Comment, CHARACTERIZATION, VALUATION, AND DISTRIBUTION OF PENSIONS AT DIVORCE

Responding to the continued steady rate of divorce, the increased number of two income families, and the variety of benefits offered by employers, the area of marital property has developed significantly in the last two decades. Past theories of dependency and support have grown into a theory of economic partnership.[1] This evolution has resulted in the broadening of the definition of marital property to include intangible assets, such as professional goodwill, celebrity status, earning potential, and wage continuation benefits or pensions.[2] Often a divorcing couple's asset of greatest monetary value is a contingent or vested property interest in a retirement pension.[3] Usually it has been earned either partly or entirely during the marriage and therefore considered marital or community property subject to equitable or equal division upon divorce. As with all property in a divorce, retirement pensions must be characterized, valued, and distributed. Pensions may be vested or non-vested, matured

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1 Pamela A. Belt, Note, Bush v. Taylor: *A New Exception to Discharge in Bankruptcy*?, 44 ARK. L. REV. 757 (1991); *see also*, Grace Ganz Blumberg, *Marital Property Treatment of Pensions, Disability Pay, Workers' Compensation, and Other Wage Substitutes: An Insurance, or Replacement Analysis*, 33 UCLA L. REV. 1250 (1986).

2 *In re* Marriage of Brown, 544 P.2d 561 (Cal. 1976) (pension right whether vested or not is a community property asset); Stern v. Stern, 331 A.2d 257 (N.J. 1975) (partner's interest in law firm was marital property); Piscopo v. Piscopo, 557 A.2d 1040 (N.J. Super. Ct. App. Div. (1989) (comedian Joe Piscopo's celebrity goodwill attributable to his celebrity status was marital property); Golub v. Golub, 527 N.Y.S.2d 946 (N.Y. App. Div. 1988) (finding that Marisa Berensen's earning potential as a model and actress could be valued and should be subject to division as marital property upon divorce); O'Brien v. O'Brien, 489 N.E.2d 712 (N.Y. 1985) (license to practice medicine was marital property); *In re* Marriage of Fleege, 588 P.2d 1136 (Wash. 1979) (goodwill of dental practice was community property). *See also* William R. Horbatt & Alan M. Grosman, *Division of Retiree Health Benefits on Divorce: The New Equitable Distribution Frontier*, 28 FAM. L.Q. 327, 329, 332-33 (1994).

3 Carol V. Calhoun & Gregory L. Needles, *The Division of Pensions Across Borders*, 13 J. AM. ACAD. MATRIM. LAW. 211 (1996).

or non-matured, or a combination of any of these.[4] Since pensions often reflect post-dissolution wages or increases accrued post-dissolution, they are frequently the source of family court litigation.

This article will discuss the characterization, valuation, and distribution of retirement pensions over the past decade. A brief overview of some of the general characteristics of the main types of pensions will be provided followed by a discussion of some of the more recent case law dealing with characterization, valuation, and distribution upon dissolution.

I. Pensions: A General Discussion

Generally, pensions can be divided into three main categories: private, public, and military. Most of the characteristics of pension plans overlap, but some legislative and statutory provisions are specific for each type.

A. *Private Pension Plans*

In 1974, Congress enacted the Employee Retirement Income Security Act of 1974[5] (ERISA) which provided for favorable income tax treatment for pension plans sponsored by private employers. ERISA does not require the type of benefits to be provided; it only regulates them.[6] In an effort to provide

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[4] A pension vests when the employee has completed the period of employment required that entitles him to payment from the pension plan. Once it vests, the employee may leave his employment and receive benefits when he retires. A pension is mature when the employee meets the criteria needed to obtain the benefits, usually either actual retirement or reaching the age at which he may retire. Thus, a pension plan may be vested, but not mature. For example, if a plan vests in five years and the age of retirement is sixty, a forty-year old employee who has worked for a corporation for ten years will have a vested but immature pension. *See* Grace Ganz Blumberg, *Marital Property Treatment of Pensions, Disability Pay, Workers' Compensation, and Other Wage Substitutes: An Insurance, or Replacement Analysis*, 33 UCLA L. REV. 1250, 1259-60 (1986).

[5] EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461 (1985)) [hereinafter ERISA].

[6] Pamela B. Rudmore & Douglas I. Friedman, *Pension Benefits in Alabama Divorce Cases After The Retirement Equity Act of 1984*, 37 ALA. L. REV. 639, 656 (1986).

some financial safeguards for widows, widowers, and divorcees, Congress amended ERISA with the passage of the Retirement Equity Act of 1984 (REA).[7] REA requires that specific types of pensions provide joint and survivor annuity benefits for the participant's spouse.

> "The object of REA was to better protect women who had contributed to their marriage's financial security through their work in the home, anticipated sharing in the pension income received upon their husband's retirement, but were left inescapably dependent on their husband's earnings, at the mercy of death or divorce."[8]

The REA provides for the division of pension plan assets upon divorce through the implementation of a Qualified Domestic Relations Order (QDRO) along with extensive regulations contained in the Internal Revenue Code.[9] Guaranteed payment of pension plans, even if the employer defaults, is provided by the Pension benefit Guaranty Corporation. ERISA requires vesting to occur in five years unless a graded vesting system is used which requires vesting in seven years. Once vesting occurs, the employee is assured receipt of the earned benefits.[10]

There are generally two types of pension plans: defined benefit plans and defined contribution plans. Under a defined benefit plan the actual benefit is defined in the plan. The employee receives a fixed amount which begins at retirement and continues for life. At the time of divorce, it may be difficult to determine a defined benefit plan's value. Courts must assess the probability that the pension will be collected as well as the expected lifespan of the employee.[11]

In defined contribution plans, annual contributions are made to the plan and the amount contributed into the em-

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7 RETIREMENT EQUITY ACT OF 1984, Pub. L. No. 98-397, 98 Stat. 1426 (codified in sections of 26 U.S.C. and 29 U.S.C. (1984)) [hereinafter REA].

