Memorandum 84-9

Subject: Study F-663 - Division of Pensions (Policy Issues)

BACKGROUND

At the November 1983 meeting the Commission directed the staff to prepare for its consideration a tentative recommendation (with the view to distributing the tentative recommendation for comment if it appears to be a reasonable solution to the problem of division of pensions) along the following lines:

> The court at dissolution of marriage should be authorized to divide the community property retirement benefits when they contractually become payable and to divide them at that time simply by an arithmetical calculation of how long those retirement benefits were earned during marriage and how long they were earned outside the marriage. If the nonemployee spouse dies first, his or her share would go to his or her heirs or devisees.

This memorandum includes a staff draft implementing this approach (see Exhibit 1), and raises a number of policy issues the Commission should consider in determining whether this is a reasonable solution to the problem.

SOME TERMINOLOGY

Although we use the terms "pension plan" and "retirement benefit" loosely, the terms are somewhat misleading in their implication that all pension plans and retirement benefits are sufficiently similar that they can be lumped together and given similar treatment upon dissolution of marriage. In fact, the Family Law Act provisions on joinder of pension plans goes so far as to use the single term "employee pension benefit plan." Civil Code § 4363.3. However, there are innumerable types and variations of plans, benefits, funds, and accounts, with characteristics so different that their only common feature is that they are all forms of deferred compensation.

The deferred compensation feature is significant since it is the basis for division of employee pension benefit plans between the employee spouse and the nonemployee spouse. Deferred compensation is property or an interest in property acquired during marriage and therefore is community property owned equally by the spouses and subject to division at dissolution of marriage. This is true regardless whether the compensation is paid at dissolution of marriage or to be paid at a later date.

The most useful distinction among various types of deferred compensation, for purposes of division, is between "defined contribution" plans and "defined benefit" plans. This terminology is derived from the Internal Revenue Code. Under a defined contribution plan, a separate account is kept for each employee showing sums contributed by the employee and by the employer on the employee's behalf. IRC § 414(c). The present value of the employee's interest in a plan of this type is therefore not difficult to determine in the ordinary case where the employee's right to the funds in the account is absolute. Stock option and profit sharing plans are often deferred compensation of the defined contribution type.

Unlike a defined contribution plan, a "defined benefit" plan does not involve a separate account detailing contributions by the employer and employee. Labor for the employer over a specified period of time qualifies the employee to receive plan benefits either in a fixed amount or as a percentage of salary at retirement, or of average salary for a period before retirement. IRC § 414(j). The present value of the employee's interest in this type of plan cannot be determined with precision since it will depend on a number of unknown variables, such as age at retirement, salary at retirement, etc. In the ordinary case, extensive use of actuarial computations is necessary to determine the present value of a plan of this type.

Among each of these two general types of plans there may be differences as to vesting, maturity, options, and death benefits. An employee's interest in a plan is "vested" if the employee has worked the required length of time to qualify for benefits under the plan. Once an employee's interest is vested, the employee is entitled to receive benefits under the plan upon maturity even though the employee may have terminated employment before that time. It should be noted that even a vested right to benefits under a plan may be subject to divestment under some plans in unusual situations (e.g., the employee terminates employment and sets up a competing business). Even though an employee's interest in a plan is not yet vested, the nonemployee spouse has an interest in the plan that is subject to division, either by discounting the value of the plan for the possibility that it may never become vested or by reserving jurisdiction to see if it becomes vested. In re Marriage of Brown, 15 Cal.3d 838, 544 P.2d 561, 126 Cal. Rptr. 633 (1976).

An employee's interest in a plan is "matured" when the employee has satisfied all conditions precedent to receiving benefits under the plan and would be entitled to actual payment upon retirement and making a claim for payment. It is important to note that the employee's interest may be matured even though the employee is relatively young and active, with no intention to retire in the immediate future. This was the situation in In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981), which held the employee spouse must pay the nonemployee spouse his or her share on maturity, even though the employee spouse does not choose to retire and is not receiving payments.

Payments under a matured plan are actuarily adjusted based on the age of the employee at retirement; a younger employee receives a lower payment, an older employee receives a higher payment, based on the actuarial assumption that the length of time the payments are made will vary accordingly, with the result that the total amounts paid out are equalized. In addition, employee pension benefit plans also ordinarily offer a number of different payment "options," likewise actuarily equalized, that may best suit the employee. The choice of options, in addition to the timing of retirement, has generated litigation, since the option choice most advantageous to the employee spouse may not be the most advantageous to the nonemployee spouse, depending upon his or her age, health, financial circumstances, etc. The courts have held that the employee spouse, by exercising a choice of options, cannot defeat or reduce the interest of the nonemployee spouse. See, e.g., In re Marriage of Stenquist, 21 Cal.3d 779, 582 P.2d 96, 148 Cal. Rptr. 9 (1978).

Among the more difficult problems that have arisen so far with respect to options that defeat the nonemployee spouse's interest involve election of a "joint and survivor annuity." This is a provision that, upon the death of the employee spouse, an annuity of one-half the employee's retirement benefits will be paid to the surviving spouse; the amount of the employee spouse's benefits are actuarily reduced to cover the cost of continued payments to the surviving spouse for life. This option must be offered by all employee pension benefit plans under ERISA and is a popular option with the employee spouse. However, it is an unpopular option with the ex-spouse in cases where the employee spouse has remarried, since it reduces the benefits to which the ex-spouse is entitled. The ex-spouse was able to preclude the pension plan from honoring a joint and survivor annuity election by the employee spouse in In re Marriage of Lionberger, 97 Cal. App.3d 56, 158 Cal. Rptr. 535 (1979).

