#F-663 8/27/84

Memorandum 84-60

Subject: Study F-663 - Division of Pensions (Draft of Tentative Recommendation)

Background

The Commission in April commenced its study of problems involved in division of pensions at dissolution of marriage. After reviewing a staff study and letters from interested persons concerning basic policy issues, the Commission preliminarily concluded that the court should be permitted to exercise its discretion between the present disposition and reservation of jurisdiction approaches to division, depending on the particular case. The Commission also felt that if the court elects to reserve jurisdiction, the court should have further discretion to require division either when the pension is matured or when payments on the plan are actually made, thus overruling In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981) (interest of community in pension must be divided when plan is vested and matured, whether or not plan is yet in pay status). A staff draft of a tentative recommendation embodying these decisions is attached to this memorandum.

New Developments

Meanwhile, we have received a number of letters commenting on the basic issues and there has been a major new development in the law of which the Commission should be aware. The Retirement Equity Act of 1984 (H.R. 4280) includes special rules for assignment of pension rights under ERISA pursuant to court orders in dissolution, support, and other marital proceedings. The gist of the new law is to make clear that the anti-assignment provisions of ERISA do not apply to family law orders; moreover, the new law prescribes procedures to be followed by the plan administrator and the nonemployee spouse with respect to a court order. Under the new law, a court order may require payment directly to the nonemployee spouse. The new law specifically recognizes the right to require a Gillmore-type payment to a nonemployee spouse even though the pension plan is not yet in pay status as to the employee spouse. The new law prescribes rules for payment to the nonemployee spouse where the employee spouse dies before retirement. The new law requires the pension plan administrator to notify the nonemployee spouse when a court

order has been received, and requires payment of benefits into escrow during litigation between the spouses over their rights. The new law also provides rules for determining the tax treatment of benefits divided. The new rules are effective immediately.

The impact of the new law on California family law proceedings and practice is not yet clear. The staff has met with a group of Northern California lawyers who represent union pension plans to discuss issues involving drafting of legislation in this area. The preliminary sense of these lawyers is that the new federal law opens the door for additional complexity and confusion through case development and that general statutory guidelines would be helpful. However, some time and care should be taken in the development of the statutory guidelines.

Comments on Policy Issues

Since the Commission first commenced consideration of division of pensions we have received a number of further communications concerning policy issues. The communications are attached to this memorandum as Exhibits and are summarized below.

Present disposition v. reservation of jurisdiction. The Legislative Subcommittee of the Probate, Trust and Estate Planning Committee of the Beverly Hills Bar Association (Exhibit 1) believes the court should have discretion to select the appropriate method of division. This is consistent with the Commission's tentative conclusion. The Subcommittee also suggests a number of factors the court could consider in the exercise of its discretion; we have incorporated these in our draft. Comments from Murray Projector (Exhibit 4)--an actuary--and from Glen Hardie (Exhibit 6)--a lawyer--both of whom are active and have written in this field are also to the effect that court discretion is appropriate.

Overruling Gillmore. The Commission tentatively decided to overrule the rquirement of In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981), that the employee spouse must make payments on the pension to the nonemployee spouse when the pension is vested and matured, regardless whether the employee spouse has actually retired and even though the plan is not yet in pay status. Under our draft statute, the court would have discretion whether to require payments when the pension is vested and matured or when it is actually in pay status.

Dennis Cornell (Exhibit 3) has written to suggest an alternate solution to the Gillmore problem. "This solution is to include in the court's order, after a pension plan has been joined, that the pension plan pay the benefits directly to the non-employee spouse at that time when the employed spouse first becomes eligible to receive the benefits, whether or not the employed spouse has, in fact, retired. It is a simple, computerized calculation that can be made by the pension plans as to what the non-employee spouse would be entitled to receive had the employed spouse retired at the earliest possible time. When that time arrives, the non-employee spouse can receive her benefits directly from the pension plan. In this fashion, the employed spouse does not have his income impaired whatsoever and you have removed the unequalized burden. At the same time, the nonemployee spouse has received his or her full value." The staff believes this solution is sound, but politically it may be difficult to enact because of the burden on pension plans. Mr. Cornell's sense is that pension plan opposition may be overcome "by pointing out the fundamental fairness and practicality of the result. It may well be one of the few pieces of legislation that draws united support from both the employed and nonemployed spouses." The staff also notes that the new ERISA provisions specifically recognize this sort of approach. See 29 U.S.C. 1956(d)(3)(E).

Time rule. The staff has in the past proposed adoption of the "time rule" for computing the interest of the community in a pension plan. Under the time rule, the interest of the community in the pension payments is the proportion of the time the employee worked while married out of the total time the employee worked. The reason for this proposal is that it simplifies computations and is basically fair. The Commission took no action on this matter in its initial deliberations.

The Legislative Subcommittee of the Probate, Trust and Estate Planning Committee of the Beverly Hills Bar Association (Exhibit 1) agrees with the simplicity and administrative ease of this approach, but believes there should merely be a presumption favoring its use; the parties should be able to show actual contributions in some cases. DRC Associates (Exhibit 5)--an appraiser--believes the time rule would violate separate property principles and would be unfair to the employee spouse in many situations. Dick Johnson (Exhbit 6)--a pension lawyer--has dictated a memorandum in which he points out some possible pitfalls

in requiring division to be based upon a time rule. And Warren Saltzman (Exhibit 8)--also a pension lawyer-has provided a draft that seeks to deal with division on a more sophisticated basis by distinguishing among various types of pensions and applying a special rule tailored to each type.