8 Kahn v. Kahn, 801 F. Supp. 1237, 1243 (S.D.N.Y. 1992) (quoting Geraldine Ferraro in the Pension Equity for Women: Hearings on H.R. 2100 before the Subcommittee on Labor-Management Relations of the Commission on Education and Labor, 98th Cong. 1st Sess. 26 (1983)).

9 James P. Jennings, *Determining the Expected Present Value of Defined Benefit Pension Plan Assets*, 52 Mo.B. 9 (January/February 1996).

10 *Id*.

11 Philip R. Miller, Comment, *Division of Post-Divorce Pension Increases: A Reconsideration of* Shill v. Shill, 29 IDAHO L. REV. 999, 1031 n.2 (1992-93). *See also* Rudmore & Friedman, *supra* note 6 at 656.

ployee's plan is specifically indicated in the plan. The amount may be based on the employee's compensation (money purchase plan) or on the employer's profit (profit sharing plan) determined annually.[12]

Pension plans regulated by ERISA and REA provide payment to the employee in the form of a qualified joint and survivor annuity (QJSA) unless the employee's spouse voluntarily waives the QJSA. Upon divorce, the non-employee spouse can be protected by a QDRO which provides that part of the employee's pension shall be paid to an alternate payee, usually the ex-spouse or dependents, specified in the order.[13] QDROs are based on state domestic or family law.[14]

B. *Public or Civil Service Pensions*

Public pension plans are those provided to federal and state employees, such as fireman, policeman, and teachers. Congress has expressly exempted government retirement funds, such as police and fireman's disability and pension funds, from ERISA's scope.[15]

C. *Military Pension Plans*

After a designated period of service in any branch of the military, the service person is entitled to receive a retirement pension.[16] If the service member qualifies for disability pay, this amount is deducted from the pension. Since disability pay is subject to better tax treatment, if qualified, most retired service members will elect to split their total benefits into disability and non-disability pensions.[17] Most states consider disability pension

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12 *See* Rudmore & Friedman, *supra* note 6, at 640.

13 Elizabeth Brody, *Marital Status and 60+ Crowd*, 164-Oct N.J. LAW. 39, 42-43 n.28 (Oct. 1994).

14 29 U.S.C. § 1056(d)(3)(B)(ii) (1984).

15 29 U.S.C. §§ 1002(32), 1003(b)(1) (1974). *See also* Erb v. Erb, 661 N.E.2d 175 (Ohio 1996).

16 10 U.S.C. § 3914 (1980). Enlisted members may retire after 20 years of service.

17 *See* Mansell v. Mansell, 490 U.S. 581 (1989). Major Mansell waived an amount of his military retirement pay so he could receive VA benefits. The Supreme Court reversed the California court's holding that his total retirement benefits were community property. In evaluating the language of the Uni-

benefits as separate property, often decreasing the amount available for distribution upon divorce.

The evolution of the treatment of military retirement funds upon dissolution or divorce has paralleled, or perhaps instigated, significant changes in the treatment of all pension benefits. Since military pensions were created by the federal government, they are different than other pension plans and have developed in a different manner.[18]

In 1981, the United States Supreme Court ruled in *McCarty v. McCarty*[19] that federal law preempted state courts from treating military nondisability retirement benefits as community property to be divided upon dissolution. Military spouses could not receive any property interest in the service member spouse's pension. Although this decision was strongly criticized, it became "the law of the land."[20] However, the Court's opinion did indicate that Congress was responsible for any changes to military pension plan policies.[21]

Congress appropriately reacted by passing the Uniformed Services Former Spouses' Protection Act (Act) which was signed into law on September 8, 1982.[22] The passage of the Act was welcomed by the significant number of spouses (usually women) who had given up their own career opportunities due to relocation requirements or other responsibilities inherent as a military

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formed Services Former Spouses' Protection Act and legislative history, the Court indicated that it:

> realize[d] that reading the statute literally may inflict some economic harm on many former spouses. But we decline to misread the statute in order to reach a sympathetic result when such a reading requires us to do violence to the plain language of the statute and to ignore much of the legislative history. Congress chose the language that requires us to decide as we do, and Congress is free to change it.

Id. at 594.

18 Mark E. Henderson, *Dividing Military Retirement Pay and Disability Pay: A More Equitable Approach*, 134 MIL. L. REV. 87 (1991).

19 McCarty v. McCarty, 453 U.S. 210 (1981).

20 Robert A. Winter, Jr. *Divisibility of Military Nondisability Retirement Pension Benefits Upon Marriage Dissolution:* McCarty v. McCarty, *The Uniformed Services Former Spouses' Protection Act, and Beyond*, 22 J. FAM. L. 333 (1983/1984).

21 *McCarty*, 453 U.S. at 235-36.