Employee pension benefit plans also vary in their treatment of benefits upon the death of the employee spouse. Many defined contribution plans pay out the accumulated funds in the employee's account at the employee's death. Defined benefit plans, on the other hand, frequently terminate benefits upon the employee's death or pay out a small death benefit to the surviving spouse. Under existing California law, the interest of the nonemployee spouse in pension benefits terminates on the death of the employee spouse. Benson v. City of Los Angeles, 60 Cal.2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963).

TWO APPROACHES TO DIVISION

The foregoing discussion of employee pension benefit plans begins to illustrate the difficulties and complexities facing the courts in making an appropriate division at dissolution of marriage. Under existing law, the choices available are variations on two themes: a present disposition approach and a reservation of jurisdiction approach. In the present disposition approach, the parties accept a current valuation of their retirement benefits. These benefits are awarded to the spouse-employee covered by the benefits, and the other spouse is awarded other community assets of equivalent value. In the reservation of jurisdiction approach, the parties agree (or the court compels them) to wait until retirement, at which time the parties or the court decide how the retirement benefits are to be divided.

These two methods of handling retirement assets are recognized in the case law and have been given judicial approval. In re Marriage of Brown, supra. A trial court has broad discretion to select either method. It is so broad, in fact, that there are no reported appellate cases reversing the method of disposition made by the trial court.

By allowing the trial judge broad discretion, the appellate courts have provided little guidance as to when one method may be more appropriate than the other. In Phillipson v. Board of Administration, 3 Cal.3d 32, 89 Cal. Rptr. 61 (1970), the present disposition was declared the preferred method, but later cases such as Marriage of Skaden, 19 Cal.3d 679, 139 Cal. Rptr. 566 (1977), appear to negate any preference. As a result, some judges favor the present disposition system while others favor reserving jurisdiction.

Advantages and Disadvantages of Present Disposition

Under the present disposition appraach, the current value of the employee pension benefit plan is determined by actuarial computation, the portion attributable to the community is ascertained, and that portion is awarded to the employee spouse with offsetting property of equal value awarded to the nonemployee spouse. Each of these steps deserves some elaboration.

In order to determine the current value of the employee pension benefit plan, the appraiser must first distinguish between defined contribution and defined benefit plans. In the case of a defined contribution plan, the current value of the plan is known, but the value may have to be actuarily adjusted for the possibility that the benefits may not become vested or may not mature. Since, often, defined contribution plans are vested and are payable at death if the employee dies before the benefits mature, there may be little difficulty ascertaining the value of the benefits with precision.

In the case of a defined benefit plan, all that is known is the value of the benefits to be paid upon maturity if the employee works sufficiently long that the benefits become vested and if the employee survives to maturity. The appraiser must estimate the employee's salary at retirement, age and length of service at retirement, and other variables that affect the benefits. The appraiser must then use mortality tables and turnover tables to compute the actuarial probability that the benefits will be paid and must discount the estimated amount of benefits by this probability. For example, if an estimated $100,000 benefits are payable to the employee at age 65 and if mortality tables show, at the time of calculation, that the employee has a 90% chance of reaching age 65, the $100,000 must be reduced to $90,000 for purposes of computing current value. After discounting the amount of the benefits for contingencies, the appraiser must further discount the amount of the benefits to their present value, assuming a reasonable rate of return on the investment. For a detailed description of the valuation process, see Projector, Valuation of Retirement Benefits in Marriage Dissolutions, 50 L.A. Bar Bull. 229 (1975).

Several features about this process are immediately apparent. First, the problem of deriving a current value for employee pension plan benefits requires use of valuation experts and is necessarily speculative. This generates expense and litigation. Second, the actuarial valuation process necessarily yields an incorrect valuation in every case. In the example above (10% reduction in value due to a 90% mortality/survival factor), if the employee actually survives to age 65, the employee's interest will have been undervalued by 10%; if the employee fails to survive to age 65, the employee's interest will have been overvalued by 90%. It is true, in the aggregate, that the value of all employees' interests must be reduced by 10% to yield an actuarily correct result. But in the individual case this process results in inequity to either the employee spouse or the nonemployee spouse due to overvaluation or undervaluation each time.

Once the current value of the benefits is determined, the portion of the benefits attributable to community property (i.e., the portion earned during marriage) must be determined. Again, in the case of a defined contribution plan, the actual contributions of the employee and employer during marriage are known. In the case of a defined benefit plan, however, there may be no contribution allocable to the employer or employee, and the total time employed while married and while not married probably is not yet known. Once again, the appraiser will have to make some estimates for purposes of allocating the community portion of the retirement benefits.

After determination of the community interest in the retirement benefits, that interest can be assigned to the employee spouse and other community property of equal value can be assigned to the non-employee spouse. This assumes, of course, that there is other community property of equal value. Many times the employee pension benefit plan is the most significant asset of the community. In other cases there may be a family home that can be exchanged for the retirement plan. However, if there are not sufficient community assets to pay for the retirement plan, the employee may have to give a promissory note to the nonemployee spouse and pay for the plan on an installment basis.

