

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:)	Chapter 11
)	
LIFE FUND 5.1, LLC, <i>et al.</i> , ¹)	Case No. 09 B 32672
)	
Debtors.)	Jointly Administered
)	Hearing Date: October 18, 2010
)	Hearing Time: 9:30 a.m.

**JOHN HANCOCK’S LIMITED OBJECTION TO
TRUSTEE’S NOTICE OF HEARING ON PROPOSED SALE OF
TRANSAMERICA POLICY 60059453, METLIFE POLICY
U7403296 AND JOHN HANCOCK POLICY UL00267681
FREE AND CLEAR OF LIENS, CLAIMS AND ENCUMBRANCES**

John Hancock Life Insurance Company (U.S.A.) (“John Hancock”), by and through its undersigned attorneys, submits this limited objection to the Trustee’s Notice of Hearing on Proposed Sale of Transamerica Policy 60059453, MetLife Policy U7403296 and John Hancock Policy UL00267681 Free and Clear of Liens, Claims and Encumbrances (the “Notice of Hearing”). In support of this limited objection, John Hancock states as follows:

INTRODUCTION

1. On October 8, 2010, the Trustee filed the Notice of Hearing proposing to sell Transamerica Policy 60059453, MetLife Policy U7403296, and John Hancock Policy UL00267681 free and clear of liens, claims and encumbrances. (Docket No. 482).² The

¹ The Debtors in the cases are: (1) Life Fund 5.1, LLC; (2) Life Fund 5.2, LLC; (3) A&O Life Fund, LLC; (4) A&O Resource Management, LLC; (5) A&O Bonded Life Settlement, LLC; (6) A&O Bonded Life Assets, LLC; and (7) Houston Tanglewood Partners, LLC (collectively the “Debtors”).

² On July 26, 2010, the Trustee filed a Motion for Orders: (1) Approving (A) Procedures for the Sale of Life Policy Assets Free and Clear of Claims and Encumbrances and with Certain Findings and (B) Procedures to Redeem or Allow Life Policy Assets to Lapse; (2) Determining Estates’ Rights to and in Policies; (3) Preventing Insurers from Taking Certain Acts with Respect to Policies; and (4) Granting

(Continued)

Notice of Hearing states that the Trustee shall appear before this Court on October 18, 2010 to request that the Court enter a proposed order which purports to authorize the sale of certain life insurance policies “free and clear of liens, claims, interests, and encumbrances” (the “Sale Order”). One of the subject policies is a life insurance policy issued by John Hancock Life Insurance Company (now John Hancock Life Insurance Company (U.S.A.)) (Policy No. UL00267681) (the “Policy”).

2. John Hancock does not oppose the proposed sale of the Policy by the Trustee, nor does it intend to thwart the sale process. Rather, John Hancock seeks limited protections in the Sale Order to preserve its existing rights with respect to the Policy, and to make clear that nothing in the Sale Order effects John Hancock’s right to assert claims and defenses, including: (i) fraud in the formation of the Policy; (ii) the lack of an insurable interest in the Policy; and (iii) any competing claims for the death benefit proceeds of the Policy.

3. The Sale Order seeks a finding by this Court that the sale of the Policy shall be “free and clear of liens, claims, interests and encumbrances” under Section 363 of the Bankruptcy Code. (Sale Order, ¶¶’s H and 5, pp. 3-4). Section 363, however, does not provide the Trustee with any authority to modify John Hancock’s rights under the Policy or applicable law. In essence, the Sale Order seeks to provide the proposed purchaser of the Policy with greater rights than currently exist.

(Continued)

Related Relief (the “Sale Motion”) (Docket No. 403). Certain Insurers, including John Hancock, filed a limited objection to the Sale Motion, for reasons that include the reasons set forth in this limited objection. (Docket No. 451). After hearing oral argument on August 18, 2010, this Court refused to enter the Trustee’s proposed order which, among other things, purported to modify the rights of the Insurers.

4. In an effort to resolve this issue without the need for judicial intervention, John Hancock proposed to the Trustee that the Sale Order include the following language to clarify that John Hancock's rights under the Policy and applicable law are not being modified:

Notwithstanding anything to the contrary in this Order: (1) the Subject Assets are not sold free and clear of any rights of an Insurer under a Policy that arise (a) under a Policy or any applicable law or (b) any loans under the Policy; and (2) nothing in this Order shall affect or modify the rights, defenses and remedies of any Insurer arising under or related to the Subject Assets or any applicable law.

The parties are currently engaged in discussions regarding modified language to resolve this issue.

5. In the previously filed Sale Motion, the Trustee sought to extinguish the rights of John Hancock to challenge the validity of the Policy, and to interplead the death benefit proceeds of the Policy. This Court rejected the Trustee's attempt to modify John Hancock's rights, and John Hancock now files this limited objection to protect those same rights.

ARGUMENT

A. JOHN HANCOCK HAS CONTRACTUAL AND STATUTORY RIGHTS REGARDING THE POLICY AND MAY POSSESS CLAIMS AND DEFENSES AS TO THE VALIDITY OF THE POLICY.

