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EXEMPTION OF INSURANCE AND OTHER PROPERTY IN THE VIRGINIAS AND CAROLINAS

E. McGruder Faris, Jr.*

Current state statutes on the exemption of debtors' property from execution processes are for the most part needlessly unrealistic. While it is true that some jurisdictions have in recent years recodified their exemption laws to meet the needs of an inflationary and mechanized economy, others have been content to roll along with exemptions designed in part for the horse and buggy days.

That the law of exemptions has lagged behind economic development is clearly illustrated by the provision of the North Carolina Constitution of 1868 which permits a homestead exemption not exceeding $1,000. South Carolina and West Virginia provide the same. These provisions obviously offer the debtor only a small fraction of the protection to which he was originally entitled. Even attempts at modernizing our exemption laws have often been rather feeble. For example, while Virginia in 1936 did recognize the advent of the motor vehicle by giving farmers an exemption of “one tractor, not exceeding in value five hundred dollars,” the legislature apparently assumes that “one yoke of oxen” and a cart will supply other transportation essential for farm operation.

Although the above illustrations indicate that certain exemptions have decreased relatively with the passage of time, there are other exemption statutes which show an undue solicitude for the debtor at the expense of his creditor. A leading offender in this respect is the exemption of various types of insurance benefits. Because the exemption of insurance is not necessarily related to the needs of the debtor and his dependents, special attention will be given to the subject. A few suggestions for change will be offered.

Before proceeding to examine insurance exemptions in particular, it seems appropriate to outline present day exemption laws in general. This will enable the reader to see the insurance exemptions as parts of a whole, somewhat haphazard, statutory scheme. An examination of these laws may leave one with the impression that they, like Topsy, just sort of grew. Attention is particularly directed to state constitutional provisions dealing with the exemption of per-

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sonal property. If the wording of a constitutional provision seems to place a maximum on the amount of personal property which can be claimed as exempt, there is reason to question the constitutionality of a mere statute expanding the size of exemptions.

In the outline below the miscellaneous exemptions are grouped according to jurisdictions.\(^1\) While this makes the process of comparison somewhat more difficult, the average reader will probably be more interested in the laws of a given jurisdiction than in the manner in which they compare with those in other states.\(^2\) For those interested in the comparative aspect of exemption laws, the process of comparison may be somewhat simplified by the references given. Following the outline, a few general comparative comments will be made.

I. OUTLINE OF EXEMPTION LAWS

**North Carolina**

*Homestead:* "[A] homestead ... not exceeding in value one thousand dollars ...."\(^3\) Protection is limited to residents and generally can be claimed only in real property and not the proceeds thereof.\(^4\)

*Personal Property:* "The personal property of any resident of this state, to the value of five hundred dollars ...."\(^5\)

*Tools of Trade:* Prior to the adoption of the above provision on personal property in the Constitution of 1868, North Carolina did enumerate certain articles (including farming and mechanical tools, libraries of licensed attorneys, and instruments of surgeons and dentists) that were exempt from debtor's execution.\(^6\) There was no monetary limit on the quantity of such tools of trade or profession

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\(^1\)The exemption laws considered here have been limited to those of North Carolina, South Carolina, Virginia, and West Virginia. For a comparison with other jurisdictions see Joslin, Exemption Laws: Time For Modernization, 34 Ind. L.J. 355 (1959).

\(^2\)It seems appropriate here to insert a word of warning. Although the lists of exemptions in the outline are relatively complete, some exemptions may have been omitted. By way of explanation it should be pointed out that not all "exemptions" are indexed under that heading. Some are under the heading "execution." Others can be found only under the name of the particular item believed to be the subject matter of an exemption. Finally, some exemptions exist by case law alone and are not fully indexed.

\(^3\)N.C. Const. art. X, § 2 (1868). See also N.C. Gen. Stats. §§ 1-373, -386 (1953).

\(^4\)N.C. Gen. Stats. § 1-369 and annotations. Cf. note 63 infra. For a comprehensive discussion see Aycock, Homestead Exemption in North Carolina, 29 N.C.L. Rev. 143 (1930).


which could be held exempt. Since 1868, tools of trade or profession can be claimed only under the personal property exemption.

Wages: Wages already earned by the debtor are generally available to meet the claims of his creditor; however, there is a special exemption of wages earned within sixty days of the date of attempted execution, provided the debtor can show that such prior wages are necessary for the use of a family supported wholly by the labor of the debtor.\(^7\)

As to future wages of the debtor, it has been held:

"[O]ur statutes concerning proceedings supplemental to exemption were adopted from New York, where it has been steadfastly held under the original statutes that 'future earnings, wages, or salaries to become due, or which become due after service of the order of examination cannot be reached by supplementary proceedings.'"\(^8\)

Fraternal Benefit Society Benefits: No right or benefit from any society for the relief of employees, including railroad and other relief associations, shall be liable to any process to subject such benefit to the debts of any member or any other person who may have any right thereunder, either before or after payment.\(^9\)

Workmen's Compensation Benefits: All compensation awarded under the laws of North Carolina is exempt from claims of creditors and from taxes,\(^10\) but a compensation award by another state is not exempt in North Carolina. Even North Carolina awards lose their exempt status upon being converted into other property, and this includes the depositing of the money in a bank, even though there is no commingling with other funds.\(^11\)

Retirement and Relief Payments: Among the several special retirement and relief funds, the proceeds of which are exempt, are Firemen's Relief Fund,\(^12\) Law Enforcement Officer's Relief Fund,\(^13\) City and County Retirement Systems,\(^14\) and Old Age Assistance.\(^15\)

Farmers' Special Exemptions: No statute giving special exemp-

\(^7\)N.C. Gen. Stats. § 1-362 (1953).
\(^10\)Id. at § 97-21.
\(^11\)Id. at § 108-32.
\(^12\)N.C. Gen. Stats. § 118-36 (1958).
\(^13\)Id. at § 143-166.
\(^14\)Id. at § 128-31.
\(^15\)Id. at § 108-32.
tions to farmers was found; however, execution may not be levied on growing crops until they are matured.16

*Life Insurance:* Proceeds of life insurance without monetary limit pass to named beneficiaries free of claims of the insured's creditors. This will be discussed in more detail later.

