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## **Handling Community Property Claims Against Life Insurance in California: The Modified Risk Payment Theory**

The concept of community property is used in eight American jurisdictions<sup>1</sup> as a method to protect the contributions of each spouse to the acquisition and maintenance of the marital estate.<sup>2</sup> The system, however, is not perfect and many difficult issues can arise when community property is distributed. Life insurance is a unique form of property that raises unique community property issues in both the

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1. The community property jurisdictions are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. See Vaughn, *The Policy of Community Property and Inter-Spousal Transactions*, 19 BAYLOR L. REV. 20, 20-21 (1967) (discussing derivation of community property laws in American jurisdictions). Wisconsin has adopted a substantial portion of the Uniform Marital Property Act. See WIS. STAT. ANN. §§ 766.01-766.65 (West Supp. 1986). The Uniform Marital Property Act borrows heavily from community property concepts. See UNIF. MARITAL PROP. ACT, prefatory note at 6-7 (Proposed Official Draft 1983).

2. The original purpose of the community property concept was not to create equality between spouses. G. MCKAY, A TREATISE ON THE LAW OF COMMUNITY PROPERTY § 62 (2d ed. 1925). The concept of community property was probably developed in order to preserve familial property. *Id.* at § 61. Modern California community property law operates on the theory that nonmonetary contributions of a spouse to the community estate are as important as financial contributions. See, e.g., *Meyer v. Kinzer*, 12 Cal. 247, 251 (1859). The court stated that: "[T]he marriage, in respect to property acquired during its existence, is a community of which each spouse is a member, equally contributing by his or her industry to its prosperity, and possessing an equal right to succeed to the property after dissolution . . ." *Id.* See also *McCarty v. McCarty*, 453 U.S. 210, 216 (1981) ("Like seven other states, California treats all property earned by either spouse during the marriage as community property; each spouse is deemed to make an equal contribution to the marital enterprise . . ."). See generally *In re Marriage of Bridgen*, 80 Cal. App. 3d 380, 389-90, 145 Cal. Rptr. 716, 722-23 (1978).

dissolution and decedent's estate contexts.<sup>3</sup> An insured has the right to designate a beneficiary under the terms of a life insurance contract.<sup>4</sup> Community property issues arise when community property funds are used to pay premiums, yet the designated beneficiary is someone other than the noninsured spouse.<sup>5</sup> The treatment of life insurance in the dissolution setting is distinct from that in the decedent's estate setting. The reason for this distinction is that in the decedent's estate context, the value of a life insurance policy is absolutely liquidated. In the dissolution context, on the other hand, valuation of life insurance is extremely difficult because the policy is intangible.<sup>6</sup> One of the major problems in dividing life insurance policies upon dissolution is that the rules designed to govern the death situation do not effectively translate into the dissolution context. The challenge is to provide for a unified analysis that treats division of life insurance in accordance with its unique properties as an asset.

There are three basic theories that have been applied to community property claims against life insurance proceeds. The inception of title theory awards the proceeds to the estate making the first premium payment.<sup>7</sup> The apportionment theory awards the proceeds in accordance with the pro rata share of premium payments made over the life of the policy by the separate and community estates.<sup>8</sup> The risk payment doctrine recognizes that, usually, only the most recent premium payment purchases the protection provided by the life insurance policy.<sup>9</sup> The result of the risk payment theory is that life insurance proceeds are ordinarily awarded to the estate which has paid the last premium.<sup>10</sup>

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3. Compare *Life Ins. Co. v. Cassidy*, 35 Cal. 3d 599, 605-07, 676 P.2d 1050, 1052-54, 200 Cal. Rptr. 28, 30-32 (1984) (death) and *Shaw v. Board of Admin.*, 109 Cal. App. 2d 770, 776-77, 241 P.2d 635, 638-39 (1956) (death) with *Cardew v. Cardew*, 192 Cal. App. 2d 502, 516-17, 13 Cal. Rptr. 620, 628 (1961) (dissolution).

4. J. GREIDER & W. BEADLES, *LAW AND THE LIFE INSURANCE CONTRACT* 157 (4th ed. 1979); S.S. HUEBNER & K. BLACK, *LIFE INSURANCE* 152 (9th ed. 1976).

5. Compare *Mayman v. Brown*, 12 Cal. App. 2d 272, 273, 55 P.2d 539, 539 (1936) (all premiums paid from community property) and *Grimm v. Grimm*, 26 Cal. 2d 173, 175, 157 P.2d 841, 842 (1945) (all premiums paid from community property) with *Gettman v. City of Los Angeles*, 87 Cal. App. 2d 862, 865, 197 P.2d 817, 819 (1948) (portion of premiums paid from community property).

6. See *infra* note 18. See also *In re Marriage of Gonzalez*, 168 Cal. App. 3d 1023, 1025, 214 Cal. Rptr. 634, 637 (1985) (discussion of difficulty in valuing life insurance upon dissolution).

7. See *infra* text accompanying notes 64 & 67-85.

8. See *infra* text accompanying notes 65 & 87-95.

9. See *infra* text accompanying notes 66 & 96-111.

10. See *id.*

This comment will explore the issues raised by community property claims against life insurance policies.<sup>11</sup> California law regarding distribution of community property upon dissolution of marriage or death of a spouse will be discussed.<sup>12</sup> An explanation of the nature of life insurance as an asset<sup>13</sup> will be followed by a brief survey of the various approaches of the community property jurisdictions to community property claims against life insurance proceeds.<sup>14</sup> Recent California law on divisibility and distribution of life insurance upon dissolution and death will then be detailed, including a discussion of an appellate level split of authority regarding divisibility of term insurance upon dissolution of marriage.<sup>15</sup> Finally, this comment will suggest that a modified risk payment theory should be adopted in order to treat life insurance in accordance with its nature as an asset.<sup>16</sup>

#### DISTRIBUTION OF COMMUNITY PROPERTY

California law requires equal division of all community property upon dissolution of marriage.<sup>17</sup> Intangible assets<sup>18</sup> are divisible to the extent that they can be properly valued.<sup>19</sup> If a proper present value cannot be ascertained at the time of the dissolution proceeding, California courts are empowered to retain jurisdiction over the

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11. See *infra* text accompanying notes 17-206.

12. See *infra* text accompanying notes 17-26.

13. See *infra* text accompanying notes 27-60.

14. See *infra* text accompanying notes 61-122.

15. See *infra* text accompanying notes 123-81.

16. See *infra* text accompanying notes 182-206.

17. CAL. CIV. CODE § 4800(a) (West Supp. 1986).

18. An intangible asset is defined as "a non-physical, non-current asset which exists only in connection with something else." BLACK'S LAW DICTIONARY 726 (5th ed. 1979). Term life insurance is intangible property under this definition because payment of the policy proceeds is contingent upon the death of the insured occurring during the term specified by the contract. See D. MCGILL, LIFE INSURANCE 43-44 (rev. ed. 1967).

19. *In re* Marriage of Brown, 15 Cal. 3d 838, 847, 544 P.2d 561, 566-67, 126 Cal. Rptr. 633, 638-39 (1976) (nonvested pension rights subject to division in a marriage dissolution proceeding). See also *In re* Marriage of Skaden, 19 Cal. 3d 679, 686-88, 566 P.2d 249, 252-54, 139 Cal. Rptr. 615, 618-19 (1977) (employee termination benefits held divisible); *In re* Marriage of Gonzalez, 168 Cal. App. 3d 1021, 1025-26, 214 Cal. Rptr. 634, 637-38 (1985) (term life insurance divisible upon dissolution); *In re* Marriage of Hug, 154 Cal. App. 3d 780, 784-85, 201 Cal. Rptr. 676, 679-80 (1984) (contingent employee stock option subject to division); *In re* Marriage of Fenton, 134 Cal. App. 3d 451, 460-62, 184 Cal. Rptr. 597, 600-02 (1982) (goodwill of ongoing law practice held divisible); *In re* Marriage of Rives, 130 Cal. App. 3d 138, 150-52, 181 Cal. Rptr. 572, 577-79 (1982) (goodwill of ongoing beekeeping business held divisible); *In re* Marriage of Judd, 68 Cal. App. 3d 515, 519-21, 137 Cal. Rptr. 318, 319-20 (1977) (contingent retirement annuity plan held divisible). *But cf.* *In re* Marriage of Sullivan, 37 Cal. 3d 762, 765, 691 P.2d 1020, 1023, 209 Cal. Rptr. 354, 357 (1984) (professional education held not subject to division).

property,<sup>20</sup> valuing and dividing it when a reasonably certain value becomes apparent.<sup>21</sup>

Distribution of a deceased spouse's estate generally occurs in a probate proceeding, although life insurance is considered a nonprobate asset.<sup>22</sup> If a spouse dies intestate, the surviving spouse is entitled to all of the community property.<sup>23</sup> A deceased spouse may have attempted to dispose of community property by will or by inter vivos transfer. While a decedent is entitled to exercise testamentary power over half of the community property, the surviving spouse can invalidate the transaction to the extent that the attempted disposition represents more than half of the community property.<sup>24</sup> This rule prevails when an insured designates a life insurance policy beneficiary other than the surviving spouse.<sup>25</sup> If the policy was purchased with community funds and the beneficiary is not the surviving spouse, the surviving spouse is entitled to a share of the proceeds as community property.<sup>26</sup>

#### THE NATURE OF LIFE INSURANCE

A life insurance policy is a unilateral contract<sup>27</sup> in which the payment of a premium binds the insurer to pay a specified sum to

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20. CAL. CIV. CODE § 4800(a) (West Supp. 1986).

21. *Brown*, 15 Cal. 3d at 848, 544 P.2d at 567, 126 Cal. Rptr. at 639 (because of uncertainties affecting the vesting and maturation of some rights, the trial court should not attempt to divide present value upon dissolution but instead should award an appropriate share of the right when it is to be paid). See also *In re Marriage of Munguia*, 146 Cal. App. 3d 853, 858-59, 195 Cal. Rptr. 199, 201 (1983) (failure to retain jurisdiction over contested asset reversed); *In re Marriage of Andreen*, 76 Cal. App. 3d 667, 676, 143 Cal. Rptr. 94, 100 (1978) (attempt to divide disability allowance of a nondisabled spouse held an abuse of discretion).

22. *Estate of Welfer*, 110 Cal. App. 2d 262, 265, 242 P.2d 655, 656 (1952). "It is well settled that a beneficiary under an insurance policy takes by virtue of the contract of insurance rather than by the law of succession . . ." *Id.*

23. CAL. PROB. CODE § 6401(a) (West Supp. 1986). Intestate succession, however, will not be applied to life insurance proceeds. *Welfer*, 110 Cal. App. 2d at 265, 242 P.2d at 657 (1952).

24. CAL. PROB. CODE § 6101(b) (West Supp. 1986) (testamentary disposition); *Trimble v. Trimble*, 219 Cal. 2d 340, 347-48, 26 P.2d 477, 480-81 (1933) (inter vivos transfer).

25. *Sieroty v. Silver*, 58 Cal. 2d 799, 803, 376 P.2d 563, 566, 26 Cal. Rptr. 635, 638 (1962); *Tyre v. Aetna Life Ins. Co.*, 54 Cal. 2d 399, 404, 353 P.2d 725, 728, 6 Cal. Rptr. 13, 16 (1960); *Patillo v. Norris*, 65 Cal. App. 3d 209, 215, 135 Cal. Rptr. 210, 216-17 (1976); *Polk v. Polk*, 228 Cal. App. 2d 763, 785, 39 Cal. Rptr. 824, 837 (1964).

