

Appellant John Patrick Lowe is the duly appointed Chapter 7 Trustee (the “Trustee”) of the bankruptcy estates of Debtors Frank W. Gordon and Judith B. Gordon (collectively, “Debtors”). On September 14, 2022, the bankruptcy court rendered an Order Overruling Objection

to Exemption, overruling the Trustee's objection to the Debtors' exemption of certain life-insurance policies (Doc. #4, pp. 24-25). It is from this final order that the Trustee appeals.

II. Factual Background

Debtors elected to exempt property of their bankruptcy estate under Texas state law.¹ The objecting party bears the burden of proving that exemptions are not properly claimed. FED. R. BANKR. P. 4003(c). Debtors claimed as exempt two life-insurance policies.² The Trustee timely objected to the exemption of the policies' cash surrender value on the basis that the exemption could only be claimed by an "insured" or a "beneficiary" of an insurance policy—but not an "owner" of the insurance policy. The bankruptcy court overruled this objection, and the Trustee appealed.

¹ Upon commencement of a bankruptcy case all legal and equitable interests of a debtor in property become part of the bankruptcy estate. *See* 11 U.S.C. § 541; *see also Walden v. McGinnes*, 12 F.3d 445, 448 (5th Cir. 1994). The debtor may, however, exempt certain property from the estate, placing that property beyond the reach of creditors' claims. *See* 11 U.S.C. § 522; *see also Walden*, 12 F.3d at 448. The debtor may elect to exempt property under either the federal exemption scheme or exemptions under state law, if available. *See* 11 U.S.C. § 522. In Texas, a debtor may elect either the federal scheme or the state scheme. *See, e.g., Matter of Volpe*, 943 F.2d 1451, 1452 (5th Cir. 1991). Exemptions are governed by the federal or state law applicable on the filing date of the petition. *See* 11 U.S.C. § 522; *see also White v. Stump*, 266 U.S. 310, 312 (1924). Parties in interest, including the trustee, may object to property the debtor or debtors claim as exempt. FED. R. BANKR. P. 4003(b)

² The first insurance policy was issued on August 15, 1968, by The Northwestern Mutual Life Insurance Company, Milwaukee. It defines Frank W. Gordon as the Insured and Judith B. Gordon as the Direct Beneficiary. The second insurance policy was issued on December 4, 1959, by The Equitable Life Assurance Society of the United States. It defines the Insured as Frank W. Gordon, and an endorsement issued on December 13, 1968, defines the First Beneficiary as Judith B. Gordon.

III. Standard of Review

The bankruptcy court's order is a final appealable order over which this court has appellate jurisdiction. 28 U.S.C. § 158(a)(1). On appeal, this court reviews the bankruptcy court's findings of fact under a clearly erroneous standard and reviews conclusions of law *de novo*. *In re Mandel*, 578 Fed. App'x 376, 382 (5th Cir. 2014). Mixed questions of fact and law are also subject to *de novo* review. *See In re McLain*, 516 F.3d 301, 307 (5th Cir. 2008).

Since the primary question framed by this appeal is whether the bankruptcy court properly overruled the Trustee's objection to the claim of exemption—an issue of law—the court reviews the bankruptcy court's rulings *de novo*. *See Hawk v. Engelhart*, 871 F.3d 287, 290 (5th Cir. 2017) (“The ‘[d]etermination [of] whether an exemption from the bankruptcy estate exists is a question of law, which we review *de novo*.’” (quoting *In re Zibman*, 268 F.3d 298, 301 (5th Cir. 2001))).

IV. Analysis

When Debtors commenced the bankruptcy, all of their property became part of their bankruptcy estates. 11 U.S.C. § 541(a)(1) and (2). But debtors may exempt property from their estates. 11 U.S.C. § 522(b)(1); *see also Hawk*, 871 F.3d at 290. “An exemption is an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor.” *Owen v. Owen*, 500 U.S. 305, 308 (1991). To claim an exemption, the debtor must file a list of property claimed as exempt on a schedule of assets. 11 U.S.C. § 522(l); FED. R. BANKR. P. 4003(a). Debtors claimed the cash surrender value of the relevant life-insurance policies as exempt under Sections 1108.001 and 1108.051 of the Texas Insurance Code. *See* 11 U.S.C. § 522(b)(3) (state and non-bankruptcy federal exemptions). The cash surrender value is the amount that would be paid to the owner if the owner terminated the policy.

