Bankruptcy and Health Insurance Proceeds: Why Health Care Providers Should Not Be Subject to the Automatic Stay Provision

Kenneth N. Schott III[*]

I. INTRODUCTION

In America today, experts estimate that more than 60% of individuals who file for bankruptcy do so because of unpaid medical

* Bachelor of Science in Business Management from Grove City College; Master's Degree in Business Administration from Waynesburg University; J.D. 2015 Candidate at Duquesne University School of Law. The author would like to thank Mark D. Yochum, Professor of Law at Duquesne University School of Law, for his invaluable guidance in writing this article and John G. Wall, V.P. & Deputy General Counsel at MedExpress, for providing the vision for this article.

bills.[1] This statistic demonstrates the significant impact that healthcare expenses have on the individuals who file for bankruptcy, but it also alludes to the financial impact that bankrupt patients can have on provider–creditors, whose businesses must tolerate the risk of suffering significant financial losses, as the debts stemming from healthcare services, which were provided to the patient–debtor prior to filing a petition for bankruptcy, are often discharged[2] under either Chapter 7 or Chapter 13 of the federal Bankruptcy Code.[3] Potentially worse than the financial impact that exorbitant medical bills can have on patients and providers alike is that the provider–patient relationship can become strained to the point that the provider might consider ending the relationship, which in some cases may mean poorer health outcomes for the patient.[4]

The potential silver lining for providers and patients going through the bankruptcy process is that recent studies show over three–quarters of the individuals with a medically related bankruptcy had health insurance.[5] However, as a result of the automatic stay provision,[6] provider–creditors are unable to collect on the uncovered portions of medical bills directly from the patient–debtors, and their ability to collect the insurance proceeds directly from insurance companies is questionable at best because the issue of whether or not health insurance proceeds are property of the bankruptcy estate[7] has not been answered universally. For this reason, Congress should amend the federal Bankruptcy Code to expressly exclude health insurance proceeds from the definition of property of the bankruptcy estate, thereby permitting provider–creditors to collect health insurance proceeds directly from the debtor–patient's health insurance company in order to: (1) help mitigate the financial risk of running a medical practice; (2) alleviate the need for healthcare providers to pass the costs of unpaid medical bills to other patients; and (3) ensure that the provider–patient relationship continues.

---

1. Theresa Tamkins, *Medical Bills Prompt More than 60 Percent of U.S. Bankruptcies*, CNN (June 5, 2009, 9:33 AM), http://www.cnn.com/2009/HEALTH/06/05/bankruptcymedical.bills/.
2. Karen Caffarini, *When Patients Declare Bankruptcy: What Happens to Your Unpaid Bills?*, AMEDNEWS.COM (March 9, 2009), http://www.amednews.com/article/20090309/business/303099996/4/.
3. 11 U.S.C. §§ 727(a), 1328 (2012).
4. Caffarini, *supra* note 2.
5. Tamkins, *supra* note 1.
6. 11 U.S.C. § 362 (2012).
7. *Id.* § 541(a)(1).

Currently, there is a split of authority among the United States Circuit Courts of Appeal between the First Circuit on one side and the Third and Fifth Circuits on the other side, regarding whether or not liability insurance proceeds are considered property of the bankruptcy estate[8] such that third–party involuntary creditors are prevented by the automatic stay provision[9] from trying to collect insurance proceeds directly from insurance companies. While the analyses from these decisions do not apply directly to health insurance proceeds, this article discusses how the courts' opinions could influence the way health insurance proceeds will be treated going forward within the bankruptcy context. In addition, this article provides an overview of the bankruptcy problem nationwide, along with a parallel analysis on how the common law, existing state statutory law, and basic contract theory might differ from the approach taken by the First, Third, and Fifth Circuits in how insurance proceeds should be treated.

I. BACKGROUND AND HISTORY

A. The Scope of the Bankruptcy Problem in America

A custom data search conducted using the Bankruptcy Data Project at Harvard University revealed that the total number of individual Chapter 7[10] and Chapter 13[11] bankruptcy case filings has increased dramatically since 2006.[12] From January of 2006 through December of 2012, the number of individual Chapter 7 bankruptcy case filings has increased by 144%.[13] During this timeframe, the number of individual Chapter 13 bankruptcy case filings increased

---

8. *Compare* First Fidelity Bank v. McAteer, 985 F.2d 114, 117 (3d Cir. 1993) ("[I]f 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."), *and* Houston v. Edgeworth, 993 F.2d 51, 55–56 (5th Cir. 1993) ("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 . . . those proceeds are not property of the estate."), *with* Tringali v. Hathaway Mach. Co., Inc., 796 F.2d 553, 560 (1st Cir. 1986) (holding that "language, authority, and reason all indicate that proceeds of a liability insurance policy are property of the estate.").

9. 11 U.S.C. § 362 (2012).

10. "A bankruptcy trustee liquidates the [Chapter 7] debtor's nonexempt assets and distributes the proceeds to creditors. State law often determines whether a property is exempt from liquidation. The debtor has no liability for discharged debts." Caffarini, *supra* note 2.