26. See, e.g., *Bowman v. Bowman*, 171 Cal. App. 3d 148, 159-61, 217 Cal. Rptr. 174, 181-82 (1985); *New York Life Ins. Co. v. Bank of Italy*, 60 Cal. App. 602, 606, 214 P. 61, 63 (1923).

27. See 1 A. CORBIN, CORBIN ON CONTRACTS §§ 21, 71 (1963) (discussing unilateral contracts). In a unilateral contract, the offeree is not obligated to perform, but if the offeree does perform then the offeror is bound. *Id.* In the life insurance context the insured is usually

designated beneficiaries upon the insured's death.<sup>28</sup> As a general rule, an insurer will require evidence that an individual is insurable<sup>29</sup> before issuing the policy.<sup>30</sup> A life insurance policy protects against the risk of pecuniary loss occasioned by the death of the insured by paying a specified sum to designated beneficiaries when the insured dies.<sup>31</sup> The specified sum, generally the face amount, is paid from a fund

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not bound to pay the premiums, but if premiums are paid, the insurance company is bound to perform. *See* Freeport Sulphur Co. v. Aetna Life Ins. Co., 107 F. Supp. 508, 513 (E.D. La. 1952), *decree modified*, 206 F.2d 5 (5th Cir. 1952). Although failure to pay premiums causes the policy to lapse, there is no breach of contract by the insured. D. MCGILL, *supra* note 18, at 472-73.

28. 1 J. APPLEMAN & J. APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 2, 3 (1981).

29. To determine insurability, life insurance companies generally examine the family medical history of the potential insured for indications of genetically transmitted susceptibility to disease. *See* S.S. HUEBNER & K. BLACK, *supra* note 4, at 6, 360-72. The companies also require that the insured submit evidence of current medical condition. *Id.* If the family history reveals high susceptibility to fatal disease or if the medical evidence reveals an abnormal health condition, the potential participant can be declared uninsurable or a substandard risk. *Id.* at 373-78, 391-92. The insurability requirement is designed to prevent the phenomenon of adverse selection against a life insurance company. *Id.* at 6, 360-72. The entire life insurance system is predicated on the concept that a statistically significant number of randomly selected individuals will contribute to a general fund which, when invested, will yield an amount capable of funding the face value of all policies issued by the insurance company upon the death of any of the participants under the plan. Individuals who know or suspect that they are in poor physical health are more likely to purchase life insurance than those in good health. If individuals in poor health were allowed to participate in a life insurance plan without any health requirements, the mortality rate of life insurance participants would be much higher than the general population. The result of an increased mortality rate would be prohibitive premium rates for the population at large. *Id.* *See also* Rosenbloom v. New York Life Ins. Co., 65 F. Supp. 692, 696 (W.D. Mo. 1946) (discussion of insurability); Greenberg v. Continental Casualty Co., 24 Cal. App. 2d 506, 514-15, 75 P.2d 644, 648-49 (1938) (discussion of insurability).

30. S.S. HUEBNER & K. BLACK, *supra* note 4, at 142. Group life insurance is an important exception to the general rule. Under most group term life insurance policies, membership in the insured group is the only prerequisite to coverage other than payment of the premiums. Insurability is not considered. *Id.* at 396-418. *See also* D. MCGILL, *supra* note 18, at 680. These plans are usually tied to employment fringe benefit plans. S.S. HUEBNER & K. BLACK, *supra* note 4, at 398. Much of the recent California litigation regarding the issues raised by life insurance in the community property context has dealt with group life insurance. *See, e.g.,* Biltoft v. Wootten, 96 Cal. App. 3d 58, 157 Cal. Rptr. 581 (1979); *In re Marriage of Gonzalez*, 168 Cal. App. 3d 1021, 214 Cal. Rptr. 634. The employer typically pays most or all of the premiums as part of a fringe benefit package. *See* D. MCGILL, *supra* note 18, at 700-03. *See also* 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 47. Gifts received during marriage are considered the separate property of the donee spouse. CAL. CIV. CODE §§ 5107, 5108 (West 1983). Yet, under California case law, fringe benefits are not considered gifts to the employee, but are considered part of the remuneration received for services rendered. *Smith v. Lewis*, 13 Cal. 3d 349, 355, 530 P.2d 589, 593, 118 Cal. Rptr. 621, 625 (1975); *In re Marriage of Fithian*, 10 Cal. 3d 592, 596, 517 P.2d 449, 451, 111 Cal. Rptr. 369, 371 (1974). As a result, any group policy is potentially community property if it is part of a benefit package earned through employment by a spouse during marriage. *See, e.g.,* Bowman v. Bowman, 171 Cal. App. 3d 148, 159, 217 Cal. Rptr. 174, 181 (1985).

31. 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, §§ 2, 3; S.S. HUEBNER & K. BLACK, *supra* note 4, at 1-2.

created by the company.<sup>32</sup> The fund consists of premiums collected from all people insured by the company.<sup>33</sup> Each premium is calculated by application of a complex formula based on the life expectancy of an insured.<sup>34</sup> The cost of protection becomes greater as the chances of the insured's death increase due to advancing age.<sup>35</sup> The life insurance company will collect a premium sufficient, when invested, to yield the face value of the policy upon the actuarially expected date of the insured's death.<sup>36</sup> Although insurance companies offer a variety of different types of policies, close scrutiny shows that all are either term life insurance or cash value life insurance.<sup>37</sup>

#### A. Distinguishing Cash Value Life Insurance from Term Life Insurance

The key to distinguishing cash value life insurance from term life insurance is understanding whose resources are at risk. In a cash value policy, a portion of each premium is set aside and credited to the insured's account.<sup>38</sup> As each successive premium is paid, the amount credited to the insured's account increases, thereby accruing a cash value.<sup>39</sup> This accrued cash value is called the investment element.<sup>40</sup> Upon the death of the insured, the accrued cash value is paid to the beneficiaries as part of the proceeds.<sup>41</sup>

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32. D. MCGILL, *supra* note 18, at 133-62, 246-51; S.S. HUEBNER & K. BLACK, *supra* note 4, at 4-5, 623-31 (discussing mathematical principles behind calculation of life insurance premiums).

33. D. MCGILL, *supra* note 18, at 133-62, 246-51; S.S. HUEBNER & K. BLACK, *supra* note 4, at 4-5, 623-31 (discussing mathematical principles behind calculation of life insurance premiums).

34. D. MCGILL, *supra* note 18, at 133-62, 246-51; S.S. HUEBNER & K. BLACK, *supra* note 4, at 4-5, 623-31 (discussing mathematical principles behind calculation of life insurance premiums).

35. C. MARKEY, CALIFORNIA FAMILY LAW: PRACTICE AND PROCEDURE § 122.03(2)(b) (rev. ed. 1986).

36. D. MCGILL, *supra* note 18, at 252-60; S.S. HUEBNER & K. BLACK, *supra* note 4, at 232-319 (discussing the relationship between calculation of premiums and policy values).

37. Blanton & Ipsen, *Life Insurance: An Argument for Adoption of the Risk Payment Doctrine in Idaho*, 17 IDAHO L. REV. 423, 435 (1981). See generally S.S. HUEBNER & K. BLACK, *supra* note 4, at 66-67 (discussion of a common form of cash value life insurance called whole life insurance).

38. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 66-67; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

39. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 66-67; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

40. See Comment, *Community and Separate Property Interests in Life Insurance Proceeds: A Fresh Look*, 51 WASH. L. REV. 351, 381-82 (1976). See generally D. MCGILL, *supra* note 18, at 60-61; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

41. In some situations, the entire face value of a cash value policy is not paid to the

The portion of each premium not credited to the accrued cash value is paid into the mortality pool.<sup>42</sup> The mortality pool is a fund from which the insurance company pays proceeds not paid from the accrued cash value.<sup>43</sup> In a cash value policy, therefore, the proceeds paid upon the death of the insured contain monies from the accrued cash value and the mortality pool.<sup>44</sup> The money paid from the mortality pool is called the net amount at risk.<sup>45</sup> From the perspective of the insured, the net amount at risk is the protection element because the portion of the proceeds, not paid from the accrued cash value, come entirely from insurance company resources. In any given cash value policy, the net amount at risk can be calculated according to the following formula:<sup>46</sup>

$$\text{NAR} = \text{FV} - \text{ACV}$$

NAR = Net Amount at Risk  
 FV = Face Value of the Policy  
 ACV = Accrued Cash Value

A cash value policy, therefore, is an asset containing two elements: the investment element, or accrued cash value, composed entirely of the insured's resources, and the protection element, or the net amount at risk, composed entirely of insurance company resources.<sup>47</sup>

In a cash value policy, the right to the protection element is purchased only by the most recent premium payment.<sup>48</sup> Failure to pay a premium results in a lapse of the policy and terminates the

beneficiaries. The statement in the text, therefore, is not strictly true. If the insured has borrowed against a cash value policy and the loan is unpaid upon death, the beneficiaries will receive the face amount less the outstanding loan balance. See W. MEYER, LIFE AND HEALTH INSURANCE LAW § 11:19 (1972).

42. See 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

Since [a cash] reserve is built from the insured's own money, the company, therefore, uses the insured's own money plus interest accumulations thereon to reduce his risk each year. If death occurs during a certain year, the company, in effect, returns a portion of the insured's own funds to him . . . and pays the balance from the mortality pool.

*Id.*

43. *Id.*

44. *Id.*

45. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 7-8; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

46. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 7-8, 66-67; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2.

47. See 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2; D. MCGILL, *supra* note 18, at 60; S.S. HUEBNER & K. BLACK, *supra* note 4, at 66-67.

48. See D. MCGILL, *supra* note 18, at 291-93, 315-25; S.S. HUEBNER & K. BLACK, *supra* note 4, at 55.



protection element of the policy.<sup>49</sup> The investment element, however, is not affected by lapse.<sup>50</sup> The right to the accrued cash value remains in the insured.

Term life insurance stands in contrast to cash value life insurance. While cash value insurance has both investment and protection elements, term life insurance has only a protection element.<sup>51</sup> Term life insurance accrues no cash value<sup>52</sup> and only the most recent premium purchases the right to the proceeds.<sup>53</sup> Any payment of proceeds comes entirely from the resources of the life insurance company.<sup>54</sup> In other words, the net amount at risk is the face value.<sup>55</sup> In term life insurance, failure to pay the premium terminates the protection element and thereby eliminates any value that the policy had.<sup>56</sup> If protection for a further term is desired, a new policy must be purchased or the old policy must be renewed.<sup>57</sup> Many term

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49. See D. MCGILL, *supra* note 18, at 291-93, 315-25; S.S. HUEBNER & K. BLACK, *supra* note 4, at 307-08.

50. See D. MCGILL, *supra* note 18, at 291-93, 315-25; S.S. HUEBNER & K. BLACK, *supra* note 4, at 307-08.

51. See 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3; D. MCGILL, *supra* note 18, at 44-45; S.S. HUEBNER & K. BLACK, *supra* note 4, at 55.

52. The level-premium term policy is an exception to the statement in the text. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 55-59; D. MCGILL, *supra* note 18, at 33-35; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3. The premium on a level-premium term policy is determined by calculating the cost of protection for the life of the policy and dividing the desired number of payments into that cost. Thus a level premium is created, causing the annual or semi-annual premium to remain constant throughout the duration of the policy. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 58; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3; W. MEYER, *supra* note 41, § 10:9. Although the level-premium policy is a term policy, the excess premium is perhaps better handled as an accrued cash value. See S.S. HUEBNER & K. BLACK, *supra* note 4, at 7, 62-63 (excess premiums collected in early terms treated as a reserve).

