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Valuation, Allocation, and Distribution of Retirement Plans at Divorce: Where Are We?

ELIZABETH BARKER BRANDT*

I. Introduction

In the last thirty years, private pension savings have become one of the most significant sources of wealth to be divided when couples divorce.[1] A large number of employees are now covered by some form of retirement plan,[2] and many of those employees have one or more retirement plans that qualify under the federal Employee Retirement Income Security Act (ERISA).[3] Consequently, pensions have become one of the most substantial assets to be divided in many divorces. Lawyers and courts must be prepared to deal with these complex assets. Despite this growth in the value of pensions and over twenty-five years of court experience in the division of pensions at divorce, the law pertaining to such divisions remains tangled and confusing.

The equitable division of a pension at divorce potentially involves a number of interrelated conceptual steps. The pension must be valued,

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1. The Department of Labor reports that it currently protects over 4.3 trillion in assets belonging to 90 million participants in over 700,000 plans. Today private pension plans hold approximately 20% of all stocks and 17% of all bonds. *See* U.S. DEPARTMENT OF LABOR FACTSHEET, www.dol.gov/dol/pwba/public/pubs/factsht1.htm (visited 9/2/01).

2. By the mid-1980s, statistics indicated that over 80% of full time employees in medium and large firms were covered by pension plans. *See* Steven R. Brown, *An Interdisciplinary Analysis of the Division of Pension Benefits in Divorce and Post-Judgment Partition Actions: Cures for the Inequities in* Berry v. Berry, 39 BAYLOR L. REV. 1131, 1133 (1987).

3. 29 U.S.C. §§ 1002–1461 (2001).

the marital and non-marital interests in the pension must be allocated between the employee and her spouse, and the unemployed spouse's share of the pension must be distributed to him. These steps vary in complexity depending on the type of pension involved, whether the pension is vested[4] or mature,[5] and whether the employee has retired at the time the pension is divided. Case law surrounding the valuation, allocation, and distribution of pensions reflects substantial confusion regarding the issues involved in dividing a pension. No coherent framework or vocabulary has emerged for the process of dividing pensions at divorce.

In this article, I will discuss the valuation, allocation, and distribution of private retirement plans.[6] My goals are to survey the prevailing approaches to dividing private pensions, cut through the confusing vocabulary used by courts to describe the process, highlight the major unresolved issues, and provide guidance on the resolution of those issues. The term *pension plan* is generally used to describe two types of retirement savings plans provided by private employers: the defined contribution plan[7] and the defined benefit plan.[8] These types of plans are both recognized as retirement plans by ERISA. That act defines a pension plan as any plan maintained by an employer that provides retirement income to employees.[9] A qualified plan is one in which

4. When a pension vests, the employee becomes entitled to the benefits of the plan and cannot lose them if she leaves employment. *See* Grace Ganz Blumberg, *Marital Property Treatment of Pensions, Disability Pay, Worker's Compensation, and Other Wage Substitutes: An Insurance, or Replacement, Analysis*, 33 U.C.L.A. L. REV. 1250, 1259 (1986). The conditions under which a plan vests are generally determined by the contractual provisions of the plan, but are also regulated by the EMPLOYEE RETIREMENT INCOME SECURITY ACT (ERISA) § 203 (2001). Prior to the adoption of ERISA's statutory requirement, many pensions had long vesting periods, *see, e.g.*, Shill v. Shill, 765 P.2d 140 (Idaho 1988) (25 years). ERISA now limits vesting in most situations to seven years or less.

5. A pension is mature when the employee is eligible to retire and begin receiving benefits from the plan. *See* Blumberg, *supra* note 4, at 1259–60.

6. Although many of the concepts discussed are applicable, this article will not discuss the division of individual retirement savings devices such as IRA's. *See, e.g.*, Langschmidt v. Langschmidt, 2001 WL 468559 (Tenn. Ct. App. 2001); Lee Hargrave, *Recent Developments in the Law 1993—1994: A Faculty Symposium: Community Property Interests in Individual Retirement Accounts*, 55 LA. L. REV. 509 (1995). Nor will it discuss the division of federal and state employee pension plans or military retirement plans. *See, e.g.*, Robert A. Winter, Jr., *Divisibility of Military Nondisability Retirement Pension Benefits Upon Marriage Dissolution: McCarty v. McCarty, The Uniformed Services Former Spouses' Protection Act, and Beyond*, 22 J. FAM. L. 333 (1984); Mark E. Henderson, *Dividing Military Retirement Pay and Disability Pay: A More Equitable Approach*, 134 MIL. L. REV. 87 (1991); Mark E. Sullivan, *Military Pension Division: Crossing the Minefield*, 31 FAM. L.Q. 19 (1997).