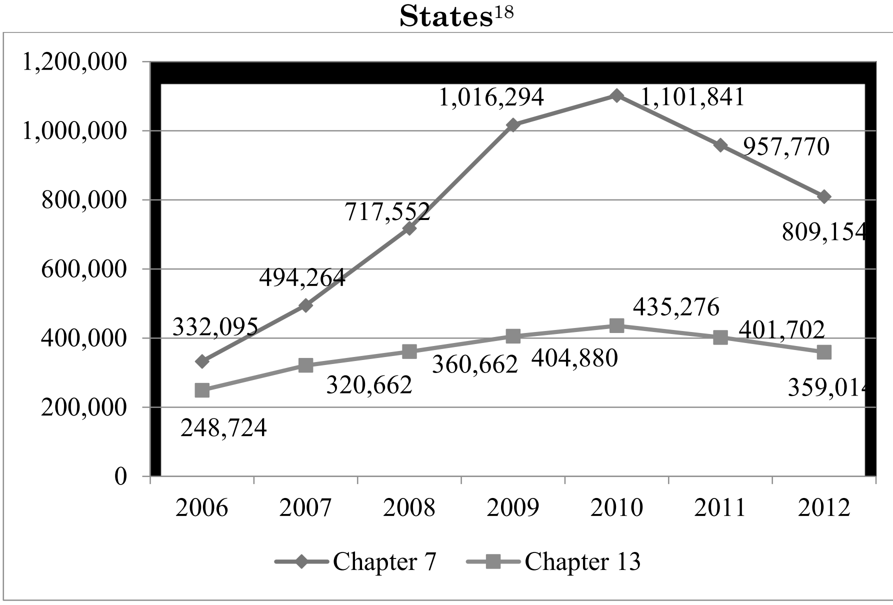
11. "Called a 'wage earner's plan,' [Chapter 13] individuals with regular incomes develop a plan to repay all or part of their debt over 3 to 5 years. Unlike Chapter 7, it allows filers to keep their house and reschedule secured debts over the life of the chapter's plan. It acts like a consolidation loan under which the debtor makes payments to a Chapter 13 trustee, who then distributes payments to creditors." *Id.*

12. *Bankruptcy Filings Database*, BANKR. DATA PROJECT AT HARV. UNIV., http://bdp.law.harvard.edu/filingsdb.cfm (last visited Oct. 30, 2013).

13. *Id.*

by 44%.[14] Admittedly, since 2010 the total number of individual bankruptcy case filings has declined[15] (a 27% decline in cases filed under Chapter 7 and an 18% decline in cases filed under Chapter 13). Bankruptcy, however, still poses a significant financial threat to creditors, including healthcare providers who may not be reimbursed for services already provided to bankrupt patients.[16] While, individuals may file bankruptcy petitions under Chapter 11, the number of individual bankruptcy cases filed under this chapter is too small to have a substantial impact on healthcare providers in a manner pertinent to the analysis of this article—only 2726 individual cases were filed under Chapter 11 during the 2012 calendar year.[17]

Figure 1: Individual Bankruptcy Cases Filed in the United States[18]



Not insignificantly, a 2009 report estimates that more than 60% of people who declare bankruptcy do so because of exorbitant medical bills.[19] According to the same report, published in the August issue of the *American Journal of Medicine*, the number of bankrupt-

14. *Id.*
15. *Id.*
16. Caffarini, *supra* note 2.
17. BANKR. DATA PROJECT AT HARV. UNIV., *supra* note 12.
18. *Id.*
19. Tamkins, *supra* note 1.

cies due to medical bills rapidly increased during the six–year period between 2001 and 2007, by almost 50%.[20] Surprisingly, low–income families do not comprise the majority of bankruptcy cases; rather, the majority of bankruptcy cases due to medical bills are comprised of well–educated middle–class homeowners.[21] Many medical bankruptcy cases are the result of gaps in health insurance coverage, which leave the typical medically–bankrupt family with an average out–of–pocket expense of $17,943.[22]

Healthcare providers are not only at risk of losing revenue for unpaid medical expenses, which are not covered by the patient–debtor's health insurance policy, but they are also in danger of losing revenue in the form of health insurance proceeds from medical expenses which were covered by the patient–debtor's insurance policy.[23] This is because health insurance proceeds may be protected by the automatic stay provision of the United States Bankruptcy Code, which automatically goes into effect once a patient–debtor files for bankruptcy under either Chapter 7 or Chapter 13 and prevents creditors from collecting against property of the debtor's bankruptcy estate or directly from the debtor.[24] Under Section 362(a) of the Bankruptcy Code, the automatic stay provision provides:

> Except as provided in subsection (b) of this section, a petition filed . . . operates as a stay, applicable to all entities, of—
>
> . . .
>
> [A]ny act to obtain possession or property of the estate or of property from the estate or to exercise control over property of the estate;
>
> . . .

20. *Id.*
21. *Id.*
22. *Id.*
23. "The bankruptcy estate is broadly defined as including 'all legal or equitable interests of the debtor in property as of the commencement of the case.' Accordingly, upon the filing of a petition, the debtor's insurance policies automatically become property of the estate." Richard L. Epling, Kerry A. Brennan & Brandon Johnson, *Intersections of Bankruptcy Law and Insurance Coverage Litigation*, 21 NORTON J. BANKR. L. & PRAC. 103, 103 (2012), *available at* http://www.pillsburylaw.com/siteFiles/Publications/EplingArticle412.pdf.
24. *See* 11 U.S.C. § 362(a)(3), (6) (2012).

