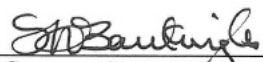




SO ORDERED.

SIGNED this 1st day of April, 2020

**THIS ORDER HAS BEEN ENTERED ON THE DOCKET.
PLEASE SEE DOCKET FOR ENTRY DATE.**


Suzanne H. Bauknicht
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

JIMMY RAY SMITH, JR.
dba SMITH MASONRY

Case No. 3:19-bk-32415-SHB
Chapter 7

Debtor

**MEMORANDUM AND ORDER ON
TRUSTEE'S OBJECTION TO EXEMPTION**

Before the Court is the Objection to Debtors' [*sic*] Claim of Exemption ("Objection to Exemption") filed by Ann Mostoller, Chapter 7 Trustee ("Trustee") on October 4, 2019 [Doc. 32], seeking to disallow Debtor's claimed exemption in a life insurance policy under Tennessee Code Annotated § 56-7-203. As directed by the Court's Order entered November 7, 2019 [Doc. 34], the parties filed a Stipulation of Facts on December 4, 2019 [Doc. 38], including the Annual Policy Statement for the statement period April 17, 2018 through April 16, 2019 as a stipulated exhibit [Doc. 38-1], and this matter became ripe on the parties' February 4, 2020 filing of briefs in support of their respective arguments [Docs. 39, 42]. The Court also takes judicial notice of material undisputed facts of record in Debtor's bankruptcy case. *See* Fed. R. Evid. 201(a). This

is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A) and (O).

Debtor filed the Voluntary Petition commencing this Chapter 7 bankruptcy case on July 31, 2019 [Doc. 1], and the Trustee was duly appointed. [Doc. 38 at ¶ 1.] On the filing date, Debtor owned a life insurance policy with John Hancock Life Insurance Company (U.S.A.) (“Insurance Policy”) that has a cash surrender value of \$9,597.72 and names Debtor’s mother, Cathy Smith, as sole beneficiary, as summarized on the Annual Policy Statement. [Doc. 38 at ¶¶ 2-4; Doc. 38-1.] On September 9, 2019, Debtor filed Amended Schedules A/B and C to include the Insurance Policy and claim it as exempt in the full cash surrender value under Tennessee Code Annotated § 56-7-203. [Doc. 20; Doc. 38 at ¶ 5.] The Trustee objected to the exemption, arguing that the exemption does not apply because Debtor’s mother is the beneficiary and she is not one of the named types of dependents included within the statute. [Doc. 32; Doc. 38 at ¶¶ 6.] The parties have stipulated that Debtor would testify that he intended to provide for his minor children when he named his mother as beneficiary, expecting that she would handle the funds for his children. [Doc. 38 at ¶ 7.]

At the time Debtor filed his bankruptcy case, his estate, consisting of all property and property interests he owned at the time, was created. 11 U.S.C. § 541(a). Notwithstanding that all of Debtor’s property is included in the bankruptcy estate, to ensure that he will retain sufficient property for his fresh start, Debtor has exempted certain property interests through 11 U.S.C. § 522 by filing Schedule C, as amended, to be “subtracted from the bankruptcy estate and not distributed to creditors,” *In re Arwood*, 289 B.R. 889, 892 (Bankr. E.D. Tenn. 2003) (citations omitted); *see* Fed. R. Bankr. P. 4003(a).

“Exemptions are determined as of the date upon which the bankruptcy case is commenced, are construed liberally in favor of debtors, and should be construed in light of the

purpose for which they are created.” *In re Lawless*, No. 10-36096, 2012 WL 2974759, at *7 (Bankr. E.D. Tenn. July 20, 2012) (brackets omitted) (quoting *In re Daley*, 459 B.R. 270, 274 (Bankr. E.D. Tenn. 2011)); *see also In re Chapman*, 424 B.R. 823, 826 (Bankr. E.D. Tenn. (2010) (citations omitted) (“[W]hen it is possible to construe an exemption statute in ways that are both favorable and unfavorable to a debtor, then the favorable method should be chosen.”)). The Trustee, who filed her objection pursuant to Federal Rule of Bankruptcy Procedure 4003(b)(1), bears the burden of proof by a preponderance of the evidence that Debtor is not entitled to the claimed exemption, and if she does not meet that burden, the claimed exemption “retains its prima facie presumption of correctness and [will] stand.” *Lawless*, 2012 WL 2974759, at *7 (citations omitted). Tennessee has “opted out” of the federal exemptions pursuant to 11 U.S.C. § 522(b), requiring Debtor to utilize Tennessee’s statutory exemptions, and, as with the federal exemption statutes, “[t]here is a ‘long-standing rule’ in Tennessee that its exemption statutes are to be liberally construed.” *In re Dunn*, No. 14-33152, 2015 WL 1865567, at *2 (Bankr. E.D. Tenn. Apr. 1, 2015) (citing *In re Hogue*, 286 S.W.3d 890, 894 (Tenn. 2009)).

