UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE: Air South Airlines, Inc. Debtor.	C/A No. 97-07229-W Adv. Pro. No. 99-80037-W
W. Ryan Hovis, Trustee Plaintiff, v. The AGES Group, L.P., Defendant.	**JUDGMENT** Chapter 7

Based upon the Findings of Fact and Conclusions of Law as recited in the attached Order of the Court, the Motion of The AGES Group, L.P. for Summary Judgment is granted.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina
November 19, 1999.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

IN RE: Air South Airlines, Inc. Debtor.	C/A No. 97-07229-W Adv. Pro. No. 99-80037-W
W. Ryan Hovis, Trustee Plaintiff, v. The AGES Group, L.P., Defendant.	**ORDER** Chapter 7

THIS MATTER comes before the Court on the Motion of AGES Group, L.P. (hereinafter "AGES") for Summary Judgment (hereinafter "Motion") pursuant to Bankruptcy Rule 7056. Based upon the pleadings and arguments of counsel, the Court makes the following Findings of Fact and Conclusions of Law pursuant to Rule 52 of the Federal Rules of Civil Procedure, made applicable by Rule 7052 of the Federal Rules of Bankruptcy Procedure:[1]

FINDINGS OF FACT

1. On March 15, 1995, Polaris Aircraft Leasing, K.B. (hereinafter "Polaris" or "Lessor") and Air South Airlines, Inc. (hereinafter "Air South," "Debtor," or "Lessee") entered into a lease agreement (the "Lease") pursuant to which Air South leased several aircrafts and engines from Polaris.

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[1] The Court notes that to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.

JW-1612-

2. Under the terms of the Lease, Debtor is required to maintain the equipment in good repair, to avoid impairment of Polaris' title to the leased equipment, and to obtain insurance on the aircrafts and engines.

3. The Lease provides that the application of the insurance proceeds should be as follows:

(a) all insurance payments received as the result of an Event of Loss occurring during the Term will be paid to Lessor and Lessor will pay the balance of those amounts to Lessee after deduction of all amounts which may be or become payable by Lessee to Lessor under this Agreement;

(b) all insurance proceeds of any property, damage or loss to the Aircraft, any Engine or any Part occurring during the Term not constituting an Event of Loss and in excess of the Damage Notification Threshold will be paid to Lessor and applied in payment (or to reimburse Lessee) for repairs or replacement property within 10 days of Lessor being satisfied that the repairs or replacement have been effected in accordance with this Agreement. Insurance proceeds in amounts below the Damage Notification Threshold may be paid by the insurer directly to Lessee. Any balance remaining may be retained by Lessor;

(c) all insurance proceeds in respect of third party liability will, except to the extent paid by the insurers to the relevant third party, be paid to Lessor to be paid directly in satisfaction of the relevant liability or to Lessee in reimbursement of any payment so made; [or]

(d) notwithstanding Clauses 9.7(a), (b) or (c), if at the time of the payment of any such insurance proceeds a Default has occurred and is continuing, all such proceeds will be paid to or retained by Lessor to be applied toward payment of any amounts which may be or become payable by Lessee in such order as Lessor sees fit or as Lessor may elect.

4. According to the Lease, Air South would be paid the insurance proceeds if the damages were less than the damage notification threshold of $100,000.

5. In compliance with the Lease, Air South obtained an Aircraft Hull Deductible Insurance Policy (the "Insurance Policy") with Cigna. The effective dates of the Insurance Policy were from July 23, 1995 through July 22, 1996.

6. On August 3, 1995, a certificate of insurance was issued in favor of Polaris designating Polaris as the loss payee.[2]

7. In late 1995, Air South and AGES entered into an Engine Maintenance Agreement pursuant to which AGES agreed to repair engines for Air South for a percentage of the repair costs.

8, On March 20, 1996, while an airplane was in flight, two of the engines that Polaris had leased to Air South sustained substantial damage. With Polaris' knowledge, Air South submitted the Engines to AGES for repair. AGES charged Air South $875,509.91 for the repairs.

9. On July 17, 1996, Air South submitted a notice of property loss (the "Insurance Claim").

10. On May 22, 1997, Air South signed a Form of Release and Discharge settling the Insurance Claim and authorizing Cigna to pay AGES the sum of $400,000, the amount of the claim under this policy in excess of the damage notification threshold.

11. Cigna issued the $400,000 check on June 2, 1997. The check was made payable to AGES exclusively and was written from Cigna's checking account.

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[2] In the subsection entitled "Loss Payee," the certificate states that "in respect of any claim, in excess of the damage notification threshold, all losses will be settled with and paid to the Lessor for the amount of all interests."

12. On or about August 28, 1997, Debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. The matter was converted to Chapter 7 on or about October 16, 1997.