Section 1108.001 of the Texas Insurance Code provides that “exemptions under this chapter are in addition to the exemptions from garnishment, attachment, execution or other seizure under Chapter 42, Property Code.”

Section 1108.051 of the Insurance Code (“Section 1108.051”) provides the following:

- (a) Except as provided by Section 1108.053, this section applies to any benefits, including the cash value and proceeds of an insurance policy, to be provided to an insured or beneficiary under:
 - (1) an insurance policy or annuity contract issued by a life, health, or accident insurance company, including a mutual company or fraternal benefit society; or
 - (2) an annuity or benefit plan used by an employer or individual.
- (b) Notwithstanding any other provision of this code, insurance or annuity benefits described by Subsection (a):
 - (1) inure exclusively to the benefit of the person for whose use and benefit the insurance or annuity is designated in the policy or contract; and
 - (2) are fully exempt from:
 - (A) garnishment, attachment, execution, or other seizure;
 - (B) seizure, appropriation, or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, either before or after the benefits are provided; and
 - (C) a demand in a bankruptcy proceeding of the insured or beneficiary.

Section 1108.051. Subsection (a) defines *what* is protected, while subsection (b) spells out *how* it is protected.

Section 1108.053 carves out exceptions to Section 1108.051’s application, providing that Section 1108.051’s exemptions “do not apply to: (1) a premium payment made in fraud of a creditor, subject to the applicable statute of limitations for recovering the payment; (2) a debt of

the insured or beneficiary secured by a pledge of the insurance policy or the proceeds of the policy; or (3) a child support lien or levy under Chapter 157, Family Code.” Tex. Ins. Code § 1108.053.

The Trustee objected to the Debtors’ claim of exemption. The party objecting to a claim of exemption has the burden of proof. FED. R. BANKR. P. 4003(c) (“[T]he objecting party has the burden of proving that the exemptions are not properly claimed.”). Texas exemptions “should be liberally construed in favor of express exemptions, and should never be restricted in their meaning and effect so as to minimize their operation upon the beneficent objects of the statutes.” *Hickman v. Hickman*, 234 S.W.2d 410, 413 (Tex. 1950) (citation omitted).

As the issue presented here involves the interpretation and construction of a Texas statute, this court applies the statutory analysis that a Texas court would. *See LaSalle Bank Nat. Ass’n v. Sleutel*, 289 F.3d 837, 839 (5th Cir. 2002). “In Texas, the cardinal rule of statutory construction is to ascertain the “legislature’s intent,” and to give effect to that intent. The duty of the court is to construe a statute as written and ascertain the legislature’s intent from the language of the act.” *Id.* (quoting *McNeil v. Time Ins. Co.*, 205 F.3d 179, 183 (5th Cir. 2000)); *see also CenterPoint Energy Houston Elec. LLC v. Harris Cnty. Toll Rd. Auth.*, 436 F.3d 541, 545-46 (5th Cir. 2006). “A court may not read statutes to make their words superfluous or insignificant.” *In re Scott*, 193 B.R. 805, 809 (Bankr. N.D. Tex. 1996) (citing *Woodfork v. Marine Cooks & Stewards Union*, 642 F.2d 966, 970-71 (5th Cir. 1981)). This teaching takes on special importance when a federal court construes a state statute. *Scott*, 193 B.R. at 809. Additionally, federal courts “are given more than firm guidance in our interpretation by the Texas courts’ longstanding admonition that exemption statutes are to be liberally construed in favor of the claimant.” *Walden*, 12 F.3d at 448.

Despite Mr. Gordon being defined as the insured and Mrs. Gordon being defined as the beneficiary in both relevant policies, the Trustee argues that, in the context of this case, Mr. Gordon

is the owner—not the insured—and Mrs. Gordon’s status as a beneficiary is irrelevant because Mr. Gordon is still alive. In other words, a contingent beneficiary has no right to cash surrender value until the insured dies, because the owner of the policy may at any time either surrender the policy in exchange for the cash surrender value or change the beneficiary designation. The Trustee argues that the statute does not provide that an owner—the one who owns the cash surrender value of a life-insurance policy—may exempt the cash surrender value of that policy from the claims of his or her creditors. In other words, the Trustee asserts that the cash surrender value in the two policies at issue is not owned by either the “insured” or the “beneficiary.” To bolster this argument, the Trustee cites to *In re Brothers*, 94 B.R. 82 (Bankr. N.D. Tex. 1988), for the proposition that the cash surrender value is owned by the “owner.” Because the statute does not provide for a claim of exemption in the owner’s rights to the cash surrender value, the Trustee argues that his objection should be sustained.

