

Life insurance policy exempt in Chapter 7 bankruptcy

Shielded under state law despite being for benefit of trust

By: Eric T. Berkman September 13, 2017



A Chapter 7 debtor could claim an exemption on the cash surrender value of a life insurance policy that named as beneficiary a revocable family trust, a U.S. Bankruptcy Court judge has found.

Under G.L.c. 175, §125, the owner of a life insurance policy can shield it from creditors as long as he is not the policy's beneficiary, the beneficiary has not changed since the policy took effect, and the beneficiary has an "insurable interest" in the insured.

Chapter 7 Trustee Debora A. Casey of Hingham argued that, based on the 2005 U.S. Bankruptcy Court decision in *In re Chevalier*, the exemption should be denied.

In *Chevalier*, the judge determined that a debtor's life insurance policy designating his probate estate as beneficiary did not qualify for the statutory exemption because he could alter his estate plan any time to favor those without an insurable interest.

Casey contended that the debtor's trust presented the same issues, but Judge Joan N. Feeney disagreed.

"[B]ankruptcy courts look to substance rather than form to ascertain whether there are beneficiaries with insurable interests in insurance policies under [Chapter 175, Section 125]," Feeney wrote. "[T]he Trust document, which sets forth the identity of beneficiaries, namely, the Debtor's children and stepson, establishes that they have insurable interests."

The 16-page decision is *In Re: Volk, Anthony J.*, Lawyers Weekly No. 04-043-17. The full text of the ruling can be found at [here](#).

'Have to be wary'

Debtor's counsel Roger C. Stanford of New Bedford said the decision recognizes the need for more flexibility in exemptions.

"I've had a great deal of reservations about the life insurance exemptions which focus on the beneficiary without acknowledging that life happens," he said. "People die or get divorced. People have children or adopt them. In one of the cases Judge Feeney quoted, the people got divorced and the Probate Court ordered that the beneficiaries be changed. Then the Bankruptcy Court disqualified the policy."

Adam J. Ruttenberg of Boston, who represented the trustee, said Feeney's ruling was not surprising as exemptions are generally construed in favor of the debtor.

"I thought given the decision in *Chevalier*, it's not so easy for a debtor to get the exemption where the beneficiary [of a life insurance policy] is an entity and not a human being — [and that] the same logic would apply here," Ruttenberg said. "But Judge Feeney saw it differently."

Steven Weiss of Springfield, the trustee in the *Chevalier* case, said it was not difficult to distinguish *Volk* from *Chevalier*.

In *Volk*, the beneficiary of the life insurance policy was the trust, "and the beneficiaries of the trust were [the debtor's] kids," Weiss said. "So it was easy for the judge to determine that all the beneficiaries had an insurable

interest. In *Chevalier*, the judge couldn't make that determination because there wasn't enough evidence of who had any interest [in Chevalier's probate estate], let alone whether it was an insurable interest."

David R. Chenelle, a bankruptcy lawyer in Westford, said he handled a case similar to *Volk*, though his client had seven different whole-life policies. He said he had to look at the original insurance applications and current beneficiary terms to make sure they had not changed and that their relationships to the debtor would give them an insurable interest.

"You have to be wary in these situations," he said. "I'd use *Chevalier* and *Volk* in tandem to make sure Section 125 is applicable and to do so before you apply for bankruptcy."

Donald R. Lassman, a Needham bankruptcy attorney, said *Volk* is particularly helpful because so many lawyers mistakenly believe the cash value of a life insurance policy is per se exempt under Massachusetts law and pay no heed to the policy beneficiaries.

"This decision should dispel that myth and reinforce the importance of carefully investigating life insurance policies to determine if the policy is indeed exempt," he said. "The decision also highlights the complexity added to the analysis when the policy beneficiary is a trust ... and is a reminder that the designation of the insured's probate estate as policy beneficiary is fatal to a successful exemption claim because the original beneficiaries and their insurable interests are indeterminate."

