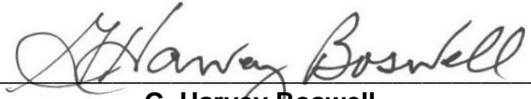




Dated: November 19, 2004
The following is SO ORDERED.


G. Harvey Boswell
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

In re:

BILLY W. KELLEY AND DOROTHY A. KELLEY,

Case No. 04-12920

Debtors.

Chapter 7

MEMORANDUM OPINION AND ORDER RE CHAPTER 7 TRUSTEE'S (1) "OBJECTION TO CLAIMED EXEMPTIONS" AND (2) "OBJECTION TO DEBTORS AMENDED CLAIMED EXEMPTIONS"

The Court conducted a hearing on the Chapter 7 Trustee's "Objection to Claimed Exemptions" on September 1, 2004, and "Objection to Debtors Amended Claimed Exemptions" on October 13, 2004. FED. R. BANKR. P. 9014. Resolution of these matters is a core proceeding. 28 U.S.C. § 157(b)(2). The Court has reviewed the testimony from the hearing and the record as a whole. This Memorandum Opinion and Order shall serve as the Court's findings of facts and conclusions of law. FED. R. BANKR. P. 7052.

I. FINDINGS OF FACT

The facts in this matter are not in dispute. The debtors, Billy and Dorothy Kelley filed their joint chapter 7 petition on June 30, 2004. Approximately one week later, on July 5, 2004, Dorothy Kelley unexpectedly passed away. As the beneficiary of his wife's life insurance policy, Billy Kelly received \$25,000.00 in life insurance proceeds. Billy Kelley filed an amended schedule C on July 30, 2004, to claim

an exemption in the proceeds under T.C.A. § 26-2-110. The Chapter 7 Trustee, (“trustee”), filed an objection to this exemption on August 4 ,2004. The trustee alleged that T.C.A. § 26-2-110 when read together with T.C.A. § 56-7-201 does not allow a beneficiary of a life insurance policy to exempt the proceeds from his creditors.

In response to the trustee’s objection, the debtor filed a second amended schedule C on September 1, 2004, on which he added T.C.A. §§ 56-7-201, 56-7-203, and 26-2-105 to T.C.A. § 26-2-110 as the legal authority for the exemption. The trustee filed an objection to the amended exemption on September 14, 2004, in which he again alleged that a beneficiary is not allowed to exempt life insurance proceeds from his creditors. The debtor is seeking to use the life insurance proceeds to pay medical bills and funeral bills for Dorothy Kelley.

II. Conclusions of Law

At issue in this case is whether or not the debtors can claim an exemption in the \$25,000.00 life insurance proceeds Billy Kelley received when Dorothy Kelley passed away. In order to determine this, the Court must look to both bankruptcy and Tennessee law. The starting place for the investigation is § 541 of the Bankruptcy code which provides that the filing of a chapter 7 petition creates a bankruptcy estate, comprised in part of “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541(a)(1). Pursuant to § 541(a)(5)(C), property that the debtor acquires within 180 days after the filing of his petition “as a beneficiary of a life insurance policy or of a death benefit plan” is also included within the bankruptcy estate. 11 U.S.C. § 541(a)(5)(C). Billy Kelley became entitled to acquire the proceeds of the life insurance policy one week after filing for bankruptcy relief so clearly the proceeds are property of the estate.

Although the Court has determined that the life insurance proceeds fall within § 541, the “property of the estate” issue is complicated in this case by § 302 of the Bankruptcy Code. Section 302 provides for the joint administration of bankruptcy cases filed by married couples:

- (a)** A joint case under a chapter of this title is commenced by the filing with the bankruptcy court of a single petition under such chapter by an individual that may be a debtor under such chapter and such individual's spouse. The commencement of a joint case under a chapter of this title constitutes an order for relief under such chapter.
- (b)** After the commencement of a joint case, the court shall determine the extent, if any, to which the debtors' estates shall be consolidated.

11 U.S.C.A. § 302. Although joint petitions are administered as one case under § 302(a), “separate estates will exist for each debtor unless and until the court orders substantive consolidation of the estates” pursuant to § 302(b). *In re Crowell*, 53 B.R. 555, 557 (Bankr. M.D. Tenn. 1985) (citation omitted); *In re Olien*, 256

B.R. 280, 283 (Bankr. E.D. Tenn. 2000); *In re Nipper*, 243 B.R. 33, 39 (Bankr. E.D. Tenn. 1999). “Section 302 is designed for ease of administration and to permit the payment of only one filing fee . . .” *Crowell*, 53 B.R. at 557 (citation omitted). Unless a court orders consolidation of the estates, one trustee administers two separate estates in a joint case. *In re Olien*, 256 B.R. 280, 283 (Bankr. E.D. Tenn. 2000). Additionally, “[t]he assets of each estate can only be used to satisfy the claims against that estate.” *In re Cash*, 1994 WL 732826, *1 (Bankr. N.D. Ohio 1994).