*Group Insurance:* As amended in 1957, the statute on exemption of group insurance benefits makes proceeds of group life insurance which are payable to the estate of the insured a part of his estate for the payment of his debts. Apart from this limited availability of life insurance, all rights of any person in any type of group insurance are free from the claims of the *creditors of any party* with an interest under the policy.27

*Spendthrift Trusts:* North Carolina allows by statute a very limited spendthrift trust. Such a trust is free from the claims of the cestui's creditors to the extent that the corpus does not yield in excess of a net $500 per year at the time the trust is created.18 Only trusts created for the benefit of relatives of the grantor qualify for the spendthrift exemption. These limitations have been criticized by Mr. Gilbert T. Stephenson.19

**South Carolina**

*Homestead:* "[T]o the head of any family residing in this state, a homestead in lands...to value of one thousand dollars..."20

*Personal Property:* "[T]o the head of every family residing in this state...personal property to the value of five hundred dollars."21

*Tools of Trade:* "[A]ny person not the head of a family shall be entitled to like exemption as provided for the head of a family in all necessary wearing apparel and tools and implements of trade, not exceeding in value the sum of three hundred dollars."22

*Wages:* The statutory exemption of wages is identical to that of North Carolina shown above. Compensation earned within sixty days preceding an order of execution against such back wages is exempt from execution if the debtor shows such compensation to be necessary

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16 Id. at § 1-315(4).
17 Id. at § 58-213.
18 Id. at § 41-9.
22 Ibid.
to support a dependent family. As to the availability of process against future earnings, no statutory or case authority was found. In the absence of a provision permitting garnishment or other process against a certain part of future earnings, it may be assumed that South Carolina will probably follow the case law of North Carolina, which makes it virtually impossible for a creditor to reach his debtor's future earnings.

*Fraternal Benefit Society Benefits:* No benefit of any person before or after payment shall be subject to any process for the debt of any person having rights under the policy.

*Workmen's Compensation Benefits:* All compensation awarded by South Carolina "shall be exempt from all claims of creditors."

*State Retirement System:* All rights and receipts of a state employee under the South Carolina Retirement System are exempt from any process.

*Firemen's Pension Fund:* Rights in this fund are fully exempt.

*Life Insurance:* Life insurance payable to a married woman, her children, or children of the insured husband to the extent of $25,000 passes to such named beneficiaries free of the claims of the decedent's creditors. This provision will be considered in more detail later.

*Spendthrift Trust Exemptions:* While the case law of South Carolina does to some extent recognize the validity of a spendthrift trust, there is no statutory regulation of the subject, except a provision passed in 1953 governing a spendthrift trust in life insurance proceeds.

*Virginia*

*Homestead:* "Every householder or head of family shall be entitled ... in addition to articles now exempt ... to hold exempt ... his real or personal property ... to the value of not exceeding two thousand dollars. . . ."

*Personal Property:* Virginia makes no special provision for the
exemption of a specific amount of personal property as distinguished from real property. Rather, as shown above, the homestead exemption is worded so as to apply to both realty and personalty. The above provision, however, does imply that there are other exemptions of personal property made available by statute. Among the items of personal property specifically exempt by statute at the adoption of the Constitution of 1902 were one pot, one spinning wheel, and all squirrels not raised for sale. This policy of exempting particular articles of personal property is continued today, and the debtor's squirrels are still secure from a creditor's talons.

**Tools of Trade:** Among the numerous enumerated items exempt from execution in Virginia are tools of trade of a mechanic not exceeding the value of $200. Prior to the 1956 amendment, the amount was limited to $100.

**Wages:** Of the four states considered, Virginia has the most comprehensive statutory scheme for exempting part of the wages of a debtor. The statute specifically applies the exemption to both past and future wages. A distinction between a householder and a non-householder is made, with the householder receiving the greater exemption. For the householder the exemption is 75 per cent of wages, and under the 1954 amendments the minimum amount exempt is $100, and the maximum $150 per month. By the 1958 amendments both the minimum and the maximum were increased $15 for each dependent child of the householder. For the non-householder the exemption is limited to 50 per cent of the exemption granted to a laboring man who is a householder.

**Farmers' Special Exemptions:** Farmers are recognized as a specially protected debtor class, and certain enumerated articles used for agriculture are specifically exempt. As previously stated, the 1956 amendment finally recognized the advent of the motor vehicle by exempting one tractor not exceeding the value of $500. One further agricultural exemption is found in the statutory provisions on methods of execution, where it is provided that growing crops are generally not subject to levy.

**Workmen's Compensation:** All claims and compensation from claims are exempt from the levy of all creditors.

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3Id. at § 34-26.
3Id. at § 34-29.
3Id. at § 34-27.
3Id. at § 8-421.1.
3Id. at § 65-79.
Unemployment Compensation: Such benefits are exempt from claims for debt so long as the benefits are not mingled with other funds of the recipient. The exception to this general exemption is that claims arising for necessaries supplied during the period of unemployment may be realized out of the unemployment benefits.\textsuperscript{39} Is there merit to this exception from the general exemption?