> [A]ny act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title[25]

As a result of the automatic stay provision, the determinative factor for healthcare providers in regard to their ability to collect health insurance proceeds directly from an insurance company as compensation for covered medical services, despite a patient–debtor filing for bankruptcy, is whether or not the insurance proceeds are considered property of the bankruptcy estate.[26] Property of the estate is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case."[27] If the insurance proceeds are property of the estate, then the automatic stay provision applies and the healthcare provider may not collect the insurance proceeds directly from the insurance company.[28] On the other hand, if the insurance proceeds are not property of the estate, then there is nothing to prevent the healthcare provider from collecting the insurance proceeds directly from the insurance company.[29] The latter scenario, at the very least, limits healthcare providers' exposure to the financial risk that bankrupt patients represent to only those medical expenses that are not covered by the debtor–patient's health insurance policy because the insurance proceeds would not be subject to the automatic stay provision; therefore, healthcare providers can collect the proceeds directly from the insurance company.[30]

The financial risk that bankruptcy presents to healthcare providers adds to an already heavy financial burden imposed upon healthcare providers by state and federal regulations, as well as the mounting costs of medical education.[31] For example, medical malpractice insurance premiums are very high, even in an average cost

25. *Id.*
26. *Id.* § 541.
27. *Id.*
28. *Id.* § 362(a)(3).
29. *Id.*
30. *Id.*
31. *See* Alexis Writing, *The Average Cost for Medical Malpractice Insurance*, EHOW (last visited Oct. 30, 2013), http://www.ehow.com/about_5514154_average-cost-medical-malpractice-insurance.html; Parija Kavilanz, *Medicare Doctor's Pay to be Cut*, CNN (Mar. 3, 2013 5:34 PM), http://money.cnn.com/2013/03/02/smallbusiness/medicare-doctors-spending-cuts/; ASS'N OF AM. MED. COLL., https://services.aamc.org/tsfreports/report_median.cfm?year_of_study=2013 (last visited Oct. 30, 2013).

state such as Pennsylvania;[32] declining reimbursement from Medicare programs[33] is creating slimmer margins for physician practices; and, according to the Association of American Medical Colleges (AAMC), the median tuition at a medical school in the United States during the 2012–2013 school year was $28,719 for a resident and $49,821 for a non–resident.[34] These increasing education costs are part of the reason why the AAMC is projecting a physician shortage of 124,000 physicians by 2020.[35] Thirty–seven percent of this shortage is estimated to be attributable to primary care physicians as students, seeking more lucrative careers as specialists to offset the cost of their medical education, avoiding careers in primary care.[36] Therefore, it is bad policy to add to this already heavy financial burden by classifying health insurance proceeds as property of the estate, thereby effectively removing from the province of healthcare providers the practical capability to collect health insurance proceeds for services performed because a patient–debtor has filed for bankruptcy. Simply put, healthcare providers do not need to assume any more financial risk than they already have, especially when the potential impact of the Affordable Care Act on bankruptcy and healthcare providers is, at the very least, an unknown variable and, at best, a wild guess.[37]

B. Chapter 7 Versus Chapter 13: How Do They Affect Healthcare Providers?

Patient–debtors who file under Chapter 7 present a greater risk to healthcare providers' bottom lines than patients who file under

32. A recent article on the costs associated with medical malpractice insurance states:

> Pennsylvania malpractice insurance falls in the middle with respect to average cost. Rates differ between the major insurers due to demographic and claims differences. In 2009, base rates for general surgery could be as low as $28,000 annually or as high as $50,000. Internal medicine malpractice insurance costs varied between around $6,000 to $11,000. Obstetricians/gynecologists could find themselves paying up to $64,000 or more for coverage.

Writing, *supra* note 31.

33. "Medicare payments to health care providers, health care plans and drug plans will be reduced by 2% starting April 1, [2013] according to the Centers for Medicare & Medicaid Services . . . . Over the last 12 years, Medicare payments to physicians have increased by only 4%, while the cost of providing care has jumped 20%." Kavilanz, *supra* note 31.

34. ASS'N OF AM. MED. COLL., *supra* note 31.

35. Jake Miller, *Issue Brief: Health Care*, CBSNEWS (Oct. 1, 2012, 12:00 PM), http://www.cbsnews.com/8301-505103_162-57522437/issue-brief-health-care/.

36. *Id.*

37. 42 U.S.C. §§ 18001–18121 (2012) (The Affordable Care Act ("ACA") is an unknown quantity at this point in time relative to its potential impact on the costs of providing healthcare services. Moreover, the author is not referencing any specific provision of the ACA and cannot speak specifically to how the ACA will impact healthcare costs from the perspective of healthcare providers.)

Chapter 13.[38] Under Chapter 7, the patient–debtor undergoes a liquidation process in which an interim[39] or an elected[40] trustee liquidates the patient–debtor's nonexempt assets which comprise the property of the estate. The trustee then distributes the patient–debtor's nonexempt assets according to the provisions of 11 U.S.C. §§ 724–726—provisions which provide for a hierarchy of creditors that ensures that certain claims are given priority over others.[41] Secured claims are given top priority over all other types of claims.[42] Next in line are unsecured claims which have statutory priority; these include but are not limited to claims for domestic support obligations, claims for administrative expenses, and unsecured claims of governmental units.[43] Finally, "any allowed unsecured claim[s]" filed on time are given priority ahead of unsecured and secured claims that are not filed on time.[44]

Healthcare providers are part of the second tier of creditors with statutory priority because they have "allowed unsecured claims . . . arising from . . . the purchase of services."[45] This places healthcare providers in an unenviable position, because not only do they have a lower priority than the debtor's secured creditors, but they also fall in line behind six other kinds of unsecured creditors who have statutory priority before the healthcare provider's claim is entitled to compensation.[46] Under these circumstances, healthcare providers bear tremendous risk because once all of the financial resources from the liquidated nonexempt assets are distributed to creditors with a higher level of priority, any outstanding lower level priority claims are discharged and the debtor is no longer liable to pay back any portion of any outstanding debt.[47] Assuming *arguendo*, that health insurance proceeds are considered property of the bankruptcy estate, it is very unlikely that an impacted healthcare provider will ever see a penny of what was owed to him or her under the terms of the insurance policy.[48] While it is possible to seek a

38. "With Chapter 7 liquidation, most unsecured debt, including medical bills, usually are discharged. With Chapter 13 reorganization, you might get a portion of what is owed, but it could take years." Caffarini, *supra* note 2.

39. *See* 11 U.S.C. § 701 (2012).

