

In the United States Bankruptcy Court

for the Northern District of Iowa

GAIL LEE SHEARER
TIMOTHY LOUIS SHEARER
Debtor(s).

Bankruptcy No. 97-01020-C

Chapter 7

ORDER RE: OBJECTION TO EXEMPTION

The matter before the Court is Trustee's Objection to Exemption under Iowa Code sec. 627.6(6). Trustee alleges Debtors' life insurance policies are not exempt under § 627.6(6) as the named beneficiaries do not qualify under the statute. A hearing on Trustee's objection and Debtors' resistance thereto was held on July 9, 1997 in Cedar Rapids, Iowa. Present was Debtor Gail Shearer, represented by Henry Nathanson. Also present was Trustee Harry Terpstra. Debtor Gail Shearer was the only person to testify at the hearing. Debtors subsequently submitted a memorandum of authorities and Trustee filed a response. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

FINDINGS OF FACT

The Shearers filed a joint, voluntary Chapter 7 petition on April 8, 1997. They were separated at the time the petition was filed. Mrs. Shearer and her three children, all by a former marriage, were living with Mrs. Shearer's parents. The Shearers continue to pursue a dissolution of their marriage.

Debtors' Schedule B included life insurance policies on each Debtor with an aggregate current market value listed as \$20,000, equally divided between them. The entire stated market value of \$20,000 was included on Debtors' Schedule C as exempt property. The policies were purchased earlier in 1997.

Trustee filed an objection to the exemption of the cash value of the life insurance policies. He claims that the status of the beneficiaries of the policies does not allow for an exemption under § 627.6(6). A notice of compromise and settlement was filed by Trustee concerning the cash value of the policy on Debtor Timothy Louis Shearer. The estate receives approximately 50% of the policy cash value under this compromise, which the Court has approved.

The remaining issue involves the exempt status of the cash value of the life insurance policy on the life of Mrs. Shearer. Mrs. Shearer testified that her desire to provide for her children was the motivation behind her purchase of an insurance policy on her life prior to the filing of the Shearers' Chapter 7 petition. Her intention was to leave the majority of the \$80,000 proceeds of the policy, upon her death, to her three children. She stated that she was advised by her insurance agent not to leave the death benefit directly to her minor children, as it would be held by the insurance company until they were 18 years old. Acting on this advice, she named Mr. Shearer as 30% beneficiary of the policy, as she had always intended, and named her father as 70% beneficiary to the remainder. She testified that she and her parents had discussed the future of the children should she die. Her parents agreed to have the children continue to live with them, and the 70% proceeds of the insurance policy were to be used

by her father for the children's care. Mrs. Shearer testified she intended that the death benefit payable to her father was to be used to establish a trust for her children. Mr. Shearer's interest as a 30% beneficiary is not in controversy in these proceedings.

CONCLUSIONS OF LAW

Trustee bases his objection on Iowa Code sec. 627.6(6), which establishes the exemption from execution for life insurance policies. Trustee states that the beneficiary designation on Mrs. Shearer's policy does not comply with § 627.6(6) because it names as a beneficiary someone who is not a spouse, child, or dependent of the insured.

A debtor in the State of Iowa is not entitled to elect exemptions under 11 U.S.C. § 522(d). Iowa Code § 627.10. In Iowa, debtors claim "state-created exemptions," and the Court looks to Iowa law to decide whether the exemptions should be allowed. In re Krantz, 97 B.R. 514, 521 (Bankr. N.D. Iowa 1989).

The exemption for life insurance policies is included in Iowa Code sec. 627.6(6) which states:

627.6 General exemptions.

A debtor who is a resident of this state may hold exempt from execution the following property:

. . . .

6. The interest of an individual in any . . . cash surrender value of . . . a life insurance policy owned by the individual if the beneficiary of the policy is the individual's spouse, child, or dependent. However, the amount of the exemption shall not exceed ten thousand dollars in the aggregate of any interest or value in insurance acquired within two years of the date . . . exemptions are claimed.

Trustee objects to the Shearers' claim of exemption of the cash value of Mrs. Shearer's life insurance policy, relying on the beneficiary designation on the policy. Trustee's direct examination of Mrs. Shearer established that her father is not her dependent. Trustee contends, since 70% of the death benefit is payable to a non-dependent, 70% of the cash value is not eligible for exemption under Iowa Code sec. 627.6(6) and should be part of the bankruptcy estate.

