

In the United States Bankruptcy Court

for the Northern District of Iowa

DANIEL JAMES ELLIS
Debtor(s).

Bankruptcy No. 99-00191-D
Chapter 7

ORDER RE TRUSTEE'S FINAL REPORT

On November 14, 2000, the above-captioned matter came on for hearing on Trustee's Final Report and Debtor's objection thereto. Debtor Daniel Ellis appeared with Attorney Thomas Verhulst. Trustee Sheryl Youngblut appeared in person. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A), (K), (O).

STATEMENT OF THE CASE

Debtor objects to Trustee's proposed distribution to Creditor Janet B. Ellis. Trustee's final report provides for payment to Ms. Ellis of \$24,447.04 as a priority claim for support. This is the amount listed as due on Ms. Ellis' Proof of Claim filed July 27, 1999. It represents balances due on monthly child support payments and does not include attorney fees awarded in the parties' dissolution proceedings. Debtor asserts Ms. Ellis' claim arising from the dissolution court's attorney fee judgments should also be paid as a priority claim from the bankruptcy estate.

FINDINGS

Debtor filed a Motion on March 19, 1999 to avoid liens of three creditors, including Ms. Ellis, on real estate and a 1996 Chevrolet truck which Debtor claimed exempt. Also at that time, Trustee and Ms. Ellis filed Objections to Exemptions. In resolving these matters, the Court filed a Proceeding Memo and Order on May 26, 1999, which states, in part, as follows:

[T]hose issues involving Debtor and Janet Ellis will be resolved by a filing of an adversary proceeding no later than June 8, 1999. The remaining issues involving exemption issues and lien avoidance issues will be continued and will be heard at the same time as trial in the adversary as all issues will be interrelated.

In re Ellis, No. 99-00191-D, "Proceeding Memo and Order" (Bankr. N.D. Iowa May 26, 1999).

Ms. Ellis timely filed her adversary complaint in Adv. No. 99-9085-D. The complaint asserts the attorney fee obligations are nondischargeable as being in the nature of support and that "the judgment lien does not impair any exemption to which Debtor is entitled to claim."

Ms. Ellis' judgments for attorney fees arise from the parties' dissolution proceedings. On September 17, 1996, the Buchanan County, Iowa District Court awarded Ms. Ellis a total of \$3,700 in attorney

fees for services rendered by attorney Donna Lesyshun of Tyler Lesyshen Law Firm.⁽¹⁾ Debtor conceded the nondischargeability of \$200 of this total which represented a penalty for contempt. The dissolution court awarded Ms. Ellis an additional attorney fee judgment on September 2, 1997 for \$4,100 for services rendered by her attorney Lucy E. Harrington of White & Johnson law firm.⁽²⁾ Based on the current record, the Court assumes that any claims by Tyler Lesyshen Law Office or Lucy E. Harrington and White & Johnson are subsumed by the attorney fee judgments held by Ms. Ellis.

These judgments for attorney fees were rendered in Buchanan County, Iowa. Debtor's homestead real estate is located in Clayton County, Iowa. It is unclear from the record whether Ms. Ellis' judgments attached to Debtor's real estate as judicial liens. According to Iowa law, in order to become a lien on real estate, a judgment must be registered in the county where the property is located unless the court that rendered the judgment is located in the same county as the property. Iowa Code §§ 624.23-24; Crawford v. Hall, 464 N.W.2d 464, 465-66 (Iowa App. 1990).

Ms. Ellis levied on Debtor's 1996 Chevrolet truck, VIN #1GEGK29R5TE161414, to secure her Buchanan County attorney fee judgments. The judgments, therefore, constitute a lien on Debtor's truck. The title to the truck also shows a previously perfected lien of Creditor GMAC.⁽³⁾ On July 15, 1998, the date the sheriff levied on Debtor's truck, the total due on Ms. Ellis' judgments was \$8,783.08 which represents the amounts of the two judgments plus interest awarded by the dissolution court.

