UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Central Division

In re:	)	Bankr. No. 97-30115
	)	
LEROY EMIL NEUHARTH	)	Chapter 7
Soc. Sec. No. 504-38-2288	)	
Debtor.	)	
	)	
	)	
JOHN S. LOVALD, TRUSTEE	)	Adv. No. 98-3004
Plaintiff,	)	
	)	
-vs-	)	MEMORANDUM OF DECISION
	)	RE: PLAINTIFF'S MOTION
FIRST FIDELITY BANK, LEROY	)	FOR SUMMARY JUDGMENT
EMIL NEUHARTH AND JEFFERSON-	)	
PILOT LIFE INSURANCE	)	
Defendants.	)	

The matter before the Court is the Motion for Summary Judgment filed by Plaintiff and Defendant First Fidelity Bank's response. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision and Order and subsequent summary judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Plaintiff's Motion for Summary Judgment must be denied and that summary judgment should be entered for Defendant First Fidelity Bank.

Summary of Facts.

Over the years, Leroy E. Neuharth (Neuharth) and his wife, Sharon, borrowed money from First Fidelity Bank of Burke (Bank) to finance their farming operation. In 1983, the notes were consolidated into one. By 1987, the total principal and interest due on the consolidated note was about $400,000.00. As part of an agreement with the Bank, Neuharth purchased a life insurance policy on July 20, 1987 with a death benefit of $400,000.00. He assigned

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it to the Bank on August 13, 1987. The Bank took the life insurance policy assignment in lieu of the debt repayment and eventually released its mortgages on other property of Neuharth's.

One document that was a part of Neuharth and the Bank's agreement was an undated MEMORANDUM OF UNDERSTANDING. It provided:

> Upon receipt of the remaining $60,000.00 insurance premium with a remaining balance of $54,000.00 drawing interest at 11.00%, commencing April 1, 1988, and the payment of the remaining balance of a $29,800.00 note dated November 17, 1987, with a remaining balance as of April 4, 1988, of $28,350.00 plus interest, the bank will effect all real and personal property releases now held on Leroy and Sharon Neuharth.

According to an officer of the Bank, the MEMORANDUM was executed at the same time as the ASSIGNMENT. The ASSIGNMENT provided, in part:

> A. For Value Received the undersigned hereby assign, transfer and set over to First Fidelity Bank[,] its successors and assigns (herein called the "Assignee") Policy No. VPB218935 issued by KENTUCKY CENTRAL LIFE INSURANCE COMPANY ... upon the life of Leroy E. Neuharth of Burke, South Dakota and all claims, options, privileges, rights, title and interest therein and thereunder (except as provided in Paragraph C hereof), subject to all terms and conditions of the policy and to all superior liens, if any, which the Insurer may have against the policy.
>
> B. It is expressly agreed that, without detracting from the generality of the foregoing, the following specific rights are included . . .:
>
> > 1. The sole right to collect from the Insurer the net proceeds of the Policy when it becomes a claim by death or maturity[.]
>
> ....
>
> D. This assignment is made and the Policy is to be held as collateral security for any and all liabilities of the undersigned, or any of them, to the Assignee, either now existing or that may hereafter arise in the ordinary course of business between any of the undersigned and the Assignee[.]

The insurance company acknowledged the ASSIGNMENT on September 2, 1987. The Bank took possession of the policy and the ASSIGNMENT.

Neuharth made his last payment on the consolidated note on October 7, 1987. The Bank never initiated any formal collection action on the consolidated note. The debt was eventually charged off the Bank's books.