Terminable interest rule. One aspect of existing pension law that has generated criticism is the case-law rule that the interest of the nonemployee spouse is terminated by the death of either spouse. The Commission declined to deal with this matter initially. The Executive Committee of the State Bar Family Law Section has written to request that the Commission reconsider this decision--"the terminable interest rule is highly unpopular, is unfair to the non-employed spouse, and [its repeal] is not terribly offensive to anyone." The Legislative Subcommittee of the Beverly Hills Bar Association Probate, Trust and Estate Planning Committee (Exhibit 1) was more equivocal about the terminable interest rule, seeing both advantages and disadvantages in it. Concerns were also expressed by Dick Johnson (Exhibit 7).

Conclusion

The comments we have received directed to matters dealt with in the draft tentative recommendation are generally consistent with the thrust of the tentative recommendation. The staff believes that what we have so far is basically sound and we should proceed to distribute it more widely for comment. In this connection, the staff also recommends that we draft the Gillmore solution proposed by Mr. Cornell--splitting payments between employee and nonemployee spouse in a vested and matured pension plan on demand by each--and seek comments on this solution. This may give us a preliminary reading on the politics of the proposed solution.

The impact of the new ERISA legislation, and the comments on the related pension policy issues, require further consideration. We could review and deal with these matters over the coming year, with the view to having a comprehensive recommendation on the subject for the 1986 legislative session. An alternative would be to seek development of uniform legislation on this subject, since many pension plans operate

nationally and are faced with a bewildering assortment of approaches to dividing the pension.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

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PLEASE REFER YOUR REPLY TO:

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April 26, 1984

Nathaniel Sterling
Assistant Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94306

Re: Memorandum 84-9, Study F-663
Division of Pensions

Dear Nat:

This letter sets forth the comments on the above study of the Legislative Subcommittee (the "Subcommittee") of the Probate, Trust and Estate Planning Committee of the Beverly Hills Bar Association. Please note that the comments set forth in this letter only reflect the views of the Subcommittee.

1. Reservation of Jurisdiction (New Civil Code Section 4800.4)

The Subcommittee is in agreement with the view that given the appropriate circumstances, a court should reserve jurisdiction with respect to the division of pensions incident to a divorce or legal separation until payments are actually made. The reservation of jurisdiction approach is particularly appropriate where pension benefits comprise the most

significant asset of the community and the employee is relatively young and has no intention to retire in the immediate future. As pointed out by the Commission's study, under current law, an employee whose interest has matured but who does not expect to retire is presently required to transfer other assets to the nonemployee spouse in exchange for the interest of the nonemployee spouse in the plan. Such a transfer may have adverse tax consequences to both spouses. In addition to the potentially adverse tax ramifications of such a transfer, the present disposition approach also seemingly ignores the expectation of the parties. Had they remained married, the nonemployee spouse would not have received retirement benefits until the actual retirement of the employee spouse.

On the other hand, under certain circumstances the reservation of jurisdiction approach may not be appropriate where it would enable the employee spouse to defeat the interest of the nonemployee spouse in the retirement plan. This could occur where the employee spouse is in a position to control investments and/or distributions of retirement plans.

The Subcommittee agrees that there may be situations where the reservation of jurisdiction approach may therefore not be appropriate. We question, however, whether HR-10 plans and/or IRAs should be excluded from the reservation of jurisdiction approach on the basis that such 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." Under certain circumstances, such retirement vehicles are less flexible and less subject to the control of the spouses than conventional retirement plans. To illustrate, an individual is not permitted to pledge an individual retirement account as security for a loan without adverse income tax consequences. I.R.C. §§ 408(e)(4) and 4975. Loans made by HR-10 plans to owner-employees are subject to a member of adverse tax consequences, including excise taxes and the possible loss of tax-exempt status. I.R.C. §§ 4975(d) and 401(a)(13). By contrast, subject to certain limitations, loans may be made by retirement plans, other than HR-10 plans, without adverse tax consequences to the employee spouse. See I.R.C. §§ 72 and 4975(d)(1). Distributions from an IRA before an individual attains age 59½ are generally subject to an

additional tax equal to 10% of the amount of the distribution. I.R.C. § 408(f). In other words, IRAs and HR-10 plans may be subject to greater controls and less flexibility, at least insofar as plan distributions and loans are concerned, than conventional retirement plans. For this reason, we would not automatically exclude HR-10 plans and IRA's from the reservation of jurisdiction approach. Rather, a court should be given discretion to determine whether or not to adopt the reservation of jurisdiction approach. This discretion would extend to conventional plans, as well as HR-10 plans and IRAs. In exercising its discretion, a court would take into account a number of factors, including the age of the parties, the extent of and basis of other property of the spouses and any potentially adverse or unfair tax consequences which may result from the present disposition approach. In addition, a court would consider the degree of control possessed by the employee spouse and/or related persons over the retirement plan.

2. Disposition of nonemployee spouse's interest upon the death of the nonemployee spouse.

The recommendation in the commission study which generated the greatest controversy among Subcommittee members was the proposed amendment to Civil Code § 4800.4(b). This change would enable the nonemployee spouse to dispose of his or her interest in the plan at death. We were unable to agree on whether or not this is a desirable change. Subcommittee members opposing the change stated that retirement plans are intended to provide benefits for spouses during their nonproductive years. Therefore, it would be inconsistent with this basic design for the nonemployee spouse to be able to leave his or her interest in the plan to his or her heirs. On the other hand, those Subcommittee members favoring the change agreed with the argument that denying the nonemployee spouse the right to dispose of his or her interest at death may require a court to compensate the nonemployee spouse for the probability that he or she may predecease the employee spouse and award the nonemployee spouse more than half of the retirement benefits to compensate him or her for the contingency that he or she may predecease the employee spouse. Those Subcommittee members favoring the proposal also pointed out that retirement plans should be treated like any other form of community property. To illustrate, each spouse is entitled

to one-half of community funds in a savings account whether or not such funds were intended by the spouses to provide for their retirement.

