

# Pre-petition Payment of Insurance Proceeds Triggers Preference Recovery

## WRITTEN BY

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Section 547 of the Bankruptcy Code provides for the potential recovery of transfers of a debtor's property occurring within 90 days of bankruptcy. Typically, preference actions involve payments to vendors who previously did business with the debtor on credit. However, vendors are not the only ones who can be tangled up in preference litigation. In a recent case before the U.S. Court of Appeals for the Fifth Circuit, the question of whether a payout of insurance proceeds to a tort claimant, made pre-petition pursuant to Texas state insurance law, should be classified as a "transfer of an interest of the debtor in property" under 11 U.S.C. Section 547. See *Law Office of Rogelio Solis v. Curtis*, No. 23-40125, 2023 U.S. App. LEXIS 26621, at \*2 (5th Cir. Oct. 6, 2023). In upholding the bankruptcy court's determination that the payment of insurance proceeds could be such a transfer, the Fifth Circuit underscored the complex interplay between state law, bankruptcy law and the rights of creditors in bankruptcy proceedings.

On Dec. 19, 2020, a tractor-trailer owned by Josiah's Trucking LLC (Josiah's Trucking) collided with another vehicle, causing the death of two individuals. At that time, Josiah's Trucking held insurance coverage with Brooklyn Specialty Insurance Co. RRG, Inc. which carried a policy limit of \$1,000,000. The mother of one of the victims, Ana Gomez, and the family of the other, the Tellez family, each sought legal representation and initiated insurance claims. The Law Firm of Rogelio Solis, PLLC (the Solis Firm) represented Ana Gomez, while the Tellez family contacted Escobar & Cardenas to represent their interests.

Shortly after the accident, negotiations ensued between the Tellez family and Brooklyn Specialty, following which a lawsuit was filed against Josiah's Trucking, its owner, and the driver. In contrast, Gomez, represented by the Solis Firm, submitted a Stowers demand under Texas law for the policy limit. On Jan. 12, 2021, Brooklyn Specialty transferred the full \$1,000,000 to the Solis Firm's IOLTA account in settlement of the Gomez claims. Notice of payment was promptly communicated to the Tellez family that the policy had been exhausted. Shortly thereafter, the Tellez family, initiated an involuntary bankruptcy proceeding against Josiah's Trucking (hereinafter the debtor). On Feb. 9, the interim trustee commenced an adversary proceeding against Gomez and the Solis Firm under Bankruptcy Code Sections 547 and 550 to recover the insurance proceeds. The defendants sought to dismiss the action arguing that the insurance proceeds were not property of the debtor's estate since it held "neither legal title in nor a contractual right to the policy proceeds, and otherwise lacked control over their disbursement."

In denying the motion to dismiss, the court had to determine whether the pre-petition payment of the policy proceeds to a tort claimant could be considered a “transfer of an interest of the debtor in property,” thereby falling within the scope of the Bankruptcy Code’s avoidance provisions. To address this question, the bankruptcy court relied on precedent established in *In re OGA Charters. Martinez v. OGA Charters (In re OGA Charters)*, 901 F.3d 599 (5th Cir. 2018). In *OGA Charters*, the Fifth Circuit held that in certain limited circumstances where “a siege” of tort claimants pursuing a debtor’s estate exceed the policy limits, the debtor may hold an equitable interest in such insurance proceeds and can then be classified as property of the estate. The court found that such “limited circumstances” existed, since claims arising from the accident far exceeded the \$1,000,000 policy limit. Next the bankruptcy court examined whether the pre-petition payment of the insurance proceeds “affected” the debtor’s equitable interests, which it found did not.

On appeal, Gomez and the Solis Firm, argued that under Texas law, the debtor did not possess a legal or equitable right to the policy proceeds. However, the Fifth Circuit firmly adhered to the rule of orderliness, which obligates a panel to follow its precedent such as *OGA Charters*. Thus, where claims in excess of policy limits exist, the insurance proceeds are deemed to be property of the estate, however, this property interest “does not bestow upon the debtor a right to pocket the proceeds.” In so ruling, the court reaffirmed that under certain circumstances, insurance proceeds may be considered property of the estate, even if the debtor lacks an absolute right to these proceeds under state law.

Furthermore, the court addressed the distinction between two relevant sections of the Bankruptcy Code: Section 541, which defines the creation of an estate in bankruptcy, and Section 547, which delineates how a trustee may avoid certain transfers. The court concluded that “an interest of the debtor in property” under Section 547(b) should be interpreted consistently with “interests of the debtor in property” under Section 541(a)(1). In other words, if the insurance proceeds would have become part of the estate had they not been transferred pre-petition, they should be considered property of the estate for the purposes of the avoidance provision. This decision is anchored in the principle that the avoidance provision aims to preserve property that would have been included in the bankruptcy estate had it not been transferred before the initiation of bankruptcy proceedings, as outlined by the Supreme Court in *Begier v. IRS*, 496 U.S. 53 (1990). The policy proceeds, therefore, are considered property of the estate in line with the principles established in *Begier* and subsequent interpretations within the Fifth Circuit. Thus, the Fifth Circuit also affirmed the lower court’s finding that the payment of the insurance proceeds prior to bankruptcy did not “affect the debtor’s equitable interest in them at the time the petition was filed.”

In affirming the bankruptcy court’s judgment, the Fifth Circuit’s ruling reinforces the view that, under specific circumstances, the pre-petition payment of insurance proceeds to a tort claimant can indeed be classified as a transfer of the debtor’s property, subject to avoidance under the Bankruptcy Code. Given the prevalence of mass tort cases, counsel needs to be aware that payments from an insurance policy, the limits of which could be exceeded as a result of other pending litigation, might be clawed back in the event the owner of the policy filed bankruptcy within 90 days of receipt of payment. This case also serves as a reminder of the intricate interplay between federal law within bankruptcy proceedings, and the rights of creditors under the complex legal framework of state law. It reinforces the importance of carefully assessing the circumstances surrounding an insurance claim and understanding the applicability of established circuit precedents, even when state law nuances may suggest a different interpretation.

This case also highlights the need for a consistent and principled approach to dealing with pre-petition insurance

policies in the context of bankruptcy. Ultimately, the ruling appears to align with the objectives of the Bankruptcy Code to ensure fair and equitable distribution of assets among creditors.

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*\*Brenden Dahrouge is not admitted to practice law in any jurisdiction; application pending for admission to the New York Bar.*

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