INSURANCE PROCEEDS IN CONSUMER CASES

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"The best-laid schemes o' mice an' men. Gang aft a-gley." Robert Burns, To a Mouse[1]

INTRODUCTION

The Chapter 13 was filed. The 341 went smoothly. The case was confirmed on the first setting. The debtor paid regularly and on time for three and a half years. What could possible go wrong? Well, there's a decent chance the debtor will get in a car wreck[2] or have some other damage to secured property that results in an insurance claim, which will in turn lead to competing claims with regard to the insurance proceeds. Does the secured creditor have a lien on the proceeds? What happens to the secured claim? Can the debtor use the proceeds to buy a replacement car/house? Can the trustee take the proceeds to pay the unsecured creditors and/or take their fee from the proceeds? This paper attempts to answer some of these questions.

CHARACTER OF INSURANCE PROCEEDS

Whenever there are insurance proceeds which are payable to a debtor or which are related to the business or property of the debtor or the estate, the first question which needs to be asked is: "Are the insurance proceeds property of the estate?" As with almost every legal question, the answer is: "It depends."[3]

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[1] For those of you who are not Scottish: "The best laid plans of mice and men often go astray."

[2] According to the National Highway Traffic Safety Administration, there were 6,756,000 motor vehicle traffic crashes in 2019. According to statistica.com, there were approximately 280 million vehicles operating on the roads in the United States in the fourth quarter of 2019. Thus, the average vehicle had approximately a 1 in 41 chance of being in a car wreck. This doesn't include damage to vehicles from non-traffic sources like floods, fire, or hail.

[3] The author has long opined that the first answer to any legal question is "It depends" followed by a series of questions to determine the facts and circumstances surrounding the issue. Indeed, it is hard to go wrong always starting with "it depends" if for no other reason than it gives the attorney time to think about the correct answer.

The character of the insurance proceeds will have a profound effect on how they are treated in the bankruptcy. If the proceeds are property of the estate under 11 U.S.C. §541(a)(1), then they will be subject to the jurisdiction of the bankruptcy court. If they are property of the debtor or property of the estate, they will be further subject to the automatic stay of 11 U.S.C. §362, and creditors will have to obtain relief from the stay to, for instance, accept and apply the insurance proceeds.[4] To the extent that insurance proceeds are property of the estate, those proceeds may increase the overall value of the estate for the benefit of creditors.

Section 541(a) of the Bankruptcy Code defines "property of the estate" quite broadly. Property of the estate includes, "all legal or equitable interests of the debtor in property as of the commencement of the case." Based on this broad definition, courts generally include the debtor's insurance policies themselves as property of the estate.[5] *See, Matter of Gulf Tampa Drydock Co*, 49 B.R. 154 (Bankr.M.D.Fla. 1985). In that case, Judge Paskay held that certain policies which covered various aspects of the debtor's business were property of the estate. *Id*. at 157. Thus, they were subject to the automatic stay and could not be cancelled by the insurance company. *Id*. Further, as property of the estate, the trustee could use or sell the policies pursuant to 11 U.S.C. §363. *Id*.

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[4] The automatic stay is implicated in a number of areas with regard to insurance proceeds, as set forth hereinbelow. For instance, a creditor may issue a Letter of Guaranty assuring the insurance company it will release a vehicle title once paid. The amount the creditor puts in the Letter of Guaranty may have implications with regard to attempting to collect a debt. Further, if the creditor accepts insurance proceeds and releases the title, it may have exercised control over property of the estate.

[5] Note, however, that just because an insurance policy covers the property of the estate or the property of the debtor, that policy may not be the debtor's policy. For instance, force-placed insurance may have been obtained by and list the lien creditor as beneficiary, so the estate would have no interest in the policy. On the other hand, if the creditor obtains force-placed insurance but charges the debtor for it and lists the debtor as beneficiary and the creditor as loss payee, the policy may be property of the estate. Or, for instance, a co-debtor may purchase a policy which lists the debtor as an insured or a covered driver on the policy, but the policy itself will be the property of the co-debtor, not the debtor or the estate.

Even though the policy itself may be property of the estate, however, the proceeds may not be, depending on the type of policy and the policy language at issue. See, *In re Louisiana World Exposition, Inc*., 832 F.2d 1391, 1399 (5th Cir. 1987)(Ownership of a policy "does not inexorably lead to ownership of the proceeds."). "The question is not who owns the policies, but who owns the liability proceeds. Although the answer to the first question quite often supplies the answer to the second, this is not always so..." *Id*.

Liability Policies

As a general rule the proceeds of most standard liability policies are not considered property of the estate. As the Fifth Circuit has explained:

> The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.
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> Examples of insurance policies whose proceeds are property of the estate include casualty, collision, life, and fire insurance policies in which the debtor is a beneficiary. Proceeds of such insurance policies, if made payable to the debtor rather than a third party such as a creditor, are property of the estate and may inure to all bankruptcy creditors. But under the typical liability policy, the debtor will not have a cognizable interest in the proceeds of the policy. Those proceeds will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract.

Matter of Edgeworth, 993 F.2d 51, 55-56 (5th Cir. 1993)(footnotes omitted).

Since liability insurance proceeds are not property of the estate, and because payment of the liability insurance proceeds to the liability claimant will reduce the unsecured creditor pool in the bankruptcy, courts will often lift the automatic stay to allow a liability claimant to proceed solely against the insurance proceeds. *See, In re Calsol, Inc*., 419 F. App'x 753 (9th Cir. 2011); *Baez v. Med. Liab. Mut. Ins. Co.*, 136 B.R. 65, 68 (S.D.N.Y. 1992); *In re Fernstrom Storage &*

Van Co., 100 B.R. 1017, 1023 (Bankr. N.D. Ill. 1989), *aff'd*, 938 F.2d 731 (7th Cir. 1991). Since the suit does not involve property of the estate, one court noted:

> Since the Debtors' equity in property is not at issue here, the burden to resist lifting of the stay rests entirely with the Debtor. Curiously, the cases considering such requests for relief tend toward asking the question: "Why should the court lift the stay?" The statute, by its burden shifting, seems almost instead to ask, "why shouldn't the stay be lifted?"

In re Abeinsa Holding, Inc., No. 16-10790 (KJC), 2016 Bankr.LEXIS at *7-8 (Bankr. D. Del. Oct. 6, 2016).[6]

On the other hand, proceeds that are paid directly to a debtor pursuant to the terms of the policy will generally be property of the estate. As noted above, the Fifth Circuit said:

> Examples of insurance policies whose proceeds are property of the estate include casualty, collision, life, and fire insurance policies in which the debtor is a beneficiary. Proceeds of such insurance policies, if made payable to the debtor rather than a third party such as a creditor, are property of the estate and may inure to all bankruptcy creditors.

Matter of Edgeworth, 993 F.2d 51, 55-56 (5th Cir. 1993)(footnotes omitted).

Note, however, that the Fifth Circuit said that such proceeds *may* inure to all bankruptcy creditors. That will not always be the case. Even where insurance proceeds are considered property of the estate, the proceeds may not be available for distribution to unsecured creditors.

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[6] Although it is beyond the scope of this paper, it is worth noting that some courts have prohibited creditors from pursuing insurance proceeds in a separate proceeding because such proceeding may exhaust the proceeds directly affecting the unsecured creditor's pool in the bankruptcy. *See, i.e.*, *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1008 (4th Cir. 1986), *cert. denied*, 479 U.S. 876, 107 S.Ct. 251, 93 L.Ed.2d 177 (1986). This can also be the case with regard to Director and Officer insurance covering both the debtor's officers and directors and the debtor itself. *See, In re Circle K Corp*., 121 B.R. 257 (Bankr.D.Ariz. 1990). For a fuller discussion on this issue, see, Epling, Brennan & Johnson, *Intersections of Bankruptcy Law and Insurance Coverage Litigation*, Norton Journal of Bankruptcy Law and Practice, Vol. 21 #2, 2012.

Indeed, the Fifth Circuit recently recognized this exception to *Edgeworth* in *In re OGA Charters, L.L.C.*, 901 F.3d 599 (5th Cir. 2018) in which it held that the apparent insufficiency of insurance proceeds due to the policy limit gave the debtor an equitable interest in having the proceeds applied to satisfy as many claims as possible, which was enough to bring the policy proceeds into "property of the estate."

> At least one case makes reference to a the fact that if proceeds were considered property of the estate, then such proceeds would be subject to the distributive priorities accorded under the Bankruptcy Code. *See, In re Sfuzzi, Inc*., 191 B.R. 664 (Bankr.N.D.Tex.1996), *see also*, 11 U.S.C. 726 ("property of the estate shall be distributed" according to priority); 11 U.S.C. § 507, 1129. Such a situation is clearly untenable, because, by the happenstance of viable claims of certain creditors to proceeds from the insurance policies, it would effectively allow creditors with claims not covered under the insurance policies, and thus, not entitled to recover directly from the insurers under the insurance policies, to recover indirectly through a distribution of property of the estate. Although this Court ultimately agrees with the conclusion reached by the bankruptcy court in *Sfuzzi*, this Court is not of the opinion that a finding that the proceeds are property of the estate would result in distribution of such proceeds among creditors without claims covered by the particular insurance. Property of the estate comes into the estate subject to all restrictions applicable to that property under state law, unless the restriction is undone by the Bankruptcy Code. *See, Board of Trade v. Johnson*, 264 U.S. 1, 44 S.Ct. 232, 68 L.Ed. 533 (1924); *see also, Butner v. United States*, 440 U.S. 48, 54–55, 99 S.Ct. 914, 917–918, 59 L.Ed.2d 136 (1979). Thus, the insurance proceeds, if they were considered property of the estate, necessarily would be distributed only to those to whom the state insurance law, or the policies themselves, gave a right to distribution.

Landry v. Exxon Pipeline Co., 260 B.R. 769, n.62 (Bankr.M.D.La. 2001).

Credit Life and Credit Disability Policies

As one law review article noted: "Creditors win cases involving credit life and credit disability insurance." Joann Henderson, Bankruptcy Disaster Relief: A Chapter 13 Debtor's Right to Use Insurance Proceeds to Repair or Replace Collateral, 35 Gonz. L.Rev. 21, 36 (1999/2000). The leading case on credit life is *First Fidelity Bank v. McAteer*, 985 F.2d 114 (3rd Cir. 1993). In *McAteer*, the joint debtors had credit life. One of the debtors died and the surviving debtor moved to compel the creditor to turn over credit life proceeds in excess of the amounts due to the creditor under the confirmed plan. The Bankruptcy Court ordered the proceeds turned over. The District Court affirmed. The Third Circuit overturned the lower courts and held that the proceeds were the property of the creditor, not the debtor or the debtors' estate.

The Court first noted that ownership of the policy does not necessarily entail ownership of the proceeds, as noted above. The Court said:

> Ownership of a life insurance policy, such as involved here, does not necessarily entail ownership of the proceeds of that policy. Several different parties may have a property interest in such a policy or its proceeds, including the owner, the insured, and the beneficiary, all of whom may be different persons. A purchaser or owner may take out a policy, for example, on the life of a person in whom he or she has an insurable interest such as a spouse and name a child as the beneficiary. On the other hand, the owner may buy a policy on the life of his or her spouse and name himself or herself as beneficiary. In any event, once the insured dies, the beneficiary, who may or may not be the owner of the policy, becomes entitled to the proceeds of the policy. *Aetna Life Ins. Co. of Hartford, Conn. v. Acker*, 93 F.2d 975 (3d Cir.1937).

