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Life Insurance As Security for a Debt and the Applicability of the Rule against Wager Contracts

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Life Insurance as Security for a Debt and the Applicability of the Rule Against Wager Contracts

Estate of Bean v. Hazel[1]

I. INTRODUCTION

Every jurisdiction has a rule against wager contracts, developed to discourage speculation in human life and attendant moral hazard.[2] In the life insurance context, the rule in Missouri prohibiting wager contracts applies only "where a policy is taken out by, and premiums paid by, a person who has no insurable interest in the life of the insured, or when a policy has been assigned for speculative purposes."[3]

The Missouri Supreme Court, in *Estate of Bean v. Hazel*, correctly limited the creditor's recovery on the debtor's life insurance policy to the amount of the debt, plus interest. However, in doing so, the court disregarded precedent set in *Butterworth* by holding that the rule against wager contracts applies even when the insured takes out the life insurance policy and pays the premiums.

Application of the rule to these facts does not promote the primary purposes of the rule and does not produce instability in the insured's right to designate whomever she pleases as beneficiary, irrespective of the beneficiary's insurable interest, or lack thereof.

II. FACTS AND HOLDING

On July 7, 1990, Jerry N. Bean (Bean) borrowed $120,000 from Ernest Hazel, III, (Hazel).[4] The agreement was embodied in a promissory note obligating Bean to repay Hazel in monthly installments of $2,609.09.[5] One condition of the agreement was that Bean was to purchase and maintain a life insurance policy naming Hazel as beneficiary in an amount not less than the unpaid balance on the promissory note, plus interest.[6]

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1. 972 S.W.2d 290 (Mo. 1998).

2. Moral hazard is the temptation, created by potential financial benefit, for the beneficiary of an insurance policy to destroy the insured person or property. *See generally* ROBERT H. JERRY, III, UNDERSTANDING INSURANCE LAW 254 (2d ed. 1996); Tom Baker, *On The Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996) (discussing the origin of the doctrine of moral hazard in the insurance industry and the application of the doctrine outside the traditional purview of insurance, specifically, economics).

3. Butterworth v. Mississippi Valley Trust, 240 S.W.2d 676, 682 (Mo. 1951).

4. *Bean*, 972 S.W.2d at 291.

5. *Id.*

6. Estate of Bean v. Hazel, 972 S.W.2d 290, 291 (Mo. 1998).

On July 26, 1990, Bean validly executed a change of beneficiary form on an existing life insurance policy, naming Hazel as beneficiary to policy proceeds in the amount of $120,000.[7] Bean never changed Hazel's beneficiary status and died on September 6, 1992, owing Hazel $79,795.71.[8] Hazel sought and received the designated $120,000 of policy proceeds from the issuer of Bean's life insurance policy.[9]

Bean's estate (Estate), in accordance with Missouri Revised Statutes Section 473.340,[10] subsequently filed a petition for the discovery of assets in probate court seeking to determine title and right to possession of the $120,000

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7. *Id.* The policy provided $200,000 in total proceeds. *Id.*

8. *Id.* Bean borrowed an additional $12,000 from Hazel on February 17, 1992. This loan is reflected in the unpaid balance. *Id.*

9. *Id.*

10. MO. REV. STAT. §47.340 (1994). The statute provides:

> Discovery of assets, procedure for[:]
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> 1. Any personal representative, administrator, creditor, beneficiary or other person who claims an interest in property which is claimed to be an asset of an estate or which is claimed should be an asset of an estate may file a verified petition in the probate division of the circuit court in which said estate is pending seeking determination of the title, or right to possession thereto, or both. The petition shall describe the property, if known, shall allege the nature of the interest of the petitioner and that title or possession of the property, or both, are being adversely withheld or claimed. The court may order the joinder, as a party, of any person who may claim an interest in or who may have possession of any such property.
>
> 2. Service of summons, petition and answer thereto together with all subsequent proceedings shall be governed by the Missouri Rules of Civil Procedure. Any party may demand a jury trial.
>
> 3. Upon a trial of the issues, the court shall determine the persons who have an interest in said property together with the nature and extent of any such interest. The court shall direct the delivery or transfer of the title or possession, or both, of said property to the person or persons entitled thereto and may attach the person of any party refusing to make delivery as directed. If the party found to have adversely withheld the title or possession, or both, of said property has transferred or otherwise disposed of the same, the court shall render a money judgment for the value thereof with interest thereon from the date the property, or any interest therein, was adversely withheld. In addition to a judgment for title and possession, or either, or for the value thereof, the court may enter a judgment for all losses, expenses and damages sustained, if any, but not including attorney fees, if it finds that the property was wrongfully detained, transferred or otherwise disposed of.
>
> 4. If the court finds that a complete determination of the issues cannot be had without the presence of other parties, the court may order them to be brought in by an amended or supplemental petition. The court shall order the joinder of the personal representative of the estate if he is not named as a party.

