

Dated: June 20, 2013
The following is ORDERED:



Jennie D. Latta

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UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re JAMES V. NEAL
CONNIE I. NEAL,
Debtors.

Case No. 12-25439-L
Chapter 7

**MEMORANDUM AND ORDER SUSTAINING IN PART
AND OVERRULING IN PART
TRUSTEE'S OBJECTION TO EXEMPTIONS**

THE TRUSTEE'S OBJECTION TO EXEMPTIONS came before the court for trial on June 19, 2013. Norman P. Hagemeyer, Trustee, by his attorney, Russell W. Savory, filed his objection to certain exemptions claimed by the Debtors. The Debtors, by their attorney, Eugene G. Douglass, supported the claims of exemption. After listening to the arguments of counsel and the testimony of the witness, and considering the exhibits provided and relevant law, the court makes the following findings of fact and conclusions of law.

FACTS

The Debtors filed their voluntary petition under Chapter 7 of the Bankruptcy Code on May

24, 2012. Norman P. Hagemeyer (the “Trustee”) was appointed trustee in bankruptcy on that same day. On August 23, 2012, the Trustee, through counsel Mr. Savory, filed his objection to the Debtors’ claims of exemption in the following property and for the following reasons:

- A. Ohio National Universal Life Policy in the amount of \$11,267.00, on the grounds that Debtors have submitted insufficient information demonstrating that this policy is exempt pursuant to Tennessee Code Annotated § 56-7-203 as claimed.
- B. Ohio National Universal Life Policy in the amount of \$6,870.00, on the grounds that Debtors have submitted insufficient information demonstrating that this policy is exempt pursuant to Tennessee Code Annotated § 56-7-203 as claimed.
- C. Ohio National Universal Life Policy in the amount of \$8,931.00, on the grounds that Debtors have submitted insufficient information demonstrating that this policy is exempt pursuant to Tennessee Code Annotated § 56-7-203 as claimed.
- D. Prudential Annuity, account number xxxx152 on the grounds that this property is not of a kind described in the exemption statute cited by the Debtors, Tennessee Code Annotated § 26-2-111(a)(D).
- E. Prudential Annuity, account number xxxx160 on the grounds that this property is not of a kind described in the exemption statute cited by the Debtors, Tennessee Code Annotated § 26-2-111(a)(D).
- F. Prudential Annuity, account number xxxx243 on the grounds that this

property is not of a kind described in the exemption statute cited by the Debtors, Tennessee Code Annotated § 26-2-111(a)(D).

- G. Prudential Annuity, account number xxxx524 on the grounds that this property is not of a kind described in the exemption statute cited by the Debtors, Tennessee Code Annotated § 26-2-111(a)(D).

Creditors First Alliance Bank and BankPlus Bank joined in the Trustee's objection. In response, the Debtors filed an amendment to Schedule C changing the exemption statute for the four annuity contracts to Tennessee Code Annotated § 56-7-203. No other written response was made by the Debtors at that time. Hearing on the objection was originally scheduled for September 27, 2012, but was continued numerous times at the request of counsel.

In preparation for the hearing, counsel for the Debtors, the Trustee, and BankPlus Bank filed pre-trial memoranda which have been carefully considered. The Debtors and the Trustee also filed a Joint Stipulation of Facts with attached Exhibits A-I consisting of the four annuity contracts and related annual statements, together with an account summary listing all accounts held by the Debtors at Diversified Financial Group. The Joint Stipulation provides the following information concerning the annuity contracts:

On the date of the Voluntary Chapter 7 Petition the following annuities existed and were structured as set out herein:

- A. Prudential Annuity, account number xxx4152
 - Owner: James Neal
 - Annuitant: James Neal
 - Beneficiary: Connie Neal

Value (as of 09/04/2012) \$97,595.05.

B. Prudential Annuity, account number xxx4160

Owner: James Neal

Annuitant: Connie Neal

Beneficiary: Connie Neal

Value (as of 09/04/2012) \$110,672.57.