Id. at 116.

The Court then relied on the Fifth Circuit's *Louisiana World Exposition* case (cited above) to note that the filing of the bankruptcy cannot create a greater interest than those which the Debtor would hold outside of bankruptcy:

> Furthermore, if the owner of a life insurance policy did not have an interest in its proceeds, the filing of the petition in bankruptcy cannot create one. 11 U.S.C. § 541(d) provides:
>
> > Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, ... becomes property of the estate ... only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.
>
> Thus, "the estate's legal and equitable interests in property rise no higher than those of the debtor," *In re Gagnon*, 26 B.R. 926, 928 (Bankr.M.D.Pa.1983). The estate in bankruptcy only includes property to which the debtor would have had a right if the debtor were solvent. *In re Louisiana World Exposition, Inc*., 832 F.2d 1391, 1401 (5th Cir.1987).

Id.

The *McAteer* Court then went on to note that the debtor argued that the confirmed plan was res judicata and therefore bound the creditor, arguing that meant that any insurance proceeds over-and-above those needed to pay the allowed secured claim under the plan would thus be property of the estate. But the Third Circuit noted that while the confirmed plan bound the

creditor, it did not bind third parties liable on the debt, such as the credit life insurance company.

> Furthermore, the protection from liability afforded the debtor under the Code does not affect the liability of the debtor's insurers. Courts, relying on 11 U.S.C. § 524(e), have allowed claimants to proceed with tort claims against the debtor for the purpose of collecting from the debtor's liability insurer. See e.g. *Green v. Welsh*, 956 F.2d 30 (2d Cir.1992); *In re Jet Florida Systems, Inc*., 883 F.2d 970 (11th Cir.1989). Thus, the creditor remains free to collect the full amount of the original obligation from any non-debtor party such as a guarantor or insurer.

Id. at 118. Thus, the Third Circuit held:

> In sum, the debtor Raymond McAteer simply owned the credit life insurance policy. FFB, and not McAteer, was the primary beneficiary. FFB's interest in the proceeds of the life insurance policy is not the property of the debtor's estate and thus cannot be altered by the confirmation of the Chapter 13 plan. Under the life insurance policy, in case of Mr. McAteer's death, the insurance company was required to pay the amount remaining under the schedule of indebtedness to FFB, the primary beneficiary. The confirmation of McAteer's Chapter 13 plan did not work to erase or alter FFB's right, as a third party beneficiary, to collect from the insurance company. Rather McAteer's discharge altered FFB's rights to collect from McAteer or from property of the estate. Therefore, the bankruptcy court cannot now alter the insurance contract's terms by reinterpreting the "debt" to mean the smaller "cram down" amount.

Id. at 118-119 (footnote omitted).

A similar result was reached with regard to credit disability policies in *In re Motto*, 263 B.R. 187 (Bankr.N.D.N.Y. 2001). The Court noted that, "The purpose of credit disability insurance is to protect the interests of the lender in the event of a debtor's unforeseen disability and to mitigate a debtor's hardship in light of such disability." *Id*. at 193. The Court relied upon New York insurance law to hold that:

> [A] policy of credit disability insurance vests in the borrower no rights to the proceeds derived from a claim under the policy, rather, it is only after the indebtedness has been satisfied that a borrower gains any rights to surplus proceeds. In the context of bankruptcy, a credit disability insurance policy vests in a debtor only "rights which could potentially affect the proceeds; however; the [d]ebtor does not have the type of legal or equitable ownership interest necessary under § 541(a) to make the proceeds estate property." *In re Goodenow*, 157 B.R. at 725 (emphasis in original); see also, *Johnson v. USAir Federal Credit Union* (*In re Johnson*), 162 B.R. 464, 466 (Bankr.M.D.N.C.1993)("This court will not elevate the rights of the...debtor to create an interest in a[ ] [credit disability] insurance policy that would not exist but for the bankruptcy filing.")

Id. at 194.

Note that in the Texas Insurance Code, like the New York statute, credit accident and health insurance is defined as "insurance to provide *indemnity* for payments that become due on a specific credit transaction of a debtor when the debtor is disabled, as defined in the insurance policy." Texas Insurance Code §1153.003(1) (emphasis added). Also similar to New York law, the Texas Insurance Code provides that a credit life or credit disability policy must: "state that the benefits are to be paid to the creditor to reduce or extinguish the unpaid amount of the debt and that any amount of benefits that exceeds the unpaid debt is to be paid to a beneficiary, other than the creditor, named by the debtor or to the debtor's estate." Texas Insurance Code §1153.052(3).

A similar result was reached by the Court in *In re Gladwell*, 2009 Bankr. LEXIS (Bankr.C.D.Ill. Jan. 29, 2009). The Court in *Gladwell* relief upon *First Fidelity Bank v. McAteer, supra,* to find that credit disability proceeds were not property of the estate and denied a motion for turnover of the proceeds, stating:

> Accordingly, under the reasoning of *McAteer*, *Goodenow*, and *Johnson*, the proceeds of the credit disability insurance policy are not property of the Debtors' estate under § 541 because, if the Debtors were not debtors in bankruptcy, they would not be entitled to the proceeds unless the full contract balance of the loan was paid off. As noted above, bankruptcy does not create rights in property that did not exist otherwise. *McAteer*, 985 F.2d at 117 (citing *In re Louisiana World Exposition, Inc*., 832 F.2d 1391, 1399 (5th Cir.1987)). The Debtors' Motion for Turnover should be denied.

Id. at *11-12.

Casualty Policies

But what of casualty policies? What of policies where the debtor is a beneficiary of the policy but there is also a loss-payee under the policy? (Usually a lien-holder with regard to the property insured.) Judge McGuire addressed this question in *In re Asay*, 184 B.R. 265

(Bankr.N.D.Tex. 1995). In that case, the debtor's business was damaged by fire. The debtor had an insurance policy, as required by the deed of trust held by his mortgage company, which listed the debtor as the insured and which provided that any check for a loss would be payable to the mortgage company. Judge McGuire analyzed 11 U.S.C. §541 and found that the insurance proceeds were property of the estate:

> Section 541 provides a very broad definition of estate property. *Louisiana World Exposition, Inc. v. Federal Ins. Co.* (*In re Louisiana World Exposition, Inc*.), 832 F.2d 1391, 1399 (5th Cir.1987). The insurance monies become estate property as proceeds of the Roberts Building. *See generally, Paskow v. Calvert Fire Ins. Co.*, 579 F.2d 949, 954 (5th Cir.1978) (Insurance proceeds were "proceeds" of collateral under the UCC); *Brown v. First Nat'l Bank of Dewey*, 617 F.2d 581, 582 (10th Cir.1980) (same); Tex.Bus. & Comm.Code (Tex.UCC) § 9.306(a) (" 'Proceeds' includes ... insurance payable by reason of loss or damage to the collateral, except to the extent that it is payable to a person other than a party to the security agreement "). The House and Senate reports indicate the broad reach of § 541:
>
> > Proceeds here is not to be used in a confining sense, as defined in the Uniform Commercial Code, but is intended to be a broad term to encompass all proceeds of property of the estate. The conversion in form of property of the estate does not change its character as property of the estate.
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> HR Rep. No. 595, 95th Cong., 1st Sess. 367–368 (1977); S Rep.No. 989, 95th Cong., 2d Sess. 82–83 (1978). (Emphasis added). The insurance proceeds are a change in form of estate property. The Uniform Commercial Code would characterize insurance proceeds on collateral as proceeds of the collateral. The above-quoted legislative history on § 541 indicates that § 541 is to be construed more broadly than the UCC. The Court finds that the insurance funds are property of the estate.

Id. at 266-267 (footnotes omitted). *See also, In re Hereford Biofuels, L.P.*, 466 B.R. 841 (Bankr.N.D.Tex. 2012).

Asay was based on state law. Different controlling state law could lead to a different result. A contrary result was reached by Judge Woodard of the Northern District of Mississippi in an unreported case, *In re Emily Jones*, Case. No. 15-12254-JDW-13, September 20, 2016. Since it is an unreported decision, it is worth quoting at length:

> The central question before the Court is whether the insurance proceeds are

property of the estate. If the insurance proceeds are property of the estate then the Debtor may, under certain circumstances, use the proceeds to purchase a new car with the approval of the Court pursuant to § 363 of the Bankruptcy Code. If the insurance proceeds are not property of the estate, then the Debtor would have to obtain the Creditor's consent in order to use the proceeds. Section 541(a) provides that an estate is created as of the commencement of the case that is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a). "Proceeds . . . of or from property of the estate" are also included in the bankruptcy estate. 11 U.S.C. § 541(a)(6). But not all proceeds are property of the estate.

A closer look at the meaning of "proceeds" is necessary for clarifying the precise definition ascribed thereto. The Senate and House Reports for § 541(a)(6) explains the main thrust of the provision: "[t]he conversion in form of property of the estate does not change its character as property of the estate." S.Rep. No. 989, 9th Cong., 2d Sess. 83 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5869; H.R.Rep. No. 595, 95th Cong., 1st Sess. 368 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6324. Another statement explaining the scope of § 541 also helps clarify § 541(a)(6): section 541 "is not intended to expand the debtor's rights against others more than they exist at the commencement of the case." S.Rep. No. 989 at 82, 1978 U.S.C.C.A.N. at 5868; H.R.Rep. No. 595 at 367, 1978 U.S.C.C.A.N. at 6323. Accordingly, the purpose of § 541(a)(6) is not to capture proceeds that the debtor was never entitled to receive, but instead it "maintains the value of the estate to the extent that property which is property of the estate is converted to some other form." *Landry v. Exxon Pipeline Co.*, 260 B.R. 769, 799 (Bankr. M.D. La. 2001).

The Court of Appeals for the Fifth Circuit has long held that "when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate." *Matter of Edgeworth*, 993 F.2d 51, 56 (5th Cir. 1993). Stated another way, the "central question when determining whether insurance proceeds associated with a policy are property of the bankruptcy estate is whether, in the absence of the bankruptcy proceeding, the proceeds of the policy would belong to debtor when the insurer pays a claim." *In re Equinox Oil Co., Inc.*, 300 F.3d 614, 618 (5th Cir. 2002). The rationale being that "[w]hen payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate." Edgeworth, 993 F.2d at 55-56. As a result, if an insurance policy lists a creditor or third party as the loss payee, the proceeds will not be part of the bankruptcy estate to the extent of the secured creditor's claim.

This Court has previously addressed a similar issue and applied the same Fifth Circuit precedent. *See In re Bailey*, 314 B.R. 103 (Bankr. N.D. Miss. 2004). In Bailey, the creditor and trustee agreed that the insurance proceeds up to the amount of the creditor's secured claim were to be paid to the creditor because under the insurance policy the proceeds had been assigned to the creditor. Id. at 104. The Court then considered whether the excess insurance proceeds—those proceeds left over after paying the creditor's secured claim as fixed by the chapter 13 plan—were owed to the creditor as well. The Court examined the Fifth Circuit

cases previously mentioned and held that because of the assignment provision in the insurance policy, the insurance proceeds were not property of the estate. Therefore, the proceeds were to be paid to the creditor.