Group Life Insurance: Both the policy and proceeds of group life insurance are fully exempt from the debts of the insured and the debts of any other person. The proceeds are exempt both before and after payment; and if payable to the estate of the insured rather than to a named beneficiary, the proceeds do not constitute part of his estate for payment of his debts.\textsuperscript{40} It is difficult to envision a more complete exemption. Actual needs of the debtor or the beneficiary seem completely irrelevant to the claiming of this exemption. Perhaps the exemption does aid the sale of insurance, however.

Other Special Insurance: Payments in weekly or monthly installments to the holder of an Industrial Sick Benefit Insurance Policy are exempt from debt claims against the policyholder.\textsuperscript{41} For benefits under a Fraternal Benefit Society Policy the exemption is expanded beyond protection to the insured debtor. For such a policy it is provided that no benefit of the insured or any other person shall be subject to any process before or after payment to satisfy the debt of any insured or any other person.\textsuperscript{42} Benefits of any person under a policy of life insurance issued by a Co-operative Non-Profit Life Benefit Company are granted a broad immunity from execution similar to that granted to benefits under a policy issued by a Fraternal Benefit Society.\textsuperscript{43} Again we see that it is the character of the insurer rather than the character of the debtor that determines whether a particular asset is subject to the claims of the debtor's creditors. Burial Society benefits are likewise given broad immunity from claims of creditors of any person with a right to such benefits.\textsuperscript{44}

Life Insurance: The extent to which various rights under an ordinary policy of life insurance are exempt from the claims of the various parties with rights under a life insurance policy will be considered in more detail later. Suffice it to say here that regardless of what par-
ties are entitled to protection, there is a limit on the amount of life insurance that will be exempt from the claims of creditors during the life of the insured.\textsuperscript{45}

\textit{Retirement Benefits:} Benefits received from the Virginia Supplementary Retirement System are not subject to any legal process.\textsuperscript{46}

\textit{Spendthrift Trusts:} From 1918 until 1958 Virginia recognized the spendthrift trust to the extent of $100,000 of corpus, and the income therefrom was not available to satisfy liabilities of the beneficiary. In 1958 the monetary amount of the exemption was increased to $200,000.\textsuperscript{47}

There are also special exemption provisions for spendthrift trusts created under life insurance policies.\textsuperscript{48} The ordinary spendthrift trust statute and that dealing with a life insurance spendthrift provision have been correlated. The total exemption of the two types of trusts shall not exceed the $200,000 maximum permitted by the basic spendthrift provision. A beneficiary is given an election as to how the maximum shall be allocated between the two types of spendthrift trusts.\textsuperscript{49}

\textit{West Virginia}

\textit{Homestead:} "Any husband or parent residing in this state... may hold a homestead of the value of one thousand dollars...."\textsuperscript{50}

\textit{Personal Property:} "[P]ersonal property to the value of two hundred dollars... subject to such regulations as may be prescribed."\textsuperscript{51}

\textit{Tools of Trade:} "Any mechanic... whether he be a husband or parent... may hold working tools... to the value of fifty dollars... provided that in no case shall the exemption (personal property) allowed one person exceed two hundred dollars."\textsuperscript{52}

\textit{Wages:} Wages due or to become due within one year can be reached by a "suggestee execution" against the debtor's employer, but only to the extent of 20 per cent of the wages. Also, a minimum of $10 per week is completely unreachable by the creditor in a proceeding against the employer. As to wages in excess of $10 weekly minimum, or in excess of the 20 per cent available under the "suggestee

\textsuperscript{45}Id. at §§ 38.1-448 to -451.
\textsuperscript{46}Id. at § 51-111.15.
\textsuperscript{47}Id. at § 55-19.
\textsuperscript{48}Id. at 38.1-444 to -447.
\textsuperscript{49}Id. at § 38.1-446.
execution," the debtor may still claim his $200 personal property exemption. This $200 exemption may be asserted anew each pay period.33

Group Life Insurance: The policy and proceeds of group life insurance, before and after payment, are not subject to claims of creditors of any person having a right under the policy.34

Fraternal Benefit Society Benefits: No process can reach any right of any person in any benefit of a fraternal benefit society, whether the right arises before or after payment.35

Judges' Retirement Fund Benefits: Judges' rights from this fund are exempt from any process.66

State Teachers' Retirement: All benefits under the State Teachers' Retirement System are beyond reach of any process.67

Life Insurance: Generally, the proceeds and avails of life insurance policies payable to persons other than the named insured are free from the claims of creditors of the named insured.38 The application of this provision will be considered later.

Spendthrift Trusts: The West Virginia statute on spendthrift trusts is modelled upon the Virginia provision; however, the $200,000 limitation on the trust corpus is omitted.39 Thus, there is no statutory limit on the amount of property that may be placed beyond the reach of the beneficiary's creditors by means of a trust with spendthrift provisions.

Welfare Benefits: Payments under general relief are not subject to any process.60

Workmen's Compensation Benefits: These benefits are free from the claims of creditors of either the worker or other beneficiary both before and after payment, except that counsel fees claimed in connection with the award may be enforced against the award.61 It has

33W. Va. Code Ann. §§ 3834(3), (9), (16), (25) (1955). Under these provisions it appears that if the debtor was receiving $1,000 per weekly pay period, 20%, or $200, could be reached under "suggestee execution," unless the debtor chose to renew his $200 personal exemption in this amount each week.
34Id. at § 3398(28).
35Id. at § 3472(259).
36Id. at § 5260(14).
37Id. at § 1846(30).
41Id. at § 2543.
been held that compensation benefits retain their exempt character even after their deposit in a bank account, so long as there is no commingling with other funds. 62

II. COMPARISON OF EXEMPTION LAWS

As previously mentioned, the above outlines of exemption laws have been grouped according to the individual states so that the reader can see in one place most of the exemptions for a given jurisdiction. It seems appropriate, however, to make some general comparisons of the various exemptions.