However, Boston attorney Joseph L. Bierwirth Jr., who handles trust litigation, was puzzled by Feeney's analysis.

"Assets held in revocable trusts are, for the most part, treated as the donor's property during lifetime," he said. "Such trusts are often called 'will substitutes.' For these reasons, I have a hard time distinguishing a life insurance policy payable on death to the owner's estate from one payable to a revocable trust."



Donald R. Lassman said Volk is particularly helpful because so many lawyers mistakenly believe the cash value of a life insurance policy is per se exempt under Massachusetts law and pay no heed to the policy beneficiaries. "This decision should dispel that myth," he said.

Claimed exemption

Debtor Anthony J. Volk filed for Chapter 7 bankruptcy on Feb. 24, 2016. In his petition, he claimed an exemption pursuant to Chapter 175, §125 in a whole-life policy with Guardian Life Insurance Co. of America.

The original and sole beneficiary of the policy, which had a cash surrender value of \$23,527, was the Volk Family Revocable Trust. The trust had been created by the debtor and his late wife in 1993.

The trust set out provisions relating to a "marital share," a "children's share" and a "family share" relating to Volk's daughters and his stepson. In 2004, the debtor amended the trust to specifically name his son, Warren Volk, as entitled to a family share.

The trustee objected to the exemption, contending that the trust as policy beneficiary in the case had the same qualities that the Bankruptcy Court found wanting with respect to the probate estate as policy beneficiary in *Chevalier*.

Specifically, the trustee argued, the Volk trust was revocable with the debtor retaining the right to change the trust beneficiaries, which, in fact, he did when he amended the trust in 2004.

Just as a simple alteration to the estate plan in *Chevalier* could undermine Chapter 175, §125 by retaining the exemption while changing the policy beneficiary, so too could a change in trust beneficiaries here, the trustee argued.

The debtor, however, distinguished *Chevalier* by arguing that the named trust beneficiaries — namely his children and stepson — had an insurable interest. He also argued that while distributions under the trust may have changed when he amended it to specifically name his son, the amendment did not change the identity of the beneficiaries.

Insurable interests

Feeney agreed with the debtor, explaining that bankruptcy courts look to substance rather than form to determine whether the cash value of a life insurance policy is exempt under the statute.

In other words, Feeney said, the fact that a policy beneficiary is an entity, such as a trust or a probate estate, rather than an individual is not dispositive. The determining factor is whether the policy beneficiary has an insurable interest.

Here, Feeney said, the trust was the beneficiary of the policy from the start and, while the trust had been amended to include a share for the debtor's son, the other trust beneficiaries remained unchanged.

"Given that '[t]he overriding purpose of this statutory scheme is to protect the interests of life insurance beneficiaries from the creditors of the person who purchased or owns the policy,' the Court concludes that the Debtor has established that the beneficiary has not changed and that the Trust document, which sets forth the identity of beneficiaries, namely, the Debtor's children and stepson, establishes that they have insurable interests," Feeney said, quoting *In re Chung-I Liang*, a 2012 Bankruptcy Court decision.

More specifically, Feeney said, children have an insurable interest in the lives of their parents by virtue of their status alone, and they retain that interest into adulthood, even if they do not rely on the parent for support.

Accordingly, she concluded, the trustee's objection should be overruled.

In Re: Volk, Anthony J.

THE ISSUE: Could a Chapter 7 debtor claim an exemption on the cash surrender value of a life insurance policy that named as beneficiary a family trust?

THE DECISION: Yes (U.S. Bankruptcy Court)

LAWYERS: Roger C. Stanford of Lang, Xifaras & Bullard, New Bedford (debtor)

Adam J. Ruttenberg and Justin Kesselman, of Posternak, Blankstein & Lund, Boston (trustee)

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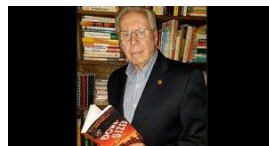
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