The majority of the courts that have addressed an issue similar to the one before this Court have agreed with this reasoning—that where a debtor is not entitled to receive the proceeds of an insurance policy, § 541(a)(6) does not create new rights for the bankruptcy estate. *In re Huff*, 322 B.R. 661, n. 21 (Bankr M.D. Ga. 2005)(compiling cases); *Bailey*, 314 B.R. at 106; *Carey v. Gen. Motors Acceptance Corp.* (*In re Carey*), 202 B.R. 796 (Bankr. N.D. Ga. 1996); In re Shamburger, 189 B.R. 965 (Bankr. N.D. Ala. 1996); *In re Suter*, 181 B.R. 116 (Bankr. N.D. Ala. 1994). As such, where a creditor is named as loss payee under an insurance policy and is entitled to receive the insurance proceeds when the collateral is destroyed, the proceeds are not property of the estate and the debtor cannot force substitution of collateral over the objection of the creditor. The main case relied on by the Debtor also bears this out. *See In re Coker*, 216 B.R. 843, 848-53 (Bankr. N.D. Ala. 1997).

The court in Coker recognized that where a secured creditor is designated as loss payee, "its right to insurance proceeds is superior to the debtor's rights." Id. at 848.4 Two other cases were cited by the Debtor to bolster her position that insurance proceeds are property of the estate: *In re Young* and *In re Granville*. This issue is not before the Court here. *See also Ford Motor Credit Co. v. Stevens* (*In re Stevens*), 130 F.3d 1027 (11th Cir. 1997). There are no excess proceeds in the instant case. After payment of all proceeds to the Creditor, the Creditor will have an unsecured deficiency claim. *Young*, 2000 WL 33673801 (Bankr. M.D. N.C. June 21, 2000); *Granville*, 2014 WL 1347039 (Bankr. E.D. Ky. Apr. 4, 2014). Both of these cases are also distinguishable, however. In *Young*, the parties agreed that the proceeds were property of the estate, so the court never decided that issue. 2000 WL 33673801 at *2. Rather, the question there was whether the creditor "violated the stay in delaying the substitution of collateral." Id. at *3. Likewise, in *Granville*, the court dealt with a difference set of facts. 2014 WL 1347039 at *1. The debtor's car was totaled in an accident caused by a third party. Id. The court likened the third party's actions to a tort against the debtor and found that the fact the third party's insurer was making the payment to the debtor was immaterial. Id. at *2. The "proceeds" were due to the debtor because a tort was committed against the debtor and the debtor was entitled to compensation. Id.

Here, the Debtor took out an insurance policy on the Vehicle and named the Creditor as the sole loss payee. The Vehicle has been totaled, and the insurer is ready to write a check for $6,384 as the net payout for the Vehicle. Because the Creditor is the loss payee, it is entitled to receive the check from the insurer. If not for the bankruptcy filing, there would be no question as to who owns the insurance proceeds. According to Fifth Circuit precedent, the Debtor does not have a legally cognizable interest in the insurance proceeds and, thus, those proceeds are not property of the estate.

In re Emily Jones, Case No. 15-12254 (Bankr. N.D. Miss. September 20, 2016). *See also, In re*

Suter, 181 B.R. 116 (Bankr.N.D.Ala. 1994):

> Ownership of an insurance policy does not necessarily entail ownership of the proceeds of the policy. Parties may contract that someone other than the policy owner will receive the proceeds of the policy. The named beneficiary of an insurance policy is the owner of the policy proceeds. The Supreme Court of Alabama has stated, "A loss payable clause in an insurance policy gives the party named as the one to whom payment is to be made the superior right to recover to the extent of his or her interest, and the assured can only recover any balance in excess." *Home Ins. Co. of New York v. Tumlin*, 241 Ala. 356, 2 So.2d 435 (1941). Because AmSouth was the loss payee of the insurance policy, the proceeds of the policy are not property of the bankruptcy estate and are payable to AmSouth, at least to the extent of AmSouth's interest in the property insured. *Accord, First Fidelity Bank v. McAteer*, 985 F.2d 114 (3rd Cir.1993); *In re Anchorage Nautical Tours, Inc*., 102 B.R. 741 (9th Cir. BAP 1989); *In re Johnson*, 162 B.R. 464 (Bankr.M.D.N.C.1993); *In re Goodenow*, 157 B.R. 724 (Bankr.D.Me.1993); *In re McLean Industries, Inc.*, 132 B.R. 271 (Bankr.S.D.N.Y.1991); *In re Offshore Carrier and Liner Service, Inc*., 82 B.R. 504 (Bankr.E.D.Mo.1988).

Id. at 119 (footnote omitted). However, the Court in *Suter* did find that the creditor's interest in proceeds over-and-above its allowed secured claim were extinguished by the confirmed plan.[7]

A third interpretation is provided by *American Bankers Ins. Co. of Florida v. Maness*, 101 F.3d 358 (4th Cir. 1996). In that case, the court held that payouts from insurance policies were not property of the bankruptcy estate stating that:

> [W]e refuse to hold that § 541(a)(6) requires as a matter of federal law, that payouts from insurance policies be regarded as proceeds of property of the bankruptcy estate merely because the property insured is part of the bankruptcy estate. American common law has long and firmly held that casualty payments from insurance policies do not stand in the place of the damaged property. "It is well established that ... proceeds of a fire policy ... [do] not arise from property, but from a personal contract between insurer and insured." 4 Collier on Bankruptcy ¶ 541.12 (15th ed. 1996); *Columbia Ins. Co. v. Lawrence*, 35 U.S. (10 Pet.) 507, 512, 9 L.Ed. 512 (1836) (citing "Lord Chancellor King, in Lynch v. Dalzell, (3 Bro.P.C. 497 s.c., 2 Marsh on Ins. b. 4, ch. 4, p. 803) ... [as] saying, 'these policies are not insurances of the specific things (goods) mentioned to be insured; nor do such insurances attach to the realty, or in any manner go with the same, as incident, ... but they are only special agreements with the persons insured against such loss or damage as they may sustain.' "); *Hopkins Ill. Elevator Co. v. Pentell* (*In re Pentell*), 777 F.2d 1281, 1284 (7th Cir.1985) ("[T]he insurance proceeds are not considered to be derived from the real property...."). We think it

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[7] Such a holding would no doubt be different after the BAPCPA amendments to 11 U.S.C. §1325(a)(5)(B)(i)(I) as set forth hereinbelow.

> unlikely that § 541(a)(6)'s mixed legislative history indicates a Congressional intent to reject this extensive body of common law.

Id. at 364-365. The Court went on to hold that under Virginia law, insurance payouts were not proceeds derived from the property itself, so the insurance proceeds were not property of the estate unless it designated the estate as the insured.[8]

An interesting wrinkle may arise in the case of leased property. In that such case, sometimes the payee under the policy is only the lessee, not the lessor. In this situation, the insurance proceeds would not be proceeds of estate property and would not be property of the estate. *See, i.e., In re Air South Airlines, Inc*., 1999 WL 33486098 (Bankr.D.S.C. November 19, 1999). Indeed, since the Texas Insurance Code §841.001 defines the "beneficiary" as the "person to whom an insurance policy is payable," it would therefore behoove a creditor to ask, especially in cases where the debtor is not the owner of the property insured, who exactly is designated as the beneficiary under the policy. Indeed, even under Judge McGuire's analysis in *Asay*, if the creditor was the only named beneficiary under the policy, or even if the debtor was not one of the named beneficiaries, the insurance proceeds would not be property of the estate.[9]

So, are casualty insurance proceeds property of the estate? Maybe yes. Maybe no. If the proceeds are not property of the estate, then per the *Emily Jones* case and its predecessor, *In re Bailey*, 314 B.R. 103 (Bankr.N.D.Miss. 2004), or *American Bankers Ins. v. Maness*, *supra*, the

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[8] In *Maness*, the insurance policy was obtained by the debtor post-petition on estate property, so the Court said that fact that the debtor and not the estate was listed as loss payee meant that the estate did not have an interest in the policy proceeds.

[9] This could likewise arise in situations where the debtor says that, although they are the legal owner of the vehicle, another party is the equitable owner and the other party drives the car, pays for it, and provides insurance. This leads to questions (beyond the scope of this paper) about whether the "other party" has an insurable interest as required under Texas law to insure the property. *See*, *Jones v. Texas Pacific Indemnity Co.*, 853 S.W.2d 791 (Tex.App. - Dallas 1993, no writ). *See also*, *In re Kip and Andrea Richards Family Farm & Ranch, LLC* (622 B.R. 727 (Bankr.D.Neb. 2020). A helpful analysis is found at: Can You Insure a Car You Don't Own: A Complete Guide, https://www.compare.com/auto-insurance/resources/insure-car-you-dont-own.

proceeds would be distributed to the lienholder/loss payee and that would end the inquiry. But even if the proceeds are property of the estate, it does not end the inquiry as to the rights to the distribution of those proceeds. Even if the proceeds are still property of the estate, the secured creditor/lienholder may still have an interest in those insurance proceeds in which case those proceeds will be the cash collateral of the secured creditor.

Guaranteed Asset Protection (GAP) Insurance

Guaranteed Asset Protection Insurance is optional insurance to cover a shortfall between collision or comprehensive insurance and the value of the vehicle in the event the vehicle is damaged or stolen.[10] "Gap insurance is insurance that covers the difference between what a vehicle with a lien is worth and the amount owed to the creditor holding that lien." *In re Mancini*, 390 B.R. 796, 804 (Bankr.M.D.Penn. 2008). "[T]he sole purpose of GAP insurance is to protect the owner of the vehicle in instances in which the portion of damage done to the vehicle is greater than its value." *Id*. at 806, *quoting*, *In re Honcoop*, 377 B.R. 719, 723 (Bankr.M.D.Fla.2007).

The Allstate.com website defines GAP insurance as, "an optional car insurance coverage that helps pay off your auto loan if your car is totaled or stolen and you owe more than the car's depreciated value. Gap insurance may also be called "loan/lease gap coverage." This type of coverage is only available if you're the original loan- or leaseholder on a new vehicle. Gap insurance helps pay the gap between the depreciated value of your car and what you still owe on the car." That same website goes on to note: "Keep in mind that, in the above scenario, the car

[10] Note that a contract might provide for a GAP waiver agreement in lieu of GAP insurance. (See Texas Administrative Code §83.812). This is an agreement by the lender to waive any gap in coverage as opposed to third-party insurance which pays the lender in the event of a shortfall of insurance proceeds. The lender, in effect, is self-insuring but because it is a contractual agreement and not insurance, *per se*; it is beyond the scope of this paper.

insurance reimbursement goes completely to your auto lender to pay off a car that's no longer driveable."

The important note here is that, per the insurance contract, the beneficiary of the policy is the lender, not the debtor. Therefore, as in the case of credit life and credit disability policies (above), the insurance proceeds would be payable directly to the creditor and would not be property of the estate.

