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RIGHTS OF CREDITORS IN INSURANCE—THE TENNESSEE EXEMPTION STATUTES

PAUL J. HARTMAN*

I. EXEMPTION STATUTES IN GENERAL

The subject of the availability of assets to creditors is important when a trustee in bankruptcy as a representative of creditors is seeking to gather assets to pay off creditors; and the subject is of equal importance where a single creditor, not in a bankruptcy proceeding, is seeking to satisfy his claim out of the assets of his debtor. Whatever is property in the hands of the debtor is available to his creditors, unless it is exempt by law. This property is his estate, considered indifferently from the standpoint of the single creditor who seeks to realize for himself alone, or of the trustee in bankruptcy as a representative of creditors.[1]

The concept of exemption of an asset from creditors stems from bankruptcy under the Roman system.[2] In the medieval bankruptcies which took place at the great fairs under the law merchant, the debtor was allowed scanty bedding and clothing and the tools of his trade.[3] The English statutory bankruptcy, which had its origin in 1571, made no reference to exemptions until 1705, when the law was amended to set apart an allowance for "a bankrupt surrendering and conforming" and giving full discovery of his estate.[4] This practice was continued in English legislation, so that today the English Law gives a bankrupt who is truthful upon his examination exemptions of necessary wearing apparel and bedding for himself, his wife and children, the tools of his trade and certain other allowances.[5]

Until the Act of 1867, the American Bankruptcy Acts dealt with the subject of allowances to the debtor for support of himself and family as the English had done.[6] Then for the first time the Bankruptcy Act gave effect to the exemption laws of the states to the extent that they were more liberal than the Bankruptcy law. From this Act of 1867 sprang the far-reaching provisions on exemptions contained in the Act of 1898 and its amendments. The present statute follows this same line. In so far as exemptions from claims

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1. GLENN, LIQUIDATION 465 (1935). "Every debtor's property, except such as may be specially exempt by law, is assets for the satisfaction of all his just debts." TENN. CODE ANN. § 8197 (Williams 1934).

2. See 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 168a (Rev. ed. 1940).

3. *Ibid.*

4. 2 COMYNS, DIGEST OF THE LAWS OF ENGLAND 149 (5th ed. 1824).

5. Bankruptcy Act, 1914, 4 & 5 GEO. 5, c. 59, § 38; 2 HALSBURY, LAWS OF ENGLAND 195-96 (2d ed., Hailsham, 1931).

6. 1 COLLIER, BANKRUPTCY 7, 793-94 (14th ed., Moore, 1940).

of creditors are concerned, exemptions given the debtor from the claims of the single creditor by state law are now respected by the National Bankruptcy Act. The Bankruptcy Act leaves the whole subject of exemptions to state law, perhaps as a matter of expediency to quiet opposition to the Act. In section 6 of the Bankruptcy Act it is carefully provided that the Act "shall not affect the allowance to bankrupts of the exemptions which are prescribed by the laws of the United States or by the state laws in force at the time of the filing of the petition in the state wherein they have had heir domicile for the six months immediately preceding the filing of the petition, or for a longer portion of such six months than in any other State. . . ."[7] While section 70(a) of the Bankruptcy Act in sweeping provisions vests the trustee in bankruptcy with title to all the debtor's assets as of the date of the petition, it excepts "property which is held to be exempt."[8]

It will be noticed that the Act gives federal exemptions. There are some federal statutes that do grant certain exemptions to specified classes of persons. Included in these federal exemptions are such items as pension money,[9] soldiers bonuses[10] and soldiers savings.[11]

Since the National Bankruptcy Act recognizes the exemptions granted by the states, a consideration of the subject of exemptions in bankruptcy, as well as in the single creditor's suit, can go hand in hand. This is especially so in view of the fact that the bankruptcy court is bound by the state statute as interpreted by the courts of the applicable state.[12]

Today's solicitude of the legislatures and courts for the poor man in protecting him and his belongings from the claims of his creditors is a far cry from the privations of the debtors' prison.[13] The benevolent social policy of shielding a debtor and his family from utter destitution has grown as a part of the American tradition. The exemption statutes of the states are manifold. They range from the early statutes exempting only personal property such as wearing apparel and the instruments or books necessary to the debtor's avocation, to the modern legislation which allows the debtor to

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7. 52 STAT. 847 (1938), 11 U.S.C.A. § 24 (Supp. 1951).

8. 64 STAT. 26 (1950), 11 U.S.C.A. § 110 (Supp. 1951). As we will see in detail later, insurance policies exempt from the claims of creditors in Tennessee by virtue of statutes, do not pass to the trustee in bankruptcy. Dawson v. National Life Ins. Co., 156 Tenn. 306, 300 S.W. 567 (1927); *see* Elledge v. Sumpter, 140 Tenn. 11, 14-15, 203 S.W. 346 (1917).

9. 54 STAT. 1195 (1940), 38 U.S.C.A. § 454a (1942).

10. 44 STAT. 827 (1926), 38 U.S.C.A. § 618 (1942); 50 STAT. 641 (1937), 38 U.S.C.A. § 686c (1942).

11. 64 STAT. 271 (1950), 10 U.S.C.A. § 906 (Supp. 1951).

12. Burns v. Kinzer, 161 F.2d 806 (6th Cir. 1947); Palais v. DeJarnette, 145 F.2d 953 (4th Cir. 1944).

13. See 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES c. 11 (REV. ed. 1940).

set apart all sorts of chattels,[14] and a piece of land as a "homestead,"[15] or to create an estate for his family by means of insurance on his own life for the benefit of his family.[16] The "homestead" exemption may be used where the debtor owns land, but there has also grown up the idea that something other than land and chattels should be put out of the reach of creditors. This desire has found fulfillment to a large extent in the development of insurance as an exempt asset. It is in the field of insurance that we find perhaps the most widespread, popular and important application of the American idea of exempt assets.

In the absence of some exempting statute, creditors may find insurance carried by a debtor to be a valuable source for the satisfaction of their claims. As we will see presently, this is true where a single creditor is proceeding against the debtor, and the trustee in bankruptcy may be in an even more favored position than the single creditor when the debtor has insurance.

Where no state exemption law enables the debtor to fend off his creditors, insurance policies payable to the insured or his estate, when matured by the expiration of some specified period or by the death of the insured, are assets subject to the claims of creditors.[17] Moreover, where there are exemption statutes, insurance may become liable for the debts of the insured, unless it is for the benefit of the class of benefactors favored by the exemption statutes. Exclusion of the favored class by the insured destroys the exemption.[18] Likewise, if the policy payable to the insured has a cash surrender value, it generally is an available asset, even to creditors who are asserting their claims in a nonbankruptcy proceedings, in the absence of an exemption statute.[19]

Where the life insurance policy is payable to the debtor's estate the policy on its face is an asset of the estate if it has a cash surrender value, in the absence of an exemption statute, and the trustee in bankruptcy takes it accordingly.[20] But the bankrupt may ransom the policy by paying the

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14. Chattel exemption laws exist in all of the states. See 1 HANNA AND MACLACHLAN, CASES ON CREDITORS' RIGHTS 63 (1949). For a lengthy list of exemptions in Tennessee, see TENN. CODE ANN. §§ 7707, 7709-10, 7712, 7715-18 (Williams 1934) and *Id.* at §§ 7701-01.2, 7708, 7711, 7713-14, 7714.2-14.7, 7718.1-18.5 (Supp. 1951).

15. Homestead exemption statutes exist in all states except Delaware and Rhode Island. See 1 HANNA AND MACLACHLAN, CASES ON CREDITORS' RIGHTS 63 (1949). For the Tennessee "homestead" exemption, see TENN. CODE ANN. §§ 7720-33 (Williams 1934), and *Id* at § 7719 (Supp. 1951).

16. See 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES §§ 175-76 (Rev. ed. 1940).

17. See VANCE, INSURANCE § 121 (3d ed., Anderson, 1951); Rose v. Wortham, 95 Tenn. 505, 32 S.W. 458 (1895); Rison v. T. W. Wilkerson & Co., 35 Tenn. 564 (1856).

18. Sparkman-Thompson, Inc. v. Chandler, 162 Tenn. 614, 39 S.W.2d 741 (1931) (insurance payable to estate of insured was willed to a person not within the class protected by statutes, creditors could reach it to satisfy their claims).

19. VANCE, INSURANCE § 121 (3d ed., Anderson, 1951).

20. 64 STAT. 26 (1950), 11 U.S.C.A. § 110a(3) (Supp. 1951).

trustee the equivalent of the cash surrender value as soon as that figure can be ascertained and stated to the trustee by the insurer.[21] Thus, the trustee in bankruptcy has no trouble in getting the cash surrender value of a policy as an asset for the creditors. Of course, the policy may have no cash surrender value available to the bankrupt at the time of bankruptcy, in which case no asset passes to the trustee.[22]

Where the debtor takes out a life insurance policy payable to a third person, the single creditor is not in so favorable a position as the trustee in bankruptcy. The single creditor in a nonbankruptcy proceeding, in the absence of statutes providing otherwise, generally has no interest in policies payable to third persons. This is so even though the policy has a change-of-beneficiary clause. Thus, where the policy is payable to a third person as beneficiary, and not to the insured or his estate, it is not an asset which can be reached by a creditor who is seeking to satisfy his claim in a nonbankruptcy proceedings, even where the policy provides for a change of beneficiary.[23]

Here it may be necessary to throw a debtor into bankruptcy in order to reach the insurance for creditors. The Bankruptcy Act has a provision that is tailored to fit just such sort of a situation. It provides that the trustee is vested with all powers which the bankrupt might have exercised for his own benefit.[24] This provision will take care of the ease where the debtor has taken out insurance payable to a third party as a beneficiary, but with a change-of-beneficiary clause. By acting seasonably, the trustee may exercise the reserved power to change the beneficiary and secure the policy for the estate by making the bankrupt's estate the beneficiary. Then the trustee can get the cash surrender value, if any.[25] But the bankrupt can still redeem the policy from the trustee by paying the cash surrender value.

If the policy happens to be payable to a third party as a beneficiary, and is without a change-of-beneficiary clause, the beneficiary's vested interest prevails and the trustee gets nothing, because the bankrupt himself, being

21. 64 STAT. 26 (1950), 11 U.S.C.A. § 110a(5) (Supp. 1951).

22. Burlingham v. Crouse, 228 U.S. 459, 33 Sup. Ct. 564, 57 L. Ed. 920 (1913).

23. Gurnett v. Mutual Life Ins. Co., 356 Ill. 612, 191 N.E. 250 (1934); VANCE, INSURANCE §§ 108, 122 (3d ed., Anderson, 1951). It is difficult, therefore, to agree with what seems to be the view expressed twenty years ago that where an insurance policy has a change of beneficiary clause, it is an asset of the insured's estate in Tennessee and can be reached by his creditors in nonbankruptcy proceedings. See Grade, *Exemption of Life Insurance Policies Under Tennessee Statutes and in Bankruptcy,* 11 TENN. L. REV. 84, 85-87 (1932). The Tennessee cases cited by the author of that article do not support his contention. They did not involve the question whether a creditor in a nonbankruptcy proceedings can reach the proceeds of a policy which had a change-of-beneficiary clause. The cited cases only involved questions concerning the nature of the interest acquired by a beneficiary under such a policy.

24. 64 STAT. 26 (1950), 11 U.S.C.A. § 110a(3) (Supp. 1951).