13. On February 9, 1999, the Trustee commenced an adversary proceeding against AGES to recover, among other items, the $400,000 insurance payment which he alleges is a preferential payment pursuant to 11 U.S.C. §547.[3] The Complaint was amended on May 11, 1999 to correct the name of AGES, to affirmatively plead that the $400,000 was property of the estate, and to request the recovery of the other payments the Trustee alleges were made within the 90-day preference period.[4]

14. The preference period begins on May 30, 1997 and runs through August 28, 1997.

CONCLUSIONS OF LAW

I. Standard for Granting a Motion for Summary Judgment

Rule 56(c) of the Federal Rules of Civil Procedure, made applicable to adversary proceedings under the Bankruptcy Code by Bankruptcy Rule 7056, provides that a party may move for summary judgment, and that such judgment "shall be rendered forthwith" if the evidence and pleadings "show that there is no genuine issue as to any material fact" and that the moving party is "entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

The United States Supreme Court has emphasized that "the plain language of Rule 56(c)

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[3] Subsequent references to the Bankruptcy Code shall be by section number only.

[4] This motion for summary judgment is restricted to the $400,000 and does not request a finding on the other payments which were added by the amended complaint. The issue before the Court is restricted to whether the $400,000 was property of Debtor. AGES raised other defenses regarding the $400,000 payment, including the argument that the transfer of the insurance proceeds did not occur within the preference period. However, the Court does not address the other issues raised at this time because it concludes that the $400,000 was not property of the bankruptcy estate.

mandates the entry of summary judgment . . . against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). The party opposing summary judgment may not rest on its pleadings but must set forth specific facts that show the existence of a genuine issue for trial. Dunes Hotel Assoc. v. Hyatt Corp. (In re Dunes Hotel Assoc.), 194 B.R. 967, 976 (Bankr. D.S.C. 1995). The Court of Appeals for the Fourth Circuit has recognized that trial judges have "the affirmative obligation . . . to prevent 'factually unsupported claims and defenses' from proceeding to trial." Felty v. Graves-Humpreys Co., 818 F.2d 1126, 1128 (4th Cir. 1987) (citing Celotex, 477 U.S. at 323-24).

After the movant has proved the absence of any genuine issue of material fact, the party opposing summary judgment then bears the burden to prove specific facts which show the existence of a genuine issue for trial. In re Dunes Hotel Assoc., 194 B.R. at 976 (citations omitted). No genuine issue for trial exists unless there is "sufficient evidence favoring the non-moving party for a jury to return a verdict for that party." Id. Once AGES has set forth evidence and pleadings to show that there are no genuine issues of material fact, and that it is entitled to judgment as a matter of law; unless the Trustee presents evidence of specific facts showing the existence of genuine factual issues for trial, AGES is entitled to summary judgment.

II. Property of the Estate

Section 547(b) gives trustees the authority to avoid preferential transfers. The section provides as follows:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--
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> (1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) made--
(A) on or within 90 days before the date of the filing of the petition; or
(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if--
(A) the cases were a case under chapter 7 of this title;
(B) the transfer had not been made; and
(c) such creditor received payment of such debt to the extent provided by the provisions of this title.

The issue before this Court is whether the $400,000 in insurance proceeds is "property of the debtor" pursuant to §547(b). In Beiger v. IRS, 496 U.S. 53, 58 (1990), the Supreme Court limited a trustee's §547(b)'s avoidance power to "property of the debtor".

> Because the purpose of the avoidance provision is to preserve the property includable within the bankruptcy estate--the property available for distribution to creditor-- 'property of the debtor' subject to the preferential transfer provision is best understood as that property that would have been part of the estate had it not been transferred before the commencement of bankruptcy proceedings.

Id. at 58. In order to prevail on a preferential transfer action, the Trustee would need to establish that the $400,000 payment was property of Air South. Based upon the facts before the Court, Debtor's interest in the $400,000 payment is insufficient to cause it to become property of the estate; therefore, the Trustee cannot prevail on his complaint as a matter of law.

Section 541 provides guidance as to what constitutes "property of the estate." Property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." Several courts have examined the issue of whether insurance

proceeds constitute property of the debtor, and they have reached various results. At least one court has analyzed the issue under §541(b)(1) which provides that "Property of the estate does not include--(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor." See In re Encinas, 27 B.R. 79 (Bankr. D. Or. 1983). In In re Encinas, Beneficial had given a loan to the debtors which was secured by the debtors' household goods. As part of the agreement, the debtors were required to obtain insurance on the household goods. The household goods sustained major damage in a fire. Two months after the loss, the debtors filed for Chapter 13 relief. The order of confirmation of the debtors' plan provided that Beneficial's lien in the household goods was voided pursuant to §522(f). Beneficial objected and requested that the court enter an order modifying the plan to specify that Beneficial's rights to the insurance money were not affected. In concluding that the insurance proceeds were not property of the debtors' estate and that Beneficial's rights to the insurance proceeds were unaffected by the debtors' filing of the Chapter 13 case, the court held that:

> [T]he debtors' interest in the insurance proceeds is, at most, a legal interest only. Under these circumstances, the power vested in the debtors by virtue of their bare legal title under the insurance draft may only be exercised solely for the benefit of Beneficial. Thus, the signing of the insurance draft held by Beneficial is the kind of "power" excepted by 11 U.S. C. §541(b) from the Bankruptcy Code definition of the debtors' estate.