Id.

in proceeds from Bean's life insurance policy.[11] The trial court held that Hazel was entitled to the contested assets and did not hold the excess policy proceeds in trust for the Estate.[12] The Estate appealed to the Missouri Court of Appeals for the Eastern District of Missouri, which reversed the trial court's ruling.[13] The Missouri Supreme Court then granted transfer.[14]

On transfer to the Missouri Supreme Court, Hazel contended he was entitled to the proceeds in excess of the outstanding debt, citing favorable authority from other jurisdictions.[15] The Missouri Supreme Court disagreed and reversed the trial court's ruling.[16] The court held that when a debtor names a creditor as a beneficiary on a life insurance policy taken out and maintained by the debtor and the creditor's policy proceeds are disproportionate to the outstanding debt, the creditor is only entitled to policy proceeds in the amount of the outstanding debt and holds the excess proceeds in trust for the debtor's estate.[17]

III. LEGAL BACKGROUND

A. Introduction to the Rule Against Wager Contracts

All jurisdictions have a rule against wager contracts. The Rule was promulgated to discourage speculation in human life and eliminate an incentive for the beneficiary of a life insurance policy to hasten the demise of the insured.[18] If a stranger takes out fire insurance on another's house, he will not lose any money or be damaged in any way if the house burns down. Yet, if the house

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11. Estate of Bean v. Hazel, 972 S.W.2d 290, 291 (Mo. 1998).

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.* at 291-92.

16. *Id.* at 293.

17. Estate of Bean v. Hazel, 972 S.W.2d 290, 291-93 (Mo. 1998).

18. *See* 43 AM. JUR. 2D § 976 (1982); *see also* JANICE E. GREIDER & WILLIAM T. BEADLES, LAW AND THE LIFE INSURANCE CONTRACT 57 (3d ed. 1974).

> In its basic outline, a life insurance contract obligates one party to pay another a specific sum of money on the happening of an event that is presumably not within the control of either. Such an agreement bears more than a passing resemblance to a wager. It is obvious also that an unscrupulous person standing to gain from the destruction of an insured piece of property or an insured life might feel a strong temptation, under some circumstances, to implement the whims of chance in his own favor. If life insurance contracts were issued indiscriminately, therefore, they could pose a double threat to the public welfare. To the evils attendant on gambling would be added the possibility of creating a motive for murder in the minds of the unscrupulous.

Id. See generally JERRY, *supra* note 2, at 233-36, 250-54.

does happen to be destroyed in a fire, he receives the proceeds from the fire insurance policy. This tends to create an incentive for the beneficiary to burn down the house. Likewise, someone cannot purchase life insurance on a total stranger, wagering that he will die before more is paid in premiums than the policy pays off. This creates an incentive for the beneficiary to pay as little in premiums as possible by killing the insured. The rule against wager contracts seeks to eliminate this type of speculation and evil incentive.[19]

To eliminate this speculation and evil incentive, it is universally held that one must have an insurable interest in the life of the insured to take out and pay for a life insurance policy on that person.[20] An insurable interest can arise out of a family, business, or financial relation.[21] The Supreme Court defined an insurable interest as some "reasonable expectation of advantage or benefit" from the continued life of the insured.[22] The expectation of continued benefit is thought to be a sufficient deterrent to evil motive.[23]

Speculation and moral hazard can arise in cases where the beneficiary takes out the policy on the insured, where the insured names a third party as beneficiary, and where the insured takes out a policy and assigns the policy to a third party. In all of these arrangements, motive for foul play is possible. However, each of these transactions may be perfectly legitimate. The primary purpose of the rule against wager contracts is to prevent speculation and attendant moral hazard.[24] Thus, the court will examine the circumstances of the transaction to determine if there is a speculative purpose; that is, whether the transaction is "cover for a wager contract."[25]

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19. *See* 43 AM. JUR. 2D § 976 (1982).

20. *Id. See also* GREIDER, *supra* note 18, at 57 ("These problems are avoided by one legal requirement—the requirement of an insurable interest on the part of the person who will benefit from a life insurance contract."); DAN M. MCGILL, LEGAL ASPECTS OF LIFE INSURANCE 51 (1959) ("The insurable interest requirement originated as a means of controlling wagering in human lives and still finds its greatest significance in that function, but it was also intended to reduce the threat of murder created by the insuring of one person's life for the benefit of another.").

21. *See* 43 AM. JUR. 2D § 976 (1982).

22. Warnock v. Davis, 104 U.S. 775, 779 (1881). *See* BUIST M. ANDERSON, VANCE ON INSURANCE § 31, at 190 (3d ed. 1951) (hereinafter VANCE ON INSURANCE) (defining insurable interest as "the policy of the law [which] requires that the assured shall have an interest to preserve the life of the insured in spite of the insurance, rather than to destroy it because of the insurance").

23. The expectation of benefit sufficient to create an insurable interest cannot be satisfied by the expectation of the payment of the life insurance proceeds; otherwise, there could be no rule against wager contracts.