The exchange of the retirement plan for other community property is "clean"--it makes the plan the employee's own, without further complications of having the nonemployee spouse involved at the time of retirement, selection of options, etc. It avoids having to involve the court again at a later time, which could happen if the court reserves jurisdiction over the property. It avoids involvement of the pension fund in the litigation and leaves the fund responsible only to one person--the employee spouse.

However, the present disposition method also has substantial drawbacks. The employee spouse may be impoverished by the loss of all community assets in exchange for a future interest in retirement benefits that the employee may never realize, either through failure of vesting or of maturity. Many persons believe that they are being forced to give up real assets for future speculative value; "This view is strongly held, and not without reason." Hardie, Pay Now or Later: Alternatives in the Disposition of Retirement Benefits on Divorce, 53 Cal. St. Bar J. 106, 110 (1978). There are also tax disadvantages for the employee spouse, who receives retirement benefits that are taxable as ordinary income while the nonemployee spouse receives an asset taxable at capital gains rates.

It has also been argued that the present disposition method is basically unfair to the nonemployee spouse due to "an inherently conservative valuation process." Professor Bruch states that, "Because of the pressure to amass assets at divorce to offset the inflated equity in the family home, many women have traded important interests in their spouses' pensions for the ability to stay in the home. . . . In most cases, both spouses would be better served in the long run with an approach that preserves old-age security for each, and separates this issue from a search for current liquidity. . . . Those who have taken unduly small returns on community property pension rights, the inevitable result of an inherently conservative valuation process, may well regret this step as they approach old age, and the taxpaying public will share in the costs of their unfortunate choice." Bruch, The Definition and Division of Marital Property in California: Towards Parity and Simplicity, 33 Hastings L.J. 769, 851-53 (1982) (footnote omitted).

In summary, then, the present disposition method offers the possibility of a clean break between the parties without ensuing complications; the matter is settled once and for all at dissolution of marriage. However, this is achieved at the price of complex, speculative, and necessarily incorrect valuations, extensive litigation, adverse tax consequences, and a basic unfairness perceived by both the employee spouse and the nonemployee spouse. For these reasons, there are many strong advocates of a reservation of jurisdiction procedure for dealing with employee pension benefit plans.

Advantages and Disadvantages of Reserved Jurisdiction

The speculation inherent in deriving current value of retirement benefits, and the risk that the employee spouse will have to pay the nonemployee spouse for benefits that the employee spouse never receives, can be avoided by not dividing the retirement benefits at dissolution but by the court reserving jurisdiction to divide the benefits when received. Under the reservation of jurisdiction approach, the actual amount of retirement benefits to be received is known, and the court can order the share of the nonemployee spouse turned over as the benefits are paid. The exact share of the nonemployee spouse will also be known at this time, based either on actual contributions made during marriage or on proportion of time of employment during marriage.

Both of the Commission's family law consultants favor the reservation of jurisdiction approach as a general rule for dividing retirement benefits. Professor Reppy states, "The pro rata formula is the far more desirable remedy in that it avoids the difficulties of present valuation and allows the spouses to share both in sums subsequently paid under the pension plan and in the risk of termination." Reppy, Community and Separate Interests in Pensions and Social Security Benefits After Marriage of Brown and ERISA, 25 UCLA L. Rev. 417, 428 (1978). See also Bruch, The Definition and Division of Marital Property in California: Towards Parity and Simplicity, 33 Hastings L.J. 769, 852 (1982). Judge Harvey, whose letter to the Commission was attached to Memorandum 83-83, states: "But, it would be far fairer to both parties, would obviate the need to employ expert actuaries in every case, and permit the equal division of the community property in every case if this court were authorized to divide the community property retirement benefits when they contractually become payable and to divide them at that time simply by an arithmetical calculation of how long those retirement benefits were earned during marriage and how long there were earned outside the marriage."

While reservation of jurisdiction cures the main defects of the present division approach, reservation of jurisdiction has its own problems, which cannot be ignored. First is simply the mechanics of reserving jurisdiction. It requires further burden on the court to reopen proceedings at a later time, as well as on the parties and their attorneys. It requires the nonemployee spouse to keep track of the status of the employee spouse--whether he or she has moved, changed jobs, decided to retire, etc.

These problems could be mitigated somewhat by making a present court order for payment of future benefits on the basis of a formula set out in the order, but whether such an order would be honored in most cases is problematical: "Few companies have developed sophisticated data base systems for pension plans, and even fewer have the capability to store and retrieve information about the marital status of employees and prior claims against an employee's pension benefit. In some cases, joinders to the plan may never be seen by the administrator. If they are, and some type of settlement is made to dispose of the pension issue, the administrator is seldom informed. It is naive to assume that several years later the plan administrator will have any information regarding the divorce, let alone information regarding the final disposition of the pension. Administrators change, offices move, files go into storage or are lost, the spouse may have moved leaving no forwarding address or changed her name through remarriage. In many cases, deferred vested benefits are awaiting application but the participant can no longer be located." Hardie and Sutcliffe, Reserving Jurisdiction: A Potential Trap, California Lawyer 33, 35 (July/August 1982).

These practical problems have caused some pension plan experts to conclude that reservation of jurisdiction has only a limited usefulness and is feasible mainly when the dissolution occurs near the time of retirement. Of course, this is also the time when the present disposition technique is also most accurate and involves least risk to the parties.

In addition to the practical problems in reserving jurisdiction, there are problems in enforcing the court order dividing the retirement benefits as paid. If the payments are made to the employee spouse, there is no assurance that he or she will voluntarily pay over the share of the nonemployee spouse. We have sufficient experience with enforcement of support obligations to know this is a real problem. This problem can be mitigated by joining the pension plan as a party to the litigation and requiring issuance of separate checks to the employee and nonemployee spouses. Civil Code Sections 4363.1-4363.3 were enacted in

1977 to provide a procedure for joining a pension plan and making a court order for disposition of the retirement benefits binding upon the plan. So far as we know, this scheme is working satisfactorily in those cases where joinder is possible.

Reservation of jurisdiction defers receipt of the nonemployee spouse's interest in the employee pension benefit plan until the benefits are paid. During this period a number of contingencies may occur that are undesirable from the perspective of the nonemployee spouse. If the employee dies, many pension plans provide no benefits. The right of the nonemployee spouse, then, is dependent upon the health, accident-proneness, and other happenstances of the employee spouse. From the perspective of the employee spouse, however, this is only proper--a contingent right of the employee spouse should not be converted into a present benefit of the nonemployee spouse at the expense and risk of the employee spouse. The nonemployee spouse should be entitled to share only what the employee spouse has--the right to receive benefits when paid if all contingencies are satisfied.

This reasoning also applies to another situation. Many times pension funds are poorly managed and produce a low return on investment; this may be especially true of defined contribution plans. Sometimes the plans become insolvent or the plan manager absconds. These risks probably should be borne equally by the spouses. Under ERISA there is a Pension Benefit Guaranty Corporation to cover benefits up to a certain level if the pension plan terminates. It is not clear that the PBGC benefits are covered in a reservation of jurisdiction. Certainly, if the Commission adopts a reservation of jurisdiction scheme, this matter should be addressed.

Suppose during the interim period the nonemployee spouse dies? Of course, it can be argued that then the nonemployee spouse isn't hurt, since the retirement fund is intended to support the parties during retirement and the nonemployee spouse no longer needs support, being dead. This is in fact the reasoning of <u>Waite v. Waite</u>, 6 Cal.3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972), and has come to be known as the "terminable interest" rule. The commentators, including the Commission's family law consultants, strongly disagree with the terminable interest rule. Apart from present disposition, the only apparent remedy for the terminable interest rule is to make the nonemployee spouse's interest in retirement benefits devisable and descendable. This would require either that the decedent's estate be kept open to receive benefits when paid, or that as part of the court's decree the future benefits are distributed to creditors, heirs, and devisees in some manner that will be workable. Whether the pension plan or the employee spouse should be joined in such a proceeding is problematical.

Assuming the court reserves jurisdiction and the employee spouse, nonemployee spouse, and pension plan all survive the vicissitudes of life until the time the benefits mature, the question then arises of when the nonemployee spouse is entitled to payment. In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981), involved reservation of jurisdiction where the employee spouse became eligible to retire in his early 50's but intended to continue working for some time to come; the nonemployee spouse sought payment of her share immediately upon maturity of the employee spouse's interest. The court held that the nonemployee spouse was entitled to be paid, since the benefits were both vested and matured. The employee spouse "will not forfeit his benefits if he leaves his employment voluntarily, is terminated or retires. The only condition precedent to payment of the benefits is his retirement, a condition totally within his control. A unilateral choice to postpose retirement cannot be manipulated so as to impair a spouse's interest in those retirement benefits." 29 Cal.3d at 423. In other words, reservation of jurisdiction under existing law can be made only until the time of maturity; thereafter there must be a division of the asset. To the employee spouse's objection that he was being forced to retire, the court disingenuously replied that he is free to continue working; he simply must either pay for the nonemployee spouse's share of the benefits at their present value, or pay her a share on an installment basis. In essence, the court reserves jurisdiction until the benefits mature, then applies the present disposition method, which should be easier to apply because many of the contingencies that make valuation a problem have been removed. However, not all the contingencies have been removed, so all the problems of the present disposition method are still present. As Judge Harvey has written to the Commission, "If the husband pays his wife for her share of the retirement benefits, and then dies before retiring, it is obvious that only the wife may be compensated for much of the retirement benefits. By converting a conditional right--conditional on retirement, which was in the control of the employee-spouse--into an unconditional, presently payable right, the Supreme Court has managed to conceive of a scheme where, in many cases, only the nonemployee-spouse will be fully compensated for the value of the retirement benefits. Simultaneously, the Supreme Court has converted payments intended for subsistence during nonproductive years into an immediately payable sum during the parties' productive years so far as the nonemployee spouse is concerned."

Legislation could provide that where the court reserves jurisdiction, the retirement benefits are not to be paid to the nonemployee spouse until actually paid out by the pension fund. This would further simplify the computation problem and eliminate any burden on the employee spouse. However, is it fair to the nonemployee spouse for the employee spouse to have full control over the timing of retirement benefits? The Supreme Court says no, pointing out that both the timing of receipt and the control of an asset are important aspects of its value; postponement of benefits late in life may completely defeat the nonemployee spouse's interest; the employee spouse's decision to wait to receive the pension until it will be most profitable and convenient to him deprives the nonemployee spouse of her rights; her financial situation may involve factors significantly different from his; and support is not an adequate interim remedy for the nonemployee spouse, who should not be dependent on the discretion of the court to provide her the equivalent of what should be hers as a matter of absolute right. Others would say it is fair to make the nonemployee spouse wait: if the parties remain married, all the nonemployee spouse could expect to receive until actual retirement would be support as a spouse; a retirement allowance would not be received until the employee spouse actually decided to, and did, retire; for retirement is intended to, and does, simply provide support during the years following active employment.

