Till Death Do Us Part, Unless I Need to Sue Your Estate

July 7, 2020 **|** by Gary Botwinick, Bonnie Frost, Matheu Nunn

As published by the New Jersey Law Journal, Law.com, July 7, 2020

This article provides case law-based examples of what can go wrong if you fail to draft life insurance provisions in your child- or spousal-support agreements, as well as tips for drafting such provisions.

Review the last 10 marital settlement agreements you drafted. Did those agreements involve payment/receipt of spousal or child support? Do those agreements contain life insurance provisions to secure spousal/child support? If you fail to draft life insurance provisions in your agreements with the same detail as an "anti-*Lepis*" provision, you may commit malpractice or invite unnecessary estate litigation—or *both*. This article provides case law-based examples of what can go wrong and tips on how to avoid pitfalls.

In 2019, we participated in *Woytas v. Greenwood Tree Experts*, 237 N.J. 501 (2019). The case was grounded in a tousled intersection of divorce, life insurance, and suicide. The agreement between the decedent/former husband and his ex-wife required the decedent to "maintain a $400,000 life insurance policy *for the duration* of his alimony obligation," naming his ex-wife beneficiary. *Id.* at 506 (emphasis added). The agreement also required the decedent to maintain $750,000 of life insurance for his three children "to be reduced by $250,000 upon a child's emancipation." *Ibid.* The agreement included a handwritten clause providing: "[i]n the event either party fails to maintain the life insurance [policy requirements], such party's estate shall be liable for any *outstanding obligations* owed under this Agreement." *Id.* at 506-07 (emphasis added).
Although the decedent obtained the requisite life insurance coverage, he committed suicide; in turn, two of three life insurance companies refused to pay death benefits. Complicating matters further, the decedent died with an insolvent estate. Both the trial court and Appellate Division held the decedent's estate liable for the entire death benefit of the life insurance policies notwithstanding the parties' handwritten provision that obligated the parties' estates to pay for *outstanding obligations*. The Supreme

Court affirmed the lower courts' rulings on different grounds. The court held that the decedent's ex-wife would receive the entirety of the estate because the decedent's "outstanding child support obligations exceed[ed] the value of the remaining assets …." ***Id.*** at 515. It added: "[i]n a closer case, a remand for a precise calculation of damages would be appropriate. Here, because there would be no remaining estate assets to pay [the ex-wife's] claims, remand for a precise damages calculation is unnecessary." ***Ibid.*** Stated differently, if the decedent's estate had more assets, the ex-wife's claims would have been limited to recovery on the outstanding obligations and not the death benefit of the life insurance policies. Cf. ***Jacobitti v. Jacobitti***, 135 N.J. 571, 574-82 (1994) (affirming trial court requirement that elderly divorced man place assets in a trust to secure the support obligation he owed to his former wife and that upon wife's death, "the corpus would be distributed" to the husband, his estate, or a designated charity).

In ***Della Terza v. Estate of Della Terza***, 276 N.J. Super. 46 (App. Div. 1994), the parties' judgment of divorce provided that the husband "shall maintain the child of the marriage as beneficiary on his life insurance policy until she becomes emancipated." Following the divorce, the husband re-married; had a second child; and designated his new spouse as beneficiary of his only life insurance policy. When he died, his second wife received the life insurance proceeds notwithstanding his first daughter remained unemancipated. The Appellate Division held that "[b]ecause the amount of the policy to be maintained [in the parties' judgment of divorce] was not specified, fair concepts of equitable assignment and reasonable expectation entitle plaintiff only to the value of the insurance policy at the time of the judgment of divorce enhanced by such increases as may be represented by generally applied salary improvements decedent would have received in the position he then held until the date of his death …." ***Id***. at 50-51.

Similarly, in ***DeCeglia v. Estate of Colletti***, 265 N.J. Super. 128 (App. Div. 1993), the decedent had a child out of wedlock. Prior to his death, the decedent named his mother and sister as beneficiaries of his group life insurance. ***Ibid.*** Following the decedent's death, the child's mother sought to obtain the life insurance proceeds for the benefit of the child; a trial court awarded her with the proceeds. On appeal, the Appellate Division reversed the trial court, concluding that the child's mother was not entitled to the ***entirety*** of the life insurance proceeds, but that she could "pursue a claim for child support from the insurance proceeds." ***Id.*** at 141. ***See also Raynor v. Raynor***, 319 N.J. Super. 591 (App. Div. 1999).