53. D. MCGILL, *supra* note 18, at 44. "All premiums paid for the term protection are considered to be fully earned by the company by the end of the term, whether or not a loss has occurred, and the policy has no further value." *Id.*

54. See 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3; S.S. HUEBNER & K. BLACK, *supra* note 4, at 5-7, 55 (since net amount at risk decreases as reserve increases, the face value of a term policy is the net amount at risk because there is no accrual of a reserve in term policies).

55. S.S. HUEBNER & K. BLACK, *supra* note 4, at 7-8.

56. D. MCGILL, *supra* note 18, at 44; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3. See *Wall v. Equitable Life Assurance Soc'y*, 33 Cal. App. 2d 112, 115, 91 P.2d 145, 147 (1939) (dictum) (quarterly premiums purchase life insurance only for the quarter in which they are paid). See also S.S. HUEBNER & K. BLACK, *supra* note 4, at 55 (at the end of policy term, policy has no further value). Many policies do contain provisions for reinstatement of coverage subsequent to a lapse. Reinstatement is usually conditioned upon evidence of insurability. See *id.* at 141-42. See also *Kennedy v. Occidental Life Ins. Co.*, 18 Cal. 2d 627, 635, 117 P.2d 3, 7 (1941) (discussion of reinstatement).

57. D. MCGILL, *supra* note 18, at 44-45; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3.

insurance policies have a renewability feature.<sup>58</sup> The main characteristic of this type of term policy is automatic extension of protection for a new term upon payment of a new and higher premium,<sup>59</sup> without proof of insurability.<sup>60</sup>

#### CURRENT APPROACHES TO HANDLING COMMUNITY PROPERTY CLAIMS AGAINST LIFE INSURANCE PROCEEDS

The death of a spouse triggers distribution of community property.<sup>61</sup> If community funds were used to pay life insurance premiums and the designated beneficiary is not the surviving spouse, the surviving spouse may nonetheless have a community property interest in the proceeds.<sup>62</sup> Community property jurisdictions have developed three conflicting theories designed to determine the community interest in life insurance proceeds. In the life insurance context, the right to the life insurance proceeds is the asset that is being distributed upon the insured's death. When a community property claim is made against a policy, the court must determine whether community funds have paid for the right to the proceeds. If community funds have contributed to the protection element or the investment element, then a share of the proceeds should be awarded to the surviving spouse as community property.<sup>63</sup>

The inception of title theory characterizes proceeds as separate or community depending on the character of funds used to pay the first premium.<sup>64</sup> The apportionment theory divides pro rata interests in the proceeds based on the percentage of community funds and separate funds used to pay premiums over the life of the policy.<sup>65</sup>

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58. S.S. HUEBNER & K. BLACK, *supra* note 4, at 55; D. MCGILL, *supra* note 18, at 44-46.

59. 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3; D. MCGILL, *supra* note 18, at 31; C. MARKEY, *supra* note 33, § 122.03(2)(b).

60. D. MCGILL, *supra* note 18, at 45; S.S. HUEBNER & K. BLACK, *supra* note 4 at 55-56; W. MEYER, *supra* note 41, § 12:8.

61. CAL. PROB. CODE § 6401(a) (West Supp. 1986).

62. See *infra* notes 65 & 87-95 (discussion of apportionment approach).

63. See CAL. CIV. CODE § 5110 (West 1983) (assets acquired during marriage presumed to be community property).

64. See, e.g., *Succession of Verneville*, 120 La. 605, 45 So. 520 (1908); *McCurdy v. McCurdy*, 372 S.W.2d 381 (Tex. Civ. App. 1963).

65. See, e.g., *Modern Woodmen of America v. Gray*, 113 Cal. App. 729, 299 P. 754 (1931); *Small v. Bartyzel*, 27 Wash. 2d 176, 177 P.2d 391 (1947). Under the Uniform Marital Property Act if an insured brings a life insurance policy into the marriage and funds from the marital estate are used to pay premiums, the proceeds are apportioned. UNIF. MARITAL PROP. ACT § 12(c)(2) (Proposed Official Draft 1983). If a life insurance policy is purchased during the marriage, however, the proceeds are marital property regardless of the character of

Under the risk payment theory, the proceeds are awarded as separate or community to the estate which made the last premium payment.<sup>66</sup> All of these theories contain defects in that they either fail to treat life insurance in accordance with its true nature as an asset or they fail to recognize the potential contribution of prior premium payments to purchase of the protection element.

A. *The Inception of Title Theory*

One approach to community property issues raised by life insurance is the inception of title doctrine.<sup>67</sup> When confronted with a community property claim against life insurance proceeds, a court applying the inception of title doctrine will first determine whether community or separate funds were used to pay the first premium.<sup>68</sup> If the separate estate of an insured spouse made the first premium payment, the policy is considered a separate asset.<sup>69</sup> The designated beneficiary is, therefore, entitled to the proceeds upon the death of the insured.<sup>70</sup> The court will, however, require the beneficiary to reimburse the community estate for half of the premiums paid with community funds.<sup>71</sup> If the community estate made the first payment, however, the noninsured spouse is entitled to half the proceeds, less reimbursement to the separate estate, of the full amount of any premiums paid from the separate estate.<sup>72</sup>

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funds used to pay the premiums. *Id.* § 12(c)(1). The Uniform Marital Property Act, therefore, applies the apportionment theory to policies purchased before marriage and the inception of title theory to policies purchased during marriage. *See infra* text accompanying notes 67-94 (discussing the apportionment and inception of title theories).

66. *See, e.g., Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 660, 689 P.2d 46, 51 (1984).

67. An in-depth treatment of the inception of title doctrine is beyond the scope of this comment since California does not employ the theory in life insurance cases. The textual discussion following this footnote is a cursory treatment of the doctrine. Application of this doctrine is complex and subject to many intricacies. For a detailed treatment of the inception of title doctrine, see generally Comment, *supra* note 40, at 355-65; Blanton & Ipsen, *supra* note 37, at 444-59.

68. *McCurdy v. McCurdy*, 372 S.W.2d 381, 382 (Tex. Civ. App. 1963).

69. *Id.*

70. *Id.* at 384.

71. LA. CIV. CODE ANN. art. 2366 (West 1985); *see also McCurdy*, 372 S.W.2d at 384. *Cf. In re Marriage of Gowdy*, 178 Cal. App. 3d 1228, 1234, 224 Cal. Rptr. 400, 404 (1986) (community property contributions to separate property assets reimbursable on a pro tanto basis). *But cf. In re Marriage of Camire*, 105 Cal. App. 3d 859, 866-67, 164 Cal. Rptr. 667, 671 (1980) (consensual community property contributions to separate property assets not reimbursable). *Contra In re Marriage of Moore*, 28 Cal. 3d 366, 371-73, 618 P.2d 208, 210-11, 168 Cal. Rptr. 662, 664-65 (1980) (later California Supreme Court case holding that community estate entitled to a pro tanto interest for consensual reduction of mortgage on separate property asset, yet not expressly overruling *Camire*).

72. *See Amason v. Franklin Life Ins. Co.*, 428 F.2d 1144, 1145 (5th Cir. 1970) (federal court applying Texas law).

The inception of title approach treats a life insurance policy like a tangible asset acquired on installments.<sup>73</sup> When tangible separate property is improved by community funds, the community estate is reimbursed for its cash contribution.<sup>74</sup> The community estate, however, is not given credit for appreciation and only the actual dollar contribution is recoverable.<sup>75</sup> Any life insurance premiums paid from community funds on a policy brought into the marriage by the insured are analogized to improvements of tangible separate property.<sup>76</sup>

The inception of title theory is faulty because the theory fails to recognize the nature of life insurance as an asset.<sup>77</sup> Since term life insurance contains only a protection element,<sup>78</sup> the right to payment of the proceeds has been purchased solely by the most recent premium payment.<sup>79</sup> The inception of title approach, however, gives the prior estate credit for acquisition of the protection element on the basis of the *first* premium payment.<sup>80</sup> Awarding term life insurance proceeds on the basis of the first premium payment is inconsistent with the fact that the first premium purchased protection only during the first term.<sup>81</sup>

Similarly, the inception of title approach mishandles cash value life insurance. Cash value life insurance contains a protection element and an investment element.<sup>82</sup> In cash value life insurance the right to the proceeds has only partially been purchased by prior premiums.<sup>83</sup>

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73. See, e.g., Rothman v. Rumbeck, 54 Ariz. 443, 96 P.2d 755 (1939).

74. See *supra* note 71 and accompanying text (community estate entitled to reimbursement for payments made on separate property assets).

75. Connell v. Connell, 331 So. 2d 4, 6 (La. 1976).

76. McCurdy v. McCurdy, 372 S.W.2d 381, 382-83 (Tex. Civ. App. 1963).

77. See Comment, *supra* note 40, at 357-65.

78. 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 3; S.S. HUEBNER & K. BLACK, *supra* note 4, at 5.

79. See D. MCGILL, *supra* note 18, at 44 (if the most recent premium due is not paid, the beneficiaries of the policy receive nothing).

80. See McCurdy v. McCurdy, 372 S.W.2d 381, 384 (Tex. Civ. App. 1963).

81. See *In re Marraige of Munguia*, 146 Cal. App. 3d 853, 861, 195 Cal. Rptr. 199, 203 (1983). In *Munguia*, the court awarded the noninsured spouse a half interest in the accrued cash value of a life insurance policy upon dissolution. Although the court did not discuss division of the protection element, the opinion implies that the protection element has no value until the insured's death. *Id.* at 861, 195 Cal. Rptr. at 203. Since prior premium payments applied to the protection element are exhausted when the term ends, only the estate paying the most recent premium should be awarded the protection element. See D. MCGILL, *supra* note 18, at 44. See also *In re Marriage of Holmgren*, 60 Cal. App. 3d 869, 871, 130 Cal. Rptr. 440, 441 (1976) (division of accrued cash value affirmed without discussion or disposition of the protection element).

82. D. MCGILL, *supra* note 18, at 60-61; see also Comment, *supra* note 40, at 381-82.

83. D. MCGILL, *supra* note 18, at 60-61; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2; W. MEYER, *supra* note 41, § 11:19.

In a cash value policy, the prior premiums have contributed to the investment element but not to the protection element.<sup>84</sup> Only the portion of the premium applied to the investment element should be awarded to the estate paying prior premiums. The estate paying the last premium has paid for the protection element and should be awarded the net amount at risk.<sup>85</sup> The inception of title analysis is faulty because the doctrine fails to recognize that title to the protection element is not purchased by the first premium payment but rather by the last premium paid.<sup>86</sup>

### B. *The Apportionment Theory*

The apportionment theory also treats life insurance as an asset acquired on an installment basis.<sup>87</sup> Unlike the inception of title theory, the apportionment theory does not characterize life insurance proceeds as separate or community property. Instead, the interests of each estate in the contested policy are calculated on a pro rata basis according to the ratio of separate and community funds used to pay premiums over the life of the policy.<sup>88</sup> The estate paying prior premiums is thereby given credit for the purchase of the protection element.<sup>89</sup>

The apportionment theory is unpersuasive because it ignores the unique properties of life insurance as an asset.<sup>90</sup> The proceeds of both cash value and term life insurance are treated the same under the apportionment theory,<sup>91</sup> yet the protection element of either type of policy is purchased by the estate making the last premium pay-

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84. D. MCGILL, *supra* note 18, at 60-61; 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2; W. MEYER, *supra* note 41, § 11:19.

