#F-633 3/7/85

Memorandum 85-39

Subject: Study F-633 - Division of Pensions (Schedule for Consideration of Study)

At the January 1985 meeting the Commission reviewed comments on the tentative recommendation relating to division of employee pension benefit plans. After some discussion, the Commission deferred action on the tentative recommendation, pending receipt of a detailed report from the State Bar Family Law Section.

We are now informed that the State Bar will be unable to consider the matter in time for our March meeting as planned. The earliest they would be able to consider the matter is at their May meeting. This means that, after allowing time for them to make their report and for our staff to analyze the report and sent the report and analysis to the Commission sufficiently in time for Commission study before the meeting, the earliest the Commission would be able to take up this matter is at its June meeting.

Under this schedule it is unlikely we will have any legislation for this session on pensions. It will be too late to introduce a bill or even to amend our proposals into another bill in the first house, assuming we can find an author willing to amend our proposals into another bill.

We understand from some lawyers representing pension plans under ERISA that court ordered pension divisions are being honored under the new federal legislation if it appears to the pension plan that the order conforms to federal requirements for a Qualified Domestic Relations Order (QDRO). Where it is not clear whether a property division order is a QDRO, however, there is considerable confusion as to the rights of the parties and the interrelation of federal pension law with state domestic relations law.

Assembly Member McAlister has introduced legislation to require the Public Employees' Retirement System to make a study to determine the feasibility of dividing the pension between the spouses, as ERISA now permits for private pension plans under QDROs. See Assembly Bill No. 988, a copy of which is attached as Exhibit 1.

Our options at this point appear to be either to introduce the proposals we have already circulated for comment (see Memorandum 85-15)

by finding an existing bill to amend the proposals into now, or to do a longer-term study that deals with the problems in division of pensions more comprehensively.

On this point, a letter we have just received, attached as Exhibit 2, is relevant. The author of the letter, a Sacramento family lawyer, opposes the Commission's tentative recommendation to overrule Gillmore. He points out that absent other protections for the nonemployee spouse, such as splitting the pension and paying directly to the nonemployee spouse, Gillmore provides important protections. He notes the need for legislation to authorize public retirement plans to split the pension as ERISA now authorizes for private retirement plans, and also points out the interrelation of the terminable interest rule and the need to modify it in order to make sense out of this whole area.

This letter reinforces a point that the staff has been making at the past few meetings. The problems involved here are not simple, and should be dealt with comprehensively. The staff believes it would be a mistake simply to introduce a bill to implement our current tentative recommendation. We believe it is an important matter that deserves careful and thoughtful study. This will take a substantial amount of Commission and staff time and should be given highest priority as soon as our resources permit.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

CALIFORNIA LEGISLATURE—1985-86 REGULAR SESSION

ASSEMBLY BILL No. 988

Introduced by Assembly Member McAlister

February 26, 1985

An act to add Section 21201.6 to the Government Code, relating to the Public Employees' Retirement System.

LEGISLATIVE COUNSEL'S DIGEST

AB 988, as introduced, McAlister. Payment of PERS interest awarded nonemployee spouse: Study by PERS.

The existing Public Employees' Retirement Law confers administrative control of the system upon the Board of Administration.

This bill would require the board to provide for a study of specified issues raised in the case In re Marriage of Gillmore, 29 Cal. 3d 418, and to determine the feasibility of separation of the interest awarded the nonemployee spouse and direct payment of each interest to the owner thereof.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

SECTION 1. Section 21201.6 is added to the Government Code, to read:

21201.6. The board shall provide for a study of the issues raised in the case In re Marriage of Gillmore, 29 Cal, 3d 418, relating to the payment of the interest in benefits of the retirement system which interest is awarded, as part of the division of community property, to a nonemployee spouse, which study shall determine the feasibility of separation of the interest awarded the nonemployee spouse and direct payment of each interest

to the owner thereof.

EXHIBIT 2

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March 5, 1985

California Law Revision Commission
400 Middlefield Road, Suite D-2
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Gentlemen:

It is my understanding that the California Law Revision Commission is about to recommend legislation overturning the ruling of In re marriage of Gillmore (1981) 29 Cal. 3rd 418, 174 Cal. Rptr. 493, which allows the nonemployee spouse to collect his/her community interest in retirement benefits from the employee spouse when the employee spouse becomes eligible but does not in fact retire. I would like to go on record to strongly oppose such a change. The Gillmore case is very well reasoned and reaches an equitable result.

Many of the nonemployee spouses have to wait many years for the retirement benefits to mature. Some employee spouses absolutely refuse to retire, thus permanently depriving the other spouse of a very valuable property right. In many instances, the delay in retirement actually decreases the value of both parties' rights in the retirement plan. The nonemployee spouse should not be penalized by the employee spouse's decision. Gillmore is the only real protection afforded to the nonemployee spouse.

Where the court has initially reserved jurisdiction to divide the retirement benefits equally, the property division would not be equal without Gillmore. Without any right to control the receipt of the benefit, the nonemployee spouse's interest has substantially less monetary value even if divided according to the "time rule" when utlimately received at the choice of the employee.

The recent revision of federal law for retirement plans governed by ERISA permits the nonemployee spouse to obtain direct payment from the plan. This eliminates the cash flow problem for the employee spouse and allows the nonemployee spouse to elect such benefits. However, it should be noted that the federal legislation fails to give the nonemployee spouse the cost of living increases that would have been received had the employee retired; such a failure is unnecessary and inequitable.