3. The "Time Rule"

The "time rule" to measure the community's interest in the plan was also the subject of some controversy among Subcommittee members. Our thinking is that proration on the basis of time has the basic advantage of simplicity and ease of administration. There should therefore be a presumption that the interest of the community in the retirement plan should be computed pursuant to the time rule. This presumption should be rebuttable, however, by either spouse on the basis of contributions to and earnings of the retirement plan before, during and after marriage.

Please feel free to call to discuss any questions or comments you may have concerning this letter.

Sincerely,

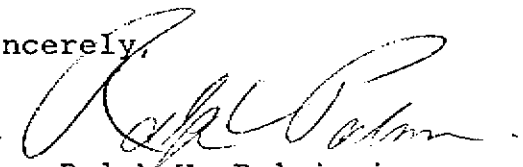
By 
Ralph V. Palmieri

EXHIBIT 2

FAMILY LAW SECTION
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May 9, 1984

Nathaniel Sterling, Esq.
California Law Revision Commission
4000 Middlefield Road
Room D-2
Palo Alto, California 94306

Dear Nat:

At the Executive Committee meeting of April 28, 1984, Pam Pierson reported that the Commission had decided to leave the terminable interest rule intact.

The report caused some puzzlement among the Committee members and the consensus of the Committee was that we should ask the Commission to reconsider its position since the terminable interest rule is highly unpopular, is unfair to the non-employed spouse, and is not terribly offensive to anyone.

This letter is that request.

Thank you for considering our position.

Sincerely,

JAN C. GABRIELSON

JCG/nm

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May 23, 1984

Mr. Nathaniel Sterling
Assistant Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Room D-2
Palo Alto, CA 94306

Dear Mr. Sterling:

I am writing concerning Memorandum 84-9, dated December 14, 1983, which you wrote concerning division of pensions in dissolution actions. Even though I was on your mailing list, I did not receive a copy of this memorandum and first learned of it when I read the memorandum in Community Property Journal, Volume 11, No. 1.

I am very active in pension matters and I have been active in some of the cases that you have reviewed and were reviewed by your staff when preparing the memorandum. Accordingly, I have some very definite feelings in how to resolve some of the major problems that you raise in your memorandum.

At the outset, I personally feel that there should be two basic concepts which must be acknowledged when dealing with pensions. One is that the parties should share the risk and the benefits equally. You have expressed that very eloquently in your memorandum. The other is that the non-employee spouse should be placed in the same position as the employee spouse, no better, no worse. It is the latter proposition that most scholars and writers on the subject have trouble dealing with. The court that dealt with it best was the Court of Appeal in its opinion in the case of In Re the Marriage of Luciano. Simply stated, the proposition is that the non-employee spouse should get the retirement benefits that he or she would have been entitled to had the employee spouse retired on time. The non-employee spouse would be in no better position, but no worse.

In your memorandum you comment that this places an unfair burden on the employee spouse by forcing him to retire. However, you also point out in another passage that rarely would the retirement benefits be any greater burden than a spousal support obligation. For that reason, there certainly wouldn't be any threat of

forcing early retirement on an employee spouse. You also make the comment that the payments, if it were retirement, would be non-deductible to the employee spouse. I disagree.

However, I have a solution to the problem which I think addresses your concerns of providing full value to the non-employee spouse, and control to the non-employee spouse, while at the same time making sure that both parties share the risk. This solution is to include in the court's order, after a pension plan has been joined, that the pension plan pay the benefits directly to the non-employee spouse at that time when the employed spouse first becomes eligible to receive the benefits, whether or not the employed spouse has, in fact, retired. It is a simple, computerized calculation that can be made by the pension plans as to what the non-employee spouse would be entitled to receive had the employed spouse retired at the earliest possible time. When that time arrives, the non-employee spouse can receive her benefits directly from the pension plan. In this fashion, the employed spouse does not have his income impaired whatsoever and you have removed the unequalized burden. At the same time, the non-employee spouse has received his or her full value. This proposal, of course, only works on those plans that can be joined in a dissolution action. Those pension plans that cannot be joined as a result of pre-emption through sovereign immunity, generally military and civil service pensions, would have to be dealt with differently. In such a case, I feel that the continuation of the Luciano-Gillmore doctrine is appropriate when weighed against the loss of value to the non-employee spouse by pursuing alternative proposals. The exceptions will be small in number compared to the plans that can be joined and would be bound by my suggested approach. In your memorandum, you referred to the pension plans being required to set up two separate plans for the spouses. My suggestion might result, practically, in that being done, but it is certainly not requiring that result.

None of the pension plans that have been joined in my cases which contain such an order have contested the order. However, I must honestly tell you that none of the pension plans have paid benefits under the order as the employee spouses have yet to attain minimum retirement age.

I hope these comments are reviewed and are not too late to provide input into the decision you will be making concerning proposed legislation. I expect that my proposal, if adopted, would run into serious opposition from the pension plans but nothing that

cannot be overcome by pointing out the fundamental fairness and practicality of the result. It may well be one of the few pieces of legislation that draws united support from both the employed and the non-employed spouses. Thank you for the opportunity to comment.

Very truly yours,

ALLEN, CORNELL & MASON

By Dennis A. Cornell
DENNIS A. CORNELL

DAC/rmr

EXHIBIT 4

MURRAY PROJECTOR, F.S.A.
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June 8, 1984

Mr. Nathaniel Sterling
Assistant Executive Director
California Law Revision Commission
4000 Middlefield Road
Palo Alto, California 94306

Re: "Division of Pensions: Reserved Jurisdiction Approach Preferred"
Community Property Journal Winter 1984

Dear Mr. Sterling:

My experience and analysis are in conflict with the conclusion in your staff memorandum that "on balance, the reserved jurisdiction approach is basically simpler and fairer to the parties, and should be preferred." The following comments on portions of your memorandum are in support of my contrary conclusion that if there is to be a preferred approach, then it should be the present disposition (present value) approach.