22 UNIFORMED SERVICES FORMER SPOUSES ACT, Pub. L. No. 97-252, 96 Stat. 730 (1982) (codified at 10 U.S.C. § 1408 (1982)).

wife. The Act returned the responsibility of dividing military retirement pay back to the states. One commentator indicated that although he was not surprised at the debate and controversy the Act's passage caused, he was surprised at "the degree of complexity [it] injected into family law. . . . The complexity . . . flows from the confusing nature of military and retired pay and other benefits afforded to members of the armed forces and their families."[23] Courts seem to be handling these complexities in stride and are struggling with valuation and distribution questions similar to those with other types of pensions. Although a few states have not provided significant clarity, most states find military pensions divisible upon dissolution of marriage.[24]

II. Characterization, Valuation, and Distribution

Upon dissolution a court evaluates a couple's assets in three stages: first, a court must determine whether the item is community property or marital property subject to equitable distribution; next, it determines what method is most appropriate for valuation; and finally, it determines how the property should be distributed.[25] Pensions undergo these assessments. No significant differences exist between the ways community property states and marital property states treat retirement pension benefits.

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[23] Jeffrey S. Guilford, *Exploring the Labyrinth: Current Issues Under the Uniformed Services Former Spouses' Protection Act*, 132 MIL. L. REV. 43 (1991).

[24] *See* TJAGSA Practice notes: Family Law Notes, Dept, of Army Pamphlet 27-50-284, *State-By-State Analysis of the Divisibility of Military Retired Pay*, 1996-JUL ARMY LAW. 22 (July 1996). The majority of states clearly consider military pensions divisible. Other states including Connecticut, Georgia, Nevada, and Vermont, are less clear. The authors indicate that Arkansas, Indiana, and North Carolina consider only vested pensions as marital property. Military pensions in Puerto Rico are not divisible, but may be considered in determining child support and alimony.

[25] Black's Law Dictionary defines property:

> commonly used to denote everything which is the subject of ownership, corporeal or incorporeal, tangible or intangible, visible or invisible, real or personal; everything that has an exchangeable value or which goes to make up wealth or estate. It extends to every species of valuation right and interest, and includes real and personal property, easements, franchises, and incorporeal hereditaments.

1095 (6th Ed. 1990).

A. *Characterization*

A significant amount of litigation was conducted during the mid-1970s through the late 1980s to determine if retirement pensions should be considered as marital property.[26] Although litigation still persists concerning this matter, it has decreased significantly and current litigation is centered on the valuation and distribution of retirement funds.

Pensions are considered a method of deferred compensation from the employer for services rendered by the employee.[27] They represent a contractual right to future benefits payable upon retirement and are a type of intangible property.[28]

Pensions are often used in determining alimony or child support payments, but courts have recognized the shortcomings of specifically assessing payments to the non-employee spouse as alimony, even though such classification provides for future modification based on changes in circumstances: "[I]t is sometimes better to classify the division of the pension as a property division rather than spousal support so the allowance is not lost on death or remarriage."[29]

State statutes may exempt pension plans from being considered as marital property. For example, in Kentucky and Missouri, teacher's pensions are considered the teacher's separate property and therefore, not subject to equitable distribution upon dissolution.[30] The constitutionality of Kentucky's statute

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26 *See, e.g.*, *In re* Marriage of Brown, 544 P.2d 561 (Cal. 1976) (The California Supreme Court held that pensions are not just an expectancy, but a legally protected property interest. California courts had previously determined that contingent interests, such as an attorney's contingent fees, were community property subject to division.); Shill v. Shill, 599 P.2d 1004 (Idaho 1979); Hiscox v. Hiscox, 385 N.E.2d 1166 (Ind. Ct. App. 1979); Boyd v. Boyd, 323 N.W.2d 553 (Mich. Ct. App. 1982).

27 *See In re* Marriage of Brown, 544 P.2d at 561.

28 Krafick v. Krafick, 663 A.2d 365, 370 (Conn. 1995) (interpreting the term property broadly in evaluating the equitable distribution of property and concluding that "property as used [in the state statute] includes the right, contractual in nature, to receive vested pension benefits in the future.").

29 *In re* Marriage of Branstetter, 508 N.W.2d 638, 642 (Iowa 1993), citing Taylor v. Taylor, 329 N.W.2d 795, 798 (Minn. 1983).

30 *See* KY. REV. STAT. ANN. § 161.700(2) (Banks-Baldwin 1996); MO. REV. STAT. §§ 169.572, 452.355 (1991).

was challenged in *Waggoner v. Waggoner*.[31] Mrs. Waggoner had been a public school teacher for thirty-six years and had contributed to the Teacher's Retirement System (TRS) established and required by the state. The *Waggoner* Court found the statute to be constitutional and rejected and disclaimed the husband's premise that it was a special law prohibited by Kentucky's Constitution.

When Social Security was enacted, Kentucky teachers were excepted from coverage by Social Security because they were already participating in an established state employee retirement system. The court reviewed the legislative history of the exemption and found that the TRS had been established "as an incentive to attract and retain teachers, as other retirement systems have been found to do."[32] The statute applied equally to all teachers and a distinctive purpose existed for its enactment; therefore, the legislation was justified and constitutional since teachers are the only state employees not covered by Social Security.[33] In addition to providing incentives, the Teacher's Retirement System also relieved society of the burden of having to support retired teachers.[34]

In addition to Kentucky's statute that forbids the classification of teacher's pension as marital property,[35] another state statute provides that if one spouse's retirement benefits are exempted from classification as marital property or considered in

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31 846 S.W.2d 704, 707 (Ky. 1992). Kentucky's Constitution prohibits the passage of "special" laws. Laws must apply equally to everyone in a class and the classification must be supported by distinctive and natural reasons. The court concluded that teachers were a special class and the statute was rationally related to protecting teachers. *Id*.

32 *Id*.

33 Judge Leibson in his dissenting opinion indicated that the Social Security rationale "didn't wash" because the teacher (in this instance) would receive Social Security benefits from her husband because they had been married for thirty-four years. "Fair is fair. Teachers are not entitled to special privileges in divorce court." *Id*. at 710.