Id. at 81; see also In re Ivory, 32 B.R. 788 (Bankr. D. Or. 1983). Following the In re Encinas court's reasoning that the party entitled to insurance proceeds is the party whose interest was intended to be protected by the policy, not the party who merely held bare legal title; Air South has at most legal title in the insurance proceeds, and it is clear from the language of the Lease that Polaris, the Lessor, would be entitled to the $400,000 payment from the insurer.

The Trustee cited Bradt v. Woodlawn Auto Workers, F.C.U. (In re Bradt), 757 F.2d 512 (2d Cir. 1985) for the proposition that insurance proceeds from a pre-petition policy are considered property of the estate. In re Bradt was analyzed by the Court of Appeals for the Fourth Circuit in American Bankers Ins. v. Maness, 101 F.3d 358 (4th Cir. 1996), which had before it the issue of whether insurance proceeds from post-petition policies were part of the bankruptcy estate and concluded that such proceeds did not constitute part of the debtor's estate. The court in Maness discussed the difference between the facts before it and the facts in In re Bradt and drew a distinction in the fact that in the latter case, the asset in question was insurance proceeds from a pre-petition insurance policy. In analyzing In re Bradt, the Court of Appeals for the Fourth Circuit noted: "Rather, it appears that the insurance policies considered in Bradt (and its progeny) were issued pre-petition and so the policies themselves constituted property of the bankruptcy estate. Any payments from pre-petition policies are indisputably 'proceeds' of estate property . . ." Id. at 364.

In In re Bradt, Mr. Bradt purchased a car with funds loaned to him by Credit Union and promised to keep insurance on the vehicle. He then filed a petition for relief under Chapter 7. A couple of months later, he was involved in a wreck. Mr. Bradt had insured the car, naming himself and the Credit Union as loss payees. The insurance company issued a check covering the repair bill and made it payable to both the debtor and the Credit Union. The court held that "the insurance payment for repairs to an automobile that is property of the estate unquestionably is also property of the estate." Id. at 515. The facts in In re Bradt are clearly distinguishable from the facts presented in the case now before this Court. In this case, in fact, Debtor is not the owner of the engines which bears the ultimate risk of any damage or loss, rather, it is only leasing

them from Polaris. Furthermore, in In re Bradt, the debtor, as one of the named loss payees, had a contractual interest in the insurance proceeds. Debtor in the case before this Court is not the loss payee of the policy and the check that Cigna issued for the repair done to the engines was made payable only to AGES, who repaired the equipment. Because Polaris was designated as the loss payee under the Insurance Policy and the Lease provides that the proceeds would be applied to discharge third party liability in this situation, Polaris and AGES were the only entities with a possible interest in the proceeds. Air South only had a right in the proceeds if the damages to the engines were less that the damage notification threshold of $100,000. Because the damages in this case exceeded the threshold, Air South had no interest in the proceeds,[5] and it cannot step into the shoes of Polaris in order to establish a property interest in the insurance proceeds for preference purposes.

The courts have construed the definition of "property of the estate" rather broadly, and

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[5] The court in In re Suter, 181 B.R. 116 (Bankr. N.D. Ala. 1994), demonstrates the distinctions in the holdings of cases dealing with the issue of whether insurance proceeds are property of the debtor's estate. In In re Suter, the creditor of a Chapter 13 debtor was the loss payee of an insurance policy. The court held that because the creditor was the loss payee, the proceeds of the policy were not property of the bankruptcy estate and were payable to the creditor to the extent of its interest in the property insured. The court then added,

> The present case may be distinguishable from cases in which the secured creditor only has a security interest in the insurance proceeds and is not a loss payee on the policy, as well as cases in which the insurance proceeds are payable jointly to the debtor and the secured creditor.