C. Prudential Annuity, account number xxx3243

Owner: Connie Neal

Annuitant: Connie Neal

Beneficiary: James Neal

Value (as of 09/04/2012) \$97,492.42.

D. Prudential Annuity, account number xxx4524

Owner: Connie Neal

Annuitant: James Neal

Beneficiary: James Neal

Value (as of 09/04/2012) \$113,626.45.

The stipulation included no information concerning the life insurance policies that are also the subject of the Trustee's Objection to Claim of Exemption. No reasonable explanation was given for the failure of the Debtors to produce copies of these policies for inspection by the Trustee. At the hearing, the Debtors were directed to amend their Schedule C within thirty days to properly identify those policies and were directed to produce copies of those policies for the Trustee within the same thirty days.

In addition to the stipulated facts, Mr. Douglass called one witness, Mr. Alvin Shelby, the Debtors' financial advisor who sold them the annuity contracts that are disputed. Mr. Shelby testified that the annuity contracts are not "qualified" annuities, which he explained means that the owner is not entitled to an income tax deduction for funds paid into the contract and that there is no requirement that withdrawals be taken at a certain age. Mr. Shelby testified that the Debtors purchased these contracts because at the time of their purchase the Debtors enjoyed substantial income, were able to fully fund their other retirement accounts, and desired another vehicle for tax-advantaged retirement savings. Mr. Shelby explained that the annuity contracts permitted earnings on the Debtors' investments to accumulate without requiring immediate payment of taxes on earnings.

Mr. Douglass attempted to have Mr. Shelby testify that the way that the annuity contracts are administered differs from the language of the contract. Mr. Savory raised objections based upon the parol evidence rule and the hearsay rule, which were sustained. Mr. Douglass also attempted to have Mr. Shelby qualified as an expert in the interpretation and administration of annuity contracts. Mr. Savory's objections to this procedure were sustained both on the basis that there had been no prior disclosure of Mr. Shelby's qualifications and/or written report as required by Rule 26(b)(2) of the Federal Rules of Civil Procedure, made applicable to contested matters in bankruptcy by Rules 7026 and 9014(c) of the Federal Rules of Bankruptcy Procedure, but also because Mr. Shelby's testimony revealed that he is in fact not an expert on the matters in dispute.

In response to questions posed by the court, Mr. Shelby testified that the terms "Participant" and "Owner" are interchangeable in the annuity contracts because the same form of contract is used

by Prudential for both individual annuity contracts and for group retirement accounts.¹ Mr. Shelby indicated that the contracts owned by the Debtors are individual annuity contracts. He also testified that before the death of the annuitant, the owner of the contract has the right to obtain the value of the contract by surrendering the contract and to change the designation of the beneficiary.

The annuity contracts, Exhibits A, C, E, and G to the Joint Stipulation, contain the following relevant definitions, which will be used as appropriate in the remainder of this memorandum:

Account Value: The value of each allocation to a Sub-account or a Fixed Allocation prior to the Annuity Date, plus any earnings and/or less any losses, distributions, and charges thereon, before assessment of any applicable contingent deferred sales charge and/or any applicable maintenance fee. Account Value is determined separately for each Sub-account and for each Fixed Allocation, and then totaled to determine Account Value for your entire Annuity. Account Value of each Fixed

¹ I do not agree with Mr. Shelby's characterization. It is not the case that "Participant" and "Owner" are equivalent defined terms under the annuity contracts. As more fully set forth below, "Owner" is a defined term under the contracts and refers to the owner of a "master group contract under which an Annuity is issued." The participant is not a defined term in the definitions section of the contract, but is a person named in the annuity schedule. If the participant is a natural person, he or she is not an owner in the sense of the defined term "Owner," but in the colloquial sense according to which the participant is the purchaser of the contract and thus the person who has the right to name the annuitant and beneficiary. The contract does not limit participants to natural persons, however. For example, in the description of the Death Benefit, the Annuity provides that, "If the Annuity is owned by an entity, the death benefit is payable upon the Annuitant's death, if there is no Contingent Annuitant. *See, e.g.*, Ex. A - part 2, page 11 of 13. Each of the contracts was represented to the court to be identical. Therefore, I have used Exhibits A, the contract Annuity xxx4152, as an example.

