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Bankruptcy--Life Insurance--Trustee Not Entitled to Case Surrender Value of Policy

Arthur Mark Recht
West Virginia University College of Law

Bankruptcy — Life Insurance — Trustee Not Entitled to Cash Surrender Value of Policy

The bankrupt possessed an insurance policy containing a clause which reserved the right to change the beneficiary. The trustee attempted to secure the cash surrender value of the policy as part of the bankrupt's assets. The referee in bankruptcy found that the trustee was entitled to the receipt of the cash surrender value of the policy. *Held* — In reversing the referee, that under W. VA. CODE ch. 33, art. 6, § 27(a) (Michie Supp. 1960), such proceeds from a life insurance policy are exempt from creditors. *In re White,* 185 F. Supp. 609 (N.D. W. Va. 1960).

To what extent is a trustee in bankruptcy entitled to the proceeds from the cash surrender value of a life insurance policy? This problem arises, in the same form, in three distinct areas: first, where the policy does not contain a clause which reserves the right to change the beneficiary; second, where a clause is contained in the policy, reserving the right to change the beneficiary; third, where states have enacted insurance exemption legislation. A discussion of the authorities limited to these three areas would be germane.

It is almost a universal doctrine that, in the absence of any explicit right to change the beneficiary, a beneficiary of a life insurance policy acquires a vested right of which he cannot be deprived. 2 WILLISTON, CONTRACTS § 396 (rev. ed. 1936); *Central Bank of Washington v. Hume,* 128 U.S. 195 (1888); *Hamilton v. McLain,* 83 W. Va. 433, 98 S.E. 445 (1919).

To allow the trustee in bankruptcy to secure proceeds of a life insurance policy, ultimately establishes the corollary that a vested interest in the beneficiary is destroyed. On the basis of this rationale, the courts hold that the trustee is not entitled to the cash surrender value of a life insurance policy where no power is reserved to change the beneficiary. *In re Reiter,* 58 F. 2d 631 (2d Cir. 1932).

Where a life insurance policy explicitly reserves the power in the insured to change the beneficiary, the beneficiary does not receive a vested interest, but possesses a mere expectancy. *Bennett v. Bennett,* 135 W. Va. 3, 62 S.E.2d 273 (1950); *Smith v. Coleman,*

184 Va. 259, 35 S.E.2d 107 (1945); *Mutual Benefit Life Ins. Co. v. Swett,* 222 Fed. 200 (6th Cir. 1915). To enable the trustee to secure the cash surrender value of a policy reserving the right to change the beneficiary would not be a violation of any vested right, the trustee is merely destroying an already defeasible interest. *Cohen v. Samuels,* 245 U.S. 50 (1917).

The Bankruptcy Act § 70(a) (3), (5), 30 Stat. 566 (1898), as amended, 11 U.S.C. § 110(a) (3), (5) (1952), provides that property which the bankrupt has the power to acquire for his own benefit shall vest in the trustee in bankruptcy.

This section of the Bankruptcy Act is implemented in the *Cohen* case, *supra,* where the court reasoned that even though a policy may not explicitly state that it is payable to the insured, this purpose could be effected by a simple declaration changing the beneficiary. While such a power could facilitate the execution of a fraud on creditors, *In re Grant,* 21 F.2d 88 (W.D. Wis. 1927), the more immediate effect of this doctrine was to deprive a bankrupt's dependents of life insurance protection. Consequently, numerous exemption statutes were enacted to alleviate this onerous result.

The principal case is representative of cases which are decided according to some state exemption statute. It is interesting to note that the insurance policy in question in the principal case included a clause which reserved the right to change the beneficiary. To reconcile the conclusion in the principal case with the authorities listed in the previous area, it is necessary to examine the West Virginia statute which specifically relates to this problem.

If a policy of insurance is effected by a person either on his own or another's life, in favor of another person other than himself, the lawful beneficiary of such a policy shall, in the absence of fraud, be entitled to the proceeds and avails of such a policy against creditors, *whether or not the power is reserved to change the beneficiary.* W. VA. CODE ch. 33, art. 6, § 27(a) (Michie Supp. 1960).

The rights of an insured's creditors under this statute have never been passed on before in West Virginia. The statute, however, has been the subject of consideration on two previous occasions, *Bennett v. Bennett,* 135 W. Va. 3, 62 S.E.2d 273 (1950), and *Scruggs v. Jefferson Standard Life Ins. Co.,* 125 W. Va. 89, 23 S.E.2d 74 (1942). The conclusion in the *Bennett* case could

not lend assistance to the court in the principal case as it was not concerned with the rights of creditors of the insured to the proceeds of the policy. The *Scruggs* case, *supra,* merely recognized the existence of the statute and did not apply it to reach its conclusion.

Since this is a case of first impression relative to this area, it is appropriate to examine, by way of analogy, authorities of other jurisdictions relating to similar statutes.

First, to what extent do these state statutes govern the decisions under the federal Bankruptcy Act? This question is properly answered in *Holden v. Straton,* 198 U.S. 202 (1905), where the court held that state statutes exempting insurance proceeds are applicable under the federal Bankruptcy Act. Bankruptcy Act § 70(a), 30 Stat. 566 (1898), as amended, 11 U.S.C. § 110(a) (1952), provides that where property is of the nature that will be included in the bankrupt's assets, then it shall only be excluded to the extent that it is exempt under state law.

In *In re Beckman,* 50 F. Supp. 339 (N.D. Ala. 1943), the court interpreted an Alabama statute which is essentially the same as that of West Virginia. CODE OF ALA. RECOMPILED tit. 7, § 624 (1958). This court held that when an insurance policy is exempt under state law, the trustee would have no right to the proceeds of the policy, even though the insured has reserved the right to change the beneficiary.

Similar holdings may be found in *Schwartz v. Seldin,* 153 F.2d 334 (2d Cir. 1946), interpreting N.Y. INS. LAWS § 166, and in *In re Fogel,* 164 F.2d (7th Cir. 1947), interpreting BURNS'S ANN. STAT. IND. § 39-4210 (1952). These cases seem to be in full accord with the prevailing view throughout the country.

The conclusion of the principal case makes it clear that West Virginia is in accord with the weight of authority in those jurisdictions which resolve this problem realistically through the use of legislative enactment.

Arthur Mark Recht