85. See Comment, *supra* note 40, at 372-73; Blanton & Ipsen, *supra* note 37, at 463-64.

86. See Comment, *supra* note 40, at 372-73; Blanton & Ipsen, *supra* note 37, at 463-64.

87. Comment, *supra* note 40, at 366.

88. See, e.g., Biltoft v. Wootten, 96 Cal. App. 3d 58, 62, 157 Cal. Rptr. 581, 583-84 (1979); Patillo v. Norris, 65 Cal. App. 3d 209, 217-18, 135 Cal. Rptr. 210, 215-16 (1976); Polk v. Polk, 228 Cal. App. 2d 763, 781, 38 Cal. Rptr. 824, 834-35 (1964); Gettman v. City of Los Angeles, 87 Cal. App. 2d 862, 865-66, 197 P.2d 817, 819 (1948); Bazzell v. Endriss, 41 Cal. App. 2d 463, 464, 107 P.2d 49, 49-50 (1940); McBride v. McBride, 11 Cal. App. 2d 521, 524, 54 P.2d 480, 482 (1936); Modern Woodmen of America v. Gray, 113 Cal. App. 729, 733-34, 299 P. 754, 755 (1931).

89. *Modern Woodmen*, 113 Cal. App. at 733-34, 299 P. at 755.

90. See *Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 659, 689 P.2d 48, 50 (1984) "[W]e reject the approach of the California courts. This approach is based upon the questionable assumption that uninsurability occurs at the inception of the contract." *Id.*

91. Compare *Dixon Lumber Co. v. Peacock*, 217 Cal. 415, 416, 19 P.2d 233 (1933) (whole life contract subject to apportionment rule) with *Modern Woodmen*, 113 Cal. App. at 734, 299 P. at 755 (term life contract subject to apportionment).

ment.<sup>92</sup> A court applying the apportionment theory will award a portion of the net amount at risk to the estate making prior premium payments.<sup>93</sup> Apportionment should not be applied to the protection element since the portion of prior premium payments applied to the protection element was expended in providing protection during prior terms.<sup>94</sup> The investment element of a cash value policy, on the other hand, should be apportioned because the investment element of prior premiums has been applied to the accrued cash value.<sup>95</sup>

### C. The Risk Payment Theory

The risk payment theory recognizes the unique character of life insurance as an asset.<sup>96</sup> A court applying the risk payment theory in a contest over a term insurance policy will award the proceeds to the estate making the most recent premium payment.<sup>97</sup> The rationale behind the risk payment theory is that only the most recent premium payment purchases the protection element of a life insurance policy.<sup>98</sup> If the last premium payment was paid from a separate property source, the protection element is declared entirely separate property. The same principle applies when the last premium payment is made from a community property source. If the last premium is of a mixed character, the net amount at risk should then be apportioned.<sup>99</sup>

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92. See *Wadsworth*, 102 Wash. 2d at 659, 689 P.2d at 49-50 (term life insurance); 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2 (cash value life insurance).

93. See, e.g., *Biltoft v. Wootten*, 96 Cal. App. 3d 58, 157 Cal. Rptr. 581 (1979).

94. D. MCGILL, *supra* note 18, at 44.

95. See Comment, *supra* note 40, at 382.

96. See *Blanton & Ipsen*, *supra* note 37, at 428-35, 463-66; Comment, *supra* note 40, at 352-55, 372-90.

97. *Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 660, 689 P.2d 48, 51 (1984). Other courts in community property jurisdictions have awarded the proceeds of term life insurance on the basis of which estate paid the last premium. These courts, however, have failed to state that they were in fact applying the risk payment theory. *Id.* at 659, 689 P.2d at 50. See, e.g., *Gaethje v. Gaethje*, 8 Ariz. App. 47, 52, 442 P.2d 870, 875 (1968); *Lock v. Lock*, 8 Ariz. App. 138, 145, 444 P.2d 163, 170 (1968); *Travelers Ins. Co. v. Johnson*, 97 Idaho 336, 340, 544 P.2d 294, 298 (1975); *Phillips v. Wellborn*, 89 N.M. 340, 342, 552 P.2d 471, 473 (1976).

98. *Wadsworth*, 102 Wash. 2d at 659, 689 P.2d at 49-50.

99. Premium payments of a mixed separate and community character can occur when the payment is made from a separate property and a community property source, or when funds from a bank account containing deposits of both separate and community property are used. See *Estate of Murphy*, 15 Cal. 3d 907, 917-19, 544 P.2d 956, 963-65, 126 Cal. Rptr. 820, 827-29 (1976). Because mixed payments are necessarily commingled, an issue of tracing the funds to their source may arise. *Id.* A discussion of tracing is beyond the scope of this comment. See generally *id.*; *In re Marriage of Mix*, 14 Cal. 3d 604, 611-12, 536 P.2d 479, 484, 122 Cal. Rptr. 79, 84 (1975); *Hicks v. Hicks*, 211 Cal. App. 2d 144, 157-62, 27 Cal. Rptr. 307, 315-19 (1962).

No court has yet applied the risk payment doctrine in a cash value life insurance proceed contest. Presumably the proceeds would be segregated into portions representing the accrued cash value and the net amount at risk. The accrued cash value would be apportioned and the protection element would be awarded to the estate making the last premium payment.<sup>100</sup>

Unlike the inception of title and apportionment theories, the risk payment theory treats life insurance properly in most cases because the risk payment theory recognizes that the last premium usually purchases the protection element. Merely awarding the protection element on the basis of the last premium paid, however, may ignore the contribution of prior payments to the purchase of the protection element.<sup>101</sup> If an insured becomes a substandard risk<sup>102</sup> or uninsurable at a time when the prior estate is making premium payments, then the prior estate may have contributed to procurement of the protection element at a lower cost.<sup>103</sup> The renewability feature, contained in many life insurance policies, guarantees continued coverage at the existing rate without regard to insurability.<sup>104</sup> Without the renewability feature, the insured would be forced to pay a higher rate or, if the insured becomes uninsurable, go without coverage.<sup>105</sup> Had prior premiums not been paid, the renewability feature could not operate. In many cases, therefore, prior premiums have either allowed purchase

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100. See *In re Marriage of Munguia*, 146 Cal. App. 3d 853, 861, 195 Cal. Rptr. 199, 203 (1983) (cash value apportioned upon dissolution, no award of protection element made). See also Comment, *supra* note 40, at 382 (suggesting that the cash value of a life insurance policy be apportioned).

101. See C. MARKEY, *supra* note 35, § 24.45(3)(e).

[I]t could be argued that policies are worth more than their cash surrender value, or in the case of term insurance, more than nothing, based on their replacement value. Replacement value may be significantly higher than cash surrender value in situations where the insurability of the insured is lessened because of advancing age or declining health, and the existing policy cannot be cancelled or contains a guaranty of insurability. The replacement value can be obtained from an insurance broker by inquiring as to the price of a new policy with similar terms on the life of the insured.

*Id.* See also W. HOGOBOOM & D. KING, CALIFORNIA PRACTICE GUIDE: FAMILY LAW § 8:29.2 (rev. ed. 1986).

102. For a discussion of "lessened insurability," more commonly known as substandard risk, see generally D. MCGILL, *supra* note 18, at 425-26; S.S. HUEBNER & K. BLACK, *supra* note 4, at 373-78, 390-91. Uninsurability occurs when no life insurance company will issue a policy. D. MCGILL, *supra* note 18, at 408-09.

103. See *supra* note 101 (discussion of replacement value).

104. See *supra* notes 57-60 and accompanying text (discussion of the renewability feature).

105. See *supra* notes 29-30 and accompanying text (discussion of insurability). See also *supra* note 102 (discussion of substandard risk).

of the protection element at a lower rate or have allowed coverage where none would have been available.<sup>106</sup>

In the community property context, it must be determined if the prior estate (i.e. the estate, separate or community, paying premiums prior to a change in marital status) has contributed to purchase of the protection element at a lower cost. Otherwise, the risk payment theory dictates that the subsequent estate (i.e. the estate paying premiums upon the death of the insured) be awarded the protection element. The test to determine whether the prior estate has contributed to a lower cost protection element is based on inquiry into replacement cost.<sup>107</sup> If, upon a change in marital status, an insured could obtain comparable coverage at the existing premium rate, then the prior estate has not contributed to a lower cost protection element.<sup>108</sup> On the other hand, if replacement premiums would be higher upon a change in marital status, then the prior estate has made the protection element available to the subsequent estate at a lower cost due to the renewability feature. The prior estate, therefore, should be credited for contributing to a lower cost protection element.<sup>109</sup> The risk payment theory should be modified to include consideration of replacement value.<sup>110</sup> Because the benefit of lower cost protection is conferred upon the insured by the contribution of the prior premium payments, the estate paying prior premiums should be compensated for this contribution.<sup>111</sup>

106. See *supra* note 101 (discussion of replacement value).

107. *Id.*

108. The basic situation in which renewability will affect the cost of the protection element is when replacement value is higher than current cost. See C. MARKEY, *supra* note 35, § 24.45(3)(e). See also W. HOGOBOOM & D. KING, *supra* note 101, § 8:29.2 (discussing replacement value). If replacement cost is higher than current cost, then the insured, by virtue of prior premium payments, has acquired the right to the protection element at a lower cost than would have been the case if prior premiums had not been paid. C. MARKEY, *supra* note 35, § 24.45(3)(e). The converse of Markey's proposition is if the same life insurance coverage can be secured at the same cost as under the existing contract, then prior premiums have not contributed to the cost of protection or any other noncumulative rights. See *id.*

109. See *supra* note 108.

110. See Comment, *supra* note 40, at 377-79. "However, if the courts choose to value insurability, the risk payment doctrine can be modified to accommodate this purpose." *Id.* The author of the above comment concludes that insurability is simply too difficult to value and, therefore, there should be a conclusive presumption that the estate paying the last term insurance premiums has purchased the policy. *Id.* One author however, has suggested that replacement value is a simple way of valuing the insurability right. C. MARKEY, *supra* note 35, § 24.45(3)(e). See also W. HOGOBOOM & D. KING, *supra* note 101, § 8:29.2 (discussing replacement value). The thrust of this comment is that a modified risk payment theory, combining the risk payment and replacement value approaches, be adopted in California. See *infra* text accompanying notes 182-205 (discussion of the modified risk payment approach).

111. The estate paying prior premiums may have helped the insured acquire the right to



D. *The Three Theories at Work: An Illustrative Hypothetical*

Application of the inception of title, apportionment, and risk payment theories can be illustrated by a hypothetical. Suppose that Harry, a twenty-six-year-old male, purchases a renewable term life insurance policy in 1986 with a face amount of \$100,000 and pays three yearly premiums from his separate estate.<sup>112</sup> In 1989, at age twenty-nine, Harry marries Wilma and the next seven annual premiums are paid from community funds.<sup>113</sup> When the policy was first purchased, Harry designated his mother, Maria, as beneficiary. In 1995, at age thirty-six, Harry dies. Wilma then claims a community property interest in the proceeds, while Maria claims the entire amount. What are the relative rights of Maria and Wilma?

In an inception of title jurisdiction, the policy would be the separate property of Harry because the first premium was paid from separate funds.<sup>114</sup> Wilma would be entitled to reimbursement because the

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the protection element at a lower cost than if prior premiums had not been paid. C. MARKEY, *supra* note 35, § 24.45(3)(e). If prior premiums are paid from community funds, then the right to lower cost protection is acquired by the community estate. *See* CAL. CIV. CODE § 5110 (West 1983) (assets acquired during marriage presumed community property). Similarly, if prior premiums are paid from separate funds, the right to the lower cost protection is acquired by the separate estate. *See* CAL. CIV. CODE §§ 5118, 5119 (West 1983) (asset acquired subsequent to legal separation presumed to be separate property).

112. The premium figures for this hypothetical were derived from consultation with New York Life Insurance Company agent Jim Hetherington. Conversation with Jim Hetherington (Aug. 22, 1986) (notes on file at *Pacific Law Journal*).