25. Cohn v. Malone, 248 U.S. 450, 39 Sup. Ct 141, 63 L. Ed. 352 (1919); Cohen v. Samuels, 245 U.S. 50, 38 Sup. Ct. 36, 62 L. Ed. 143 (1917).

unable to change the beneficiary, had no asset.[26] However, if the beneficiary of a life insurance policy becomes bankrupt, and the insured does not have the right to change the beneficiary, the beneficial interest in the policy is an asset of the estate of the bankrupt beneficiary, to which the trustee is entitled.[27]

Since there is no exception in the Bankruptcy Act covering the situation where the beneficiary is bankrupt, the determinative factor as to whether the trustee of the bankrupt beneficiary gets an asset is whether the beneficiary does or does not have a vested interest in the policy as of the date of bankruptcy. In the absence of a controlling exemption statute, the trustee of the bankrupt beneficiary will not get an asset if the insured reserved the right to change the beneficiary.[28]

Various sorts of disability payments likewise are assets which can be reached as an asset for creditors, in the absence of some exempting statute.[29]

The foregoing discussion concerning the handling of insurance as an asset of the debtor generally describes the situation where the insurance is not exempt from claims of creditors by virtue of a statute. To a considerable degree, state legislatures have modified the rule that insurance is an asset for creditors. This has been done by exempting policies, despite the change-of-beneficiary clause. These exempting statutes are viewed not only as creating exemptions when the single creditor is pursuing his debtor in a nonbankruptcy proceedings, but also, as we have seen, the National Bankruptcy Act itself respects these exemptions, so that the trustee in bankruptcy cannot reach the proceeds of an insurance policy which are exempt under local law.

There are powerful public policy considerations favoring the exemption of life and accident insurance from the claims of creditors. The benign purpose of these exemption statutes is, of course, to secure the dependents of the insured from suffering and want.[30] As a result of this attitude every state has passed some type of insurance exemption statute. The commendable belief that the head of a family should make provisions for his dependents conflicts with the strong policy considerations that require a debtor to use his resources to pay his debts.

26. Massachusetts Mutual Life Ins. Co. v. Switow, 30 F. Supp. 809 (W.D. Ky. 1940); *see* Central Bank of Washington v. Hume, 128 U.S. 195, 206, 9 Sup. Ct. 41, 32 L. Ed. 370 (1888).

27. Wolter v. Johnston, 34 F.2d 598 (3d Cir. 1929), *cert. denied*, 280 U.S. 606 (1930).

28. Massachusetts Mutual Life Ins. Co. v. Switow, 30 F. Supp. 809 (W.D. Ky. 1940).

29. Legg v. St. John, 296 U.S. 489, 56 Sup. Ct. 336, 80 L. Ed. 345 (1936) (construing Tennessee statute); Samuels v. Quartin, 108 F.2d 789 (2d Cir. 1940); Cravens v. Robbins, 8 Tenn. App. 435 (M.S. 1928).

30. "The object of this statute was to enable a husband, when death deprived wife and children of his support, to secure them from want and to prevent them from becoming a charge upon the public." American Trust & Banking Co. v. Lessly, 171 Tenn. 561, 564, 106 S.W.2d 551 (1937); *see* White v. Bickford, 146 Tenn. 608, 613, 244 S.W. 49 (1922); VANCE, INSURANCE § 124 (3d ed., Anderson, 1951).

There must, therefore, be an appraisal and accommodation of these competing demands. The legislatures of the various states, and to some degree the courts independent of legislative action, have endeavored to work out a proper adjustment between the conflicting interest of creditors and dependents of the insured.

The remaining effort in this article will include a detailed examination of Tennessee statutes exempting insurance, with a comparison of the Tennessee law with that of other states on this subject.

II. The Tennessee Statutes Exempting Insurance from Creditors

(1) *Statutes Protecting the Proceeds of Matured Policies from Claims of Creditors*

Tennessee, at present, has two main statutes which are pertinent here. They are code sections 8456 and 8558. Section 8456, which is much the older of the two, provides:

> "Any life insurance effected by a husband on his own life shall, in case of his death, inure to the benefit of his widow and children; and the money thence arising shall be divided between them according to the statutes of distribution, without being in any manner subject to the debts of the husband."[31]

Section 8458 provides:

> "The net amount payable under any policy of life insurance or under any annuity contract upon the life of any person made for the benefit of, or assigned to, the wife and/or children, or dependent relatives of such person, shall be exempt from all claims of the creditors of such person arising out of or based upon any obligation created after the effective date of this Code, whether or not the right to change the named beneficiary is reserved by or permitted to such person."[32]

More than a century ago the Tennessee legislature took steps to preserve a debtor's life insurance for the maintenance of his widow and children. As early as 1846,[33] the legislature provided that "any husband may effect a life insurance on his own life, and the same shall in all cases enure to the benefit of his widow and heirs in the present rates of distribution, without being in any manner subject to the debts of said husband, whether by attachment, execution or otherwise." The substance of this legislation appeared in the Code of 1858 as section 2478 which reads: "Any life insurance effected by a husband on his own life shall, in case of his death, inure to the benefit of his widow and children; and the money thence arising shall be divided between them according to the law of distributions, without being in any

31. TENN. CODE ANN. § 8456 (Williams 1934).
32. *Id.* § 8458.
33. Tenn. Acts 1845-46, c. 216, § 3.

manner subject to the debts of the husband, whether by attachment, execution, or otherwise."[34] This section, in essence, has been carried as part of the law of Tennessee ever since, and is the present section 8456, quoted previously.

In 1925 Tennessee widened, to some extent, the compass of her exemption statute. The legislature passed a statute, which is, in substance, the present code section 8458, providing:

> "That the net amount payable under any policy of life insurance or under any annuity contract upon the life of any person heretofore or hereafter made for the benefit of, or assigned to, the wife or children, or dependent relatives of such persons, shall be exempt from all claims of the creditors of such person arising out of or based upon any obligation created after the passage of this Act, whether or not the right to change the named beneficiary is reserved by or permitted to such person."[35]

Without going into unnecessary detail, it may be well to notice some of the differences between the above two exemption statutes. Section 8458 exempts annuity contracts, while section 8456 does not. Section 8458 has a broader class of protected beneficiaries than does section 8456. Under section 8456 the insurance inures only to the widow and children of the insured, whereas section 8458 broadens the favored class of beneficiary to include "dependent relatives" of the insured. Under section 8456 the protected insurance can be payable to the insured or his estate, but section 8458 provides that the insurance, or annuity, must be made for the benefit of, or assigned to, the designated beneficiary. These distinctions would not appear to make any practical difference in result unless one or the other of the sections is repealed. So long as both remain on the books the protection afforded by both taken together provides the scope of exemption. Of course, too, insurance taken out before 1925, the effective date of section 8458, could not come within the exemption provision of that section.

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34. Tenn. Code § 2478 (1858).

35. Tenn. Acts 1925, c. 113, § 1. In substance this is the present section 8458, quoted at the beginning of this subsection of this article. Also appearing in the Tennessee Code during portions of Tennessee legislative history, have been two other statutes dealing with insurance exemptions. In the Code of 1858 there appeared section 2294, which provided: "A life insurance effected by a husband on his own life shall inure to the benefit of the widow and next of kin, to be distributed as personal property free from the claims of his creditors." A good many of the cases hereafter considered will involve this section. This section was carried forward in the Tennessee Code for a number of years. See Tenn. Code § 3135 (1884); Tenn. Code Ann. § 4030 (Shannon 1917). It did not appear in the Code of 1932 nor in the present code. It must have been dropped because it does not seem to add anything to section 8456 of the present Code, quoted in full above. Also there appeared in the Code of 1896 section 2265, along the same line as the exemption statute passed in 1925 and quoted above. Section 2265 of the 1896 Code provided: "When policies of insurance are effected by any person on his life, for the benefit of his wife, or for the benefit of any one or more of his children, or for the joint benefit of his wife and children, the creditors of the person thus insuring shall have no claim on the proceeds of the policy, and the same shall inure to the person for whose benefit the insurance was effected. Creditors shall have an insurable interest in the lives of their debtors." This section appeared in the 1918 Code, but also was dropped later. It did not appear in the 1932 Code, nor in the present Code. The Act of 1925 (section 8458 of present Code) gives broader exemptions than did this section.

Both sections must be read together to round out the picture with respect to the exemption from creditors of the proceeds of policies of insurance in Tennessee. They have been so read together by the court for this purpose.[36] Taking the two exemption statutes together we see that protection is afforded only to the wife, children and dependent relatives of the insured, but the court has construed the statute to afford this protection even though the insurance is payable to the estate of the insured husband.[37] Moreover, the insured is protected from the claims of creditors even though the right to change the beneficiary is reserved by him. These statutes do not protect against the creditors of the beneficiaries, but only against creditors of the insured.

Tennessee also has a statute protecting the proceeds of fraternal benefit insurance. It provides:

> "No money or other benefit, charity, or relief, or aid to be paid, provided, or rendered by any such society [fraternal benefit society] shall be liable to attachment, garnishment, or other process, or be seized, taken, appropriated, or applied by any legal or equitable process to pay any debt or liability of a member or beneficiary, or any other person who may have a right thereunder, either before or after payment."[38]

This statute is broad enough to protect fraternal benefits from creditors of the member of the society and also to protect against creditors of the beneficiary. There has not been much litigation involving this statute after its constitutionality was sustained.[39] This statute protects the fraternal benefits only from ordinary debts of the insured or beneficiary and not assessments by which the benefit is created and made possible.[40]

It should be observed that the Tennessee statutes exempting ordinary insurance exempt the full amount of the proceeds of a policy of insurance, with no limitation on either the amount which can be spent by way of premiums nor on the amount of proceeds protected from the creditors.[41] In this respect the Tennessee exemption statutes differ from those of a good many other states. Some states provide that the amount of insurance exempt from the claims of creditors is limited to a specified sum.[42] Other states place a limitation on the amount of insurance that can be insulated from

36. See Sparkman-Thompson, Inc. v. Chandler, 162 Tenn. 614, 39 S.W.2d 741 (1931). Tennessee also has a statute which provides that a married woman may insure the life of her husband that such insurance is not subject to the debts of the husband. TENN. CODE ANN. § 8457 (Williams 1934).

37. Adams v. Garraway, 179 Tenn. 93, 162 S.W.2d 1086 (1941).

38. TENN. CODE ANN. § 6398 (Williams 1941).

39. Hamilton National Bank v. Amster, 134 Tenn. 537, 184 S.W. 5 (1915).

40. Allen v. Cunningham, 143 Tenn. 11, 223 S.W. 450 (1919).

41. See Harvey v. Harrison, 89 Tenn. 470, 14 S.W. 1083 (1891).

42. ARIZ. CODE ANN. § 24-601(13) (1939) ($10,000); MINN. STAT. ANN. § 550.37 (West Supp. 1951) ($10,000); S.D. CODE § 31.1509 (1939) ($5,000); WIS. STAT. § 272.18 (19) (1949) ($5,000). In Mississippi, where the insurance is payable to the estate of the insured, there is a $5,000 limit, less certain debts. Where the insurance is payable to a beneficiary other than the insured, there is a limit of $10,000. See MISS. CODE ANN. §§ 308-09 (1942).

claims of creditors by providing that only insurance purchased with a specified amount of annual premiums is exempt.[43] The bulk of states, however, like Tennessee, place no limitation on the amount of exemption, either by way of limiting the amount of protected proceeds or limiting the amount of premium that can be spent.[44]

It is important also to observe that the Tennessee exemption statutes provide that the protected insurance shall inure to the benefit of a limited class of designated beneficiaries—the widow, children and dependent relatives. In this respect, too, Tennessee differs from many of her sister states. Exemption statutes have varying qualifications, varying with the states, as to the beneficiaries who may avail themselves of the advantage of the exemption. The statutes found in some of the states limit the class of protected beneficiary, usually to the wife and children.[45] Perhaps the greater number of states, however, have now expanded the protected class of beneficiary by removing all restrictions in this respect.

