

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT

BANKRUPTCY JUDGE

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June 4, 2004

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Subject: *In re Nichole M. Morrison,*
Chapter 13; Bankr. No. 04-40185

Dear Counsel and Trustee:

The matter before the Court, as a part of the confirmation of Debtor's plan dated February 17, 2004, is whether Debtor, over the objection of the United States' Rural Housing Service, should be allowed to pay her regular monthly mortgage payments to Rural Housing directly while her payments that cure the mortgage arrearage to Rural Housing are being made through the Chapter 13 trustee. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter decision and accompanying order shall constitute the Court's findings and conclusions pursuant to Fed.Rs.Bankr.P. 7052 and 9014(c). As discussed below, Debtor will be given conditional approval to make her regular payments directly to Rural Housing.

Summary. Nichole M. Morrison owns a home in Huron, South Dakota. The United States Department of Agriculture's Rural Housing Service ("Rural Housing") holds the mortgage on the property. Morrison became delinquent on her mortgage payments beginning in January 2002.

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Morrison ("Debtor") filed a Chapter 13 petition in bankruptcy on February 17, 2004. At the time of her petition, she stated she owed Rural Housing \$72,616.76 while her home was worth \$62,216.00. In her plan, Debtor acknowledged she was in default to Rural Housing for \$9,947.06 and she proposed to repay this sum through the Chapter 13 trustee over several years with interest. In her plan, Debtor also stated that she would make directly her regular monthly mortgage payment of \$539.86 to Rural Housing.

Debtor's monthly plan payments, both direct and through the case trustee, totaled \$865.16. Debtor's monthly income, all from fixed sources, is \$2,386.68, and her monthly expenses, excluding her mortgage payment, are \$1,521.52. That leaves Debtor with no income cushion above her proposed plan payments.

Rural Housing objected to Debtor's proposed plan. It said that the value of the home should be stated at \$71,464.42 and that Rural Housing should be listed as fully secured. Rural Housing also objected to the regular mortgage payments being made directly. It also wanted the plan clarified to state that Debtor had not claimed a homestead exemption and that Debtor's monthly mortgage payments could vary based on a change in Debtor's subsidy or her escrow account.

A confirmation hearing was held May 5, 2004, and short briefs were received from counsel on the direct payments issue.

Discussion. Section 1326(c) of the Bankruptcy Code provides:

Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

This Court has previously ruled that under the language of § 1326(c)¹, a Chapter 13 plan may provide both for payments

¹ At the time the *Hines* decision was entered, § 1328(c) was actually § 1328(b), though the language was identical. Amendments to the statute in 1984 added a new subsection (a) and moved subsection (b) to subsection (c).

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through the case trustee and also for payments made directly from the debtor to the creditor. *In re Hines*, 7 B.R. 415, 420 (Bankr. D.S.D. 1980)(Ecker, J.). The Court also held that, except for direct payments on a home mortgage, any direct payments by the debtor were subject to the trustee's standing fee, just as were payments made by the case trustee. *Id.* at 420-21. The Court gave several equitable reasons for exempting home mortgage payments from the general trustee fee scheme.

A different conclusion was reached in *In re Weber*, 114 B.R. 194 (Bankr. D. Neb. 1988). In *Weber*, the court held that a debtor could not cure a mortgage default with payment through the case trustee while making regular monthly payments directly to the creditor. *Id.* at 196. The court, relying on *Foster v. Heitkamp (In re Foster)*, 670 F.2d 478, 489 (B.A.P. 5th Cir. 1982), held such a provision violated 11 U.S.C. § 1322(b)(5), which allows a Chapter 13 plan to "provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending."

A few years after *Hines*, the United States District Court for the District of South Dakota ruled on a similar issue in a Chapter 12 case. In *Yarnall v. Erickson Partnership (In re Erickson Partnership)*, 83 B.R. 725 (D.S.D. 1988), the Court held that a Chapter 12 debtor could make direct plan payments to secured creditors if the proposed payments did not discriminate unfairly and if they are proposed in good faith. *Id.* at 727-28. Good faith was to be considered in light of whether the creditor had agreed to be paid directly, whether the creditor was able to self-monitor payment, and whether a remedy device was included in the direct payment scheme. *Id.* at 728. The Court reached its conclusion based both on the language of 11 U.S.C. § 1226(c), which is identical to § 1326(c), and other Chapter 12 statutes, and also on relevant case law. Differing from the Chapter 13 case of *Hines*, however, the parties and the Court all agreed that the Chapter 12 debtor did not have to pay trustee's fees on the plan payments that the debtor made directly to creditors. *Id.* at 727.

The reasoning in *Erickson* was adopted by the Court of Appeals for the Eighth Circuit in *Wagner v. Armstrong (In re Wagner)*, 36 F.3d 723 (8th Cir. 1994). The Court held that a Chapter 12 debtor could make payments directly to a secured

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creditor and that the direct payments were not subject to the case trustee's fees. *Id.* at 726-28; accord *Haden v. Pelofsky*, 212 F.3d 466, 472 (8th Cir. 2000)(Chapter 12 plan may provide for direct payments if other requirements for confirmation are met).

Because § 1326(c) is identical to § 1226(c), this Court will follow the guidance of *Wagner*, and will allow Debtor to pay directly her regular monthly mortgage payments to Rural Housing. However, guided by *Erickson*, the Court concludes that a remedy device for Rural Housing should be in place because of the large arrearage and because the feasibility margin of Debtor's plan is slim. Accordingly, while Debtor may make her regular monthly mortgage payments to Rural Housing directly, if she becomes delinquent on those payments by more than ten days, all subsequent regular mortgage payments² shall be made through the case trustee and shall be subject to the trustee's statutory fee. This change in payment procedure will be triggered by an affidavit of default filed by counsel for Rural Housing and an order of this court, which will be entered without further notice or hearing.

Debtor shall prepare a Plan as Confirmed that is consistent with this letter decision and with the earlier agreements she made with Rural Housing regarding its other objections to her plan.

Sincerely,
/s/ Irvin N. Hoyt
Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: case file (docket original)

² If Debtor's arrearage in regular monthly mortgage payments through the case trustee grows, both the case trustee and Rural Housing may, of course, move to dismiss or convert the case under 11 U.S.C. § 1307(c)(6).