40. *Id.* § 702.

41. *Id.* § 726.

42. *Id.* § 725.

43. *Id.* § 507.

44. *Id.* § 726(a)(2).

45. *Id.* § 507(a)(7).

46. *Id.* § 507.

47. *Id.* § 727.

48. ELIZABETH WARREN ET AL., THE LAW OF DEBTORS AND CREDITORS 2013 CASEBOOK SUPPLEMENT 167 (Vicki Been et al. eds., 6th ed. 2013) ("Although secured creditors have priority only in their collateral, their security interests often swallow virtually all the value

reaffirmation agreement from a patient–debtor once the bankruptcy process is complete, it is highly unlikely that medical bills would be included in such agreements.[49]

Alternatively, patient–debtors who file under Chapter 13 make it possible for healthcare providers to be reimbursed for their health insurance claims through a reorganization payment plan.[50] The payment plan is designed for individuals with regular incomes to repay their debt over a three–to–five year period, with a focus on repaying secured debts first.[51]

C. The United States Courts of Appeal for the First, Third, and Fifth Circuits' Analysis of Liability Insurance Proceeds May Provide a Guide on How Health Insurance Proceeds Should be Viewed

The concept of how insurance proceeds should be treated for purposes of bankruptcy proceedings has been subject to analysis since 1989, but early on, the concept was generally analyzed within the context of liability insurance proceeds and not health insurance proceeds.[52] At that time, the argument was that liability insurance proceeds should be considered property of the estate for purposes of bankruptcy proceedings to give effect to the overriding policy which governs bankruptcy: "equitably distributing a debtor's assets among creditors."[53] Over time, however, a new line of cases emerged out of the Third and Fifth Circuits, indicating that some jurisdictions are leaning toward viewing liability insurance proceeds as *not* being part of the property of the bankruptcy estate because the debtor is not directly entitled to payment of the insurance

---

in an estate . . . [i]n the great majority of liquidation cases, only priority creditors—and sometimes not all of them—will actually receive a distribution or "dividend" from the estate under section 726.").

49. Caffarini, *supra* note 2.

50. Healthcare providers with Chapter 13 bankruptcy patients should file a claim immediately because the plain language of the statute requires "full payment" of "all claims entitled to priority." The plain language of the statute provides:

> (a)The plan—
> (1) shall provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;
> (2) shall provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim . . .

11 U.S.C. § 1322(a)(1)–(2) (2012).

51. Caffarini, *supra* note 2.

52. *See* Barry L. Zaretsky, *The Second Circuit Review—1987–1988 Term: Bankruptcy: Insurance Proceeds in Bankruptcy*, 55 BROOK. L. REV. 373, 373 (1989).

53. *Id.* at 374.

proceeds.[54] Rather, the typical insurance company makes payment directly to the injured third party and, therefore, even though there is no privity between the insurer and the injured third party, an equitable interest in the insurance proceeds is created on behalf of the injured third party at the time the injury occurs.[55]

While there are some notable similarities between the two types of insurance, each has distinct characteristics such that cases involving health insurance proceeds should be analyzed separately from, but compared with, the case trends involving liability insurance. Most notably, a liability policy, such as an automobile insurance policy, is designed to be used infrequently in order to cover damages incurred by a third party in an unanticipated accident. On the other hand, with a health insurance policy, it is anticipated that the insurer will reimburse healthcare providers fairly frequently for everyday kinds of healthcare services, while also providing coverage for rare but significant healthcare emergencies.[56] Ultimately, this separate analysis leads to the conclusion that health insurance proceeds should not be treated as property of the bankruptcy estate.

II. ANALYSIS

Before looking more extensively at how the United States Courts of Appeal for the First, Third, and Fifth Circuits have treated the issue of liability insurance proceeds for purposes of the bankruptcy estate, this article looks at a few state law and common law doctrines, which may provide some alternative solutions, or perhaps guidance, for solving the issue of whether healthcare insurance proceeds should be considered property of the bankruptcy estate.[57]

A. Doctrine of Necessaries

The Doctrine of Necessaries is a common law rule that has been codified in a number of states, including Pennsylvania and Virginia.[58] It provides:

---

54. *See* First Fidelity Bank v. McAteer, 985 F.2d 114 (3d Cir. 1993); Houston v. Edgeworth, 993 F.2d 51 (5th Cir. 1993).

55. *See* First Fidelity Bank v. McAteer, 985 F.2d 114 (3d Cir. 1993); Houston v. Edgeworth, 993 F.2d 51 (5th Cir. 1993).

56. *See* Scott Galupo, *Please Stop Comparing Health Insurance to Car Insurance*, THE AM. CONSERVATIVE (Oct. 30, 2013, 6:30 AM), http://www.theamericanconservative.com/please-stop-comparing-health-insurance-to-car-insurance/.

57. 40 PA. CONS. STAT. ANN. § 117 (West 2012); 23 PA. CONS. STAT. ANN. § 4102 (West 2012).

58. *See* 23 PA. CONS. STAT. ANN. § 4102 (West 2012); VA. CODE ANN. § 55–37 (West 2012); Connor v. Sw. Fla. Reg'l Med. Ctr., Inc., 668 So. 2d 175 (Fla. 1995).