While most states will not apply the exemption where the insurance is payable to the insured or his estate, nine states, including Tennessee, have statutes which exempt the proceeds of life insurance not only when payable to certain third parties as beneficiaries, but also payable to the insured or his

43. Cal. Code Civ. Proc. Ann. § 690.19 (1949) ($500); Idaho Code Ann. § 11-205(9) (1947) ($250); Mich. Stat. Ann. § 24.288 (Moore 1943) (if the wife insures life of husband, exemption is limited to insurance bought with $300 annual premium); Mont. Rev. Codes Ann. § 93-5814 (Choate and Wertz 1947) ($500); Mo. Rev. Stat. Ann. § 5850 (1939) ($500); Nev. Comp. Laws Ann. § 8844(14) (Supp. 1941) ($500); S.C. Code Ann. § 7985 (1942) ($500); Utah Code Ann. § 104-37-13(8) (1943). Other states at one time similarly limited the amount. Alabama, Connecticut, Nebraska, New York, West Virginia and Wisconsin.

44. Ala. Code Ann. tit. 7, § 624 (1940); Ark. Stat. Ann. § 66-511 (1947); Colo. Stat. Ann. c. 87, § 40 (Cum. Supp. 1951); Del. Rev. Code § 504 (1935); Fla. Stat. Ann. § 222.13 (1941); Ga. Code Ann. § 56-905 (1933); Ill. Ann. Stat. c. 73, § 850 (Smith-Hurd Perm. ed. 1940); Ind. Ann. Stat. § 39-4210 (Burns 1952); Iowa Code Ann. § 511.37 (1946); Kan. Gen. Stat. Ann. § 40-414 (Cum. Supp. 1947); Ky. Stat. Ann. §§ 654-55 (Carroll 1936); La. Gen. Stat. Ann. § 4105 (1939); Me. Rev. Stat. c. 156, § 21 (1944); Md. Ann. Code Gen. Laws art. 45, §§ 8-9 (Cum. Supp. 1947); Mass. Ann. Laws c. 175, §§ 125-26 (1948); Mich. Stat. Ann. § 24.287 (Henderson 1938) (but a limitation where wife insures life of husband, see § 24.288; Neb. Rev. Stat. § 44-371 (1943); N.H. Rev. Laws c. 327, §§ 1-3 (1942); N.J. Stat. Ann. §§ 17:34-28, 17:34-29 (1937); N.M. Stat. Ann. § 21-505 (1941); N.Y. Insurance Law § 166; N.C. Const. Art. X, § 7, N.C. Gen. Stat. Ann. §§ 58-205, 58-206 (1950); N.D. Rev. Code § 26-1018 (1943); Ohio Gen. Code Ann. §§ 9394, 9397 (1938); Okla. Stat. tit. 36, §§ 211-12 (1941); Ore. Comp. Laws Ann. § 101-514 (1940); Pa. Stat. Ann. tit. 40, § 517 (1930); R.I. Gen. Laws c. 153, § 13 (1938); Tex. Rev. Civ. Stat. Ann. art. 3832a (1945), Tex. Ins. Code art. 21.22 (Vernon 1951); Vt. Pub. Laws §§ 3177-78, 9122 (1947); Wash. Rev. Stat. Ann. § 7230-1 (Supp. 1940); W. Va. Code Ann. §§ 3359, 4753 (1949); Wyo. Comp. Stat. Ann. § 52-514 (1945). Virginia is somewhat unusual in that she does not exempt ordinary life insurance, but does exempt proceeds from group life insurance, Va. Code Ann. § 38-432 (1950), fraternal society benefits § 38-285, co-operative non-profit life benefits § 38-285, sick and accident benefits § 38-227, and burial society benefits § 38-152.

45. Among the states which have a limited class of beneficiaries are to be found Ariz. Code Ann. § 24-601 (1939); Iowa Code Ann. § 8776 (1949); Mich. Stat. Ann. § 24.287 (Moore 1943); Minn. Stat. Ann. § 550.37 (West Supp. 1951); S.C. Code Ann. § 7985 (1942); S.D. Code § 31.1509 (1939).

estate.[46] Under the Tennessee law, where the insured dies leaving an insurance policy payable to his estate or to his personal representation, and no disposition of the proceeds is made by will or assignment, the proceeds will go the class of beneficiaries protected, to the exclusion of the claims of the creditors of the insured.[47]

Tennessee, however, protects only against the creditors of the insured, and not against the creditors of the beneficiary. So insurance funds received by the widow from a policy on her deceased husband's life are not exempt from debts contracted by her.[48]

In the light of the legislative purpose to preserve something free for dependents from the claims of creditors, the exemption statutes have generally received a liberal judicial construction. The Tennessee courts have demonstrated this liberality. Since the exemption statute does not say when the insurance must be "effected by the husband," the court takes the position that the purpose behind the statute warrants a construction sufficiently liberal to cover insurance taken out before the marriage.[49]

The insurance fund is not considered an asset of the insured's estate, subject to his debts. This privileged sanctuary created by the exemption statutes cannot be invaded, even for funeral expenses.[50]

The exempt insurance is a fund secured by statute to the care and support of his dependents.[51] In determining whether a particular claimant should receive the insurance free from the creditors of the insured, the Tennessee court has decided that the payment of the proceeds under the statute is not limited to those persons who are citizens of Tennessee at the time.[52] In this respect the court departed from the law governing other kinds of exemptions, such as homestead exemptions and the year's support out of the estate of the husband or father, where it has limited the benefits of the exemption to citizens of Tennessee.[53] Since the insurance exemption statutes are not limited in their

46. FLA. STAT. ANN. § 222.13; IOWA CODE ANN. § 511.37 (1946); LA. GEN. STAT. ANN. § 4105 (1939); ME. REV. STAT. c. 156, § 21 (1944); MISS. CODE ANN. § 309 (1942); N.M. STAT. ANN. § 21-505 (Supp. 1943); N.D. REV. CODE § 26-1018 (1943); S.D. CODE § 51.1805 (1939); TENN. CODE ANN. §§ 8456, 8458 (Williams 1934).

47. Cooper v. Wright, 110 Tenn. 214, 75 S.W. 1049 (1903); *see* Nashville Trust Co. v. First National Bank, 123 Tenn. 617, 624, 134 S.W. 311, 313 (1910).

48. *In re* Day, 176 Fed. 377 (M.D. Tenn. 1909); Levy & Co. v. Davis, 125 Tenn. 342, 142 S.W. 1118 (1911); *cf.* Poore v. Bowlin, 150 Tenn. 412, 265 S.W. 671 (1924) (Workmen's Compensation Act exempts compensation from claims of creditors of both the employee and his dependents).

49. Rose v. Wortham, 95 Tenn. 505, 32 S.W. 458 (1895).

50. Stokes v. Stokes, 19 Tenn. App. 504, 90 S.W.2d 543 (M.S. 1935).

51. See *In re* Stansell, 8 F.2d 363, 364 (W.D. Tenn. 1925), construing Tennessee statute.

52. White v. Bickford, 146 Tenn. 608, 244 S.W. 49 (1922).

53. *Ibid.*

operation, like the ordinary exemption laws, to citizens of Tennessee, a child who is a nonresident of Tennessee can properly share under the insurance exemption statute.[54] Also, insurance will inure to the benefit of a child of the insured by a former marriage.[55]

The Tennessee court feels that the consideration behind the insurance exemption statutes making provisions for the dependents of the insured are sufficiently strong to require that the year's support for the widow and family must be set apart out of the assets of the insured which would otherwise be liable for payment of his debts, and cannot be taken from the exempt insurance fund.[56] Even though the creditor's chance of realizing his claim in full is reduced by this interpretation, the court takes the position that property coming within one type of exemption cannot be invaded to set up the other; else the letter as well as the spirit of the exemption statutes would be violated.[57]

While a husband has the power to make his insurance immune from the claims of creditors so as to provide a fund for his dependents, nevertheless he may dispose of the insurance fund as he sees fit, even to the extent of removing this immunity. The exemption statutes do not deprive the husband of power to control the matter of who shall benefit by his insurance. The insurance is his property and subject to his disposition. Consequently, the insured may direct in the policy itself that persons other than the class named in the exemption statute shall be the beneficiaries of the policy.[58] Where the insured reserves the right to change the beneficiary, the insured may remove the immunity given to insurance proceeds by making a creditor the beneficiary in place of a dependent relative who would otherwise have taken the insurance free from the claim of insured's creditors.[59] The statutes exempting the proceeds of life insurance from claims of creditors do not deprive the insured of the power to substitute another beneficiary who is not within the class protected by the statutes, since insurance exemption statutes do not clothe the class favored by the statute with any vested interest in the proceeds of the policy.[60]

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54. *Ibid.*
55. Chrisman v. Chrisman, 141 Tenn. 424, 210 S.W. 783 (1918).
56. Agee v. Saunders, 127 Tenn. 680, 157 S.W. 64 (1913); Combs v. Combs, 131 Tenn. 66, 173 S.W. 441 (1914).
57. *See* Agee v. Saunders, 127 Tenn. 680, 685, 157 S.W. 64, 65 (1913).
58. *See* Adams v. Garraway, 179 Tenn. 93, 96, 162 S.W.2d 1086, 1087 (1942).
59. Lunsford v. Nashville Savings & Loan Corp., 162 Tenn. 179, 35 S.W.2d 395 (1931); *see* Life Association v. Winn, 96 Tenn. 224, 227, 33 S.W. 1045 (1895).
60. Lunsford v. Nashville Savings & Loan Corp., 162 Tenn. 179, 35 S.W.2d 395 (1931); Butler v. Fowler, 28 Tenn. App. 217, 188 S.W.2d 612 (M.S. 1944). It should not be forgotten, however, that under the old line policies where there is no reservation of power by the insured to change a beneficiary, the designation of a third person as a beneficiary does vest that person with an indefeasible property right to the policy, which the insured cannot affect without the consent of the beneficiary. *E.g.*, Simms v. Randall, 117 Tenn. 543, 96 S.W. 971 (1906); see VANCE, INSURANCE § 106 (3d ed., Anderson, 1951).

A like disposition of insurance proceeds payable to the husband's own estate or to his personal representative may, by assignment, will or other appropriate means, be made payable to some person other than the class of recipients named in the exemption statutes as the benefactors of the insurance, and thus defeat the exemption.[61] If the insured excludes the class favored by the exemption statute, it will destroy the effect of the exemption as to insurance payable to his estate, and creditors of the insured can reach the fund.[62]

It is also well settled that while the insured does have the power to dispose of the proceeds of his insurance policies as he sees fit to persons other than those named in the exemption statutes, such disposition will not be made unless the insured clearly expressed an intent to oust the statutory beneficiaries. Since the insurance exemption statutes were enacted to protect the dependents of the insured, the court will not pass the insurance to others in the absence of "apt words clearly indicative of such intention."[63]

Even though no claims of creditors are involved, a husband's insurance will, in the absence of a clear intent by the insured to the contrary, pass under the provisions of the exemption statute and will be divided as there

61. American Trust & Banking Co. v. Twinam, 187 Tenn. 570, 216 S.W.2d 314 (1948) (assigned to a creditor); Nashville Trust Co. v. First National Bank, 123 Tenn. 617, 134 S.W. 311 (1910); Rison v. T. W. Wilkerson & Co., 35 Tenn. 565 (1856) (policy not payable to widow and children was assigned by husband to creditor—creditor prevailed to extent of his debt); Third National Bank v. Hall, 30 Tenn. App. 586, 209 S.W.2d 46 (M.S. 1947); *see* American Trust Co. v. Sperry, 157 Tenn. 43, 46, 5 S.W.2d 957 (1928). This principle has also been applied where the disposition of the policy by the husband was by will where the policy was payable to the insured's estate or to his personal representative. The claim of the legatee under the will is superior to that of the widow and children in such cases. Union Trust Co. v. Cox, 108 Tenn. 316, 67 S.W. 814 (1902) (policy made subject to debts of insured by will); Williams v. Carson, 68 Tenn. 516 (1876). In Butler v. Fowler, 28 Tenn. App. 217, 188 S.W.2d 612 (M.S. 1944), the insured and his wife were separated prior to the death of the insured, who made his home with his sister who paid the funeral expenses of the insured. Both the wife and sister claimed the proceeds of the policy payable to the insured's estate. The sister was awarded the proceeds of the policy. The widow receivd the proceeds of a policy naming her as beneficiary. The court is not very explicit as to its reasons for awarding the policy to the sister.