The issues for determination are, first, whether the named beneficiary in a life insurance policy is conclusively presumed to be the payee under the life insurance policy. If so, the inquiry need not proceed further because Debtor Gail Shearer's father is the payee and does not qualify under the statute. However, if the named beneficiary's right to the insurance proceeds is not absolute, this Court must determine the circumstances under which such an exception exists. The parties indicated to the Court that their research does not reveal any case directly on point. This Court has also failed to find a case which completely answers these questions. The issues raised are of first impression in this Court and in the State of Iowa.

The Court first notes that the exemption statutes in Iowa are liberally construed to benefit those claiming an exemption. "The Iowa Supreme Court has repeatedly held that exemption statutes shall be liberally construed in favor of those claiming benefits of the exemptions." In re Bertram, 59 B.R. 186, 188 (Bankr. N.D. Iowa 1986) (citations omitted). "The main purpose of [the exemption laws] is to

support and protect the family, and to educate and train the young." In re Krantz, 97 B.R. 514, 526 (Bankr. N.D. Iowa 1989) (citations omitted). "We have said that the exemption statutes in Iowa were enacted for the benefit of the husband, wife, and family." Serrano v. Hendricks, 400 N.W.2d 77, 80 (Iowa App. 1986). "It would be incongruous and unjust to hold that all of these exemptions from liability for ordinary debts should operate to the prejudice of the wife or children ... when the principal reason for the exemption was to secure these dependents." In re Bagnall's Guardianship, 29 N.W.2d 597, 615 (Iowa 1947).

The beneficiary under a life insurance contract is the person or entity designated to receive the proceeds of the insurance upon the death of the insured. As a contract of insurance, the ordinary rules of construction as to contracts apply. While no case is exactly on point, sufficient law exists in Iowa so that it can be concluded with some certainty that the named beneficiary need not be the recipient of the insurance proceeds under all circumstances. This is particularly true where the familial unit is involved. Many courts, including Iowa courts, construe the term beneficiary using equitable principles. These courts conclude that, under equitable principles, "equity will consider as done that which should have been done." Thompson v. Thompson, 156 F.2d 581, 586 (8th Cir. 1946) (citing Crowell v. Northwestern Nat'l. Life Ins. Co., 118 N.W. 412 (Iowa 1908)).

Applying these principles, the Iowa Supreme Court has on numerous occasions awarded the proceeds of life insurance policies to individuals other than the named beneficiary. In In re Paul's Estate, 3 N.W.2d 186, 190-191 (Iowa 1942), the Iowa Supreme Court concluded that an oral agreement by the deceased insured was valid and that the life insurance proceeds would be payable to individuals who provided care to the decedent in his last illness even though the decedent's son was the named beneficiary. The court, in so doing, discussed numerous cases in which it had previously applied equitable principles and found that a court of equity can enforce the intent of the insured. This intent can be enforced against all individuals who do not have a superior equitable interest. Id. The court concluded that the insured intended to pay those individuals providing services to him and the Iowa Supreme Court gave legal recognition to this intent even though another individual was the named beneficiary. Id.

This view is consistently recognized and is again stated by the Iowa Supreme Court in Sorensen v. Nelson, 342 N.W.2d 477 (Iowa 1984). In Sorensen, Mr. Sorensen named his spouse as primary beneficiary and his mother as contingent beneficiary on a life insurance policy. The parties were subsequently divorced after which Mr. Sorensen died. Both decedent's mother and ex-wife made claim to the life insurance proceeds. Id. at 478-79. The Iowa Supreme Court interpreted the language of the dissolution decree. In so doing, it relied heavily on the intent of the parties. The Court awarded the insurance proceeds to the decedent's mother even though his ex-wife remained the primary beneficiary. The Iowa Supreme Court held that such a result is warranted where it is clearly shown to be the intent of the parties. "This reasoning is supported, as in other contract cases by the primary rule of construction requiring the court to ascertain and give effect to the mutual intention of the parties." Id. at 480 (citations omitted).