> At common law, a married woman's legal identity merged with that of her husband, a condition known as coverture. She was unable to own property, enter into contracts, or receive credit. A married woman was therefore dependent upon her husband for maintenance and support, and he was under a corresponding legal duty to provide his wife with food, clothing, shelter, and *medical services*. The common law doctrine of necessaries mitigated the possible effects of coverture in the event a woman's husband failed to fulfill his support obligation. Under the doctrine, a husband was liable to a third party for any necessaries that the third party provided for his wife. Because the duty of support was uniquely the husband's obligation, and because coverture restricted the wife's access to the economic realm, the doctrine did not impose a similar liability upon married women.[59]

As society has evolved, a number of states, including Pennsylvania, amended their state constitutions to include equal rights amendments to prevent "future enactments of discriminatory state legislation" and to "erase the many instances of sex–based classification in existing state laws."[60] As a result of changing cultural norms, Pennsylvania's Doctrine of Necessaries today is gender–neutral and reads:

> In all cases where debts are contracted for necessaries by either spouse for the support and maintenance of the family, it shall be lawful for the creditor in this case to institute suit against the husband and wife for the price of such necessaries and, after obtaining a judgment, have an execution against the spouse contracting the debt alone; and, if no property of that spouse is found, execution may be levied upon and satisfied out of the separate property of the other spouse.[61]

In Pennsylvania, therefore, the property assets of a spouse who individually files for bankruptcy under Chapter 7 or Chapter 13 would still be protected by the automatic stay provision of the federal bankruptcy code,[62] because the Pennsylvania Doctrine of Necessaries requires the creditor to obtain a judgment against the

59. *Connor*, 668 So. 2d at 175–76 (emphasis added).
60. "In 1971, Pennsylvania became the first state to amend its constitution to include an equal rights amendment." Elizabeth A. Heaney, *Comment: Pennsylvania's Doctrine of Necessities: An Anachronism Demanding Abolishment*, 101 DICK. L. REV. 233, 240 (1996).
61. 23 PA. CONS. STAT. ANN. § 4102 (West 2012).
62. 11 U.S.C. § 362(a)(3) (2012).

debtor and the spouse before the debt may be satisfied by the spouse's separate property which is not property of the bankruptcy estate.[63] The federal Bankruptcy Code demands this result because obtaining such a judgment against the debtor, notwithstanding the fact that the claim is also against the debtor's spouse, is a violation of the automatic stay provision.[64]

Virginia takes a statutory approach similar to Pennsylvania by making the Doctrine of Necessaries gender–neutral: "[t]he [D]octrine of [N]ecessaries as it existed at common law shall apply equally to both spouses, except where they are permanently living separate and apart[.]"[65] However, Virginia's Doctrine of Necessaries statute differs from the Pennsylvania statute in its effect on the bankruptcy estate because there is no requirement to obtain a judgment against the debtor first.[66] In the absence of a judgment against the debtor requirement, an unsecured creditor or healthcare provider could assert a claim against the debtor's spouse's separate property for unpaid medical expenses without violating the automatic stay provision of the federal Bankruptcy Code.[67] In other states there has been a trend within the judicial branch of the government to abrogate the Doctrine of Necessaries eliminating the opportunity for creditors to seek reimbursement from the debtor's spouse altogether.[68]

The Doctrine of Necessaries is one potential solution for healthcare providers who have insured patients with unpaid medical bills that have filed for bankruptcy. However, this common law doctrine has some obvious weaknesses as a method to get around the automatic stay provision of the federal Bankruptcy Code.[69] First, the inconsistent application of the common law rule from state to state and the fact that it has been abrogated in other states

---

63. 23 PA. CONS. STAT. ANN. § 4102 (West 2012).

64. The federal Bankruptcy Code provides:

> (a) Except as provided in subsection (b) of this section, a petition filed . . . operates as a stay, applicable to all entities of—
>
> (1) the commencement or continuation, including the issuance or employment of process, of a **judicial**, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

11 U.S.C. § 362(a)(1) (2012) (emphasis added).

65. VA CODE ANN. § 55–37 (West 2012).

66. *Id.*

67. 11 U.S.C. § 362 (2012).

68. *See, e.g.*, Connor v. Sw. Fla. Reg'l Med. Ctr., Inc., 668 So. 2d 175, 176 (Fla. 1995) (listing Alabama and Maryland as two states which have abrogated the common law Doctrine of Necessaries).

69. 11 U.S.C. § 362 (2012).

limits its applicability nationally.[70] Second, the Doctrine of Necessaries only applies to the spouses of debtors, and therefore does not capture single persons with health insurance who file for bankruptcy and have unpaid medical bills.[71] To be sure, the Doctrine of Necessaries will work in narrow instances where the bankrupt debtor is married, lives in a state that still honors this common law doctrine, and does not have a judgment against the debtor requirement.[72] However, because of its limited scope and reach, and the trend towards abrogation, the Doctrine of Necessaries does not provide an adequate solution for creditors seeking to consistently collect insurance proceeds from debtors who have filed for bankruptcy.

B. Taking Direct Action in Pennsylvania

In Pennsylvania, an insurer is not permitted to issue a liability insurance policy unless there is a provision in the insurance contract requiring the insurer to pay for damages for injury or loss to a third party even in the event that the insured becomes insolvent or bankrupt.[73] The plain language of the statute reads as follows:

> No policy of insurance against loss or damage resulting from accident to or injury suffered by an employee or other person and for which the person insured is liable, or against loss or damage to property caused by animals or by any vehicle drawn, propelled or operated by any motive power and for which loss or damage the person insured is liable, shall hereafter be issued or delivered in this State by any corporation, or other insurer, authorized to do business in this State, unless there shall be contained within such policy a provision that the insolvency or bankruptcy of the person insured shall not release the insurance carrier from the payment of damages for injury sustained or loss occasioned during the life of such policy, and stating that in case execution against the insured is returned unsatisfied in an action brought by the injured person, or his or her personal representative in case death results from the accident, because of such insolvency or bankruptcy, then an action may be maintained by the injured person, or his or her personal representative, against such corporation, under the

70. *See* 23 PA. CONS. STAT. ANN. § 4102 (West 2012); VA. CODE ANN. § 55–37 (West 2012); *Connor*, 668 So. 2d at 176 (listing Alabama and Maryland as two states which have abrogated the common law Doctrine of Necessaries).