62. Sparkman-Thompson, Inc. v. Chandler, 162 Tenn. 614, 39 S.W.2d 741 (1931) (insurance payable to the insured's estate and by him disposed of by will to a person other than those listed as benefactors in the exemption statute).

63. Adams v. Garraway, 179 Tenn. 93, 162 S.W.2d 1086 (1941); Waldrum v. Waldrum, 14 Tenn. App. 342 (M.S. 1931). In J. Bouchard & Sons Co. v. Nashville Protestant Hospital, 177 Tenn. 151, 146 S.W.2d 956 (1941), where the proceeds of insurance policies were not specifically set apart for the payment of the insured's debts, the widow took the insurance in preference to the claims of a hospital irrespective of the fact that the insured, because of his breach of duty in handling the affairs of the hospital which he managed, apparently contributed to its insolvency. The policy also had a rider assigning the policy to the claimant hospital "as its interest may appear." The language was not strong enough to divest the claim of the widow. In American Trust & Banking Co. v. Twinam, 187 Tenn. 570, 216 S.W.2d 314 (1948), a marriage settlement wherein the wife "waives all rights to and interest in the property and estate" of the insured husband, when no specific mention was made of insurance payable to his personal representatives or assignees, did not cut the wife (widow) out of the insurance.

directed, rather than be treated as part of the insured's estate.[64] The court reasons that while the primary purpose of the insurance exemption statutes is to preserve a fund for the dependents of the insured, that a secondary purpose of the statutes is to provide for the disposition of the insurance fund among those named in the statute.[65]

The policy considerations behind the insurance exemption statutes appear in clear focus also where the husband has, in fact, assigned insurance payable to his estate, along with other collateral, to secure a debt. There the widow and children may be able to require the secured creditor to proceed first against the other collateral.[66] This is so even though by requiring the secured creditor to go against the collateral other than the insurance, the general creditors of the insured are hurt, since the rights of the widow and children to the insurance are superior to the claims of the general creditors.[67] This is a sort of reverse marshalling of assets, since the equitable doctrine of marshalling requires that a person having two funds to satisfy his demand cannot disappoint a party having access to but one of the funds.[68] As we have just seen the husband may, however, by virtue of his control over his insurance, assign it as security and make it clear that the debt should be paid out of the proceeds of the insurance before other assets of the insured are applied.[69]

The power of the insured husband to direct the distribution of his insurance to benefactors, other than his dependents named in the exemption statute, is unlike general exemption law. While the husband is the owner of insurance payable to himself or his personal representatives and has a right to dispose of it to persons other than his dependents, with respect to other exempt property under the general exemption laws the husband has no such power. The property that is exempt under the general exemption laws, such as the homestead and the widow's year's support, does not belong to the estate of the deceased husband.[70] The widow is entitled to these general exemptions during the lifetime of the husband; they cannot be appropriated to

64. Chrisman v. Chrisman, 141 Tenn. 424, 210 S.W. 783 (1918) (proceeds of policy did not pass under will leaving all insured's estate to his wife but to the persons named in the exemption statute); Agee v. Saunders, 127 Tenn. 680, 157 S.W. 64 (1913), overruling *sub silentio,* Weil v. Trafford, 3 Tenn. Ch. 108 (1875).

65. *See* Chrisman v. Chrisman, 141 Tenn. 424, 428-30, 210 S.W. 783, 784-85 (1918).

66. Cabbage v. Citizens Bank & Trust Co., 31 Tenn. App. 283, 214 S.W.2d 572 (E.S. 1948); Third National Bank v. Hall, 30 Tenn. App. 586, 209 S.W.2d 46 (M.S. 1947).

67. Cabbage v. Citizens Bank & Trust Co., 31 Tenn. App. 283, 214 S.W.2d 572 (E.S. 1948).

68. *See* Cabbage v. Citizens Bank & Trust Co., 31 Tenn. App. 283, 304, 214 S.W.2d 572, 580 (E.S. 1948).

69. American Trust and Banking Co. v. Twinam, 187 Tenn. 570, 216 S.W.2d 314 (1948), distinguishing Third National Bank v. Hall, 30 Tenn. App. 586, 209 S.W.2d 46 (M.S. 1947) on the ground that the insured manifested a different intent in the two cases.

70. *See* McAdams v. McAdams, 177 Tenn. 67, 74, 146 S.W.2d 140, 143 (1941).

satisfy claims of creditors of his estate, nor can they pass under the husband's will against the right of the widow.[71] These general exemption laws are said to have been enacted from considerations of public concern and to subserve the general welfare; consequently, they cannot be abrogated by mere private agreement.[72] Since the insurance exemption statutes were enacted for the support of dependents, the same as the general exemption statutes, the writer has some difficulty in understanding why public policy forbids the husband to make it possible for creditors to reach the generally exempt property but permits him to waive the insurance exemption.

(2) *The Statute Protecting the Cash Value of Unmatured Life Insurance from Claims of Creditors*

Unless there is an exempting statute, the cash surrender value of a policy, within certain limitations, is an asset available to creditors, both as to the trustee in bankruptcy and to the creditors who are asserting their claims in a nonbankruptcy proceedings.[73] But practically every state now has at least one statute, the effect of which is to protect the cash value of a life insurance policy in bankruptcy or otherwise from the claims of creditors of the insured.[74] While Tennessee does not have any statute specifically exempting the cash surrender value of life insurance from the creditors of the insured, nevertheless the general insurance exemption statutes have been construed to fend off the insured's creditors from the cash surrender value of the insured's life insurance.[75]

71. *See* American Trust & Banking Co. v. Twinam, 187 Tenn. 570, 576, 216 S.W.2d 314, 317 (1948). *Cf.* McAdams v. McAdams, 177 Tenn. 67, 146 S.W.2d 140 (1941), where the court declared that a contract to waive homestead and year's support exemption, even if entered into before marriage, would be void as against public policy.

72. *See* American Trust & Banking Co. v. Twinam, 187 Tenn. 570, 576, 216 S.W.2d 314, 317 (1948).

73. See VANCE, INSURANCE § 121 (3d ed., Anderson, 1951); and see notes 19-20, *supra.*

74. See VANCE, INSURANCE § 124 (3d ed., Anderson, 1951).

75. TENN. CODE ANN. §§ 8456, 8458 (Williams 1934) (quoted in text above). For a holding see Dawson v. National Life Ins. Co., 156 Tenn. 306, 300 S.W. 567 (1927), construing sections 4030 and 4231 of the Tennessee Code of 1917, as exempting the cash surrender value of a life policy. Section 4030 no longer appears in the Tennessee Code, see note 35, *supra.* Section 4231 is, in substance, section 8456 of the present Code. At a later date the Tennessee court has expressed the opinion that the present section 8456 protects the cash surrender value from creditors. *See* Strader v. Aetna Life Ins. Co., 181 Tenn. 444, 452, 181 S.W.2d 622, 625 (1943). The Federal case of *In re* Stansell, 8 F.2d 363 (W.D. Tenn. 1925), construed the act of 1875, no longer a part of the Tennessee statutes, as exempting the cash surrender value. See note 35, *supra,* for a discussion of the history of the act of 1875. The Stansell court refused to follow the earlier federal case of *In re* Moore, 173 Fed. 679 (E.D. Tenn. 1909), which held that the Tennessee statutes did not exempt the cash surrender value of life policies from claims of creditors. While the act of 1875 is no longer a part of the Tennessee statutes, the Tennessee act of 1925 (now Code section 8458) seems even broader in its scope of exemption than the act of 1875. Moreover, the act of 1925 has been declared by the Tennessee court to exempt the cash surrender value of a life policy from the claims of creditors. *See* Lunsford v. Nashville Savings & Loan Corp., 162 Tenn. 179, 182, 35 S.W.2d 393 (1931). There seems little doubt that the present Tennessee statutes do protect the cash surrender value of life policies from the claims of creditors of the insured. However, for a presentation of the position that these cases exempting the cash surrender value are wrong on

In exempting the cash surrender value of life policies the Tennessee court reasons that the exemption statutes were enacted to enable the husband and father to provide a fund for his dependents so that they would not become public charges, and that if the "creditors could impound and appropriate the insurance the day before the death of the insured the object of the statute would fail."[76]

Since Tennessee has no separate statute expressly exempting the cash surrender value, but depends upon the general exemption statutes discussed in detail earlier in connection with exemptions of matured insurance, the matters there discussed are, in general, applicable here, especially the policy considerations behind the statute. No detailed repetition of those matters will be given here. The Tennessee statutes limit the protection to the wife, children and dependents of the insured; the protection is afforded even though the policy contains a change-of-beneficiary clause; and there is no limit on the amount of insurance that can be placed beyond the reach of creditors. The court has applied the same liberality of construction to the statute with respect to the cash surrender value as it has in regard to matured insurance.[77] There have been but few cases involving the cash surrender aspect of the exemption statutes.

Assuming that the cash surrender value of a policy is beyond the reach of creditors in nonbankruptcy proceedings by virtue of the exemption statute, what is the effect of such exemptions on the passing of the policy to the trustee in bankruptcy? Does the trustee have power to reach the cash surrender value as an asset for creditors, irrespective of the exemption statute? The answer is simple. The trustee cannot reach the cash surrender value so long as the policy is for the benefit of the class named in the statute. The National Bankruptcy Act respects the exemptions provided by the law of the state of the bankrupt's domicile,[78] with the result that the cash surrender value of policies, exempt under state law, does not pass to the trustee in bankruptcy. The Supreme Court of the United States has made it clear that the trustee in bankruptcy takes no interest in the cash surrender value of a policy made exempt from creditors by local law.[79] The exemption statutes in Tennessee likewise have been construed to exempt the cash surrender value of insurance policies from the trustee in bankruptcy.[80]

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principle and public policy, see Grade, *Exemption of Life Insurance Policies Under Tennessee Statutes and in Bankruptcy*, 11 TENN. L. REV. 84, 90-95 (1933).

76. Dawson v. National Life Ins. Co., 156 Tenn. 306, 310-11, 300 S.W. 567, 569 (1927).

77. See Dawson v. National Life Ins. Co., 156 Tenn. 306, 300 S.W. 567 (1927).

78. 52 STAT. 847 (1938), 11 U.S.C.A. § 24 (Supp. 1951); 64 STAT. 26 (1950), 11 U.S.C.A. § 110 (Supp. 1951).

79. Holden v. Stratton, 198 U.S. 202, 25 Sup. Ct. 656, 49 L. Ed. 1018 (1905).

80. *In re* Stansell, 8 F.2d 363 (W.D. Tenn. 1925); Dawson v. National Life Ins. Co., 156 Tenn. 306, 300 S.W. 567 (1927). *Contra: In re* Moore, 173 Fed. 679 (E.D. Tenn. 1909).

