

Chapter 13 Trustee Eastern District of Kentucky

What To Do With Insurance Proceeds When a Car Securing a Claim Being Paid Through the Plan Is Damaged or Destroyed

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Part I: Tips for Debtors' Attorneys:

- 1) Inform the debtor at the beginning of the case to let you know if at any time during the case a car subject to a creditor's lien is damaged or destroyed.
- 2) Insurance proceeds are property of the estate, even if the wreck occurred after confirmation.
 - a) The Bankruptcy Court determines the parties' respective entitlement to the insurance proceeds.
 - b) A court order is necessary before the insurance company can properly disburse funds to anyone.
 - c) The terms of the confirmed plan still control how much the creditor will receive on its claim, and the funds should be disbursed and accounted for by the trustee (if the claim is being paid through the plan by the trustee).
- 3) When the car has been wrecked and the debtor calls, get from the debtor:
 - a) Name of insurance company;
 - b) Agent's (or other contact person's) name & phone number;
 - c) Amount of the loss payment;
 - d) Whether the vehicle has been totaled.
- 4) Check the 13network to see how much is still owed on the secured claim being paid through the plan; you need to know whether:
 - a) the insurance proceeds will be enough to pay the secured portion of the claim; or
 - b) there will be funds left over.
- 5) Call the secured creditor and/or its attorney of record to discuss options, but any agreement as to how to disburse funds must be in an order agreed to by the trustee.
- 6) File a motion for an order:
 - a) Directing the named insurance company to send insurance proceeds in the amount of \$__ to the trustee:
 - i) DO put in the motion and order the trustee's name (Chapter 13 Trustee, EDKY) and payment address (PO Box 1766, Memphis, TN 38101-1766) in bold print so the insurance company knows where to send the funds.

- ii) DON'T FORGET to send a copy of the motion and especially the order to the appropriate person at the insurance company.
 - iii) DON'T ask that the insurance company pay any portion of the proceeds directly to the debtor or directly to the lienholder/loss payee; the trustee will handle the accounting and distribution.
- b) Authorizing the trustee to disburse the insurance proceeds, less the trustee's percentage fee, to the creditor on its secured claim:
- i) DO identify the creditor's name, collateral description, and the court claim number;
 - ii) DON'T say that the trustee shall pay the sum of \$___ to the secured creditor.
 - (1) The amount will change between the date of the motion and the date the trustee actually disburses the funds.
 - (2) It's ok to say that the trustee shall pay the proceeds to the creditor on its secured claim, which at the time of this motion has an unpaid principal balance of approximately \$___.
 - (3) Or it's ok to omit the amount from the motion.
- c) Setting forth what the trustee is to do with any surplus funds; options generally are to:
- i) Refund surplus funds to the debtor as exempt property (or because the debtor has paid down the debt via plan payments and has thus acquired equity in the vehicle);
 - ii) Keep the exempt proceeds and apply them towards completion of the debtor's plan payments (which will allow the debtor to complete the plan sooner); or
 - iii) Hold surplus proceeds in escrow pending completion of the plan (which some creditors might require):
 - (1) If the debtor completes plan payments and gets a discharge, the surplus funds will go to the debtor (or in rare situations, to the trustee for the benefit of unsecured creditors);
 - (2) If the case is dismissed or converted, the creditor's lien attaches to the surplus proceeds to pay any unsecured balance of a split claim, interest at the contract rate, fees, costs, and other charges allowed under the contract.
 - (3) See *In re Kelley*, Case #11-51197, Doc. #92 (Bankr. E.D. Ky., Memorandum Opinion November 8, 2012) (Wise, J.).
- d) Stating that the trustee shall continue paying the claim per the confirmed plan:
- i) Any remaining principal balance of the secured claim will be paid with interest per the confirmed plan; and
 - ii) Any unsecured portion of the claim will be paid pro rata with all other unsecured claims.
- e) Requiring the secured creditor to release its lien so that title can be transferred to the insurance company (if the car is a total loss).
- 7) After the appropriate order is entered:
- a) Serve it on the insurance company;
 - b) Check the 13network periodically to make sure the trustee receives the funds;
 - c) Check to make sure the trustee disbursed the funds as expected.

- 8) If debtor needs to buy a replacement vehicle:
 - a) Go over the debtor's financial situation and prepare amended Schedules I & J to be filed;
 - b) File an application to incur debt and amended Schedules I & J; and/or
 - c) File a motion to modify the plan, and amended schedules I & J, to lower plan payments to enable the debtor to make direct payments on the new debt.
- 9) In the alternative to paying off the secured claim and buying a new vehicle, file a motion to substitute collateral (i.e., to use cash collateral for the purchase of a replacement vehicle).
 - a) Request an order:
 - i) Authorizing the insurance company to pay the proceeds to the debtor for the sole purpose of purchasing a vehicle of like value;
 - ii) Giving the secured creditor a lien on the replacement vehicle as adequate protection; and
 - iii) Authorizing the trustee to continue making payments to the secured creditor on its claim per the confirmed plan.
 - b) Expect opposition from the creditor, but terms can usually be negotiated.
- 10) If the secured portion of the claim was paid in full before the car was wrecked, a court order is still required before the insurance company can properly disburse funds (even to the debtor). Always file a motion to request an order directing how the insurance proceeds are to be paid.
 - a) Unless the creditor has already released its lien, its lien still attaches to the proceeds, and it is entitled to get notice of the proposed distribution of funds to the debtor (the creditor might want the funds to be escrowed pending completion of the plan).
 - b) In rare circumstances, the trustee might claim an interest in the insurance proceeds and thus should be on notice as to the debtor's request that the insurance company pay the debtor directly.

Part II: Tips for Creditors' Attorneys:

- 1) Insurance proceeds are property of the estate, even if the wreck occurred after confirmation.
- 2) The creditor's lien attaches to the proceeds (assuming the contract so provides).
- 3) The Bankruptcy Court determines the parties' respective entitlement to the insurance proceeds, and a court order is necessary before the insurance company can properly disburse funds to anyone.
- 4) If the claim is being paid through the plan by the trustee, the insurance proceeds should also be distributed through the plan.
- 5) The trustee should be able to retain her percentage fee from the distribution of insurance proceeds since the proceeds are a substitution for the debtors' plan payments (but one creditor's attorney says he intends to challenge this when the right case comes along).
- 6) The creditor will not receive more from insurance proceeds than it would receive from debtor payments in the chapter 13 plan, provided the debtor completes plan payments, even if the insurance proceeds are greater than the amount necessary to pay the secured claim per the confirmed plan.
- 7) The creditor may request that surplus insurance funds be held in escrow pending completion of the plan in order to adequately protect its security interest in the proceeds of its collateral.
 - a) If the debtor completes plan payments and gets a discharge, the surplus funds will go to the debtor (or in rare situations, to the trustee for the benefit of unsecured creditors);
 - b) If the case is dismissed or converted, the creditor is entitled to receive the funds to apply towards any unsecured balance of a split claim, interest at the contract rate, fees, costs, and other charges allowed under the contract.
 - c) See *In re Kelley*, Case #11-51197, Doc. #92 (Bankr. E.D. Ky., Memorandum Opinion November 8, 2012) (Wise, J.).
 - d) The creditor will likely need to release its lien in the vehicle (if it's a total loss) so that the insurance company will be assured of getting its salvage title in exchange for payment of the proceeds, but the creditor's lien in the proceeds can be retained by the court order requiring the funds to be escrowed.
- 8) If the creditor receives insurance proceeds either directly from the insurance company as loss payee or because the debtor has endorsed the check and sent it to the lienholder, the creditor may not apply the proceeds against the claim without an order of the Bankruptcy Court.
- 9) If the insurance proceeds are expected to be less than the amount necessary to pay the balance owed on the claim, the creditor should ensure that the trustee will continue paying the claim per the confirmed plan:
 - i) Any remaining principal balance of the secured claim will be paid with interest per the confirmed plan; and
 - ii) Any unsecured portion of the claim will be paid pro rata with all other unsecured claims.
- 10) If the debtor files a motion to substitute collateral, the creditor should be actively involved in making sure its interest is adequately protected.