24. *See* VANCE ON INSURANCE, *supra* note 22, § 31, at 190 (stating that "[t]he essential thing is that the policy shall be obtained in good faith, and not for the purpose of speculating upon the hazard of a life in which the insured has no interest") (quoting Connecticut Mut. Life Ins. Co. v. Schaefer, 94 U.S. 457, 460 (1876)).

25. *See* WARREN FREEDMAN, RICHARDS ON THE LAW OF INSURANCE §92, at 381

A colorful application of the rule against wager contracts is found in *Lakin v. Postal Life Insurance Co.*[26] Henry Lakin (Lakin) ran a small roofing business and placed an advertisement in the *Kansas City Star* for a single man, aged 25 to 30, to work as a helper for room and board and wages.[27] W. Harvey Hankinson (Hankinson) answered the advertisement, began working for Lakin as a helper, and lived in Lakin's home.[28] Only seven days after the advertisement was placed, Lakin approached an insurance agent stating he had a new "partner" and that he wanted his new partner to take out a life insurance policy naming Lakin as beneficiary.[29] Lakin had some initial trouble persuading a life insurance company to issue a policy on Hankinson;[30] however, Hankinson eventually took out a term life insurance policy providing twenty-five thousand dollars in death benefits.[31] The policy paid twice that amount in the event of accidental death of the insured. Lakin paid the premium on the life insurance policy.[32] Although Hankinson initially named his wife as a beneficiary,[33] he later named Lakin as the beneficiary.[34] Less than two months later, Lakin killed Hankinson while hunting.[35] Lakin claimed that Hankinson tossed his gun to him and in doing so "his finger must have hit the trigger."[36] Hankinson died from a gunshot wound to the chest.[37] Postal Life Insurance Company (Postal Life), who issued Hankinson's policy, denied Lakin's application for the proceeds and Lakin filed suit.[38] Postal Life maintained, inter alia,[39] that Lakin had no insurable interest in the life of Hankinson.[40] The Missouri Supreme Court agreed, stating that the mere designation of Hankinson as Lakin's partner, as dubious as it was on these facts,[41] did not create an insurable interest in Lakin on the life of

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(5th ed. 1952)(hereinafter RICHARDS ON INSURANCE) (stating that "where the insured is merely a nominal party whose life and name are used to cover a scheme to obtain speculative insurance, the courts will invalidate the life insurance policy as violative of public policy").

26. 316 S.W.2d 542 (Mo. 1958).

27. *Id.* at 544.

28. *Id.*

29. *Id.* at 546.

30. *Id.*

31. Lakin v. Postal Life Ins. Co., 316 S.W.2d 542, 546 (Mo. 1958).

32. *Id.*

33. *Id.* at 547.

34. *Id.*

35. *Id.* at 548.

36. Lakin v. Postal Life Ins. Co., 316 S.W.2d 542, 548 (Mo. 1958).

37. *Id.*

38. *Id.* at 544.

39. Postal Life also maintained that Lakin intentionally killed Hankinson. *Id.*

40. *Id.*

41. There was no evidence that Hankinson was a partner in Lakin's business, other than Lakin's statements to that effect. Lakin v. Postal Life Ins. Co., 316 S.W.2d 542, 551

Hankinson.[42] "A person cannot take out a valid and enforceable policy of insurance for his own benefit on the life of a person in which he has no insurable interest; such a policy or contract of insurance is void and unenforceable on the grounds of public policy, it being merely a wager contract."[43]

B. The Rule Against Wager Contracts in a Creditor-Debtor Relationship

When a life insurance policy is used as security for a debt, it is uniformly held that a creditor has an insurable interest in the life of his debtor.[44] A creditor can receive proceeds from a debtor's life insurance policy in a variety of ways. She can be named the beneficiary of her debtor's life insurance policy, or she can be assigned the policy. She can also take out a life insurance policy on the life of her debtor. Jurisdictions accommodate these distinctions differently, with sometimes dispositive results. The legal scrutiny paid upon the beneficiary is greater when the beneficiary takes out the life insurance policy on the insured. This is because it is the classic circumstance that gave rise to the insurable interest requirement, and consequently to the rule against wager contracts.[45] That is not to say that courts will not look into the circumstances surrounding a designation, by the insured, of a beneficiary who has no insurable interest when the evidence so warrants.[46] It is just that the first two scenarios are closer to the fact patterns that gave rise to the insurable interest doctrine, and thus, these situations will more likely alert judicial antennae to possible speculative purposes. The overarching principle in all cases is that the policy must be taken out in good faith and not as a subterfuge for a wager contract.[47]

Almost without exception, however, the creditor pays or agrees to pay the premiums on the debtor's policy; that is, the debtor does not maintain the policy.[48] This distinction is important and will be developed in the commentary

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(Mo. 1958).

42. *Id.* at 550.

43. *Id.*

44. *See* 43 AM. JUR. 2D § 992 (1982); VANCE ON INSURANCE, *supra* note 22, § 32, at 200 (stating that "[i]t is well settled that a creditor has an insurable interest in the life of his debtor").

45. *See* JERRY, *supra* note 2, at 251 (stating that "[w]here an individual takes out insurance on the life of another, a greater risk exists that the evils to which the insurable interest is directed—destruction of the insured and wagering—will occur").