Third Party Policies

The situation may arise wherein the asset is property of the estate because the debtor is listed as an owner on the deed, contract, or title, but the insurance is actually purchased by a third party. This can arise in various situations such as: (1) a co-debtor/co-owner on the property who pays for the insurance; (2) a straw purchase where the debtor is the owner, but claims that the asset was purchased for and used by a third party who provides the insurance; or (3) the owner of a corporation purchases the asset but the corporation actually uses and pays insurance on the asset.[11] In such case, the policy would not be property of the estate but, it could be argued, the proceeds would arguably still be property of the estate in that "Proceeds . . . of or from property of the estate" are also included in the bankruptcy estate. 11 U.S.C. § 541(a)(6). However, the above-analysis regarding ownership of the proceeds based on the beneficiary of the policy would still apply. Thus, the best that can be said as to the right to insurance proceeds in a fact-pattern such as this is "it depends."[12]

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[11] The author has encountered all of these situations in cases, as well as others. Creditors must take care in that insurance provided by a third party on an asset of the debtor may not be valid in that the insurance company may allege that the third party cannot insure an interest in property the third party does not own. This gets into state law issues of what types of property interests are insurable which is beyond the scope of this paper.

[12] See footnote 3, *supra*.

CASUALTY INSURANCE PROCEEDS AS CASH COLLATERAL

As noted above, even if the casualty insurance proceeds are property of the estate, they may still not be freely available for distribution to creditors of the estate. Casualty insurance proceeds are, by definition, *proceeds* of collateral and if the secured creditor has a lien on the collateral, it has a lien on the proceeds.[13]

Generally, a security agreement will provide that the security interest applies to not only the collateral itself, but as to all proceeds of the collateral including insurance proceeds. A typical Texas Motor Vehicle Retail Installment Sales Contract provides:

> **Security Interest**: To secure all that you owe on this contract and all your promises in it, you give Creditor a security interest in:
>
> - the motor vehicle including all accessories and parts now or later attached and any other goods financed in this contract.
> - all insurance proceeds and other proceeds received for the motor vehicle.
> - any insurance policy, service contract or other contract financed by Creditor and any proceeds of those contract; and
> - any refund of charges included in this contract for insurance or service contracts

Thus, the security agreement grants a creditor a lien on the insurance proceeds.

Even if the security agreement does not specifically provide that the creditor has a lien on the insurance proceeds, the U.C.C. grants a lien creditor a lien on all proceeds of the collateral:

> Article 9 makes a significant inroad on the idea that insurance is a personal contract between the insured and the insurance company. After the 1972 amendments to Article 9, proceeds are automatically covered without need to describe them in the security agreement, and such proceeds include casualty

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[13] Note that in addition to casualty insurance payments, which are proceeds of damaged property, a creditor may have a direct lien on insurance proceeds such as when a creditor has a blanket lien on intangibles or a creditor takes a lien on life insurance proceeds pursuant to the U.C.C. *See, i.e.*, *In re Investment and Tax Services, Inc*., 148 B.R. 571 (Bankr.D.Minn. 1992). This gives rise to a number of issues regarding perfection, etc., discussed in that case, which are beyond the scope of this paper. If there is a valid lien on the proceeds, the discussions herein regarding cash collateral and distribution of proceeds would apply.

> insurance to the extent payable to a party to the security agreement. A perfected security interest in the collateral will give the creditor a perfected security interest in the proceeds, and failure to perfect the original security interest will result in non-perfection of the proceeds. The proceeds of the insurance policy are derivative; they substitute for the collateral.
>
> The creditor does not have to be the named payee in order to have this security interest in the proceeds under Article 9.144 Similarly, a creditor does not have to rely on an equitable lien because Article 9 provides a legal lien. UCC 9-306(1) provides the only requirement B that is, the insurance must be payable to a party to the security agreement, which could be either the debtor or the secured party. As to the existence of a security interest in insurance proceeds, the creditor does not have to be the named loss payee. Article 9 rejects the personal nature of insurance when the insurance proceeds derive from Article 9 collateral.

Joann Henderson, Bankruptcy Disaster Relief: A Chapter 13 Debtor's Right to Use Insurance Proceeds to Repair or Replace Collateral, 35 Gonz. L.Rev. 21, 40-42 (1999/2000) (Footnotes omitted). Under current Texas law, a secured creditor has a lien on proceeds of collateral pursuant to Texas Business and Commerce Code § 9.203(f); "The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by Section 9.315 and is also attachment of a security interest in a supporting obligation for the collateral." Texas Business and Commerce Code § 9.315(a)(2) provides: "a security interest attaches to any identifiable proceeds of collateral."

If the secured creditor has a lien on the insurance proceeds, then those insurance proceeds become the cash collateral of the creditor. *See, Matter of Carey*, 202 B.R. 796 (Bankr.M.D.Ga. 1996). 11 U.S.C. §363(a) defines cash collateral as:

> (a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

Id. Note that the definition specifically includes "proceeds" of property. Although Judge McGuire in *Asay* did not specifically call the insurance proceeds "cash collateral," he did state

that "Debtors may not use the funds unless they are able to furnish adequate protection under §§ 363(c)(2)(B) and 363(e)." *In re Asay*, 184 B.R. at 269.

Other courts have recognized insurance proceeds as cash collateral. *See, i.e., In re Coker*, 216 B.R. 843 (Bankr.N.D.Ala. 1997) and *In re Young*, 2000 WL 33673801 (Bankr.M.D.N.C. June 21, 2000).

Per 11 U.S.C. §363(c)(2), the trustee may not use cash collateral unless the creditor consents or the Court authorizes such use "in accordance with the provisions of this section." The bankruptcy Code at 11 U.S.C. §363(e) prohibits the use of cash collateral unless the entity with the lien thereon is provided adequate protection of its interest in the cash collateral. Of note is 11 U.S.C. §363(p) "In any hearing under this section... the trustee has the burden of proof on the issue of adequate protection." *Id*. "Because of the unique nature of cash collateral, however, special protections apply to prevent its dissipation. Thus, cash collateral cannot be used unless the creditor consents or unless, after notice and a hearing, the court determines that the creditor is provided adequate protection." *Matter of Carey*, 202 B.R. 796, 798-799 (Bankr.M.D.Ga. 1996).

As insurance proceeds could be cash collateral, a debtor must be very cautious in simply spending any insurance proceeds without court approval. *In re Pereira*, 2019 Bankr. LEXIS 1057 (Bankr.M.D.Fla. Apr. 5, 2019) provides something of a cautionary tale regarding unauthorized use of insurance proceeds. In that case, the debtor used a check made out only to her to allegedly make repairs to the property. However, even though the court stated it would have no doubt allowed the debtor to use the cash collateral to make repairs, it added that it would have put controls in place to see this was done. In the event, the court was "not confident" the debtor had made the repairs. The court reserved the issue of holding the debtors in contempt pending further developments in the case.

The misuse of cash collateral is serious. See, Wymen, Cash Collateral: The Risks of

Non-Consensual Use (https://www.justice.gov/archive/ust/articles/docs/cashcoll-01.pdf). See also: Goldstein & Sloane, Spending Other People's Money: Creditor's Remedies for the Misuse of Cash Collateral in Bankruptcy, *University of Miami Business Law Review*, 4-1-1999.

As one court has succinctly stated:

> It is true that there are no apparent provisions of the Code which specifically provide sanctions for the failure of the debtor to comply with 'cash collateral' requirements. However § 105(a) of the Code gives to the Bankruptcy Court the power to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.
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> *Mercantile Nat'l Bank at Dallas v. Aerosmith Denton Corp*. (*In re Aerosmith Denton Corp*.), 36 B.R. 116, 119 (Bankr.N.D.Tex.1983); see also *In re Mr. Gatti's, Inc.*, 164 B.R. 929, 942 (Bankr.W.D.Tex.1994) (recognizing § 105 powers as a remedy for violations of § 363); *In re Telesphere Communications, Inc*., 148 B.R. 525, 531 (Bankr.N.D.Ill.1992) (same). *But see Indian Motocycle Assocs. III Ltd. Partnership v. Massachusetts Hous. Fin. Agency*, 66 F.3d 1246, 1251 (1st Cir.1995) (warning against the bankruptcy court fashioning the extraordinary remedy of 'reimbursement'); *Centerre Bank Nat'l Assoc. v. Continental Marine Corp*. (*In re Continental Marine Corp*.), 35 B.R. 990, 992 (Bankr.E.D.Mo.1984) (declining to use contempt powers as remedy for misuse of cash collateral). *See generally* Stephen Mount, Note, Standards and Sanctions for the Use of Cash Collateral Under the Bankruptcy Code, 63 TEX.L.REV. 341 (1984).

In re Kleather, 208 B.R. 406, 414-415 (Bankr.S.D.Ohio 1997).

INSURANCE PROCEEDS OF EXEMPT PROPERTY AND PROPERTY VESTED IN THE DEBTOR

Note that even if the debtor owns the damaged property free and clear of liens, or if the proceeds are enough to pay off the secured creditor in full, the trustee may claim an interest in the insurance proceeds. The trustee will, no doubt, want the proceeds to distribute to unsecured creditors. The debtor will want to keep the proceeds, arguing perhaps that they are the proceeds of exempt property and thus exempt, or that they are not income of the debtor that the debtor is required to contribute to the plan.

There is often an incentive for a debtor in bankruptcy to value their personal property as

low as possible. They might, for instance, want to fit more under any exemptions cap. But what happens when the debtor lists negligible values for the property and then there is a fire and the insurance proceeds considerably exceed the values placed by the debtor on the property? That is precisely what happened in *In re Taylor*, 23 B.R. 539 (S.D.Ohio 1982). In *Taylor*, the debtor exempted personal property in the amount of $3,800.00. There was a fire and the insurance proceeds were $30,947.00. The Court found that the debtor had an insurance interest in the items and was not limited by the value the debtor placed on the items. Rather, the debtor should receive the insurance proceeds up to the maximum exemptions applicable to those items.

> We must conclude that the principal reason for exemptions is to preserve the fresh start of the debtor. That preservation assures to the debtor clothing, certain items of furniture, appliances and so forth in order to carry on normal and necessary every day life activities. While there is no provision arising out of the exemptions statutes for the debtor to obtain a head start, it is meaningless for the debtor to be given a fresh start when that start does not include those items which the debtor properly owned, claimed as exempt and is entitled to as exempt items. Therefore, in the matter before us, each item properly claimed as exempt to which the debtors are entitled to have an exemption is further protected by the debtors' insurable interest which is limited only by the maximum dollar amount found in the exemption statute.

Id. at 540-541. In *In re Stimer*, 2016 Bankr. LEXIS 2659 (Bankr.N.D.Ohio July 20, 2016) the debtors were allowed to apply exemption limit to insurance proceeds for property damaged in a fire prior to the filng of the bankruptcy.

But see *Payne v. Wood*, 775 F.2d 202 (7th Cir. 1985). In that case, the debtors claimed property as exempt under Illinois law and listed values therefore. The Seventh Circuit said that:

> With respect to the property in the estate, the difference between market value insurance and replacement value insurance is a distraction. The fire turned physical assets of the estate into insurance proceeds; the trustee gets whatever these proceeds happen to be. Similarly, the Paynes get whatever the proceeds happen to be for the property that was exempted. The Paynes argue that they should be entitled to the proceeds on all property that could have been put within the limit in Illinois, but this is not so. The partition between debtors and estate depends on what was actually exempted, not what could have been exempted.