Allocation on other than such Fixed Allocation's Maturity Date is calculated using a market value adjustment.²

Accumulation Period: The period of time from the Issue Date through the day preceding the Annuity Date.

Annuitant: Annuity payments are based upon this person's life.

Annuity Date: The date on which annuity payments are to commence.

Annuity: A summary of your rights and benefits under the contract shown in the Schedule.

Beneficiary: The person designated as the recipient of the death benefit.

Contingent Annuitant: The person named to become the Annuitant on the Annuitant's Death prior to the Annuity Date.

Fixed Allocation: An allocation of Account Value that is to be credited a fixed rate of interest for a specific Guarantee Period during the Accumulation Period and is to be supported by assets in the Fixed Separate Account.

Fixed Separate Account: A separate account shown in the Schedule used in relation to Fixed Allocations.

Guarantee Period: A period of time during the Accumulation Period during which we credit a fixed rate of interest on a Fixed Allocation.

Owner: The person or entity shown in the Schedule unless later changed, that owns the master group contract under which an Annuity is issued.³

² See, e.g., Ex. A, page 10 of 10.

³ See e.g., Ex. A - part 2, page 1 of 13.

Surrender Value: The value of your Annuity available upon surrender prior to the Annuity Date. It equals the Account Value as of the date we price the surrender less any applicable contingent deferred sales charge, any applicable tax charges, any charges due for any optional benefits provided by rider or endorsement and any applicable maintenance fee.

We, us, our: Prudential Annuities Life Assurance Corporation.

You, your: The participant shown in the Schedule.

The Schedule is made a part of the Annuity and gives information such as the name of the Participant, the name of the Annuitant, the Annuity Date, the Contingent Annuitant, the Beneficiary, the Purchase Payment and Net Purchase Payment, the Minimum Surrender Value After Withdrawal, and the Contingent Deferred Sales Charge.⁴

The Annuity attempts to limit the rights of creditors. It provides: “Claims of Creditors: To the extent permitted by law, no payment under the contract shown in the Schedule or any Annuity thereunder is subject to the claims of the creditors of the Owner, you or any other participant, Annuitant or Beneficiary.⁵ The only law relied upon by the Debtors with respect to their claim that the value of their Annuities is exempt from their creditors is Tennessee Code Annotated § 56-7-203.

JURISDICTION

Jurisdiction over a contested matter arising under the Bankruptcy Code lies with the district court. 28 U.S.C. § 1334(b). Pursuant to authority granted to the district courts at 28 U.S.C. § 157(a), the district court for the Western District of Tennessee has referred to the bankruptcy judges

⁴ See, e.g., Ex. A, Page 8 of 10.

⁵ See, e.g., Ex. A - part 3, Page 1 of 14.

of this district all cases arising under title 11 and all proceedings arising under title 11 or arising in or related to a case under title 11. *In re Jurisdiction and Proceedings Under the Bankruptcy Amendments Act of 1984*, Misc. No. 81-30 (W.D. Tenn. July 10, 1984). The determination of objections to exemptions are core proceedings arising under the Bankruptcy Code. *See* 28 U.S.C. § 157(b)(2)(B). The bankruptcy court has authority to enter an order determining whether a debtor is able to claim an exemption in particular property of the estate subject only to appellate review.

ANALYSIS

Tennessee is an “opt out” state; thus Tennessee debtors must claim the exemptions provided by Tennessee law. *See* 11 U.S.C. § 522(b); Tennessee Code Annotated § 26-2-112. The Debtors claim that the four annuity contracts are exempt from claims of creditors in their bankruptcy case by virtue of Tennessee Code Annotated § 56-7-203. That statute provides:

56-7-203. Life insurance or annuity for or assigned to spouse or children or dependent relatives exempt from claims of creditors.

