IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF IOWA

In the Matter of:

Preston Wayne Nelson Christine Margaret Nelson	Case No. 13-00801-als7
Debtors	Chapter 7
Rolling Hills Bank and Trust	Adv. Pro. 14-30059-als
Plaintiff	
v.	
Preston Wayne Nelson Christine Margaret Nelson	
Defendants	

MEMORANDUM OF DECISION
(date entered on docket: September 14, 2015)

Trial was conducted on the Plaintiff's complaint seeking a declaratory judgment regarding the status of its interests in Preston Nelson's assignment of two term life insurance policies. Bradley R. Kruse appeared for the Plaintiff, Rolling Hills Bank & Trust ("Bank"). The Defendants, Preston and Christine Nelson are represented by Deborah L. Petersen.

The court has jurisdiction of these matters pursuant to 28 U.S.C. sections 157(b)(1) and 1334. Upon consideration of the evidence and arguments the following findings of fact and conclusions of law are entered by the Court pursuant to Federal Rules of Bankruptcy Procedure 7052 and 9014.

Background

The facts in this case are not disputed. Pacific Investments, L.L.C. was a business owned by the Nelsons. At issue in this case are loans made by the Bank to this business under five promissory notes[1] with an aggregate outstanding balance in excess of $1 million. Each of these individual notes indicates that additional security for payment of the obligation included the assignment of two life insurance policies. The parties stipulate that there was an assignment of term life insurance policy number 9930964 with Genworth Life Insurance Company on November 20, 2009 and that an assignment of policy number 210215736 issued by Met Life was made on June 21 2010. Both of these documents state that the following right(s) are conveyed by the assignment: "The sole right to collect from the Insurer the net proceeds of the Policy when it becomes a claim by death or maturity." On July 25, 2011 both Preston and Christine Nelson executed personal guaranties in favor of the Bank related to the Pacific Investments debt. On November 9, 2012 the Bank, Pacific Investments and the Nelsons entered into three agreements, a Voluntary Surrender of Collateral, an Assignment of Litigation and Claim and a Release of Guaranties. It was about this same time that the Bank began making the premium payments on the assigned life insurance policies. Pacific Investments filed its Statement of Dissolution with the Iowa Secretary of State on November 5, 2012.

On March 25, 2013 the Nelsons filed a voluntary chapter 7 bankruptcy petition. The life insurance policies were not disclosed as assets. Schedule F of the filing identifies the guaranties owing to the Bank as disputed.[2] The Bank filed an unsecured proof of claim in the amount of

[1] Loan number 20050575 dated July 25, 2011; loan number 20052550 dated June 5, 2012; loan number 20052560 dated June 5, 2012; loan number 20052760 dated July 5, 2012 and loan number 20052940 dated August 9, 2013.

[2] The Nelsons were required to assist and cooperate with the Bank in the pending litigation in order for the release of their guaranties to be effective which was the explanation for including this debt and its disputed characterization on the schedules.

$1,327,930.61 for loans and personal guaranties. No objections were filed to this claim. During the administration of the case a dispute arose related to the sale of assets by the chapter 7 trustee. A timely objection to the dischargeability of debt pursuant to 11 U.S.C. sections 523(a)(2) and 523(a)(6) was filed by the Bank. The Bank and the Nelsons resolved the sale dispute and the adversary proceeding by executing a Settlement Agreement on December 6, 2013. According to the docket the trustee's final report was approved and the case was closed by Final Decree on July 3, 2014. A motion to reopen the case was filed by the Bank on October 21, 2014. This adversary proceeding related to the Bank's interests in the assigned insurance policies was then filed.

Discussion

The Bank's complaint seeks declaratory relief under two counts. Count I requests a conclusion that the insurance policies are not property of the bankruptcy estate. Count II seeks a determination of the validity, priority and extent of the Bank's lien against the life insurance policies. In support of their respective positions the parties set forth a variety of arguments, some of which are duplicative and some of which do not neatly fit within the parameters of the requested relief. The primary issues in controversy are: whether the insurance policies are property of the estate; the type of assignments given; whether and to what extent, a lien, if any, arises under the assignments; and whether the assignments are enforceable. Each of these issues will be separately addressed.