Id. at 204-205. (Footnote omitted). While the Seventh Circuit noted that its ruling seemed harsh

in light of the debtors' circumstances, it noted:

> Rough justice, no doubt. Even if all of the Paynes' furniture, dishes, and small appliances were worth no more than $715 in August 1981, their insurance policy would have paid more. But any other principle would encourage the making of excessively general claims in the hope that if omissions should be discovered, the debtors could argue that the omitted property was "really" in some broadly worded category. The roughness of this justice does not always hurt debtors, either. The omissions from their schedule of assets might have been grounds to set aside the discharge; the trustee settled for a lesser remedy. The bankruptcy court might have concluded that the large appliances had been misdescribed (all were newer than the schedule asserted) and reduced the payments on that account. And the bankruptcy court might have decided that the policy itself is an asset of the estate, which would have directed all of the proceeds to the trustee. The policy was property of the debtors, but they did not list it among the items for which they claimed exemption. If the property was insured in December 1981 because of a premium paid before August 1981, the trustee might have claimed the policy. Other cases have held that the failure to list a policy of insurance means that the trustee gets the proceeds. *Patton v. Fidelity-Philadelphia Trust Co.*, 246 F.Supp. 1015, 1018-20 (E.D.Pa.1965); *In re Rogers*, 45 F.Supp. 297 (E.D.N.Y.1942); *In re Elliott, supra; In re Howard*, 6 B.R. 220 (Bankr.S.D.Ohio 1980).

Id. at 206-207 (footnote omitted).

In re Simpson, 238 B.R. 776 (Bankr.S.D.Ill. 1999) distinguished *Payne v. Wood*. The court found that the debtor's interest in casualty proceeds were not an interest in a motor vehicle, and therefore the debtor could not claim an exemption in the proceeds of the vehicle when damaged. As the Court said,

> A debtor's right to insurance proceeds for damage to property derives, not from the property itself, but from a contract of indemnity between the debtor and the insurance company. The contract is personal to the debtor and does not "run with" the property or remain in effect once the property changes hands. *See Ketcham v. Ketcham*, 269 Ill. 584, 109 N.E. 1025, 1027 (1915); *Russell v. Williams*, 58 Cal.2d 487, 24 Cal.Rptr. 859, 374 P.2d 827, 829 (1962). Although a debtor must have an insurable interest in property in order to enter into such a contract, the insurance proceeds for destruction of this interest are paid, "not as the price or equivalent of the property insured," but under an agreement to indemnify the debtor against its loss, "the consideration for which was the premium paid, and not any interest in such property." *Monniea v. German Ins. Co.*, 12 Ill.App. 240, 244 (1883).

Id. at 779. The Court, however, allowed the debtor ten days to amend his exemptions to exempt the insurance proceeds. *Accord, In re Wiesner*, 267 B.R. 32 (Bankr.D.Mass 2001) (likewise,

holding insurance proceeds are proceeds of the policy, not the property itself, so exempting property did not exempt proceeds.) *See also*, *In re Villescas*, 632 B.R. 223 (Bankr.D.Utah 2021) (exemption in insurance proceeds for vehicle when the case converted from Chapter 13 to Chapter 7).

What if the plan provides that property vests in the debtor at confirmation? Since the property is no longer property of the estate, does the trustee have any interest? The Court addressed that question in *In re Granville*, 2014 Bankr. LEXIS 1373 (Bankr.E.D.Ky. April 4, 2014):

> Given that the Debtor's acquisition of the proceeds occurred after confirmation of her plan, the vesting provision of § 1327(b) is of limited relevance to this dispute and the plain language of § 1306(a)(1) controls. That provision includes as property of the estate, "all property of the kind specified in [§ 541] that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under Chapter 7, 11, or 12 of this title, whichever occurs first." Thus, the Insurance Payment is property of the bankruptcy estate.

Id. at *5-6. (Footnote omitted).

In *In re Perine*, 2021 Bankr. LEXIS 2238 (Bankr.S.D.Ala. June 28, 2021), the Court found that the issue of vesting did not matter since the plan provided that property of the estate did not vest in the debtor at confirmation so as to preserve the automatic stay as to those assets, as many of the form plans in Texas provide. However, the Court did state that the trustee should not be allowed to modify the plan to add the insurance proceeds to the assets to be distributed to the unsecured creditors since "...the value of the 2012 Hyundai Accent has already been factored into the liquidation analysis and the calculation of plan payments." *Id*. at *4.

PAYMENT OF PROCEEDS TO THE TRUSTEE AND TRUSTEE FEES

The Trustee Fee in Payments to Secured Creditors

As noted above, insurance proceeds are the cash collateral of the secured creditor. So, if

the trustee is paid insurance proceeds, the trustee must immediately segregate and account for those proceeds. 11 U.S.C. §363(c)(4). The trustee cannot simply take the trustee fee out of the cash collateral upon receipt because use of cash collateral requires that either the secured creditor consent or the court authorizes such use after notice and hearing. 11 U.S.C. §363(c)(2). Further, in order to use cash collateral, the trustee must provide adequate protection. 11 U.S.C. §363(e).

Indeed, the trustee is not entitled to a trustee fee out of insurance proceeds payable to secured creditors. Insurance proceeds are not "payments under the Plan" for which the trustee is entitled to a fee. Indeed, they are *not* payments under the plan, but are akin to surrender of collateral.

> In both cases before the Court, the insurance proceeds are a substitute for the creditors' collateral which was, effectively, surrendered upon its destruction. The entire purpose of property insurance is to protect the insured in the event of damage or loss. Essentially, any proceeds from such insurance serve as a substitute for the insured collateral. *In re Feher*, 202 B.R. 966, 970–71 (Bankr.S.D.Ill.1996). *See also In re Stevens*, 130 F.3d 1027, 1030 (11th Cir.1997) (insurance proceeds act as a substitute for the insured collateral); *In re Suter*, 181 B.R. 116, 120 (Bankr.N.D.Ala.1994) ("[f]rom a secured creditor's perspective, property insurance is a substitute for the collateral insured").
>
> Insurance proceeds are not intended to be a payment from the debtor's income or other property. Rather, such proceeds flow from destruction of the creditor's security and serve as a replacement of that collateral, albeit in a different form. In the present cases, although the secured vehicles have been converted to cash proceeds, these vehicles remain the creditors' collateral. For this reason, payment of the insurance proceeds in each of these cases fails to qualify as a "payment" from the debtor's income or other property but, instead, constitutes a surrender of collateral to the creditors.
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> Because the Court finds that there was no "payment" within the meaning of § 586(e)(2) in either of these cases, the trustee is not entitled to collect a fee on the insurance proceeds. As explained above, § 586(e)(2) specifically provides that the trustee may assess a fee only on "payments received." In addition, there is no reason to require payment of the insurance proceeds to be made through the trustee. Rather, requiring the insurance proceeds to be funneled through the trustee merely so he can assess his fee would create an unnecessary windfall to the trustee, especially when the only administrative function to be performed by the trustee would be to collect his fee.

In re Derickson, 226 B.R. 879, 881-882 (Bankr.S.D.Ill. 1998). As insurance proceeds are akin to surrender, the trustee is not entitled to a fee thereon. The trustee does not collect a fee on the value of collateral surrendered to a secured creditor under the plan. Ergo, the trustee cannot collect a fee from the insurance proceeds.

Judge Jeffrey Norman, then of the Bankruptcy Court for the Western District of Louisiana before he returned to the Great State of Texas[14], himself a former Chapter 13 Trustee, agreed:

> To the extent insurance proceeds from estate property are payments received by the Chapter 13 Trustee, 28 U.S.C. § 586(e)(2) requires the Trustee assess the percentage fee for compensation and expenses. However, if insurance proceeds are substantial, deduction of the usual percentage fee may result in a windfall for the Chapter 13 trustee. Depending on the circumstances, this could lead to a hardship for the debtor or creditors.
>
> There are two conflicting points of view regarding the collection of the trustee fee. The Chapter 13 Trustee urges this Court to adopt the holding in *Nardello v. Balboa* (*In re Nardello*), 514 B.R. 105 (Bankr.D.N.J.2014). In that case, the court held "[t]he plain language of Section 586 directs the standing trustee to collect a percentage fee based on 'all payments received' by the trustee and this language makes payment of the percentage fee mandatory." This interpretation would allow the Chapter 13 Trustee to collect the statutory trustee fee on the insurance proceeds in this case.
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> The alternative view, which Santander and the debtor urge this Court adopt, is the holding in *McRoberts v. Associates Commer. Corp*. (*In re Derickson*), 226 B.R. 879, (Bankr.S.D.Ill.1998). The holding in that case, which concerns insurance proceeds, is that the Trustee is not entitled to the statutory fee because the insurance proceeds were not a payment from the debtors' income or other property; instead, the proceeds constituted a surrender of collateral to the creditor. *Id*. That court found there was no "payment" within the meaning of § 586(e)(2); therefore, the Chapter 13 Trustee was not entitled to collect a fee on the insurance proceeds. *Id*.
>
> This Court finds *McRoberts* more persuasive. Insurance proceeds are not intended as a payment from the debtor's income or other property. Rather, such proceeds flow from destruction of the creditor's security, and serve as a replacement of that

[14] The author has the utmost respect for the State of Louisiana, since he married a Louisiana native and LSU graduate who brainwashed their son into being a Tigers fan, but Texas is, after all, Texas.

> collateral, albeit in a different form. In this case, the debtor's 2013 Chrysler 200 has been converted to insurance proceeds and these proceeds remain the creditor's collateral. For this reason, payment of the insurance proceeds fails to qualify as a "payment" from the debtor's income or other property, but instead constitutes a surrender of collateral to the creditor. Because the Court finds that there was no "payment" within the meaning of 28 U.S.C. § 586(e)(2), the Trustee is not entitled to collect a fee on the insurance proceeds distributed to Santander.
>
> While the Chapter 13 Trustee raises concerns that she is entitled to a trustee fee simply because the funds are in her hands and will be disbursed by her, the insurance proceeds are in the Trustee's possession for accounting purposes only. This Court has routinely required insurance proceeds in all Chapter 13 cases be paid to the Chapter 13 Trustee. Such a requirement ensures that all parties, including the debtor, secured creditors and unsecured creditors, only receive funds to which they are entitled. This requirement additionally ensures accurate recording keeping to which the Court, creditors and the debtor may access and on which they may rely. Reliable records of accounting on each case is important for the Court to properly evaluate any disputes regarding Chapter 13 Trustee receipts and payments. Having a centralized database which can be easily accessed, and which is accurate, is of the utmost importance to the Court in both reviewing and evaluating cases. This is especially important given the large number of Chapter 13 cases this Court has jurisdiction over. On each Chapter 13 case, the Court should be able to review how much has been paid to every party, the timing of those payments, and what amount is yet to be paid. These records would not be available in a centralized location but for the Standing Chapter 13 Trustee, who maintains accounting records on each case and is audited by the United States Trustee annually. These records are accurate and are easily available without extra cost or effort via the Chapter 13 Trustee's website to the Court, debtors and all parties in interest.
>
> While insurance proceeds in this case will be paid in full to the secured creditor, there are other instances where this will not be the case. Insurance proceeds on vehicles, especially in older Chapter 13 cases where vehicle debts have been paid down by the plan payments, can exceed both the payoff to the secured creditor, as well as the exemption allowed by the State of Louisiana. In these cases, the debtor would typically receive the amount of the allowed vehicle exemption without a trustee fee. *See Law v. Siegel*, 134 S.Ct. 1188 (2014). However, if insurance proceeds exceed both the total of a secured creditor's claim as well as the exemption allowed, there may be insurance proceeds which could possibly be disbursed to unsecured creditors by the Trustee. In these instances, the Chapter 13 Trustee is entitled to collect her statutory fee under 28 U.S.C. § 586(e)(2), but only on the insurance proceeds that would be disbursed to unsecured creditors.