Comment Number	Memorandum Page	Memorandum Text and My Comment
1	19	"Payments under a matured plan are actuarially adjusted," etc. Note that the adjustments are not always on an actuarial basis. Often the payments are not adjusted at all, or are adjusted on a basis that is more favorable to the employee than is the actuarial adjustment
2	20-21	"In the reservation of jurisdiction approach, the parties agree (or the court compels them) to wait until retirement . . ." This should read "wait until retirement or retirement eligibility." (See your discussion of Gillmore on page 26.)

Comment Number	Memorandum Page	Memorandum Text and My Comment
3	21	"The appraiser must estimate the employee's salary at retirement, age and length of service at retirement, and other variables that affect the benefits." This explanation is in conflict with usual appraisal procedure which is based on accrued community pension benefits. Hence, we use current salaries and length of service during the community's existence, and not salary and length of service at retirement.
4	22 (footnote)	Any memorandum that cites Projector, Valuation of Retirement Benefits in Marriage Dissolutions, 50 L.A. Bar Bull. 229 (1975) can't be all bad.
5	22	". . . , 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 actuarially 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." The numbers in the above quotation come from my article (comment 4), but the conclusion that "the actuarial valuation process necessarily yields an incorrect valuation in every case" is yours alone, and is in direct conflict with my intention and conclusion.

Comment Number	Memorandum Page	Memorandum Text and My Comment
5 (continued)	22	Note that my article, after presenting the numbers you quoted, then goes on to explain that the actuarial present value is the fair value, and that the "unfairness" you see in the example is "illusory." I do not fault you for drawing your own conclusion from an example designed to explain how an an actuarial present value is calculated. But it disturbs me that you do not mention the several paragraphs devoted to rebutting the interpretation that you draw from my example. Note that your misinterpretation is not uncommon. The fact that the article explains away the apparent inequity that you see in it demonstrates that such misinterpretation is common and expected. However, the explaining away usually takes more exposition to be successful than was available in the 1975 article, which article covered many other subjects. For a better exposition please read the attached article, entitled "A Fair Value is a Fair Value," from the Summer 1979 issue of the Los Angeles County Bar Association's Family Law News and Review. It is unfortunate that this later article was not available to you and the Commission before reaching your conclusions. Rather than my repeating what it says, please read it carefully, all of it. The arguments you use against present disposition are addressed in this attachment.
6	22	". . . the total time employed while married . . . is not yet known." For pension valuation purposes the total time employed while married is defined as employment time between marriage and separation, and this time is always known before trial.

Comment Number	Memorandum Page	Memorandum Text and My Comment
7	23	"The employee spouse may be impoverished by the loss of all cummunity assets in retirement benefits . . ." Trial courts use the present disposition method only if there are sufficient other assets and income to justify its use. If a court ever did "impoverish" an employed spouse by present disposition of a pension, then it is that court which should be criticized rather than the method itself.
8	23	"an inherently conservative valuation process." It is difficult to prove whether our usual valuation process is inherently conservative, inherently liberal, or inherently fair. Opposing counsel often (usually) asserts that the process is inherently conservative or inherently liberal, but my colleagues and I deny both extreme views.
9	23	"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.' [13] Hardie, Pay Now or Later: Alternatives in the Disposition of Retirement Benefits on Divorce 53 Cal. St. Bar J. 106, 110 (1978)" The nine words quoted from L. Glenn Hardie's article give a distorted picture of Hardie's views on the so-called speculative nature of an actuarial present value calculation. The following paragraph from page 109 of his article gives a more complete and accurate presentation of his conclusions.

Comment Number	Memorandum Page	Memorandum Text and My Comment
		"Thus, the objection that the method is 'speculative' is true, but it is also a non sequitur. We use speculation in all phases of the law. We speculate about the extent and severity of pain and suffering, and its dollar value. We speculate about a person's life expectancy in wrongful death cases -- speculation based on statistics and probability -- and we speculate about what his earnings might have been. We speculate about goodwill, and we speculate about a wife's ability to support herself in the future. The speculation employed in a present value calculation of a future benefit is speculation only to the extent that we do not know what will happen to this employee in the future, but we do know what the probabilities are. These probabilities are taken into consideration by the actuary, and thus the final result makes sense to the actuary, to the annuity expert, and to the mathematician. Given its solid basis in logic, and in the insurance and pension planning profession, the present value calculation of a defined benefit plan is both legitimate and appropriate."
10	23	"necessarily incorrect valuations." The arguments leading to this conclusion are most unpersuasive to me, as shown, especially in comments 5 and 9.
11	28	"But disability pay is separate property, subject to division." This is no longer fully accurate. (See In re Marriage of Webb);979) 94 C.A. 3d 334. 156 CR 334, and In re Marriage of Samuels (1979) 96 C.A. 3d 122. 158 CR 38, and In reMarriage of Pace (1982) 132 C.A. 3d 548. 183 CR 314.)

Comment Number	Memorandum Page	Memorandum Text and My Comment
12	29	"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 non-employee spouse, and problems concerning the timing and choice of options by which the employee spouse could gain unfair advantage over the nonemployee spouse." Yes, very much yes. These problems are of greater magnitude than those associated with present disposition by actuarial present value. If there is to be a preferred approach, then it should be the present disposition (present value) approach.

Yours sincerely,

Murray

MURRAY PROJECTOR
MP:ef
Attachment: noted
CC: David L. Price, Esq.
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L. Glenn Hardie, Esq.
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A FAIR VALUE IS A FAIR VALUE

Murray Projector, F.S.A.

The disposition of a defined benefit pension in a marriage dissolution is a vexatious issue. The courts must generally choose between assigning the pension interest to the employee spouse, with offsetting community assets awarded to the non-employee spouse, or reserving jurisdiction and then ordering suitable payment in kind to each spouse when pension benefits become payable.

If there are insufficient other assets available for offsetting the defined benefit pension asset, then the choice is easy. But if there are sufficient other community assets, and the attorneys plead contrary dispositions, then the choice becomes more difficult.

