

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

RANDY E. PEBBLES,
REBECCA PEBBLES,

Debtors.

Case No. 87-1454-C

Chapter 13

MEMORANDUM OF DECISION AND ORDER

On July 14, 1987 an objection to debtors' claim of exempt property filed on behalf of Aetna Casualty & Surety Company (Aetna) and resistances to debtors' motion for turnover filed on behalf of Aetna and Share Health Plan of Iowa, Inc. (Share) came on for hearing before this court in Des Moines, Iowa. Steven C. Jayne appeared on behalf of the debtors. Timothy C. Hogan appeared on behalf of Aetna. David Head appeared on behalf of Share. Joe W. Warford, the Chapter 13 trustee was also present. At the close of the hearing the parties were given ten days to brief whether the property at issue is property of the estate and to provide the court with a copy of pertinent state court filings.

STATE COURT BACKGROUND

The debtor, Randy Pebbles, sustained injuries as a result of a motor vehicle accident on March 25, 1984 involving one Kevin Eddy, Aetna's insured. On July 5, 1984 Aetna and Mr. Pebbles entered into a release and settlement agreement. The agreement provided for a lump sum payment of \$19,668.88 on the day of execution of the agreement, \$200.00 a month for the

remainder of Mr. Pebble's life, and various lump sum payments totalling \$50,000.00 through the year of 2004.

At the time of the accident the debtor was insured under a Subscription Certificate from Share. Share contends that it paid for \$15,315.69 of covered expenses incurred by Mr. Pebbles in the treatment of his injuries. On February 15, 1986 Share filed a petition in Polk County District Court, CL64-37914, against the Pebbles and Aetna for reimbursement of said medical expenses. On March 10, 1986 Aetna filed a cross claim against the Pebbles for indemnification. On August 20, 1986 Aetna filed a petition for interpleader in Polk County District Court, CL67-39531, in which it admitted that money was due and owing to either the Pebbles or to Share. On August 28, 1986 the state court ordered Aetna to make payments under the settlement agreement to the Polk County Clerk of Court until such time as the state court determined who is the proper party to receive the payments.

On October 31, 1986 the state court granted Share's motion for partial summary judgment against the Pebbles in Share's petition, (CL64-37914). Judgment was entered on November 11, 1986 and ordered that Share shall recover \$15,315.69 from the settlement proceeds as reimbursement for the amount paid for medical bills on behalf of Pebbles. On January 12, 1987 that judgment was modified to allow recovery in the amount of \$14,863.69. On July 1, 1987 the state court granted Aetna's motion for partial summary judgment against Share in the same action (CL64-37914) and judgment was entered

on July 13, 1987 ordering that Aetna has no liability to Share "for amounts previously paid to Pebbles" and that Share's petition against Aetna is dismissed.

As of this date Aetna's interpleader action (CL67-39531) remains on file pending a determination of who is the proper party to receive payments under the settlement agreement-- Pebbles or Share.

BANKRUPTCY COURT BACKGROUND

On May 29, 1987 the debtors filed a petition for relief under Chapter 13 of the Bankruptcy Code. The debtors claim on their Chapter 13 statement (Property Claimed Exempt) that their interest in the release and settlement agreement is exempt pursuant to Iowa Code section 627.6(8)(e) as a pension, annuity, or similar plan or contract." On June 19, 1987 Aetna filed an objection to debtors' claim of exempt property asserting that an interest arising out of a settlement of a lawsuit is not a pension or annuity under Iowa Code section 627.6(8)(e).¹ Also on June 19, 1987 Aetna moved to modify the automatic stay to permit Aetna to continue making payments into the registry of the state court. An order authorizing Aetna to continue making such payments was entered by this court on June 30, 1987.

On June 19, 1987 the debtors filed a motion for turnover² pursuant to 11 U.S.C. section 542 seeking an order directing

¹ At the July 14, 1987 hearing the debtors orally amended their Chapter 13 statement to claim their interest in the settlement agreement exempt under Iowa Code section 627.6(8)(c) as well as 627.6(8)(e). A formal written amendment was filed on August 24, 1987 and resisted by Aetna on August 25, 1987. and Share on August 28, 1987.

² A proceeding to recover money or property of the estate is an adversary proceeding governed by Part VII of the Rules of Bankruptcy Procedure. See Fed. R. Bankr. P. 7001(1). Although the debtors have failed to properly file a

the Polk County Clerk of Court to turn over all monies on deposit and to further direct Aetna to deliver future payments to the debtor or to the Chapter 13 trustee. A resistance to the debtors' motion for turn over was-filed on behalf of Aetna on June 23, 1987. On June 24, 1987 Share also filed a resistance to the debtors' motion. Aetna argues that the debtors' interest in the settlement agreement is not exempt under the Iowa Code and thus is not subject to turnover under section 542(a) of the Bankruptcy Code. Share argues that the funds held by the Polk County Clerk of Court are not property of the estate and are not exempt under the Iowa Code.