Debtors argue that Section 1108.051(a) unambiguously applies to “cash value.” Debtors also take issue with the Trustee’s distinction between an “owner” and an “insured,” arguing that Debtors fall within the umbrella of the exemption statute.

It is undisputed that Debtors did not surrender either of the policies to obtain the cash surrender value before commencing their bankruptcy. The Trustee posits that the Fifth Circuit suggests that cash surrender value—in an existing policy—is not exempt, citing to *In re Trautman*, 496 F.3d 366 (5th Cir. 2007) (holding that cash value of life-insurance policy that was surrendered pre-petition was non-exempt). The Trustee asserts that if “benefits” in Section 1108.051 does not include surrendered cash value, then “benefits” also does not include cash surrender value still in the policy. The court rejects the Trustee’s interpretation. The *Trautman* court instead suggests that unsurrendered cash value—in other words, cash value remaining in an existing policy—is exempt.

Id. at 370 (“Texas, presumably desiring to protect the named, contingent beneficiaries of existing whole-life policies, amended the statute to include ‘cash values.’ As a result, debtors cannot now garnish, seize, or claim in bankruptcy the cash value of an existing policy – a blessing to contingent beneficiaries, who now *may* later receive a death-benefit.”⁵). Because this case involves cash value in existing life-insurance policies, *Trautman* does not answer the question.

To answer the question, this court looks to Section 1108.051’s legislative history as guidance. Article 21.22(1) of the Texas Insurance Code was originally enacted in 1927 and provided the following:

No money or benefits of any kind to be paid or rendered on a weekly, monthly or other periodic or installment basis to the insured or any beneficiary under any policy of life insurance issued by a life, health or accident insurance company; including mutual and fraternal insurance, or under any plan or program of annuities and benefits in use by any employer shall be liable to execution, attachment, garnishment, or other process or be seized, taken or appropriated or applied by any legal or equitable process or operation of law to pay any debt or liability of the insured or of any beneficiary, either before or after said money or benefits is or are paid or rendered, except for premiums payable on such policy or a debt of the insured secured by a pledge thereof.

Act Approved March 30, 1927, 40th Leg., R.S., ch. 234, 1927 Tex. Gen. Laws 348 (appeared originally as Tex. Rev. Civ. Stat. 5068a) (“Article 21.22(1)”). Since the statute’s enactment,

⁵ The word “debtors” here appears to be used in error. In context, the Fifth Circuit presumably means that *creditors* “cannot now garnish, seize, or claim in bankruptcy the cash values of an existing policy.” See, e.g., *In re Meinscher*, No. 22-509-25-CAG, 2023 WL 1999098, at *4 n.6 (Bankr. W.D. Tex. Feb. 14, 2023).

Legislature has twice, in 1951⁷ and 2001⁸, revisited it for non-substantive revisions and codifications, and on three occasions, in 1987⁹, 1991¹⁰, and 1993¹¹, has substantively amended it.

⁷ In 1951, the Legislature arranged and codified the statutes related to insurance, repealed Tex. Rev. Civ. Stat. 5068a, and enacted Article 21.22 of the Texas Insurance Code without any substantive amendment. *See* Act of June 7, 1951, 52d Leg., R.S., ch. 491, §§ 1, 4, 1951 Tex. Gen. Laws 868, 1076, 1091-92.

⁸ In 2001, the Legislature, in a nonsubstantive revision of statutes relating to insurance, repealed Article 21.22(1) and enacted Section 1108.051. *See* Act of May 22, 2001, 77th Leg. R.S., ch. 1419, §§ 2, 31, and 32, 2001 Tex. Gen. Laws 4073, 4208, 4209.

