

THE PRACTITIONER

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Policy Decision

When Disability Payments Do Not Qualify as Community Property

In its recent decision *In re Marriage of Elfmont*, 95 Daily Journal D.A.R. 4521, the California Supreme Court determined "under what circumstances ... disability insurance benefits received by a husband after dissolution of the marriage [should] be divided as community property." Focusing on the intent of the party paying the premium at the time of renewal and on the perceived purpose of disability insurance, the Court held that none of the benefits payable were community property.

Elfmont involved a 12-year marriage and three term disability insurance policies obtained initially during the marriage to cover the husband, an obstetrician/gynecologist. The policies were renewable every three months and contained a guaranteed renewal provision. During the marriage, the policies (including the guaranteed renewal rights) were all purchased with community funds; after separation, they were maintained with the husband's separate funds. Payment of benefits did not begin until 32 months after separation.

Among other things, the Court found that the husband had a retirement plan to which he had been contributing \$60,000 a year (presumably during the marriage). The Court also recited the trial court's finding that the husband knew he had back problems when he originally obtained the insurance policies.

In analyzing this issue, the majority ostensibly relied upon the intent test set forth in *In re Marriage of Saslow*, 40 Cal.3d 848 (1985). *Saslow* involved an 18-year marriage and the benefits payable under the terms of several disability insurance policies purchased during the marriage with community funds. The husband began to receive the disability benefits during the marriage. The wife was also disabled, suffering from Hodgkin's disease. The husband had not invested in a retirement or pension plan despite having the assets to do so. Although the court ordered the husband to pay half the benefits as spousal support (which would be modifiable), the wife appealed on the basis that she should have received her one-half interest as community property.

Following *In re Marriage of Stenquist*, 21 Cal.3d 779 (1978) (only the portion of disability benefits attributable to pre-marriage efforts and those that exceeded the normal retirement pension were separate property), the *Saslow* Court determined that the trial court must "treat disability benefits as separate property insofar as they are intended to replace post-dissolution earnings that would have been the

separate property income of the disabled spouse, and treat the benefits as community property insofar as they are intended to provide retirement income." *Saslow* at 861.

The *Elfmont* Court stated, "Under *Saslow*, ... we look to 'the spouses' intent' not only 'at the time the disability insurance was originally purchased,' but also 'at the times that decisions were made to continue the insurance in force rather than to let it lapse.'" *Elfmont* at 4521, citing *Saslow* at 861. "Spousal intent at the later time is especially important when a basic change of circumstances, such as the parties' separation, has intervened since the insurance was originally purchased." *Elfmont* at 4523.

The Court found that "no evidence indicates the husband's decision to renew the insurance after the parties' separation, by paying premiums out of his separate property, was accompanied by any intent to provide community retirement income. Accordingly, proof that continuation of his disability coverage was dependent upon policy renewal rights purchased with premiums paid out of community funds would not establish any community property interest in the insurance proceeds." *Elfmont* at 4521.

The Court distinguished the purposes of the disability benefits at issue in *Elfmont* from term life insurance benefits. Term life insurance benefits are paid to survivors, not the insured, and offset the economic consequences of the insured's death. Term disability, by contrast, intends to replace lost earnings of the insured. In fairly conclusory fashion, the opinion stated, "Unlike a right to renew term life insurance, which keeps alive a possibility of benefits in which the community

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will have an interest, the right to renew the insured spouse's term disability insurance after separation does not give rise to any community property interest in the insured's disability benefits." *Elfmont* at 4524. In this case, in which there was evidence the husband intended the disability insurance policy to function as an early retirement fund, such a statement about the purpose of term disability seems overbroad.

What then of the value of the renewal right, a right obtained by the community that the husband, because of his degenerated back condition, would not have been able to obtain post-separation? In the case of life insurance, the Court acknowledged that the community may have an interest in the proceeds commensurate with the community's contribution to obtain the renewal right (citing *Bowman v Bowman*, 171 Cal.App.3d 148 (1985); *In re Marriage of Gonzalez*, 168 Cal.App.3d 1021 (1985); and *Bilby v Wooten*, 96 Cal.App.3d 58 (1979)). The Court found no such interest in this case.

Justice George, while concurring with the majority's holding under the facts of this case, asserted that the husband should be required to reimburse the community for the value of the renewal right. Using a type of syllogism, he stated that property acquired during marriage with community funds is community

property; that this principle applies to insurance policies obtained during the marriage with community funds and that, upon dissolution, one spouse is not entitled to appropriate a community asset for his own use without reimbursing the community. *Elfmont* at 4526. Thus, the community should have a right of reimbursement.

Justice George further stated, "At the time of separation, each disability policy was itself a community asset." The husband, according to

Justice George, appropriated the renewal right for his own benefit. The renewal right is valuable whether or not the insured remained insurable. If the insured would not have been insurable after separation but for the contractual renewal right obtained during marriage, then the right is particularly valuable. However, even if the insured remains insurable, the renewal right that guarantees the premium will remain unchanged over time is valuable, since the insured need not obtain a new policy on the open market at a higher rate based on the insured's increased age.

If the term policy were allowed to lapse, "the insured spouse, not having used a community asset, would not have any obligation to reimburse the community." *Elfmont* at 4527. As Justice George's opinion implies, the fact that the insured elects to renew the policy, rather than let it lapse and obtain a new policy, is itself an indication of the value of the right. *Elfmont* at 4527.

Justice Kennard dissented, asserting that the rule in *Saslow* should apply to these facts as a matter of equity and precedent. "Unlike the majority, I would apply the *Saslow* rule to this case and hold that to the extent the marital couple intended the disability policy to provide for retirement income, the policy proceeds are community property, in an amount proportional to the percentage of the policy premiums paid for with community funds." *Elfmont* at 4528.

Like Justice George, Justice Kennard believed the majority overlooked the continuous aspect of the term policy that the renewal right guarantees and sees a valuable benefit in that renewal right. *Elfmont* at 4530. Justice Kennard would have apportioned the benefits between community and separate property interests to recognize the community's contribution to obtaining the initial policy and the valuable renewal right it contains. *Elfmont* at 4530.

It is difficult to understand how the *Elfmont* majority so readily dismissed the community's interest in the term policies, or at least in the policies' guaranteed rights of renewal that were clearly acquired with community funds to benefit the community. This seems especially inequitable when the insured spouse will likely seek a reduction or termination of spousal support obligations following the disability that results in the policy payouts.

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