46. *See* JERRY, *supra* note 2, at 251 (stating "[f]or the court to take this step, the beneficiary must lack an interest, either economic or familial, in the life of the insured").

47. *See* VANCE ON INSURANCE, *supra* note 22, § 31, at 190.

48. *But see* Sachs v. United States, 412 F.2d 357, 365 n.5 (8th Cir. 1969) (stating that "[i]t is immaterial whether the debtor or creditor pays the premiums and even whether the debtor knows about the life insurance contract") (citing Morrow v. National Life, 168 S.W. 881 (Mo. Ct. App. 1914)). The *Morrow* court stated the policy was valid

below. Problems arise when the policy proceeds going to the creditor exceed the amount of the debt. Whether the creditor's recovery on the debtor's life insurance policy is limited to the amount of the debt becomes the issue.

Three solutions have evolved in response to this issue. First, some jurisdictions limit the creditor's recovery, per se, to the amount of the debt, plus premiums paid, plus interest.[49] Second, some jurisdictions allow a creditor to recover the full amount of the policy proceeds, if the proceeds are not grossly disproportionate to the debt.[50] Third, some jurisdictions allow a creditor full recovery, absent evidence of speculation or proof of contrary intent on the part of the debtor.[51]

Jurisdictions limiting recovery of a creditor to the amount of the debt, plus premiums paid, plus interest, state that a creditor has an insurable interest in her debtor's life only to the extent of the debt.[52] Any assurance over this amount is mere speculation.[53] In these jurisdictions, however, the entire policy is not void and unenforceable because of this perceived speculative purpose.[54] The portion of the policy necessary to satisfy the debt, plus premiums, plus interest is valid as to the creditor.[55] The balance is valid and is held in trust for the debtor's

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when taken out and paid for by either the insured or the creditor. *Morrow*, 168 S.W.2d at 883. However, the court later stated the beneficiary must possess an insurable interest in the life of the insured, as per statute § 6956 R.S. 1909. *Id.* at 882. The court then reasoned that because the statute required the beneficiary to have an insurable interest, the rule against wager contracts was applicable irrespective of who paid the premiums. *Id.* at 883. Today, there is no statute in Missouri requiring the beneficiary to have an insurable interest in the life of the insured. Therefore, the foundation for the decision in *Sachs* is unsound, making the holding suspect.

49. *See* Warnock v. Davis, 104 U.S. 775 (1881); Sachs v. United States, 412 F.2d 357 (8th Cir. 1969); Jimenez v. Protective Life Ins. Co., 8 Cal. App.4th 528 (Cal. Ct. App. 1992); Progressive Life Ins. Co. v. Bohannon, 40 S.E.2d 564 (Ga. Ct. App. 1946); Morrow v. National Life, 168 S.W. 881 (Mo. Ct. App. 1914); Strode v. Meyer Bros. Drug Co., 74 S.W. 379 (Mo. Ct. App. 1903); Froiland v. Tritle, 484 N.W.2d 310 (S.D. 1992); Burnett v. Amicable Life Ins. Co., 195 S.W.2d 237 (Tex. Ct. App. 1946).

50. *See* Amick v. Butler, 12 N.E. 518 (Ind. 1887); Lakin v. Postal Life Ins. Co., 316 S.W.2d 542 (Mo. 1958); *see also* 43 AM. JUR. 2D § 992, at n.53.

51. *See* Grigsby v. Russell, 222 U.S. 149 (1911); New York Life v. Baum, 700 F.2d 928 (5th Cir. 1983); American Cas. Co. v. Rose, 340 F.2d 469 (10th Cir. 1964); Zolintakis v. Orfanos, 119 F.2d 571 (10th Cir. 1941); Graves v. Norred, 510 So. 2d 816 (Ala. 1987); Lewellyn v. Dobson Bros., 262 S.E.2d 726 (S.C. 1980); Hackney v. Sharp, 157 S.W.2d 827 (Tenn. 1942).

52. *See e.g.*, Strode v. Meyer Bros. Drug Co., 74 S.W. 379, 381 (Mo. Ct. App. 1903).

53. *Id.*

54. *Id.*

55. *Id.*

estate.[56] Thus, there is no net benefit to the creditor upon the death of the debtor, eliminating any speculation or evil incentive.