Pursuant to FED. R. BANKR. P. 1015, a court may order joint administration of a joint petition; however, a court must make a determination in accordance with 11 U.S.C. § 302(b) in order to effect such a consolidation. *Crowell*, 53 B.R. at 557. “Absent a Court Order to consolidate, joint administration has absolutely no impact on the legal rights and obligations of the Debtor, Creditors, or the Trustee.” *Olien*, 256 B.R. at 283 (citations omitted). As in the majority of joint petitions filed in this district, the Court has not ordered a consolidation of the estates in the case at bar. As a result, the Court must consider the estates of Billy Kelley and Dorothy Kelley separate from one another when dealing with the property interests at issue.

In the case at bar, there are two separate estates: the estate of Billy Kelley and the estate of Dorothy Kelley.¹ Section 56-7-201 of the Tennessee Code provides that life insurance proceeds payable to a spouse or children of a decedent passes to such person without being subject to the debts of the decedent. T.C.A. § 56-7-201. The effect of this statute is that insurance proceeds do not become an asset of the decedent’s estate. *Wolfe v. Mid-Continent Corp.*, 222 Tenn. 348, 435 S.W.2d 836, 841 (Tenn. 1968) (discussing § 56-7-201’s predecessor § 56-1108: “Such insurance is not an asset of the estate; for while the Executor may collect it, he acts as a mere conduit to pass it to the statutory beneficiaries free from claims against the estate.”). Because Billy Kelley was the named beneficiary under Dorothy Kelley’s life insurance policy, the proceeds he received are property of his estate. The proceeds are not part of Dorothy Kelley’s estate and, as a result, could not be used to satisfy the claims against her estate.²

¹Pursuant to Fed. R. Bankr. P. 1016, Dorothy Kelley’s post-petition death did not affect her estate:

“[d]eath or incompetency of the debtor shall not abate a liquidation case under chapter 7 of the Code. In such event the estate shall be administered and the case concluded in the same manner, so far as possible, as though the death or incompetency had not occurred.”

FED. R. BANKR. P. 1016.

²The life insurance proceeds would also be unavailable to pay Dorothy Kelley’s creditors under T.C.A. § 56-7-201 which will be discussed infra. *See also*, FN 3.

Although the Court has determined that the life insurance proceeds are property of Billy Kelley's estate, it may be possible for Billy Kelley to exempt the proceeds pursuant to 11 U.S.C. § 522. The Bankruptcy Code provides that debtors may utilize the exemptions listed in § 522(d) or those set forth by applicable state law, unless state law prohibits the use of the § 522(d) exemptions. 11 U.S.C. § 522(b). Tennessee has enacted such a prohibition and, as a result, its citizens in bankruptcy are limited to the exemptions provided by Tennessee law. T.C.A. § 26-2-112. In a joint case, "each spouse can claim an exemption only in property from his or her separate estate." *In re Cash*, 1994 WL 732826, *1 (Bankr. N.D. Ohio 1994).

The debtors have claimed the \$25,000.00 life insurance proceeds exempt under T.C.A. §§ 26-2-105, 26-2-110, 56-7-201, and 56-7-203. Section 26-2-105 exempts monies received under certain pension plans from a debtor's estate. *In re Thompkins*, 263 B.R. 223, 225 (Bankr. W.D. Tenn. 2001). Pursuant to § 26-2-105's language, life insurance proceeds are not exemptable under this section. Section 26-2-110 exempts accident, health or disability insurance proceeds which compensate for losses by reason of "accidental personal injuries, or . . . physical disability resulting from disease." In the case at bar, there was no allegation or proof that the proceeds Billy Kelley received were from an accident, health or disability insurance policy. The proceeds were from a simple life insurance policy and, as such, are not exemptable under § 26-2-110.

In addition to T.C.A. §§ 26-2-105 and 26-2-110, the debtor has also claimed the life insurance proceeds exempt under T.C.A. § 56-7-203. Section 56-7-203 provides that:

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 such persons, shall be exempt from all claims of the creditors of such 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 such person.