On March 14, 2000, this Court ruled in Ms. Ellis' adversary case that the attorney fees awarded in the parties' dissolution proceedings are excepted from discharge under §523(a)(5). The Court's ruling concludes the attorney fee obligations are in the nature of support. The ruling does not directly address avoidance of the liens on Debtor's real estate and the 1996 Chevy truck. However, liens for obligations that are in the nature of support and nondischargeable under §523(a)(5) are not avoidable under §522(f)(1)(A).⁽⁴⁾

In conclusion, Ms. Ellis' claim for attorney fees is nondischargeable and is secured by a nonavoidable judgment lien on Debtor's 1996 Chevy truck and, perhaps, on Debtor's homestead real estate. Ms. Ellis' claims are priority claims in Debtor's case pursuant to §507(a)(7). Further, they are secured claims to the extent of the liens on Debtor's 1996 Chevy truck and real estate.

CONCLUSIONS OF LAW

Debtor argues that Ms. Ellis' claim arising from the judgments for attorney fees should be paid from property of the estate as a priority claim. This argument requires the Court to determine whether this claim should be treated as a secured claim or a priority claim, or both.

Generally, if a lien is perfected, it must be satisfied out of the asset it encumbers before any proceeds of the asset are available to priority or general unsecured creditors. In re Darnell, 834 F.2d 1263, 1265 (6th Cir. 1987). "One of the central functions of a bankruptcy case is to distribute the assets of the debtor among the various creditors. . . . First in line are property claimants, such as secured creditors . . . who receive either their property or its equivalent value. The remaining assets in the estate are then distributed to all unsecured, general creditors. . . . Priority claims are entitled to be paid before other unsecured, nonpriority claims." Norton Bankruptcy Law and Practice 2d §42:1 at 42-3 (1997). Priority claims are subordinated to claims that are secured by a perfected lien against the debtor's property. Darnell, 834 F.2d at 1266.

Although Ms. Ellis did not list her secured claim in the Proof of Claim she filed, her filings in the bankruptcy case and the adversary proceeding are sufficient to constitute an informal proof of claim. See In re Wigoda, 234 B.R. 413, 415 (Bankr. N.D. Ill. 1999); In re Scott, 227 B.R. 832, 834 (Bankr. S.D. Ind. 1998). The deadline for filing a proof of claim in this case was July 6, 1999. Ms. Ellis filed her proof of claim for support payments on April 29, 1999. She filed her adversary complaint on June 8, 1999.

Creditors with secured claims, such as Ms. Ellis' claim based on the dissolution court's attorney fee judgments, are entitled to satisfaction from their collateral. A debtor's assets are, generally, subject to and must first be used to satisfy perfected liens that attach to the property. In re Buzzworm, Inc., 178 B.R. 503, 511 (Bankr. D. Colo. 1994). Only after looking to their collateral do secured creditors receive distribution from the bankruptcy estate as undersecured claimants. Deficiency claims of a secured creditor are general unsecured claims. In re Harloff, 247 B.R. 523, 529 (Bankr. M.D. Fla. 2000). An undersecured creditor holds a secured claim only to the extent of the value of its collateral. In re Schwinn Bicycle Co., 200 B.R. 980, 988 (Bankr. N.D. Ill. 1996). Any remaining balance is deemed an unsecured deficiency claim and entitles its holder to share pro rata with other unsecured creditors in a Chapter 7 distribution. Id.

If Ms. Ellis is undersecured, however, her deficiency claim is not merely a general unsecured claim, but is a priority claim under §507(a)(7). Generally, only unsecured claims receive priority under §507(a). See In re Wrigley, 195 B.R. 914, 915 (Bankr. E.D. Ark. 1996) (stating property tax claimant must look first to its collateral for payment of its debt rather than claiming a priority under §507(a)); United States v. TM Building Products, Ltd., 231 B.R. 364, 371 (S.D. Fla. 1998) (same re IRS claim for unpaid social security and unemployment taxes).

In Wrigley, the Court noted that the priority provision for taxes, now §507(a)(8), applies only to unsecured property taxes according to its express language. 195 B.R. at 915. Likewise, in TM Building Products, the court held that, with a tax lien perfected prepetition, the creditor is classified as "secured" and the priority rules of §507(a)(8) do not apply. 231 B.R. at 371.

