedules of creditors.

The trustee concluded the sale. He filed his *Final Report and Proposed Distribution* on October 7, 1997. The report did not propose any distribution to the State of Washington on account of its lien. After payment of administrative expenses, the trustee proposed pro rata distribution of \$5,754.84 to three unsecured creditors who had filed claims--Sears Card, Greenwood Trust Co., and Mellon Bank, N.A. The *Report and Notice* were not served on the State of Washington. Notice was served on the Iowa Department of Human Services in Des Moines (docket no. 25). The State of Washington did not file a proof of claim or an objection to the Final Report. The United States Trustee reviewed the report and made no objection. The court approved the requests for compensation and the claims report (docket no. 26). The trustee distributed estate property in accordance with the report. The *Final Decree* entered on December 29, 1997 (docket no. 28).

On February 24, 1998, the State of Washington, represented by Huibregtse, filed a motion to reopen the case for the purpose of dealing with the failure of the trustee to make a distribution to the State of Washington on account of its lien (docket no. 29). The motion to reopen was granted (docket no. 31), the case was reopened, and Molstad was again appointed trustee (docket no. 32). The State of Washington then filed its *Objection to Final Distribution and Request for Recoupment* (docket no. 33). It asks that the trustee recover the portion of the estate property on which the State of Washington had a lien and that the funds be distributed to the State.

The trustee does not dispute the facts. He contends that the motion should be denied because Washington did not file a proof of claim or object to the distribution. The trustee argues that the State of Washington had notice of the *Final Report* because Huibregtse was its agent and he had actual knowledge of the *Report*.

There is insufficient evidence that at the time of the service of *Notice of the Final Report*, Huibregtse or the Iowa Department of Human Services was the agent for service of the State of Washington. I find that the State of Washington did not receive proper notice of the *Final Report*. I will consider the State's objection to the *Final Report* as timely. I conclude that it should be sustained.

The failure of the State of Washington to file a proof of claim did not have the effect of voiding its lien against the proceeds of sale. 11 U.S.C. § 506(d)(2). The trustee had agreed that the State of Washington had a lien in one-half of the proceeds of the land sale. The trustee incorrectly distributed to other creditors funds covered by Washington's lien. The proposed distribution should not have been approved. Sustaining the objection at this time is not moot as the trustee has a right to recover from a creditor any excess payment or transfer. See

11 U.S.C. § 502(j); United States v. Rhodery (In re R & W Enterprises), 181 B.R. 624, 636-37 (Bankr. N.D. Fla. 1994).

It is not appropriate in this proceeding to order the distributees to return the payments. They are not before the court. As to the motion filed, the appropriate remedy is to sustain the State of Washington's objection to the *Final Report and Proposed Distribution* on the ground that it fails to recognize Washington's lien in estate property.

IT IS ORDERED that the objection of the State of Washington to the trustee's *Final Report and Proposed Distribution* filed October 7, 1997 is sustained.

SO ORDERED THIS DAY OF MAY 1998.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order and a judgment by U.S. mail to Alvin Ford, Don Molstad, Robert Huibregtse, and U.S. Trustee.