Under the earlier exemption statutes of some states it was not clear whether the policy was protected in bankruptcy when the insured retained the right to change the beneficiary and hence to surrender the policy for its cash value.[81] Under the Tennessee exemption statute it is not necessary for the insured to give up his right to change beneficiaries in order to secure the exemption of his policy, provided, of course, the policy is for the benefit of the protected class.[82]

We know, of course, that in the absence of an exemption statute the trustee is able to reach the cash surrender value of a policy as an asset for creditors, providing the bankrupt insured has reserved the right to change beneficiaries. The trustee could simply exercise the bankrupt's power to change beneficiaries and put the estate of the bankrupt in the beneficiary's place and, treating the policy as an asset, collect the cash surrender value for the benefit of creditors.[83]

(3) *The Statute Protecting Disability Policies and Disability Income from Claims of Creditors*

Unless there is a special exemption statute, disability benefits constitute an asset for creditors.[84] Being an asset, the disability claim will also pass to the trustee in bankruptcy where not specifically exempt.[85] The Tennessee statutes which exempt life insurance do not exempt payment for disability under a policy of health insurance, either from an ordinary creditor,[86] or a trustee in bankruptcy.[87] A trustee in bankruptcy was permitted to take over a disability claim in Tennessee, even where the disability income provisions of the policy were written along with a life insurance policy and the life insurance portion of the policy was exempt from creditors by reason of the Tennessee exemption statute.[88] Immediately thereafter the Tennessee legislature passed a statute expressly and specifically exempting disability income.[89]

The Tennessee statute uses sweeping terms. It exempts sums payable under accident, health or disability insurance caused by either accidental per-

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81. VANCE, INSURANCE, § 124 (3d ed., Anderson, 1951).

82. TENN. CODE ANN. § 8458 (Williams 1934).

83. Under section 70(a) of the Bankruptcy Act the trustee is allowed to exercise all the power available to the bankrupt, and may thus hold the policy as an asset, unless the bankrupt hands over the cash surrender value, which he may do. 64 STAT. 26 (1950), 11 U.S.C.A. § 110(a)(3.5) (Supp. 1951).

84. Cravens v. Robbins, 8 Tenn. App. 435 (M.S. 1928).

85. Legg v. St. John, 296 U.S. 489, 56 Sup. Ct. 336, 80 L. Ed. 345 (1936).

86. Cravens v. Robbins, 8 Tenn. App. 435 (M.S. 1928).

87. Legg v. St. John, 296 U.S. 489, 56 Sup. Ct. 336, 80 L. Ed. 345 (1936).

88. *Ibid.*

89. TENN. CODE ANN. §§ 7718.1-18.5 (Supp. 1951). This Act is construed in Strader v. Aetna Life Ins. Co., 181 Tenn. 444, 181 S.W.2d 622 (1943).

sonal injuries or disease. It also exempts such sums as may be due in the event the insured dies. The act calls for a liberal construction. It specifically provides that the rule of common law requiring strict construction of statutes in derogation of the common law shall not be applicable to the provisions of this act. It expressly declares that it is remedial and that it should be given a broad and equitable construction by the courts to the end that the objects and purposes of the act may be realized and attained.

There has been very little litigation involving the Tennessee statute exempting disability benefits. It has, however, been interpreted to prevent the insurance company from offsetting indebtedness of the insured resulting from overpayments against disability benefit due from the insurance company.[90] This interpretation is consistent with holdings in other jurisdictions.[91] Public policy favors the exemption of disability benefits from creditors, and statutes achieving that end have been passed in many states.[92]

(4) *The Statute Protecting Annuities from Claims of Creditors*

In the absence of an exemption statute, annuity payments constitute an asset of the debtor and may be reached by the trustee in bankruptcy.[93] Retirement annuity contracts are not "insurance" within the meaning of statutes exempting insurance, and, in the absence of a statute specifically exempting retirement annuities, they are assets for creditors.[94] This problem will not come up in Tennessee, however, so long as the annuity is payable for the benefit of the wife, children or dependent relatives of the annuitant, because Tennessee has a statute expressly exempting annuity payments from creditors of the person on whose life the annuity contract is taken out.[95] The problem would arise in Tennessee, of course, if the person for whose benefit the annuity contract is taken out is not a member of the limited class of benefactors for whose benefit the statute preserves the annuity income from the claims of creditors.

Several states have passed statutes designed to protect annuities and annuity income from creditors.[96] Section 8458 of the present Tennessee Code

90. Strader v. Aetna Life Ins. Co., 181 Tenn. 444, 181 S.W.2d 622 (1943); *cf.* Collier v. Murphy, 90 Tenn. 300, 16 S.W. 465 (1891) (could not offset claim against exempt wages).

91. See, *e.g.*, Wilkes v. Equitable Life Assurance Society, 289 N.Y. 63, 43 N.E.2d 812 (1942); Atlantic Life Ins. Co. v. Ring, 167 Va. 121, 187 S.E. 449 (1936).

92. See VANCE, INSURANCE 750 (3d ed., Anderson, 1951) showing the states that have enacted such statutes.

93. *In re* Walsh, 19 F. Supp. 567 (D. Minn. 1937).

94. *Ibid.*

95. TENN. CODE ANN. § 8458 (Williams 1934).

96. See VANCE, INSURANCE 749-50 (3d ed., Anderson, 1951) for the states that have passed these statutes.

is designed, among other things, to give protection to annuities. It is very indefinite as to its application and there apparently has not been any Tennessee case specifically construing the annuity feature of the statute. The statute provides that the "net amount payable . . . under any annuity contract upon the life of any person made for the benefit of, or assigned to the wife and/or children or dependent relatives" shall be exempt from claims of creditors of the person on whose life the annuity contract was taken out. This protection is afforded even though the policy contains a clause reserving the right to change the beneficiary.

What does this statute mean? Does it mean that these designated beneficiaries must, in fact, be named in the annuity contract, or is it enough to say that the annuity is "made for the benefit of" the protected class, even though payable to the person upon whose life the contract is taken out? The exact answer to that question is to be found in the opinions of Tennessee cases yet to be written. In view of the liberality of protection given under the Tennessee exemption statutes, the writer ventures to suggest that the benefactors need not be named specifically in the policy, and that it is enough to exempt from creditors even though the annuity is payable to the person on whose life the contract is written.

An annuity exemption statute almost identical with the Tennessee statute has been held, by respectable authority, to protect the annuity from claims of creditors even though the annuity contract was payable to the annuitant during his life time, and at his death to his wife.[97]

III. Insurance Purchased with Embezzled Funds

When an insured has paid for his insurance with embezzled or misappropriated funds, several problems are presented. It is clear, however, that where a wrongdoer uses other people's money to pay premiums on a policy of insurance upon the wrongdoer's life, the person to whom the money belonged may follow his money into the proceeds of the policy. The courts generally make the wrongdoer a constructive trustee and allow the person defrauded to recover the trust property and its proceeds, against anyone except a *bona fide* purchaser, provided the misappropriated funds can be traced.[98]

Assuming the funds can be traced, the next question is, how much of the insurance proceeds may the defrauded person claim? He is at least entitled to the amount of misappropriated money used to pay premiums; how-

97. Bowers v. Reinhard, 78 F.2d 776 (3d Cir. 1935) (Pennsylvania statute). The annuitant's interest was exempt from creditors during his life, even though the contract had a change-of-beneficiary clause.

98. See 3 Scott, Trusts § 508.4 (1939).

ever, there is a conflict of authority on whether he is entitled to more than that amount. A few courts limit the recovery of the defrauded person to the amount of misappropriated money used to pay premiums, plus interest.[99] This is not the weight of authority, however.[100] The greater number of states, including Tennessee, follow the usual method of tracing trust funds and allow the defrauded person to recover the full amount of the proceeds, if all the premiums were paid with misappropriated money.[101]

True the person who has been wronged may get a windfall, if the insurance is taken out on the eve of the insured's death, for there the amount of the proceeds will be greater than the amount of the defrauded person's money used to pay premiums; but the defrauded person involuntarily invested in a profitable venture and should be permitted to recover the amount of insurance purchased with his money. This view does not unfairly treat the beneficiary of the insurance policy, even though the beneficiary may be perfectly innocent, for he is a donee and is not in the position of a *bona fide* purchaser for value. Having paid none of the premiums the beneficiary should not be permitted to profit through the wrongful use of somebody else's money.

Similarly, if the premiums were paid partly with the money of the defrauded person, and partly with the wrongdoer's money, the weight of authority, including Tennessee, takes the view that the defrauded person is entitled to a *pro rata* share of the whole proceeds of the insurance policy.[102] Here, again, there is some authority which limits the relief to a lien upon the insurance proceeds, to the extent of the amount of money wrongfully applied in paying premiums.[103]

What is the impact of the insurance exemption statutes on the right of the defrauded person to recover where misappropriated money has been used by the insured to pay premiums? Do these statutes exempting insurance from claims of creditors also prevent the defrauded person from recovering

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99. Hubbard v. Stapp, 32 Ill. App. 541 (1889); Thum v. Wolstenholme, 21 Utah 446, 61 Pac. 537 (1900); *see* American National Bank v. King, 158 Okla. 278, 13 P.2d 164, 166 (1932).

100. See VANCE, INSURANCE § 125 (3d ed., Anderson, 1951); 3 SCOTT, TRUSTS §§ 508.4, 516.1 (1939).

101. Brown v. New York Life Ins. Co., 152 F.2d 246 (9th Cir. 1945); Vorlander v. Keyes, 1 F.2d 67 (8th Cir. 1924); Massachusetts Bonding and Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548 (1923); Shaler v. Trowbridge, 28 N.J. Eq. 595 (1877); McConnell v. Henochsberg, 11 Tenn. App. 176 (W.S. 1929); Truelsch v. Northwestern Mutual Life Ins. Co., 186 Wis. 239, 202 N.W. 352 (1925).

102. Vorlander v. Keyes, 1 F.2d 67 (8th Cir. 1924); Brodie v. Barnes, 56 Cal. App.2d 315, 132 P.2d 595 (1942); Massachusetts Bonding & Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548 (1923); McConnell v. Henochsberg, 11 Tenn. App. 176 (W.S. 1929); Truelsch v. Northwestern Mutual Life Ins. Co., 186 Wis. 239, 202 N.W. 352 (1925); see VANCE, INSURANCE § 125 (3d ed., Anderson, 1951).

103. Board of Public Instruction v. Mathis, 132 Fla. 289, 181 So. 147 (1938); Hubbard v. Stapp, 32 Ill. App. 541 (1889); Thum v. Wolstenholme, 21 Utah 446, 61 Pac. 537 (1900).

out of the proceeds of the policy? While the exemption statutes are liberally construed to protect the dependents of the insured, they should not be used to encourage fraud by making a safe depository for misappropriated funds. Where the beneficiary has paid no part of the premium, his rights must yield to the paramount rights of the defrauded person whose money kept the policy alive. Consequently, the proceeds of policies purchased with misappropriated funds are not made exempt from the claim of the defrauded person by virtue of the exemption statutes.[104]

IV. Insurance as a Fraudulent Conveyance

There are two main aspects to this problem. One phase arises when the policy has been assigned or the beneficiary changed so as to cut out the creditors at a time when the insured is insolvent. The other phase has to do with the payment of insurance by an insolvent insured.

Suppose an insolvent man takes out a policy on his own life in favor of his wife, or takes it out payable to his estate and later assigns it to her or makes her the beneficiary. Assume that the naming of the wife as the beneficiary or the assignment to her, is a gratuitous act, she furnishing no consideration in either instance. The insured then keeps up the policy by paying the premiums while he remains insolvent. Is not the payment of premiums by the insured, or changing the beneficiary or assigning the policy so as to cut out the creditors of the insured—all while he is insolvent—a fraudulent conveyance? Has not this debtor's estate, otherwise available to his creditors, been diminished, with the resulting injury to the creditors? Should not the creditors of the insured be able to reach the policy or its proceeds?