PREMIUMS		
Year	Premium	Accumulated Premiums
1986	\$141	\$ 141
1987	\$147	\$ 288
1988	\$155	\$ 443
1989	\$161	\$ 604
1990	\$168	\$ 772
1991	\$175	\$ 947
1992	\$183	\$1130
1993	\$191	\$1321
1994	\$198	\$1519
1995	\$208	\$1727

The premiums for the first three years of the contract are guaranteed. The premium amounts for the fourth and subsequent years of the contract are determined each year by New York Life Insurance Company in accordance with performance. The actual premium payable after the third year may be more or less than premiums listed above. The company does maintain a maximum premium amount in each contract. *Id.* The hypothetical premiums used in this comment are for purposes of illustration only.

113. *Id.*

114. *See supra* note 68 and accompanying text (first premium payment determines separate or community character of life insurance).

premium payments made over seven years by the community estate will be considered improvement of separate property.<sup>115</sup> Under the facts of the hypothetical, the community estate of Harry and Wilma made seven premium payments totaling \$1284.<sup>116</sup> Wilma is entitled to \$642 as reimbursement for premiums paid with community property funds and the remainder, or \$99,358, is awarded to Maria.

In an apportionment theory jurisdiction, a court would look to the total amount of premiums paid over the life of the policy.<sup>117</sup> In the hypothetical case, the community estate of Harry and Wilma paid \$1284 of the \$1727 in premiums over the life of the policy.<sup>118</sup> A court applying the apportionment theory would reason that 74.34% of the funds required for acquisition of the asset were paid from the community estate and, therefore, a like percentage of the proceeds must be considered community property.<sup>119</sup> In this case, \$74,340 of the proceeds will be community property and \$25,660 will be separate property. Wilma will be awarded her half of the community property or \$37,170, while Maria will receive the other \$37,170 that represents Harry's community interest. Maria should also receive the \$25,660 attributable to the separate property premium payments of Harry, giving her a total recovery of \$62,830.

In a risk payment jurisdiction, a court will look to which estate paid for the protection element of the policy.<sup>120</sup> In this case, the policy is term and therefore contains only a protection element.<sup>121</sup> Because the last premium payment in the hypothetical case was made from the community estate of Harry and Wilma, the proceeds are wholly community.<sup>122</sup> Wilma is entitled to half the proceeds, or \$50,000, as her community interest. Maria, the designated beneficiary, is entitled to the remaining \$50,000, the community interest of Harry.

#### THE CURRENT STATE OF CALIFORNIA LAW

When confronted with community property claims against life insurance proceeds, California courts apply the apportionment theory

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115. See *supra* note 71 and accompanying text (community estate entitled to reimbursement for improvement of separate property asset).

116. Conversation with Jim Hetherington, *supra* note 112.

117. See *supra* note 88 and accompanying text (community and separate interests in life insurance calculated on the basis of pro rata share of separate and community funds used to pay premiums over life of the policy).

118. Conversation with Jim Hetherington, *supra* note 112.

119. *Biltoft v. Wootten*, 96 Cal. App. 3d 58, 62, 157 Cal. Rptr. 581, 583-84 (1979).

120. *Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 659, 689 P.2d 48, 49-50 (1984).

121. See *supra* note 51 and accompanying text.

122. *Wadsworth*, 102 Wash. 2d at 659, 689 P.2d at 49-50.

to determine the interests of the claimants.<sup>123</sup> Division of life insurance policies upon dissolution of marriage, however, has led to conflicting decisions among the California Courts of Appeal.<sup>124</sup> While the apportionment rule remains good law, language in recent court of appeal decisions shows a growing recognition of the true nature of life insurance as an asset.<sup>125</sup> The division of life insurance upon dissolution of marriage and distribution of life insurance proceeds upon death should be controlled by the same theoretical framework in order to produce consistent results. The current state of California law is a mixture of differing analyses and inconsistent results. Four opinions, written over the last six years, illustrate the inconsistency.

A. *Biltoft v. Wootten: Apportionment Applied in the Context of a Contest Over Proceeds*

The California Court of Appeal for the Fourth District affirmed the apportionment rule in a contest over the proceeds of a term insurance policy in the case of *Biltoft v. Wootten*.<sup>126</sup> The deceased insured had entered into a federal employees group term insurance policy during marriage.<sup>127</sup> The insured spouse and the noninsured spouse were later legally separated.<sup>128</sup> Separate funds of the insured spouse were then used to pay the premiums and the noninsured spouse was removed as designated beneficiary.<sup>129</sup> Following the death of the insured, the designated beneficiaries argued that each premium payment purchased a new contract of insurance and, therefore, the right to the proceeds was procured by the contract in existence upon the insured's death.<sup>130</sup> Implicit in the beneficiaries' argument is the risk payment theory.<sup>131</sup>

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123. Compare *Biltoft*, 96 Cal. App. 3d 58, 62, 157 Cal. Rptr. 581, 583-84 (term) with *Dixon Lumber Co. v. Peacock*, 217 Cal. 415, 416, 418-19, 19 P.2d 233, 233-34 (1933) (cash value).

124. Compare *In re Marriage of Lorenz*, 146 Cal. App. 3d 464, 468, 194 Cal. Rptr. 237, 239 (1983) with *In re Marriage of Gonzalez*, 168 Cal. App. 3d 1021, 1026, 214 Cal. Rptr. 634, 637-38 (1985).

125. See *Aetna Life Ins. Co. v. Primofiore*, 80 Cal. App. 3d 920, 926, 145 Cal. Rptr. 922, 925 (1978) (term life insurance policy has no value prior to the death of the insured). See also *In re Marriage of Munguia*, 146 Cal. App. 3d 853, 861, 195 Cal. Rptr. 199, 203 (1983) (protection element of cash value policy not divided upon dissolution of marriage).

126. 96 Cal. App. 3d 58, 157 Cal. Rptr. 581 (1979).

127. *Id.* at 59, 157 Cal. Rptr. at 582.

128. *Id.* at 59-60, 157 Cal. Rptr. at 582. Under California law, remuneration received for services rendered after legal separation is considered separate property. CAL. CIV. CODE § 5118 (West 1983); *Patillo v. Norris*, 65 Cal. App. 3d 209, 218, 135 Cal. Rptr. 210, 216 (1976); *In re Marriage of Wall*, 29 Cal. App. 3d 76, 78-79, 105 Cal. Rptr. 201, 202 (1972).

129. *Biltoft*, 96 Cal. App. 3d at 60, 157 Cal. Rptr. at 582.

130. *Id.* at 60, 157 Cal. Rptr. at 582.

131. See 1 VALUATION AND DISTRIBUTION OF MARITAL PROPERTY § 20.04(2)(f)(i)(C) (J.

The *Biltoft* court rejected the new contract argument, and applied the apportionment rule instead.<sup>132</sup> The court asserted that at least four contractual rights were purchased by prior premium payments. The four rights cited by the court included protection from inquiry into insurability, guaranteed coverage as long as federal employment continued, the right to convert the policy to an individual policy upon termination of employment, and continued coverage at a reduced face amount if conversion were not elected.<sup>133</sup> Because prior premiums had contributed to acquisition of these four rights, the court reasoned, the proceeds should be subject to the apportionment rule.<sup>134</sup> The court, however, failed to recognize that these four rights only affect the cost of the protection element if the existing policy cannot be replaced with a new policy on the same terms.<sup>135</sup> For example, if a new policy can be purchased at the same premium rate without regard to insurability, then prior premiums have done nothing to protect the insured from inquiry into insurability. Likewise, if a replacement policy provides for conversion to an individual policy upon termination of employment on the same terms as those in the existing policy, then prior premiums have not contributed to the procurement of the conversion right.

Furthermore, the court did not discuss which premium payments purchased the protection element of the policy. Determining which estate purchased the protection element is the crucial inquiry under the *Biltoft* facts because the policy at issue contained only a protection element.<sup>136</sup> Because the court is dividing the proceeds, the focus should be on which estate purchased the right to proceeds. The other features in a term policy should influence proceed distribution only if they have affected the cost of the protection element.<sup>137</sup>

Under the policy at issue in *Biltoft*, the insured could probably have elected continued coverage whether or not he was still insurable.<sup>138</sup> The only time that insurability will affect the protection element

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McCahey 2d ed. 1986) (describing the risk payment theory as the annual policy theory).

132. *Biltoft*, 96 Cal. App. 3d at 62, 157 Cal. Rptr. at 583.

133. *Id.* at 61, 157 Cal. Rptr. at 583.

134. *Id.* at 61-62, 157 Cal. Rptr. at 583.

135. See C. MARKEY, *supra* note 35, § 24.45(3)(e). See also *supra* notes 101 & 108.

136. *Biltoft*, 96 Cal. App. 3d at 60, 157 Cal. Rptr. at 582.

137. See C. MARKEY, *supra* note 35, § 24.45(3)(e).

138. *Id.* See also D. MCGILL, *supra* note 18, at 680; S.S. HUEBNER & K. BLACK, *supra* note 4, at 397 (discussion of the relationship between insurability and group life insurance).

is if the insured becomes uninsurable prior to separation.<sup>139</sup> If uninsurability occurs prior to separation and a replacement policy would require evidence of insurability,<sup>140</sup> then the insured will not be able to procure replacement coverage at the same premium rate. In *Biltoft*, however, the existing policy probably did not require evidence of insurability for participation because it was a group term policy.<sup>141</sup> If insurability would not be considered under a replacement policy, then uninsurability does not affect the cost of the protection element. The insured in *Biltoft* probably could have secured a replacement policy on the same terms without regard to insurability if he was still a federal employee upon separation.<sup>142</sup> Similarly, if the insured is still insurable, a replacement policy can be obtained on the same terms as the existing policy because insurability can be proven when selecting a new policy.<sup>143</sup>

In summary, the *Biltoft* court made no effort at actual valuation of the respective contributions of each estate to procurement of the protection element of the policy. The court merely assumed that each premium payment went towards purchase of the protection element

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139. If the insured is uninsurable at the time of separation then replacement coverage cannot be secured. See D. MCGILL, *supra* note 18, at 375-407 (discussing uninsurability factors); S.S. HUEBNER & K. BLACK, *supra* note 4, at 60, 360-72 (discussing selection and classification of life insurance risks). In fact, one becomes uninsurable because the risk of death is simply too great. D. MCGILL, *supra* note 18, at 407-09 (discussing hypothetical calculation of risks). One might think that, if a person were uninsurable, an insurance company would accept an amount approaching the face value in return for issuance of a policy. Insurance companies will not issue a policy under these circumstances, however, because the proceeds would be subject to federal estate and gift tax, thereby defeating the exemption from such taxes that the proceeds normally enjoy. See generally 4 J. RABKIN & M. JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 61.07 (rev. ed. 1986) (discussing the federal estate and gift tax implications of life insurance). The insured may, however, have become a substandard risk prior to separation. See generally D. MCGILL, *supra* note 18, at 407, 421-30. If the insured has become a substandard risk prior to separation, then the community estate has contributed to the acquisition of the protection element at a lower cost. See C. MARKEY, *supra* note 35, § 24.45(3)(e).

140. See D. MCGILL, *supra* note 18, at 407; S.S. HUEBNER & K. BLACK, *supra* note 4, at 360-72 (discussion of the concept of insurability).

141. See *supra* note 30 (proof of insurability usually not required for coverage under group term life insurance).

142. See D. MCGILL, *supra* note 18, at 680; S.S. HUEBNER & K. BLACK, *supra* note 4, at 397 (discussing the relationship between group life insurance and insurability).