Unlike all of the other priorities, §507(a)(7) is not expressly limited to unsecured claims for alimony, maintenance or support. It has been noted that this was probably a legislative oversight. Collier Bankruptcy Manual ¶ 507.09, at p. 507-29 (Lawrence P. King ed., 1999). No other cases address whether §507(a)(7) should include secured claims for alimony, maintenance or support in the priority distribution. The Court believes allowing secured claims to receive priority under §507(a)(7) would undermine the Bankruptcy Code's distributive scheme. Secured creditors' claims can be satisfied through their collateral. Bankruptcy trustees collect all of a debtor's property which is free from liens to distribute to unsecured creditors, after priority claimants are paid. Allowing Ms. Ellis's secured claim to be paid as a priority claim would result in Debtor retaining an asset regardless of the lien and Ms. Ellis receiving a distribution from the estate which reduces the amount available to unsecured creditors. Although the language of §507(a)(7) does not limit its effectiveness to unsecured claims, the Court will apply it here only to the extent Ms. Ellis is undersecured.

Based on the foregoing, Ms. Ellis has a secured claim to the extent of the value of her collateral. See 11 U.S.C. 506(a). Because Ms. Ellis' claim is also a §507(a)(7) priority claim, she is entitled to priority distribution from the bankruptcy estate to the extent she may be undersecured by the collateral. The Court is not able to determine the extent to which Ms. Ellis is secured based on the present record.

It is necessary to determine the value of Ms. Ellis' secured claim before the Court can gauge the extent of her priority claim to be payable from the estate. Therefore, an evidentiary hearing is necessary. Ms. Ellis is entitled to notice of this hearing pursuant to Fed. R. Bankr. P. 3012. Procedures to be followed are set out in Local Rule 3012-1. The Court requests the parties present evidence from which the Court may make findings regarding the following information:

1. The value of Debtor's 1996 Chevy truck and the amounts and priorities of any other liens on the truck.
2. Proof of any lien on Debtor's homestead real estate arising from Ms. Ellis' attorney fee judgments.
3. If Ms. Ellis has a lien on the homestead, the value of the homestead and the amounts and priorities of any other liens on the homestead.
4. If Ms. Ellis' claim which is undersecured, the amount of her claim which is undersecured and entitled to priority payment under §507(a)(7).

WHEREFORE, further hearing on Trustee's Final Report and Debtor's Objection thereto is necessary.

FURTHER, the parties are directed to present evidence as to the above matters at a hearing scheduled for:

January 31, 2001 at 11:00 a.m.

in the Bankruptcy Court Room, 6th & Locust, Federal Building, U.S. Post Office, DUBUQUE, IOWA.

FURTHER, notice of this Order shall be given to Creditor Janet Ellis.

SO ORDERED this 4th day of December, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge

1. The Tyler Lesyshen Law office filed a Proof of Claim on April 16, 1999. It asserts an unsecured claim of \$3,351.81. Apparently, this claim duplicates Ms. Ellis' September 17, 1996 attorney fee judgment. The Final Report proposes payment of \$82.62 to Tyler Lesyshen Law Office as an unsecured creditor.

2. Debtor's schedules include Lucy E. Harrington as an unsecured creditor with a claim of \$4,000 constituting attorney fees awarded against Debtor arising from child support. Neither Ms. Harrington nor White & Johnson filed a proof of claim; Trustee proposes no distribution on this scheduled claim in the Final Report.

3. The Court notes that Debtor reaffirmed his debt to GMAC on March 19, 1999 in the amount of \$6,698.26, to be paid over a period of 19 months. According to the Court's calculations, this amount was scheduled to be paid in full by now.

4. Debtor is only entitled to avoid Ms. Ellis' liens if the liens do not secure a debt for maintenance, alimony or support. In re Taylor, 233 B.R. 639, 642 (S.D.N.Y. 1999); 11 U.S.C. §522(f)(1)(A)(i). The 1994 amendments to §522(f) excepted judicial liens involving support from Debtor's avoidance rights.

In re Lowe, 250 B.R. 422, 424 (Bankr. M.D. Fla. 2000). The language of the support exception to lien avoidance is the same as the language for excepting debts for support from discharge under §523(a)(5) and was intended to be read coextensively with it. Id. at 426; In re Allen, 217 B.R. 247, 249 n.3 (Bankr. S.D. Ill. 1998). A lien securing an attorney fee award which constitutes a support debt under §523(a)(5) is excepted from Debtor's avoidance rights under §522(f)(1)(A). Allen, 217 B.R. at 250.