On principle it should be clear that these transactions should constitute a fraudulent conveyance,[105] and there is considerable authority so holding. Presently we will examine the specific effects of the exemption statutes on these problems. However, in the absence of any controlling exemption statutes changing the result, there is very little dissent from the view that changing the beneficiary or the assignment of the policy gratuitously, while the insured is insolvent, so as to cut out creditors, is a fraudulent conveyance which the creditors can successfully attack.[106]

104. Massachusetts Bonding & Ins. Co. v. Josselyn, 224 Mich. 159, 194 N.W. 548 (1923); McConnell v. Henochsberg, 11 Tenn. App. 176 (W.S. 1929); Truelsch v. Northwestern Mutual Life Ins. Co., 186 Wis. 239, 202 N.W. 352 (1925). A Georgia case decided by a divided court, which took a contrary position, seems wrong. Bennett v. Rosborough, 155 Ga. 265, 116 S.E. 788 (1923). For criticism of this case, see Vance, Insurance § 125, n.4 (3d ed., Anderson, 1951).

105. See 1 Glenn, Fraudulent Conveyances and Preferences § 177(a) (Rev. ed. 1940).

106. Navassa Guano Co. v. Cockfield, 253 Fed. 883 (4th Cir. 1918); Aetna National Bank v. Manhattan Life Ins. Co., 24 Fed. 769 (S.D.N.Y. 1885); Friedman v. Fennell,

On the point whether the policy must have a cash surrender value at the time of the transfer in order to constitute a fraudulent conveyance, the courts are sharply divided, however, both where an applicable exemption statute is involved and also where that feature is not present. One line of authority holds that a policy of life insurance confers valuable property rights which, in the absence of transfer, would go to the insured's estate, and therefore the proceeds inure to the benefit of creditors. This view says that the policy need have no cash surrender value at the time of transfer in order to be a fraud on creditors. The courts taking this view reason that the policies are valuable contracts and that they constitute property, and that the transfer should, therefore, be governed by the same rules as the transfer of other property.[107] On the other hand, another view maintains that, unless there is a cash surrender value, there is nothing to be transferred in fraud of creditors.[108] Even under this view that, if there is no cash surrender value there is no asset to be transferred in fraud of creditors, the court will let the creditor reach the proceeds if the change of beneficiary is on the eve of the insured's death.[109] In such case it cannot be plausibly contended that the transferred policy is valueless, because of the practical certainty that the life of the insured would soon end, and the pecuniary value of the policy at the time of the transfer closely approximates its face amount.

Have the exemption statutes modified the rule that a gratuitous assignment or change of beneficiary of a policy payable to the insured's estate (and also an asset available to his creditors)[110] is a fraudulent transfer? That is, does it constitute a fraudulent conveyance where the insolvent insured assigns the policy or changes the beneficiary so that the proceeds, which would otherwise go to creditors, will now go to a member of the class in whose hands the insurance is protected from claims of creditors of the insured? A short answer to this question would be that these statutes have considerably nar-

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94 Ala. 570, 10 So. 649 (1892); Bryson v. Manhart, 11 Cal. App.2d 691, 54 P.2d 778 (1936); Reynolds v. Aetna Life Ins. Co., 160 N.Y. 635, 55 N.E. 305 (1899); Mahood v. Maynard, 114 W. Va. 385, 171 S.E. 884 (1933).

107. McCarthy v. Griffin, 299 Mass. 309, 12 N.E.2d 836 (1938) (exemption statute involved); Catchings v. Manlove, 39 Miss. 655 (1861); Gould v. Fleitmann, 188 App. Div. 759, 176 N.Y. Supp. 631 (1st Dep't 1919), *aff'd*, 230 N.Y. 569, 130 N.E. 897 (1920); Burton v. Farinholt, 86 N.E. 259 (1882); Fidelity Trust Co. v. Union National Bank, 313 Pa. 467, 169 Atl. 209 (1933), *cert. denied*, 291 U.S. 680 (1934) (exemption statute involved); *see* Love v. First National Bank, 228 Ala. 258, 153 So. 189, 192 (1934); Walter v. Hartman, 67 S.W. 467 (Tenn. 1902).

108. Union Central Life Ins. Co. v. Flicker, 101 F.2d 857 (9th Cir. 1939); Davis v. Cramer, 133 Ark. 224, 202 S.W. 239 (1918); Equitable Life Assurance Society v. Hitchcock, 270 Mich. 72, 258 N.W. 214 (1935); Coalter v. Willard, 156 Va. 79, 158 S.E. 724 (1931).

109. Navassa Guano Co. v. Cockfield, 253 Fed. 883 (4th Cir. 1918).

110. This additional assumption must be made because at least nine states, including Tennessee, have statutes which protect the proceeds of life insurance policies from claims of creditors not only when left to specified beneficiaries, but also when left to the insured or his estate. See note 46, *supra*.

rowed the scope of the transfer in fraud of creditors, but a brief analysis of this process is necessary.

Suppose a state has a statute which applies only where the beneficiary is named as such in the policy. There has been a difference of opinion among the courts as to whether this type of statute is available only in aid of beneficiaries named as such when the policy is originally effected, or whether it also protects when the beneficiary is designated subsequent to the original issue by virtue of a change of beneficiary clause. Very respectable authority has taken the somewhat narrow Massachusetts view that, under a statute of this sort, the person whose claim to the proceeds arose only by a change of beneficiary or transfer subsequent to the original issue of the policy, cannot find shelter under the exemption statute. In such situations a transfer or change of beneficiary by an insolvent insured, when the proceeds otherwise would have been available to creditors had there been no change of beneficiary, is a fraud on creditors, even though the beneficiary presumably would have been protected had the policy originally named him beneficiary.[111] Under virtually an identical statute, however, it has been held that the statute is broad enough to protect the beneficiary from the insured's creditors even where the policy originally was payable to the insured's estate (and available to creditors) but in which the insured subsequently, while insolvent, changed the beneficiary to a third party within the protected class.[112]

Caution must be exercised in reading the exemption statutes. They vary greatly from state to state, and even the same state may give broader protection to one class of beneficiary than to others. Massachusetts furnishes a ready example. As we have just seen, Massachusetts takes the view that the statute requiring a beneficiary to be named in the policy will not protect a beneficiary who claims the proceeds where he has been made such under a change of beneficiary clause; such a change by an insolvent debtor is a fraud on creditors. However, Massachusetts has another statute which provides additional ways for making insurance immune from claims of creditors where a married woman is involved. This statute exempts insurance for a

111. Pope v. Carter, 210 Ala. 533, 98 So. 726 (1924); McCarthy v. Griffin, 299 Mass. 309, 12 N.E.2d 836 (1938); York v. Flaherty, 210 Mass. 35, 96 N.E. 53 (1911); Ionia County Savings Bank v. McLean, 84 Mich. 625, 48 N.W. 159 (1891). Later Michigan held that there can be no fraudulent conveyance by a transfer of insurance unless the policy has a cash surrender value. While this limits the *Ionia* case on that point, it does not affect the point for which the *Ionia* case is here cited. Equitable Life Assurance Society v. Hitchcock, 270 Mich. 72, 258 N.W. 214 (1935); Stoudt v. Guaranty Trust Co., 150 Misc. 675, 271 N.Y. Supp. 409 (Sup. Ct. 1933).

This distinct between the transfer of a policy taken out by the insured and payable to his estate, and obtaining a policy on the insured's own life and payable to his dependents had been thought to make a difference as to the fraudulent aspects of the situation, even in the absence of a controlling statute. Central Bank v. Hume, 128 U.S. 195, 9 Sup. Ct. 41, 32 L. Ed. 370 (1888).

112. Borg v. McCroskery, 120 N.J. Eq. 80, 184 Atl. 187 (1936).

married woman, not only where the policy is made payable to her, but also where the policy, after issue, is assigned, transferred or in any other manner made payable to her. Other states, including Tennessee, have similar statutes. Under this type of exemption statute, it is not a fraud on creditors for an insolvent insured to make a gratuitous transfer of the policy to the protected beneficiary, thus cutting out creditors, even though the creditor could have reached the proceeds had not the transfer been made.[113]

Of course, if the policy is assigned, or the beneficiary changed, to a person who is not within the class protected by the exemption statute, the law of fraudulent transfers as it exists in the absence of an exemption statute, should govern. There, we have just seen, the transaction can be successfully attacked by creditors as a fraudulent conveyance. That problem will come up in Tennessee, where the insurance exemption statutes protect only a limited class—the wife, children and dependent relatives. Insurance for the benefit of any other person is not insulated from the claims of the insured's creditors.[114] Tennessee has followed the predominant view that a gratuitous assignment of a policy by an insolvent insured to a person not protected by the exemption statute, is a fraud on creditors' allowing them to satisfy their claims out of the entire proceeds of the insurance.[115] There apparently has been no Tennessee case raising the question of a fraud on creditors where the beneficiary is changed to a nonprotected person, but the law governing the assignment of a policy should be applicable to a change-of-beneficiary situation.

Some exemption statutes have been construed to mean that, while the exemption may be given by assignment, that a good faith assignment is meant; and that an assignment by an insolvent insured is not one which will insulate against the claims of creditors. Under this view an assignment of an insurance policy by a debtor, while insolvent, is fraudulent and void as against creditors even though the transfer is to a member of the class which otherwise would have been protected.[116] At least one case has held that a change of beneficiary by an insolvent insured in contemplation of impending death so

113. York v. Flaherty, 210 Mass. 35, 96 N.E. 53 (1911); Bailey v. Wood, 202 Mass. 562, 89 N.E. 149 (1909); Teague v. Pilot Life Ins. Co., 200 N.C. 450, 157 S.E. 421 (1931); Pearsall v. Bloodworth, 194 N.C. 628, 140 S.E. 303 (1927).

114. Lunsford v. Nashville Savings & Loan Corp., 162 Tenn. 179, 35 S.W.2d 395 (1931).

115. Walter v. Hartman, 67 S.W. 476 (Tenn. 1902).

116. *In re* McKown's Estate, 198 Pa. 96, 47 Atl. 1111 (1901); Schad's Appeal, 88 Pa. 111 (1878). The statute then in effect in Pennsylvania required that there must be a bona fide assignment. The present Pennsylvania statute still provides for assignment of the policy as a way to insulate against claims of creditors, but "bona fide" has been dropped from the statute. PA. STAT. ANN. tit. 40, § 517 (1930). A Maryland court, however, in construing a statute that is almost an exact duplicate of the Pennsylvania statute involved in the *Schad* and *McKown* cases, reached a conclusion opposite to that reached by the Pennsylvania court, and held that an insolvent insured could make a bona fide assignment of a policy. Earnshaw v. Stewart, 64 Md. 513, 2 Atl. 734 (1886).

as to eliminate creditors, constitutes a fraud on creditors, although the new beneficiary ostensibly would have been entitled to the protection of the statute had the change been made when the insured had a normal expectancy of life.[117]

As to whether payment of insurance premiums by an insolvent insured is a fraudulent conveyance, there is a sharp division among the courts. Some authority considers it a fraud on creditors for the insured to pay premiums while insolvent, even for the protection of his dependents.[118] Under this view it is frankly recognized that the payment of premiums, while insolvent, is manifestly a voluntary transfer of property without providing for existing debts. The courts treating the payment of premiums as a fraudulent conveyance consider it no different from the situation where the insolvent transfers houses, lands, money or securities directly to his dependents, without receiving adequate consideration. By payment of premiums while insolvent the insured has withdrawn from creditors his assets with which he paid the premiums.

