LIFE INSURANCE BENEFICIARY DISPUTES

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Who gets the Money?

The easy and most common answer: the designated beneficiary. But when faced with a contest, an insurance company is rarely going to pick the winner. Instead, the insurance company will likely file an interpleader, deposit the disputed proceeds in the registry, and let a court sort it out.

Common Grounds for a Beneficiary Dispute

- The alternative will contest
- Attempted beneficiary designations
- Designations of former spouses
- Community Property Claims
- Disqualification of a beneficiary

First Questions to Ask

- Was the policy obtained through an employer or the military?
- How much is the policy benefit?

Texas or Federal Law?

This issue is critical, because it determines the available rights and remedies. And it often determines the outcome. Most commonly, it determines the rights of spouses and former spouses. It can determine jurisdiction and the right to a jury trial.

Texas Law Typically Applies

- When the policy is purchased through an agent or the insurance company
- When the policy is obtained through an employer that is a political subdivision
  ERS – State of Texas, school districts, public servants, public hospitals

Federal Law Typically Applies

- When the policy is obtained through a private employer - ERISA
- When the policy is obtained by an active military servicemember – SGLI
- When the policy is obtained by a retired military servicemember – VGLI
- When the policy is obtained by a federal government employee – FEGLI

The Alternative Will Contest

Lack of Capacity or Undue Influence

<u>Capacity</u>

See Texas Pattern Jury Charge 230.2 regarding testamentary capacity. An insurance policy is considered a contract and not a testamentary instrument. However, the analysis of mental capacity is similar. *See Bach v. Hudson*, 596 S.W.2d 673, 675 (Tex.Civ.App.-Corpus Christi 1980, no writ) (“The legal standards for determining the existence of mental capacity for the purposes of executing a will or deed are substantially the same as the mental capacity for executing a contract”).

Sufficient mental capacity to contract in Texas involves showing that the contracting party “appreciated the effect of what [she] was doing and understood the nature and consequences of [her] acts and the business [she] was transacting.” *Mandell & Wright v. Thomas*, 441 S.W.2d 841, 845 (Tex.1969); *Board of Regents of the Univ. of Tex. v. Yarbrough*, 470 S.W.2d 86, 90 (Tex.Civ.App.-Waco 1971, writ ref'd n.r.e.). Mental capacity, or lack thereof, may be shown by circumstantial evidence, including: (1) a person's outward conduct, “manifesting an inward and causing condition;” (2) any pre-existing external circumstances tending to produce a special mental condition; and (3) the prior or subsequent existence of a mental condition from which a person's mental capacity (or incapacity) at the time in question may be inferred. *See Bach*, 596 S.W.2d at 676. As a general rule, the question of whether a person, at the time of contracting, knows or understands the nature and consequences of their actions is a question of fact. *See Fox v. Lewis*, 344 S.W.2d 731, 739 (Tex.Civ.App.-Austin 1961, writ ref'd n.r.e.).

<u>Undue Influence</u>

See Texas Pattern Jury Charge 230.5 and 230.6 regarding fraud and undue influence. Undue influence is typically proven with circumstantial evidence. *Rothermel v. Duncan*, 369 S.W.2d 917, 923 (Tex. 1963); *Watson v. Dingier*, 831 S.W.2d 834, 837 (Tex. App.-Houston [14th District] 1992, writ denied). When identifying undue influence, Texas courts consider various factors, including: 1) the nature of the relationship between the victim, the contestant, and the alleged influencer; 2) whether the alleged influencer had that opportunity to exert influence; 3) the circumstances surrounding the drafting and execution of the document; 4) whether the alleged influencer had a fraudulent motive; and 5) whether there has been habitual subjection of the victim to the control of another. *Rothermel* at 922.

Undue influence and lack of capacity are separate theories for overturning a will or a beneficiary designation. However, weakness of mind and body is considered a material factor in determining whether a person was in a condition to be susceptible to undue influence. *Long v. Long*, 125 S.W.2d 1034, 1036 (Tex.1939).

Federal courts will typically borrow from the law of forum state to evaluate undue influence and capacity claims. *See Harmon v. Harmon*, 962 F. Supp. 2d 873, 881-82 (S.D. Tex. 2013).