– 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 relative 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.

This statute was the subject of extended analysis in my prior decision, *In re DeMarco*, ___ B.R. ___, 2013 WL 2100521 (Bankr. W.D. Tenn. May 10, 2013). Reference to that opinion is made for a more detailed discussion of the relevant issues. The present case raises few if any new questions.

As indicated by Mr. Shelby, the annuities purchased by the Debtors were essentially retirement savings accounts. In each case, the Debtor-participant invested some amount for the purchase of the annuity contract. The Debtor-participant was able to choose among available

investment options during the Accumulation Period. The issuer of the contracts guaranteed a minimum return during the Guarantee Period. The Accumulation Period in which new investments could be made and investment returns were accumulated was intended to end on the day just prior to the Annuity Date. On the Annuity Date, annuity payments were to begin: for a life, for a life with years certain, for joint lives, or for a certain period.⁶ During the Accumulation Period the Debtor-participant is entitled to surrender the Annuity in exchange for its Surrender Value.⁷ During the Accumulation Period, a death benefit is payable to the Beneficiary upon the death of the participant shown in the Schedule.⁸ The Annuity Dates for each of the Annuities is specified in the Schedule. The Annuity Date for Annuity xxxx4152 is August 1, 2053. The Annuity Date for the other three contracts is March 1, 2049. Each of these contracts remained in the Accumulation Period when the Debtors' bankruptcy petition was filed.

The description of the annuity contracts given by Mr. Shelby is consistent with the description given by Black's Law Dictionary for annuities used as retirement savings account: "annuity: ... 4. A savings account with an insurance company or investment company, usu. established for retirement income. Payments into the account accumulate tax-free, and the account is taxed only when the annuitant withdraws money in retirement." Bryan A. Garner, *Blacks Law Dictionary*, Seventh Edition (West 1999). This description is consistent with terms of the Annuities purchased by the Debtors.

⁶ See, e.g., Ex. A - part 2, Page 13 of 13.

⁷ See, e.g., Ex. A - part 2, Page 9 of 13.

⁸ See, e.g., Ex. A - part 2, Page 11 of 13.

The Debtors argue that the Tennessee statute protects each of the four Annuities because it is the death of the owner that triggers entitlement to the Death Benefit. Counsel agrees that both of the Debtors were alive at the time that their bankruptcy petition was filed and on the date of the hearing. The Death Benefit under the contracts is simply not in dispute. Instead, the question is whether the Debtors in whatever capacity they have with respect to the Annuities can exempt from property of the estate the Surrender Value of the contracts.

The Debtors rely upon two decisions from other Tennessee bankruptcy judges in support of their claims to exemption. The first is *In re Billington*, 376 B.R. 239 (Bankr. M.D. Tenn. 2007). In that case Bankruptcy Judge Paine overruled the trustee in bankruptcy's objection to the debtor's claim of exemption in two life insurance policies under Tennessee Code Annotated § 56-7-203. The policies were owned by the debtor, the life insured was apparently that of the debtor, although this is not specifically stated, and two beneficiaries were named: the debtor's non-dependent mother as primary beneficiary and the debtor's son as contingent beneficiary. At the time of trial, the debtor's mother was still living. The issue before the court was whether the Tennessee statute applies when the primary beneficiary is not a dependent of the insured, but the contingent beneficiary is. Bankruptcy Judge Paine overruled the trustee's objection because the statute is silent as to whether the beneficiary protected from creditors of the insured must be the primary beneficiary or may be a contingent beneficiary.