In *Strode v. Meyer Bros. Drug Co.*,[57] John Stokes (Stokes) owed Meyer Brothers Drug Co. (Meyer Drug) $111 as a business debt.[58] Stokes, at the suggestion of Meyer Drug, took out a five thousand dollar life insurance policy and named Meyer Drug beneficiary in the amount of $4950 with $50 going to his estate.[59] Meyer Drug paid all the premiums until Stokes died three years later.[60] Meyer Drug refused to pay the estate any portion of the designated proceeds.[61] The court determined that the policy was taken out as security for the debt owed.[62] Consequently, the court held that "the creditor . . . acquires the status of beneficiary as far as is necessary to make him whole and no further. As to the remainder of the insurance money, he stands as trustee for the estate of the insured."[63]

Jurisdictions allowing a creditor to recover the full amount of the policy proceeds when the difference between the proceeds and the debt is not grossly disproportionate reason that a creditor should not lose money on the death of her debtor.[64] The creditor should be allowed to assure the debtor in an amount greater than the amount of the debt because the creditor pays the premiums and interest. This allows the creditor a greater opportunity to avoid a loss upon the debtor's death.[65] The critical question under this formulation of the rule is

56. *Id.*

57. Strode v. Meyer Bros. Drug Co., 74 S.W. 379, 381 (Mo. Ct. App. 1903).

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. Strode v. Meyer Bros. Drug Co., 74 S.W. 379, 380-81 (Mo. Ct. App. 1903).

63. *Id.* at 381. The court acknowledged that some jurisdictions do not limit a creditor's recovery on the debtor's life insurance policy when the difference between the debt and the proceeds is not "unreasonable." *Id.* The court found, however, that the "egregious disproportion" between the debt and the proceeds prohibit Meyer Drug from receiving the designated policy proceeds. *Id.*

64. *See e.g.*, Amick v. Butler, 12 N.E. 518 (Ind. 1887).

65. *See* MCGILL, *supra* note 20, at 64 (stating that this rule is "largely due to the notion that a creditor should be allowed to insure the debtor's life for a sum estimated to be sufficient to reimburse the creditor, at the debtor's death, for premiums paid on the policy, with interest thereon, plus the debt and accumulated interest"). However, this rule has been severely criticized as engendering "practical embarrassment" because:

> [T]he validity of the contract should be determined according to the motives of the parties and the contract viewed at its date, rather than after the death of the insured . . . [and because] the total of the premium, as thus computed [based on the life expectancy of the insured] with interest thereon, will generally exceed the face amount of the policy, no matter how large or how small the amount of the insurance, leaving to the creditor nothing at all to apply upon the debt. [Further] to permit the creditor to take out insurance,

whether the disproportion indicates that the policy was taken out as a wager; the greater the disproportion, the greater the suggestion that the policy was taken out for a speculative purpose.[66]

In *Amick v. Butler*,[67] Frazee owed Amick six hundred dollars. At Amick's suggestion, Frazee took out a two thousand dollar life insurance policy on himself and named Amick as beneficiary.[68] Amick agreed to pay all the premiums.[69] Frazee died approximately two years after the policy was taken out.[70] Deducting the amount of the debt and the premium payments, $1259 of policy proceeds remained, which Amick refused to pay to Frazee's administrator, Butler.[71] The court held:

> [A] creditor may in good faith take insurance upon the life of his debtor, either by procuring a policy in which he is designated as the beneficiary, or by assignment... the amount of the insurance obtained must bear some just proportion to the debt . . . and the probable contingencies attending the future maintenance of the policy. The circumstances must be such as not to raise the presumption that the transaction on its face was a mere speculation.[72]

Having determined that the policy was taken out in good faith and did not feature characteristics of "mere speculation," the court found Amick obtained a vested right to collect the full amount of the policy proceeds.[73] Even though there was an oral agreement that Amick would return the policy to Frazee if the debt and the premiums on the policy were paid,[74] the court determined this was not enough to create a trust for Frazee's estate.[75]

> greatly in excess of the debt, offers a clear inducement to the creditor to shorten the debtor's life, and therefore, contravenes a recognized principle of public policy.

RICHARDS ON INSURANCE, *supra* note 25, § 98, at 397. *See also* VANCE ON INSURANCE, *supra* note 22, § 32, at 200 (stating a similar criticism).

66. *See* GREIDER, *supra* note 18, at 131 (stating "if the insurance is unreasonably high in relation to the amount of the debt, the facts themselves suggest that the transaction is in reality a wager").

67. 12 N.E. 518 (Ind. 1887).

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. Amick v. Butler, 12 N.E. 518, 520 (Ind. 1887).

73. *Id.* at 521.

74. *Id.* at 518.

75. *Id.* at 521. Interestingly, the court stated that when the policy is a security for the debt and the debtor maintains the policy, any excess proceeds are to be held in trust for the debtor's estate, irrespective of the designation of the creditor as beneficiary in the

In jurisdictions allowing a creditor to recover the full amount of the policy proceeds, absent speculative purpose or contrary intent of the debtor, the designation of the beneficiary for the full policy proceeds is presumed to be the insured's overriding intent.[76] In *American Casualty Co. v. Rose*,[77] Verl Rose (Rose) took out and paid for a thirty day life insurance policy paying fifty thousand dollars in the event of an accidental death.[78] Rose, an automobile stunt performer in "Auto Thrill Circus,"[79] named his employer, John King (King), the beneficiary of the policy.[80] There was evidence that Rose owed King one or two thousand dollars.[81] The court first stated that Rose had an insurable interest in his own life and was free to name anyone as beneficiary, irrespective of the beneficiary's insurable interest, or lack thereof.[82] Further, the court determined that King was named the beneficiary "without limitation" and that a creditor-debtor relationship creates no presumption that the debtor intended to limit the creditor's recovery on the life insurance policy.[83] The court, citing *Zolitakis v. Orfanos*,[84] stated that a trust can be created by an express or implicit understanding of the parties that the excess proceeds of a policy, assigned as security for a debt, will be held for the debtor's estate.[85] However, the debtor's estate has the burden of proving by "clear and unmistakable proof" that it was the debtor's intent to limit the creditor's recovery on the policy to the amount of the debt.[86]