Homestead

In all four states there are both constitutional and statutory provisions on the matter of homestead. In no case do the present statutes on homestead attempt to expand the constitutional limitations. Only Virginia expressly makes the homestead exemption applicable to personal property. While homestead is basically limited to land in the other states, there are cases permitting the claiming of the exemption in the proceeds of land when it is not feasible to lay off the homestead in realty proper. 63 In all states the exemption is limited to the head of a household who is a resident. The monetary limits, not exceeding $2,000 in any state, give only a fraction of the protection originally granted. By way of contrast, California grants a homestead of $12,500. 64

Personal Property

While North Carolina, South Carolina, and West Virginia exempt a specified dollar amount of personal property, Virginia provides for the exemption of particular items of personalty. In all four states there are constitutional provisions on the exemption of personal property. Whether these constitutional provisions limit the power of the legislature to create new exemptions will be considered later.

Wages

While all four states have some statutory provision on the exemption of wages, there is a wide variety in the scope of the exemption. North and South Carolina have similar provisions exempting wages earned within the sixty-day period preceding the date of execution.

63 Leak v. Gay, 107 N.C. 468, 12 S.E. 512 (1890).
DEBTORS' EXEMPTIONS

There are no provisions for the exemption of future wages in these states. North Carolina, however, does take the position that future wages are unavailable to creditors, not for the reason that there is an express exemption of such wages, but simply because this is the type of asset that does not render itself the subject matter of an execution type of process. By way of contrast, Virginia and West Virginia by statute do recognize that future wages are the subject of process and provide limited protection to the wage-earning debtor. The Virginia statute is the more comprehensive—and provides both a minimum and a maximum amount to be left to the debtor. West Virginia provides for a minimum wage exemption, but places no dollar maximum on the 80 per cent of a given wage claim that is secured to the debtor.

Retirement and Relief Payments

Each of the four states has some provision exempting payments received under certain retirement or relief plans. The broad exemption of such payments seems to give an unwarranted immunity. Surely, even relief payments should be available to creditors who are supplying the needs of the relief or retired debtor. Virginia recognizes this to some extent when it provides that unemployment payments are available to those creditors who supply necessaries during the period of unemployment.

Special Insurance Exemptions

Rights under Fraternal Benefit Society insurance plans are exempt in all four states. Only South Carolina does not have a special exemption for rights under group insurance policies. The wording of these special insurance exemptions is extremely broad; it seems to grant the particular payment itself an exempt status regardless of to whom the payment is made. It is submitted that it would be better to measure the exemption by the need of the debtor rather than to immunize the asset simply because it is payable by a particular type of insurance organization or payable under a particular type of policy.

III. Exceptions from Exemptions

While many assets are exempt against creditors in general, certain claims are treated as superior to the debtor's exemption rights. By statute and by case law we find penetrations being made into the debtor's exemption haven. It is interesting to note that the older exemption laws usually specify the types of claims which are superior to the
exemption, while the more recent exemption acts are almost uniformly silent on the matter. To illustrate the older approach, Virginia provides that the homestead exemption shall not extend to: claims for the purchase price of the property being proceeded against, claims of a laboring person for services rendered, claims of a public officer for fees due him, claims for rent, or claims for taxes.\(^6\) North Carolina specifically makes taxes and claims for purchase price superior to the homestead exemption,\(^6\) and this express exception has been extended by case law to the personal property exemption.\(^6\)

When a statute provides for an exemption from "debt," some courts have seen fit to give a restricted meaning to that term. For example, it has been held that the obligation of a husband to support his wife is more than a mere "debt" and is superior to homestead and personal property exemptions.\(^6\) On the other hand, a judgment based on a tort claim has been held to be a "debt" and thus subject to the claim of exemption.\(^6\) While there is scant judicial construction of the term "debt" as used in the more recent exemption laws, earlier decisions on the type of claims considered to be "debts" under the older exemption laws can be useful in defeating exemptions when a superior right to assets is alleged. This restricting of an exemption so as not to have it available against certain obligations of the debtor will be made more difficult when facing a statute omitting the word "debt" in the creation of the exemption,\(^7\) or a statute using the phrase "debt or liability."\(^7\)

IV. GENERAL PRINCIPLES OF INSURANCE AND EXECUTION PROCESSES

Before proceeding to examine the history and present status of the insurance exemption in the Virginias and Carolinas, it is fitting to inquire into the general nature of the insurance contract. While vague definitions used in the solution of particular problems in true insurance


\(^{6}\)N.C. Const. art. X, § 2 (1868).

\(^{6}\)City of Wilmington v. James Sprunt & Sons, 114 N.C. 310, 19 S.E. 348 (1894).

\(^{6}\)Anderson v. Anderson, 183 N.C. 139, 110 S.E. 863 (1922).

\(^{6}\)Dellinger v. Tweed, 66 N.C. 206 (1872).

\(^{7}\)W. Va. Code Ann. § 626(103a) (1959) omits the word "debt" and provides: "General relief payments received under the provisions of this article shall be exempted from the collection of taxes (except sales), from levy of execution, garnishment, and any other legal process." Could a wife demand support from these payments?

\(^{7}\)N.C. Gen. Stats. § 58-283 exempts rights under Fraternal Benefit Policies from any process "to pay any debt or liability." (Emphasis added.)
litigation will not necessarily aid an understanding of the exemption problem, still certain basic principles are firmly established and should be remembered. In its simplest form, insurance is no more than a contract whereby the insurer, in exchange for a premium, promises to compensate another for loss realized upon the happening of the event insured against. In the field of property insurance compensation is basically by way of indemnification for actual loss suffered. Since the event insured against may never occur, the insurer is often not called on to perform its part of the aleatory contract.

By way of contrast, a contract of life insurance is not one of indemnity for actual pecuniary loss. It is in reality an executory contract calling for the payment of a fixed sum upon the happening of a condition precedent, the death of the insured. This event is certain to happen, although the exact time is unknown. In the typical situation the insurer pays back only the money that has been given to it to hold in quasi-trust for the insured. It is only in the case of premature death that the payment at death embraces an element of indemnity.\textsuperscript{72}

In considering the contract of life insurance, it is emphasized that although the paramount contractual provisions pertain to the payment of a stated sum upon the death of the insured, yet there are other contractual rights and privileges of significance and of monetary value. Among the more common rights paid for, and usually retained by the insured, are the following: (1) right to borrow money from the insurer, with the policy to be used as security for the loan; (2) right to surrender the policy for a sum of money (cash surrender value); (3) right to change beneficiaries; (4) right to reinstate the policy after its lapse due to nonpayment of premium; (5) right to receive paid up or extended insurance in the event of default in premium payment.

All of these rights have a monetary value in the sense that the insured is willing to pay to receive them. Likewise, they have a monetary value in the sense that third persons would be willing to buy one or more of these rights in an open market. Whether there is an open market depends on whether the insured is free to sell them; this in turn depends on the terms of the insurance contract and the policy of the law regarding the assignment of insurance choses in action. One restriction in the law of property insurance is the requirement that the assignee must have an insurable interest in the property covered by the policy. This insurable interest requirement is not

\textsuperscript{72}Vance, Insurance § 15 (3d ed. 1951).
so strictly adhered to in the assignment of life insurance; normally an insured may assign a policy on his own life to any person whom he chooses.

At this point we may summarize. An insurance policy is simply a contract, and one usually creating several rights. Some of these rights belong primarily to the named beneficiary; others belong primarily to the insured. Any of these will have a monetary value provided there is no contractual or legal obstacle to assigning them. Under the general law of debtor and creditor today and apart from exemption statutes, a judgment creditor may proceed against nearly every assignable or saleable asset of his debtor. This general rule is limited when the asset sought is of a somewhat contingent nature. Examples of such unavailable, though valuable, assets are expectancies of prospective heirs and interests in tenancies by entirety.

With these basic principles in mind, and apart from exemption statutes, are a debtor's rights as beneficiary or insured available to his creditors? We find that there is a basis for holding, even without reliance on an exemption law, that some rights under a life insurance policy are not available to creditors. First, an insurance policy as a chose in action was not subject to levy and sale by execution at common law. Further, even under statutes which do permit some type of post-judgment process against choses in action, there are numerous cases holding that a policy of life insurance is not liable to seizure by any legal process so long as the insurer's duty to pay is subject to a contingency or a condition precedent.⁷³

V. CURRENT LAW ON THE INSURANCE EXEMPTION IN THE VIRGINIAS AND CAROLINAS

North Carolina

Of the four states considered, only North Carolina has a constitutional provision exempting life insurance.⁷⁴ Article X, section 7 of the 1868 Constitution originally provided that if a husband insures his own life for the sole use and benefit of his wife and children, the proceeds payable to them at his death are free from the claims of his creditors and representatives. In 1931 this provision was expanded to exempt such a policy from the claims of the husband’s creditors during his life if the insurance is issued for the sole use and benefit of his wife and children. In addition to the amended constitutional

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⁷³See id. at §§ 120-24 for general considerations on exemption of insurance.
⁷⁴N.C. Const. art. X, § 7 (1868).
provision, there are two statutes exempting insurance, the second being merely an amendment of the first.\(^7\)

Because of these amendments to both the Constitution and the statute, it is necessary to consider several different periods in the development of the life insurance exemption in North Carolina. From the ratification of the original constitutional provision until 1899, there was no statute on the matter. The few cases decided during this time did little more than restate the constitutional rule. Although the court in *Hooker v. Sugg\(^7\)\) seemed to make its exemption decision dependent on the constitutional provision, there is language indicating that the same result could have been achieved without aid of the provision. It was said that the beneficiary’s interest in an insurance policy “vests under the policy at once upon its execution.” This statement accurately sets forth what was probably the prevailing rule at the time it was made in 1889, the reason for the rule being that most of the older policies had no provision permitting the change of beneficiaries.\(^7\) If the policy gave the beneficiary the immediate and full interest and reserved no right to the insured, it would seem that such policy would not be an asset of the insured at any time; and a statute would not be necessary to place the policy rights beyond the reach of the insured’s creditors.

The second stage of development in North Carolina came with the passage of the first insurance exemption statute in 1899.\(^7\) Its wording expanded the exemption of the Constitution which protected only the wife and children and purported to exempt insurance payable to any person other than the party who effectuated the policy. Although the statute does purport to expand the class of beneficiaries protected against the insured’s creditors, as yet no case has passed on its constitutionality in this respect.

Other aspects of the relationship between the unamended constitutional provision and the 1899 statute, however, have been ruled on. In *Whiting v. Squires\(^7\)\) the Court of Appeals for the Fourth Circuit examined the problem of whether the cash surrender value of a policy payable to a bankrupt’s wife could be reached by a trustee in bank-

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\(^{7}\)102 N.C. 115, 119, 8 S.E. 919 (1889), stated: “The provision in the Constitution, Article X, Section 7, which authorizes such an insurance for the benefit of the wife and children, not as yet regulated by statute, clearly looks to a provision to them, so that they may not be left destitute by the death of an insolvent husband and father, and is personal to them when they survive.”
\(^{7}\)Vance, Insurance §§ 105-08 (3d ed. 1951).
\(^{7}\)6 F.2d 100 (4th Cir. 1925), cert. denied, 269 U.S. 487 (1925).
ruptcy when the policy reserved to the insured the power to change the beneficiaries. In holding the cash surrender value not exempt during the life of the insured, the court said, "But the exemption does not embrace the surrender value, the property of the husband, of a policy in which he can change the beneficiary at will." It was further stated that the legislature could not expand the constitutional exemption. Several facts of this case should be remembered as later developments are considered. First, the insured was living at the time his creditors proceeded against rights under the policy. Second, the right proceeded against was the cash surrender value which belonged to the insured. Third, the insured had the right to change beneficiaries. Fourth, the wife was named beneficiary at the time the creditors took action.

Several years after the decision in Whiting v. Squires both the constitutional provision and the statute were amended in 1931. As previously stated, the statutory amendment actually took the form of an independent section and made several changes in the then existing

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6 F.2d at 101-02.

"The legislature could not by statute add to the constitutional exemption. Wharton v. Taylor, 88 N.C. 230. Therefore it could not make an exemption of the surrender value of the policy which might or might not, according to the will of the husband, fall to the wife or the wife and children as a policy of which they were beneficiaries at the death of the husband. It follows that, if the statute be construed as embracing the surrender value of a policy like these, it would be invalid as a legislative attempt to enlarge the insurance exemption of the wife and children provided by the Constitution." Id. at 102.

Chronologically the next significant insurance case is Pearsall v. Bloodworth, 194 N.C. 628, 140 S.E. 303 (1927), which held that when a husband takes out a policy with a case surrender value and makes it payable to his estate, but then exercises his power to change beneficiary and nominate his wife, such a change is not a transfer in fraud of his creditors even though he is insolvent at the time the change of beneficiary occurs. At his death the wife is entitled to the proceeds free from claims of his creditors. The decision is based on a rather unusual provision of the insurance law (§ 58-205) which provides that when any married woman receives insurance money, she is entitled to it for "her separate use and benefit," and if she predeceases her husband, the proceeds shall be for the separate use of her children. While this "separate use and benefit" provision may have been intended as an exemption statute, it clearly goes beyond the provisions of the Constitution in using the words "a married woman," rather than the term "wife." True, the case did involve the wife of the insured in question, but the statute relied on by the court seems to create a broader exemption.

In the South Carolina statute, note go infra, it is clearer that the expression "any married woman" means the wife of the insured.

N.C. Gen. Stats. § 58-206 (1930): "If a policy of life insurance is effected by any person on his own life or on another life in favor of a person other than himself, or, except in cases of transfer with intent to defraud creditors, if a policy of life insurance is assigned or in any way made payable to any such person, the lawful beneficiary or assignee thereof, other than the insured or the person so
law. A few of these changes should be considered. First, it uses the expression "proceeds and avails," as distinguished from the expression "proceeds" in the 1899 law, and thus implies that both death and life benefits are to be protected. It provides that these rights are protected from the insured's creditors even when he retains the right to change beneficiaries, or when he is the contingent beneficiary if the named beneficiary predeceases him. Having thus sought to protect the policy as a whole to the named beneficiary, the section finally shows some solicitude for the insured's creditors and permits them to recover with interest any premiums paid with an intent to defraud creditors. Also, creditors are not precluded from reaching policies assigned in fraud of creditors. As a result of the above statutory changes in 1931, the present law on the exemption of life insurance is further complicated; and since 1931 the North Carolina Supreme Court has referred to the matter in only two cases. In *Commissioner of Banks v. Yelverton* it was held that the 1931 amendment did not apply to policies issued prior to the amendment, at least as against creditors existing at the time of the amendment. It is submitted that whatever effect the amendment may have on the rights of creditors, the statute should apply equally to policies issued before or after the amendment in the case of creditors who became such after 1931.

In *Meadows Fertilizer Co. v. Godley* the only other North Carolina decision since 1931 on the insurance exemption, it was held that when a husband changes beneficiaries and nominates his wife, she, upon his death, is entitled to the proceeds free from the claims of his general creditors. Again we have only a question concerning death benefits payable to the wife. Thus on its facts and decision the case

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4204 N.C. 441, 168 S.E. 505 (1933).
8204 N.C. 243, 167 S.E. 816 (1933).
is not significantly different from the earlier Pearsall\textsuperscript{8} case and adds little to one's understanding of the problem.

Regarding the 1931 constitutional amendment which during the life of the insured exempts policies for the sole benefit of his wife and children, the principal problem will be in determining what policies are for their sole benefit. If the amendment was an attempt to alter the effect of the Squires\textsuperscript{7} decision, then it might be argued that even when the insured husband has a power to change beneficiaries and the right to the cash surrender value, still the policy is for the sole benefit of the wife and children until he exercises his rights and thus divests them of their present right to receive full payment when he dies. By reading the 1931 statutory amendment and the constitutional amendment together, there is reason to believe that the legislature did intend to limit the effect of the Squires case. So far as the constitutional amendment alone is concerned, however, the wording clearly falls short of overruling Squires. At the same time the statutory amendment seems to be just another unconstitutional attempt, under the rule laid down in Squires,\textsuperscript{8} at expanding the insurance exemption.