The actuarial present value of the retirement benefit is usually available for determining the amount of other assets to be awarded the non-employee spouse in exchange for the employee spouse retaining all retirement rights. The question facing the court is then easy to state: Is it fairer to pay now or later? Is it fairer to buy-out now based on a single value in advance of realized contingencies, or to let said realized contingencies determine actual payments to each spouse?

Opposing counsel spend much time arguing the two alternatives. The court is allowed discretion in each case, as circumstances and judgment dictate. Much has been written about the advantages and disadvantages of each alternative.

Despite the extensive discussion of this question, it is apparent that the courts and attorneys do not always understand the nature of an actuarial present value appraisal or future pension payments. The pervasive lack of understanding is to be expected, because explanation has not been readily available.

It is not the *calculation* of the present value that is now of concern. It is the *meaning* of the value so calculated that needs exposure. It is difficult for courts and attorneys to arrive at the best solutions when there is disagreement on the meaning of the present value.

There is frequently an instinctive or "gut" feeling that reserved jurisdiction is "inherently" fairer, that the actuarial present value is a product of imagination unrelated to reality. These views are symptomatic of a need to explain what an actuarial present value is, and what it is not.

We will concentrate on that meaning, rather than on the mechanics of present value calculations. It is hoped that said values will then receive a more even-handed reception than is presently the case. The uneven current treatment is evident, with an appreciable number of exceptions, despite Supreme Court sanction of the use of actuarial present values.

I. Heads or Tails

Suppose the community owns a ticket to a special coin tossing to be held next week. One coin will be tossed. If it comes up heads, the ticket bearer receives $1,000. If it comes up tails, there is a zero payout. And suppose further that there is need to appraise this ticket as of now, in advance of next week's coin tossing.

Most people would agree on $500 as a fair price for the ticket. This price seems reasonable, even if the supposition is carried to hundreds of tickets for hundreds of coin tossings in hundreds of locations.

The next step is to suppose a review of actual outcomes one month later, after all these heads or tails happenings have taken place, and then to compare the fair price of $500 per ticket with actual events. How does the fair price of $500 compare with the effect of each toss on each ticket holder? In some cases the fair price is $500 more than the amount realized; in some cases it's $500 less.

In no case does the accepted appraised price prove equal to the actual value determined by subsequent events. Thus we have a fair price which is always "wrong," when rightness and wrongness are determined by future events.

At this point, some of those who originally agreed with the $500 appraisal become uneasy. A fair price that is always contradicted by future events is hard for many to accept. For others, this apparent conflict presents no difficulty. The latter group makes and maintains the distinction between a *fair value* and *predicted outcome*. The $500 is a fair price; it *is not* a prediction of future events.

The apparent paradox is not really a paradox. The alleged deficiency of a fair price that never matches future events is actually a defect in the choice of a criterion for fairness. When reviewing the fairness of the $500 ticket valuation, the subsequent outcome of head or tail is irrelevant. (What *is* relevant, of course, is that heads will come up about half the time when a large number of coins has been tossed.)

The analogy with actuarial present values of defined benefit pension plans is obvious. A fair value for an employee spouse's pension benefits is neither a prediction of value, nor of how long the employee will live. It is a fair value now, based upon known probabilities of future events. If present values are calculated properly, then future realized values will exceed fair values about half the time, and fall short the other half.

From the viewpoint of spouses, the relationship between later realizations and actuarial present values should be dissociated from what is equitable now. Later events, such as length of life, are chance events unrelated to need or merit. To measure the community interest at trial by the outcome of fortuitous events, as is done by reserving jurisdiction, is again using the wrong criterion for a fair value.

The present value approach determines the value of a community asset at time of trial. It is the value now of a ticket to a coin tossing, and the rightness of that value will not be better determined by waiting for events to unfold.

II. Death and Taxes

Estate tax regulations provide for charitable gifts which have the effect of reducing the decedent's estate tax. In some cases, the decedent has assigned a life estate interest to an individual, with a charity as remainderman. How large is the charitable gift in such a situation?

Tables are provided to determine the amount of the charitable gift for a remainder interest. Suppose, for example, a 60-year-old widow with a life estate in a $100,000 portfolio.

The prescribed tables show a 0.62226 life estate factor and a 0.36774 remainder interest. (These are actuarial present value factors for each $1.00 of assigned assets.) For $100,000 the remainder value (charitable deduction) is $100,000 times 0.36774, which is $36,774.

This $36,774 is the prescribed charitable deduction for the estate without consideration of the widow's *actual* longevity. Should she die soon after the decedent, then the $36,774 deduction was, in retrospect, "unfairly low"; the "right" deduction "should" have been closer to $100,000. If she lives to 110, then the $36,774 was, with the use of hindsight, "unfairly high"; and the "right" deduction "should" have been lower.

In principle, the regulations could have provided for keeping the estate open, and determining the fair tax when the life estate interest is terminated by the death of the widow. It is fortunate, however, that the estate tax regulations do not allow the reserved jurisdiction option, which would lead to unnecessary expense, delay, and litigation.

One could list many reasons why the immediate buy-out procedure is prescribed for charitable remainder tax situations, and in other tax situations involving life annuities or life estates. Whatever the reasons, it is worth noting that the prescribed use of actuarial present values is accepted by practitioners as being fair. There is no concern that values determined by later events do not match those resulting from the earlier required factors.

There is an understanding that the present value is the proper value, and that the fairness of the published remainder factors cannot be judged by later events.

III. More Than Tossing a Coin

It is obviously true that in arriving at an actuarial present value for a pension income, more is involved than merely calculating the probability of a coin coming up heads or tails. There are more contingencies to consider, and judgment is needed for quantifying these contingencies. The resulting present value is, nevertheless, similar in concept to the $500 ticket appraisal and the $36,774 charitable deduction.