Undue influence claims can be particularly difficult to defend in beneficiary designation disputes. Unlike with a will, there are typically no particular formalities required for a beneficiary designation. There may not even be an actual signature, with many larger insurance companies moving toward online designations. Therefore, there are often not the usual witnesses you would find in a will contest to testify regarding the circumstances of the execution. It is not difficult to imagine an influencer cornering a policyholder and improperly influencing a designation. With an online designation, it is very possible a family member, trusted friend, or housekeeper could have access to the insured's password and make an online designation without the insured's consent or even knowledge.

<u>Tip for estate planners</u>:

Oversee the designation during the will signing, with the general safeguards and witnesses. Often, the client will know the designation is likely to draw a challenge. If so, consider following similar execution processing as you would for a will to bolster your role as a witness.

Attempted Beneficiary Designations

Common scenarios:

- **Insured sends the correct form, but makes a mistake**
    - **Have time to correct the mistake?**
- **Insured sends the correct form, but it gets lost**
- **Insured completes the form, but does not send**
- **Insured sends a change, but not on the correct form**
- **Insured makes statements regarding wishes**
- **Insured makes a later, contrary provision in a will**

A common scenario is a claim that the insured attempted to make a designation, but the insurance company rejected it for some reason. Perhaps the insured did not use the proper form, there was not a required witness, or the insurance company believed the designation was unclear for some reason. While the insurance company has substantial discretion, when faced with a challenge the insurance company prefers a court make the ultimate determination.

Texas follows the doctrine of substantial compliance. However, the Texas version of substantial compliance is fairly strict. Substantial compliance in Texas means that the insured has done all that reasonably could be done to effect the change. *See Creighton v. Barnes*, 257 S.W.2d 101, 103 (1953). For example, where the insured completed and returned a change form naming her parents as beneficiaries but it was returned for correction because parents' names were abbreviated, insured had substantially complied with policy change requirements. *Gladding v. Prudential Ins. Co. of Am.*, 521 S.W.2d 736, 737 (Tex.App.-Houston 1975, writ ref'd n.r.e.).

What can work? A letter to the insurance company from the insured attempting a clear change. What will not work is an alleged attempt to make a designation through a will. *See Creighton*, 257 S.W.2d at 104.

There are federal cases that appear to bless the doctrine of substantial compliance for ERISA policies. *See Metropolitan Life Ins. Co. v. Johnson*, 297 F.3d 558 (7th Cir.2002) (court would examine whether insured evidenced his intent to make a change of beneficiary and attempted to effectuate that change by undertaking positive action). However, there are cases holding that strict compliance with designation formalities is required for SGLI policies. *See Dohnalik v. Somner*, 467 F.3d 488, 490 (5th Cir. 2006). Even then, the servicemember has complied with the formalities when he has delivered the designation to the service, even if it is later misplaced. *See Coomer v. United States*, 471 F.2d 1, 6 (5th Cir. 1973).

Some policies are more detailed than others regarding the requirements for a beneficiary designation. Most do not require witnesses and/or a notary. Texas courts typically give the insurance company great latitude in deciding what is an acceptable designation, even if the insurance company does not comply with its own procedures for accepting a beneficiary designation. There is Texas authority that policy requirements for designating or changing the beneficiary are primarily for the benefit of the insurance company and compliance with them may be waived by the insurance company during the lifetime of the insured. *See Fidelity Union Life Insurance Company v. Methven*, 346 S.W.2d 797, 799 (Tex. 1961); *Tramel v. Estate of Billings*, 699 S.W.2d 259 (Tex.App.—San Antonio 1985, no writ). However, a designation not consistent with the policy terms is likely to support a challenge on other grounds.

Texas Family Code and Community Property Rights

Common Scenarios:

- **Pre-divorce designation of former spouse**
- **Community property claim**

This is an area where it is particularly crucial to determine whether Texas or federal law applies. Federal law will preempt Texas law, when dealing with ERISA, SGLI, VGLI and FEGLI policies. The preemption applies to former spouse designations and to community property claims.