Between early 1990 and the autumn of 1997, Neuharth borrowed additional funds from the Bank. All these debts were repaid except one, an auto loan, in October 1997. Neuharth (Debtor), by then divorced from Sharon, filed a Chapter 7 petition for bankruptcy relief on November 17, 1997. He stated in his schedules that the Bank had a claim of $4,486.35 that was secured by a Cadillac valued at $4,500.00.[1] He scheduled the life insurance policy and its cash value as an asset of the bankruptcy estate and he declared $10,000.00 of the cash value exempt. The life insurance policy has a current cash value of $49,561.78, after application of a surrender charge. Debtor's MEMORANDUM OF UNDERSTANDING with the Bank was also acknowledged on Debtor's schedule of general unsecured creditors. The value was stated as "Unknown, if secured."

Trustee John S. Lovald commenced this adversary proceeding seeking a determination that Debtor's assignment of the life insurance policy to the Bank is no longer valid. He argued that because all but one debt owed by Debtor to the Bank has been paid and because the automobile that secured the remaining note had been surrendered, the Bank no longer had any enforceable notes under S.D.C.L. § 15-2-13(1) and thus no longer had an insurable interest

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[1] According to the deposition of a Bank officer, Debtor surrendered the vehicle to the Bank post-petition.

in Debtor's life.

The Bank answered that the assignment was still valid because Debtor, through the assignment, had reaffirmed the debts that the assignment secured. Debtor and the title company, also defendants, have remained on the sidelines awaiting a determination of the continued validity of the assignment.

The Trustee, using 11 U.S.C. § 558 to step into Debtor's shoes to raise any defenses Debtor may have against the assignment, filed a motion for summary judgment. He again argued that the Bank had no enforceable notes and thus no insurable interest that would render the assignment effective on the petition date. The Bank stood on the validity of the assignment, disputed the Trustee's statute of limitations argument, and disputed the Trustee's argument that the Bank's charge-off of the consolidated note rendered the note uncollectible. The Bank also argued that there was no statute of limitations that applied to the assignment as security.

Discussion.

After a review and application of the Bankruptcy Code, state code, relevant case law, and the facts presented, the Court concludes that Debtor's assignment of the life insurance policy to the Bank was a valid pre-petition transfer. It is not defeated by any statute of limitations and it survives the Trustee's avoiding powers under 11 U.S.C. § 544(a)(1).

The U.C.C. does not apply to Debtor's assignment of the insurance policy. Pursuant to S.D.C.L. § 57A-9-104(7), Debtor's

transfer of his interests in the life insurance policies is excluded from the Uniform Commercial Code.[2] While the benefits of an insurance policy may be a general intangible under S.D.C.L. § 57A-9-106, that section gives way to the more specific provisions of § 57A-9-104(7), which excludes from the U.C.C. interests in and claims under insurance policies. *Miller v. Norwest Bank Minnesota (In re Investments and Tax Services, Inc.)*, 148 B.R. 571, 574 (Bankr. D. Minn. 1992). Other state law must therefor be applied to determine the Bank's and Trustee's interests in the insurance policy.

The validity of the assignment is not affected by any statute of limitation. The Uniform Commercial Code does apply to the 1983 consolidated note given by Debtor to the Bank.[3] Under S.D.C.L. § 57A-3-118(b), it appears that the statute of limitations on the consolidated note has run because the Bank has made no demand for payment within ten years after Debtor's last payment. All the subsequent notes have essentially been paid. Accordingly, the Bank has lost all or nearly all of the insurable interest generally required by S.D.C.L. § 58-10-3. *See Froiland v. Tritle*, 484 N.W.2d

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[2] The exception in S.D.C.L. § 57A-9-104(7) for proceeds does not apply because the life insurance policy's cash surrender value or death benefits will not be insurance proceeds payable by reason of loss or damage to collateral. *See* S.D.C.L. § 57A-9-306(1).

[3] Because it is not material to this decision and because the issue was not raised by either party, the Court has not considered whether Debtor has waived any statute of limitations regarding the consolidated note and whether any waiver would be binding on the Trustee.

310, 312-13 (S.D. 1992). However, state law does not require the Bank to have an insurable interest, i.e., an enforceable note, to support this insurance policy assignment.