Understanding actuarial present values leads to the following conclusions:

1. An actuarial present value is a fair value, without being a prediction of future realized value.

2. Dividing retirement payments as received means replacing fair actuarial present values with those determined by fortuitous and chance events, and which are only partially related to need, merit and fairness.

3. Assuming sufficient other assets, the courts should state their preference for immediate buy-out, which would then permit counsel to concentrate on issues more appropriate for adversary procedures.

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EXHIBIT 5

DRC ASSOCIATES, INC.

4966 EL CAMINO REAL, SUITE 121
LOS ALTOS, CA. 94022
(415) 969-2388

July 12, 1984

California Law Revision Commission
4000 Middlefield Road
Palo Alto, CA 94306

Re: Valuation of Pensions in Dissolution of Marriage

Dear Commission Members:

The proposed reserved jurisdiction method of dividing pensions (as described in Comm. Property Journal, Winter, 1984) directly conflicts with and fails to conform with Civil Code Sec. 5118 -- e.g., "earnings and accumulations of a spouse --- while living separate and apart from the other spouse, are the separate property of the spouse."

Based upon my personal experience in appraising over 250 various retirement plans in marital dissolutions, I conclude that if the proposed time-rule reserved jurisdiction were applied to all dissolutions, approximately 60 to 70% of such pensions divisions would result in a significant divesture of the employed spouse's separate property.

In order to understand, in financial terms, why and how this loss of the employed spouse's (ES) separate property would occur, one must first make a distinction among the 3 most common types of defined benefit pension plans, which are:

(1) Linear-accrual, no employee contributions
(2) Non-linear accrual, no employee contributions
(3) Non-linear accrual, employee contributions

(1) Linear accrual pensions accumulate or accrue retirement benefits in a linear "so-much-per year" manner. That is, each year of service is "worth" a constant amount per year's service. Obviously, then, a post-marital year contributes the same as does a marital year toward the ultimate pension that is paid. For these types of plans, the proposed time-rule reserved jurisdiction works fairly for both the employed spouse (ES) and the non-employed spouse (NES). These types of plans, however, are in a minority in today's world of ever-increasing employee benefits. Furthermore, their present actuarial value, and often even their eventual retirement values are not that great, usually resulting in relatively easy settlement at divorce.

(2) Non-linear accrual pensions, accumulate or accrue retirement benefits in a non-linear manner. Each year of post-marital service is worth an increasingly greater amount than any year of marital service because of the forces of:

(a) Inflation increasing the 3 or 5-year average wages at retirement time.

and

(b) Separate property (post-marital) merit pay raises increasing the average wages.

and

(c) Separate property (post-marital) service years are sometimes "worth more" than marital years, e.g., 2.0 to 2.4% per year for age 60-65 service vs. 1.4 to 2.0% per year for age 55-60 service.

For these types of plans, the proposed time-rule reserved jurisdiction usually always awards post-marital separate property of the ES to the NES, by giving the NES benefit of separate property pay increases and value per year amounts actually earned and accrued during post-marital years.

(3) Non-linear accrual pensions with employee contributions, have all of the same characteristics as in (2), and in addition, the ES contributes year-by-year 7 to 8% of his annual pay into the retirement plan. In this instance, obviously the grossest conflict with Sec. 5118 occurs, since not only are forces 2(a), (b), and (c) above working against the ES's interests, but also he is directly divesting post-marital earnings (at an increasing rate due to increasing wages) into accruing a retirement benefit that will be divided on an "every-year-is-equal" time rule!! Such divesture of the ES's separate property would be especially significant in state, and municipal retirement plans, as well as private plans which require or allow employee contributions.

Since, in my experience, 60 to 70% of pension plans are type (2) or (3) above, it is my opinion that, as described above, any time-rule reserved jurisdiction pension division would result in frequent and significant amounts of separate property transfer from the employed spouse to the non-employed spouse.

Please call upon me if you have any questions regarding pension valuation, or if I can further assist or support the efforts of the California Law Revision Commission.

Sincerely,

R. E. Hansen

Ronald E. Hansen, A.S.A.

Encl: Qualifications-R.E. Hansen

REH/ssc

EXHIBIT 6

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July 13, 1984

Nathaniel Sterling, Esq.
c/o California Law Revision
Commission
4000 Midfield Road
Palo Alto, CA 94306

Dear Mr. Sterling:

I read with great interest your recent article in the Community Property Journal. You correctly pointed out some of the troubling issues associated with both an in-kind division of pensions, and a reservation of jurisdiction for a later distribution of pension benefits.

What bothered me about your article was that its conclusion - that a reservation of jurisdiction should be preferred - does not follow from the argument. If anything, the fact that both dispositions have pros and cons supports the existing practice of giving trial courts discretion to use either method. Your recommendation, should it become law, would preclude trial courts and the parties from using their best judgment to fashion a fair disposition on a case by case basis. Why this discretion should be taken away is not at all evident from your article. If one form of disposition is so inherently more fair that all reasonable people agree, there would be little argument; but even your article points out that both forms of disposition have benefits and burdens which make neither one inherently more fair than the other.

In fact, a blind reliance on reserving jurisdiction is often unfair and creates ridiculous results. Suppose, for example, that a husband and wife are both school teachers and both in their late 30's. A's pension has been valued at $19,000 and B's at $17,500. Your proposal would have the parties wait 15 to 25 years before they could really completely sever their economic relationship. Since each of the parties will pay to and receive from the other, a roughly equivalent amount from their respect pensions, there is absolutely no real economic benefit to be gained by either party by waiting. By making an in-kind division now, the parties end their economic relationship, and they can get on with their lives. In this situation, there is no justification for a reservation of jurisdiction, yet your proposal would wipe out this perfectly reasonable approach, and it is a fact

situation which occurs with great frequency today.