⁹ In 1987, the Legislature amended Article 21.22(1), eliminating the phrase “on a weekly, monthly, or other periodic or installment basis” to make clear that the section applies to *any* benefits. *See* Act of March 12, 1987, 70th Leg., R.S., Ch. 5, 1987 Tex. Gen. Laws 22. This amendment eliminated any distinction in the applicability of the exemption to benefits based on the method of payment. *See In re Young*, 166 B.R. 854, 857 (Bankr. E.D. Tex. 1994). Following the 1987 amendment, the *Brothers* court rendered an opinion addressing cash values of life-insurance policies, holding that as to life-insurance policies in existence on the date the bankruptcy petition was filed, the cash value was exempt *only in part*, under Article 21.22(1), as the amount of the exemption was limited by the exemption provisions of the Chapter 42 of the Property Code, which allows debtors to maintain a limited amount of life insurance for the protection of their families. *In re Brothers*, 94 B.R. 82, 85-86 (Bankr. N.D. Tex. 1988). The court noted that cash values “are available to the debtor at any time he or she might wish to terminate the insurance contract, or convert the funds to paid up insurance, therefore, they are also available to the Trustee.” *Id.* at 85 (citing *n In re Howerton*, 21 B.R. 621, 623 (Bankr. N.D. Tex. 1982)).

¹⁰ The 1991 Legislature added the following italicized portions to the beginning of Article 21.22(1), “*Notwithstanding any provision of this code other than this article, all money or benefits of any kind, including policy proceeds and cash values, to be paid or rendered to the insured or any beneficiary under any policy of insurance ...*.” *See* Act of May 22, 1991, 72d R.S. Ch. 609 § 1, 1991 Tex. Gen. Laws 2217. This provision was added to provide for an unlimited exemption for insurance proceeds and it expanded the exemption “to provide for a total exemption of life insurance cash values [,] which prevails over the conflicting portion of Section 42.001 of the Texas Property Code.” *See In re Borchers*, 192 B.R. 698, 705 (Bankr. W.D. Tex. 1996). The 1991 amendment also added what now appears as subsection (b)(1), which provides that the benefits referred to in subsection (a) “*Inure exclusively to the benefit of the person for whose use and benefit the insurance is designated in the policy; and (2) be fully exempt*” under certain circumstances, including from all demands in any bankruptcy proceeding of the insured or beneficiary. *See* Act of May 22, 1991, 72d R.S. Ch. 609 § 1, 1991 Tex. Gen. Laws 2217.

Throughout the multiple amendments of Section 1108.051, “the Insurance Code has continually reaffirmed its elemental character providing an exemption for ‘ ... money or benefits of any kind ... to be paid or rendered ... to any beneficiary under any policy of insurance ... ’ and providing that such money or benefits shall be protected from legal or equitable process to pay the debts of the insured or the beneficiary ‘ ... either before or after said money or benefits is or are paid or rendered’” *Young*, 166 B.R. at 858. The Legislature clearly intended to protect the “cash value” of unsurrendered life-insurance policies from claims of creditors *and* from liquidation by trustees. *Cf. Trautman*, 496 F.3d at 371 (holding that proceeds from *surrendered* policy are not exempt under Section 1108.051).

The Trustee’s argument focuses on Mr. Gordon’s status as owner of the policies, but no party disputes that Debtors are the insured and the beneficiary of the policies. Because Mr. Gordon is the insured and Mrs. Gordon is the beneficiary of each policy—and because an insured and a beneficiary can claim the exemption—reaching the owner question is unnecessary.

Considering the plain language of the statute, the court concludes that the Trustee has not met his burden. *See* FED. R. BANKR. P. 4003(c). Section 1108.051 unambiguously provides an exemption for benefits “to be provided to an insured or beneficiary” under a life-insurance policy. Therefore, the statute explicitly allows Debtors to exempt the cash value of the existing life-insurance policies.

¹¹ The last substantive amendment to Article 21.22(1) occurred in 1993, by which the Legislature included annuity contracts, along with the particular types of insurance policies, and made other changes to clarify that all annuity contracts issued by qualifying companies in use by an employer or individual shall be considered a policy or contract of insurance. *See* Act of May 30, 1993, 73d R.S., Ch. 685, § 20.20, 1993 Tex. Gen. Laws 2559, 2706.

The court concludes that the life-insurance policies at issue qualify as exempt property under Section 1108.051.

V. Conclusion

In accordance with the foregoing,

IT IS THEREFORE ORDERED that the September 14, 2022 Order Overruling Objection to Exemption is **AFFIRMED**.

A Final Judgment shall be filed subsequently.

SIGNED this 18th day of April, 2023.



LEE YEAKEL
UNITED STATES DISTRICT JUDGE