**Dated: January 12, 2010**
**The following is ORDERED:**

Jennie D. Latta
**UNITED STATES BANKRUPTCY JUDGE**

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UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

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In re
RAYMOND WILLIAMS,
Debtor.

Case No. 07-32566-L
Chapter 13

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**MEMORANDUM OPINION ON DEBTOR'S MOTION TO ALLOW SUBSTITUTION OF COLLATERAL AND CREDITOR'S OBJECTION THERETO**

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This matter came before the court on November 5, 2009, on motion of the Debtor for substitution of collateral following a declaration by Arch Insurance Company ("Arch") that his vehicle was a total economic loss. Budget Auto Sales ("Budget"), secured creditor, objected to the motion on the basis that its interests are not adequately protected as the result of the failure of the Debtor to make all the payments required under his confirmed plan and further on the basis that the Debtor had agreed that the casualty insurance proceeds would be paid to Budget. Subsequent to the evidentiary hearing, the court requested that the parties supplement the record with a copy of the insurance policy. A copy of the policy, which was issued to the Chapter 13 Trustees for this district,

was delivered by counsel for Sylvia Brown, Chapter 13 trustee, on December 15, 2009, together with the individual certificate issued to the Debtor. Having carefully reviewed the record and the testimony of the witnesses, the court makes the following findings of fact and conclusions of law. Fed. R. Bank. P. 7052.

**FINDINGS OF FACT**

The Debtor purchased a used 1997 F150 truck from Budget on January 27, 2007. On December 13, 2007, the Debtor commenced this Chapter 13 case by filing a voluntary petition. Budget filed a proof of claim in the amount of $4,928.30, which included the balance remaining to be paid for the truck and an attorney fee of $125.00. The Debtor's plan, which was confirmed on March 6, 2008, provided for treatment of Budget's claim as fully secured to be repaid together with interest in monthly installments of $150.00. Apparently, the truck was involved in an accident prior to confirmation that rendered it a total economic loss. The Debtor filed a motion on April 4, 2008, seeking to substitute another vehicle for the truck. This motion was not opposed, and an order was entered June 6, 2008, permitting the Debtor to substitute a 2000 Chevrolet Blazer for the truck, with Budget to be "included through the plan as loss payee." No other modification of the plan was made. The Debtor remained obligated to repay Budget the amount of its claim, together with interest, in monthly installments of $150.00.

On June 9, 2009, the Blazer was struck by a falling tree limb and declared a total economic loss. The Debtor filed the instant motion to substitute collateral, asking to be permitted to use insurance proceeds of $3,950.00 to purchase another vehicle. While the motion to substitute collateral was pending, the Debtor executed a Proof of Loss that directed Arch to pay the insurance proceeds to "Budget Auto Sales - For the Account of Raymond Williams." At the hearing on this

matter, the Debtor testified that he understood the document to merely authorize his car to be picked up, presumably by the insurance company, which was to retain the salvage. The Debtor's attorney also stated that he understood that execution of the Proof of Loss was a necessary step in processing the claim. The Debtor further testified that he is employed by Estes Truck Lines and that his place of employment is 7-8 miles from his home. He said that he gets off work in the evening after public transportation is no longer available and has been relying upon a girlfriend and her son to provide transportation for himself and his four teenage children.

At the time of the hearing on November 5, 2009, the Chapter 13 trustee had paid Budget 12 out of 20 scheduled payments under the confirmed plan. The court was not told the remaining balance to be paid to Budget, but was told by counsel for the Chapter 13 trustee that Budget had received $2,636.60, which included some interest. The parties agree that a check for the insurance proceeds in the amount of $3,950.00 was mailed to Budget. Counsel for Budget indicated that the check had been deposited. Given Budget's claim of $4,298.30, it appears that the insurance proceeds exceed the remaining balance due to Budget by some amount.