34 *Id*. at 706.

35 KY. REV. STAT. ANN. § 161.700(2) (Banks-Baldwin 1996). The statute covers school employees and teachers' retirement benefits: "Retirement allowance, disability allowance, accumulated contributions, or any other benefit under the retirement system shall not be classified as marital property. . . . [or] shall not be considered as an economic circumstance during the division of marital property. . . ." *Waggoner*, 846 S.W.2d at 706.

the equitable distribution of marital assets, "then the retirement benefits of the other spouse shall also be excepted, or not considered, as the case may be."[36] The *Waggoner* court indicated that "the combination of [the two statutes] protects the spouse of a teacher covered by the TRS plan."[37] However, given the generally low salaries of public school teachers, the fact that a teacher is often a woman earning an income second to the husband's, and the likelihood that the husband will have a retirement plan of greater worth, unfair consesquences will most often result for the teacher.

Three years after subsequent to *Waggoner v. Waggoner*, the Kentucky appellate court in *Turner v. Turner* recognized this dilemma.[38] Evaluating the two states the *Turner* Court stated:

> Even in a situation where the teacher/spouse has taught only a short time and has accrued a correspondingly small pension, and the other spouse has a large pension amassed after many years of work, the court is powerless to consider this 'economic circumstance' when deciding how the other marital property is to be divided. While we may agree with [the wife] that this can lead to a very inequitable result. . . it is up to the legislature and not this court to correct the problem.[39]

Missouri also has a statute that precludes teacher's pensions from consideration as marital property.[40] In *Kieninger v. Catlett*,[41] Catlett claimed that the statute only provided that the benefits were not divisible, not that they should not be considered in determining an equitable division of the assets. The appellate court upheld the decision, citing a previous case which had determined that a teacher's pension was separate, not marital property.[42]

The classification of pension benefits as marital property upon dissolution has been challenged as violating anti-assign-

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36 KY. REV. STAT. ANN. § 403.190 (Banks-Baldwin 1996).

37 *Waggoner*, 846 S.W.2d 704, 708 (Ky. 1992).

38 Turner v. Turner, 908 S.W.2d 124 (Ky. Ct. App. 1995) (holding that even though teacher's spouse's pension was valued at significantly more than the teacher's pension, the court was unable to consider the difference in values in considering an equitable distribution of the marital assets).

39 *Id*. at 125.

40 MO. REV. STAT. §§ 169.572, 452.355 (1991) (repealing MO. REV. STAT. § 169.142 which allowed teacher's pension to be divided upon dissolution).

41 854 S.W.2d 59 (Mo. Ct. App. 1993).

42 Gismegian v. Gismegian, 849 S.W.2d 201 (Mo. Ct. App. 1993).

ment clauses found in pension plans.[43] In *In re* Marriage of Branstetter, in response to the firefighter-husband's claim, the court stated that the "generally recognized rule and holding of the courts, that statutes which provide that property or payments of specified kinds are exempt from judgment, execution or liability for debts have no application in the award or collection of alimony or support for a wife or minor child."[44] Therefore, an equitable distribution of marital assets is not tantamount to an assignment which is prohibited by most pensions.[45]

As previously indicated, Congress' enactment of Uniformed Services Former Spouses' Protection Act returned to the states the ability to determine how military non-disability pensions will be treated upon dissolution. Although most states consider pensions, vested or non-vested, to be marital or community property, Arkansas, Indiana, and North Carolina do not consider non-vested military pensions as marital property.[46] Additionally, variation exists among these states in determining when a pension is "vested".

For example, in *Christopher v. Christopher*,[47] an Arkansas case involving a military pension, the couple had been married to each other twice. At the time of the first divorce, the military husband had not served enough time for his pension to be vested and it was not considered in the property settlement. The couple remarried eight months after the divorce and remained married for nine years during which time the husband's pension vested. The husband contended that the wife's portion should be calculated using only the number of years of the second marriage since that was when the pension vested. The court disagreed and used the total number of years the couple was married.[48]

The North Carolina Court of Appeals also determined that a wife should not receive any portion of her husband's military re-

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43 *See generally*, Board of Pension Trustees v. Vizcaino, 635 So. 2d 1012 (Fla. Dist. Ct. App. 1994) (holding that unlike private pension plans subject to QDROs and therefore assignment, government pensions could not be assigned if they contained an anti-assignment provision); *but see, In re* Marriage of Branstetter, 508 N.W.2d 638 (Iowa 1993), discussed *infra* at note 29.

44 *In re* Marriage of Branstetter, 508 N.W.2d at 640.

45 24 Am. Jur. 2d *Divorce and Separation* § 907 (1983).

46 *See* TJAGSA Practice Notes, *supra* note 23.

47 871 S.W.2d 398 (Ark. 1994).

48 *Id*. at 399.

tirement pension because it was not vested.[49] The North Carolina court determined that the military pension in question was not vested because the service member had only been in the military for seventeen years and had not met the minimum twenty year service requirement specified in 10 U.S.C. § 3914.

