UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In Re:

RANDY PIAZZA
DAWN PIAZZA

Case No. 92-12792 K

Debtors

The facts of this case are unique. The question presented is how the Chapter 13 Trustee should disburse $6,728 that he is holding, now that the Debtors have exercised their absolute right under 11 U.S.C. § 1307(b) to withdraw from their Chapter 13 case. The money can either be distributed to the Debtors, secured creditors, unsecured creditors, or some combination of the above.

Tonawanda Valley Federal Credit Union is an unsecured creditor in this 1992 Chapter 13 case. Through counsel, it successfully pressed objections to confirmation of the Debtors' plan for failure of the Debtors to make some provision in favor of creditors for the prospect of success in a personal injury action which Debtor Dawn Piazza was prosecuting in another forum. As a result of the credit union's efforts, and after substantial proceedings including at least two hearings before the Court, the Debtors agreed that the following language would be contained in this Court's order confirming their Chapter 13 plan:

1. Trustee and attorney Don Iwanicki are to be kept

advised of personal suit progress.

2. Trustee must approve any settlement of personal injury suit in writing.

3. Trustee retains interest in suit.

Tape recordings of the hearings before the Court make it clear that the credit union's concerns, which led to the inclusion of the above language, were two-fold. First, it was important that there be recognition that some portion of any proceeds of that personal injury lawsuit might not be exemptible under 11 U.S.C. § 522 and New York Debtor and Creditor Law Article 10a. Second, it was important that the Debtors not be permitted to channel their income to the payment only of secured debts while the lawsuit was pending, and then withdraw from the Chapter 13 case before realizing any proceeds from the personal injury action, thereby leaving unsecured creditors with no remedies or rights as to the non-exempt proceeds.

The language inserted in the Order of Confirmation, to which the Debtors agreed, addressed these concerns. It is absolutely clear from the tape recorded colloquies that the possibility had not been entertained that the Debtors would withdraw from their Chapter 13 Plan before their secured debts were paid. The fear had been that they would withdraw after their pre-petition mortgage arrears had been paid and after the stripped-down value of their 1989 Bronco had been paid. In fact, the personal injury cause of action was settled, with permission of this Court, in the summer of 1993 for $25,000. After payment of attorneys' fees and after Court approval of a

proposal whereby the Debtors received $10,000 from the net proceeds to compromise their claim of exemption, the Chapter 13 Trustee obtained funds now totalling $6,728.

The Debtors filed their affidavit withdrawing from Chapter 13 on December 28, 1994. At that time, $2,870 was still unpaid on the pre-petition mortgage arrears owed to Citicorp Mortgage. No funds had been distributed to filed unsecured claims totalling approximately $7100, and the Debtors were asserting entitlement to all of the funds held by the Trustee.

The Court can readily dispose of the Debtors' argument that they are entitled to these funds. Although they have an absolute right to withdraw from Chapter 13, that does not mean that rights that were given to creditors in their Plan or the order confirming the Plan are nullified as to a *res* in existence. "The provisions of a confirmed plan bind the debtor and each creditor...." 11 U.S.C. § 1327(a). Dismissal of the case at the Debtors' request does not undo that binding affect.

The Debtor alternatively argues that the secured claims should be paid in full before any distribution is made to unsecured claims, since that is the normal distributive priority set forth by Chapter 13 Debtors in their plans and the orders confirming plans. Such a distribution inures to the benefit of debtors because each payment to secured creditors redeems the collateral from that dollar amount of lien. If that alternative argument were sustained here,

the $6,728 on hand would be paid as follows: $2,870 to Citicorp Mortgage and the balance to be shared pro rata among over $7,000 of unsecured claims.[1]

The credit union argues, however, that rights as to the proceeds of the personal injury action were battled for and obtained for the protection of unsecured creditors, that secured creditors are protected by their interest in collateral other than these funds, and that the funds should be distributed entirely to unsecured creditors pro rata.

These arguments persuade the Court that the funds should not be distributed first to secured creditors, but the answer to the question of whether secured creditors should receive anything at all is not so clear.

The record in this case, including the recordings of the hearings, unequivocally demonstrate that the proceeds of the personal injury settlement were not simply to be treated as general property of the estate, such as the regular deductions from the Debtors' income, that would be subject to the general provisions of the Plan.

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[1] In open court at the most recent hearing, counsel for Tonawanda Valley Federal Credit Union raised issue as to the allowability of a certain student loan claim in the amount of $2,542 on the grounds that it had not initially been scheduled by the Debtor. The credit union suggests that the claim might be a post-petition claim, or perhaps a late-filed claim, not allowable in the case. If this were so, the pro rata share of other unsecured claims would be increased, but no objection has been filed by anyone as to the student loan claim, and the Court must, for now, consider the claim to be allowable along with other unsecured claims.

Instead, the record clearly shows that the Debtors' counsel, the credit union's counsel, the Chapter 13 Trustee, and the Court all assumed that secured claims would have been paid in full from the income of the Debtors before these funds were to be distributed. No provision was made for the current circumstance. Upon whom shall the burden of this oversight fall?

Any distribution to the secured creditor would benefit the Debtors by redeeming their house from that dollar amount of lien, and it was only through the efforts of an unsecured creditor that this fund was created. However, it is not at all clear that some provision for secured creditors would not have been successfully bargained for by the Debtors at the time of confirmation had the problem been foreseen.

There is no answer to this question at law, and any claim by the Court to have discerned an answer in the record would not be intellectually honest. The Court must look solely to equity. In doing so it rejects the Chapter 7 model -- the result that would be obtained if the case were converted to Chapter 7 -- for the simple reason that this case is in fact not converting to Chapter 7. By withdrawing from Chapter 13, which is their right, the Debtors are seeking to avoid the Chapter 7 result, and no suggestion has been made that this case may be converted to Chapter 7 over their objection.

The Court Orders as follows:

Subject to any claims objection,[2] the Chapter 13 Trustee shall:

1. Deduct from the sum on hand his commissions and expenses in the usual manner.

2. Pay $1500 on account of the remaining secured claim.

3. Pay the remaining amounts to timely-filed pre-petition unsecured claims pro rata.

Said distribution will result in a higher percentage payment to unsecured creditors than to the secured creditor.

IT IS SO ORDERED.

Dated: Buffalo, New York
February 24, 1995

/s/Michael J. Kaplan
_____
U.S.B.J.

[2]If the Trustee or the Credit Union wishes to object to the student loan claim, it shall be done within 20 days after the Debtors respond to any inquiry regarding that claim, and any distribution of funds shall await the outcome of such objection.