**ANALYSIS**

Nowhere in the Bankruptcy Code or Rules will be found reference to a "motion to substitute collateral." Such motions are frequently filed, however, when a vehicle which serves as collateral for a loan treated under a Chapter 13 plan is involved in an accident and is declared a total economic loss. In that event, the debtor asks permission to use the resulting insurance proceeds to purchase another vehicle that will enable the debtor to get to and from work in order to fund his plan. The provisions of the confirmed plan with respect to the secured creditor remain the same. From the debtor's point of view, little is changed if he is able to purchase a comparable vehicle for the amount

of the insurance proceeds. The substitution of collateral carries some additional risk for the secured creditor, however, because it is asked to forgo immediate repayment of the balance of its claim from the insurance proceeds. Often a secured lender will impose conditions on the substitution such as the right to inspect or approve the proposed replacement vehicle. More often than not, in this district, debtors are permitted to use insurance proceeds to purchase substitute collateral. The practice is similar to that described by the Bankruptcy Court for the Middle District of North Carolina:

> It has long been the practice in this district to permit a debtor to substitute collateral in the event a vehicle has been declared a total loss and the vehicle was covered by insurance. Typically, the insurance proceeds check is made payable to the debtor, the owner of the policy, and the creditor, the loss payee under the policy. The debtor is permitted to use the insurance proceeds to obtain a replacement vehicle and the creditor is given a replacement lien. The treatment afforded the creditor under the plan is unchanged. These transactions usually occur on an informal basis without court intervention.

*In re Young*, 2000 WL 33673801, slip op. at *2 (Bankr. M.D. N.C. 2000). This paragraph could have been written by any of the bankruptcy judges in this district. Counsel for Budget does not suggest that this typical practice should be changed. Rather, counsel suggests that the Debtor intended a different result in this case by signing the Proof of Loss with payment to be made solely to Budget. Further, Budget argues that its interests are not adequately protected because the Debtor's plan payments are not current. Thus, this case raises the question whether, under the circumstances here, the secured creditor may successfully resist the Debtor's motion to substitute collateral.

As a number of courts have recognized, the motion to substitute collateral is in effect a motion for permission to use cash collateral pursuant to section 363 of the Bankruptcy Code. *See, e.g., In re Coker*, 216 B.R. 843, 847-48 (Bankr. N.D. Ala. 1997); and *In re Carey*, 202 B.R. 796

(M.D. Ga. 1996). Section 363 defines cash collateral as cash or cash equivalents whenever acquired in which the bankruptcy estate and an entity other than the estate have an interest. *See* 11 U.S.C. § 363(a). In the Western District of Tennessee, the order of confirmation of a Chapter 13 plan typically provides for all property to remain property of the estate until discharge, dismissal, or specific order of the court. *Cf.* 11 U.S.C. § 1327(b). This was true of the order entered in the present case. Although the Debtor was permitted to use his vehicle in furtherance of his plan, it nevertheless remained property of his bankruptcy estate subject to the lien of Budget. Both the estate and Budget had an interest in the Debtor's vehicle at the time that it was destroyed. Whether and to what extent the parties' respective interests continued in the proceeds is determinative of whether the proceeds are available for use by the Debtor as cash collateral. As observed by Judge Tom Waldron, "the issue of whether proceeds are property of a debtor's estate is not simple, [and] is dependent upon the nature of the policy and the specific provisions governing the parties' interests in the payment of policy proceeds." *Ledford v. Fidelity Fin. Serv. (In re Hill)*, 174 B.R. 949, 952 (Bankr. S.D. Ohio 1994).