C. *The Rule Favoring Free Designation of a Beneficiary*

Finally, as noted in the preceding case, it is universally held that a person has an insurable interest in his own life and is free, in the absence of statute, to designate whomever he pleases as the beneficiary, irrespective of the beneficiary's insurable interest, or lack thereof, in the life of the insured.[87] The

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life insurance policy. *Id.* at 520.

76. *See, e.g.*, American Cas. Co. v. Rose, 340 F.2d 469 (10th Cir. 1964).

77. 340 F.2d 469 (10th Cir. 1964).

78. *Id.*

79. *Id.* at 470.

80. *Id.* at 469-70.

81. *Id.* at 470.

82. American Cas. Co. v. Rose, 340 F.2d 469, 471 (10th Cir. 1964).

83. *Id.*

84. 119 F.2d 571 (10th Cir. 1941).

85. *American Cas. Co.*, 340 F.2d at 471.

86. *Id.*

87. *See* 43 AM. JUR. 2D § 974 (1982); ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW § 3.5(a), at 120 (1971) (stating that the "assertion that 'every person has an insurable interest in his own life' is a fictional way of saying that, despite the applicability of an insurable interest doctrine to life insurance contracts, every person sui juris may validly contract for insurance on his own life, designating whomever he

only exception is that the policy is void if the designation of the beneficiary is merely "cover for a wager contract."[88] This policy gives effect to the grantor's intent and prevents the insurer from attempting to escape liability on a valid insurance contract by asserting that the named beneficiary lacks an insurable interest in the life of the insured.[89]

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will as beneficiary"); see also VANCE ON INSURANCE, *supra* note 22, § 31, at 188, which states:

> It is more accurate to say that the question of insurable interest is immaterial when the policy is on the insured's own life. The presence of an insurable interest is really required only as evidence of the good faith of the parties, and it is contrary to human experience that a man should insure his own life for the purpose of speculation, or be tempted to take his own life in order to secure payment of money to some other, although instances of such gruesome fraud upon insurers is not wanting. Consequently, it is held that the mere fact that a man of his own motion insures his life for the benefit either of himself or of another is sufficient evidence of good faith to validate the contract.

88. 43 AM. JUR. 2D § 974 (1982).

89. *See* New York Life Ins. Co. v. Baum, 700 F.2d 928, 934-35 (5th Cir. 1983). In some jurisdictions it is held that only an insurer can assert that the beneficiary or assignee lacks an insurable interest in the life of the insured. This rule is "derived from the notion that only a party to a contract should have standing to raise an issue that might void the contract." JERRY, *supra* note 2, at 265. In Missouri, ostensibly only the insurer can raise lack of insurable interest. Lowe v. Rennert, 869 S.W.2d 199, 203 (Mo. Ct. App. 1993). The court in *Lowe*, however, allowed the insured to assert the beneficiary's lack of insurable interest in the insured's life. *Id.* The issue of standing was not raised in *Bean*, however, the court allowed the Estate to question Hazel's insurable interest. This may be because the Estate was also a beneficiary of the life insurance policy at issue, therefore giving the Estate privity that may satisfy the contractual rationale of the rule. If the Estate had not been a beneficiary also, the standing issue may have become central. Nonetheless, the continued validity of the rule in Missouri is suspect. Authorities on insurance law have also reached different results interpreting the majority view on the use of this "standing" rule. *See* KEETON, *supra* note 86, § 3.3(b), at 103-04 (stating the majority view is that only the insurer may assert lack of insurable interest, yet noting due to its inconsistent application, "it seems doubtful indeed that it represents the prevailing view"); JERRY, *supra* note 2, at 265 (stating that "[m]ost courts adhere to the view that only an insurer has standing to raise the absence of insurable interest" but "some courts have simply overlooked the rule"). *But see* RICHARDS ON INSURANCE, *supra* note 25, § 89, at 372 (stating "the great weight of authority in the United States" allows third parties to assert lack of insurable interest).

IV. THE INSTANT DECISION

A. The Majority Opinion

The majority first determined whether the rule against wager contracts was applicable in the present case.[90] Because there was a creditor-debtor relationship between Bean and Hazel and because Hazel was designated beneficiary of Bean's life insurance policy as security for the debt, the court analyzed the circumstances to determine whether there was a speculative purpose that would require application of the rule against wager contracts.[91] The court found that the policy proceeds to Hazel were "disproportionately large when compared to the debt," sufficient to be deemed an "improper speculative purpose."[92]

Although the majority acknowledged that the rule against wager contracts can conflict with the rule favoring an insured's free designation of a beneficiary,[93] the rule favoring free designation is applicable "provided it not be done by way of cover for a wagering policy."[94] However, because the proceeds payable to Hazel were disproportionate to the debt, there was an improper speculative purpose.[95] Implicitly, if there was an improper speculative purpose, the designation of beneficiary was "cover for a wagering policy." Consequently, the rule favoring free designation of a beneficiary was overridden by the rule against wager contracts.