Texas Family Code Regarding Designations of Former Spouses

§ 9.301. Pre-Decree Designation of Ex-Spouse as Beneficiary of Life Insurance:

(a) If a decree of divorce or annulment is rendered after an insured has designated the insured's spouse as a beneficiary under a life insurance policy in force at the time of rendition, a provision in the policy in favor of the insured's former spouse is not effective unless:

(1) the decree designates the insured's former spouse as the beneficiary;
(2) the insured redesignates the former spouse as the beneficiary after rendition of the decree; or
(3) the former spouse is designated to receive the proceeds in trust for, on behalf of, or for the benefit of a child or a dependent of either former spouse.

(b) If a designation is not effective under Subsection (a), the proceeds of the policy are payable to the named alternative beneficiary or, if there is not a named alternative beneficiary, to the estate of the insured.

There are very limited exceptions, as the statute is strictly construed. *See Provident Life & Acc. Ins. Co. v. Cleveland*, 460 Fed. Appx. 359, 360-61 (5th Cir. 2012). Thus, a designation of "ex-spouse" is not effective when made before the divorce was final. *Id.* However, see *Primerica Life Insurance Company v. Purselley*, 2017 WL 3780274 (N.D. Tex., Dallas Division, August 31, 2017), where husband had gifted complete ownership of the property to his wife before the divorce. The court found that § 9.301 did not apply in that situation.

If there is no designated alternative/contingent beneficiary, the proceeds go to the insured's estate. For former spouses, Texas Estates Code § 123.001, invalidates pre-divorce provisions for former spouses. However, note exception for "unless the will expressly provides otherwise."

ERISA

A spouse has rights to ERISA pension benefits, unless the spouses executes a specific waiver. But life insurance is considered a welfare benefit, not a pension benefit under ERISA. A spouse has no particular rights to an ERISA life insurance policy.

ERISA preempts state laws voiding designations in favor of former spouses. *See Egelhoff v. Egelhoff ex rel. Breiner*, 121 S.Ct. 1322 (2001). The Supreme Court has made clear that individual state statutes are preempted to the extent they conflict with ERISA's requirement that plans be administered, and benefits be paid, in accordance with plan documents. Thus, citing Texas Family Code §9.301 will not be successful if the policy is governed by federal law.

The proper method to divest a former spouse of a federal life insurance policy is through a Qualified Domestic Relations Order (QDRO). A divorcing spouse can waive pension and life insurance benefits if they execute a QDRO.

To qualify as a QDRO, a divorce decree must "clearly specif[y]" the name and last known mailing address of the participant and the name and mailing address of each alternate payee covered by the order; the amount or percentage of the participant's benefits to be paid by the plan to each such alternate payee or the manner in which such amount or percentage is to be determined; the number of payments or period to which the order applies; and each plan to which such order applies. 29 USC § 1056(d)(3)(C). A domestic relations order cannot qualify as a QDRO if it requires a plan to provide any type or form of benefit, or any option, not otherwise provided under the plan; requires the plan to provide increased benefits; or requires the payment of benefits to an alternate payee that are required to be paid to another alternate payee under another order previously determined to be a QDRO. § 1056(d)(3)(D). A plan is required to establish written procedures for determining whether a domestic relations order is a QDRO. § 1056(d)(3)(G)(ii).

An emerging exception is when there is no QDRO, but the former spouse waives any interest in or claim to life insurance proceeds and/or employee benefits. Such cannot be the basis to challenge the payout to the ex-spouse. However, it may provide for a suit to recover the benefits after payment. *See Hennig v. Didyk*, 438 S.W.3d 177 (Tex.App.-Dallas 2014, pet. denied); *see also Flesner v. Flesner*, 845 F.Supp.2d 791, 799–802 (S.D.Tex.2012) (federal court holding such claims not preempted by ERISA).

FEGLI

The analysis is similar to ERISA policies. However, it does not appear that the divorce waiver claim illustrated in *Hennig* is available in FEGLI cases. *See Hillman v. Maretta*, 133 S.Ct. 1943, 1952 (2013); *Walsh v. Montes*, 388 P.3d 262, 265 (N. Mex. 2016) (noting differences in FEGLI and ERISA beneficiary regulations).

Community Property Claims

Community property claims are preempted for policies governed by Federal law. *See Barnett v. Barnett*, 67 S.W.3d 107, 126 (Tex.2001) (surviving spouse does not have a claim for fraud on the community when ERISA governed the distribution of the life insurance policy); *Metropolitan Life Insurance Co. v. Bell*, 924 F.Supp. 63, 65 (E.D.Tex.1995) (state community property claims preempted by FEGLI); *Prudential Ins. Co. of Am. v. Goodman*, 895 F. Supp. 137, 140 (S.D. Tex. 1995).

Common misconceptions regarding community property and life insurance:

- The spouse has no rights
- The spouse gets it all if community funds paid for the premiums

Life insurance is either separate or community property. *See Wohlenberg v. Wohlenberg,* 485 S.W.2d 342, 348 (Tex.Civ.App.–El Paso 1972, no writ) (describing inception-of-title doctrine as "emphatically applied to life insurance policies"). Per the inception-of-title doctrine, the separate or community character of a policy is determined by the time and circumstances of its acquisition. *Barnett v. Barnett*, 67 S.W.3d 107, 111 (Tex.2001) ("Generally, whether property is separate or community is determined by its character at inception, and this general rule applies to life insurance policies.").

Policies purchased before marriage are the separate property of the acquiring spouse. *Id.* A spouse has no claim to the proceeds of a separate property policy, although they may be entitled to reimbursement for half of the premium payments made during the marriage. *See Camp v. Camp*, 972 S.W.2d 906, 909 (Tex. App.—Corpus Christi 1998, pet. denied).

Policies acquired during marriage are presumptively community property. But that does not mean the spouse has a right to half of the policy benefits. Instead, the spouse has a claim for constructive fraud on the community. *See Madrigal v. Madrigal*, 115 S. W.3d 32, 35 (Tex.App.–San Antonio 2003, no pet.) A surviving spouse establishes a prima facie case of constructive fraud on the community with proof that the life insurance policy was purchased with community funds for the benefit of a person outside the community. *Murphy v. Metro. Life Ins. Co.,* 498 S.W.2d 278, 282 (Tex.Civ.App.-Houston [14th Dist.] 1973, writ ref'd n.r.e.).

The determination of such constructive fraud is a fact issue for the jury. The jury will consider (1) the size of the gift in relation to the total size of the community estate; (2) the adequacy of the estate remaining to support the surviving spouse in spite of the gift; (3) the relationship of the donor to the donee; and (4) whether special circumstances existed to justify the gift. *Barnett,* 67 S.W.3d at 126.

The burden is on the non-spouse recipient to establish that the "gift" of the proceeds does not work a constructive fraud on the spouse. *See In re Estate of Vackar*, 345 S.W.3d 588, 598 (Tex. App. - San Antonio 2011, no pet). Just because the spouse received other funds from the estate to "match" the disputed life insurance proceeds does not necessarily establish fairness. *Id.*

Disqualification/Invalid Designations

Slayer statute

Texas Insurance Code § 1103.151. Forfeiture:

> A beneficiary of a life insurance policy or contract forfeits the beneficiary's interest in the policy or contract if the beneficiary is a principal or an accomplice in wilfully bringing about the death of the insured.

Federal courts will apply slayer statute concepts to ERISA policies. See *Admin. Comm. for the H.E.B. Inv. & Ret. Plan v. Harris*, 217 F.Supp.2d 759, 760 (E.D.Tex.2002).

Using POA to make a designation

Texas Estates Code § 752.108(b). § 752.108. Insurance and Annuity Transactions:

> (b) Unless the principal has granted the authority to create or change a beneficiary designation expressly as required by Section 751.031(b)(4), an agent may be named a beneficiary of an insurance contract or an extension, renewal, or substitute for the contract only to the extent the agent was named as a beneficiary by the principal.

Note that the Texas legislature made significant changes to durable powers of attorney in the 2017 session. Different standards are likely apply for POA's executed after the effective date of the revised statute.

Designation made in violation of a court order during a divorce

Courts often enter temporary orders at the outset of divorce cases. These orders typically include a prohibition from either party changing the beneficiary designation on any life insurance policy during the pendency of the divorce.

Designations made in violation of such court orders are still valid. *See Korzekwa v. Prudential Ins. Co*., 669 S.W.2d 775, 778 (Tex.App.-San Antonio 1984, writ dism'd) (husband's beneficiary change, in violation of temporary order, was not voided, as an act done in violation of an injunction is not a nullity); *See also State Farm Life Ins. Co. v. Martinez,* 174 S.W.3d 772, 781 (Tex. App. - Waco 2005), rev'd on other grounds, 216 S.W.3d 799 (Tex. 2007) (life insurance designation valid, even if made in violation of divorce decree). The Fifth Circuit, applying Texas law, has specifically found that the violation of a temporary injunction does not void a beneficiary change. In *Davis v. Prudential Ins. Co*., 331 F.2d 346, 348 (5th Cir.1964), the Fifth Circuit stated that "there is no merit in the contention that this change of beneficiary and transfer of proceeds were void because in violation of injunctive orders." The Fifth Circuit further noted:

> Injunctions may be enforced by contempt proceedings, damage actions, or actions to enforce a penalty included within the injunctive order, but they do not, under the circumstances here, operate to void the transfer they prohibit in a suit by the protected party against the transferee.
> *Id.* at 350.

This view is in accord with the majority of jurisdictions analyzing designation made in contravention of an injunctive type order. *See* e.g., *Briece v. Briece,* 703 F.2d 1045, 1047 (8th Cir.1983) (affirming a district court's grant of summary judgment for the new beneficiary and deciding that "to so recognize the temporary restraining order would be to give it the effect of a final distribution of marital property"); *Am. Fam. Life Ins. Co. v. Noruk*, 528 N.W.2d 921, 923 (Minn.App.1995) ("when one of the parties dies, however, a temporary restraining order has no effect and the court's jurisdiction to enforce it ends"); *In re Demis,* 191 B.R. 851, 859 (Bankr.D.Mont.1996) ("[c]ourts have so refused to nullify acts done in violation of an injunction because an injunction is in personam, not in rem").

The Interpleader

Texas and federal law protects an insurance company that files an interpleader in response to a beneficiary contest:

- Texas common law provides that an insurer faced with rival claims to policy proceeds could interplead the funds, join the rivals who claimed them, and be discharged from further liability. A stakeholder is entitled to recover its attorney's fees from the deposited funds unless there were no rival claimants or the interpleader was unreasonably delayed. *State Farm Life Insurance Co. v. Martinez*, 216 S.W.3d 799, 808 (Tex. 2007); Texas Rule of Civil Procedure 43;

- Federal Rule of Civil Procedure 22 and 28 U.S.C. § 1332.

If you represent the party contesting a designation, it is crucial to assert the contest in writing to the insurance company before it pays out the proceeds. That can often be a matter of only a few weeks after the insured dies. If you will not handle a contest, considering writing a contest letter with the direction to the client to retain another attorney to actually pursue the contest.

The insurance company will rarely intentionally ignore a contest letter. That is particularly true when the allegations include lack of mental capacity, undue influence or fraud. Even in facially incorrect challenges, such as community property claims regarding ERISA policies, insurance companies are reluctant to pay the proceeds and risk a court finding it paid the wrong claimant.

Upon receiving notice of a contest, most insurance companies will send a pre-interpleader letter to the competing claimants. This letter will typically provide notice of competing claims to the policy proceeds and that the insurance company will allow 30 to 60 days for the parties to negotiate a compromise. That letter typically suggests the parties seriously consider a settlement to avoid the length and expense of litigation. Each company has its own procedures of course. Some will simply refer the matter to outside counsel to file the interpleader, without sending a pre-interpleader letter.

After the competing parties appear in the interpleader case, the insurance company typically seeks an agreed order of dismissal. If the parties agree, the order typically provides an award of some attorney's fees from the policy proceeds for the insurance company's pursuit of the interpleader. If the parties do not agree, the court will consider the amount of reasonable and necessary fees for the insurance company. The awarded fees will generally be much lower if the competing parties agree to dismiss the insurance company as soon as possible after it files the interpleader. *See Connecticut General Life Ins. v. Thomas*, 910 F.Supp. 297, 305 (S.D.Tex.1995).