13 NEWS©

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PRACTITIONER'S FORUM:

DEALING WITH LACK OF INSURANCE

by David Koukol, Attorney at Law

The first rule in bankruptcy is that it is usually unfair. The second rule in bankruptcy is that it is always unfair to those parties involved, particularly creditors, who do not follow the statutes and rules to enforce their rights and protect their interests.

When creditors have a properly perfected security interest in property of the debtor, they are entitled to have the debtor continue to abide by the contract entered into pre-petition. It is sound business practice to take the steps necessary to protect one's interests. Often in bankruptcy the only effective way to do this is to hire legal counsel with experience in enforcing creditors' rights.

One of the frustrating situations in which creditors find themselves when a customer files bankruptcy is where the creditor has loaned money and taken a security interest in a piece of equipment to assure performance by the customer. A common scenario might involve the creditor financing the debtor's purchase of a motor vehicle. The debtor signs a purchase agreement/note and security agreement, and the creditor's lien is noted on the vehicle's title to perfect the security interest. The purchase agreement or note requires the debtor to maintain insurance on the vehicle.

Before filing, the debtor's history is replete with lapses of insurance and reminder letters, with the creditor giving the debtor chances to cure the default by providing proof the collateral is insured. Sometimes the debtor's habits do not change after filing and there continue to be defaults. However, when the debtor files bankruptcy, the Bankruptcy Code and associated rules step in to affect the creditor's relationship with the debtor and the collateral. No longer can the creditor simply repossess the vehicle. This leaves the creditor in the precarious position of having the collateral uninsured, no payments being made, and the inability to repossess. The result is a frustrated creditor whose hands are effectively tied by the Code.

The creditor's remedy for such a scenario is to immediately file a motion for relief on the grounds that the debtor's failure to abide by the contract's terms (specifically, making timely payments and maintaining insurance) is "cause" under Section 362 for relief from the stay. A letter outlining the default should be sent to the debtor if required under the contract language, but usually the requirement for maintaining items like insurance does not provide for notice to the debtor. Insurance either is maintained, or it is not. Once the creditor finds that insurance has lapsed or been canceled, prompt action should be taken to obtain relief and get the collateral.

Debtors who frequently allow their insurance to lapse should have the ramifications of failing to maintain insurance clearly explained. As an incentive to the recalcitrant debtor and assurance to the creditor, there can be a stipulation requiring the debtor to abide by the contract's terms, providing for automatic relief in the event of a default. Court approval of the stipulation should be obtained. If a debtor or debtor's counsel will not agree to a stipulation with such a "drop dead" clause, the creditor is left with no alternative but to file a motion for relief from the automatic stay. The $60 filing fee can be a disincentive, but the motion is necessary to get the right to go after the collateral. In most cases where the debtor has failed to provide the required insurance, no resistance to the motion will be filed and relief will be granted. If a debtor fights the motion, he or she will have to provide proof of insurance and adequate protection. If the proof is provided at the last minute, a creditor would be wise to obtain a stipulation that the next time the debtor defaults relief will be automatic.

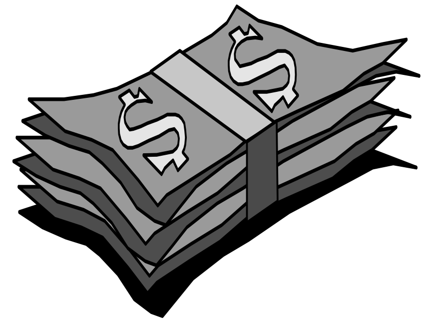
Counsel representing debtors can avoid unnecessary motions for relief by explaining to their clients that the mere filing of bankruptcy does not give them an excuse to not abide by their contracts for property they want to retain. A more preferable way of handling insurance questions, from the creditor's perspective, is to have a stipulation that sets forth the debtor's duty to abide by the contract and the penalties (i.e. automatic relief from stay) for breaching those duties. A fairly drawn stipulation with appropriate notice to the debtor will give the debtor the structure needed to keep insurance current and the creditor the assurance that the collateral will be continuously insured.

This month's article was contributed by David J. Koukol. Mr. Koukol graduated from the University of Nebraska at Lincoln. He obtained his juris doctorate degree from the University of Nebraska College of Law, Lincoln, Nebraska in 1984, and was Law Clerk to Senior United States District Court Judge Richard E. Robinson. He is currently engaged in general private practice and bankruptcy practice with emphasis on creditor representation.

The Eighth Circuit Court of Appeals decided on May 6, 1996 in ***Christians v. Crystal Evangelical Church*** (1996 WL 223998) that the Religious Freedoms Restoration Act (42 U.S.C. § 2000bb) is violated by a chapter 7 trustee's 11 U.S.C. § 548 action to recover the debtors' prepetition tithes. The RFRA requires a showing of "compelling governmental interest" to justify any "substantial burden" on an individual's free exercise of religion. The Court held that the chapter 7 trustee's recovery from debtors' church substantially burdened debtor's free exercise rights and that the bankruptcy policies behind the trustee's power to recover fraudulent conveyances did not amount to a compelling governmental interest. Of interest to tax attorneys and the Internal Revenue Service, the Court distinguished, among other things, the government's interest in collection of taxes, which it acknowledged to be compelling.

Q: ***On October 22, 1994, the debt eligibility limits in Chapter 13 cases was raised from $100,000 to $250,000 in noncontingent, liquidated, unsecured debts and from $350,000 to $750,000 in noncontingent, liquidated, secured debts pursuant to the Bankruptcy Reform Act of 1994. Didn't that change in the statute significantly increase the number of Chapter 13 filings in the District of Nebraska?***

A: This question has been frequently directed to me. Actually, the statutory change has not significantly increased the Chapter 13 caseload in the District of Nebraska. A query of all Nebraska Chapter 13 filings since the effective date of the Act revealed fifty (50) cases where the debts exceeded the previous jurisdictional requirements. Only six (6) of those cases involved secured debts which exceeded $350,000. Forty-four (44) cases dealt with unsecured debts which exceeded $100,000.



Processing cutoff for checks in June will be the third (3rd) Friday of the month or June 21, 1996. Checks will be mailed on the fourth (4th) Friday of the month or June 28, 1996.

Cutoff for confirmation orders is 10 days prior to the mailing or Tuesday, June 18, 1996.

EDITOR'S COMMENT

This newsletter is being published to facilitate communication between the Chapter 13 Trustee's Office and the many people we serve. The information is not meant to constitute legal advice or recommendations to individuals. If you would like to contribute an article, conference or program information, law review article, book review, comment, or question for further feedback from others, please call me directly or mail your item to:

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