In this district, by standing order, the court has approved a program to provide automobile insurance to certain Chapter 13 debtors who propose to treat claims secured by an automobile in their Chapter 13 plan. *See Order for Chapter 13 Casualty Insurance* (Bankr. W.D. Tenn. January 12, 1982). According to the standing order, the court found it to be "in the best interest of both Debtors and Creditors to maintain required casualty insurance on certain vehicles in Chapter 13 estates" and that "a program should be instituted to insure [sic] adequate protection for said vehicles." *Id.* Pursuant to this order and subsequent amendments, the Chapter 13 trustees have obtained a blanket insurance policy that provides casualty insurance, but not liability insurance, to

all debtors with secured vehicles that have a retail value in excess of $1,000.00, who are not able to provide proof of private insurance. Insurance premiums are paid through the Chapter 13 plan. At the court's request, a copy of this policy, entitled "Chapter 13 Wage Earner Automobile Policy" ("Policy"), was provided by counsel for the Chapter 13 trustee, which was marked Trial Exhibit 2. The "Named Insureds" under the policy include the Chapter 13 Trustees for the Western District of Tennessee, Western Division, and the designated individual debtors who are issued a Certificate of Insurance. *See* Policy, page 1, and Endorsement AIC-WEP-E6(2/03). The Debtor in this case was issued such a certificate. A copy of this certificate was likewise provided to the court by the Chapter 13 trustee and was marked Trial Exhibit 3. The certificate names Budget Auto Sales as the Loss Payee.

> By endorsement, the Policy provides the following with respect to the Loss Payee:
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> > Loss or damage under this policy shall be paid, as interest may appear, to you and the loss payee shown in the Declarations Page or in this endorsement. This insurance with respect to the interest of the loss payee, shall not become invalid because of your fraudulent acts or omissions. However, we reserve the right to cancel the policy as permitted by policy terms and the cancellation shall terminate this agreement as to the loss payee's interest. We will give the same advance notice of cancellation to the loss payee as we give to the named insured shown in the Declarations.

Policy, Endorsement AIC-WEP-E3(2.03)TN. The court has searched in vain for a definition of "you" under the policy, but assumes that it refers in this clause to the "Named Insured," which includes the Chapter 13 Trustees and the individual debtor designated in the Certificate of Insurance. In other words, the court reads the loss payable clause to designate as potential beneficiaries under the policy the bankruptcy estate, the Debtor, and the loss payee, as their respective interests may appear.

Pursuant to 11 U.S.C. §§ 541(a)(7) and 1306(a), property of the estate includes any interest in property that the estate acquires after the commencement of the case. Property of the bankruptcy estate also includes "proceeds" of property of the estate pursuant to 11 U.S.C. § 541(a)(6). The estate in this case had an interest in the Blazer and in the Policy obtained by the Chapter 13 trustees that arose after the commencement of the Debtor's bankruptcy case. A portion of the Debtor's plan payments each month was used to make premium payments. There is authority to the effect that proceeds of casualty insurance covering property of the estate are likewise property of the estate. *See, Ford Motor Credit Co. v. Stevens*, 130 F.3d 1027, 1029 (11th Cir. 1997)*; Houston v. Edgeworth* , 993 F.2d 51 (5th Cir. 1993); and *Bradt v. Woodlawn Auto Workers F.C.U.*, 757 F.2d 512 (2nd Cir 1985). In *Stevens,* for example, the secured creditor, as loss payee under a policy of automobile insurance, was permitted to retain insurance proceeds resulting from the post-confirmation destruction of its collateral, up to the remaining balance owed on its secured claim together with interest at the rate provided in the confirmed plan. The creditor argued that it ought to be permitted to retain additional proceeds reflecting its original contractual interest rate on the basis that the proceeds it received as loss payee were not property of the bankruptcy estate. In rejecting this argument, the court said:

> The policy at issue in this case is intended to protect both the owner and the secured creditor in the event of the destruction of the security (the truck). In the context of the insurance policy on the truck, therefore, the proceeds act as a substitute for the insured collateral. *See Bradt v. Woodlawn Auto Workers (In re Bradt),* 757 F.2d 512, 515 (2d Cir. 1985) (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977)) (holding that broad definition of "proceeds" under 11 U.S.C. § 541(a)(6) encompasses insurance proceeds that simply represent a "conversion in form of property of the estate."); *In re Suter*, 181 B.R. 116, 120 (Bankr. N.D. Ala. 1994) (observing that, "[f]rom a secured creditor's perspective, property insurance is a substitute for the collateral insured.").