On the other end of the spectrum, a highly compensated professional usually benefits by a reservation of jurisdiction, while his wife usually suffers. Dr. A's community often consists of a highly appreciated home, a medical practice, rarely worth the equity in the family home, a pension which he controls, and miscellaneous assets. Whatever the property disposition is by the court, Dr. A will walk away from this marriage with his high-earning power intact. Ms. A will undoubtedly need the home to raise the children in - but if the pension is not awarded to him, the wife may be put in the absurd position of owing him money to equalize the division of property; or worse, having to sell the home because she cannot come up with the money to equalize the payment (if one reserves jurisdiction, the $150,000.00 in Dr. A's pension account is now valued at zero). This result is not only absurd, but tragic. Yet your proposal would take away the court's power to fashion a realistic property division which would prevent this result. Professor Bruch's concern that wives not trade later security for present liquidity is a valid one, but should not wives be given the choice? Should they not have the ability to at least argue for what they perceive to be in their best interests, rather than have the Legislature decide what is best for them?

There are no easy solutions to this problem. Either disposition has its benefits and its burdens. You should recognize that no disposition is "better" and leave the parties and courts the freedom to chose between two admittedly imperfect choices. Some choice is better than no choice. Frankly, I think my client and I can do a better job of deciding what is best for her (or him) than can the Legislature. I urge you to not make the recommendation contained in your article, but leave the present situation as it is.

Very truly yours,

L. Glenn Hardie

LGH v

EXHIBIT 7

MEMORANDUM

TO: FILE

FROM: RCJ

DATE: May 10, 1984

RE: Division of Pensions in Divorces - Community Property Journal Vol. XI, No. 1

In our discussions with Nathaniel Sterling of the California Law Revision Commission, 4000 Middlefield Road, Palo Alto, CA 94306, I believe we should emphasize the Plan's interest in these matters.

A basic contention should be that it makes little difference to the Plan to whom it pays money but, in no event, should a Plan pay out amounts of money that it would not have paid had a divorce not occurred. I am particularly concerned about proposed Section 4800.4(b) which says the interest of the non-employee spouse is subject to testamentary and non-testamentary disposition. First of all, this seems to give the non-employee spouse more rights than the employee spouse has and may well violate the anti-alienation provisions of the Code. In addition, I think that a statement should be made about what happens in a situation where an employee dies before age 55 after the divorce has ordered a portion of the pension payable to the non-employee spouse. If the Plan would not pay any benefits to anyone in this situation,

then the non-employee spouse should not be entitled to receive anything. It does not seem to me that this is clear under the proposed legislation. It also seems to me unclear that the non-employee spouse's interest in the pension terminates on the death of the employee spouse, except to the extent that there are death benefits or survivors annuities payable.

I am also concerned that under Section 5106 that the Plan be protected from adverse claims unless, before the payment, the administrator has received written notice that some other person is claiming it. I am concerned of the administrator's ability to retain records of divorces especially in situations where they are joined as a party for 20 or 30 years before payments are made. I would like to see some protections written in here to protect the Plan, such as saying that the non-employee spouse must notify the Plan every five years or so of her rights to the pension when it is ready to be distributed and, also, giving the Plan the right to recover any overpayments to the employee spouse that should have gone to the non-employee spouse from later distributions to the employee spouse. This, of course, may create problems under the Internal Revenue Code.

The provisions of Section 5110.450 with respect to dividing benefit in proportion to the time during marriage of the person's employment seems completely contrary to the basic philosophy of the divorce laws, especially when applied

to define contribution plans. In small companies where the divorced person is completely in charge, it could lead to manipulation such as terminating the original plan and starting a completely new plan where the spouse would have no interest at all. In addition, with the advent of cafeteria-style programs, it could lead to employees selecting other benefits rather than retirement plans simply because of the divorce. It would seem to me that the fact of a prior divorce should have no effect on a person's subsequent selection of a type of benefit. Thus, I think, the rule should continue to be that benefits earned after the date of separation are the employee's separate property.

The employee should retain the right to choose type of distribution most favorable to him from a tax standpoint, i.e. [illegible] lump sum distribution. [illegible] [illegible] that if he wants (annuity)

EXHIBIT 8

DRAFT FOR CONSIDERATION WITH RESPECT TO PROPOSED DIVORCE LEGISLATION IN DETERMINING AMOUNT WHICH IS COMMUNITY PROPERTY

The community's share of any benefits payable from a pension plan (as defined in ERISA §3(2)(A)) shall be divided between the parties. The community's share shall be that portion of the benefits payable under the plan which are attributable to the marital period, excluding any addition thereto attributable solely to a post-separation disability. In determining what portion of the total benefits are "attributable to the marital period," all pension plans shall be classified as either "individual account plans" (as defined in ERISA §3(34)) or "defined benefit plans" (as defined in ERISA §3(35)) and the following rules shall be applied:

A) In the case of an individual account plan, the portion attributable to the marital period will be a fraction of the total benefit (including all earnings and reallocated forfeitures, if any), the numerator of the fraction being the amount of contributions made to the Plan on behalf of the employee based on employment during the marital period and the denominator being the total contributions made to the plan on behalf of the employee. All contributions allocable to a fiscal year of a plan will be deemed to accrue equally during each day of the period, regardless of when the contribution is actually made or the dates the employee's compensation is paid.

B) In the case of a defined benefit plan, the portion attributable to the marital period will be determined as follows:

(1) If the amount of benefit is based solely on contributions made to the plan in connection with the participant's

employment and not in whole or in part on the length of that employment, the computation shall be made in the same manner as for an individual account plan.

(2) If the amount of benefit is based solely on the participant's career compensation or final compensation and not in whole or in part on the length of employment, the community's share will be a fraction of the total benefit, the numerator of the fraction being number of years of employment during the martial period and the denominator being the total number of years of employment with employers maintaining the plan.