Under S.D.C.L. § 58-10-6.1, an assignee does not need to have an insurable interest to deem a transfer of an interest in a life insurance policy enforceable if the policy terms are met and if the insured's spouse consents. This assignment given by Debtor to the Bank qualifies because Debtor's wife at the time consented by her signature on the ASSIGNMENT and the insurance company accepted the ASSIGNMENT. While other, more general state statues would require the Bank to have a valid, enforceable note to maintain an interest in the policy as security, *see, e.g., United States v. Burke*, 548 F. Supp. 724, 727 (D.S.D. 1982), and S.D.C.L. § 44-11-11, § 58-10-6.1 controls because it is more specific. *Wildeboer v. South Dakota Junior Chamber of Commerce, Inc.*, 561 N.W.2d 666, 670 (S.D. 1997)(general statute yields to specific statute when they are inconsistent).

Debtor's transfer of his interests in the life insurance policy to the Bank constituted a valid assignment. Under the common law[4], an assignment is

> more than a security for the payment of debts; it is an absolute appropriation of property to their payment. It

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[4] An assignment for the benefit of a specific creditor under the common law, as in this case, must be distinguished from an assignment for the benefit of all creditors that is governed by the state code. *See* S.D.C.L. ch. 54-9 and *Sandwich Manufacturing Co. v. Max*, 58 N.W. 14 (S.D. 1894).

> does not create a lien in favor of creditors upon property which in equity is still regarded as the assignor's, but it passes both the legal and the equitable title to the property absolutely beyond the control of the assignor.

Brekke v. Crew, 178 N.W. 146, 149 (S.D. 1920)(quoting BURRILL ON ASSIGNMENTS (5th ed.), § 6). The test for an assignment is

> was it the intention of the parties, at the time the instrument was executed, to divest the debtor of the title, and so make an appropriation of the property affected to the raising of a fund to pay the debts?

Brekke, 178 N.W. at 149 (quoting *Smead & Powell v. Chandler*, 76 S.W. 1066, 1069 (Ark. 1903) (applying Missouri law); *Springer v. J.R. Clark Co.*, 138 F.2d 722, 726-27 (8th Cir. 1943)(equitable assignment shown by terms of agreement construed in reference to surrounding circumstances and will be enforced against third parties with notice); and *State Central Savings Bank v. Hemmy*, 77 F.2d 458, 460 (8th Cir. 1935).

> No particular form is necessary provided there is shown an intention to appropriate on the one hand and to receive on the other. [Cites omitted.] In proving such an intention, the parties are not confined to the instrument itself if it be part only of an entire transaction, but they may show the entire situation of which the instrument was a part.

Hemmy, 77 F.2d at 460 (cites therein). As distinguished from an equitable lien, an equitable assignment gives the assignee a title that "although not cognizable at law, equity will recognize." *Tobin v. Insurance Agency Co.*, 80 F.2d 241, 243 (8th Cir. 1935).

When the ASSIGNMENT and the MEMORANDUM OF UNDERSTANDING executed by Debtor, his wife, and the Bank are considered under the circumstances that existed when the documents were signed, it is

clear that Debtor's assignment of the life insurance policy was a true assignment and not a security interest or a mere promise to pay. Debtor divested himself of all incidents of ownership and gave the Bank possession of the policy in lieu of payment on the consolidated note and to get other collateral released. Most important, Debtor retained no ability to revoke or alter the assignment. *Springer*, 138 F.2d at 728.

> The assignor must not retain any control over the fund, any authority to collect, or any power of revocation. If he do, it is fatal to the claim of the assignee. The transfer must be of such a character that the fund holder can safely pay, and is compellable to do so, though forbidden by the assignor.

Christmas v. Russell, 81 U.S. 69, 82 (1871)(quoted in *Long v. Farmers State Bank*, 147 F. 360, 364 (8th Cir. 1906)). Finally, notice of the assignment was given to the insurance provider, the provider acknowledged the assignment, and the Bank took possession of the ASSIGNMENT and policy.