The second case relied upon by the Debtors is *In re Clemmer*, 184 B.R. 935 (Bankr., E.D. Tenn. 1995). In that case, the trustee in bankruptcy objected to the debtor's claim of exemption in two annuity contracts and three life insurance policies under Tennessee Code Annotated § 56-7-203. Counsel for the Debtors relies upon this case for the purpose of demonstrating that a debtor's interest

in an annuity contract may be protected from creditors; therefore the discussion here focuses only on the treatment of the annuity contracts at issue in *Clemmer*. The debtor was the owner and annuitant under both of the annuity contracts at issue in that case. The beneficiary under each of the contracts was the debtor's son. The debtor's son was entitled to the value of the contracts in the event that the debtor died prior to distribution under the contracts. The debtor's son was an adult at the time of the hearing. He was not financially dependent on the debtor at that time. The trustee in bankruptcy argued that § 56-7-203 should be limited to apply only when *dependent* children are named as beneficiaries under an annuity contract. Bankruptcy Judge Stair rejected this argument based upon the language of the statute which does not limit the children who may be triggering beneficiaries under the statute to *dependent* children.

Neither of the cases relied upon by the Debtors provide help in determining the issues raised in the present case.

In *DeMarco* I indicated that the application of Tennessee Code Annotated § 56-7-203 to any particular case is best determined by substituting description and then the actual name of the insured (or annuitant) for the term "person" wherever it occurs. Applying first the description, "annuitant" in the present case yields the following result:

The net amount payable under any policy of life insurance or under any annuity contract upon the life of the **annuitant** made for the benefit of, or assigned to, the spouse and/or children, or dependent relative of the **annuitant**, shall be exempt from all claims of the creditors of the **annuitant** 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 the **annuitant**.

Whether or not the annuitant is the owner of (or participant in) the contract, the statute protects the “net amount payable” under an annuity contract from the creditors of the annuitant.

Prior to the Annuity Date, defined as the date on which annuity payments are to commence,⁹ the Debtors’ Annuities may be surrendered for their Surrender Value, defined as the value available upon surrender prior to the Annuity Date.¹⁰ The Surrender Value under the Debtors’ Annuities is the “net amount payable” under the statute. The right to surrender the Annuities for their Surrender Value is a right that came to be held by the Trustee as the result of the filing of the Debtors’ bankruptcy petition. The Trustee can exercise this right for the benefit of the Debtors’ creditors unless the Debtors may exempt the Surrender Value from the claims of their creditors. Therefore, if “Surrender Value” is substituted for “net amount payable,” references to insurance policies are excluded, and the name of the actual annuitant is substituted, the application of the statute to the Annuities at issue in this case becomes even more clear.

In the case of Annuities xxx4152 and xxx4524, James is the Annuitant. Substituting his name for “annuitant” yields the following result:

The **Surrender Value** under any annuity contract upon the life of **JAMES** made for the benefit of, or assigned to, the spouse and/or children, or dependent relative of **JAMES**, shall be exempt from all claims of the creditors of **JAMES** 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 **JAMES**.

Annuity xxx4152 is made for the benefit of Connie. Connie is the spouse of James. Therefore, the

⁹ See, e.g., Ex. A, page 10 of 10.

¹⁰ See e.g., Ex. A - part 2, page 1 of 13.

exemption applies to protect the Surrender Value of the Annuity from the claims of the creditors of James, who is both the participant and the Annuitant under Annuity xxx4152. Annuity xxx4524, on the other hand, is made for the benefit of James. James is not his own spouse. Therefore, the exemption does not apply.

In the case of Annuities xxx4160 and xxx3243, Connie is the Annuitant. Substituting her name for “annuitant” yields this result:

The **Surrender Value** under any annuity contract upon the life of **CONNIE** made for the benefit of, or assigned to, the spouse and/or children, or dependent relative of the **CONNIE**, shall be exempt from all claims of the creditors of **CONNIE** 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 **CONNIE**.

Annuity xxx4160 is made for the benefit of Connie. Connie is not her own spouse. Therefore, the exemption does not apply. Annuity xxx3243, on the other hand, is made for the benefit of James. James is the spouse of Connie. Therefore, the exemption does apply to protect the Surrender Value of the contract from the claims of the creditors of Connie, who is both the participant and the Annuitant under this Annuity xxx3243.

