Equitable distribution: Classification of Life Insurance Policies and Proceeds

In *Crago v. Crago*, 268 NC App 154 (2019), the court of appeal rejected a request to apply the analytic approach to classify life insurance proceeds received by wife before the date of separation. The analytic approach is the classification approach adopted by the appellate court to classify personal injury settlement proceeds, *see Johnson v. Johnson*, 317 NC 437 (1986), and workers compensation payments, see *Freeman v. Freeman,* 107 NC App 644 (1992). The analytic approach classifies the proceeds according to what the payments were intended to compensate. So, to the extent a personal injury settlement replaces economic loss to the marriage, it is marital. To the extent it compensates a spouse for future lost wages or personal pain and suffering, it is separate.

In rejecting the analytic approach, the court in *Crago* held that prior case law established that life insurance policies and the proceeds from life insurance policies are classified using fundamental principles of classification, meaning by applying the statutory definition of marital property and the source of funds doctrine. The court of appeals in *Crago* referred to this as the "mechanistic approach." In an opinion issued shortly after *Crago*, *Richter v. Richter*, 271 NC App 644 (2020), the court of appeals further explained that application of fundamental classification principles means the court must first determine the property interest owned by one or both parties on the date of separation. If not owned on the date of separation, proceeds from life insurance policies cannot be marital property but the policy itself may be marital property.

Life Insurance Policies

While every opinion issued by the court of appeals regarding life insurance in equitable distribution to date has involved a dispute over the classification of proceeds paid from a life insurance policy, the court has made it clear in these cases that the policy itself should be classified if owned by the parties on the date of separation.

In *Foster v. Foster*, 90 N.C. App. 265 (1988), the parties owned whole life insurance policies covering the lives of their children on the date of separation. Evidence showed the policy at issue had a value of $20 on the date on the date of separation. The child covered by that policy died during separation and wife argued the proceeds should be classified as marital property because until the date of separation, the premiums for the policy were paid with marital funds. As discussed in more detail below, the court of appeals held that the proceeds received after the date of separation were not marital property. However, the court held that the cash value of the whole life policy on the date of separation was marital because all premiums up until the date of separation had been paid with marital funds. Because any value of the policy on the date of separation had been acquired using marital funds, the policy itself was marital. *See also Edwards v. Edwards,* 110 NC App 1 (1993)(remanding case to trial court to determine the date of separation value of a policy and holding that all value established would be marital because all premiums up until the date of separation had been paid with marital funds), and *Richter v. Rickter*, 271 NC App 644 (2020)(noting that while whole life policies generally have value, term life policies generally do not).

Life Insurance Proceeds

Foster v. Foster, 90 N.C. App. 265 (1988), was the first appellate case in North Carolina to address the classification of life insurance proceeds. The court held in that case that because the parties had no vested right to receive the proceeds until the death of the child and the child did not die until after the date of separation, the proceeds could not be marital property. *See* GS 50-20(b)(1)(marital property is property owned by either or both parties on the date of separation). The only property interest owned by the parties on the date of separation was the policy itself. The court held that because all premiums after the date of separation had been paid by father, the proceeds were his property.

The result in *Crago* was different because wife received the proceeds from the life insurance policy before the date of separation and continued to own the proceeds on the date of separation. Wife had purchased the life insurance policy on the life of her former husband before she married Mr. Crago. She continued to pay the premiums for the policy after her marriage to Mr. Crago and shortly before their separation, the former husband died and wife received the proceeds.

Wife urged the court to use the analytic approach in this situation to classify the proceeds according to the intended use of the proceeds. She argued that because the policy had been purchased and maintained to provide support for the children of wife and her first husband should their father pass away, public policy should support a classification that would honor that intention. Both the trial court and the court of appeals rejected wife's argument and held that the proceeds were marital because they were acquired during the marriage, owned by a party on the date of separation, marital funds had been used to pay the premiums during the marriage and wife was not able to show that her separate funds had been used to pay any portion of the premiums.

In *Richter v. Richter*, 271 NC App 644 (2020), husband received life insurance proceeds from a policy on the life of his former wife and owned those proceeds on the date of separation. Unlike the situation in *Crago*, no marital funds had been used to pay the premiums on that policy. Instead, the former wife purchased the policy, paid all premiums and designated Mr. Richter the sole beneficiary. Both the trial court and the court of appeals concluded that while the proceeds were acquired during the marriage and owned by a party on the date of separation, husband established that he acquired the proceeds as the result of a gift from a third party to him alone. GS 50-20(b)(2)(gifts to a spouse during the marriage is the separate property of that spouse).