There is, however, authority to the effect that the payment of premiums by an insolvent debtor, where the insurance is for the benefit of his dependents, need not amount to a fraudulent conveyance. *Stokes & Son v. Coffey*[119] is perhaps the fountain-head for a curious doctrine that an insolvent man can insure his life for the benefit of his dependents and pay premiums while insolvent, and the dependents can keep the proceeds free from the claims of the insured's creditors, provided that only a *moderate* amount of income is used for this purpose.[120] This view, expressed by way of dictum in the *Stokes* case, received definite judicial sanction by the Supreme Court of the United States in *Central National Bank v. Hume*.[121] There the Court refused to allow a creditor to recover either the proceeds of the policy or the premiums paid by the insolvent insured, where a fraudulent intent of both parties to the transaction could not be made out. This ease went about as far as any in applying what the Court considered sound public policy to allow a debtor to protect his family from destitution after the death of the insured. The Court reasoned "that . . . public policy . . . recognizes the support of wife and children as a positive obligation in law as well as morals, [and]

117. La Borde v. Farmers' State Bank, 116 Neb. 33, 215 N.W. 559 (1927).

118. Fearn v. Ward, 80 Ala. 555, 2 So. 114 (1887); Merchants' and Miners' Transportation Co. v. Borland, 53 N.J. Eq. 282, 31 Atl. 272 (1895); Stokes v. Amerman, 121 N.Y. 337, 24 N.E. 819 (1890) (exempting statute involved); *see* Love v. First National Bank, 228 Ala. 258, 153 So. 189, 192 (1934); White v. Pacific Mutual Life Ins. Co., 150 Va. 849, 143 S.E. 340, 344 (1928). Of course there can be no fraudulent conveyance where the payment of the premiums did not diminish the insured's estate. Roberts v. Winton, 100 Tenn. 484, 45 S.W. 673 (1898) (insured gave worthless check which was paid by a third person).

119. 71 Ky. 533 (1871).

120. The creditors actually reached the fund in the *Stokes* case, but the court expressed the view by way of dictum. See Stokes & Son v. Coffey, 71 Ky. 533, 537-38 (1871).

121. 128 U.S. 195, 9 Sup. Ct. 41, 32 L. Ed. 370 (1888).

should be extended to protect them from destitution after the debtor's death, by permitting him not to accumulate a fund as a permanent provision, but to devote a moderate portion of his earnings to keep on foot a security for support . . . at least to the extent of requiring that . . . the fraudulent intent of both parties to the transaction should be made out."[122] Even in the absence of a statute authorizing such a result, this doctrine has had recognition by other courts.[123]

In the absence of a statute permitting it, the doctrine that an insolvent debtor may insure his life for the benefit of his dependents and pay premiums out of his estate, while sustained by substantial authority, seems to have its foundation in judicial sympathy for the dependents, rather than in any sound principle of the law of fraudulent conveyances. If such a graft is to be made upon the statutes governing fraudulent transfers, it is suggested that the legislatures, rather than the courts, should perform the operation.

At least one state in its over-zealous efforts to protect the beneficiaries of insurance policies against the creditors of the insured, has carried the doctrine of the *Hume* case, as to what must be proved to make out a case showing fraud of creditors, one illogical step further. In permitting an insolvent insured to carry insurance for beneficiaries, free from claims of the insured's creditors, a Texas court proclaimed that an intent to defraud creditors is not made out unless it is shown, not only that the insured was insolvent, but also that the beneficiary and the insurance company knew of insured's intent to defraud creditors.[124] Requiring the creditor to prove as a prerequisite to recovery that the beneficiary, to say nothing of the insurance company, was a party to the fraud, is virtually an impossibility, and such a requirement finds no basis in the law of fraudulent conveyances. In the case of a gift by an insolvent debtor (the equivalent of gratuitously selecting a beneficiary of an insurance policy) the intent of the donee (beneficiary), much less of the insurance company, is immaterial in determining whether there is a fraudulent conveyance. The rule that, to set aside a fraudulent conveyance the fraud must be brought home to the transferee, as well as the transferor, has no application to voluntary transfers, supported by no consideration.[125]

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122. Central Bank v. Hume, 128 U.S. 195, 211-12, 9 Sup. Ct. 41, 32 L. Ed. 370 (1888).

123. Hendrie & Bolthoff Mfg. Co. v. Platt, 13 Colo. App. 15, 56 Pac. 209 (1899); *see* Ramsey v. Nichols, 73 Ill. App. 643, 655 (1898).

124. San Jacinto Bldg., Inc. v. Brown, 79 S.W.2d 164 (Tex. Civ. App. 1935). Texas had an exemption statute, but no mention was made of it by the court. TEX. REV. STAT. ANN. art. 5068(a) (1940). This exemption statute now is found in TEXAS STAT. ANN., The Insurance Code of 1951 art. 21.22 (1951).

125. Love v. First National Bank, 228 Ala. 258, 153 So. 189 (1934); Security Trust Co. v. Silverman, 210 Cal. 578, 292 Pac. 636 (1930); Gould v. Fleitman, 188 App. Div. 759, 176 N.Y. Supp. 631 (1st Dep't 1919); Raleigh Co. v. Garland, 22 Tenn. App. 256, 120 S.W.2d 1005 (E.S. 1938); TENN. CODE ANN. § 7274 (Williams 1934), which is a section of the Uniform Fraudulent Conveyance Act, which has been adopted in 20 states, including Tennessee. See 9A U.L.A. 42 for the states adopting it. Other states make it even more difficult for a man to defraud his creditors by giving away his

Assuming that it is decided that a fraudulent conveyance case has been made out where the insolvent debtor has paid premiums on insurance policies, the next question is the extent of the creditor's recovery. One view, which developed early, gave the creditors all the proceeds of the policy.[126] The creditors were permitted to claim the whole policy as a "trust fund."

Other courts have given a clear-cut answer to that reasoning, however, in allowing the creditors to reach only the premiums paid, plus interest. The creditors, these courts reason, are not like the beneficiary of a trust who traces misappropriated funds, for the reason that a debtor does not hold his estate in trust for his creditors. If a trustee buys an insurance policy with misappropriated funds, then all the insurance can properly go to the beneficiary, even though the amount of the insurance is much larger than the amount of the misappropriated money.[127] The defrauded person then made an involuntary investment.

A creditor who sets aside a fraudulent conveyance, however, is entitled to no more than his debtor transferred. Only to the extent the insured's funds have been withdrawn from his estate to carry insurance can it be said that the insurance has prejudiced creditors. So, the better and more logical view would allow the creditor to reach only the amount of premiums fraudulently paid, with interest.[128] This is the view approved by text writers.[129] Since the beneficiary can keep the proceeds of the policy, less the total amount of premiums paid by the insolvent debtor, this view affords a measure of financial protection to the beneficiaries against want and suffering, and at the same time the creditors have not been fended off by reason of a fraudulent conveyance. As we will see presently, the great bulk of modern statutes exempting insurance from the claims of the insured's creditors are in accord with this view, permitting creditors to recover the amount of premiums paid in fraud of creditors.

Having now sketched in some background for the fraudulent conveyance aspects of insurance by payment of premiums by the insured while insolvent, we will now focus our attention more closely on the impact of the exemption statutes on this problem. What has been the effect on the fraudulent conveyance features of the statutes exempting insurance from the claims of creditors?

As we have already had occasion to observe, some statutes place a limit on the amount of insurance exempted from claims of creditors. This is

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property. The Virginias have virtually a fraud-proof statute. Their legislatures have expressly provided that every gift, conveyance, assignment or transfer which is not upon consideration deemed valuable in law shall be void as to creditors at the time it was made. VA. CODE § 55-81 (1950); W. VA. CODE ANN. 3987 (1949).

126. Fearn v. Ward, 80 Ala. 555, 2 So. 114 (1887); Merchants' and Miners' Transportation Co. v. Borland, 53 N.J. Eq. 282, 31 Atl. 272 (1895).

127. See pp. 777-79, *supra*, "Insurance Purchased with Embezzeled Funds."

128. Clay County Bank v. Wilson, 109 W. Va. 684, 158 S.E. 517 (1930); *see* White v. Pacific Mutual Life Ins. Co., 150 Va. 849, 143 S.E. 340, 344 (1928).

129. 1 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 178 (Rev. ed. 1940).

done either by exempting a stated face amount of insurance or an amount which can be bought with a certain annual premium—say $250 or $500. Other statutes place no restrictions on the amount of exempt insurance. Most of the modern exemption statutes now have a provision concerning premiums paid in fraud of creditors. This appears to be true especially in states which place no limit on the amount of insurance that can be made exempt from creditors of the insured. Most of the states which place no restriction on the amount of exempt insurance impose the restriction that where the insured pays premiums in fraud of creditors, the creditors have recourse against the proceeds of the insurance, usually for the amount of the premiums or the premiums plus interest.[130]

The statutes limiting the amount of insurance that can be made exempt from the insured's creditors often provide also that premiums paid in fraud of creditors are recoverable by the creditors.[131] Where the amount of insurance exceeds the exemption limitations provided by the statute, the creditors can satisfy their claims out of the proceeds of the insurance benefits in excess of the exemption provided. This type of statute may be interpreted as giving an absolute right to the creditors to reach the insurance in excess of the exempt amount, without regard to the insured's financial condition when he paid the premium,[132] or the court may imply a condition of insolvency on the part of the insured when he paid the premiums and require that the proceeds in excess of the exempt amount can be reached only as a fraudulent transfer.[133] Even though an exemption statute does not provide expressly that premiums paid in fraud of creditors can be reached by the creditors, nevertheless the proceeds of the insurance, in excess of the amount exempt by statute may be liable for the premiums paid by the insured while insolvent.[134]

130. Ark. Stat. Ann. § 66-511 (Cum. Supp. 1951); Colo. Stat. Ann. c. 87, § 40 (Cum. Supp. 1951); Conn. Rev. Gen. Stat. § 6150 (1949); Ga. Code, tit. 56, § 905 (1937); Ill. Ann. Stat. c. 73, § 850 (1936); Ky. Stat. Ann. §§ 654-55 (Carroll 1936); Me. Rev. Stat. c. 156, § 21 (1944); Mass. Ann. Laws c. 175 §§ 125, 126 (1948); Mich. Stat. Ann. § 24.287 (Moore 1943); N.H. Rev. Laws c. 327, §§ 1-3 (1942); N.J. Stat. Ann. §§ 17:34-28, 17:34-29 (1939); N.Y. Ins. Law § 166; N.C. Gen. Stat. c. 58, § 206 (1950); Ohio Gen. Code Ann. §§ 9394, 9397 (1938); Okla. Stat. tit. 36, § 211 (1941); Ore. Comp. Laws Ann. tit. 101, § 514 (1940); R.I. Gen. Laws c. 153, § 13 (1938); Wash. Rev. Stat. Ann. § 7230-1 (Supp. 1940); W. Va. Code Ann. § 3359 (Supp. 1951); Wyo. Comp. Stat. Ann. c. 52, § 514 (1945).

131. Wis. Stat. § 272.18(19) (1949) ($5,000 limit); S.C. Code Ann. § 7985 (1942) ($500 annual premium limit).

132. Bartram v. Hopkins, 71 Conn. 505, 42 Atl. 645 (1899). Connecticut has now removed the limitation on the amount of exempt insurance. Conn. Rev. Gen. Stat. § 6150 (1949).

133. Harriman Nat. Bank v. Huiet, 249 Fed. 856 (4th Cir. 1917) (construing the South Carolina statute).

134. See Johnson v. Bacon, 92 Miss. 156, 45 So. 858 (1908), where the statute exempts $10,000 from creditors. The entire amount paid for premiums by the insured while insolvent on a $25,000 policy was recoverable out of the insurance in excess of $10,000. Love v. First National Bank, 228 Ala. 258, 153 So. 189 (1934).