71. 23 PA. CONS. STAT. ANN. § 4102 (West 2012); VA. CODE ANN. § 55–37 (West 2012).

72. VA. CODE ANN. § 55–37 (West 2012).

73. 40 PA. CONS. STAT. ANN. § 117 (West 2012).

> terms of the policy, for the amount of the judgment in the said action, not exceeding the amount of the policy.[74]

The key to the direct action statute is that the injured third party must obtain a judgment against the debtor before the injured third party can maintain an action against the insurer.[75]

In *Gubbiotti v. Santey*, Appellee Michael Santey was involved in an automobile accident with the Appellants, Frank Gubbiotti, Linda Gubiotti, Dean W. Pavinski, and Sheryl Pavinski, who subsequently filed complaints against Santey alleging personal injuries resulting from the accident.[76] Santey filed a Chapter 7 bankruptcy petition in which the Appellants' personal injury claims were listed as creditors holding unsecured non–priority claims.[77] The Appellants were provided with notice of the Suggestions of Bankruptcy as well as notice of Bankruptcy filing regarding their claims against Santey by February 9, 2010.[78] On May 14, 2010, Santey was granted a discharge[79] of all debts accumulated prior to the order date. Thereafter, Santey filed a motion seeking to amend his answer to the personal injury actions filed against him to include the affirmative defense of discharge from bankruptcy and to obtain summary judgment on that basis.[80] The trial court granted the motion and the Appellants' claims were dismissed.[81]

On appeal, the Appellants argued that the trial court erred in granting Santey's motion for summary judgment "because they [were] seeking recovery for their injuries from Santey's insurance carrier, and not Santey individually."[82] The Appellants based their

74. *Id.*

75. Gubbiotti v. Santey, 52 A.3d 272, 274 (Pa. Super. Ct. 2012), *appeal denied*, 67 A.3d 798 (Pa. 2013), *appeal denied*, 67 A.3d 797 (Pa. 2013).

76. *Id.* at 272.

77. *Id.* at 273.

78. *Id.*

79. The federal Bankruptcy Code provides:

> (b) Except as provided in section 523 of this title [11 USCS § 523], a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief under this chapter [11 USCS §§ 701 et seq.], and any liability on a claim that is determined under section 502 of this title [11 USCS § 502] as if such claim had arisen before the commencement of the case, whether or not a proof of claim based on any such debt or liability is filed under section 501 of this title [11 USCS § 501], and whether or not a claim based on any such debt or liability is allowed under section 502 of this title [11 USCS § 502].

11 U.S.C. § 727(b) (2012).

80. *Gubbiotti*, 52 A.3d at 273.

81. *Id.*

82. *Id.* at 274.

claim on the plain language of the Pennsylvania Direct Action Statute.[83] However, their argument failed in the eyes of the Pennsylvania Superior Court because Appellants failed to obtain a judgment against Santey to determine his liability under his auto insurance policy.[84] Moreover, Santey properly provided notice to the Appellants of the Bankruptcy proceedings giving the Appellants until April 27, 2010 to file a Complaint Objecting to Discharge of Debtor or to Determine Dischargeability of Certain Debts.[85]

The Pennsylvania Direct Action statute[86] is another potential solution for creditors seeking to collect insurance proceeds owed to them by insurers of bankrupt debtors. If each state creates similar legislation to Pennsylvania's Direct Action statute,[87] which accounts for health insurance proceeds as well as liability insurance proceeds for injured third parties, then healthcare providers would have reasonable means to collect unpaid medical bills covered by the debtor's insurance policy. This type of legislation would certainly be a step in the right direction for healthcare providers seeking to collect insurance proceeds owed to them from insurers of bankrupt patients.

However, *Gubiotti* demonstrates that not all third parties who have a cause of action under Pennsylvania's Direct Action statute[88] fully understand the nature of the bankruptcy process, nor the necessary steps they need to take to intervene in the bankruptcy proceedings to enforce their direct action claim against the insurer.[89] To fully understand these details and properly enforce a direct action claim, a third party or healthcare provider would most likely need to obtain the services of and incur the expenses of hiring legal counsel to help file the necessary paperwork on time and to obtain an appropriate judgment against the debtor. As a result, many healthcare providers would miss out on their opportunity to file a

83. 40 PA. CONS. STAT. ANN. § 117 (West 2012).

84. The court in *Gubbiotti* held:

> The plain language of 40 PA.STAT. § 117 permits the garnishment of an insurance company for a *judgment* entered against an insolvent or bankrupt insured. This provision does not permit an action against the insured, which would clearly violate the discharge order, but rather permits an action directly against the *insurer* where a judgment has been entered, in case of insolvency or bankruptcy. In this case, Santey's liability under any applicable automobile insurance policy has not been determined, and accordingly, no judgment against Santey has been entered. Therefore, 40 PA.STAT. § 117 is inapplicable and provides Appellants with no relief.

Gubbiotti, 52 A.3d at 274.

85. *Id.*

86. 40 PA. CONS. STAT. ANN . § 117 (West 2012).

87. *Id.*

88. *Id.*

89. *Gubiotti*, 52 A.3d at 274.

direct action claim against the insurer, or would incur needless attorney's fees if they were able to successfully file their claim. In conclusion, a modified form of the Pennsylvania Direct Action statute,[90] which would provide a cause of action for healthcare providers to file a claim directly against insurers of bankrupt patients, is potentially a step in the right direction, but it is still not "direct" enough. The law needs to provide healthcare provider–creditors with an easier way to collect insurance proceeds "directly" from insurers without the hassle of going through the legal process.

