New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
©2009 INCISIVE MEDIA US PROPERTIES, LLC
An incisivemedia publication
VOLUME 241—NO. 34
MONDAY, FEBRUARY 23, 2009

EMPLOYEE BENEFITS

Expert Analysis

When Divorce Decree Is Not Shared With the Benefits Plan

What happens when an ex-spouse has waived pension benefits in a divorce decree, but no corresponding change of beneficiary has been filed with the plan? The U.S. Supreme Court recently addressed this seemingly commonplace issue in *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan*, 2009 U.S. LEXIS 869. The case required the Court to resolve the tension between an employee benefit plan's administrative efficiency concerns in not wanting to look at external documents and a plan participant's intended disposition of plan benefits.

The Court held that a waiver of benefits is not an "alienation" of benefits prohibited by the antialienation provisions of the Employee Retirement Income Security Act (ERISA). However, the Court also held that such a waiver need not be respected by a plan where plan documents provide a specific method for designating beneficiaries that has not been followed.

The decision resolved two splits among U.S. Courts of Appeals and state Supreme and has far reaching implications for administrators and beneficiaries of benefit plans subject to ERISA.

Background

William Kennedy, an employee at E.I. DuPont de Nemours & Company, participated in the company's savings and investment plan (SIP) for a number of years. The SIP allowed William to "designate any beneficiary or beneficiaries…to receive all or part" of his benefits at death. The SIP further gave William the right to "replace or revoke such designation." The plan provided, however, that all designations must be made in the manner required by the plan administrator and the administrator had created specific forms for this purpose. If William were to die without a spouse or designated beneficiary, the plan directed that "distribution shall be made to, or in accordance with the directions of, the executor or administrator of the decedent's estate."

By **Donald P. Carleen**



In 1971, William Kennedy married Liv Kennedy and thereafter properly designated her as beneficiary under the SIP. In 1994 William and Liv divorced with a decree divesting Liv of her rights under the SIP. William failed, however, to execute a revised plan beneficiary form and, therefore, Liv remained the named beneficiary in SIP documentation.

William died in 2001 and, as directed by SIP documentation, the plan paid the funds in the SIP account to Liv. The executrix of William's estate, Kari Kennedy, had asked DuPont to disburse the funds to the estate. So following the disbursement to Liv, the estate filed suit against both DuPont and the administrator of the SIP. The estate argued that the divorce decree was a valid waiver of Liv's rights under the SIP and, therefore, the funds should not have been delivered to William's SIP designee.

Based on Fifth Circuit precedent upholding the validity of waivers of rights under ERISA plans, the district court agreed with the estate. However, the Fifth Circuit reversed, holding that the waiver was in violation of ERISA's provisions prohibiting the assignment or alienation of pension benefits and was therefore invalid. The appellate court based its reasoning in large part upon ERISA §206(d)(3), which creates an exception to the antialienation provision for so-called "qualified domestic relations orders" or QDROs, which are domestic relations orders meeting certain requirements specified in ERISA.

The portion of the divorce decree containing the waiver did not constitute a QDRO. The circuit noted that the QDRO rule was created as a special exception to the antialienation restriction. The court reasoned by implication that other spousal waivers must be barred by the antialienation restriction or there would have been no reason to create the QDRO exception. Therefore, the Fifth Circuit found that the plan had properly paid the benefits to Liv.

Supreme Court Ruling

A unanimous U.S. Supreme Court agreed that the plan properly paid the benefits to Liv. The affirmance, however, was founded on a differing rationale.

The Court found Liv's waiver to be valid, and began its analysis by unraveling the Fifth Circuit's assertion that ERISA's antialienation clause barred the waiver. The Court first looked to traditional legal definitions of the terms "assigned" and "alienated" in determining the scope of the antialienation clause. The historical legal meaning of "assign" has been "to transfer." Similarly "alienate" has historically meant "to transfer" or "to convey."

The Fifth Circuit had found Liv's waiver to be an impermissible alienation by broadly

DONALD P. CARLEEN *is a partner and chairs the executive compensation and employee benefits group at Fried, Frank, Harris, Shriver & Jacobson.* JEFFREY ROSS *and* TRENT MOHNEY, *associates with the firm, assisted in the preparation of this article.*

interpreting the term "alienation" and viewing Liv's waiver as an indirect transfer encompassed by the term. The Supreme Court discarded this construction as overly broad and found that the waiver was not a transfer or conveyance as contemplated by the antialienation clause.

