

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

DONALD D. SPEARS,
PHYLLIS M. SPEARS,
Engaged in Farming,

Case No. 86-3019-C J

Chapter 11

Debtors.

ORDER ON OBJECTION TO PLAN

On June 30, 1988, the Federal Land Bank of Omaha (FLB), a creditor in this Chapter 11 case, filed an objection to the debtors' plan of reorganization filed March 28, 1988. The matter came on for hearing before this court in Des Moines, Iowa on August 17, 1988. Dan Childers appeared on behalf of the debtors; Tom Burke appeared on behalf of FLB; and Terry Gibson appeared on behalf of the U.S. Trustee. At the close of the hearing the parties were given until September 16, 1988 to file briefs. The matter was considered fully submitted on that date.

FACTUAL BACKGROUND

On February 1, 1979, the debtors borrowed from FLB the principal sum of \$292,500.00. At that time Mr. Spears enrolled in a "mortgage protection insurance program" being offered through Bankers Life Company of Des Moines, Iowa now known as Principal Financial Group (Principal). The application for said insurance was accepted by Principal effective April 20, 1979 for the amount borrowed from FLB.

The group life insurance policy insured the debtor, Donald D. Spears, and named FLB as group policyholder. Section 12 of the insurance policy governs the total disability income benefit. It provides:

If a person becomes totally disabled prior to the date he is sixty-five years of age and while he is insured under this policy and if such total disability continues uninterruptedly for at least 180 consecutive days, the Company, upon receipt of written proof and subject to all provisions of this Policy, during the continuance of such disability and without further payment of premium, (a) will pay in annual installments to the Group Policyholder the annual principal and interest payment due from the Person, each annual payment not to exceed 10% of the amount of the Person's insurance in force on the date disability commences; and (b) will provide a death benefit payable as provided in Section 11...

The first installment shall be due and payable to the Group Policyholder on the loan installment due date ... (Emphasis added.)

The total disability income benefits automatically and immediately cease on the earliest of the following occurrences: the date the Person's total disability no longer exists; or the date the Person fails to submit to any required medical examination; or the date the Person fails to submit any required proof of the uninterrupted existence of such total disability; or the date the total amount of the Person's insurance in force on the date total disability commenced has been paid. The mortgage protection insurance as a whole terminates on the earliest of the following events: the date

the loan obligation is discharged; the day preceding the premium due date when the premium is not paid within the grace period; the date the loan obligation is transferred or assumed by any individual(s) other than the insured; or the date the period of redemption expires under a mortgage foreclosure or any other forced sale of the person's interest in the security for which the mortgage loan was contracted.

On March 7, 1983, Mr. Spears became totally disabled as a result of Alzheimer's disease. His recovery is unlikely. The proper claim forms were submitted to Principal. It began paying the annual disability payments of \$28,885.90 (10% of the policy benefits available on the date of disability) to FLB on April 30, 1984. Principal has made annual payments through April 30, 1988. FLB has applied those payments against its claim.

The remaining annual payments will be made on April 30 of the next five years (1989 through 1993). They totaled approximately \$144,279.50 as of September 23, 1988. The present value of the remaining benefits is \$112,918.00 (assuming a 10% discount rate).

The value of the real estate securing FLB's claim was \$214,000.00 on August 17, 1988. The claim is further secured by FLB's stock in the amount of \$14,000.00. If the FLB is found to be fully secured as of August 17, 1988, its claim would consist of \$312,409.34 principal and interest plus interest at the rate of \$111.71227 per day plus attorney's fees.

FLB contends that the disability benefits payable under the insurance policy are property of the estate and that it has a charge against or interest in that property. Accordingly, the FLB argues that the debtors' plan fails to comply with 11 U.S.C. section 1129(a)(7)(A)(ii) or section 1129(b) (2)(A)(i) because it does not include in the secured claim of the FLB the present value of the remaining disability benefits under the insurance policy.

The debtors reason that the purpose of the insurance merely was to make the risk of a default on payment of the obligation lower and not to add to the value of the collateral. Therefore, the debtors suggest that the payments being received by FLB should be applied to the value of the other security, thereby reducing the total secured claim of FLB. The debtors do not contend that the payments are not property of the estate nor that FLB is not entitled to the payments. Rather they challenge the "double counting" that would result if the present value of the stream of payments was added to the allowed secured claim.

DISCUSSION

At the outset, the court questions what appears to be an implicit stipulation by the parties that the benefits in issue are property of the estate. Although 11 U.S.C. section 541(a)(1) provides that an estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case", Congress did not intend for the estate to succeed to a greater interest in property than

that held by the debtor. In re Auto-Train Corp., 53 B.R. 990, 994 (Bankr. D. D.C. 1985). See 11 U.S.C. section 541 (b)(1) (power that debtor may exercise solely for benefit of another is not property of the estate) and 11 U.S.C. section 541(d) (property in which debtor holds legal title only may become property of the estate only to the extent of the legal title).