C. Following the Lead of the Third and Fifth Circuits: Why the Debtor May Not Have a Legal or Equitable Interest in Healthcare Insurance Proceeds

Alternatively, the easiest and most effective solution for healthcare provider–creditors to be able to collect unpaid health insurance proceeds on medical services already provided is to not include insurance proceeds from a debtor's health insurance policy in the definition of property of the bankruptcy estate.[91] Under this definition, the healthcare provider would be able to collect insurance proceeds directly from the insurance company without triggering the automatic stay provision of the federal bankruptcy code.[92] This potential solution clearly presents a better alternative for provider–creditors to consistently and effectively collect insurance proceeds owed to them than the Doctrine of Necessaries, which only applies in limited circumstances,[93] and the Pennsylvania Direct Action statute, which entails a great deal of time and expense, along with a working knowledge of the judicial process.[94]

Currently, there is a split of authority among the United States Circuit Courts of Appeals over whether liability insurance proceeds should be considered property of the bankruptcy estate.[95] While liability insurance proceeds are distinguishable from health insurance proceeds, this split of authority sheds light on how health insurance proceeds may be analyzed with regard to the concept of property of the bankruptcy estate.[96]

---

90. 40 PA. CONS. STAT. ANN. § 117 (West 2012).

91. Property of the estate is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541 (2012).

92. *Id.* § 362(a)(3).

93. 23 PA. CONS. STAT. ANN. § 4102 (West 2012); VA CODE ANN. § 55–37 (West 2012).

94. 40 PA. CONS. STAT. ANN. § 117 (West 2012).

95. *See supra* text accompanying note 8.

96. 11 U.S.C. § 541 (2012).

In analyzing the definition of property of the bankruptcy estate, the United States Court of Appeals for the First Circuit noted in *Tringali v. Hathaway Mach. Co., Inc.*, that:

> The Supreme Court has said, interpreting this section, that "the House and Senate Reports on the Bankruptcy Code indicate that § 541(a)(1)'s scope is broad," and it quoted the following from the legislative history: The scope of this paragraph [§ 541(a)(1)] is broad. It includes all kinds of property, including tangible or intangible property, causes of action . . . and all other forms of property currently specified in section 70a of the Bankruptcy Act.[97]

Despite this broad definition, some courts have determined that what is property of the bankruptcy estate depends upon the type of insurance policy under consideration.[98] For example, the Fifth Circuit Court of Appeals concluded in *In re Louisiana World Exposition Inc.*, that the insurance proceeds from a Directors and Officers insurance policy were not property of the bankruptcy estate.[99] In coming to this conclusion, the Fifth Circuit Court of Appeals:

> [D]istinguished titular ownership of a *policy* from total ownership of the *proceeds* of that policy, holding that the proceeds of Directors and Officers (D&O) liability insurance policies were *not* part of a corporation's bankruptcy estate even though the policies were purchased and owned by the corporation. The policies at issue in that case provided liability coverage *only* for the corporate debtor's directors and officers and for the obligation of the corporation to indemnify those directors and officers. Thus, under the D&O policies, the insurance companies' obligations flowed only to the corporate debtor's directors and officers, who were the only insureds under the policies. The policies did *not* afford the debtor corporation any direct coverage

97. Tringali v. Hathaway Mach. Co., Inc., 796 F.2d 553, 560 (1st Cir. 1986).

98. A recent article summarized this viewpoint by stating:

> [A]s a general rule: [e]xamples of insurance policies whose proceeds are property of the estate include casualty, collision, life, and fire insurance policies in which the debtor is a beneficiary. Proceeds of such insurance policies, if made payable to the debtor rather than a third party such as a creditor, are property of the estate and may inure to all bankruptcy creditors. But under the typical liability policy, the debtor will not have a cognizable interest in the proceeds of the policy. Those proceeds will normally be payable only for the benefit of those harmed by the debtor under the terms of the insurance contract.

Epling, *supra* note 23, at 104.

99. In re Louisiana World Exposition Inc., 832 F.2d 1391, 1401 (5th Cir. 1987) ("[L]iability proceeds which belong only to directors and officers, are not part of the estate . . . .").

> for liability to third–party claimants. In that narrow factual context, we concluded that the debtor corporation's ownership of the policies was not enough to render the proceeds of those policies property of the corporation's bankruptcy estate. Consequently, despite the debtor's legal ownership of the policies, this court determined that the directors and officers were the equitable owners of all of the *proceeds* of those policies, pretermitting inclusion of the proceeds in the estate of the debtor.[100]

Following the line of thinking from the Court of Appeals for the Third and Fifth Circuits, it stands to reason that the owner of a health insurance policy has legal title due to privity of contract with the insurer, but the healthcare providers who supply medical services to the policy owner become the owners of equitable title to the insurance proceeds. While the analysis of liability insurance proceeds conducted by the Court of Appeals for the Third and Fifth Circuits[101] is helpful, health insurance proceeds are different from liability insurance proceeds because in most cases the right to health insurance proceeds is assigned by the patient–debtor to the provider–creditor prior to the provision for and consumption of healthcare services, whereas the independent third–party who is injured by a debtor covered by a liability insurance policy does not receive an assignment of the debtor's contract rights. While the arguments put forth by the Court of Appeals for the Third and Fifth Circuits are highly persuasive, the striking difference between the two types of insurance proceeds means that the courts' collective analysis does not provide a justifiable basis for concluding that health insurance proceeds are not property of the bankruptcy estate nor free from the automatic stay provision, such that providers can collect insurance proceeds directly from insurers where a patient–debtor files for bankruptcy.