It is true that Debtor retained certain rights under the ASSIGNMENT. Debtor specifically retained the right to disability payments, the right to change the beneficiary, and the right to choose the mode of payment. However, even those retained rights were specifically stated not to impair the Bank's rights.

> [T]hese [retained] rights shall in no way impair the right of the [Bank] to surrender the Policy completely with all its incidents or impair any other right of the [Bank] hereunder and any designation or change of beneficiary or election of a mode of settlement shall be made subject to this assignment and to the rights of the [Bank] hereunder.

Therefore, Debtor did not retain any rights under the policy that

were superior to the Bank's.

It is true that the ASSIGNMENT states that the assignment is being made and the Bank is holding the insurance policy as collateral and that any funds received in excess of the existing debt are to be paid by the Bank to the policy's beneficiaries. Those provisions read alone, or especially when read with knowledge that the statute of limitations has now run on the consolidated note, could lead to the conclusion that the assignment fails because no enforceable debt exists. That conclusion, however, would ignore the absolute transfer provisions of the ASSIGNMENT that divested Debtor of all incidents of ownership of the life insurance policy. It would also ignore the other circumstances surrounding the assignment. See *Boyle v. Vivian State Bank*, 226 N.W. 579, 581 (S.D. 1929)(assignment may be implied by the surrounding circumstances); and *Wagner v. Farmers Cooperative Elevator Co. (In re Wagner)*, 173 B.R. 916, 920(N.D. Ia. 1994)(when deciding whether an assignment exists, the facts and circumstances surrounding the agreement are more relevant than the lack of the term "assignment" in the agreement). Debtor and the Bank both acknowledged that Debtor purchased the policy and assigned it to the Bank for the definitive purpose of making the Bank nearly whole on the consolidated note and to allow the Bank to release its other collateral. And the parties fulfilled these intentions: Debtor purchased and assigned the life insurance policy, gave the insurance company notice of the assignment, and gave the Bank possession of the policy; and, the Bank released its other

collateral and commenced no formal action to collect on the consolidated note. The parties' intention that the assignment be absolute was further expressed through the MEMORANDUM OF UNDERSTANDING executed about the same time and the parties' compliance with it, and by the fact that Debtor made no further payments on the consolidated note shortly after the ASSIGNMENT and MEMORANDUM OF UNDERSTANDING were signed. *See Munn v. Robison*, 203 F.2d 778, 780-81 (8th Cir. 1953); *compare Spiro State Bank v. Bankers National Life Ins. Co.*, 69 F.2d 185, 188 (8th Cir. 1934)(no evidence of an assignment, only of the debtor's unexecuted promise to obtain insurance to cover his debts).

On the petition date, only Debtor's remaining interest in the insurance policy came into the bankruptcy estate. Under 11 U.S.C. § 541(a), only the debtor's interest in property becomes property of the bankruptcy estate. The assignment from Debtor to the Bank was complete at the time of execution, not when the policy benefits will be paid. *Ebert v. Dailey Directional Services (In re Gibraltar Resources, Inc.)*, 202 B.R. 586, 588-89 (Bankr. N.D. Tex. 1996). Therefore, only Debtor's retained interests in the life insurance policy came into the bankruptcy estate. Those were the right to any disability payments and the conditional rights to change the beneficiary or to choose the mode of payment, as discussed above. *State Banking & Trust Co. v. Taylor*, 127 N.W. 590, 594 (S.D. 1910)(quoting CYCLOPEDIA OF LAW AND PROCEDURE, vol. 4, p. 632); *Mulhern v. Albin*, 163 F.2d 41, 43 (8th Cir. 1947); and

Ketchikan Shipyard, Inc. v. Anchorage Nautical Tours, Inc. (In re Anchorage Nautical Tours, Inc.), 102 B.R. 741, 743-44 (9th Cir. B.A.P. 1989)(cites therein). "[T]he broad concepts of estate property and its proceeds do not bring into the estate property that the debtor should not own if solvent." *Anchorage Nautical Tours*, 102 B.R. at 745. Here, all the incidents of ownership under the policy had been assigned to the Bank pre-petition. *See In re Independent Pier Co.*, 209 B.R. 333, 340-41 (Bankr. E.D. Pa. 1997).