Using this method, I conclude that contract numbers 4152 and 3243 are exempt from the claims of the respective creditors of the Debtors as Annuitants-participants. The fact that the Debtors are the participants for these policies is important not for the application of the statute, but for the determination of who is entitled to the Surrender Value. Each of the Debtors owns one of the contracts that is exempt from the claims of the Annuitant’s creditors. Where the Annuitant and the participant are the same person, the creditors are also the same. Therefore, the contracts are

exempt from the claims of the creditors of the respective Debtors in their bankruptcy case because the Debtor is both owner and annuitant. Even though the Debtors have filed a joint bankruptcy case, entitlement to exemptions is separate with respect to each individual debtor. *See* 11 U.S.C. § 522(m).

The Trustee argues that Annuities xxx4152 and xxx3243 are not exempt from the claims of creditors of the Debtors for a different reason. He asserts that the exemption relied upon by the Debtors is not available to a beneficiary under the statute. This argument is based upon two bankruptcy court decisions. The first is *In re LaForest*, 2009 WL 902304 (Bankr. E.D.Tenn. March 31, 2009). That case involved a debtor's claim of exemption in her right to receive payments under a settlement annuity. The debtor was a beneficiary, but not the owner nor the annuitant under the contract. Based upon the decision in *Billington* and the second decision relied upon by the Trustee, *In re Olien*, 256 B.R. 280 (E.D. Tenn. 2000), Bankruptcy Judge Stair noted that the phrase "exempt from the all claims of the creditors of the person" in Tennessee Code Annotated § 56-7-203 does not cover creditors of the beneficiaries to an annuity. That is, proceeds in the hands of a beneficiary are not exempt from the claims of *her* creditors. In the statute, the phrase "upon the life of any person" refers to the life of the insured or annuitant, not the life of the owner of a policy or contract *qua* owner. In many instances the insured or annuitant *is* the owner, but this is not always true. The statute protects the value of a policy or contract from the creditors of the insured or annuitant – not from the creditors of the owner *qua* owner, and not from the creditors of the beneficiary. In every case, the court must look to the identity of the insured or annuitant to determine the relevant creditors and thus the proper application of the exemption.

In the case of Annuity xxx4152, the Annuitant is James, and in the case of Annuity xxx3243, the Annuitant is Connie. The Surrender Values of these contracts is exempt from the claims of creditors of the respective Annuitants. Because the Annuitants under these contracts are also the participants under those same contracts, the Surrender Values are exempt from claims of creditors in the Annuitant-participant's respective bankruptcy estates.

CONCLUSION

For the foregoing reasons, the following is **ORDERED**:

1. The Debtors are ordered to amend their Schedule C to adequately identify the insurance policies they claim are exempt from the claims of creditors and to provide the Trustee with copies of those policies on or before Friday, July 19, 2013. If they fail to do so, the Trustee may present an order declaring his objection to the claimed exemption in the insurance policies to be **SUSTAINED**.
2. The Trustee's objection to the James Neal's claim of exemption in Annuity xxx4152 is **OVERRULED**.
3. The Trustee's objection to the James Neal's claim of exemption in Annuity xxx4160 is **SUSTAINED**.
4. The Trustee's objection to the Connie Neal's claim of exemption in Annuity xxx3243 is **OVERRULED**.
5. The Trustee's objection to the Connie Neal's claim of exemption in Annuity xxx4524 is **SUSTAINED**.
6. James Neal is directed to turn over to the Trustee Annuity xxx4160 on or before Friday, July 19, 2013.

7. Connie Neal is directed to turn over to the Trustee Annuity xxx4524 on or before Friday, July 19, 2013.

cc: Debtors
Counsel for Debtors
Trustee
Counsel for Trustee
Counsel for First Alliance Bank
Counsel for BankPlus Bank
The United States Trustee
All creditors and interested parties