143. See C. MARKEY, *supra* note 35, § 24.45(3)(e). In fact, if the contract contains a renewability feature, the insured will probably be able to secure coverage at a lower premium cost. Conversation with Jim Hetherington, *supra* note 112. In a renewable term contract, the premium includes a charge which represents the increased risk of adverse selection attributable to renewability without proof of insurability. See D. MCGILL, *supra* note 18, at 44-46. See also *supra* note 27 (discussing the relationship between the renewability feature and insurability). The reason premiums will be lower is that the life insurance company is writing a contract on one who is currently insurable and therefore there is no danger of adverse selection. D. MCGILL, *supra* note 18, at 44-46.

of the policy.<sup>144</sup> The crucial inquiry in determining the contribution of prior premiums to the existing policy values is whether replacement coverage can be secured and at what cost.<sup>145</sup> If identical coverage at the same premium rate can be purchased, then only the most recent premium has purchased the nonaccrued contract rights, including the protection element.<sup>146</sup> Because the *Biltoft* court failed to make this inquiry, the replacement value of the policy at issue in the case is unknown. If there was no replacement value, then the court gave prior premiums credit for an acquisition they did not make.

*B. The First Step Towards Adoption of the Risk Payment Theory: In re Marriage of Lorenz*

The California Court of Appeal for the Second District confronted term life insurance as a community property asset in the case of *In re Marriage of Lorenz*.<sup>147</sup> The divisibility of term life insurance upon dissolution of marriage was at issue in *Lorenz*.<sup>148</sup> The court did not discuss when the policy was first purchased, but it is clear that community funds were used to pay some of the premiums.<sup>149</sup> Holding that term life insurance cannot be divided upon dissolution, the court stated that term policies have no value until the death of the insured.<sup>150</sup> *Biltoft* was distinguished on the grounds that once the insured has died, the value of term life insurance is easily ascertainable.<sup>151</sup> The reasoning of the *Lorenz* opinion, however, is inconsistent with the underlying rationale of *Biltoft* that prior premiums contribute to acquisition of certain accrued values in the policy.<sup>152</sup> *Lorenz* thus contradicts the basis of the holding in *Biltoft*.<sup>153</sup>

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144. By dividing the net amount at risk, the court must have assumed that the protection element was an asset purchased on installments. See *supra* text accompanying notes 87 & 90-94 (treatment of protection element as an asset purchased on installments improper).

145. See C. MARKEY, *supra* note 35, § 24.45(3)(e).

146. See *id.* See also Comment, *supra* note 40, at 372-73; Blanton & Ipsen, *supra* note 37, at 463-64.

147. 146 Cal. App. 3d 464, 194 Cal. Rptr. 237 (1983).

148. *Id.* at 466, 194 Cal. Rptr. at 238.

149. *Id.*

150. *Id.* at 468, 194 Cal. Rptr. at 239.

151. *Id.* at 468, 194 Cal. Rptr. at 239-40.

152. Compare *id.* at 468, 194 Cal. Rptr. at 239-40 ("The proceeds or benefits of the policy, of course, have a value. However, until those benefits are payable, the policy itself is worthless.") with *Biltoft*, 96 Cal. App. 3d at 61-62, 157 Cal. Rptr. 583 ("These benefits were derived from the contract which had its inception during the marriage, and were preserved by the payment of premiums out of community funds during the nearly 20 years of the marriage.").

153. In other words, prior premium payments are exhausted because they have been expended by providing protection. After the term has run there is nothing left of prior

The *Lorenz* opinion can be read as adopting the basic tenet of the risk payment theory that only the most recent payment purchases the protection element.<sup>154</sup> The reading of *Lorenz* as an adoption of the risk payment theory is premised on the fact that term insurance has only a protection element and therefore accrues no cash value. The risk payment theory also rejects the idea that term insurance accrues any other value. If there are no accrued values to a term life insurance policy, then the only value it can have is the protection element. Because the protection element is purchased by current and not prior premiums, the community estate in *Lorenz* would have no interest because after separation, the separate estate will pay the premium immediately prior to the death of the insured.<sup>155</sup>

If premium payments could be analogized to installment payments in acquiring tangible property, the policy should have value prior to the death of the insured in the same way that payment of mortgage installments increases equity in real property. If the *Biltoft* pro rata apportionment formula were to be strictly applied, the court should retain jurisdiction over the policy until the death of the insured because the percentage of premiums paid by the separate and com-

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premiums and therefore there is no fund to accrue. See D. MCGILL, *supra* note 18, at 44. The situation is analogous to a long-term residential lease. If the community makes rental payments for three years under a ten-year lease during which time the fair rental value increases, the community, by maintenance of the lease, has contributed to occupancy rights under the existing lease at a lower rental value. If, however, a comparable lease could be obtained at the exact rental value as the existing lease, there is no ascertainable present value to the prior payments of rent. Prior rental payments have been exhausted in securing occupancy rights which have been used. Research has revealed no case in which a court has attempted to divide past residential rental payments. Claimants and the courts probably recognize that money expended on past rental payments has not created a divisible asset, but has been exhausted in providing past occupancy rights. This is similar to a term life insurance policy containing various contractual rights other than pure protection. If the insured can receive identical coverage at an identical premium, prior premiums have not lowered the cost of securing the rights under the policy. This discussion is for purposes of illustration only. The differences between a lease and a life insurance policy as an asset are manifest. One obvious difference is that a lease is a bilateral contract while a life insurance policy is a unilateral contract. See *Flynn v. Mikelson*, 208 Cal. App. 2d 305, 310, 25 Cal. Rptr. 138, 141 (1962). See also *De Pauw University v. United Elec. Coal Cos.*, 299 Ill. App. 339, 345, 20 N.E.2d 146, 149 (1939) (discussion of bilateral nature of a lease). A residential lease acquired during marriage is presumed to be a community asset. See CAL. CIV. CODE § 5110 (West 1983). The bilateral nature of a lease, however, also creates a community debt upon the execution of the lease. See CAL. CIV. CODE §§ 5120.020, 5120.030, 5120.110 (West Supp. 1986). Because a life insurance contract does not create an obligation on the part of the insured, a policy acquired during marriage does not create a community debt. See CAL. CIV. CODE § 5120.020 (West Supp. 1986).

154. See *Aetna Life Ins. Co v. Wadsworth*, 102 Wash. 2d 652, 657-58, 689 P.2d 48, 49-50 (1984); Comment, *supra* note 40, at 372-73; Blanton & Ipsen, *supra* note 37, at 463-64.

155. See CAL. CIV. CODE §§ 5118, 5119 (West 1983) (assets acquired subsequent to legal separation are presumed to be separate property).

munity estates over the life of the policy will not be known until that time.<sup>156</sup> By waiting until the insured's death to distribute the protection element of the policy, a court would be consistent with *Biltoft*.

Citation of *Lorenz* as authority for the risk payment doctrine should be approached with caution for two reasons. First, the court never expressly stated that it was adopting the risk payment theory. Secondly, the court cited *Biltoft* as the controlling precedent in a proceed contest.<sup>157</sup> The failure of the court to fully analyze the applicability of the risk payment doctrine is revealed by the citation, with apparent approval, to *Biltoft*.

### C. Rejection of the Lorenz Approach: *In re Marriage of Gonzalez*

Confronted with the same issue as that before the *Lorenz* court, the California Court of Appeal for the Fourth District reached an opposite result. In the case of *In re Marriage of Gonzalez*,<sup>158</sup> the parties were married for twenty-two years prior to petitioning for dissolution.<sup>159</sup> The husband was a military veteran whose life was insured under both an individual term life insurance policy and a group term life insurance policy.<sup>160</sup> The court did not state how long the policies had been in existence, but they had an aggregate face value of \$45,000.<sup>161</sup> The husband appealed a trial court decision awarding one policy to the wife as her separate property and the other to the husband as his separate property.<sup>162</sup>

The appellate court in *Gonzalez*, citing *Biltoft*, held that term insurance policies have value prior to the death of the insured and, therefore, the rights under the policy should be divided in a dissolution proceeding.<sup>163</sup> The *Gonzalez* court indicated that several factors should be considered in determining the divisible value of the pol-

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156. The authority for continuing jurisdiction is found in CAL. CIV. CODE § 4800(a) (West Supp. 1986). See generally *In re Marriage of Brown*, 15 Cal. 3d 838, 849, 126 Cal. Rptr. 633, 638 (1976); *In re Marriage of Munguia*, 146 Cal. App. 3d 853, 858-59, 195 Cal. Rptr. 199, 201 (1983); *In re Marriage of Andreen*, 76 Cal. App. 3d 667, 676, 143 Cal. Rptr. 94, 99 (1978).

157. *Lorenz*, 146 Cal. App. 3d at 468, 194 Cal. Rptr. at 239.

158. 168 Cal. App. 3d 1021, 214 Cal. Rptr. 634 (1985).

159. *Id.* at 1022, 214 Cal. Rptr. at 635.

160. *Id.* at 1023, 214 Cal. Rptr. at 635.

161. *Id.* at 1026, 214 Cal. Rptr. at 638.

162. *Id.* at 1022-23, 214 Cal. Rptr. at 635-36.

163. *Id.* at 1025-26, 214 Cal. Rptr. at 637-38 (citing *Biltoft v. Wootten*, 96 Cal. App. 3d 58, 157 Cal. Rptr. 581 (1979)).



icy.<sup>164</sup> These factors include the face value of the policy, the amount of the premium, the life expectancy of the insured, the convertibility of the policy to whole life, the replacement value, and whether the policy ever "vests" and is considered fully paid.<sup>165</sup> The factors enumerated by the *Gonzalez* court are reasonable but they should not be applied until after the death of the insured. To do so in a dissolution proceeding would lead to conjectural ascertainment of present value.<sup>166</sup>

The *Gonzalez* opinion contains suggestions that support the adoption of the risk payment theory. The trial court was given specific direction to ascertain the contribution made by the community estate to the maintenance of the policies.<sup>167</sup> The trial court may accept the view that only the most recent premium purchases the protection element of the policy. The reference of the court of appeal to the replacement value could represent a recognition that replacement coverage is easily obtained.<sup>168</sup> The ability to procure equivalent replacement coverage should preclude a finding that the community estate has contributed to maintenance of the policy at current rates.<sup>169</sup> From the date of legal separation on the *Gonzalez* facts, the premiums on the term policies will probably be paid from the separate estate

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164. *Id.* at 1026, 214 Cal. Rptr. at 638.

The valuation and division of a term policy does, perhaps, pose a greater challenge than does a whole life policy, whose cash surrender value provides a convenient, although not necessarily accurate means of present valuation. But the task is not all that difficult. As Markey has suggested, replacement cost of a term policy may be one method of valuation, as might the sum of the community's contributions.

*Id.*

165. *Id.*

166. The present value approach, in the term life insurance context, rests on two assumptions. The first assumption is that the contract will be in existence upon the insured's death. The second assumption is that the insured will live until the actuarially expected date of death. Attempting to divide upon dissolution on the basis of present value, therefore, may violate the rule that a court should not attempt division when ascertaining value would be conjectural. *See In re Marriage of Andreen*, 76 Cal. App. 3d 667, 143 Cal. Rptr. 94 (1978). The *Andreen* court stated as follows:

[A] trial court should not attempt to dispose of disability benefits which an active, undischarged spouse may claim at some future time. The court cannot predict when or whether the covered employee will become disabled. An attempt to divide conjectural disability is an abstraction based on a possibility which may never materialize.

*Id.* at 676, 143 Cal. Rptr. at 100. Similarly, in the life insurance context, dividing the present value of the protection element would be conjectural because the insured's death may occur at a time when coverage does not exist. *Cf. In re Marriage of Munguia*, 146 Cal. App. 3d 853, 861, 195 Cal. Rptr. 199, 203 (cash value policy divided only as to accrued cash value upon dissolution).

167. *Gonzalez*, 168 Cal. App. 3d at 1026, 214 Cal. Rptr. at 638.