The Iowa Court of Appeals reaffirmed this approach in Serrano v. Hendricks, 400 N.W.2d 77 (Iowa App. 1986). In Serrano, Mr. and Mrs. Serrano received a dissolution. Mr. Serrano was to provide continuing support for the benefit of the parties' children and was to designate his ex-wife as beneficiary on his life insurance policy to insure these payments. Mr. Serrano died without having named his ex-wife as beneficiary. The District Court determined that the ex-wife would receive the equivalent of the child support award out of the insurance proceeds even though another person was the named beneficiary. Id. at 78. This holding was affirmed by the Iowa Court of Appeals. The court emphasized that equitable principles applied and the intent of the parties had a significant impact on

the resolution. In Serrano, the court pointedly noted the exemption statutes were enacted for the benefit of the husband, wife, and family and the court was, to a large extent, implementing that policy in allowing the proceeds to be paid to the decedent's children even though another was named as beneficiary in the life insurance policy. Id. at 80.

While the foregoing cases differ significantly from this case factually, they provide substantial guidance on the legal issues involved here. The Iowa courts have concluded that the denomination of a beneficiary on a life insurance policy is not conclusive under all circumstances. The courts have consistently held that while a life insurance policy is a contract and must be interpreted through the application of contractual principles, equitable principles are a significant factor in the determination of the recipient of the proceeds of a life insurance policy. The Iowa courts have consistently held that the intent of the parties controls and equity will fulfill the intent of the parties if the intent is clearly established.

This Court can, therefore, conclude with some certainty that identification of the named beneficiary does not end the analysis. The Court must determine the intent of the parties. The contents of the policy are not conclusive and parol evidence is admissible on the issue of intent. The evidentiary record is significant in making such a determination. If the record clearly establishes an intent which is contrary to that stated in the policy, the intent of the parties will control. Guided by these pronouncements from the Iowa courts, this Court must examine the evidentiary record presented to consider the weight to be given Mrs. Shearer's testimony regarding her intent when she purchased the life insurance policy in question.

Mrs. Shearer testified that it was her intent to leave the majority of the policy death benefit to her children. She explained to the insurance agent that she wanted to leave the bulk of the policy to her children upon her death. Based on the agent's advice, she designated her father as beneficiary so that the minor children would have immediate access to the funds.

The credibility of a debtor's testimonial explanation should be gauged in light of all of the surrounding circumstances. In re Losinski, 80 B.R. 464, 470 (Bankr. D. Minn. 1987). Mrs. Shearer's surrounding circumstances strongly support her contention that the designation of her father as beneficiary, and her mother as contingent beneficiary, was intended to facilitate the care and upbringing of her three minor children in the event of her death. Mrs. Shearer was separated and about to be divorced from her husband. Her estranged husband is not the father of the children and not responsible for their welfare after the dissolution. The three children were already living with her parents, as was she, at the time she purchased the life insurance policy. Mrs. Shearer testified that she and her parents had discussed the children's futures in the event of her death, and that her parents were in agreement with the plan to keep the children with them and to continue raising them.

It is entirely reasonable and consistent with the surrounding circumstances to accept Mrs. Shearer's testimony as to her intent to provide for her children upon her death by way of the life insurance policy in question here. Similarly, it is inconsistent to conclude that Mrs. Shearer would name her parents as beneficiaries on her life insurance policy without consideration of her children when she would be a single parent without benefit of outside support.

It is the conclusion of this Court that the evidentiary record clearly establishes that Mrs. Shearer named her father as beneficiary on her life insurance policy with the intent that he would act as trustee of the proceeds for the benefit of her three minor children. "An intention to create an express trust may be ascertained by a consideration of the parties' words and conduct." In re Pehkonen, 15 B.R. 577, 579 (Bankr. N.D. Iowa 1981). Mrs. Shearer's testimony and her actions are sufficient to establish

an oral trust in the proceeds of the insurance policy for the benefit of her children. A trust created for the benefit of the Debtor's children represents a qualifying beneficiary under § 627.6(6), and allows for the exemption from the bankruptcy estate that portion of the cash value of the insurance policy in which Debtor's father is the named beneficiary.

WHEREFORE, Trustee's Objection to Exemption is DENIED.

FURTHER, 70% of the cash value of Mrs. Shearer's life insurance policy is exempt which represents that portion in which Debtor's father is named as beneficiary.

SO ORDERED this 20 day of August, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge