Published on *The National Law Review* https://natlawreview.com

Cash Value of Life Insurance Policy Exempt From Garnishment

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DC Mex Holdings LLC v Affordable Land LLC and Dale Fuller, __Mich. App.__ (July 25, 2017), Case no. 332439

Michigan’s Court of Appeals recently issued an opinion interpreting a statutory provision exempting insurance proceeds from the reach of creditors in certain situations. This case may provide guidance related to estate planning and asset protection as well as dealing with collection efforts and creditor’s claims.

DC Mex Holdings LLC obtained a $2.5 million dollar judgment jointly and severally against the defendants. In an attempt to collect part of that judgment, DC Mex initiated garnishment proceedings against the universal life insurance policy issued to the individual defendant, Dale Fuller, which had a cash value of just over $73,000.

Fuller objected to the garnishment on the basis that the proceeds were exempt from creditors pursuant to M.C.L. 500.2207(1) because his daughter was the designated beneficiary, and because the proceeds were not yet owed.

The statute at issue reads in pertinent part as follows:

> It shall be lawful for…any father to insure his life for the benefit of his children…and in case that any money shall become payable under the insurance, the same shall be payable to the person or persons for whose benefit the insurance was procured…for his, her or their own use and benefit, free from all claims of the representatives of such husband or father, or of any of his creditors…and the proceeds of any policy of life or endowment insurance, which is payable to the…children of the insured or to a trustee for the benefit of the…children of the insured, including the cash value thereof, shall be exempt from execution or liability to any creditor of the insured…and shall apply to insurance payable to the above enumerated persons or classes of persons, whether they shall have become entitled thereto as originally designated

beneficiaries, by beneficiary designation subsequent to the issuance of the policy, or by assignment (except in case of transfer with intent to defraud creditors).

Pursuant to the policy terms, Fuller had the option of surrendering the policy to obtain the net cash value. However, doing so would reduce the value of the death benefit, an important factor in the Court's ultimate conclusion.

DC Mex argued the statute did not protect the cash value of the policy during the insured's lifetime because the statute designated the cash value as a subset of "proceeds", and proceeds only became relevant or payable upon death. Fuller argued that the life insurance was payable to his daughter, so the cash value of the policy was exempt from his creditors.

The Court of Appeals disagreed with both and held that the phrase "proceeds of any policy…including the cash value thereof" referred to the entire amount of the proceeds that was payable to the beneficiary. Accordingly, the Court held the cash value was exempt from garnishment efforts.

The Court explained that its rationale was consistent with the public policy of protecting insurance intended to provide for an insured's spouse and children from creditor's claims after the insured's death. In this case, the Court's interpretation prevented the devaluation or default of the policy, which was also consistent with the legislature's intent evidenced by the language exempting the cash value of the proceeds.

The Court also rejected DC Mex's argument that Fuller engaged in a fraudulent transfer precluding application of the exemption when he changed the policy beneficiary, while the lawsuit was pending, from a trust for his children's benefit to Fuller's only child, his daughter. The Court found that the statute expressly provided for proceeds payable to a trustee for the benefit of the insured's children. Since the original beneficiary was exempt and the changed beneficiary was exempt, the Court held there was no fraudulent transfer.

Life insurance is a popular estate planning option to provide support for surviving children, and the Court's ruling provides further asset protection for an owner of a policy during the owner's lifetime.

National Law Review, Volume VII, Number 214