D. The First Circuit's Alternative Analysis and Application of Basic Contract Theory

Property of the bankruptcy estate is defined as "all legal or equitable interests of the debtor in property as of the commencement of the case."[102] As the First Circuit Court of Appeals pointed out in *Tringali*, "[t]he scope of this paragraph [§ 541(a)(1)] is broad . . . [i]t

---

100. Homsy v. Floyd, 51 F.3d 530, 533–34 (5th Cir. 1995).

101. *See* First Fidelity Bank v. McAteer, 985 F.2d 114 (3d Cir. 1993); Houston v. Edgeworth, 993 F.2d 51 (5th Cir. 1993).

102. 11 U.S.C. § 541(a)(1) (2012).

includes all kinds of property, including tangible or intangible property, causes of action . . . and all other forms of property[.]"[103] "In many contexts . . . 'contract rights' are treated as [intangible] property."[104] In a typical bilateral contract, there are rights and duties on both sides of the contract.[105] In the context of a health insurance contract, the insurer has the right to collect monthly insurance premiums and a corresponding duty to pay insurance proceeds to the insured, per the terms of the contract, as he or she consumes healthcare services. Conversely, the insured has a right to payment of insurance proceeds, per the terms of the contract, triggered by the consumption of healthcare services and a duty to pay monthly insurance premiums to the insurer. Because health insurance proceeds constitute a contract right, they must be viewed as a legal interest in intangible property;[106] hence, health insurance proceeds are property of the bankruptcy estate.[107]

This conclusion, however, gives rise to additional inquiries. What happens to this property interest where the insured assigns his or her right to the health insurance proceeds to a healthcare provider? Does the insured–assignor relinquish all rights to the insurance proceeds to the provider–assignee such that the insured–assignor, who subsequently becomes the debtor in a bankruptcy proceeding, no longer has a "legal or equitable interest in property?"[108] According to a Texas Court of Appeals, an assignment of health insurance proceeds creates separation of legal and equitable title to the anticipated insurance proceeds wherein the insured–debtor retains legal title and the provider–creditor maintains equitable title.[109] As a result, the court also held that the anticipated health insurance proceeds were still property of the estate for bankruptcy purposes because the insured–debtor retained legal title.[110] Interestingly, the court imposed a constructive trust on the insured–debtor, despite the debtor having legal title to the health insurance proceeds and

---

103. Tringali v. Hathaway Mach. Co., Inc., 796 F.2d 553, 560 (1st Cir. 1986).
104. WARREN, *supra* note 46, at 108.
105. *See* 17 AM. JUR. 2D CONTRACTS § 8 (2014).
106. WARREN, *supra* note 46, at 108.
107. 11 U.S.C. § 541(a)(1) (2012).
108. *Id.*
109. Univ. of Tex. Med. Branch at Galveston v. Allan, 777 S.W.2d 450, 454 (Tex. App. 1989).
110. *Id.*

claiming them as exempt property under Section 522(d)(5) of the Bankruptcy Code,[111] under the theory of unjust enrichment.[112]

The court in *University of Texas Medical Branch at Galveston* provides a creative solution to the issue; however, its analysis leaves the door open for opposing legal arguments. For example, some legal scholars would argue that instead of a separation of legal and equitable title occurring where an insured–patient assigns his right to insurance proceeds to a provider that "an effective assignment extinguishes the right [entirely] in the assignor and recreates the right in the assignee to performance by the obligor who owes the correlative duty."[113] If this is the case, then the debtor no longer has any "legal or equitable interest"[114] in the insurance proceeds and is therefore, not subject to the automatic stay provision.[115]

Ultimately, the contract theory of assignment, with regard to how it is applied to health insurance proceeds, could lead to a split of authority similar to the existing split between the United States Courts of Appeals for the First Circuit on one side and the Third and Fifth Circuits on the other. This would create a lack of predictability for all parties involved, creating messy legal and policy arguments on both sides in the lower court systems resulting in a different legal standard from one district to the next. In order to prevent such a mess, the best solution is for Congress to amend the Bankruptcy Code to expressly exclude health insurance proceeds from the definition of property of the estate.

III. CONCLUSION

With an estimated 60% of individual bankruptcy cases in America stemming from unpaid medical bills,[116] the economic impact of bankruptcy on patients and healthcare providers is significant. Today more than ever, providers are faced with an uncertain financial future due to the ever increasing cost of a medical education, the substantial expense of obtaining medical malpractice insurance, and the unknown impact of new federal laws such as the Affordable

---

111. "The following property may be exempted under subsection (b)(2) of this section: [t]he debtor's aggregate interest in any property, not to exceed in value $1,225 . . . ." 11 U.S.C. § 522(d)(5) (2012).
112. *Univ. of Texas Med. Branch at Galveston*, 777 S.W.2d at 454–55.
113. JOHN EDWARD MURRAY, JR., CONTRACTS: CASES AND MATERIALS 745 (6th ed. 2006).
114. 11 U.S.C. § 541(a)(1) (2012).
115. *Id.* § 362.
116. Tamkins, *supra* note 1.

Care Act.[117] In light of the ever increasing costs of running a medical practice, it is incumbent upon Congress to help mitigate the financial risk for providers and the cost of healthcare for patients. The foregoing analysis demonstrates how existing case law, common law doctrine, state statutory law, and basic contract principles do not provide a clear and consistent basis for ensuring that this goal is achieved universally. Therefore, Congress should amend the federal Bankruptcy Code to expressly exclude health insurance proceeds from the definition of property of the bankruptcy estate, thereby permitting provider–creditors to collect health insurance proceeds directly from the debtor–patient's health insurance company.

117. Writing, *supra* note 31; ASSOC. OF AM. MED. COLL., *supra* note 31; 42 U.S.C. §§ 18001–18121 (2012).