In evaluating its statutes, Indiana's courts determined that while a trial court must "consider a spouse's pension plan as a factor in dividing existing marital property, an actual award under the property settlement must consist of assets in which the parties have a vested interest."[50] A narrow definition of vesting was provided in *Hiscox v. Hiscox*.[51] Mr. Hiscox had retired from the military and was receiving pension benefits at the time of the dissolution. However, the court indicated that since the payments "were contingent on his survival and upon the amount of income received from other sources,"[52] he did not have a vested present interest in the property; therefore, the pension benefits were not divisible as marital property.[53]

Although courts encourage divorcing couples to reach amicable agreements regarding property settlements and will allow a couple to contract around a pension, due diligence in drafting, defining terms, and expressing intentions is required. As demonstrated in *Keffer v. Keffer*,[54] the parties may have to live with inequitable results because the contract does not offend principles of contract law. In *Keffer*, the parties agreed that the husband would pay the wife a certain amount of his salary, and "[i]ncome earned outside of [his] primary place of employment [would] not

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49 George v. George, 444 S.E.2d 449 (N.C. Ct. App. 1994).

50 Hiscox v. Hiscox, 395 N.E.2d 1166, 1167 (Ind. Ct. App. 1979).

51 *Id*. at 1166.

52 *Id*. at 1168.

53 *Id. But see* 10 U.S.C. § 3914 (indicating vesting of military retirement benefits occurs after the service member has been in the military for 20 years).

54 852 P.2d 394 (Alaska 1993). Neither party was represented by counsel in the dissolution proceeding; however, Gypsy Keffer received some legal advice through Women's Services in Homer, Alaska. For the appeal, Gypsy testified by affidavit that "I agreed to not take any of his retirement. . . because we agreed that he was going to be paying me alimony." *Id*. at 397. At the hearing, she testified that: "I told him I wasn't going to ask for half of what was in his retirement fund. . . I was trying to be nice, and wanted him to have enough money to live comfortably, as well as keep paying me when he retired." *Id*. The court found that "Gypsy's support was based on her relinquishment of Thomas' retirement, [and enforced their] agreement without modification." *Id*.

be included in [the] calculation."[55] Later, due to corporate reorganizations and management changes, the husband's position was eliminated and he took early retirement. The *Keffer* Court held that his retirement pension was not considered "salary." Considering the situation surrounding Mr. Keffer's unemployment, the court essentially found that Mrs. Keffer got that for which she contracted; since Mr. Keffer had not voluntarily become unemployed, he had met the good faith requirements of the contract. The dissent indicated that the payments from his salary were alimony payments and his unemployment was a change in circumstances which should be used to reevaluate the payments.

A recent Mississippi case also construed the terms and definitions of a contract between a divorced couple.[56] The couple had an agreement providing that the wife would continue to receive alimony after the husband retired. The contract specifically stated that she was to receive "one-half of any and all retirement benefits of any description"[57] unless she remarried or died. Upon divorce, a QDRO was entered with just one retirement account listed. Later, the wife found another account the husband had with his employer entitled as a "savings and investment account" which contained a substantially larger amount of money. The chancery court held that the investment and savings account was not a retirement account based on its name. The Mississippi Supreme Court disagreed after evaluating the purpose and nature of the account, and determined it was a retirement fund meeting ERISA's definition of a defined contribution plan.[58]

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55 *Id*. at 395.

56 Holloman v. Holloman, 1996 WL 529540, at *1 (Miss. Sept. 19, 1996). This was the second marriage to each other and lasted only four days. The dissent indicated that it was "not equitable to expect such a division of assets after such a short marriage." *Id*. at *9. Both parties had counsel, were informed and voluntarily entered into the agreement. *Id*.

57 *Id*. at *6.

58 *Id*. The 'retirement' account held $16,000; the 'savings and investment' account's value was $209,000.

B. *Valuation and Distribution*

Although valuation and distribution of marital property can be two separate functions, they are interdependent in the division of pensions. Most courts recognize the importance of remaining flexible in assessing the value and method of pension distributions.

> [G]oals of equality and equity require that no one method should be used to the exclusion of other apportionment techniques. . . . [B]ecause of the great variations in pension plans and communal situations no one method can accomplish justice in every case. It is essential, therefore, that courts be able to take advantage of reasonable alternatives and adjustment in order to accomplish an equal distribution in an equitable manner in all situations.[59]

Generally, courts recognize two different methods for the valuation and distribution of pensions: the present value (or lump sum) method and the reserved jurisdiction (or the "if, as and when it comes in") method.[60]

The lump sum method allows the parties to determine and distribute the value of the pension at the time of divorce. This method is preferred when the pension can be adequately valued and sufficient assets (either cash or property) exist in the marital estate to offset the present value of the non-employee spouse's portion of the pension. The lump sum method is frequently used when the pension is a defined contribution plan. Since this type of pension plan is funded by contributions to the participant's account, its value is readily ascertainable at the time of separation or dissolution. The present value is generally this amount; however, "the face value of the account may be discounted for the possibility of forfeiture if the pension is nonvested or nonmatured."[61]

The lump sum method may also be preferred when a defined benefit pension plan has little value and/or sufficient other marital assets exist to compensate the non-employee for the value of her share. Although determining the present value, especially

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59 Mechana v. Lambert, 635 So. 2d 747, 749 (La. Ct. App. 1994).

60 Some courts split the reserved jurisdiction method into two separate methods: those that determine the formula at the time of divorce, but defer distribution until the pension is available and those that defer both the formula determination and distribution until it is available.

61 *In re* Marriage of Nordahl, 834 P.2d 838, 839 (Colo. Ct. App. 1992).

with a defined benefit plan, may be difficult,[62] the lump sum method provides for immediate resolution of the parties' assets, avoids the continued financial relationship of the parties and eliminates the need for continued jurisdiction of the court. With a defined benefit plan, courts usually use actuarial and investment data to help assess the appropriate value and then discount it to a present value.[63] One drawback to using the present value method is that it "places the entire risk of forfeiture before maturity on the employee spouse."[64] Another drawback is that the non-employee spouse may receive less if the present value is determined to be significantly lower than the value at actual retirement. Many parties may willingly accept either of these risks for the benefit of being able to get on with their separate lives.