Under the exemption statutes which permit the creditors to recover premiums paid with intent to defraud creditors, there has arisen considerable controversy as to what must be shown to convince the court that there was such a fraudulent undertaking by the insured. We have already noticed that some of the earlier cases, generally not involving an exemption statute, decided that the purchase of insurance during insolvency of the insured for the benefit of his wife and children was a fraud on creditors.[135] Likewise, there is authority, under the insurance exemption statutes, which holds that an "intent to defraud" is made out by proving that the insured was insolvent when he paid the premium.[136]

Under the interpretation of some of the exemption statutes providing that premiums paid in fraud of creditors can be recovered, it is clear, however, that mere insolvency of the insured at the time he paid the premiums is not enough to show an intent to defraud creditors. The policy of the law favoring the widow and orphan may be so strong that a showing of insolvency of the insured at the time he paid the premiums is not enough to satisfy the court that there was an intent to defraud creditors. Unless the creditor produces other evidence to prove an intent to defraud, he will fail.[137]

We have just seen that even in the absence of a statute permitting it, some courts would allow an insolvent insured to devote a moderate amount of his income to the payment of insurance premiums for the benefit of his dependents, without having the transaction struck down as a fraud on the insured's creditors. The same judicial thinking set the tone for a great many of the courts when they were called upon to decide whether the payment of premiums violated the provision of the insurance exemption statutes which forbid a man to pay premiums in fraud of his creditors, and allow the premiums to be recovered by the creditors out of the proceeds of the insurance thus bought. Thus, many courts which have had to decide whether the insolvent insured paid his premiums in fraud of his creditors, in violation of the prohibition in the exemption statute, have continued to decide that an insolvent insured can use a *reasonable* amount of his income to purchase insurance, without intending to defraud his creditors.[138] Under this view the courts

135. Fearn v. Ward, 80 Ala. 555, 2 So. 114 (1887); Merchants' and Miners' Transportation Co. v. Borland, 53 N.J. Eq. 282, 31 Atl. 272 (1895).

136. Houston v. Maddux, 179 Ill. 377, 53 N.E. 599 (1899); Smith's Adm'x v. Milton, 171 Ky. 819, 188 S.W. 877 (1916); Goren v. Loeb, 124 N.J. Eq. 335, 1 A.2d 861 (1938).

137. Doethlaff v. Penn Mut. Life Ins. Co., 117 F.2d 582 (6th Cir. 1941), *cert. denied sub nom.* Gardner v. Doethlaff, 313 U.S. 579 (1941) (construing Ohio's exemption statute); Betten v. Williams, 277 Ill. App. 353 (1934); Irving Bank v. Alexander, 280 Pa. 466, 124 Atl. 634 (1924). *But cf.* Houston v. Maddux, 179 Ill. 377, 53 N.E. 599 (1899).

138. Doethlaff v. Penn Mut. Life Ins. Co., 117 F.2d 582 (6th Cir. 1941), *cert. denied sub nom.* Gardner v. Doethlaff, 313 U.S. 579 (1941); Ross v. Minnesota Life Ins. Co., 154 Minn. 186, 191 N.W. 428 (1923); Irving Bank v. Alexander, 280 Pa. 466, 124 Atl. 634 (1924); *see* Parks v. Parks' Ex'rs, 288 Ky. 350, 156 S.W.2d 90 (1941). One

get into all sorts of troublesome questions in determining what is a reasonable amount of income.

What has been the attitude of the Tennessee courts with respect to the payment of insurance premiums by an insolvent insured, in light of the exemption statutes? In the endeavor to accommodate the competing demands that the head of the family should make provisions for his dependents, and the idea that requires a debtor to use his resources to pay his debts, Tennessee has gone as far as any other state in favoring the support of dependents.

As we have recently seen, the exemption statutes of many of the states provide that premiums paid by the insured in fraud of creditors can be recovered by the creditors. It is especially significant that a provision of that sort nearly always appears in the statutes of the states where there is no statutory limit on the amount of insurance that can be placed beyond the reach of creditors. Tennessee is different. She is in that class of states whose statutes do not place any limit on the amount of insurance which can be exempted from the claims of creditors of the insured, but the Tennessee statutes make no provision by which creditors of the insured can reach premiums paid in fraud of creditors. Thus, in Tennessee there is no limit on the amount of insurance that can be made exempt from the claims of creditors, and there does not appear any limit to the extent that an insolvent debtor can go in putting his property beyond the reach of creditors through the use of the insurance device.

Tennessee courts share the feeling of a sister state that the purpose of the exemption statutes is to make the exempt amount "sacred and secure from the grasp of the law" and cannot be made liable for the debts of the insured, even for premiums paid by the insured while he is insolvent.[139] In sweeping language the Tennessee court has declared that the "exemption is valid as against crditors existing at the inception of the insurance even though the insured may have been then and may have continued to be insolvent, devoting his entire estate to the payment of insurance premiums."[140] The Tennessee court has made it crystal clear that, under the statute, "the fact of in-

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authority on insurance law says the weight of authority supports the doctrine that an insolvent husband may purchase a reasonable amount of insurance for the benefit of his family, without any right on the part of creditors to claim the amount spent for premium was a fraud on creditors, in the absence of showing an actual fraudulent intent on the part of the husband. 2 COUCH, CYCLOPEDIA OF INSURANCE LAW § 330 (1929).

139. Johnson v. Bacon, 92 Miss. 156, 45 So. 858, 859 (1908). Mississippi, however, has a limit on the amount of insurance that can be placed beyond the reach of insured's creditors. MISS. CODE ANN. §§ 308, 309 (1942).

140. Third Nat. Bank v. Hall, 30 Tenn. App. 586, 594, 209 S.W.2d 46, 49 (M.S. 1947). For square holdings that payment of premiums by an insolvent insured is not a fraud on creditors, see Harvey, Adm'r v. Harrison, 89 Tenn. 470, 14 S.W. 1083 (1891); Harrington v. Traders' Bank, 3 Tenn. Cas. 94 (1879).

solvency cannot be looked to; for the exemption is unconditional, and its express object was to withdraw a fund from creditors."[141]

While the Tennessee statutes exempting insurance say nothing with respect to premiums paid in fraud of creditors, Tennessee does have very strict laws relating to transactions in fraud of creditors. In addition to the essential provisions of the old English fraudulent conveyance statute[142] Tennessee has also adopted the very comprehensive Uniform Fraudulent Conveyance Act.[143] This Uniform Act provides, among other things, that every "conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent is fraudulent as to creditors without regard to his actual intent, if the conveyance is made or the obligation is incurred without a fair consideration."[144] Adopting the definitional sections of the Uniform Act, Tennessee defines a "conveyance" as including "every payment of money, assignment, release, transfer, lease mortgage, or pledge of tangible or intangible property, and also the creation of any lien or encumbrance."[145] Taking these several fraudulent conveyance statutes together, the net effect is to cover payment of premiums, unless that aspect of a fraudulent conveyance has been withdrawn by the exemption statutes. The Tennessee court ostensibly is of the opinion that the legislature did not intend the fraudulent conveyance statutes to have any application to insurance exemption statutes. The court has thus apparently placed the insurance exemption beyond the pale (and stigma) of a fraudulent transfer, although the exemption statutes do not provide expressly that insurance should be placed in any such privileged sanctuary.

Tennessee is not alone in this interpretation, however. Pennsylvania has an insurance exemption statute on "all-fours" with section 8458 of the Tennessee statute.[146] The exemption statute of Pennsylvania, like that of

141. Harvey, Adm'r v. Harrison, 89 Tenn. 470, 473, 14 S.W. 1083, 1084 (1891).

142. TENN. CODE ANN. § 7832 (Williams 1934).

143. *Id.* §§ 7271-83.

144. Uniform Fraudulent Conveyance Act § 4, 9A U.L.A. 73 (1951) (adopted in 20 states).

145. TENN. CODE ANN. § 7271 (Williams 1934).

146. The Pennsylvania statute reads: "The net amount payable under any policy of life insurance or under any annuity contract upon the life of any person, heretofore or hereafter made for the benefit of or assigned to the wife or children or dependent relative of such person, shall be exempt from all claims of the creditors of such person arising out of or based upon any obligation created after the passage of this act, whether or not the right to change the named beneficiary is reserved by or permitted to such person." PA. STAT. ANN. tit. 40, § 517 (1930). The Tennessee statute provides: "The net amount payable under any policy of life insurance or under any annuity contract upon the life of any person made for the benefit of, or assigned to, the wife and/or children, or dependent relatives of such persons, shall be exempt from all claims of creditors of such person arising out of or based upon any obligation credited after the effective date of this Code, whether or not the right to change the named beneficiary is reserved by or permitted to such person." TENN. CODE ANN. § 8458 (Williams 1934). See also § 8456.

Tennessee, makes no provision by which premiums paid in fraud of creditors are recoverable from the otherwise exempt insurance. The highest tribunal in Pennsylvania has interpreted this statute in the same fashion as the Tennessee court in holding that an insolvent can pay premiums and that it is not considered a fraud on creditors.[147]

An eminent present-day authority is of the opinion that these exemption statutes should not preclude the creditors from enforcing payment out of the proceeds of the insurance to the extent to which payments of premiums are made in fraud of creditors.[148] Of course, if the legislatures of the various states have, in fact, declared their respective public policy to be that the care of insurance beneficiaries (often not relatives nor dependents of the insured) is paramount to the prevention of fraud on creditors, that settles the problem. The exemption statutes then simply override the fraudulent conveyance doctrines where the two come in conflict. The writer ventures to suggest, however, that the various legislatures would be surprised more than a little with some of the constructions placed on some of the exemption statutes, particularly with respect to what must be shown in order to constitute a fraudulent conveyance. Some of the interpretations by the courts are grafts upon the exemption statutes, pure and simple.

So, in Tennessee the exemption statutes are simply treated as a legislative (and judicial) declaration of public policy in Tennessee to the effect that it is of paramount importance that the debtor family be given virtually unlimited protection from their creditors. The social function performed by securing the proceeds of insurance to dependents, although they need not be destitute, is thought by the court to be of more importance than that served by using the proceeds to meet the demands of creditors. In helping the widow and orphan before the court in the particular case at bar, however, the court may be unmindful of the widow and orphan of the creditor.

A word needs to be said concerning how the trustee in bankruptcy fits into the picture with respect to the fraudulent conveyance aspects of insurance. The National Bankruptcy Act expressly provides that the trustee can set aside transactions that are fraudulent under either any federal law or under any applicably state law.[149] The trustee may, therefore, invoke any state law that makes a transaction fraudulent as to creditors, or he may rely upon the Uniform Fraudulent Conveyance Act, as re-enacted in a provision of the Bankruptcy Act itself,[150] whichever is more favorable to the trustee.

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147. Potter Title & Trust Co. v. Fidelity Trust Co., 316 Pa. 316, 175 Atl. 400 (1934); Irving Bank v. Alexander, 280 Pa. 466, 124 Atl. 634 (1924).

148. 3 Scott, Trusts § 508.4 (1939).

149. 64 Stat. 26 (1950), 11 U.S.C.A. § 110(e) (Supp. 1951).

150. 54 Stat. 835 (1940), 11 U.S.C.A. § 107(d) (Supp. 1951).

Thus the trustee can successfully attack an insurance transaction as a fraud on creditors, if it violates the relevant fraudulent conveyance provisions of the Bankruptcy Act, or if it is a fraudulent transfer under a controlling state law. The trustee will, of course, find his recovery blocked, if a relevant state insurance exemption statute sanctions the transaction called into judgment, since the Bankruptcy Act respects the exemptions created by the applicable state law.