The court then determined that "a constructive trust will be imposed where a person wrongfully obtains the proceeds of a life insurance policy as beneficiary of the policy."[96] Because Hazel was not entitled to the excess proceeds, due to the improper speculative purpose, he wrongfully obtained the excess proceeds.[97] Therefore, the court found that Hazel held the excess proceeds in trust for the Estate.[98]

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90. Estate of Bean v. Hazel, 972 S.W.2d 290, 291-92 (Mo. 1998).

91. *Id.* at 292.

92. *Id.* The court relies on *Strode v. Meyer Bros. Drug Co.*, 74 S.W. 379 (Mo. Ct. App. 1903) to arrive at the disproportion test. In *Strode*, however, the court did not apply a disproportion test, but followed a "per se" test, holding that "the creditor ... acquires the status of beneficiary as far as is necessary to make him whole and no further. As to the remainder of the insurance money, he stands as trustee for the estate of the insured ...." *Id.* at 381.

93. "These two rules come into closest conflict where a creditor contracts with a debtor to assign the proceeds of an insurance policy as a means of securing payment of a debt and the proceeds of the policy are disproportionate to the amount owing on the debt when the insured dies." *Bean*, 972 S.W.2d at 291-92.

94. *Id.* at 291.

95. Estate of Bean v. Hazel, 972 S.W.2d 290, 292 (Mo. 1998).

96. *Id.* (quoting WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 490 (4th ed. 1989).

97. *Id.* at 293.

98. *Id.* at 292.

B. The Dissenting Opinion

The dissent found the rule against wager contracts inapplicable in the present case.[99] "[T]he rule against wager life insurance contracts only 'applies where a policy has been taken out by, and the premiums paid by, a person who has no insurable interest in the life of the insured, or when it has been assigned for speculative purposes.'"[100] Because Bean took out the policies and paid the premiums, the dissent held that the rule against wager policies was inapplicable.[101] Further, the dissent found no evidence to suggest that Bean named Hazel the beneficiary for speculative purposes.[102] Because there was no evidence of a speculative purpose, the dissent determined that Hazel was entitled to recover the full amount of the policy proceeds.[103]

V. COMMENT

Missouri precedent dictates that the rule against wager contracts applies only "where a policy is taken out by, and premiums paid by, a person who has no insurable interest in the life of the insured, or when it has been assigned for speculative purposes."[104] The rule should not be applied when the insured purchases and continues to maintain the life insurance policy because the speculation and attendant moral hazard sought to be eliminated by the rule are not present.

First, it is a dubious proposition that an insured can speculate against himself. The speculation sought to be avoided by the rule is a third party wagering that the insured will die, perhaps fortuitously, before the third party pays more in premiums than the policy pays off. There is no wager or gamble when an insured pays the premiums because the insured does not benefit. He cannot win the "bet." If there is nothing to win, there is no gamble and, thus, no speculative purpose.

Second, there is also no incentive to kill the insured. The insured's inherent interest in self-preservation is presumably sufficient to keep him from committing suicide for the benefit of his beneficiaries.[105] Moreover, if a creditor

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99. *Id.* at 293.

100. Estate of Bean v. Hazel, 972 S.W.2d 290, 293 (Mo. 1998) (quoting Butterworth v. Mississippi Valley Trust Co., 240 S.W.2d 676, 682 (Mo. 1951).

101. *Id.*

102. *Id.* at 294.

103. *Id.* at 295.

104. *Butterworth*, 240 S.W.2d at 682.

105. *See* VANCE ON INSURANCE, *supra* note 22, § 31, at 188 (stating that "it is contrary to human experience that a man . . . be tempted to take his own life in order to secure payment of money to some other").

is designated as beneficiary, the creditor is very much interested in the continued life of the insured, his debtor. The debtor can repay the debt and the creditor will still receive the policy proceeds.[106] Some might counter that there is a possibility that the creditor-beneficiary has an incentive to kill the insured to recover the policy proceeds *now*. However, as Justice Holmes stated in *Grigsby v. Russell*, "[t]he law has no universal fear of the temptation opened by a pecuniary benefit accruing upon a death."[107]

Further, the majority's application of the disproportion test is inappropriate. The disproportion between the policy proceeds and the debt is allowed for the very reason that the creditor pays the premiums.[108] This enables the creditor to better assure herself against the risk of loss on the death of her debtor.[109] Thus, when the insured pays the premiums, application of the disproportion test serves no purpose. A limitation on the creditor's recovery from the debtor's life insurance policy must be accomplished by other means.