Id. at 119 n.3; see also Carey v. General Motors Acceptance Corp. (In re Carey), 202 B.R. 796, 800 (Bankr. M.D. Ga. 1996) (holding that insurance proceeds were property of the Chapter 13 debtor's bankruptcy estate, although insurance check was made out to financing company, where financing company was merely a secured creditor, and the insurance policy permitted the payments of the proceeds to be made to *both* debtor and financing company).

they are in agreement that generally "an insurance policy will be considered property of the estate." Houston v. Edgeworth (In re Edgeworth), 993 F.2d 51, 55 (5th Cir. 1993). However, the courts have also recognized that the inquiry does not end there: "'The question is not who owns the policies, but who owns the liability proceeds.'" Id. at 55 (quoting Louisiana World Exposition, Inc. v. Federal Ins. Co. (In re Louisiana World Exposition, Inc.), 832 F.2d 1391, 1399 (5th Cir. 1987)); see also Johnson v. USAir Fed. Credit Union (In re Johnson), 162 B.R. 464, 465-66 (Bankr. M.D. N.C. 1993).

> The overriding question when determining whether insurance proceeds are property of the estate is whether the debtor would have a right to receive and keep those proceeds when the insurer paid on a claim. When a payment by the insurer cannot inure to the debtor's pecuniary benefit, then that payment should neither enhance nor decrease the bankruptcy estate. In other words, when the debtor has no legally cognizable claim to the insurance proceeds, those proceeds are not property of the estate.

In re Edgeworth, at 55-56, see also First Fidelity Bank v. McAteer, 985 F.2d 114, 117 (3d Cir. 1993) (holding that proceeds of credit life insurance policy which creditor collected after debtor died were property of creditor beneficiary of the life policy because "if the owner of a life insurance policy did not have an interest in its proceeds, the filing of the petition in bankruptcy cannot create one"); In re Johnson, 162 B.R. at 465-66 (holding that proceeds of a credit disability policy purchased by debtor for the benefit of an unsecured creditor was not property of the estate because the court could not "elevate the rights of the . . . debtor to create an interest in an insurance policy that would not exist but for the bankruptcy filing").

Turning to the case at bar, even if it were concluded that the insurance policy or the lease of the equipment were property of the bankruptcy estate, that, by itself, does not determine that

the proceeds of the insurance policy were also property of Debtor. The main question is what party had the rights to receive the $400,000 payment. At the time Debtor filed its bankruptcy petition, it had a leasehold interest in the engines, and its rights and obligations were governed by the Lease. Although the Lease sets forth several alternatives for the application of the insurance proceeds, it consistently provides that Polaris would receive insurance proceeds in excess of $100,000. There is no dispute between the parties that the insurance proceeds exceeded this amount. Moreover, the parties agree that Section 9.7 of the Lease governs the disposition of the insurance proceeds. However, the trustee asserts that Section 9.7 should be interpreted to mean that Polaris wanted either the engines repaired or the $400,000 payment and that because the engines were repaired, Polaris waived its interest in the $400,000 payment. The Court finds this argument to be unpersuasive.

The Lease provides that New York law will govern the agreement between Polaris and Air South. To determine the intent of the parties, the court must look to the contract. If the contract is unambiguous, the court will look no further to determine the parties' intent. See Namad v. Salomon Inc., 543 N.E.2d 722, 723 (N.Y. 1989). In examining the Lease, it is clear that the parties contracted for Polaris to have the sole right to recover insurance proceeds resulting from any damage to its aircraft and engines, if the amount of damages to the equipment was more than the damage notification threshold. The Lease clearly provides that the $400,000 payment belonged to Polaris but could be paid directly in respect to third party liability. As agreed by the parties, the $400,000 was paid directly by the insurer to AGES, the repairer of the Engines; thus, Air South never had an interest in the proceeds.

Further supporting this intention is the fact that Air South had the insurance company

issue a certificate of insurance which clearly identifies Polaris as the loss payee for damage to the engines. However, the Trustee asserts that the Court should find that because Air South filed the Insurance claim and signed the Form of Release and Discharge, Air South would have received the $400,000 payment if AGES had not. The Trustee has presented no evidence to support this assertion. The Court does not view the Form of Release and Discharge as convincing evidence that Air South had an interest in the proceeds. It appears that a cautious insurer would routinely require a release and authorization for payment from the lessee of damaged property as well as the owner, especially when a large claim and payment are involved.

The Trustee has failed to show any material facts in dispute; therefore, in reaching its decision, the Court applies the facts as alleged in the Complaint, Answer, pleadings of the parties, and affidavits presented by AGES. At the hearing and in his pleadings, the Trustee implied that Debtor retained actual control over the $400,000 payment; however, no evidence was presented to substantiate this claim. The Court is persuaded that the insurance proceeds are not property of Air South's bankruptcy estate. The clear language of the Lease provides that the insurance proceeds belong to Polaris, and the Certificate of Insurance's loss payee provision further supports this conclusion. Furthermore, Cigna made a check payable only to AGES pursuant to the terms of the Lease. For the reasons stated within, it is therefore

ORDERED that AGES' Motion for Summary Judgment is granted.

AND IT IS SO ORDERED.

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina,
November 19, 1999.

12