The Court noted that the Fifth Circuit's broad interpretation would create the strange situation where one would "speak of the estate as the transferee of its own decedent's property" and "speak of the decedent in his lifetime as his own transferee." Additionally, in some circumstances a surviving spouse may waive a right to pension payments due on the death of the predeceased spouse. Such waivers, as well as qualified disclaimers under the tax code, would seemingly be barred under the Fifth Circuit's interpretation, although both transactions are undisputedly permissible.

The Court further affirmed its construction of the antialienation clause by reviewing the law of trusts that "serves as ERISA's backdrop." Because the antialienation provision of ERISA is similar to a spendthrift trust provision in that each prohibits assignment or alienation of funds, the Court thought it was a useful comparison.

The Court explained that in the spendthrift trust context, beneficiaries are prohibited from transferring their interests, yet are allowed to disclaim such interests so long as the disclaimer does not purport to designate a new beneficiary.

ERISA, intended to parallel the law of trusts in many aspects, would unlikely diverge from the law of trusts in oddly forcing beneficiaries to receive interests they had disclaimed.

The Court next found that Liv's waiver did not have to be in a QDRO to be valid. The Fifth Circuit had reasoned that spousal waivers that are not part of a QDRO must be barred by ERISA's antialienation clause or there would have been no reason to create a QDRO exception allowing a spouse to eliminate their right to benefits.

The Court responded that a simple waiver of benefits is not possible through a QDRO, as QDROs require the designation of a new beneficiary. Therefore, a simple waiver of benefits cannot and does not have to be in a QDRO.

The Court similarly found that Liv's waiver was not preempted by ERISA. DuPont had argued that Liv's non-QDRO waiver was invalid because ERISA preempts "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" §514(a). ERISA defines "State law" as inclusive of "decisions" and "other State action having the effect of law" §514(c)(1). The Court found that the waiver was recognized as a creature of federal common law. Thus, despite being part of a state court decision affecting a benefit plan, it was not preempted. That is, its appearance in a state divorce decree was mere happenstance.

After recognizing the validity of Liv's waiver, the Court reaffirmed its bright line rule, well established in prior Supreme Court cases, that instructions in plan documents are preeminent. Therefore, Liv's waiver, though valid, remained subject to the administrator's duty to follow procedures in the plan documents with regard to designation of beneficiaries. This rule was founded on text of ERISA that mandates, "every employee benefit plan be established and maintained pursuant to a written instrument…specify[ing] the basis on which payments are made to and from the plan" §402(a)(1);(b)(4). Additionally, ERISA requires the plan administrator to act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [Title I] and [Title IV] of [ERISA]" §404(a)(1)(D).

The Supreme Court found that the waiver was not a transfer or conveyance as contemplated by the antialienation clause.

The Court explained that this rule minimizes the administrative burdens, delay, double liability and litigation that would be encountered if the plan were required to consider extraneous documentation. The rule allows employers to establish a procedure to govern the plan and be confident when paying benefits that no inquiry is necessary beyond the procedures provided in their own plan documents.

The Court recognized that QDROs require an administrator to enforce documents external to the plan in a limited sense. However, the Court noted that ERISA's QDRO provisions state that a "person who is an alternate payee under a [QDRO] shall be considered for purposes of any provision of [ERISA] a beneficiary under the plan" and, therefore, giving effect to a QDRO is giving effect to plan documents rather than disregarding them.

Additionally, the Court stated that enforcing a QDRO is "relatively discrete" and "a far cry from asking a plan administrator to figure out whether a claimed federal common law waiver was knowing and voluntary, whether its language addressed the particular benefits at issue, and so forth, on into factually complex and subjective determinations."

Under this rule, because William's designation of Liv was executed properly under the plan documents and Liv's waiver was not, DuPont made the correct decision in paying benefits to Liv as directed by the plan documents.

Conclusion

The result in this case may seem inequitable given what seems like compelling evidence that the parties did not intend the benefits to be paid to an ex-spouse. In this sense, the case could be viewed as a cautionary tale. All hope may not be lost for Kennedy's estate in this case, however, as the Court expressly refused to rule on whether an estate in these circumstances would have a valid state or federal contract claim against the ex-spouse and, if it has a state law claim, whether such a claim would be preempted.

Reprinted with permission from the February 23, 2009 edition of the NEW YORK LAW JOURNAL © 2009. Incisive Media US Properties, LLC. All rights reserved. Further duplication without permission is prohibited. For information, contact 877-257-3382 or reprintscustomerservice@incisivemedia.com. # 070-02-09-27