In re James, 2015 WL 1795 (Bankr.W.D.La. May 29, 2015).

In another case, the District Court in Louisiana agreed. In an extensive analysis, the Court distinguished *Nardello* and relied upon *McRoberts*, as did Judge Norman. Indeed, the

District Court rejected the requirement of paying insurance proceeds first to the Chapter 13 Trustee, only to have them then paid over to the secured creditor.

> First, the Court notes that the Bankruptcy Code allows for a direct payment of collateral from a debtor to the holder of the security interest in the collateral. 11 U.S.C. § 1325(a)(5)(c) ("the court shall affirm a plan if ... with respect to each allowed secured claim provided for by the plan ... the debtor surrenders the property securing such claim to such holder"). Obviously, in the instant case it is the insurance company that would actually make the payment of the insurance proceeds to TD Auto Finance, but such a payment would be at the direction of Samuel under his Chapter 13 plan. See Record Document 2-2 at 13. Thus, under these circumstances, the Code imposes no requirement that the trustee first receive collateral before it is turned over to a secured creditor.
>
> Second, many courts that have addressed the argument that the trustee is required to receive insurance payments for destroyed collateral before the payments are relayed to the correct parties have held that there is no such requirement. The trustee in *McRoberts* argued both that he should receive the statutory fee as discussed above and that it was necessary for the insurance proceeds for the destroyed collateral to be paid to the trustee first. 226 B.R. 879 at 882. He argued that "if creditors are permitted to receive the insurance proceeds without trustee intervention, there will be no way of monitoring what creditors have received, and this could result in overpayments." Id. The court rejected this argument, stating that this concern could "be easily remedied by requiring creditors to provide an accounting to the trustee of any insurance proceeds they receive." Id. This policy would ensure that the creditors receive no more than they are entitled to receive without creating any unnecessary costs. See id.
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> The trustee in *In re Gregory* made a similar argument, which that court also rejected. 143 B.R. 424 (E.D. Tex. 1992). There, the Chapter 13 debtors sought to sell their home to satisfy a nondischargeable tax debt owed to the IRS and directly pay the amount of the tax debt to the IRS. See id. at 425. The trustee objected to this plan, arguing in part that "absent his control of the receipt and disbursement of the payment to IRS, he will never be in a position to certify to the court that payments under the plan are complete and that all priority claims are paid." Id. at 427. The Court rejected this argument, stating that the trustee had not demonstrated how the administration of the bankruptcy estate would be assisted in any way by requiring the debtors to funnel their payment to the trustee. See id. at 428. Rather, considering the sophistication of the creditor receiving the payment, the fact that the payment was a single payment from one source, and the lack of impairment of the trustee's ability to perform his role, the court held that it was unnecessary to require the trustee to receive the payment first. See id. at 427–28.
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> The instant case similarly demonstrates that the Bankruptcy Court's policy, while well-intentioned, actually gives rise to more problems than it solves. Though the costs involved for the trustee are relatively low, they are unnecessary. As the

> *McRoberts* court pointed out, the accounting concerns behind this policy can be remedied by requiring secured creditors like TD Auto Finance to provide an accounting to the Bankruptcy Court of any insurance proceeds received. 226 B.R. 879 at 882. TD Auto Finance, like most secured creditors, is a sophisticated party that is certainly capable of providing such an accounting. Unlike the trustee in *In re Gregory*, Sikes actively supports this solution and makes no argument that this method of paying insurance proceeds to secured creditors impairs her ability to perform her role. 143 B.R. 424 at 427; see Record Document 5 at 23-24. Samuel also argues that this policy is unnecessary. See Record Document 7 at 7.
>
> Therefore, the Court finds that the Bankruptcy Court's finding/requirement that the trustee must receive insurance proceeds before paying them to creditors, which was based on the policy that required payment of the secured creditor's portion of the insurance proceeds to Sikes, should be reversed. This matter is remanded such that a written policy consistent with the instant opinion shall be implemented by the Bankruptcy Court.

Sikes v. Samuel, 559 B.R. 135, 141-142 (W.D.La. 2016).

In an unreported case, Judge Rhoades ordered that proceeds should be turned over to the trustee and the trustee was entitled to her commission therefrom, but the creditor was granted a replacement lien in the trustee's commission and the trustee's fee would be reversed and the money paid to the creditor if the case dismissed or converted.

Subtracting The Trustee Fee From a Secured Creditor's Insurance Proceeds

Even if the trustee were entitled to a fee for disbursing insurance proceeds, the trustee cannot subtract that fee from the proceeds themselves, as some trustees attempt, before disbursing the remainder of the insurance proceeds to the creditor. Such a result would violate 11 U.S.C. §1325(a)(5)(B)(ii). Under that section, a secured creditor is entitled to received under the plan "...the value, as of the effective date of the plan, of property to be distributed under the plan on account is such claim is not less than the allowed amount of such claim." If the insurance proceeds are less than the remaining allowed secured claim, then subtracting the trustees fee from such proceeds would under-pay the claim. For instance, if a creditor had an allowed secured claim of $10,000.00 and the Trustee fee was 10%, the creditor would only

receive $9,000.00 (plus interest) under the plan, with the trustee taking the other $1,000.00 as a fee. This is not paying, under the plan, "the allowed amount of such claim."[15]

One trustee has argued that she is entitled to take such fee based on *In re Foster*, 670 F.2d 478 (5th Cir. 1982). Yet *Foster* was superseded by amendment to the Bankruptcy Code as noted by *In re Reid*, 179 B.R. 504 (Bankr.E.D.Tex. 1995), *aff'd*, 77 F.3d 473 (5th Cir. 1995):

> Congress's enactment of 28 U.S.C. section 586(e)(2) limited the application of a trustee's commission to a percentage fee from all payments received by the trustee. See also *In re Gregory*, 143 B.R. 424, 427 (Bankr.E.D.Tex.1992). Consequently, section 586 provided an avenue whereby debtors could avoid commission payments by directly paying creditors. This section also effectively overruled the portion of *Matter of Foster* that allowed the trustee to collect commissions even on a debtor's direct payments to a creditor. See In re Gregory, 143 B.R. at 427–28.

Id. at n. 2. Indeed, under a trustee's argument for collection of a fee, could the trustee demand a fee from creditors equal to a percentage of the value of collateral surrendered under the plan? How would this even work? Just because collateral is converted to insurance proceeds as opposed to physically surrendered, it still operates as a surrender of collateral. *See, In re Grear*, 163 B.R. 524 (Bankr.S.D.Ill. 1994).

DIVISION OF PROCEEDS AFTER VALUATION OF COLLATERAL

Pre- versus Post-Confirmation

The issue of who is to be paid insurance proceeds and how much is heavily dependent on

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[15] It should be noted that even *In re Nardello*, upon which some trustees have relied to argue that they should collect a trustee fee on insurance proceeds, does not hold that the trustee fee should be deducted from the amounts owed to secured creditors with a lien on the collateral at issue. In that case, the secured creditor was paid in full and the question was whether the trustee could collect a fee on the *remaining* balance. Thus, even the main case cited for the proposition that a trustee is entitled to a fee for disbursing insurance proceeds does not hold that the fee should be deducted from those insurance proceeds before paying them to a creditor if it would not pay that creditor's allowed secured claim in full.

whether a case has been confirmed.[16]

Chapter 7 or Chapter 13 Pre-confirmation

If the accident occurred prior to confirmation, then the value of the collateral will be set by the amount of the insurance proceeds (assuming no Motion for Valuation has been filed and decided)[17]. *See, In re Woods*, 97 B.R. 850 (Bankr.W.D.Va. 1989). In that case, the creditor should file a Motion for Relief from Stay to allow it to accept and apply the insurance proceeds and release the salvage title to the insurance company. If proceeds are less than the contractual balance, the proceeds will pay down the debt and the deficiency will be an unsecured claim.

If the proceeds are more than the contractual balance, then the proceeds will pay off the claim and the overage will either be payable to the debtor (if the proceeds are exempt) or to the trustee (if they are not).[18]

Chapter 13 Post-confirmation - direct pay[19]

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[16] It should be noted that, although in the standard case, valuation will be set at confirmation, that is not always the case. In the Tyler Division of the Eastern District of Texas, plans are often confirmed which do not value the collateral, reserving the issue for a Motion to Value or the TRCC. The plan, therefore, would not be *res judicata* with regard to the issue of the value of the creditor's collateral, and the creditor would be entitled to the proceeds up to its contractual balance at filing, plus accrued interest per the plan. Further, it is possible that a court could entertain a Motion for Valuation prior to confirmation which would likewise be *res judicata* with regard to the bifurcation of the creditor's claim (But see note 17, below). For simplicity, however, this paper will equate valuation with confirmation.

[17] If a Motion for Valuation has been decided and the insurance proceeds are different, the party with the "short end of the stick" should consider reconsideration of the claim under 11 U.S.C. §502(j). See also, David Gray Carlson, Bifurcation of Secured Claims in Bankruptcy, 70 Am. Bank. L.J. 1,22 (1996)(Valuation and bifurcation are not final and may be revisited prior to confirmation).

[18] In case of an overage, it is best to contact both the debtor's attorney and the trustee to make sure there is no dispute as to the right to the funds. Generally the debtor and the trustee will agree to some type of solution, lest the creditor seek to deposit the funds in the registry of the court and seek its fees for so doing, depleting the funds.

[19] Generally a confirmed plan that surrenders the collateral also lifts the automatic stay, so the creditor would be able to simply apply the proceeds and release the title, same as if the vehicle had been sold after surrender.

If the collateral is being paid for directly by the debtor pursuant to the terms and conditions of the contract, then the creditor should file a Motion for Relief from Stay to apply the funds and release the title.

If the proceeds are more than the remaining allowed secured claim, then who gets the overage? If the collateral is deemed to be property of the estate (or a portion of it is property of the estate), the excess proceeds should go to the trustee to be disbursed on the allowed unsecured claims subject to the exemptions and pursuant to the confirmed plan. *In re Turnbull*, 350 B.R. 429, 434 (Bankr. N.D. Ill. 2006), *In re Kelley*, 2012 Bankr. LEXIS (Bankr. E.D. Ky No. 8, 2012). If the proceeds are less than the remaining allowed secured claim, as usually is the case, then the creditor should seek to file an amended, unsecured claim for the deficiency.

Chapter 13 Post-confirmation - through the trustee

The rub comes when the claim is being paid through the Chapter 13 Trustee. If the proceeds are less than the remaining allowed secured claim, the creditor should file a Motion for Relief from Stay with regard to the proceeds and release the salvage title. Some trustees want to receive the insurance proceeds and distribute them themselves so that they can account for the proceeds. Although the trustee should not be able to require this (*See*, *Sikes v. Samuel*, 559 B.R. 135, 141-142 (W.D.La. 2016), sometimes the insurance company pays the trustee before the secured creditor knows the collateral has been totaled.

Creditors should object to the trustee seeking to collect their percentage fee from these funds. *See*, *McRoberts v. Associates Commer. Corp*. (*In re Derickson*), 226 B.R. 879 (Bankr. S.D. Ill. 1998)(insurance proceeds did not qualify as payment from the debtor's income or other property and did not result in any trustee's fee being assessed); *In re James*, 2015 Bankr. LEXIS 1795 (Bankr.W.D.La. May 29, 2015). Some trustees will simply allow the insurance company to pay the secured creditor directly and simply account to the trustee for the payment, either

through an amended claim, a Notice of Payment, or as part of an order terminating stay.

Will the creditor have secured or unsecured claim for the deficiency with respect to its allowed secured claim? The confirmed plan is still res judicata and modification under § 1329 to surrender the property that has been deemed a total loss may not be approved. *In re Torres*, 336 B.R. 839 (Bankr. M.D. Fla. 2005), *In re Cameron*, 274 B.R. 457 (Bankr. N.D. Tex 2002); but, *see In re Davis*, 404 B.R. 183 (Bankr. S.D.Tex 2009) allowing the debtor to surrender collateral in full satisfaction of creditor's claim as a matter of equity.[20] The creditor may receive the insurance payoff, but the trustee may have to continue to pay the remaining balance of the allowed secured claim after the application of the insurance proceeds.[21]

But what if the proceeds are more than the remaining allowed secured claim? Indeed, what if the allowed secured claim has been paid in full? Is the debtor (or the trustee) simply entitled to the proceeds? 11 U.S.C. §1325(a)(5)(B)(I) provides that the secured creditor retains its lien until the earlier of discharge or payment in full of the underlying debt as determined by applicable nonbankruptcy law. So if the allowed secured claim is paid in full through the insurance proceeds (or has already been paid in full), but the claim as determined under non-bankruptcy law has not been paid in full, the secured creditor still has a lien against those funds. (See below, "Competing Interests in a Confirmed Plan Which Values the Collateral.")

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[20] In *Davis*, however, Judge Bohm noted that generally a debtor would not be allowed to depreciate collateral and then file a modification to surrender, but in that particular case, the creditor's actions in voluntarily repossessing the collateral shifted the equities enough to allow the debtor to modify to surrender and reclassify the claim from secured to unsecured.

[21] The rub comes that many of the new form plans and standing orders provide that the Trustee is to cease payments on claims once the stay is lifted. It may require a Motion to reconsider this requirement which, of course, will be a tough row to hoe. Alternatively, the creditor could ask as part of the Motion for Relief to waive this provision as a matter of equity, but that may require a separate motion. Further, the debtor may simply stop paying the trustee, allow the case to dismiss, and then file a new case and provide for the claim as a purely unsecured claim - something of a pyrrhic victory for the creditor.

Competing Interests in a Confirmed Plan That Values the Collateral

The most litigated issue with regard to insurance proceeds is in cases where the confirmed plan valued the collateral, the claim was paid through the plan, the insurance proceeds are more than the remaining allowed secured claim to be paid under the plan, and there is a remaining balance to be paid to the creditor as "determined under non-bankruptcy law."[22]

One case, *Ridge v. Union Acceptance Corp.* (*In re Ridge*), 2007 Bankr. LEXIS 3389 (Bankr.N.D.Ga. Aug. 7, 2007), cited pre-BAPCPA case law[23] and ordered the creditor to refund to the trustee the proceeds over-and-above its allowed secured claim. Another case which granted the funds to the debtor was *In re Pennington*, 2015 Bankr. LEXIS 4032 (Bankr.S.D.Tex. Nov. 30, 2015). The problem with *Pennington* is that Judge Paul ignored the provisions of 11 U.S.C. §1325(a)(5)(B)(I). Indeed, the provision was not even discussed by Judge Paul. Judge Paul said that the creditor had "no interest in the insurance proceeds." This blatantly disregards the continuing lien held by the creditor as a result of 11 U.S.C. §1325(a)(5)(B)(I). Assume, for instance, that the debtor had sought to trade in the vehicle in *Pennington* instead of it being damaged and declared a total loss. Per the reasoning in *Pennington*, a bankruptcy court could ignore §1325(a)(5)(B)(I) and order a creditor to release its lien before the debtor obtained a

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[22] 11 U.S.C. §1325(a)(5)(B)(i)(I)

[23] 11 U.S.C. §1325(a)(5)(B)(i)(I) was added by BAPCPA. Before BAPCPA, there was a split of authority as to whether a lien had to be released once the allowed secured claim was paid in full.

discharge. This is clearly contrary to the Code.[24] [25]

The majority of courts, however, have held that, based on 11 U.S.C. §1325(a)(5)(B)(I), the money should be held in trust until the debtor receives its discharge, or the case dismissed or converts. If the case dismissed or converts, the money is paid to the creditor. If the case is discharged, then the money goes to either the debtor or the trustee. *See, In re Kelley*, 2012 Bankr. LEXIS 5252 (Bankr.E.D.Ky. Nov. 8, 2012)(debtor's attorney to hold the funds)[26]; *In re Perry*, 2011 Bankr. LEXIS 4513 (Bankr.E.D.N.C. Oct. 24, 2011)(Trustee ordered to hold funds); *In re Norred*, 2011 Bankr. LEXIS 3610 (Bankr.D.Ore. Sept. 21, 2011)(Trustee to hold funds.); *In re Ross*, 2015 Bankr. LEXIS 1977 (Bankr.D.S.C. June 16, 2015)(Trustee to hold the funds). *In re Cotton*, 2015 Bankr. LEXIS 3203 (Bankr. W.D. Mo. Sept. 22, 2015)(Trustee to hold funds).[27]

One Court expressed the tension between the competing interests of the parties well:

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[24] Indeed, Judge Mullin of Fort Worth opined in an unpublished decision in the case of *In re Matthew & Erika Reino*, Case No. 16-41217, United States Bankruptcy Court for the Northern District of Texas, Fort Worth Division, that "In *In re Pennington*, for example, the court found that because the secured creditor had received payment in full of its allowed secured claim through the Chapter 13 plan (similar to this case), the secured creditor had no interest in the totaled vehicle's insurance proceeds and was not entitled to further adequate protection in that case. The Court notes, however, that the *Pennington* court did not raise or address the impact, if any, of §1325(a)(5)(B)(I)." (Footnotes omitted).

[25] In *In re Perine*, 2021 Bankr. LEXIS 2238 (Bankr.S.D.Ala. June 28, 2021) implied that the secured creditor was bound by the plan and had to release its lien once its allowed secured claim was paid, but (i) like *Pennington*, the court did not address the issue of §1325(a)(5)(B)(i)(I) and (ii) an examination of the docket shows the secured creditor did not respond to the debtor's Motion to Approve Compromise, so the Court had no evidence that the creditor's debt as determined under non-bankruptcy law was greater than the allowed secured claim. Still, it is questionable whether the Court should have ordered the secured creditor to release its lien once its allowed secured claim was paid in full.

[26] The facts in *In re Kelley we*re that the claim was a 910 claim in which the debtor's plan crammed down the interest rate but not the value. The Court held that the debtor was only entitled to the benefit of the reduced interest rate once they received a Chapter 13 discharge.

[27] In one case, Judge Parker of Tyler ordered, sua sponte, that the funds be deposited into the registry of the court. In most cases, the parties reach an agreement as to who is to hold the funds: the debtor's attorney, the creditor, the creditor's attorney, the trustee, or the registry of the court.

> Pursuant to § 348, Harley–Davidson's lien would be reinstated in full and it would be owed the contractual amount upon the conversion of Debtors' case prior to completion of the Plan. 11 U.S.C. § 348(f)(1)(C)(I) ("when a case under chapter 13 of this title is converted to a case under another chapter of this title–the claim of any creditor holding security as of the date of the filing of the petition shall continue to be secured by that security unless the full amount of such claim determined under applicable nonbankruptcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of an allowed secured claim made for the purposes of the case under chapter 13 ..."). The same is true in the event of dismissal. 11 U.S.C. § 349(b)(1)© ("Unless the court, for cause, orders otherwise, a dismissal of a case ... reinstates—any lien voided under section 506(d) of this title"). Therefore, distributing the insurance proceeds in the manner set forth in the Settlement Application at this time would dispose of the funds prematurely and leave Harley–Davidson without adequate remedy should this case be converted or dismissed prior to Debtors' completion of the Plan. To resolve the tension between the provisions of the not yet completed Plan that binds Harley–Davidson and Harley–Davidson's rights reserved under §§ 348 and 349, and as a result of the creditor's objection, the Court must provide some balance of the parties' interests.
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> The amount of the insurance proceeds available is $6,578.00.14 Harley Davidson demands $3,024.87 of this amount, leaving a difference of $3,553.13, which may be distributed to Debtors and their attorney ($595.00 for attorneys' fees, as indicated in the Settlement Application).15 Of Harley Davidson's $3,024.87 demand,16 only $563.79 is due at this time pursuant to the Plan ($538.93 for the balance of its secured claim after valuation and $24.86 for its share of distributions due to unsecured creditors). The remaining $2,461.08 must be held until Debtors have completed payments under the Plan and, thus, conversion or dismissal is no longer a concern. See *In re Perry*, C/A No. 09–04429–8–JRL, 2011 WL 5909065, at *1 (Bankr. E.D.N.C. Oct. 24, 2011) (requiring remaining insurance proceeds after payment of secured claim be held by the trustee pending completion of the plan and discharge or conversion or dismissal) (citing *In re Feher*, 202 B.R. 966, 972 (Bankr.S.D.Ill.1996)); *In re Norred*, C/A No. 09–40186–ELP13, 2011 WL 4433598, at *4 (Bankr.D.Or. Sept. 21, 2011) (requiring the remaining proceeds to be held by the trustee pending completion of the plan). Once the Plan is complete, the funds shall be distributed to the Debtors.

In re Ross, 2015 2015 Bankr. LEXIS 1977 (Bankr.D.S.C. June 16, 2015).