6. It is universally recognized that a life insurer has the right to challenge the validity of a life insurance policy procured through fraud and/or lacking an insurable interest. *See, e.g., Couch on Insurance 3d* § 41:1 (2000). Depending on which state's law applies, the insurer's right remains, in many cases, even after the expiration of an "incontestability clause" contained in a particular policy. Indeed, "[t]he majority of

jurisdictions follow the view that an incontestable clause does not prohibit insurers from resisting payment on the ground that the policy was issued to one having no insurable interest – such a defense may be raised despite the fact that the period of contestability has expired.” *Couch on Insurance 3d*, § 240:82 (2000).

7. Moreover, it is axiomatic that an incontestability clause has no impact on an insurer’s right to file an interpleader action when an insurer faces competing claims for death benefit proceeds. This is so for the simple reason that an interpleader action seeks not to void the policy, but rather seeks a judicial determination regarding to whom the death benefit proceeds shall be paid. Litigation has long abounded in connection with competing claims for death benefit proceeds, and it is therefore obvious that, in such situations, insurers must be permitted to exercise their rights to interplead the death benefit proceeds. Without the option of filing an interpleader action, John Hancock would face the possibility of a double payment scenario involving millions of dollars.

8. To the extent the Trustee seeks to use the “free and clear of liens, claims, interests and encumbrances” language contained in the Sale Order to modify John Hancock’s rights under the Policy and applicable law, the attempt should be rejected. The Bankruptcy Code does not permit a trustee to modify the rights of a counterparty to a contract by selling that contract under Section 363 of the Bankruptcy Code. To do so would allow a trustee to provide a purchaser of a contract with greater rights under the contract than existed prior to such sale. *See In re Crossman*, 259 B.R. 301, 307 (Bankr. N.D. Ill. 2001) (Section “363(b)(1) was a general enabling provision that does not expand or change a debtor’s interest in property merely because a bankruptcy petition is filed”). But, a “bankruptcy trustee succeeds only to the title and rights in property that the debtor

had at the time she filed the bankruptcy petition.” *In re Crossman*, 259 B.R. at 307 (internal citation omitted). Accordingly, The Trustee cannot provide the potential purchaser with greater rights than the Debtor had under the Policy. John Hancock has contractual and statutory rights vis-à-vis the Policy, and the Trustee may not alter those rights by selling the Policy.

B. THE POLICY CANNOT BE SOLD FREE AND CLEAR OF JOHN HANCOCK’S CLAIMS.

9. While Section 363(f) of the Bankruptcy Code authorizes the sale of property, under certain circumstances, “free and clear of any interest in such property of an entity other than the estate,” it does not authorize sales free and clear of *claims*. 11 U.S.C. § 363(f). Indeed, the Trustee cites no authority for the proposition that the Policy can lawfully be sold free and clear of John Hancock’s rights to challenge the validity of the Policy, or to interplead the death benefit proceeds of the Policy.

C. THE POLICY CANNOT BE SOLD FREE AND CLEAR OF JOHN HANCOCK’S DEFENSES.

10. Moreover, to the extent that John Hancock’s rights to challenge the validity of the Policy or to interplead the death benefit proceeds of the Policy are deemed to be interests in the Policy, such interests are in the nature of defenses to payment on the Policy, and the Policy cannot lawfully be sold free and clear of John Hancock’s defenses. *See Folger Adam Security, Inc. v. DeMatteis/MacGregor*, 209 F.3d 252, 261 (3d Cir. 2000) (there is no authority for a sale free and clear of defenses); *In re Atlantic Gulf Communities Corp.*, 326 B.R. 294, 299-300 (Bankr. D. Del. 2005) (the sale of a litigation claim does not entitle the assignee to collect in contravention of defenses).

D. JOHN HANCOCK IS ENTITLED TO ADEQUATE PROTECTION UNDER THE BANKRUPTCY CODE.

11. If John Hancock's rights with respect to the Policy are deemed to be interests, then John Hancock is entitled to adequate protection under Section 363(e) of the Bankruptcy Code, which provides:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

11 U.S.C. § 363(e).

12. The Sale Order provides that the Trustee can sell the Policy free and clear of all liens, claims, interests and encumbrances because the sale of the Policy falls within one of the subsections of Section 363(f), and John Hancock is adequately protected by having its Claims attach to the sale proceeds. (Sale Order, ¶¶'s H and 5, pp. 3-4). The Trustee, however, fails to identify which subsection of 363(f) he relies upon, and no such subsection could apply here. Moreover, the granting of a lien on the sale proceeds of \$155,000 (for the Policy which has a face amount of \$1 Million) falls woefully short of providing John Hancock with adequate protection. Similarly, such amount does not provide the indubitable equivalent of John Hancock's interest in the Policy.

13. Moreover, to the extent John Hancock's interests attach to the sale proceeds as adequate protection, such proceeds cannot be used to pay Melville without John Hancock's consent. *See e.g. In re CXM, Inc.*, 307 B.R. 94 (Bankr. N.D. Ill. 2004).³

³ John Hancock also objects to the Trustee's request to waive the 14 day stay period under Bankruptcy Rule 6004(h) and 6006(d). The Trustee has provided no grounds for such relief.

CONCLUSION

John Hancock respectfully requests that this Court deny the Trustee's request to enter the Sale Order unless John Hancock's rights are adequately protected by the inclusion in the Sale Order of the additional language proposed by John Hancock.

Dated: Chicago, Illinois
October 15, 2010

Respectfully submitted,

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