168. *See infra* note 141 (discussion of the potential contribution of prior premiums to lowering the cost of the protection element).

169. *See C. MARKEY, supra* note 35, § 24.45(3)(e).

on the term policies will probably be paid from the separate estate of the insured. Furthermore, prior premium payments made by the community estate were exhausted by providing protection during prior terms and presumably replacement value is nonexistent. There should, therefore, be no community interest in the policies.

As in *Lorenz*, the *Gonzalez* court cited *Biltoft* with approval.<sup>170</sup> The citation to *Biltoft*, however, creates an inconsistency. Assume that the trial court in *Gonzalez*, upon remand, determines that identical coverage could be retained at an identical premium as that prevailing under the existing policy. Assume further that the trial court is persuaded that only the last premium purchases the pure protection of the term policy. Under these circumstances, the trial court would have to determine that the separate estate has purchased the protection element and, therefore, there is no community interest in the policy. Yet, if the policy had never been contested in the dissolution proceeding, the noninsured spouse would be entitled to a community interest in the proceeds under the *Biltoft* formula.<sup>171</sup> In both scenarios the same dollar amount of community funds have paid premiums. The recoveries are dramatically different, however, depending on when the community property claims are pursued.

*D. Rejection of the Lorenz Approach in a Proceed Contest:*  
*Bowman v. Bowman*

In the case of *Bowman v. Bowman*<sup>172</sup> the California Court of Appeal for the Fourth District examined the cases in the context of a proceed contest. In *Bowman*, the deceased insured, Rudy, was protected by a group term policy with a face amount of \$225,000.<sup>173</sup> At the time of his death in 1981, Rudy had been married to Mary since 1979.<sup>174</sup> Prior to that, Rudy was married to Celia from 1949 to 1968.<sup>175</sup> The contested policy was first acquired in 1964. Mary

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170. *Gonzalez*, 168 Cal. App. 3d at 1026-27, 214 Cal. Rptr. at 638-39 (citing *Biltoft v. Wootten*, 96 Cal. App. 3d 58, 157 Cal. Rptr. 581).

171. See *In re Marriage of Brown*, 15 Cal. 3d 838, 850-51, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976) (“[u]nder settled principles of California community property law, property which is not mentioned in the pleadings as community property is left unadjudicated by the decree of divorce, and is subject to future adjudication, the parties being tenants in common meanwhile.”) (quoting *In re Marriage of Elkins*, 28 Cal. App. 3d 899, 903, 105 Cal. Rptr. 59, 61 (1972)).

172. 171 Cal. App. 3d 148, 217 Cal. Rptr. 174 (1985).

173. *Id.* at 159, 217 Cal. Rptr. at 181.

174. *Id.* at 151, 217 Cal. Rptr. at 175-76.

175. *Id.* at 151, 217 Cal. Rptr. at 175.

claimed the proceeds as designated beneficiary, while Celia asserted her community property rights in the proceeds.<sup>176</sup> The trial court, relying on *Lorenz*, held that Celia was entitled to nothing.<sup>177</sup> The appellate court reversed and remanded the case for a determination of Celia's community interest.<sup>178</sup>

In the remand order, the *Bowman* court expressly directed the trial court to make a determination of Celia's interest in the proceeds.<sup>179</sup> The court, however, provided very little guidance as to the method of valuing that interest.<sup>180</sup> Despite the *Biltoft* citation, there seems to have been no reason for the court to remand this case for a determination under the apportionment theory. Assuming that the actual premium payments over the life of the policy were available, the court could have apportioned the proceeds according to the pro rata interests of the claimants.<sup>181</sup> The *Bowman* decision likely stands

176. *Id.* at 151, 217 Cal. Rptr. at 176.

177. *Id.* at 159, 217 Cal. Rptr. at 181.

178. *Id.* at 161, 217 Cal. Rptr. at 182.

179. *Id.*

180. *See id.* at 159, 217 Cal. Rptr. at 181 ("Celia acquired an interest in the policy and the court erred in denying her a determination of it"). The court, however, did not state that the apportionment theory should be applied. *Id.*

181. Assume the following hypothetical premium payment schedule for a \$225,000.00 policy taken out in 1964 based on a male insured, age 36. (derived from Conversation with Jim Hetherington, *supra* note 112):

Year	PREMIUMS	
	Premium	Accumulated Premiums
1964	\$ 297	\$ 297
1965	\$ 342	\$ 640
1966	\$ 390	\$ 1029
1967	\$ 446	\$ 1475
1968	\$ 509	\$ 1984
1969	\$ 579	\$ 2562
1970	\$ 660	\$ 3222
1971	\$ 752	\$ 3973
1972	\$ 855	\$ 4829
1973	\$ 970	\$ 5799
1974	\$1094	\$ 6892
1975	\$1184	\$ 8076
1976	\$1276	\$ 9352
1977	\$1373	\$10,725
1978	\$1481	\$12,206
1979	\$1596	\$13,801
1980	\$1719	\$15,520
1981	\$1850	\$17,370

The interests of the claimants can be estimated. Under the hypothetical, the total amount of premiums paid over the life of the policy is \$17,370. *Id.* Assume that from 1969-1978, Rudy's separate estate made premium payments totaling \$10,222 or 58.85% of the total. Assume further that during the years 1964-1968, the community estate of Celia and Rudy made

as a reaffirmation of the apportionment rule. Despite the specific direction to ascertain the interests of the claimants on remand, there is a substantial probability that the trial court will apply the *Biltoft* apportionment rule.

#### A PROPOSED SOLUTION: THE MODIFIED RISK PAYMENT APPROACH

The inconsistencies of California law should be resolved by adoption of a unified theoretical approach in both the marital dissolution context and the decedent's estate context. The risk payment approach recognizes that the protection element of a life insurance policy is generally purchased by the most recent premium.<sup>182</sup> Nevertheless, prior premium payments may have contributed to acquisition of the protection element at a lower cost.<sup>183</sup> Awarding the entire proceed amount to the estate that paid the last premium may not be consistent with equitable distribution of potential contributions made by the prior premium payments.<sup>184</sup> The modified risk payment theory will award the net amount at risk to the estate making the last premium payment unless it can be shown that the prior premium payments allowed the protection element to be secured at a lower cost.<sup>185</sup> Such a showing is generally made when an insured has become a substand-

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premium payments totaling \$1,984 or 11.42% of the total. Finally, assume that in 1979-1981, community estate of Mary and Rudy made premium payments totaling \$5,164 or 29.73% of the total. Based on these percentages, Celia should receive one half of \$25,695 or \$12,847.50 as her community interest under *Biltoft*, the remainder would go to Mary as designated beneficiary. Had Rudy named a beneficiary other than Mary, then Mary would have received one-half of \$66,892.50 or \$33,446.50 as her community interest under *Biltoft*. The designated beneficiary would have received \$178,706.25 the amount remaining after subtracting the \$46,293.75 which represents the interests awarded to Mary and Celia.

182. See *Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 657-58, 689 P.2d 48, 49-50 (1984); Comment, *supra* note 40, at 372-73; Blanton & Ipsen, *supra* note 37, at 463-64.

183. C. MARKEY, *supra* note 35, § 24.45(3)(e). The Washington Supreme Court recognized that there was a potential contribution to maintenance of the policy by prior premium payments. *Wadsworth*, 102 Wash. 2d at 659, 689 P.2d at 50. The court, however, declined to accept a rule which would take the contribution into account, stating that:

We could adopt a rule requiring inquiry into the various aspects of each insurance policy to determine what, if any, features have present value. We prefer, however, to take a broader approach requiring inquiry only into whether the insurance policy is a term or cash value policy. The rule we adopt will, we hope, have the advantage of ease of application and thus avoid the time and expense of extensive litigation.

*Id.*

184. If the California courts choose to adopt the risk payment theory, valuation of potential contribution by the prior estate should be made. See C. MARKEY, *supra* note 35, § 24.45(3)(e) (discussing replacement value approach). See also W. HOGOBOOM & D. KING, *supra* note 101, §§ 8:29.2, 8:313 (discussing replacement value).

185. C. MARKEY, *supra* note 35, § 24.45(3)(e). The term "modified risk payment theory" is derived from Comment, *supra* note 40, at 377 (suggesting that the risk payment theory could be modified to account for insurability).

ard risk or uninsurable prior to a change in marital status. For example, if insurability is a factor under the existing policy and a married insured has become a substandard risk prior to legal separation, then the community property estate has contributed to a lower cost protection element. The same principle applies to the separate property estate if an insured becomes a substandard risk prior to marriage. If insurability is a factor under the existing policy of the unmarried insured, then the separate property estate has contributed to a lower cost protection element.<sup>186</sup>

After showing that the prior estate has contributed to a lower cost protection element, this contribution should be valued as if the prior estate were still paying a portion of the premium paid immediately before the death of the insured.<sup>187</sup> The valuation of the prior estate's contribution should be based on the difference between the premium actually paid and that which would have been paid had the insured been forced to obtain a replacement policy upon the change in marital status. The replacement value can be calculated by application of the following formula:

$$\frac{RP - AP}{RP} = RV$$

RP = Replacement Premium  
 AP = Actual Premium  
 RV = Replacement Value

The replacement premium is the amount that the insured would be forced to pay in order to obtain comparable coverage, while the actual premium is the amount actually paid for the protection element existing upon the death of the insured. The difference between the replacement premium and the actual premium, divided by the replacement premium, would yield the replacement value. For purposes of valuing the contribution of the prior estate, the replacement premium is treated as if it were the actual cost of the protection element. The replacement value is expressed as a percentage which represents the pro rata share of the proceeds awarded to the prior

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186. See C. MARKEY, *supra* note 35, § 24.45(3)(e).

187. Only the prior estate's contribution to the last premium payment should be considered when ascertaining replacement value. The reason for this is that, just like prior cash contributions, all prior intangible contributions to acquisition of the protection element have been exhausted by providing protection during prior terms. See *supra* note 53 and accompanying text. Only the most recent premium purchases the protection element, whether or not the amount of the premium has been kept constant due to the guaranteed insurability. *Id.*

estate.<sup>188</sup> Even if no replacement coverage could have been obtained, however, the prior premium contribution should not be valued at more than fifty percent. The rationale behind the fifty percent limitation is that the protection element is still not a cumulative asset and therefore the prior premiums and the most recent premium are mutually dependent on one another for the existence of the protection element.<sup>189</sup>

#### A. Consequences of the Modified Risk Payment Theory in a Proceed Contest

If the designated beneficiary of a life insurance policy is someone other than the spouse or ex-spouse of a deceased insured, and community funds were used to pay premiums, a contest over the policy proceeds may ensue upon the death of the insured. Although cash value life insurance can be distinguished from term life insurance, the modified risk payment theory should be applied to both.<sup>190</sup> The investment element of a cash value policy should be identified, isolated, and apportioned according to the relative dollar contributions of each estate.<sup>191</sup> On the other hand, the modified risk payment

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188. See C. MARKEY, *supra* note 35, § 24.45(3)(e). An application of the formula in the text would be as follows. Suppose at the time of separation the insured could only secure replacement coverage at a premium of \$200 annually. Suppose further that the insured's existing premium is \$150. The suggested formula treats the difference between the two premiums as if the community estate were contributing to premium payments in the amount of that difference. In the hypothetical case, the community has made a 25% contribution to the protection element. The community estate, therefore, is entitled to 25% of the proceeds. The percentage contribution of the community estate may vary depending on available replacement premium rates between the time of separation and the time of the insured's death. As Markey has suggested, however, replacement premium rates can be adduced from expert testimony. See *id.*

189. The noninsured spouse may not want to wait until the insured's death to recover. The spouse can be given a choice whether to wait or take a present value share of the community's future contribution to premium payments. The future contribution of the community estate could be ascertained by taking the dollar amount of premiums that the insured can expect to pay for the duration of his or her life expectancy and multiplying the result by the percentage figure yielded from the replacement value calculation. See *supra* note 188 and accompanying text (replacement value formula). *But cf. supra* note 166 and *infra* text accompanying note 202 (protection element should not be divided upon dissolution because valuation would be conjectural). Recovery of present value should serve to terminate the interest of the noninsured spouse in the proceeds. See *In re Marriage of Gillmore*, 29 Cal. 3d 418, 428 n.9, 629 P.2d 1, 7 n.9, 174 Cal. Rptr. 493, 499 n.9 (1981) (demand for immediate award of immature pension payments irrevocable election precluding award of future benefits).