This discussion illustrates one other serious problem with the reservation of jurisdiction approach to the division of retirement benefits--the amount of the nonemployee spouse's share remains within the control of the employee spouse, who by exercising various options can generate results to his or her own advantage and to the disadvantage of the nonemployee spouse. The courts have had to artificially manipulate the system to assure that the nonemployee spouse is not improperly denied any rights. In re Marriage of Stenquist, 21 Cal.3d 799, 582 P.2d 96, 148 Cal. Rptr. 9 (1978), for example involved exercise of an option by the employee spouse to take "disability pay" at 75% of basic pay rather than "retirement pay" at 65% of basic pay, for obvious reasons. But disability pay is separate property, not subject to division, whereas retirement pay is community property, subject to division. The court held that one spouse cannot, by involving a condition wholly within his control, defeat the community interest of the other spouse. Of the disability pay, only the portion above the amount that would be retirement pay is separate; the remainder is presumed to be community property subject to division.

Similarly, the joint and survivor annuity option mandated by ERISA can substantially lower the employee spouse's benefits (and in turn the benefits of the nonemployee spouse) in favor of the employee spouse's new spouse who survives. The courts have had to intervene here also to preclude the employee spouse from electing the joint and survivor annuity option. _In re_ Marriage of Lionberger, 97 Cal. App.3d 56, 158 Cal. Rptr. 535 (1979).

One approach to solving the joint and survivor annuity problem is to reexamine another facet of the "terminable interest" rule--that the interest of the nonemployee spouse is limited to retirement benefits payable to the employee spouse, and does not extend to death benefits payable to the employee spouses's beneficiaries or other third parties. In _Benson v. City of Los Angeles_, 60 Cal.2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963), the employee spouse earned pension rights during the first marriage but after retirement had remarried and was still remarried at the time of death. Both the first and second spouse sought a widow's pension payable by the retirement system, earned during the first marriage. The court ruled that under the terms of the pension contract the first wife was not a "widow" and the second wife was, and thus the second wife, not the first, was entitled to the widow's pension even though earned during the first marriage. This ruling has been roundly criticized, and it has been suggested that the law should make clear that the share of the nonemployee spouse in the retirement benefits payable to the employee spouse should extend to death benefits payable to third parties under the employee benefit pension plan. Such an approach would be theoretically sound where the death benefits were earned during marriage and thus may properly be considered community property subject to division. This change in the law perhaps should be incorporated in legislation implementing a reservation of jurisdiction scheme, if the scheme is to make sense and operate fairly.

To summarize, the reservation of jurisdiction approach to division of employee pension benefit plans avoids some of the worst features of present disposition--speculative valuation testimony, unequal sharing of risks, adverse tax consequences. However, there are many problems associated with the reservation of jurisdiction, including practical problems for the nonemployee spouse in obtaining payment in the future, vicissitudes during the interim that could defeat the interest of the nonemployee spouse, and problems concerning the timing and choice of options by which the employee spouse could take unfair advantage over the nonemployee spouse. It appears that these problems could be redressed to some extent by legislation, but many of them seem endemic to the basic system of reservation of jurisdiction.

STAFF PROPOSAL

As with all the problems the Commission attacks, there are no easy solutions for division of employee benefit pension plans; if there were, the problem would already have been solved and the Commission would not be working on it. Mindful of the advantages and disadvantages of both the present disposition and the reserved jurisdiction approaches, the staff concludes that on balance the reserved jurisdiction approach is basically simpler and fairer to the parties, and should be preferred. This is consistent with the recommendation of the Commission's consultants and with the Commission's basic feeling at the November 1983 meeting after reviewing Judge Harvey's observations.

The staff has prepared the draft attached as Exhibit 1 that attempts to resolve as well as possible the policy considerations involved in the reservation of jurisdiction approach. We note these matters here so that you will be alerted to them as you review the draft.

Civil Code § 4363.3 (repealed). "Employee pension benefit plan" defined

The definition of "employee pension benefit plan" currently is found among the procedural provisions for joinder of plans in dissolution proceedings. The term is a little awkward, but because it is already established and used in the Family Law Act we have preserved it in this draft, but have moved it to Section 5110.450 where it will be among the other provisions governing characterization of marital property.

Civil Code § 4800.4 (added). Division of employee pension benefit plan

Subdivision (a). The staff draft adopts a variation of the reservation of jurisdiction approach to dividing employee pension benefit plans at dissolution of marriage. The basic reservation of jurisdiction approach appears sound in that it removes from the employee spouse the risk of giving up other community assets in exchange for an asset that may never be realized due to circumstances within or beyond the control of the employee spouse; and of course, it makes the valuation process more certain and less speculative.

Under the variation proposed by the staff, the court would not actually reserve jurisdiction but would make an immediate division at dissolution by establishing a formula to be applied when payments are made. The court order would bind the pension plan if joined as a party, and if not, would be enforceable against the employee spouse. The virtues of this scheme are that it will be unnecessary for the parties to rehire attorneys and reopen proceedings at some time in the future. It also makes it easier for the nonemployee spouse to obtain his or her share of the benefits without having to somehow monitor the pension plan to find out when payments are being made.

The staff draft does not distinguish between defined contribution and defined benefit plans in this respect. Even a defined contribution plan may be subject to termination, bankruptcy, etc. The general rule is that both spouses share all risks and all benefits.

Nor does the staff draft distinguish between matured and unmatured, and vested and unvested, plans. In this regard it overrules In re Marriage of Gillmore on policy grounds--even though the employee spouse has the right to receive benefits, the employee spouse should not be forced to retire as a practical matter or be impoverished. The parties should share the benefits as received.

This approach leaves open the possibility that the employee spouse will purposefully delay taking retirement benefits in order to harm the nonemployee spouse. Or, more innocently, that the employee spouse simply has no need for the benefits at present and has more to gain by waiting, even though the nonemployee spouse is in desperate need of his or her share.

Support, of course, is the remedy designed to cure this situation; however, support is often inadequate. And, as the Supreme Court has reiterated, the nonemployee spouse should not be dependent on the discretion of the court to provide the equivalent of what should belong to the spouse as a matter of right. Another possibility, suggested by Professor Bruch, is to have the pension plan set up separate accounts for the spouses, so that each can control his or her own share. Although this solution is very attractive, the staff believes that as a political matter it would be futile to try to impose such a scheme on the pension plans. The only practical solution the staff can see is to give the court discretion, in an appropriate case, to order a division of the benefits before payment is actually made. This, of course, detracts from the basic purpose of the recommendation. It should also be recognized that the nonemployee's share of benefits before actual retirement is not likely to be more adequate than support, and requiring the employee spouse to make those payments rather than support means that the payments will not be deductible for income tax purposes by the employee spouse. What is the Commission's preference?

Subdivision (b). One branch of the terminable interest rule, that the nonemployee spouse loses his or her interest upon his or her own death (Waite v. Waite), is overruled by subdivision (b), which makes the interest of the nonemployee spouse subject to testamentary disposition.

The staff believes this may cause practical problems, however. Suppose the nonemployee spouse dies before benefits are paid out, leaving two surviving children and a predeceased child who in turn had two surviving children. If the nonemployee spouse dies intestate, the interest will be owned 1/3, 1/3, 1/6, 1/6. Is the employee pension benefit plan supposed to make individual payments to these persons, or can it simply pay to the estate? If so, must the estate remain open? Can the pension plan be required to pay unless it has been joined as a party in the probate proceeding? Suppose there is no probate proceeding; must the survivors obtain a declaration of heirship; if so, are existing procedures adequate? Similar questions can be asked for devisees, particularly residuary devisees, if the nonemployee spouse dies testate. The staff does not know the answers to these questions--perhaps our probate experts can advise us. We simply note our concern, and would add that there seems to be some logic in the Waite v. Waite concept that, "The state's concern, then, lies in provision for the subsistence of the employee and his spouse, not in the extension of benefits to such persons or organizations the spouse may select as objects of her bounty. Once the spouse dies, of course, her need for subsistence ends, and the state's interest in her sustenance reaches a coincident completion. When this termination occurs, the state's concern narrows to the sustenance of the retired employee; its pension payments must necessarily be directed to that sole objective." 6 Cal.3d at 473.

Civil Code § 5106 (amended). Payment pursuant to employee benefit plan

Civil Code Section 5106 contains protections for a pension plan that makes payments to the employee according to the terms of the plan unless the plan has received notice that another person claims an interest in the payments. The staff draft makes technical amendments in this section to conform to the terminology of defined "employee pension benefit plans."

Civil Code § 5110.450 (added). Employee pension benefit plans

Subdivision (a). The definition of "employee pension benefit plan" is taken from Section 4363.3, with a couple of minor additions taken from Section 5106. The critical feature of the definition is that the draft excludes self-employed retirement plans and individual retirement accounts. The reason for this exclusion is that these types of retirement plans are really more like savings accounts for retirement purposes, and are within the control of the spouses, not the control of a third person. For this reason, the staff believes they should be treated like any other community property at dissolution of marriage, and not wait until withdrawals or payments are made. At dissolution the court would have discretion to award the whole account to one party, to divide the account immediately, or to reserve jurisdiction for a later division, depending on such matters as tax and interest penalties and other factors.

Subdivision (b). Subdivision (b) adopts the "time rule" as the measure of the community's interest in an employee pension benefit plan--the proportion of time employed during marriage out of total time employed. This rule applies to both defined benefit plans and defined contribution plans, even though the exact amounts contributed under a defined contribution plan can be determined. The reasons for this choice are that it is simpler to have a single rule applicable to all pension benefit plans (particularly since some plans are hybrids are not easily classified as defined benefit or defined contribution) and that it is fairer in that it averages out changes in contributions due to inflation and salary increases due to advancement over the course of employment, and does not attribute to the community either too low an interest (because the marriage occurred early) or too high an interest (because the marriage occurred late). The Executive Committee of the Los Angeles County Bar Association Probate and Trust Law Section has written to us that, "In general, with regard to both defined contribution and defined benefit plans, proration on the basis of time produces a fair result. Now might be an appropriate time to codify that scheme so as to promote uniformity in application." (10/31/83).

Subdivision (b) also overrules the branch of the terminable interest rule that holds that the nonemployee spouse is not entitled to benefits paid out after the death of the employee spouse (Benson v. City of Los Angeles). Subdivision (b) gives the community an interest in all benefits paid on account of the employee spouse, including death benefits. The Commission should decide whether this is a desirable change in the law.

Transitional Provision

Because of the confusion caused in attempting to apply new rules to pending proceedings, the staff draft provides that the new rules do not apply to dissolution proceedings commenced before the operative date, even though jurisdiction may have been reserved. Our feeling is that the parties may well have worked out their property settlement on the basis of the old law, and that should continue to govern.

Likewise, the new rules would not apply in the case of a married person who dies before the operative date. Wills may have been made, and options selected, on the basis of the old law, and peoples' reasonable reliance should not be disturbed.

After the Commission has made the necessary policy decisions on this matter, the staff will prepare a complete tentative recommendation draft in anticipation of its distribution to our family law and probate law mailing lists for comment.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

Staff Draft

PROPOSED LEGISLATION

An act to amend Section 5106 of, to add Sections 4800.4 and 5110.450 to, and to repeal Section 4363.3 of, the Civil Code, relating to employee pension benefit plans.

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

404/135

Civil Code § 4363.3 (repealed). "Employee pension benefit plan" defined

SECTION 1. Section 4363.3 of the Civil Code is repealed.

~~4363.3. As used in this part, the term "employee pension benefit plan" includes public and private retirement, pension, profit sharing, stock bonus, thrift and similar plans of deferred compensation, whether of the defined contribution or defined benefit type.~~

Comment. Former Section 4363.3 is continued in subdivision (a) of Section 5110.450 (employee pension benefit plans).

404/087

Civil Code § 4800.4 (added). Division of employee pension benefit plan

SEC. 2. Section 4800.4 is added to the Civil Code, to read:

4800.4. (a) Except upon the written agreement of the parties, or on oral stipulation of the parties in open court, in a division of an employee pension benefit plan of a party upon dissolution of marriage or legal separation, the court shall order that the interest of the community in the plan be divided equally between the parties as payments or refunds are actually made pursuant to the plan.

(b) The interest of the nonemployee spouse in an employee pension benefit plan of a party is subject to testamentary and nontestamentary disposition, and absent such disposition passes by intestate succession, in the same manner and to the same extent as other property of the nonemployee spouse.

Comment. Subdivision (a) of Section 4800.4 states the general rule that the court must make an immediate division of the community interest in an employee pension benefit plan by ordering payments under the plan divided when paid. The general rule is subject to a contrary agreement of the parties, for example to value the community interest in the plan as of the time of dissolution and award the interest to the employee spouse with offsetting community property of equal value to the nonemployee spouse, or to reserve jurisdiction to divide the property when payments under the plan are made.

Immediate division of the community by ordering future payments divided when made can be facilitated by joinder of the employee pension benefit plan pursuant to Sections 4363.1 and 4363.2. The order is also enforceable against the employee spouse pursuant to Section 4351.

Subdivision (a) overrules In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981), which held that the interest of the community in an employee pension benefit plan must be divided when the employee spouse's interest in the plan is vested and matured, whether or not payments pursuant to the plan are actually being made. Under this section the community does not receive its interest in the plan until payments are actually made. The interest of the community in an employee pension benefit plan is defined in Section 5110.450.

Subdivision (b) overrules Waite v. Waite, 6 Cal.3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972), and cases following it which held that the interest of the nonemployee spouse in an employee pension benefit plan terminates upon the death of the nonemployee spouse. Subdivision (b) makes clear that the nonemployee spouse may dispose of his or her share of the community retirement benefits by will or by nontestamentary disposition such as a beneficiary or pay on death designation. The heirs or devisees of the nonemployee spouse may protect their interests by service of an appropriate notice or order in probate on the employee pension benefit plan. See Section 5106 (payments pursuant to employee benefit plan).

404/083

Civil Code § 5106 (amended). Payments pursuant to employee benefit plan

SEC. 3. Section 5106 of the Civil Code is amended to read:

5106. ~~(a)~~ Notwithstanding ~~the provisions of Section 5105 and 5125, whenever~~ any other provision of this title:

(a) Whenever payment or refund is made to a participant or ~~his~~ the participant's beneficiary or estate pursuant to a written employee benefit plan governed by the Employee Retirement Income Security Act of 1974 (P.L. 93-406), as amended, ~~such~~ the payment or refund shall fully discharge the employer and any administrator, fiduciary or insurance company making ~~such~~ the payment or refund from all adverse claims thereto unless, before ~~such~~ the payment or refund is made, the administrator of ~~such~~ the plan has received at its principal place of business within this state, written notice by or on behalf of some other person that ~~such~~ the other person claims to be entitled to ~~such~~ the payment or refund or ~~some~~ part thereof. Nothing ~~contained~~ in this ~~section shall~~

~~affect~~ subdivision affects any claim or right to any such payment or refund or part thereof as between all persons other than the employer and the fiduciary or insurance company making ~~such~~ the payment or refund. The terms "participant", "beneficiary", "employee benefit plan", "employer", "fiduciary" and "administrator" ~~shall~~ have the same meaning as provided in Section 3 of the Employee Retirement Income Security Act of 1974 (P.L. 93-406), as amended.

