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STATE EXEMPTION STATUTES IN BANKRUPTCY

Within the last few years the American lawyer has begun to realize the importance of bankruptcy as a branch of modern law. Before that time this subject was looked upon with disfavor, as an unnecessary evil which hindered creditors in getting at the assets of an insolvent and which encouraged insolvency on the part of debtors. Because of the statutory existence of Bankruptcy and because of its rigid and arbitrary rules it is a subject hard to master and has brought into being a class of lawyers who specialize in Bankruptcy and who are finding it quite a profitable field. Thus while the value of bankruptcy as an essential part of the law is slowly being recognized, the great majority of lawyers know little about the subject and are too content to let it alone.

It is to be regretted that bankruptcy has been so widely misunderstood. It is an exceedingly interesting subject and in spite of its stiff, formal phrasing every section of the Bankruptcy Act contains one or more hidden problems of the most interesting kind.

In Missouri we have a statute which reads as follows: "Policy for benefit of Married Women—Any policy of Insurance heretofore or hereafter made by any insurance company on the life of any person, expressed to be for the benefit of the wife of the insured, shall inure to her separate benefit, independently of the creditors, executors and administrators of the husband; provided, however, that in the event of the death or divorcement of the wife before the decease of the husband he shall have the right to designate another beneficiary upon written notice to the company, but such notice shall not be effected, unless endorsed upon the policy by the president or vice-president and secretary of the Company issuing the policy. But when the premiums paid in any year out of the funds or property of the husband shall exceed the sum of five hundred dollars, such exemptions from such claims

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shall not apply to so much of said premiums so paid as shall be in excess of five hundred dollars (but such excess shall inure to the benefit of his creditors)."*

The case of Haven v. Home Co. (149 Mo. App. 291), declared that this statute was in the nature of an exemption statute, and thus it follows that under this statute such policies of insurance are exempt from the control of a trustee in bankruptcy of the husband's estate under the Bankruptcy Act which provides:

"Sec. 6. Exemption of Bankrupts—(a) This act shall not affect the allowance to bankrupts of the exemptions which are prescribed by the state laws in force at the time of the filing of the petition in the state wherein they have had their domicile for the six months or the greater portion thereof immediately preceding the filing of the petition."

This seems easy enough. Insurance taken out for the benefit of a wife is not liable for the husband's debts, even though taken out on the husband's life, under the state laws; and under the Bankruptcy Act such insurance is free from the control of the husband's trustee in bankruptcy under the section immediately above, of the Bankruptcy Act. But what would be the case if the wife obtained a divorce either before or after the beginning of bankruptcy proceedings and the husband did not exercise his right to change the beneficiary? Further, let us suppose that the control of the policy is so largely in the hands of the husband that it could hardly be said to be a policy for the benefit of the wife, would such a policy be exempt under above named sections? It seems at first blush, that if the husband, under the terms of the policy, could change the beneficiary at his will, the policy would not be exempt from the control of the trustee under Sec. 70 (a) of the Bankruptcy Act which says in part:

"Title to Property—(a) The trustee of the estate of a

*Note—Sec. 6944 R. S. Mo. 1909, Sec. 6149 R. S. Mo. 1919.

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bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt, to all,........(b) property which prior to the filing of the petition he could *by any means have transferred* or which might have been levied on and sold under judicial process against him..............."

Now it seems that if a bankrupt had a policy of insurance on his life for the benefit of his wife, but which by its terms allowed him to change the beneficiary at will, the policy would pass to the trustee in bankruptcy in spite of the state exemption laws and Sec. 6 of the Bankruptcy Act.

All of these problems have been solved in the Orear Case, 189 Fed. 888. This case is so clearly stated and is of such undoubted merit that it is surprising that it is not better known. The case came up from Missouri and the facts were as follows:

Orear was the trustee in bankruptcy for the insolvent partnership of Derr Bros., which firm was composed of Jacob W. Derr and Chas. C. Derr, who were adjudged bankrupts by the United States District Court for the Eastern District of Missouri. There had been eight policies of life insurance for $2,500 each on the life of J. W. Derr which were in force at the time of adjudication in bankruptcy. One of these policies, numbered 656,496, was issued by the Northwestern Mutual Life Insurance Co. on the 27th day of January, 1906, two years before the adjudication in bankruptcy. The policy was payable to Myrtle L. Derr, wife of Jacob Derr. Myrtle L. Derr had obtained a divorce from her husband on October 1, 1908, which was after the adjudication of bankruptcy. The husband had not exercised his right to change the beneficiary as provided for in the policy as follows:

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"The insured may nominate a beneficiary or beneficiaries hereunder and may also change any beneficiary or beneficiaries nominated by him or named in the policy. A beneficiary or beneficiaries in succession to be known as contingent beneficiary or beneficiaries may be nominated by the insured or if not nominated by him by the beneficiary or beneficiaries if of lawful age. Contingent beneficiary or beneficiaries may be changed by the insured or the person or persons nominating same."

The trustee bringing suit to obtain this policy of insurance relied on these facts.

First—That, since the policy allowed the insured certain benefits during his life and allowed him to change the beneficiary at his pleasure, the policy was not for the benefit of his wife within the meaning of the Missouri statute.

Second—That since the wife had obtained a divorce from Jacob W. Derr the exemption, if any, was lost.

Third—That the exemption, if any, was personal to Myrtle L. Derr and that since she had not appeared and claimed the exemption, it was lost.

The Court in a very well written opinion delivered by Circuit Judge Smith decided every point in favor of the wife and declared that the trustee had no interest in the policy. The opinion declares in part:

"..........If the first point (made by the trustee) should be sustained it would practically nullify the statute (referring to the Missouri Exemption Statute above)...The primary purpose of such policies is still to insure against death and usually for the benefit of those dependent upon the insured, and when a modern policy is made, as in this case, payable upon the death of the insured to his wife by name as beneficiary, the fact that the insured may have the right to change the beneficiary or enjoy certain collateral rights in his lifetime, does not make it any less a policy of insurance made by an

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insurance company expressed to be for the benefit of the wife of the insured within the meaning of the statute in question...........

......"The second proposition of the trustee is equally without merit....This policy by the Missouri statute, if it belonged to the bankrupt in any sense, was declared to inure to the separate benefit of Myrtle L. Derr independently of the creditors of the husband and was not of such a character as to pass to the trustee even if the seventeenth section did not expressly exclude all exempt property from the grant to the trustee...........

.........."It is finally contended (by the trustee) that exemption is a personal privilege which can only be set up by the party entitled thereto, and as Myrtle L. Derr has not appeared and claimed the policy on her own behalf it should be awarded to the trustee. This involves several errors. The trustee is seeking to obtain property the title to which he never took. The trustee, it is true, is seeking to obtain exempt property but the trouble with his claim is that he has no title to the property he seeks to hold........" C. W. D.

The decision of *In re* Brinson, 262 Fed. 707, arising from Mississippi court on petition to revise order of referee, upholds doctrine expressed in the Orear case and goes further in holding that "The fact that the insured reserved the absolute right to change the beneficiary did not destroy the exempt character of the proceeds of the policy." Citing in support *In re* Carlon (D. C.) 189 Fed. 815; Allen v. Central Wisconsin Trust Co., 143 Wis. 381, 127 N. W. 1003. Ed.

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