Against that backdrop, are there better alternatives to consider rather than a vague provision requiring the payor spouse to maintain insurance “as security” (i.e., a “Must Maintain Requirement” or an “MMR”)? First and foremost, your agreements must specify whether the payee spouse should receive the entire death benefit of a life insurance policy, or funds equivalent to outstanding financial support existing at the time of the payor’s death. After you resolve that issue, consider the following options to ensure compliance:

Payee Spouse as Owner of Policy

This is the most common alternative to the use of MMR language. An agreement could require that the payee spouse is the owner of a policy on the life of the payor, coupled with a requirement that the payor continue to make the premium payments. This would ensure that the payee—as owner—would have the sole right to designate herself as the beneficiary. If the payor failed to make a premium payment, the payee would be immediately notified and have the opportunity to seek payment in court, or to pay the premium herself and seek reimbursement by motion.

Prior to the tax law changes in the Tax Cuts and Jobs Act of 2017, which eliminated the income taxability of alimony, premium payments by the payor would be treated as taxable alimony to the payee spouse (as the owner of the policy). However, as a result in the change in tax treatment, that issue is no longer an impediment to this arrangement.

While certainly preferred to a general MMR provision, there are some problems. One concern would be that the insurance requirements under the PSA may reduce over time. The payee spouse would be required to change the beneficiary designation on a regular basis to ensure a proper allocation of the death benefit. Additionally, if the payee has issues with respect to his or her own creditors, the policy could be lost to such a creditor. This would be a problem if the payor spouse expected that policy to be returned to the payor.

Irrevocable Beneficiary

If the concern is not whether a payor will maintain a policy, but rather whether the payor would designate the payee as beneficiary, and not change that beneficiary, a requirement that the payor irrevocably designate the payee as the beneficiary may be a better alternative. The payor would initially be required to produce evidence of the change of beneficiary, and the payee spouse would be able to verify that the "irrevocable designation" had been made. This would prevent the payor from subsequently changing the beneficiary, as the insurer would not accept such a designation without the payee's consent.

While certainly providing greater protection to the payee than simply relying on MMR provisions, there are situations where an irrevocable beneficiary designation could go wrong. If the policy is attendant to employment, loss of employment would likely terminate the protection guaranteed to the payee. If the policy is not employment-related, but an independently obtained policy, the policy could be lost due to failure to pay premiums or cancellation by the payor.

Trustee Owned Policy

The best available option to ensure that the protection afforded by the life insurance death benefit is preserved is to implement the use of a trust. Simultaneously with their settlement agreement, the parties could agree to establish a trust governed by a trust agreement, which would receive a transfer of the existing policy. All of the documents, including appropriate assignments and beneficiary designations can be drafted in advance and delivered to the insurer upon the divorce. If there is no policy in existence, the agreement can require the payee to sit for a medical examination and provide appropriate information to allow the trustee to obtain the policy after the divorce. Provisions regarding reduction of benefits over time can easily be incorporated into the trust agreement, with an alternate beneficiary for any excess benefits.

The agreement could require the payor to make payments to the trustee in advance of the premium due dates. For example, the agreement could provide that the payor must remit payments to the trustee 90 days before the premium due date. If the payment is not made, the trustee or the payor would have sufficient time to file a motion to enforce the premium payment. Moreover, the trust could even require that the payor must ensure that the trust has sufficient cash reserves to provide a source of funding in the event that the payor fails to make payments. In addition, ownership of the policy by a trustee also eliminates the likelihood that the beneficiary would be changed, as only the trustee can make the change. Although an arrangement whereby the trust owns the policy is more expensive, it affords greater protection than a basic MMR requirement.

Conclusion

Life insurance obligations in marital settlement agreements are too important for stock language. Accordingly, no matter which option the parties choose, be careful to ensure that the MMR language accurately reflects the parties' intentions.

Matheu D. Nunn is a Partner and Co-Chair of Appellate Practice at Einhorn, Barbarito, Frost & Botwinick, in Denville. Gary R. Botwinick is Co-Managing Partner at the firm, and Bonnie C. Frost is a Partner and Co-Chair of Appellate Practice.

Click here to view article on Law.com website.