(b) ~~Notwithstanding the provisions of Sections 5105 and 5125, whenever~~ Whenever payment or refund is made to an employee, former employee or ~~his~~ the beneficiary or estate of the employee or former employee pursuant to a written ~~retirement, death or other employee benefit plan or savings plan~~ employee pension benefit plan, other than a plan governed by the Employee Retirement Income Security Act of 1974 (P.L. 93-406), as amended, ~~such~~ the payment or refund shall fully discharge the employer and any trustee or insurance company making ~~such~~ the payment or refund from all adverse claims thereto unless, before ~~such~~ the payment or refund is made, the employer or former employer has received at its principal place of business within this state, written notice by or on behalf of some other person that ~~such~~ the other person claims to be entitled to ~~such~~ the payment or refund or ~~some~~ part thereof. Nothing ~~contained~~ in this ~~section shall affect~~ subdivision affects any claim or right to any such payment or refund or part thereof as between all persons other than the employer and the trustee or insurance company making ~~such~~ the payment or refund.

Comment. The amendments to Section 5106 are technical. The term "employee pension benefit plan" is defined in Section 5110.450.

404/082

Civil Code § 5110.450 (added)

SEC. 4. Article 4 (commencing with Section 5110.450) is added to Chapter 2 of Title 9 of Part 5 of Division 4 of the Civil Code, to read:

Article 4. Combined Community and Separate Property

§ 5110.450. Employee pension benefit plans

5110.450. (a) As used in this part, the term "employee pension benefit plan":

(1) Includes a public or private retirement, pension, death, profit sharing, stock bonus, thrift, savings, or similar plan of deferred

compensation, whether of the defined contribution or defined benefit type.

(2) Does not include a self-employed retirement plan or an individual retirement annuity or account.

(b) The interest of the community in an employee pension benefit plan of a married person is a proportionate amount of the payments or refunds made under the plan on account of the person. The proportionate interest of the community is the fraction of the time during marriage of the person's employment attributable to the plan out of the total time of the person's employment attributable to the plan. Payments and refunds made under an employee pension benefit plan include amounts paid by the Pension Benefit Guaranty Corporation or by a surety or otherwise as insurance, guarantee, or other security for the plan.

Comment. Subdivision (a) of Section 5110.450 defines the term "employee pension benefit plan" not only for the purpose of this section but for other places where the term is used in the Family Law Act. See, e.g., Sections 4351 (enforceability of judgment and orders), 4363 (joinder procedure), 4800.4 (division of employee pension benefit plan), 5106 (payments pursuant to employee benefit plan).

Paragraph (1) of subdivision (a) continues former Section 4363.3 ("employee pension benefit plan" defined), with the additon of references to death benefits and savings plans, formerly found in Section 5106 (payments pursuant to employee benefit plan).

Paragraph (2) of subdivision (a) is new. It is intended to exclude accounts created and controlled by the parties on their own behalf, such as Keogh Act plans and IRAs. The effect of this exclusion is that such plans and accounts are subject to division at dissolution in the same manner as other community and quasi-community property, although the parties may agree to divide such plans and accounts in the same manner as employee pension benefit plans. Compare Section 4800(a) (division of community and quasi-community property) with Section 4800.4 (division of employee pension benefit plan).

Subdivision (b) defines the community's share of retirement benefits. The definition applies for all purposes, including rights at death, and is not limited to division at dissolution of marriage.

Under the "time rule" adopted by subdivision (b), if a married person's employment that gives rise to the benefits occurs entirely during the marriage, all the benefits are community property. If the employment that gives rise to the benefits does not occur entirely during the marriage, a proportionate share of the benefits is community property based on the time under the plan during marriage and not on the contributions made to the plan during marriage. The time rule applies to defined contribution plans as well as defined benefit plans. See subdivision (a)(1). It should be noted that the time rule does not distinguish between the time the employee was domiciled in this state and the time the employee was domiciled outside the state, for the purpose of identifying "quasi-community property." All efforts during marriage are deemed to contribute to the community interest in retirement benefits.

Subdivision (b) also makes clear that the community interest in an employee pension benefit plan extends only to payments and refunds actually made under the plan to the employee or the employee's beneficiary or estate. The community interest does not include contingent benefits that are never actually paid under the terms of the plan. However, if substitute payments are made on behalf of the plan by the Pension Benefit Guaranty Corporation or another entity acting as guarantor for the plan, the community's interest includes a proportionate share of the payments actually made.

Under subdivision (b), the community interest in an employee pension benefit plan is not limited to retirement benefits, but includes death and survivor benefits as well, together with any other payments made under the plan. This overrules Benson v. City of Los Angeles, 60 Cal.2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963), and cases following it which held that the interest of the nonemployee spouse in an employee pension benefit plan terminates upon the death of the employee spouse.

368/263

Transitional provision

SEC. 5. This act applies to all employee pension benefit plans in existence on January 1, 1986, and thereafter created, except in the following cases:

(a) Division of an employee pension benefit plan on or after January 1, 1986, pursuant to proceedings for dissolution of marriage or legal separation commenced before January 1, 1986, is governed by the applicable law in effect at the time of commencement of the proceedings.

(b) Disposition of an employee pension benefit plan on or after January 1, 1986, in proceedings on the death of married person who died before January 1, 1986, is governed by the applicable law in effect at the time of death.