California should follow that federal legislation with similiar legislation to allow the nonemployee spouse to obtain direct payment of Gillmore benefits from the governmental

retirement plans for the state and local governments. However, it should allow all increases the nonemployee spouse would have received if the employee spouse had retired. Most, if not all, of the employee spouses complaints would be resolved by such legislation. Even absent such legislation, the Gillmore rights should be retained for the reasons discussed herein.

Many critics of Gillmore fail to realize the basic economic truth that after the employee reaches retirement age, the employee is actually earning only the difference between the salary and the amount of retirement the employee would receive if retired. For example, the employee is actually earning only $500 per month if receiving a salary of $2,000, but would have received retirement of $1,500. Because the nonemployee spouse who elects Gillmore rights gets none of the increased earnings benefits produced by continued employment, many nonemployee spouses do choose to delay the Gillmore election. (The nonemployee spouse receives cost of living increases only if this would have been received had the employee retired when the Gillmore election was made.) Nonemployee spouses may, however, need the money immediately when the employee spouse reaches retirement age. Thus, Gillmore strikes an equitable balance between the nonemployee spouse's benefit and the employee spouse's benefit.

If the employee wants to eliminate the Gillmore problem, he or she may request that the retirement be awarded to the employee in total. It is usually those who fought the hardest at the initial trial to obtain reservation of jurisdiction over the retirement and against award of the total asset to the employee who complain when the Gillmore rights arise later.

Parties frequently discuss and negotiate the Gillmore rights through their attorneys during dissolution of marriage if either party feels strongly about that issue. Eliminating Gillmore will make the trial courts more reluctant to retain jurisdiction because of the uncertainty faced by the nonemployee spouse, thus requiring an offset by other assets or an equalizing payment.

The more immediate need for legislation in the retirement benefit area is the need for abolition of the terminable interest doctrine. That doctrine holds that the nonemployee spouse's claim terminates on the death of the employee spouse or on the death of the nonemployee spouse, whichever comes first. Because of this doctrine, the nonemployee spouse receives substantially less than one-half of the community interest in the retirement when the regular time rule is applied after a retention of jurisdiction.

The employee spouse is definitely and totally protected until his or her death, but the nonemployee spouse will have no benefits if the employee dies first. If the nonemployee spouse dies first, the nonemployee spouse's share of the retirement reverts to the employee spouse who then receives the entire retirement benefit until death. Thus, the nonemployee spouse is left unprotected after the death of the employee spouse, and the employee spouse has a windfall on the death of the nonemployee spouse. Although this inequity can be resolved by calculating the difference in values, some courts have been reluctant to do so. Forced election of a survivor benefit to the former spouse cannot be ordered at the present time, despite the fact that such elections are frequently available and sometimes obtained by agreement.

At least three methods of eliminating the inequity of the terminable interest doctrine are available. First, the actuarial value of the difference in the value of the retirement benefits can be computed and equalized by awarding a lump sum to the nonemployee spouse or by giving the nonemployee spouse a higher percentage of the monthly payments in the retirement benefit than the time rule requires. This is based upon footnote 9 of the Waite case (1972) 6 Cal. 3rd 461, 99 Cal. Rptr. 325, 492 P. 2d 13, but is often refused by trial courts or overlooked by the actuary or attorney.

The second alternative would be to give the nonemployee spouse the right to designate a successor by will (or other appropriate document) to receive the nonemployee spouse's share of the retirement benefits if the nonemployee spouse dies first. Because the same amount of money would be paid by the retirement plan, there would be no cost to the plan. The cases which instituted the terminable interest doctrine misunderstood this basic fact. Some cases indicated that the nonemployee spouse's interest had to terminate on that person's death because of the potential cost to the retirement plan. Since the same amount of money would be divided between the employee and the nonemployee decedent's beneficiary, there would be no cost to the plan. The terminable interest doctine is, to a great degree, based upon the court's misunderstanding of actuarial valuations which can accurately discount to and for longevity, health problems etc. for the possibility that one spouse may die before the other.

The third alternative is to require that the plan award survivor benefits to the nonemployee spouse until the nonemployee spouse's death. Many plans, such as PERS, permit various options to allow the former spouse to be protected until death. This is

the most equitable resolution because it protects both spouses until death. The monthly benefits are, of course, decreased somewhat due to the possibility that the nonemployee spouse may receive benefits after the death of the employee. At the present time, this equitable result can be reached only by agreement (sometimes in exchange for Gillmore rights), since courts have refused to force such an election on the employee spouse because of case law.

The recent Chirmside (1983) 143 Cal. App. 3rd 205, 191 Cal. Rptr. 605, 1983 CFLR 2304 and Becker (November 8, 1984), 161 Cal. App. 3rd 65, 207 Cal. Rptr. 392 cases discuss the shortcomings of the terminable interest doctrine and have alleviated some of the inequities involved. However, it is obvious that legislation rather than a court decision would be a more expedient resolution of this difficult issue.

In summary, the rights of the nonemployee spouse requires more protection rather than elimination of the Gillmore rights. The archaic terminable interest doctrine should be abolished and the equitable Gillmore should remain to balance the equities. Suitable legislation should be drafted and recommended.

Very truly yours,

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& MUNSILL, A Law Corporation

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