The Trustee's avoiding powers under § 544(a)(1)[5] *do not defeat the assignment.* Under 11 U.S.C. § 544(a)(1), a case trustee assumes the status of a hypothetical judicial lien holder. With that power, he can supplant inferior, generally unperfected, liens under state law for the benefit of all creditors. *Shuster v. Doane (In re Shuster)*, 784 F.2d 883, 884 (8th Cir. 1986); *Navarro v. Lucas (In re K&A Servicing, Inc.)*, 47 B.R. 807, 813 (Bankr. N.D. Tx. 1985); and *United National Bank v. Corsica Enterprises, Inc. (In re Corsica Enterprises, Inc.)*, 40 B.R. 769, 771 (Bankr. D.S.D. 1984); *see Butner v. United States*, 440 U.S. 48, 54-55 (1979)(in bankruptcy proceedings, the court is to determine property rights by reference to state law).

Under South Dakota law, a creditor holding a judgment can, of

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[5] The Trustee has not raised any issues of a preference or fraud regarding the assignment so as to invoke his avoiding powers under §§ 547 or 548.

course, attach only property of the judgment debtor, S.D.C.L. § 15-18-2, and get a lien on it. S.D.C.L. §§ 15-18-30 (executing officer's lien on personalty) and 15-16-7 (judgment lien on real property). Here, Debtor had virtually no remaining interests in the life insurance policy on the petition date on which a judgment creditor could execute. *See Van Cise v. Merchants' National Bank*, 33 N.W. 897, 902-04 (S.D. 1887). Therefore, the Trustee's strong-arm powers provided under § 544(a)(1) do not defeat Debtor's pre-petition assignment of the insurance policy to the Bank.

S.D.C.L. § 51A-4-10 does not give the Trustee any defense to Debtor's assignment of his ownership interests in the life insurance policy to the Bank. Section 51A-4-10 of the South Dakota code permits a bank to acquire personal property of any kind to satisfy a debt. Under the statute, the bank may hold that personalty for six months before selling it. The state director of banking may extend the six months up to one year. The statute does not state that the bank's debtor has any recourse if the bank should fail to comply. Instead, it appears that the director of banking is the general compliance officer under Title 51A and may impose civil penalties. *See* S.D.C.L. § 51A-1-5. Therefore, the Court is unable to conclude that there is any defense to the assignment which Debtor had under S.D.C.L. § 51A-4-10 that the Trustee can now raise

It appearing that both parties have agreed that no material questions of fact exist, and it further appearing that all parties expected the Court to make a final ruling, and it further appearing

that requiring Defendant Bank to file a formal cross motion for summary judgment would be superfluous, *see Johnson v. Bismark Public School District*, 949 F.2d 1000, 1004-05 (8th Cir. 1991), an order shall be entered directing entry of a summary judgment for Defendant-Bank. Counsel for the Bank shall prepare the summary judgment.

Defendant-Debtor, who chose to remain on the sidelines in this adversary, may file amendments to his schedule of exempt property to reflect the Court's decision herein. F.R.Bankr.P. 1009(a). Any objections to those amended exemptions may then be timely filed by the Trustee or another party in interest. F.R.Bankr.P. 4003(b).

Dated this 19 day of March, 1999.

BY THE COURT:

Irvin N. Hoyt
Bankruptcy Judge

ATTEST:

Charles L. Nail, Jr., Clerk

By: _____
Deputy Clerk

(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

MAR 19 1999

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.

MAR 19 1999

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By_____

Case: 98-03004 Form id: 122 Ntc Date: 03/19/1999 Off: 3 Page : 1
Total notices mailed: 6

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