*Stevens*, 130 F.3d at 1030. The court concluded that where the debtor has an interest in insurance proceeds, that is, where the debtor is a potential beneficiary under the policy, the proceeds of that policy are property of the bankruptcy estate and the distribution of those proceeds is governed by the bankruptcy plan. *Id. See also, Hill*, 174 B.R. at 953 (Where loss is payable "as interest may appear" to insured and loss payee, creditor is neither the primary nor sole beneficiary of the proceeds. "Although these respective interests would ordinarily be governed by applicable non-bankruptcy law, as a result of the debtor filing bankruptcy, these respective interests are governed by the order . . . confirming the debtor's chapter 13 plan."); *In re Arkell*, 165 B.R. 432 (Bankr. M.D. Tenn. 1994) (Casualty insurance proceeds are property of the estate such that creditor's interest in insurance proceeds is limited to allowed secured claim less payments received through the plan); *Woods v. John Fox Oldsmobile, Inc. (In re Woods)*, 97 B.R. 850, 851-52 (Bankr. W.D. Va. 1989) (Insurance proceeds resulting from damage to vehicle are property of the estate.).

In contrast, where a debtor has unequivocally assigned his interest in proceeds to a secured creditor, the proceeds do not become property of the estate. *See, e.g., In re Bailey*, 314 B.R. 103 (Bankr. N.D. Miss. 2004) (Debtor's pre-petition contract with secured creditor provided that "[b]uyer hereby assigns to seller and its assigns all monies payable under the property insurance required or purchased herein . . ." and court held that this was a "contractual modification" which dictated a departure from the "general rule" that the proceeds from a casualty policy which pays the insured for a loss are property of the bankruptcy estate); *In re Suter*, 181 B.R. 116, 119 n.3 and 121 (Bankr. N.D. Ala. 1994) (Loss payee, as owner of the policy proceeds, was entitled to be paid to the extent of its interest in the property insured, but the debtor, as the owner of the policy, was entitled to any proceeds in excess of that amount. Court noted that the facts might distinguish the

case from those where insurance proceeds are payable jointly to the debtor and a secured creditor.).

As set forth above, the court reads the policy's loss payable clause in this case to designate as potential beneficiaries under the policy the bankruptcy estate, the Debtor, and the loss payee, as their respective interests may appear. As such, the provisions of the policy give an interest in any proceeds to Budget, the Debtor, and the estate, and any proceeds otherwise payable to Budget constitute cash collateral. *Hill*, at 953; *Woods*, at 852. Even so, however, if the Debtor's execution of the Proof of Loss in favor of Budget is construed as an assignment of his interest in the proceeds as Budget maintains, Budget will be entitled to retain the proceeds to the extent of the value of its secured claim. *Bailey* at 106.

The court has considered carefully each of Budget's arguments. With respect to the first argument – that by signing the Proof of Loss, the Debtor released the insurance proceeds to Budget – the court is convinced that this was not the Debtor's intent. According to the Debtor and his attorney, both thought that by signing the Proof of Loss, the Debtor was expediting the procedure for substitution of collateral. In his unrebutted, credible testimony, the Debtor said that he thought he was arranging for Budget to "pick up the car." Given his unique past experience with substitution of collateral, the court can find that it was reasonable for the Debtor to make that assumption. The Proof of Loss was signed *after* the motion for substitution was filed and *before* Budget filed its objection. The court concludes from these facts and circumstances that execution of the Proof of Loss was consistent with the Debtor's request to be permitted to use the insurance proceeds to purchase a substitute vehicle. Because the proceeds were paid to Budget for the account of the Debtor, the court further concludes that the proceeds in the hands of Budget remain

cash collateral, subject to "use" by the Debtor upon a proper showing. *See Carey v. General Motors Acceptance Corp. (In re Carey)*, 202 B.R. 796 (Bankr. M.D. Ga. 1996) (Automobile casualty insurance proceeds made payable to secured lender for the account of the debtor subject to "use" by the debtor as cash collateral.).