190. See Blanton & Ipsen, *supra* note 37, at 464-66; Comment, *supra* note 40, at 381-88.

191. See *supra* note 98 and accompanying text (discussion of the applicability of the apportionment rule to the investment element). See also Blanton & Ipsen, *supra* note 37, at 464-66, 470-71; Comment, *supra* note 40, at 383. See also 1 J. APPLEMAN & J. APPLEMAN, *supra* note 28, § 2; S.S. HUEBNER & K. BLACK, *supra* note 4, at 66-67 (discussing investment

doctrine should be applied to the protection element in precisely the same manner whether the policy at issue is term or cash value.<sup>192</sup>

The protection element is usually acquired by the estate making the most recent premium payment.<sup>193</sup> There should, therefore, be a presumption that the estate making the last premium payment is entitled to the net amount at risk.<sup>194</sup> The rationale behind the last premium presumption is that since acquisition of the protection element generally is made by the last premium, the estate paying the last premium, whether community or separate, has acquired the right to the net amount at risk. Furthermore, the insured will generally be able to secure comparable replacement coverage.<sup>195</sup> The availability of comparable replacement coverage guarantees that prior premium payments will have made no ascertainable contribution to lowering the cost of the protection element.<sup>196</sup> Once representatives of the

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element of whole life contracts). Although ascertaining the cash value of a policy may appear to be simple, there are certain facts which give rise to complex issues. *See* Blanton & Ipsen, *supra* note 37, at 464-66. At least three major issues can arise. First, an insured spouse may borrow against the accrued cash value of the policy. Second, a premium payment may be missed but coverage remains in effect due to the Automatic Premium Loan feature which pays the missed premium from the accrued cash value. Third, the relative rights to compound interest on the accrued cash value may also be at issue. *Id.* A discussion of these issues is beyond the scope of this comment, although counsel should keep them in mind when handling a case involving cash value insurance.

192. *See In re Marriage of Munguia*, 146 Cal. App. 3d 853, 861, 195 Cal. Rptr. 199, 203 (1983) (accrued cash value of a life insurance policy must be divided upon dissolution of marriage). *See also In re Marriage of Gillmore*, 29 Cal. 3d 418, 428, 629 P.2d 1, 7, 174 Cal. Rptr. 493, 499 (1981) (when a property right contains both mature and immature elements, the matured rights should be divided upon dissolution); *In re Mendenhall's Estate*, 182 Cal. App. 2d 441, 6 Cal. Rptr. 45 (1960) (cash value contributions of the community must be ascertained and divided despite beneficiary designation).

193. Most Americans are insurable. *See* Comment, *supra* note 40, at 376-77 n.108. Because most Americans are insurable, replacement contracts at existing rates are readily available. *Id.* In most cases, therefore, prior premium payments will not have contributed to acquisition of the protection element. *See* C. MARKEY, *supra* note 35, § 24.45(3)(e).

194. *See* Comment, *supra* note 40, at 377-79. An ex-spouse endeavoring to prove that the community estate has contributed to maintenance of the policy should have the burden of proof because in the usual case only the subsequent, separate estate has purchased the right to the proceeds upon the occurrence of the insured's death. *See* C. McCORMICK, McCORMICK ON EVIDENCE § 343 (E. Cleary, 3d ed. 1984).

[T]he most important consideration in the creation of presumptions is probability. Most presumptions have come into existence primarily because the judges have believed that proof of fact B renders the inference of the existence of fact A so probable that it is sensible and timesaving to assume the truth of fact A until the adversary disproves it.

*Id.* In the case of a contest over a life insurance policy, fact B is proof of which estate has paid the last premium payment, while fact A is that the last premium has purchased the protection element.

195. Replacement value approaches zero when uninsurability has not occurred or assuming that the insured has not become a standard risk. *See supra* note 193 (availability of comparable replacement contracts). *See also* S.S. HUEBNER & K. BLACK, *supra* note 4, at 372.

196. Perhaps counsel would be wise to advise insurable clients to drop existing policies in

estate making prior premium payments have shown that prior premiums have contributed to lowering the cost of the protection element, then either side can put on evidence showing the replacement value of that contribution according to the formula discussed previously.<sup>197</sup>

Insurability may have a significant impact on replacement value. If insurability is a factor under the terms of the policy, the relevant time for inquiry into the insurability of the deceased is the point at which the subsequent estate assumed the premium payments from the prior estate.<sup>198</sup> In most cases the subsequent estate will have purchased the protection element of the policy.<sup>199</sup> The only time the prior estate will have contributed to a lower cost protection element is when there is a replacement value.

### *B. Consequences of the Modified Risk Payment Theory in the Marital Dissolution Context*

In a dissolution proceeding, the type of policy at issue before the court, whether term or cash value, should first be ascertained. If the policy at issue is term life insurance, then the relevant features, such

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dissolution cases. If existing policies are dropped, it would be clear that prior premiums applied to the protection element would no longer exist. *See supra* note 141 (availability of comparable replacement contracts). On the other hand, should the California courts continue to apply the apportionment rule, intentionally allowing policies to lapse may be construed as a violation of the duty of good faith owed between spouses with respect to management and control of community assets. *See CAL. CIV. CODE* § 5125(e) (West Supp. 1986). *See also* C. MARKEY, *supra* note 35, § 5.52(3) (intentional mismanagement of community assets may give rise to a cause of action under California Civil Code § 5125(e)).

197. *See supra* text accompanying note 187. The replacement value theory is simply a way of arguing that the community is entitled to appreciation of community assets. If replacement value is higher, the value of the protection element has, in effect, appreciated due to past premium payments because it can now be purchased at a lower cost. *See Juick v. Juick*, 21 Cal. App. 3d 421, 98 Cal. Rptr. 324 (1971). In *Juick*, one spouse was awarded the community property house by the trial court. *Id.* at 424, 98 Cal. Rptr. at 326. The other spouse was awarded a note representing a half interest in the home. *Id.* The spouse holding the note argued that equal division of community property had not been achieved because any appreciation of the home would accrue to the homeowner spouse. *Id.* at 426-27, 98 Cal. Rptr. at 328-29. The *Juick* court remanded the case to the trial court for consideration of the effect of appreciation on each party's interest. *Id.* at 428-30, 98 Cal. Rptr. at 330-31.

198. If the insured could have replaced the contract at existing premiums after separation, then the community has not contributed to procurement of the protection element. *See* C. MARKEY, *supra* note 35, § 24.45(3)(e).

199. As a general proposition, uninsurability occurs later in life and therefore it is more likely that the subsequent estate will be paying the premiums when uninsurability occurs. *See Aetna Life Ins. Co. v. Wadsworth*, 102 Wash. 2d 652, 658-59, 689 P.2d 48, 50 (1984). *See also* Comment, *supra* note 40, at 376. As mortality rates decrease, it is likely that replacement value will actually decline. *See* C. MARKEY, *supra* note 35, §§ 122.03(2)(b), 24.45(3)(e). A person, age 40, has less chance of dying in the coming year than a similar person 40 years ago. The smaller the chance of the risk of death occurring, the lower the premiums will be. *Id.*



as renewability or level premium plan, should be considered.<sup>200</sup> If the court determines that prior premium payments have not contributed to replacement value, then the noninsured spouse should be denied any interest in the policy because the community estate will not purchase the protection element.<sup>201</sup> If there is a replacement value, the court should retain jurisdiction over the policy, applying the replacement value formula to the policy upon the death of the insured. The court should not attempt division of the protection element prior to the death of the insured because determination of the replacement value would be conjectural.<sup>202</sup>

Cash value life insurance presents a slightly different problem. The portion of the cash value accrued during marriage should be ascertained and divided.<sup>203</sup> The protection element of a cash value policy should be treated in exactly the same manner as a pure term policy.<sup>204</sup> In the case of either term or cash value insurance, the court should not attempt to divide the protection element until the death of the insured, retaining jurisdiction over the policy until that time.<sup>205</sup>

#### CONCLUSION

This comment has illustrated that life insurance is a unique asset which presents a challenge for the courts when both community and separate funds are used to pay premiums. By failing to recognize the nature of life insurance, courts have inadequately responded to the

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200. See *In re Marriage of Gonzalez*, 168 Cal. App. 3d 1021, 1026, 214 Cal. Rptr. 634, 638 (1985).

201. See *In re Marriage of Lorenz*, 146 Cal. App. 3d 464, 468, 194 Cal. Rptr. 238, 239 (1983) (term life insurance not divisible upon dissolution). See also *In re Marriage of Munguia*, 146 Cal. App. 3d 858, 861, 195 Cal. Rptr. 199, 203 (1983) (protection element not divided upon dissolution).

202. See *In re Marriage of Brown*, 15 Cal. 3d 838, 848, 544 P.2d 561, 567, 126 Cal. Rptr. 633, 639 (1976). See also *Munguia*, 146 Cal. App. 3d at 858-59, 195 Cal. Rptr. at 201; *In re Marriage of Andreen*, 76 Cal. App. 3d 667, 676, 143 Cal. Rptr. 94, 99-100 (1978).

203. *Munguia*, 146 Cal. App. 3d at 861, 195 Cal. Rptr. at 203.

204. See W. HOGBOOM & D. KING, *supra* note 101, § 8:313.

Whole life insurance is usually valued at its cash surrender value (ordinarily established in the policy).

However, this is not a "hard and fast" rule. Special circumstances may make cash surrender value unrealistic. For example, if the insured is no longer "insurable," the value of a whole life (and possibly a term life) policy is probably *not* its cash surrender value, because the policy cannot be purchased any longer.

*Id.* (emphasis in original) (citations omitted). Like Hogoboom and King, this author suggests that inquiry into replacement value is relevant in both term and cash value cases. Unlike Hogoboom and King, however, this author suggests that the investment and protection elements of cash value life insurance be treated separately and in accordance with the unique properties of each. See *supra* text accompanying notes 191-92.

205. See *supra* notes 20-21 and accompanying text (discussion of continuing jurisdiction).

challenge. If California courts begin to acknowledge that the nature of a term life insurance policy as an asset is pure protection, division of community assets will be consistent with what term life insurance purchases. Furthermore, the distinction between cash value life insurance and term life insurance should be recognized. Treating the protection and investment elements distinctly, yet in accordance with the unique properties of each, will result in the equitable distribution of cash value life insurance.

California law now substantially overcompensates the estate which has made prior payments.<sup>206</sup> The reason for this overcompensation is the failure to analyze the asset at issue. Adoption of the modified risk payment approach to the distribution and division of life insurance will result in a more just division of community assets. The modified risk payment theory will compensate in accordance with the contribution made by each estate towards procurement of the protection afforded by a life insurance policy.

*Daniel A. Johnson*

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206. See *Biltoft*, 96 Cal. App. 3d 58, 157 Cal. Rptr. 581. See also *Modern Woodmen of America v. Gray*, 113 Cal. App. 729, 299 P. 754 (1931).