The reserved jurisdiction method delays the valuation and distribution of the pension until it matures or is actually available for distribution. This method eliminates the speculation surrounding valuation of the pension, but requires that the court maintain jurisdiction until the pension becomes available and is actually received. At this time, the parties return to court to determine the amount each shall receive. A variation of the reserved jurisdiction method is the deferred distribution method. This method allows the court at the time of dissolution, to determine the formula to be used to calculate each spouse's portion when the pension is received. The formula is then applied when the pension becomes available.

Recognizing that one of the goals of a property settlement upon divorce is to "provide a prompt and final resolution of financial affairs," the Supreme Court of Alaska in *Wainwright v. Wainwright*[65] found that the lower court's retention of jurisdiction was in error when the holder of a nonvested pension was willing to take the risk of possible forfeiture if the plan would not vest. Both parties had pension plans: hers would vest within two

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62 *See In re* Marriage of Callaghan, 869 P.2d 240 (Kan. Ct. App. 1994), in which the wife presented evidence to support the present value of her pension plan. The evidence included taxes, life expectancy, interest rates and future retirement earnings. Since the husband provided no compelling evidence that these factors and calculations were incorrect, the appellate court confirmed the valuation. *See also* Gemma v. Gemma, 778 P.2d 429 (Nevada 1989).

63 *In re* Marriage of Nordahl, 834 P.2d at 840.

64 Krafick v. Krafick, 663 A.2d 365, 374 (Conn. 1995).

65 888 P.2d 762, 764 (Alaska 1995).

months of the divorce; his would not vest until seven years later. An earlier Alaska Supreme Court decision instituted the "deferral-until-vesting remedy . . . so that the employee spouse would not bear the risk of noninvesting."[66] The *Wainwright* Court agreed that where the employee spouse knowingly accepts the entire risk that his pension may not vest, the pension should be valued and distributed at the time of dissolution meeting the goal of dividing the marital assets and allowing the parties to move on without "financial entanglements."[67]

The formula used by most courts to determine the amount the non-employee spouse is entitled to receive from the employee spouse's pension is the coverture fraction, also referred to as the time-rule or proportionality rule.[68] It is calculated as:

$$\frac{\text{Benefit Amount} \times (\text{No. months married while earning pension}) \times 50\%}{\text{Total no. months earning pension}}$$

This formula is commonly used with defined benefit plans in which the court has retained jurisdiction.[69]

A frequent source of much litigation is the value given the benefit amount, which is usually based on the salary level attained by the employee just prior to retirement which often occurs after the marriage has ended.

> In theory an employee's acquisition of a pension right in the early years of employment during the marriage, even though based on a smaller salary, may be actually worth more than his enhancement of that right during the post-divorce years, due to the longer period of accumulated interest and investment income prior to the commencement of benefit payments . . . [T]he services rendered by the non-employee spouse . . . during the early, low paid years . . . provide the foundation for the post-divorce escalation of pension benefits and thereby usually justify applying the [coverture] fraction to the entire pension including any increases after divorce . . . .[70]

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66 *Id*. at 764, citing Laing v. Laing, 741 P.2d 649 (Alaska 1987) (holding that a nonvested pension should not be divided until the pension vests).

67 *Wainwright*, 888 P.2d at 765.

68 *But see* Maslen v. Maslen, 822 P.2d 982 (Idaho 1990) (In calculating the community interest in a pension, the court subtracted the balance at the time of marriage from the balance at the time of divorce with half of this amount going to each spouse.).

69 *Id*.

70 Mechana v. Lambert, 635 So. 2d 747, 749-50 (La. Ct. App. 1994).

Many courts have determined that increases due to investment strategies, longevity raises, or cost-of-living increases should be considered as gains due to marital or community involvement. However, the employee-spouse may present evidence to support his claim that the post-divorce increases should not be considered as marital or community property. Factors the court may consider are raises received based on post-divorce special achievements or projects, gaining additional training or education, or extraordinary promotions.[71] Courts generally allow the employee-spouse to present evidence to show what percentage of increase should be considered as post-dissolution separate property.

Courts have provided diverse reasons for determining what date should be used when calculating the amount the non-employee spouse should receive. Some courts value the pension at the date of separation;[72] others use the earliest possible retirement date; and others wait until the employee spouse actually receives the pension.

In *Katzenberger v. Katzenberger*,[73] the Pennsylvania Supreme Court held that with the deferred distribution of a defined benefit plan, the non-employee's share should be calculated on the amount the employee would receive if he were to

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71 *Id*. at 750.

72 *See, e.g.*, Surrette v. Surrette, 442 S.E.2d 123 (N.C. Ct. App. 1994). N.C. GEN. STAT. § 50-20(b)(3) states that a vested pension award will be "calculated as of the date of separation, and shall not include contributions, years of service or compensation which may accrue after the date of separation." *Id*. at 124. In Bishop v. Bishop, 440 S.E.2d 591 (N.C. 1994), the court had given specific guidelines on valuing a defined benefit plan. First, assuming employee retired on the date of separation, calculate the monthly pension amount he will be entitled to receive at the later of the date of separation or the earliest retirement age. Second, determine the life expectancy of the employee (i.e., the likely number of months he will be receiving benefits). Third, determine the then-present value using an acceptable discount rate, as of the later of the date of separation or the earliest date of retirement. Fourth, discount the then-present value to the value as of the date of separation. In *Surrette*, the court calculated the present value as of date of separation if he would receive the pension at age 50 (earliest retirement age) and also at age 65. These calculations were $19,520 and $19,612. The trial court used the average of $19,566. Although the supreme court determined that the value used should have been $19,520, it held that it was harmless error since petitioner actually received slightly more.