A. Property of the Estate

The Nelsons explain their failure to list the life insurance policies on their bankruptcy schedules as merely an oversight.[3] The Bank appears to assert that this non-disclosure constitutes an admission that the Nelsons held no remaining interest in the policies or is evidence that the assignments were absolute. Property of the estate is broadly defined. "[E]very conceivable interest of the debtor, future, nonpossessory, contingent, speculative, and derivative, is within the reach of § 541." *Tyler v. DH Capital Management, Inc.*, 736 F.3d 455, 461 (6th Cir. 2013) (quoting, *Azbill v. Kendrick* (*In re Azbill*), 385 B.R. 799 (table), 2008 WL 647407 (B.A.P. 6th Cir. Mar. 11, 2008)). An asset is not excluded from a bankruptcy estate simply because it is subject to other interests or liens. *Matter of Hawkeye Chemical Co.*, 71 B.R. 315, 321 (Bankr. S.D. Iowa 1987). Preston Nelson as the insured[4] retained specific rights under the policies which were excluded from the Bank's assignment and Christine Nelson held an interest as the beneficiary of both policies. Under the broad definition applied under 11 U.S.C. section 541(a)(1) the insurance policies qualify as property of the bankruptcy estate and failure to disclose them on the schedules does not change this outcome. *In re Miller*, 347 B.R. 48, 53 (Bankr. S.D. Tex. 2006).

B. The Assignments

Absent any restrictions contained in a life insurance policy it can be assigned. *Munn v. Robison*, 203 F.2d 778, 781 (8th Cir. 1953) (quoting *Mutual Life Ins. Co. v. Armstrong*, 117 U.S. 591, 597 (1886)). Such an assignment is recognized under Iowa law. Iowa Code section 539.1; *Provident Mut. Life Ins. Co. of Philadelphia v. Bennett*, 58 F. Supp. 72, 77 (N.D. Iowa 1944).

[3] The record suggests that this current controversy was spurred by a notice from the insurance company to the Nelsons about payment of a current premium on one of the policies because the Bank had apparently elected to not continue making the payments.

[4] The policies were not identified or admitted as exhibits. Preston Nelson's testimony as to the actual owner of the policies is unclear.

"[T]o be valid an assignment is generally said to require the same elements or attributes as are necessary for any other contract, including two or more capable parties, a lawful subject matter, mutual assent, and consideration or a substitute." 29 *Williston on Contracts* §74:3 (4th ed. 2015). An assignment, by its nature, is voluntary and cannot arise by operation of law. There are two common forms of assignment: absolute or as collateral. "[A]n assignment of an insurance policy that states no conditions [is] absolute [and] (sic) divests the insured of all right and title while vesting the beneficial interest in the policy in the assignee." *3 Couch on Insurance 3d* §37:1 (4th ed. 2011). A life insurance policy may also be assigned as collateral for payment of an assignee's obligations. *Luxton v. U.S.*, 340 F.3d 659, 662 (8th Cir. 2003) (citations omitted). Under an assignment as collateral the policy proceeds are first used to pay the amounts due to the assignee with any remaining balance being paid to the beneficiary named in the policy. *3 Couch on Insurance 3d* §37:43 (4th ed. 2011).

The Bank's argument that it received absolute assignments of the insurance policies is not persuasive. The form assignment documents executed by Preston Nelson clearly state that the policies are being assigned as collateral. No evidence or legal authority that would override this unambiguous designation on the face of the assignments was provided. In spite of the Bank's attempts to parse the types of reservations and conditions present in the assignments, the fact remains that Preston Nelson, and his beneficiary, retained various rights that prevents a determination that the assignments were absolute.

C. The Liens

The promissory notes with Pacific Investments do identify the assignments of the insurance policies as security for its debts. The underlying documents that would show the details that gave rise to the pledge of the insurance policies for those debts are not in evidence.

The Nelsons allege that the Bank has impermissibly utilized the assignments as security for the Pacific Investment debts and that it cannot perfect a lien on the insurance policies. It is true, subject to an exception not relevant here, that Article 9 of the Uniform Commercial Code does not apply to transactions that involve "a transfer in or an assignment of a claim under a policy of insurance." I.C.A. § 554.9109(4)(h); U.C.C. § 9-109(d)(8). State statutes or common law determine whether there is a security interest in a life insurance policy. *In re Rogers*, 6 B.R. 472, 474 (Bankr. S.D. Iowa 1980). Under Iowa law if a contract between the parties demonstrates the intent to assign rights in a life insurance policy, the assignee holds a security interest in the policy. *Id*. at 474-75. The assignments alone are all that is necessary to create a legitimate security interest in favor of the Bank in the life insurance policies.

An assignment constitutes "[t]he transfer of rights or property." *Black's Law Dictionary* (10th ed. 2014). However, the rights of the assignee in such a transaction may be characterized and enforced similar to a lien. For example, the assignment of a life insurance policy will serve as a lien on the policy proceeds that has priority over a beneficiary's interest up to the amount owing by the insured. Luxton v. U.S., 340 F.3d 659, 662 (8th Cir. 2003) (citations omitted). The Bank requests a determination of the validity of its "lien." Although not a lien in the true sense of the word the Bank's assignment represents a transfer of property that may be enforced similar to a lien and as such it survives the Nelsons' bankruptcy filing.