Until the Supreme Court of North Carolina speaks further on the subject, the law will be highly uncertain. Two rules, however, can be relied on. First, the wife and children will be protected from the claims of the husband's creditors both during his life and at his death if the policy is for their sole benefit. Secondly, in federal bankruptcy cases the trustee will be able to reach the cash surrender value of policies in which the insured debtor has the power to change beneficiaries.

\textit{South Carolina}

Since 1875 South Carolina has had a limited life insurance exemption for the benefit of the insured's wife and children.\textsuperscript{9} In 1947 the prior law was amended to some extent; however, before examining the present statute, it is helpful to consider the earlier law. Prior to 1947 protection was given to a married woman and her children by permitting them to take the death proceeds free from the claims of the husband's creditors if the policy were payable to such beneficiaries at his death.\textsuperscript{10} From the wording of the statute it is apparent that...
the expression "any married woman" was intended to be read as "wife of the insured."

A limiting proviso in the act stated: "If the premium paid in any one year out of the property or funds of the husband shall exceed the sum of five hundred dollars...such excess...shall inure to the benefit of such creditors...."91 Under this proviso it was only the amount of premiums in excess of $500 and not the portion of insurance purchased therewith which was available to creditors.92 Since the proviso is silent as to whether the premiums to be recoverable must be paid at a time when the insured was insolvent, it is difficult to determine whether the intention was to make all premiums in excess of $500 per year presumptively fraudulent, or whether it was meant to say that annual premiums of up to $500 would not be considered as fraudulent even when paid during a time of insolvency.93

Two cases, one state and one federal, decided under the pre-1947 statute are of continuing significance. In the case of In re Cunningham94 the question was whether a bankrupt's life policy with a cash surrender value was exempt from his creditors' claims during his life. If not so exempt under South Carolina law, the trustee in bankruptcy would have been entitled to the cash surrender value under the provisions of section 70(a)(5) of the Bankruptcy Act. The bankrupt insured contended that the policy was exempt because payable to his wife; it was further contended that this exemption was in addition to the $500 personal property exemption allowed by the Constitution of South Carolina. Assuming that the legislature intended the insurance exemption to be effective during the life of the insured, the District Court examined the constitutionality of the statute. In holding the cash surrender value available to the trustee in bankruptcy, the court stated that the statute was an unconstitutional attempt to expand the exemptions beyond those constitutionally provided.95

In 1936 almost the identical factual situation was presented to the South Carolina Supreme Court in the Wilson case.96 The lower court had held for the wife as against the trustee for the reason that the

91Ibid.
93Ibid.
9415 F.2d 700 (E.D.S.C. 1926).
95"[Section 4099 of the [South Carolina] Code is in direct conflict with the [South Carolina] Constitution in that it makes an exemption allowance to husband and wife of more than $500, and is also in conflict with the Constitution in that the Constitution has occupied the whole domain of exemptions, and the Legislature had no power to add thereto." Id. at 703. Cf. Whiting v. Squires, note 81 supra.
wife was protected by the insurance exemption even during the insured's life. On appeal the South Carolina Supreme Court avoided the constitutional issue of whether the insurance exemption act expanded the exemption law of the Constitution. This question was evaded by a holding that the statute was not intended to apply during the insured's life. After a finding that the wife was not protected, one would expect a reversal of the lower court's decision in her favor. However, the bankruptcy trustee's appeal was dismissed because he had relied solely on the constitutional issue which was found to be irrelevant. Although this is wonderfully painless result-getting, the lawyer might well wish for a fuller examination of the constitutional problem.

Turning to the present statute as amended in 1947, we find that the same class of persons, the wife and children, are protected. Since no change as to when they are protected was made, it must be assumed that the statute is effective to safeguard them only after the death of the insured, as was held in the *Wilson* case. The only real change in the section relates to the amount of insurance which will be exempt at the husband's death. Under the old law the death proceeds were exempt except to the extent that the annual premiums in excess of $500 had been paid with the husband's assets. The present law limits the exemption to $25,000 of life insurance on the life of the insured. As to the constitutionality of the amended section, there has been no case. If the *Cunningham* decision is still good law, and there is no reason to believe that it will not be followed by the federal courts at least, then the new law is also an invalid attempt to expand the constitutionally granted exemptions.

In summary, it appears that the shadow of the *Cunningham* decision falls across not only the life insurance exemption, but also across any other legislative exemption greater than those permitted by the South Carolina Constitution.

*Virginia*

Several problems concerning the life insurance exemption in Virginia have been treated by William C. Worthington in a recent article, and for this reason the following will be confined to a

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98 See note 96 supra.
99 See note 94 supra.
DEBTORS' EXEMPTIONS

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summary of the Virginia situation on the matter. First, it has been said that Virginia was the last state to adopt a special life insurance exemption. Since the adoption of the present sections in 1946, there has been no case and no amendment. Because of these factors and because the sections are not indexed in the Virginia Code under the heading "exemptions," it is suspected that their presence is not widely known. Probably due to their relatively recent origin, the Virginia provisions are more elaborately phrased than those in other states considered. This does not mean, though, that complicated questions will not arise.