73 Katzenberger v. Katzenberger, 633 A.2d 602 (Pa. 1993).

retire on the date of the separation, not the actual date of retirement. The court found that "only that pension which is available on the date of separation is marital property and that enhanced benefits purchased by employer or employee contributions following separation are not marital property."[74]

This position has not been shared by a majority of courts. For example, in a recent Illinois case, *In re Marriage of Wisniewski*,[75] the Illinois Appellate Court held that the non-employee ex-wife's share of her husband's retirement benefits should be calculated based on the total benefits accrued as of the date of his retirement, rather than the date of their divorce. In 1981, Virginia and Tom Wisniewski were divorced after twenty-one years of marriage. Tom retired thirteen years later in 1994. The trial court reserved jurisdiction to distribute the pension from his participation in the Illinois Teacher's Retirement System and later the Illinois State University Retirement System. The court used the proportionality rule.[76] Tom argued that "it is inequitable to award his ex-wife increases in benefits that compensate him for work he performed after the marriage was dissolved."[77] The court, indicating that "Thomas' argument ignores economic realities,"[78] reasoned that:

> the greater-value later years would not have been possible without the lesser-value earlier years. We cannot say the years after the marriage were more valuable than the years during the marriage. Because of the time value of money, the opposite would appear to be true, unless contributions were significantly greater in later years.[79]

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74 *Id*. at 603. *See also* Berrington v. Berrington, 633 A.2d 589 (Pa. 1993): In a deferred distribution of a defined benefit pension, the spouse not participating may not be awarded any portion of the participant-spouse's retirement benefits which are based on post-separation salary increases, incentive awards or years of service. Any retirement benefits awarded to the non-participant spouse must be based only on the participant-spouse's salary at the date of separation. However, should there be increases in retirement benefits . . . which are not attributable to the efforts or contributions of the participant-spouse any such increased benefits may be shared by the non-participant spouse based upon his or her proportionate share of the marital estate. *Id*. at 594.

75 *In re* Marriage of Wisniewski, 675 N.E.2d 1362 (Ill. App. Ct. 1997).

76 *See supra*, note 68.

77 *In re* Marriage of Wisniewski, 675 N.E.2d at 1368.

78 *Id*. at 1369.

79 *Id*.

The *Wisniewski* Court also indicated that expert testimony would have been helpful in determining which parts of the pension were marital and which were non-marital property.[80]

However, the valuation of a pension plan may become a battle of experts. In *In re Marriage of Nordahl*,[81] both parties presented expert testimony regarding the value of the husband's pension. Mr. Nordahl was forty-two years old and had been employed with the state school system for almost nineteen years at the time of the dissolution. Mr. Nordahl's expert valued the pension on the assumption that Mr. Nordahl would not complete the twenty years of service and would retire at age sixty.[82] This valuation resulted in a pension worth $45,272. The wife's expert presented valuation testimony that assumed the husband would complete thirty years of service and retire at age fifty-five. The pension was then discounted to the date of the dissolution resulting in a value of $83,052. The court found the value of the pension to be $84,000 indicating that "[t]he marital interest in the pension must be measured using the pension that will be received not upon dissolution but, rather, upon the assumed normal future retirement."[83] The court presumed that Mr. Nordahl would retire on the earliest date at which he could receive a full pension.[84]

Once the court determines the formula to be used, the issue often litigated is if the pension should be distributed when the employee-spouse becomes eligible for retirement or when the employee-spouse actually retires and begins to receive the pension benefits. Often the court will use the earliest date the employee spouse is eligible for retirement, which is also considered "control-point" valuation. The control-point valuation is the first point at which the employee has total control or has the ability to

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80 *Id*. at 1370.

81 *In re* Marriage of Nordahl, 834 P.2d at 838.

82 *Id*. at 839. Under the plan, a full retirement annuity is available after thirty years service if the employee is fifty-five years old. After completion of twenty years of service, the employee would receive a reduced benefit at age fifty-five, or a full benefit at age sixty. If he had less than twenty years of service and he left his contribution intact, he would receive full benefit at age sixty-five, or a reduced benefit at sixty. *Id*.

83 *Id*. at 841, citing 3 J. McCahey, Valuation & Distribution of Marital Property § 45.23 (1991).

84 *In re* Marriage of Nordahl, 834 P.2d 838, 841 (Colo. Ct. App. 1992).

"unilaterally elect to retire at a time of his or her choosing and start receiving benefits."[85] Many courts wrestle with this control when determining how and when to distribute retirement pensions.

Courts encourage parties to reach settlement agreements acceptable to both parties. However, just as discussed in Part A above, under "Characterization", these agreements may be subject to further litigation later when circumstances change. In *In re Marriage of Frain*,[86] the Appellate Court of Illinois evaluated the parties' settlement agreement regarding when the firefighter husband's pension would be payable to the wife.[87] The settlement agreement stated that no benefits from the husband's pension would be payable to the wife "until such time as any benefits were due and payable"[88] to the husband. At the time of dissolution, the husband had eighteen years of service as a firefighter. The Illinois Pension Code provided that if an employee had less than twenty years of service, full benefits would be received at age sixty. The husband retired after twenty-six years of service at fifty-one years of age. He began receiving his pension but did not pay any portion to his ex-wife. Based on his interpretation of the agreement, he did not have to pay any of his pension benefits to his ex-wife until he reached the age of sixty. The court disagreed with the husband's rationale that his working more than twenty years enabling him to collect his pension before age sixty occurred subsequent to the marital settlement agreement and, therefore, was his separate benefit.[89]

The fact that a pension has vested or is not vested has also been the source of litigation in determining when a pension's value should be distributed. However, with ERISA pension plans should be of little concern because ERISA plans require vesting within five or seven years if grading vesting is used. Therefore, the amount in a non-vested ERISA plan is probably modest and it is quite likely that the employee is young and several years away from retirement.