FLB urges this court to follow the broad definition of property of the estate set forth in Matter of Hawkeye Chemical Co., 71 B.R. 315 (Bankr. S.D. Iowa 1987). However, the proceeds in issue in Hawkeye resulted from a property damage and business interruption policy and the check for the proceeds had been made payable to the debtor and two of its creditors. In partial support of its argument that the proceeds were not property of the estate, one of the creditors cited In re Encinas, 27 B.R. 79 (Bankr. Ore. 1983)(casualty insurance proceeds did not constitute property of the estate under section 541 because the debtors held only legal title and the mortgagee possessed a superior right to the proceeds while the mortgage was in full force) and In re Ivory, 32 B.R. 788 (Bankr. Ore. 1983)(casualty insurance proceeds did not constitute property of the estate but, rather, amounted to a power exercised solely for the benefit of the mortgagee pursuant to section 541(b)). This court distinguished the Hawkeye facts from those in Encinas and Ivory by pointing out that "the debtor herein may arguably exercise legal title as a payee under the insurance draft

issued pursuant to the comprehensive policy for more than one entity". Hawkeye, 71 B.R. at 321.

In the present case, Mr. Spears might have some legal or equitable interest as to the entire policy. That is, section 11 of the policy provides that any balance remaining after payment of the death benefit to the group policyholder would be paid to the executors or administrators of the insured's estate. Likewise, section 13 of the policy provides for a conversion privilege (life insurance only) upon payment and discharge of the loan obligation. By contrast, Mr. Spears does not appear to have legal or equitable title to the total disability income benefits as set forth in section 12 of the policy. Clearly the benefits are paid directly by Principal to FLB. Mr. Spears is not a payee nor a co-payee. The policy does not contemplate any remaining disability benefit balance for Mr. Spears nor conversion of the disability benefit feature of the policy. Mr. Spears' interest is only that of being the insured. His life was insured for the benefit or protection of the creditor against the risk that he might not be able to pay off the loan. Hence, the court doubts that the disability benefits are property of the estate, meaning that a determination of the FLB's secured status as to such benefits would be foreclosed by operation of 11 U.S.C. section 506(a).

Assuming that the parties are correct in their agreement that the benefits in issue are property of the estate,

the end result nevertheless is the same. Section 506(a) provides in part that "[a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property,...". 11 U.S.C. section 101 does not define "interest" or "value". The definition of "lien" found at section 101(31) is of no assistance in this matter. It would be unreasonable and inconsistent with the Code as a whole to expand the concept of an allowed secured claim to include the value of contingent benefits or proceeds. If that were the case, a creditor holding a mortgage on farmland and otherwise entitled to crops or crop proceeds might ask the court to increase its allowed secured claim by some value for crops that would be planted in the future.

In this case the parties have stipulated that Mr. Spears' recovery is unlikely and that the present value of the remaining benefits is \$172,918.00. Yet, the fact upon which the court must base its decision is that Principal must pay FLB the remaining annual disability payments on April 30 of 1989, 1990, 1991, 1992 and 1993 only if Mr. Spears continues to be disabled on those dates as defined and delineated by the policy. If Mr. Spears were to recover at some point during the next five years, Principal would cease making the payments as of the appropriate date. If Mr. Spears were to die within the same time frame, the death benefit provision would apply and the stipulated present value figure for the

disability benefits would no longer be valid.

It is beyond this court's power to find conclusively that Mr. Spears will be or will not be disabled on some future date. Only time will tell. Thus, at this juncture, the actual value of the creditor's interest in any alleged interest of the estate in the disability benefits is zero. If as of April 30, 1989, Principal still must pay FLB under the terms of the policy, the actual payment will be akin to cash collateral or security--the status of which in essence self-destructs upon payment to FLB. Hence, just as the anticipated disability payments do not provide additional security to the FLB as of the effective date of the plan, they likewise do not otherwise decrease the FLB's allowed secured claim. Cf. Matter of Moellenbeck, 83 B.R. 630 (Bankr. S.D. Iowa 1988) (value of contingent IRS estate tax lien could not be subtracted from creditor's secured claim). As made, the annual payments merely decrease the outstanding claim of FLB.

CONCLUSION

WHEREFORE, based on the foregoing discussion, the court finds that the allowed secured claim of the FLB as of the effective date of the plan is neither increased nor decreased by the anticipated annual disability benefit payments in 1989 through and including 1993.

ORDER

THEREFORE, the Federal Land Bank's objection to the debtors' plan is overruled insofar as it relates to the inclusion of the anticipated disability benefits in the allowed secured portion of its claim.

The debtors are hereby ORDERED to amend their plan to clarify that the allowed secured claim is not otherwise decreased by the anticipated disability benefits and to include any and all other resolutions of objections stated on the record at the time of the confirmation hearing.

Signed and filed this 30th day of December 1988.

LEE M. JACKWIG
CHIEF U.S. BANKRUPTCY JUDGE