It is submitted that the proper construction of the two main Virginia sections should be as next indicated. First, section 38.1-448 safeguards all rights of a third party beneficiary which arise upon the death of the insured. The exceptions to this general protection of death benefits are two: (1) the insured's creditors may reach the full proceeds of policies assigned to third parties in fraud of creditors; and (2) his creditors may reach death proceeds under a policy payable to a third person to the extent that premiums were paid in fraud of creditors.

In regard to creditors' rights against life insurance during the life of the insured, it appears that policies are fully exempt except to the extent specified in section 38.1-449. This section provides that, unless the insured is a head of family, creditors of the insured may claim in full the cash surrender value or loan value of any policy under which the insured has a power to change beneficiaries. If the insured debtor is the head of a family, then the cash surrender values of policies with face values of up to $10,000 are exempt. For example, if a head-of-family has three $10,000 policies with cash surrender values of $3,000, $4,000, and $5,000, respectively, his creditors could reach the cash surrender values of two of these, but one would be exempt. Apparently the insured debtor would have the choice of which cash surrender value would be left to him. By these special provisions of section 38.1-449 Virginia seems to have solved the troublesome problem of whether or not cash surrender values are available to the insured's creditors during his life.

As to the constitutionality of the insurance exemption, it has been predicted that the statutes will be limited to the bounds established by section 190 of the Virginia Constitution.

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103 Worthington, op. cit. supra note 100, at 255.
West Virginia

As is true in the other states considered, the West Virginia statute is designed to protect persons other than the insured or the person effecting the insurance. As to death benefits, there are the two usual exceptions to the exemption. If the policy is assigned to a third party beneficiary in fraud of creditors, the exemption does not apply; and premiums paid in fraud of creditors can be recovered from the proceeds with interest.

The major problem of whether creditors of the insured may reach the cash surrender or loan value of the policy has not been passed on. Since there is no specific provision on these lifetime benefits, as in Virginia, the court will have its choice of protecting the beneficiary, as was done by the Second Circuit in the case of In re Messinger, or refusing such protection, as was done by South Carolina in the Wilson case. Since the West Virginia statute was patterned after the New York provision involved in the Messinger case, there is reason to believe that West Virginia will decide in favor of extending protection to the beneficiary during the life of the insured, even though in one sense the insured is also being indirectly given an exemption. Such a holding against the creditors' rights and in favor of the beneficiary would be in line with a general judicial trend of extending the insurance exemption at the expense of creditors regardless of whether the beneficiary requires the protection and regardless of whether the insured also has a valuable present interest in the policy.

Of the two West Virginia cases decided under the statute, only one is a life benefit case. In Scruggs v. Jefferson Standard Life Ins. Co. there is dicta to the effect that the cash surrender value is not available to creditors during the life of the insured. The actual decision was that a divorced wife claiming alimony out of the cash surrender value of her husband's life policy payable to their children could not reach this asset because the equity court had no jurisdiction over either the policy or the debtor.

7. 29 F.2d 158 (2d Cir. 1928), cert. denied, 279 U.S. 855 (1929).
8. See note 96 supra.
VI. LIFE INSURANCE AND BANKRUPTCY

Under the Bankruptcy Act any asset exempt to the debtor under the laws of his domiciliary state or under the laws of the United States is exempt in bankruptcy proceedings. The exception to this general rule is that the bankrupt may not claim his exemption in property recovered by the trustee as a voidable transfer under the Act. To the extent that life insurance is not exempt under federal or state laws, it is available to the trustee to a limited extent under section 70(a)(5) of the Bankruptcy Act.

Despite the awkward wording of this provision, it was intended to make available to the trustee the cash surrender value of any policy of life insurance under which such value is payable to the bankrupt, his estate, or his personal representatives. Protection is given to the bankrupt, however, by permitting him to keep the policy if he pays over to the trustee an amount equal to the cash surrender value. Normally a debtor should have little trouble in raising the funds, since the cash surrender value of the policy could be assigned as security for a loan to him by the company or any third party. In some instances the named beneficiaries will have assets available to pay over to the trustee, thus safeguarding their contingent rights under the policy.

As shown by the approach taken under the Bankruptcy Act, when the cash surrender or loan values of a policy are available to the insured, these rights should also be available to his creditors, even though their seizure by creditors will diminish the named beneficiary's rights upon the death of the insured. For this reason it is submitted that it would be an improvement in the law of debtor and creditor if state statutes were to use the same approach. This has been partially accomplished by the Virginia statutes, which permit loan and surrender values to be seized by creditors except to a limited extent when the insured is the head of a family.

VII. SUMMARY AND CONCLUSIONS

From the present study of the exemption laws in the Virginias and Carolinas a few conclusions can be drawn. As the real protection

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110 Under the statutes of the United States cash items such as soldier's bonuses, pension money, and certain retirements are exempt. The presence of these federal exemptions will have significance not only in the bankruptcy field, but also in state court proceedings. See Collier, Bankruptcy Manual ¶ 6.07 (2d ed. 1954).
111 Bankruptcy Act § 6 (Collier pamphlet ed. 1959).
113 See note 102 supra.
of the constitutionally granted exemptions has decreased with economic and inflationary changes, the number of special exemption statutes has increased. Despite sporadic additions and amendments to exemption statutes, it is apparent that little serious thought has been given to the larger problem of balancing the rights of debtor and creditor.

The picture of an exemption cornucopia from which flows creditor protection not necessarily related to the needs of the parties protected should give cause for constructive action to improve our present exemption laws. Modernization of these laws, however, may be complicated by the presence of constitutional provisions on debtors' exemptions. The extent to which the courts will restrict the hands of the legislatures on constitutional grounds has not yet been fully determined. Surely a challenge is presented.