Although the dissent correctly determined that the rule against wager contracts was inapplicable in the present case,[110] it failed to consider the insured's intent and the equities of the case.[111] The better reasoned approach would be to follow the jurisdictions that allow a creditor to recover the full amount of the policy proceeds, absent speculative purpose or contrary intent of the insured.

In *Bean*, there was no evidence that the transaction was cover for a wager contract. The existence of a creditor-debtor relationship was uncontested. These facts alone, however, should not limit the creditor's recovery. The contrary intent of the insured must be shown. Evidence that the insured designated the

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106. This presupposes that the debtor intended the creditor to receive the full policy proceeds. This Note, however, proposes that the creditor is entitled to full recovery so long as the intent of the debtor is not to the contrary. Therefore, whether the creditor will recover the designated policy proceeds depends upon the circumstances of the case. If it is proven that the insured intended to limit the creditor's recovery to the outstanding debt, and the outstanding debt is nil, then the creditor recovers nothing on the policy.

107. Grigsby v. Russell, 222 U.S. 149, 155-56 (1911). See also VANCE ON INSURANCE, *supra* note 22, § 31, at 189, which states:

> It is true that such a beneficiary without interest will be subject to the same temptation to terminate unlawfully the life of the insured as if he himself had taken out the policy . . . but the law considers this danger too slight for notice, since the selection of beneficiary by the insured is, in ordinary cases, sufficient guaranty of the existence of such good faith and confidence between them as will sufficiently protect the insured.

108. *See supra* note 65.

109. *See supra* note 65.

110. Estate of Bean v. Hazel, 972 S.W.2d 290, 294 (Mo. 1998).

111. "It may very well be that this result was unintentional, that Bean was merely careless in naming Hazel as beneficiary of a set amount and then failing to decrease that amount as the outstanding debt decreased." *Id.* at 295.

creditor as beneficiary solely as security for the debt is sufficient to indicate the contrary intent of the insured. If the court had decided this case based upon the parties' intentions, it would have been unnecessary to engage in a factual inquiry to determine whether Hazel was named beneficiary solely as security for the debt (although clearly he was designated for that reason), because the contrary intent of the insured was express in the promissory note. The promissory note required Bean to name Hazel as beneficiary of a life insurance policy in an "amount not less than the unpaid balance of the promissory note and the accrued interest at any time."[112] This provision indicates that both Bean and Hazel only intended for Hazel to recover from the insurance policy an amount necessary to satisfy the debt, if Bean died before his indebtedness to Hazel was extinguished. Therefore, based on the parties' intentions, Hazel would not have been allowed to escape the express intent of the promissory note when Bean designated Hazel as beneficiary and inadvertently failed to provide for a declining balance arrangement. Further, because Bean only named Hazel beneficiary in the amount of the original debt, on a policy that provided proceeds in excess of the original debt,[113] there was no evidence that Bean intended to provide Hazel with an economic windfall. As evidenced by the promissory note, Hazel was named beneficiary of the policy solely as security for Bean's indebtedness to him. Thus, Hazel would only have been entitled to recover the amount of the outstanding debt, plus interest, and the balance would have been held in constructive trust for the benefit of the Estate.

VI. CONCLUSION

The decision of the court to limit Hazel's recovery on Bean's life insurance policy by inappropriately applying the rule against wager contracts produces instability in the designation of beneficiaries in life insurance policies. Dissatisfied heirs may be able to tempt courts into applying the rationale of the present court by merely showing the existence of a creditor-debtor relationship, even when it was not the insured's intent to limit the creditor's recovery.[114]

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112. *Id.* at 291.

113. Bean named Hazel beneficiary in the amount of $120,000 on a policy that provided $200,000 in death benefits. *Id.*

114. In *Forster v. Franklin Life Ins. Co.*, 311 P.2d 700, 704 (Colo. 1957), the insured took out and paid for a life insurance policy and later named a creditor as one of the beneficiaries on the policy. The court did not limit the creditor's recovery because the trial court found that the creditor was not named beneficiary as security for the debt. Conversely, if the creditor was named beneficiary as security for the debt, the creditor's recovery would have been limited to the amount of the debt. *See also* Wages v. Wages, 42 S.E.2d 481, 486 (Ga. 1947). In *Wages*, the court held that an insured has an interest in his own life and may name anyone as beneficiary, however, "where it appears as a matter of fact that the policy is held by a creditor merely as security for a debt of the insured, the creditor is entitled only to reimbursement, and is bound to account for the

When the insured purchases and maintains the policy, the insured's designation of a beneficiary should be rebutted in only very limited circumstances, such as the present case. Requiring a showing of a creditor-debtor relationship, plus evidence of the insured's intent to limit the beneficiary's recovery to the amount of the debt, would be sufficient to promote stability in the law and to give effect to the insured's intent.

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balance to the legal representative of the debtor." *Id.* at 486. The court found sufficient evidence to affirm the trial court's ruling that the insured did not name the creditor as beneficiary solely as security for the debt, thus allowing the creditor full recovery on the insured's policy. *Id.* at 487-88.