Debtor claims that the entire cash surrender value of the Insurance Policy of \$9,597.72 is exempt under Tennessee Code Annotated § 56-7-203, which “allows for the exemption of funds in annuity contracts and the cash surrender values of policies rather than only the death proceeds payable under the contracts and policies.” *In re Clemmer*, 184 B.R. 935, 937 (Bankr. E.D. Tenn. 1995). The exemption statute at issue 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 spouse and/or children, or dependent relatives of the persons, shall be exempt from all claims of the creditors of the person arising out of or based upon any obligation created after January 1, 1932, whether or not the right to change the named beneficiary is reserved by or permitted to that person.

Tenn. Code Ann. § 56-7-203.

The parties do not dispute that the Insurance Policy names Debtor's mother, Cathy Smith, as the sole beneficiary. [Doc. 38 at ¶ 3.] The Trustee argues that this fact, in and of itself, removes the Insurance Policy from the scope of section 56-7-203, which requires that the policy in question be for the "benefit of . . . [a] dependent," including a spouse or children, and Ms. Smith is not a dependent of Debtor. On the other side, however, Debtor argues that because he intended for the Insurance Policy to benefit his children in the event of his death, a broad reading of section 56-7-203 allows for the exemption, irrespective that his mother (admittedly is not a dependent) is the named beneficiary. Case law applying the exemption statute at issue, however, does not support Debtor's argument.

In *In re Clemmer*, 184 B.R. at 938, this Court examined whether an insurance policy naming the debtor's mother and son as joint beneficiaries and two annuities naming the debtor's son as sole beneficiary were exempt under section 56-7-203. In ruling in favor of the debtor and rejecting the objecting trustee's argument that "the court should limit the statute's application to *dependent* children," the Court first examined the statutory language, finding that "[t]he Tennessee Legislature could easily have prefaced the term 'children' with the word 'dependent,' but it chose not to do so." *Id.* The court concluded "that the statutory language only allows for one interpretation: the term 'children' includes minor or adult, financially dependent or nondependent children of the debtor." *Id.* Accordingly, with respect to the annuities that named the debtor's son as sole beneficiary, the exemption provided by section 56-7-203 applied. *Id.*

Important here, for the insurance policy that named the debtor's mother as a one-third beneficiary and the son as a two-thirds beneficiary, the Court determined that the exemption was allowed only to the extent of the son's two-thirds benefit and not allowed as to "[t]he remaining

one-third of the policy, to which the debtor's nondependent mother [wa]s the beneficiary[.]” *Id.* at 939. In so finding, the Court observed:

The legislature expressly included the phrase “whether or not the right to change the named beneficiary is reserved or permitted to [the debtor]” in section 56-7-203. Although the application of this language might contradict any intent only to protect a spouse, child, or dependent relative, it does not contradict the legislature’s intent expressed by the statute, that is, to protect any life insurance policy or annuity contract from creditors to the extent the beneficiary presently named is a spouse, child, or dependent relative.

Id. (internal citations and footnote omitted).

The Court also finds instructive *In re Billington*, 376 B.R. 239 (Bankr. M.D. Tenn. 2007), a case relied on by Debtor. In *Billington*, the issue was whether a debtor could exempt a policy that named his mother as the primary beneficiary and his son as a contingent beneficiary under § 56-7-203. The court held that the exemption applied. *Id.* at 240-41. After first citing to *In re Clemmer* for an overview of the application of section 56-7-203 in the bankruptcy setting, the *Billington* court held:

The statute is silent as to . . . whether the spouse, child or dependent must be named as the primary rather than the contingent beneficiary. However, given the statute’s broad aim of protecting the debtor’s close family and dependents, the Legislature’s obvious intent of breadth of protection by not allowing a potential change in beneficiary to defeat the exemption, and *the debtor’s policies naming his son as a beneficiary (albeit contingent)*, the court finds the exemption is proper.

Id. at 241 (emphasis added).

The wording of section 56-7-203 is clear; to fall within the protection of the exemption for the insured, the named beneficiary must be one of the types of persons named in the statute – i.e., the debtor’s spouse, children, and/or dependent relative. Although the policies in both *Clemmer* and *Billington* included non-dependent parties as beneficiaries, they also expressly named the debtors’ respective sons as either a joint or contingent beneficiary to the policies. Here, had Debtor included his children as joint or contingent beneficiaries (or named them as

primary and his mother as joint or contingent), the result would be different the same as in *Clemmer* and *Billington*. However, the Insurance Policy only names Ms. Smith, who is not a dependent of Debtor, as the sole beneficiary so that section 56-7-203 does not apply to allow Debtor to exempt the cash surrender value of the Insurance Policy. *Cf. In re Billington*, 376 B.R. at 241 (“The statutory language of section 56–7–203 supports a finding that the Tennessee Legislature while recognizing that beneficiaries could change over time, intended that the statute be applied to those beneficiaries named *without regard to how the proceeds of the policy might ultimately be distributed.*” (emphasis added)).

The Court, therefore, directs the following:

1. The Objection to Debtors’ Claim of Exemption filed on October 4, 2019 [Doc. 32], is SUSTAINED.

2. Debtors’ attempted exemption under Tennessee Code Annotated section 56-7-203 of the John Hancock Life Insurance policy having a cash value of \$9,597.72 and naming his mother, Cathy Smith, as beneficiary is DISALLOWED.

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