T. C. A. § 56-7-203. Based on the "whether or not the right to change the named beneficiary is reserved by or permitted to such person" language in this section, it is generally held that § 56-7-203 only applies to cash surrender values of life insurance policies where the policy holder is still alive. *Olien*, 256 B.R. at 282; *In re Clemmer*, 184 B.R. 935, 937 (Bankr. E.D. Tenn. 1995); *Newport v. Thurman (In re Thurman)*, 127 B.R. 401, 403-06 (M.D. Tenn. 1991). Because Dorothy Kelley is no longer living, the Court concludes that T.C.A. § 56-7-203 is inapplicable to the exemption at issue.

Finally, the debtor has claimed the proceeds as exempt under T.C.A. § 56-7-201. Section 56-7-201 provides that:

Any life insurance effected by a husband or wife on such person's own life shall, in case of that person's death, inure to the benefit of the surviving spouse and children, and the money

thence arising shall be divided between them according to the statutes of distribution, *without being in any manner subject to the debts of the decedent*; provided, that the proceeds of such insurance payable to a testate estate shall pass, as part of the estate and under the dispositive provisions of the will, as ordinary cash, whether or not the will uses any apt or express words referring to the insurance proceeds, but such proceeds shall not be subject to the debts of the decedent unless specifically charged therewith in the will.

T. C. A. § 56-7-201 (emphasis added). Pursuant to this section, the proceeds of a life insurance policy payable to a spouse or child are exempt from the claims of the decedent's creditors. The debtor in this case has alleged that the proceeds are also exempt from the claims of the beneficiary's creditors; however, the Court finds that the debtor's allegation cannot be sustained. Section 56-7-201 clearly states that the proceeds are not "in any manner subject to the debts of the decedent." It does not contain any extension of this exemption to the debts of the spouse or child. Had the Tennessee legislature intended such a result, surely they would have included "or the debts of the beneficiary spouse or child" in the statute. Pursuant to this section, proceeds of life insurance policies in the hands of a decedent's spouse or child are exempt from the claims of the decedent's creditors, but not from the claims of the creditors of the spouse or children. *McLemore v. Huffines (In re Huffines)*, 57 B.R. 740, 742 (M.D. Tenn. 1985).

Based on the foregoing analysis, the Court concludes that Billy Kelley is not entitled to exempt the life insurance proceeds from his individual creditors. Despite this conclusion, the inquiry in the case at bar is not over. Because T.C.A. § 56-7-201 exempts life insurance proceeds from the claims of the decedent's creditors, the proceeds at issue in this case must be exempted from the claims of any joint creditors Billy and Dorothy Kelley have.³ The parties to this proceeding did not present any proof as to the nature of the Kelleys' debts. Therefore, the Court has no way of determining at this time whether or not Billy Kelley has any individual creditors or if all of the debts listed on the Kelleys' petition are joint creditors. If the creditors are all joint creditors, then Billy Kelley can exempt the full \$25,000.00 in life insurance proceeds. If, on the other hand, Billy Kelley has some individual creditors, the exemption will have to be reduced by the amount of such debt.

³Pursuant to T.C.A. § 56-7-201, the life insurance proceeds would also be exempt from the claims of Dorothy Kelley's individual creditors; however, that issue does not arise in this case. Because 11 U.S.C. § 302 mandates that there are two separate estates in a joint case, only the assets of Dorothy Kelley's bankruptcy estate can be used to pay her individual creditors. Since the Court has found that the life insurance proceeds are property of Billy Kelley's estate, the trustee would be unable to use the proceeds to pay any of Dorothy Kelley's individual creditors.

Being aware of the circumstances in this case, the Court regrets having to find that Billy Kelley cannot exempt the life insurance proceeds from the claims of his individual creditors. The Court is fully aware of the difficulty Billy Kelley has gone through since losing his wife. Given the unambiguity of Tennessee law on the subject though, the Court has no choice but to rule in this manner.

III. ORDER

It is therefore **ORDERED** that (1) the Chapter 7 Trustee's "Objection to Claimed Exemptions" filed on August 4, 2004, and (2) the Chapter 7 Trustee's "Objection to Debtors Amended Claimed Exemptions" filed on September 14, 2004, are **SUSTAINED IN PART AND OVERRULED IN PART** as follows:

The debtor may claim an exemption in the \$25,000.00 life insurance proceeds only to the extent that the proceeds may not be used to pay Dorothy Kelley's individual or joint creditors. The exemption does not apply to Billy Kelley's individual creditors.

Service list

debtor

Richard Walker, debtor's attorney

Jesse H. Ford, Trustee