ANALYSIS

The starting point for analysis of both the motion for turnover and the objections to property claimed as exempt is the consideration of whether the funds held in the state court registry are property of the estate. Pursuant to 11 U.S.C. section 541(a)(1), an estate is created of "all legal or equitable interests of the debtor in property as of the commencement of the case." Notwithstanding the broad scope of this section, Congress did not intend for the estate to succeed to a greater interest in property than that held by the debtor. See In re Auto-Train Corp., 53 B.R. 990, 994 (D. D.C. 1985); 11 U.S.C. 5 541(d). The bankruptcy court must look to state law to determine the existence and nature of a debtor's interest in specific property. In re Vermont Real Estate Inv. Trust, 25 B.R. 813, 016 (Bankr. D. Vt. 1982)

complaint for turnover, the court in the interest of expediency heard the debtors' motion and the resistances thereto and agreed to consider the matter under advisement.

citing In re Hurricane Elkhorn Coal Corp. II, 19 B.R. 609, 615 (Bankr. W.D. Ky. 1982).

The debtors' interest in the release and settlement agreement is governed by state law. Under Iowa law where an insurer has paid for a loss, the insured becomes a trustee for the insurer (to the extent of the loss paid by the insurer) in the recovery secured by the insured. Fireman's Ins. Co. v. Bremer, 25 F.2d 75, 76 (8th Cir. 1928); United Sec. Ins. Co. v. Johnson, 278 N.W.2d 29, 30-31 (Iowa 1979). Section 541 will not apply in a situation where property which ostensibly belongs to the debtor is, in reality, held by the debtor in trust for another. 4 Collier on Bankruptcy, § 541.01 at 541-7 (15th ed. 1986); Matter of Esteves Excavation, Inc., 56 B.R. 800, 802 (Bankr. D. N.J. 1983) (fund impressed with a trust is not property of the estate). An example of this situation is referred to in the legislative history of section 541:

For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, the payment would actually be held in a constructive trust for the person to whom the bill was owed.

H.R. Rep. No. 598, 95th Cong., 1st Sess. 361-68 (1977); S. Rep. No. 989, 95th Cong., 2nd Sess. 82-83 (1978) reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS pp. 5787, 5868, 6324. In

the instant case the state court has ruled that Share is entitled to reimbursement for medical expenses to be paid first out of the debtors' settlement agreement. Accordingly, the monies paid into the state court registry and payable pursuant to the settlement agreement may be subject to a constructive trust in favor of Share and at this juncture will not be considered property of the estate.

Additionally, the debtors' claim to the settlement proceeds is hampered by the pending interpleader action brought by Aetna to determine the proper party to receive the payments. The debtors seem to rely on 11 U.S.C. section 542(b) to require a turnover of money owed to the estate. Section 542(b), however, requires an entity that owes a debt to pay such debt to or on the order of the trustee if the debt is "property of the estate" and is "matured, payable on demand or payable on order." This section contemplates a turnover to the estate of properties or monies, which are due to the estate without dispute. See Matter of Chick Smith Ford, Inc., 46 B.R. 515, 518 (Bankr. M.D. Fla. 1985). An interpleader proceeding by its very nature evidences a dispute between parties to a given fund. See 45 Am.Jur.2d Interpleader § 1 at p. 433 (1969). As a general rule, courts agree that it is improper to grant relief which requires payment of monies in advance of the resolution on the merits of the underlying controversy, which involves the very right to the monies claimed. Matter of Chick Smith Ford, Inc., 46 B.R. at 518. "Certainly such a procedure would not be sanctioned outside

bankruptcy and there-is no just reason why it should be sanctioned just because the entity seeking to collect disputed funds happens to be a debtor under the Bankruptcy Code." Id.

In this case the underlying controversy--the entitlement to settlement proceeds--is pending in the Polk County, Iowa District Court. Since state law questions can be conveniently and authoritatively answered by the state court, abstention by this court is proper. See Matter of Bob Lee Beauty Supply Co., Inc., 56 B.R. 17, 20 (Bankr. N.D. Ala. 1985) (and cases cited therein). Accordingly, only after the state court determines the proper party to receive payments pursuant to the settlement agreement will this court reconsider the necessity of a complaint for turnover.

With regard to the objection to debtors' claim of exemption in the entire interest arising out of the release and settlement agreement, the briefs which have been filed, particularly on behalf of the debtors who bear the burden of establishing their entitlement to an exemption in the property at issue, are not well developed. Accordingly, the objection to debtors' claim of exempt property will be continued for 30 days in which time the parties are directed to further brief the claim of exemption under both Iowa Code section 627.6(8)(c) and 627.6(8)(e).

WHEREFORE, based on the foregoing analysis, the court finds that the debtors' interest in the funds held by the state court registry must be determined in the pending state

court action and is not considered property of the estate at this time.

THEREFORE, the debtors' motion for turnover is hereby denied.

IT IS FURTHER ORDERED, that the objection to the debtors' claim of exempt property is continued for 30 days in which time the parties are directed to brief the debtors' entitlement to an exemption under Iowa Code section 627.6(8)(c) and (e).

Signed and filed this 25th day of September, 1987.

LEE M. JACKWIG

U.S. BANKRUPTCY JUDGE