(3) If the amount of benefit is based on the length of the participant's employment, including without limitation, a plan in which specified benefits are earned for each year of service, the portion attributable to the marital period shall be determined under the following rules:

(a) For benefits attributable to periods of service after the Plan began (commonly referred to as future service) the marital portion shall be the amount of the benefit that would be paid by the Plan (other than for past service as provided below) determined as if the participant's benefit (as opposed to the participant's eligibility for a benefit) were calculated solely on employment during the marital period.

(b) Where a plan provides benefits attributable to period of service before the Plan began (commonly referred to as past service), the marital portion shall include such past service benefits if either the plan began prior to the marriage or the marriage was in effect at the time the participant first

worked under the plan. The marital portion shall not include such past service benefits if the participant first worked under the plan prior to the marital period.

(4) If in any one plan separate portions of a participant's benefit are calculated using different methods mentioned under paragraphs 1, 2 or 3 above (for example, if past service is determined under a method described in paragraph 3 while future service is determined under a method described in paragraph 1), then the marital portion of each separate portion will be calculated under the appropriate paragraph and the results combined to determine the total marital portion.

C) The method of calculation of the benefits for most plans should be described in paragraphs A and B. However, if the method of a plan's benefit calculation cannot be fairly categorized as provided in either paragraph A or B, the portion attributable to the marital period shall be determined consistently with the type of plan involved and the principles underlying the rules specified in paragraphs A or B, and if no other method results in a more equitable result, the provisions of paragraph B(3) shall be applied.

Staff Draft

TENTATIVE RECOMMENDATION

relating to

DIVISION OF EMPLOYEE PENSION BENEFIT PLANS

Under existing law there are two basic approaches to division of a community property interest in the pension plan of an employee at dissolution of marriage: the present disposition approach and the reservation of jurisdiction approach.[1] In the present disposition approach, a current valuation is made of the retirement benefits of the parties; these benefits are awarded to the employee spouse covered by the benefits, and the nonemployee spouse is awarded other community property assets of equivalent value. In the reservation of jurisdiction approach, the court reserves jurisdiction over the parties and pension plan 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 recongized in the case law and have been given judicial approval.[2] A trial court has broad discretion to select either method. In Phillipson v. Board of Administration,[3] the present disposition was declared the preferred method, but later cases such as Marriage of Skaden[4] appear to negate any preference. As a result, some judges prefer the present disposition system while others prefer reservation of jurisdiction. Some practitioners believe that present disposition still appears to be favored by existing law.[5]

1. See Hardie & Sutcliffe, Reserving Jurisdiction: A Potential Trap, California Lawyer 33 (July/August 1982).

2. In re Marriage of Brown, 15 Cal.3d 838, 544 P.2d 561, 126 Cal. Rptr. 633 (1976).

3. 3 Cal.3d 32, 89 Cal. Rptr. 61 (1970).

4. 19 Cal.3d 679, 139 Cal. Rptr. 566 (1977).

5. See letter to California Law Revision Commission from Family Law Section, State Bar of California, dated February 22, 1984 (copy on file in Commission office).

Neither of these approaches to division of pensions is free of practical or theoretical problems.[6] The approach that may be preferable under the circumstances of one case may not be preferable under the circumstances of another. Factors such as the age of the parties and time until retirement, whether there are other substantial amounts of community property that may offset the value of the pension plan, and the tax consequences of the different dispositions may dictate the appropriate manner of division in each case.

To the extent there is a bias in existing law for present disposition, the bias should be negated. The court should be free to exercise its discretion to select the manner of disposition most suited for the particular case.

Where the court reserves jurisdiction to divde the pension, existing law requires division at the time the pension is vested and matured, even if the plan is not yet in pay status.[7] In many cases this requirement will defeat the purposes of reservation of jurisdiction--to impose an equal sharing of risks on the employee and nonemployee spouses and to simplify the calculation of the community's interest in the pension plan. Where the court reserves jurisdiction, the court should have discretion as to the timing of the division, including the discretion to defer division until the plan is actually in pay status, so that it can devise the most appropriate resolution of each case.

The Commission's recommendations would be effectuated by enactment of the following maeasure:

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6. See Sterling, Division of Pensions: Reserved Jurisdiction Approach Preferred, 11 Community Property Journal 17 (1984).

7. In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981).

An act to add Section 4800.4 to the Civil Code, relating to marital property.

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

406/200

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

SECTION 1. Section 4800.4 is added to the Civil Code, to read:

4800.4. (a) Except upon written agreement of the parties, or on oral stiputation of the parties in open court, in a division of the interest of the community in an employee pension benefit plan of a party upon dissolution of marriage or legal separation, the court in its discretion may order an immediate division of the interest or may reserve jurisdiction to divide the interest either at the time the plan is vested and mature or at the time payments or refunds are actually made pursuant to the plan.

(b) In the exercise of its discretion pursuant to this section the court shall consider all matters relevant to the time of the division, including but not limited to the following:

(1) The age of the parties.

(2) The degree of control of the parties over the plan.

(3) The nature and extent of other property of the community.

(4) The tax consequences of the division.

Comment. Section 4800.4 makes clear that the court may select either the immediate division or the reservation of jurisdiction approach to division of an employee benefit pension plan, depending on the circumstances of the particular case. This is consistent with existing case law. The court's discretion is subject to an agreement of the parties as to the manner of division.

The authority of the court in Section 4800.4 to order the plan divided when payments are actually made under the plan overrules In re Marriage of Gillmore, 29 Cal.3d 418, 629 P.2d 1, 174 Cal. Rptr. 493 (1981) (interest of community in plan must be divided upon demand of nonemployee spouse when plan is vested and matured, whether or not plan is in pay status).

The term "employee pension benefit plan" is defined in Section 4363.3. For provisions on joinder of a plan, see Sections 4363.1 and 4363.2. On enforceability of an order against the plan, see Section 4351.