Budget does not dispute that a Chapter 13 debtor may use cash collateral after notice and a hearing if adequate protection is provided. *See* 11 U.S.C. §§ 363(c)(2) and 1303. As Chief Bankruptcy Judge Robert F. Hershner, Jr. explained in *Carey:*

> Because of the unique nature of cash collateral . . . 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. . . . [S]ection 1303 conditions, but does not prohibit, a consumer debtor's right to use cash collateral. Under sections 363(b) and 1303, notice and a hearing are required before a consumer debtor can use a secured creditor's collateral. Under section 363(b), after notice and a hearing, a consumer or business debtor can use *any* property of the estate if adequate protection is provided.

*In re Carey*, 202 B.R. at 798-99. Adequate protection may be provided by periodic cash payments, or by providing an additional or replacement lien, or by providing other relief constituting the "indubitable equivalent" of the security interest. *See* 11 U.S.C. § 361. A typical order of substitution will provide for the debtor to obtain a substitute vehicle acceptable to the secured lender with a value equal to the remaining debt owed to the secured creditor; provide that the lender will have a lien on the substitute vehicle to secure its remaining indebtedness; provide that the interest of the lender will be protected by insurance on the replacement vehicle naming the lender as loss payee; and provide that the claim of the lender will continue to be paid through the plan. *See In re Young*, slip op. at *3. This was in essence the protection provided to Budget in the prior order of substitution.

Budget argues, however, that its interest is not adequately protected because the Debtor has failed to make all payments called for under the plan. This argument fails to consider that the insurance proceeds resulting from the destruction of the Debtor's car were more than adequate to pay Budget's claim, after application of payments made pursuant to the plan, in full. Thus, if all of the insurance proceeds are used to purchase a substitute vehicle, the value of that vehicle should exceed the remaining balance of Budget's claim. Going forward, Budget will enjoy the same protection that it had under the prior order of substitution. The ability of the Debtor to get to and from work will enhance the Debtor's ability to make ongoing plan payments. Should the Debtor fail to make payments under the plan, Budget may seek relief from the automatic stay

**CONCLUSION**

Although this is the second motion for substitution of collateral filed in this case, the facts and circumstances favor the granting of the motion. The loss of the Debtor's car did not result from any error or wrongdoing on his part, and the Debtor needs a car to get to and from work in order to successfully complete his plan. As a result of the Proof of Loss calling for payment of the insurance proceeds to Budget "for the account of the Debtor," the insurance proceeds resulting from the destruction of the Blazer remain property of the bankruptcy estate subject to use by the Debtor so long as the interest of Budget is adequately protected. The interest of Budget may be adequately protected by the provision of a replacement vehicle of a value equal to the insurance proceeds. Budget may offer the Debtor a vehicle from its own inventory. In the event that Budget chooses not to do so, the Debtor may locate another suitable vehicle acceptable to Budget. In that event, Budget shall cause the insurance proceeds to be paid over to the seller of the vehicle for the account of the Debtor. Budget shall be noted as first lienholder on the title of the substitute

vehicle and shall be named loss payee on the certificate of insurance issued to the Debtor pursuant to the Trustees' insurance policy. Budget shall continue to be paid the balance of its secured claim pursuant to the Debtor's confirmed plan.

Fo the reasons set forth above, the Debtor's motion to substitute collateral is GRANTED and the objection of Budget thereto is OVERRULED. The court will enter a separate order consistent with this opinion.

cc: Debtor
Attorney for Debtor
Creditor Budget Auto Sales
Attorney for Budget Auto Sales
Chapter 13 Trustee