D. Enforcement of the Assignments

Neither party questions the validity of the assignments.[5] It is clear that guaranties were executed by Preston and Christine Nelson for the Pacific Investment debt. There is also ample

[5] The Court notes that the assignment of the Genworth policy does not include the identity of the Bank as the assignee. Whether the insurance company would take the position that this omission somehow affects its ability to enforce the terms of the assignment is unknown. *See Munn v. Robison,* 203 F.2d at 781 (citing *Herman v. Connecticut Mutual Life Ins. Co.*, 218 Mass. 181 (Mass. 1914)).

proof of obligations owing by Pacific Investments. At issue is what obligations are the subject of the assignments. The Nelsons contend that the assignments are of no force or effect because due to the parties' agreements there are no obligations that exist to which policy proceeds can be applied. For this reason they request that the assignments be reassigned or rescinded.

The agreements entered into between the parties before, and after, the Nelsons' bankruptcy filing do not specifically address the assignments. The Voluntary Surrender of Collateral and Waiver Agreement ("Surrender Agreement") executed by the parties prior to bankruptcy included a specific listing of the assets that were subject to this transaction.[6] The Surrender Agreement did not identify the insurance policies. Due to the previous assignments, it is reasonable to conclude that those had already been transferred to the Bank and further action was unnecessary. In the parties' ongoing disputes in the bankruptcy case they signed additional documents identified as a "Settlement Agreement" and "Mutual Release." According to the Nelsons these agreements also served to impair the Bank's rights under the assignments. This argument is misplaced. First, these agreements served only to resolve the objection to discharge and the sale of assets by the trustee and were not related to the Pacific Investments debts or the Nelsons' personal guaranties. Second, the "claims" being released are between the Bank and the Nelsons. The Bank holds the *right* to *receive* payment of the life insurance proceeds directly from the insurance company which excludes it from being construed as a claim, demand, or cause of action against the Nelsons.

[6] The Surrender Agreement references a security agreement giving "a security interest in all assets of Guarantors" to the Bank. Documents substantiating this statement were not provided to the Court, so it is impossible to ascertain the specifics of any such interest held by the Bank for the loans. The executed document did not identify any personal assets of the Nelsons, so it could be that any such assets were excluded from this transaction.

More problematic are the consequences of the Release of Guaranties that was executed by the parties simultaneously with the Surrender Agreement and prior to the Nelsons' bankruptcy petition. The terms for release were conditioned upon the Nelsons' cooperation in specific activities. Based upon the record, these conditions have been satisfied and there is no reason to believe that the guaranties have not been released. The assignments clearly state that the policies are held as collateral security for any and all liabilities of the undersigned, identified as Preston Nelson.[7] The Nelsons urge a conclusion that the Release of Guaranties serves as a vehicle to terminate the assignments. The Release of Guaranties does not extend that far, it simply released the personal obligation owing by the Nelsons – it did operate to alter the rights transferred to the Bank under the assignments and the resulting security interests in the proceeds of the life insurance policies.

To avoid what they describe as inevitable future litigation, both parties request the Court to determine the extent to which the assignments may be enforced. Such a determination is premature. These term policies have no current cash or surrender value. The right to payment under the current assignments is contingent upon at least two future events: continued payment of the premiums[8] and payment of a benefit due to death or maturity. The issue of whether policy proceeds can be applied to any outstanding obligations only becomes ripe if, and when, a payment is triggered under an assigned policy. At that time the Bank may be called upon, and bears the burden, to establish its right to payment.

Based upon the foregoing,

IT IS ORDERED that:

1. The insurance policies are property of the bankruptcy estate.

[7] The record lacks any information that details the liabilities owing at the time the assignments were executed.
[8] The record reflects that the Bank has ceased making the premium payments on one policy. Nothing in the record suggests that the Nelsons are required to continue making premium payments to keep this policy in force.

2. The Plaintiff obtained valid assignments of collateral in the Genworth and Met Life policies.

3. The Plaintiff holds a security interest in the assigned life insurance policies.

4. The assignment(s) remain effective.

5. The Defendants' requests for reassignment or rescission of the assignment(s) are denied.

6. The parties shall bear their own costs.

7. Judgment shall enter accordingly.

/s/ Anita L. Shodden
Anita L. Shodeen
U.S. Bankruptcy Judge

Parties receiving this Memorandum of Decision from the Clerk of Court:
Electronic Filers in this Adversary Proceeding