An interesting recent case is *In re Pagan*, 638 B.R. 887 (Bankr.E.D.Wis. January 24, 2022). In that case, the form plan the debtor was required to use had the language from 11 U.S.C. §1325(a)(5)(B)(I) saying that the creditor would retain its lien until the payment of the underlying debt determined under non-bankruptcy law or the discharge of the debt under §1328, whichever was earlier. However, the debtor also included a special provision in the "special provisions" of the plan saying "Creditors with secured claims shall retain their mortgage, lien or security interest in collateral until the earlier of (a) the payment in full of the secured portion of

their proof of claim, or (b) discharge under 11 U.S.C. § 1328." *Id*. at 892. The creditor argued that they were entitled to the proceeds over and above the allowed secured claim based on the language from §1325 in the plan. The debtor argued that the special provision required that the creditor release its lien once the claim, as provided for under the plan, was paid in full, and thus the debtor could retain the excess proceeds. The Court found that the plan provisions were inconsistent and, since the plan was construed against the drafter, the debtor, the excess insurance proceeds must be held in trust until discharge. *Id*. But the Court implied that if the debtor's "special provisions" language had been clearer, the debtor might have prevailed. *Id*. The moral of the story is that creditors should object to any plan that attempts to alter the requirements of §1325(a)(5)(B)(I).

Creditors should negotiate the payment of insurance proceeds exceeding the allowed secured claim into some type of trust account, usually held by the debtor's attorney or the trustee. Note, however, that the lien attaches to *all* of the insurance proceeds, not just the remaining debt as determined under non-bankruptcy law because the creditor will be entitled to continue to accrue interest on its debt at the contract rate of interest until the claim is paid or the debtor receives a Chapter 13 discharge.

As a practical matter, the debtor and creditor can often negotiate a settlement whereby the creditor receives some portion of the insurance proceeds - less than the remaining contractual balance but more than the remaining allowed secured claim - in order to free up the remaining funds to allow the debtor to use them for a replacement vehicle rather than both sides having to wait to see if the debtor makes it to a Chapter 13 discharge. This amount, of course, should be negotiated based on the remaining time left in the plan and the likelihood that the debtor will make it to discharge.[28]

While technically not allowed under the Code, if it is close to the end of the case, the debtor may be able to argue that the excess insurance proceeds are enough to pay off the remainder of the debtor's payments under the plan. Assuming the debtor is allowed to use the funds to pay the debtor's regular payments under the plan and is not required to pay them as additional monies to be distributed to unsecured creditors, then the creditor should allow this

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[28] The creditor, however, should be cognizant of the additional costs of keeping the loan open and monitoring the bankruptcy in the hope that the debtor will fail and the creditor will get the insurance proceeds. If the excess proceeds are only, say, $1,500.00, and the debtor has four years to go under the plan, the creditor must determine if it is cost effective to challenge the debtor's right to or use of the excess insurance proceeds.

under the "no harm, no foul" rule. There is no sense in making the debtor make trustee payments over time of $4,000.00 to pay off the plan if there are $4,000.00 in insurance proceeds which could pay off the plan. Most courts will probably allow the debtor to do this anyway.

SUBSTITUTION OF COLLATERAL

While creditors may chose to allow the use of the proceeds based on a substitution of collateral, creditors typically cannot be forced to do so in a Chapter 13 proceeding. *In re Van Stelle*, 354 B.R. 157 (Bankr. W.D. Mich. 2006).[29] *See also*, *In re Huff*, 332 B.R. 661 (Bankr. M.D. Ga. 2005) and *In re Turnbull*, 350 B.R. 429, 435 (Bankr. N.D. Ill. 2006).[30]

Some Courts, however, have allowed the debtor to use the insurance proceeds to purchase a replacement vehicle, provided that the secured creditor is granted a replacement lien in the vehicle. *See*, *In re Granville*, 2014 Bankr. LEXIS 1373 (E.D.Ky April 4, 2014). Indeed, in the *Reino* case by Judge Mullin, noted above, the debtor had improperly used the insurance proceeds to purchase a replacement vehicle without court approval to use the cash collateral. Judge Mullin ordered that the insurance proceeds could be traced to the replacement vehicle and therefore granted the secured creditor a lien on the replacement vehicle, which the creditor would be required to release if the debtor received a Chapter 13 discharge.

Note that from the creditor's perspective, the creditor should object to simply using the insurance proceeds to purchase a new vehicle. It is common knowledge that "[a] car depreciates in value practically as soon as it leaves the dealer's lot." *In re Morley*, 414 B.R. 473, 474 (Bankr. E.D.Wis. 2009). "Many payments must be made before the value of the car exceeds the remaining amount of the loan, and debtors frequently have to file a bankruptcy case before that happens." *Id*. Therefore, for the secured creditor to be adequately protected by putting it in the same position it was before the damage to the vehicle, the debtor should have to make some type

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[29] Note that *Van Stelle* turned on the issue of pre- versus post-confirmation and the vesting of the property of the estate. Thus, there may be situations where a court following *Van Stelle* may order a substitution of collateral.

[30] Unless the debtor is purchasing substitute collateral outright, it is unlikely that the debtor will find a lender who will allow a superior lien on the new collateral. Even where a debtor may seek to obtain a lien from the same creditor, the debtor would likely have to offer enough of a down payment so as to establish equity in an amount equal to the substitute lien.

of cash down payment toward the purchase in addition to the insurance proceeds.[31]

CONTRACTUAL PROVISIONS AND REPAIR OF COLLATERAL

There is a line of cases which grant the insurance proceeds to the secured creditor despite those proceeds being property of the estate. These cases rely on the contractual agreement between the debtor and the creditor. A typical Texas Motor Vehicle Retail Installment Contract provides:

> You must use physical damage insurance proceeds to repair the vehicle, unless we agree otherwise in writing. However, if the vehicle is a total loss, you must use the insurance proceeds to pay what you owe us. You agree that we can use any proceeds from insurance to repair the vehicle, or we may reduce what you owe under the contract. If we apply insurance proceeds to what you owe, they will be applied to payments in reverse order of when they are due. If your insurance on the vehicle doesn't pay all you owe, you must pay what is still owed. Once all amounts owed under this contract are paid, any remaining proceeds will be paid to you.

Note that this requires the debtor to use the insurance proceeds in a total loss to reduce the debt; not, for instance, buy another vehicle and give the creditor a security interest in that vehicle (see Substitution of Collateral, above).

As one court noted, the agreement of the parties survives the filing of the bankruptcy:

> The bankruptcy court, to the extent a security agreement is not inconsistent with bankruptcy law, upholds the parties' contract. *Butner v. United States*, 440 U.S. 48, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979). Therefore, any plan provision [requiring debtor to maintain insurance] would be duplicative.

In re Kennedy, 177 B.R. 967, 975 (Bankr.S.D.Ala. 1995). Thus, unless a plan contains a contrary provision, the contract between the parties controls.

In re Jones, 179 B.R. 450 (Bankr. E.D.Pa. 1995) used the parties' contractual provisions

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[31] A difficulty arises where the debtor wants to use the insurance proceeds as a down payment on a replacement vehicle, but borrow the remainder. In that case, the new lender will want a first lien on the vehicle leaving the original secured creditor with a second lien which may be worthless given the initial depreciation mentioned above. Creditors should be sure that their offered "adequate protection" is actually adequate protection and not just an unsecured second lien.

to find that, despite the insurance proceeds being property of the estate, the secured creditor was entitled to the proceeds since the contract gave the secured creditor absolute discretion as to whether to apply the insurance proceeds to the mortgage indebtedness or to permit their use in the repair of the property.

> However, taking the path of this court, the *Natale* court, supra, 174 B.R. at 365, concludes that, even though the hazard insurance proceeds in issue are property of the debtor's estate, the debtor's estate holds that property interest subject to the contractual, state laws rights which the mortgagee holds in the proceeds. Therefore, the parties' rights to the proceeds must be ascertained by reference to the parties' contractual rights pursuant to the interpretation of the pertinent contractual provisions under applicable state law.

Id. at 455. The court enforced the mortgage provisions with regard to the insurance proceeds:

> The portions of the mortgage emphasized at pages 453–54 supra clearly provide the Mortgagee with the absolute discretion to keep or disperse any insurance proceeds arising from damages to a mortgaged property *456 that is currently in arrears. The Debtor has not made any postpetition payments to the Mortgagee since October, 1992. Clearly, he is in arrears in an amount well in excess of the $5,686.06 total of the two checks. Thus, not only did the Debtor not have any right to an immediate payment of the insurance proceeds, he did not have any right to the proceeds at all under the terms of the parties' mortgage agreement.

Id. at 455-456. *Accord, Thomas v. Universal American Mortgage*, 1998 U.S. Dist. LEXIS 1392 (D.E.D.Pa. Feb. 6, 1998), *aff'd*, 182 F.3d 904 (3rd. Cir. 1998).

Note that this reasoning could be applied to require use of insurance proceeds to repair damaged property. Further, based on the language with regard to total loss, it could be used to prevent a debtor from attempting to keep a vehicle deemed a "total loss" by the insurance company, accepting less in insurance proceeds in return for keeping the salvaged vehicle (which the debtor then generally wants to continue to drive).[32]

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[32] The "keep a total loss vehicle" is a problem for creditors. First, they will be paid less in insurance proceeds. The debtor generally points out that the creditor will still have a lien on the vehicle the debtor is keeping, but said vehicle will then have a "salvage title," which means the remaining "collateral" is generally hard to sell and may thus have zero economic value.

As to repair, the secured creditor must be careful to make sure that the insurance proceeds are actually used to repair the vehicle. A "best practice" for creditors is to require that the insurance proceeds be placed in trust, generally with the debtor's attorney, and only paid out once the creditor has seen and approved the invoices with regard to the repairs and, ideally, inspects the vehicle or at least obtain pictures of the repairs.[33]

DEDUCTIBLES

Deductibles are often a point of contention between debtors and creditors. Debtors often try to obtain policies with a high deductible because this will result in a lower monthly insurance payment. The creditor, of course, wants a low deductible in that it can be difficult to collect the difference. Some contracts specify a maximum deductible (often $500.00 for vehicles in a consumer context, $1,000.00 for vehicles in a commercial context). Creditors should seek to enforce these requirements.[34] Creditors may also argue, given the circumstances of the debtor, that too high a deductible means that the creditor is not adequately protected.

Creditors should remember that payment of the deductible is a contractual obligation of the debtor. Often, the debtor will tender the insurance proceeds, and the creditor will accept that and write-off the balance. But the debtor has an obligation to pay the deductible to the secured creditor and, arguably, this is a post-petition obligation (assuming the damage to the collateral occurred post-petition). This prevents a debtor with a high deductible from escaping the consequences of choosing such a high deductible.

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[33] The author had a case where the debtor went to a friend to do the repairs and the "repaint" of the car was obviously done with a spray can and not done very well at that.

[34] Note that 11 U.S.C. §1326(a)(4) requires the debtor to provide creditor proof of maintenance of any "required" insurance coverage. In addition to the ability to enforce the security agreement as set forth hereinabove, this language would argue for the requirement of the debtor to maintain insurance per the provisions of the contract/security agreement.

As a last resort, depending on the case, creditor may consider objecting to the debtor obtaining their discharge at the end of a Chapter 13 case if the debtor has not paid the deductible, arguing that the debtor has not completed all payments under the plan per §1328(a).[35]

[35] Indeed, debtors sometimes amend or modify their plans after an insurance total loss to change the payment to a creditor from "through the plan" to "pay direct" in order to avoid paying any shortfall between the insurance proceeds and the allowed secured claim. Debtors should be cautious doing this, however, because the creditor could argue, again under §1328(a), that the debtor has not completed payments under the plan unless the creditor is paid in full under the terms of the contract.