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85 Donald E. Wiseman, *Earliest Retirement Date Assumption and the Distribution of Pension Benefits and Supplements*, 73 MICH. B.J. 58 (1994).

86 *In re* Marriage of Frain, 630 N.E.2d 523 (Ill. App. Ct. 1994).

87 *Id*. at 523.

88 *Id*. at 525.

89 *Id*. at 524.

ERISA plans are also subject to QDROs, which allow the court to assign or divide the pension benefits between the spouses at the time of divorce.[90] A QDRO provides for the separation of each spouse's interest in the private benefit plan: "In effect, a QDRO is a present separation of future retirement benefits . . . [It] simplifies valuation questions and is an appropriate means of giving each spouse sole and immediate control over his or her share of the retirement benefits."[91] The court determines that a fixed percentage (e.g., coverture fraction) will be distributed to each spouse when the pension matures. Under REA, the court order or court approved plan must follow specific rules. The QDRO must include the name of the pension plan, the names and addresses of the employee and former spouse, the formula to be used or the actual amount to be paid, the method of payment, and when the payments are to begin and end.[92] The QDRO must comply with the plan's rules for distribution of benefits and must be approved by the plan's administrator.[93] QDROs allow the parties to become financially disentangled while sharing the risks and uncertainty of future increases or decreases. A QDRO also essentially eliminates the requirement for continued jurisdiction by the court and the enforcement difficulties of delayed distribution, because the QDRO allows the pension plan administrator to pay the non-employee spouse directly as either a lump sum of periodic payments in the future.[94]

In *Glidewell v. Glidewell*,[95] the Kentucky Court of Appeals disregarded the husband's argument that because his pension was not vested it had zero value.[96] Although the wife had received her portion of the pension as other marital property and

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90 Denise Lamaute, *Retirement Benefits in Divorce*, NAT'L B. ASS'N MAG., May/June 1991, at 29.

91 Maslen v. Maslen, 822 P.2d 982, 989 (Idaho 1991).

92 29 U.S.C. § 1056(d)(3) (1988).

93 *See* Hoyt v. Hoyt, 559 N.E.2d 1292 (Ohio 1990) (finding that the trial court's QDRO was not specific enough to comply with ERISA's requirements).

94 *Id*. at 1292.

95 Glidewell v. Glidewell, 859 S.W.2d 657 (Ky. Ct. App. 1993) (citing Poe v. Poe, 711 S.W.2d 849 (Ky. Ct. App. 1986) in which the court recognized that a non-vested pension is marital property but that it was speculative so the division must be deferred until the pension vests).

96 *Glidewell*, 859 S.W.2d at 657. At the time of divorce, the police officer husband had been employed by the Louisville Police Department for 33

the husband received the full value of his pension, the appellate court deferred the division and distribution of his pension until it vested because it would allow the non-employee spouse to "receive exactly that portion of the pension to which she is entitled (instead of perhaps receiving an inadequate amount of . . . property), while the [employee] spouse will not be unjustly penalized by the unequal distribution . . . in the event his pension does not vest."[97]

Military pensions that do not vest until the service member has served either twenty or thirty years in the military have presented the courts with several alternatives. In *Root v. Root*,[98] the Supreme Court of Alaska determined that the trial court erred when it awarded all of the non-vested pension to the service member and awarded the wife all the equity in the marital home in an effort to "disentangl[e] the financial affairs of those seeking divorce."[99] The supreme court felt the trial court should have retained jurisdiction since the wife would not receive any equity until a leasehold expired, two months after the husband's pension vested. The trial court's error was compounded by the fact that the husband provided no evidence regarding the present value of his pension.

III. Conclusion

Since pension plan benefits are frequently the most valuable marital asset a couple may own, upon dissolution it is imperative that attorneys representing each party have a clear understanding of the various options available for valuing and distributing the asset. It may not be in the best interest of the non-pension holding spouse to sever the relationship and financial ties by taking a present value or lump sum distribution. The court will use its discretion as it considers several factors, including the time until the pension becomes available, the present and future val-

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months. The pension plan required that an officer must be employed for at least 60 months or his contributions were forfeited. *Id*. at 678.

97 *Id*. at 678. By the time the case reached the appellate court, the pension had vested and the case was remanded to determine if each spouse received an adequate share of the pension.

98 851 P.2d 67 (Alaska 1993) (the husband's pension would vest after 20 years of service in the army).

99 *Id*. at 69.

ues of the pension, the other marital assets, and financial situations of each spouse in making an equitable settlement. However, since the court bases its decision on factors provided by the parties, the attorney representing the spouse must recognize his limits and bring in expert testimony to present evidence regarding the true value of the pension plan. Additionally, attorneys should recognize that just as issues surrounding pensions have increased over the past two decades, other benefits provided by the employer, such as post-retirement health insurance, should also be evaluated as assets of the marital estate. Pension plans and health benefits should also be considered when drafting pre-nuptial agreements. With complete knowledge and a careful and thorough evaluation of all the couples' assets, attorneys can help their clients reach a fair and equitable distribution of the assets and help their clients move forward with their separate lives without difficult financial entanglements.

Susan J. Prather