7. I.R.C. § 414(i) (2001).

8. I.R.C. § 414(j).

9. ERISA §3(2)(A), defining the terms *pension plan* and *employee pension benefit plan*.

contributions to the plan are deductible by the employer and not currently taxable to the employee.[10] Most employers ensure that their plans are qualified because of the favorable tax treatment accorded to qualified plans under the Internal Revenue Code. This article discusses division of both types of qualified plans upon divorce.

The most traditional type of pension plan is a defined benefit pension plan. This type of plan provides a participant with a definite, fixed amount of benefits upon attaining retirement age.[11] This definite benefit is guaranteed in the initial pension documents and is often characterized by a formula by which benefits are determined. Once an employer establishes a defined benefit plan, it is obligated to fund the plan, usually through an annual contribution.[12] For example, a plan may provide that upon retirement a participant will receive annually the sum of two percent of his annual compensation for his total years of employment. Thus, if an employee works for twenty-five years at a salary of $10,000 per year, he will receive an annual pension benefit of $5,000 ($10,000 × 02 × 25 = $5,000). Employer contributions to a defined benefit pension plan are determined annually, based on actuarial assumptions, including salary scale, employee turnover, mortality rates, and other factors.[13]

The second type of plan governed by ERISA is the defined contribution plan. Under a defined contribution plan, such as profit sharing plans and money purchase plans,[14] an employer makes a specific contribution to the employee's retirement account.[15] Each participant in the defined contribution plan maintains an individual account balance, and the resultant earnings are divided proportionately among the participants in the plan according to the terms of the plan (generally based upon account balances) made on their behalf. Benefits earned are credited to a participant's account through accrual of benefits.[16] Under a defined contribution plan, a participant's accrued benefit is equal to his

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10. I.R.C. § 401(a)(1).
11. 26 C.F.R. § 1.401-1(b)(1)(i) (1989).
12. *Id.* Defined contribution plans may be either contributory in which case, a payroll deduction is made from the employees' salary to fund the plan, or non-contributory, in which case, the employer makes the contribution to the plan. In either situation, the contribution is treated as part of an overall package of compensation for services rendered and is therefore marital property.
13. I.R.C. § 412.
14. A money purchase plan is one where the amount the employee contributes to the plan is based on the employee's compensation. A Profit sharing plan is one in which the amount contributed to the plan is based on the employer's profit. *See* Susan J. Prather, *Characterization, Valuation and Distribution of Pensions at Divorce*, 15 J. AM. ACAD. MATRIM. L. 443, 445–46 (1998).
15. I.R.C. § 414(i); 26 C.F.R. § 1.401-1(b)(1)(ii).
16. I.R.C. § 411(a)(7).

or her account balance. In contrast to the fixed benefit of the defined benefit plan, the employee's benefit under a defined contribution plan is determined by the account balance at the date of retirement.

II. Valuing and Allocating the Marital and Non-Marital Interests in Pensions

The easiest scenario for dividing a pension plan is when the plan is mature and the employed spouse has retired and has begun receiving benefits from the plan. Under such conditions, there are no risks that the plan will not vest or that the participant will not live to maturity. The value of the plan can be easily determined. The only issue presented for the court is determining how much of the pension benefit is marital property. Two tests have emerged for purposes of characterizing a portion of such a pension as marital property: the marital fraction test[17] and the accrual-of-benefits test.

A. The Marital Fraction Approach

The marital fraction is a fractional means of allocating the marital and non-marital property interests in retirement benefits; it has been recognized in some form in most jurisdictions.[18] Courts generally have calculated the marital fraction two different ways. In the most common approach, referred to as the *time rule*, the numerator is the number of years the marriage coincided with credited employment service under the plan, and the denominator is the total number of years of credited

17. The term *marital fraction* is mine. I hesitate to add yet another term to the already confusing vocabulary of pension distribution, but none of the existing terminology neatly fits my own analysis. Marital fraction encompasses all tests which calculate the marital property share of a pension based on a ratio of marital and non-marital factors including either the length of the marriage relative to the length of employment or the relative value of marital and non-marital contributions. The marital fraction test is most frequently referred to by courts as the time rule or the coverture fraction. I have avoided the use of the term *coverture* because it raises the specter of marriage under the common law of England in which the wife was merged into the husband and lost her legal persona. *See* Reva Siegel, *The Modernization of Marital Status Law: Adjudicating Wives' Rights to Earnings*, 82 GEO. L. J. 2127 (1994). I have purposely not used that terminology in an effort to distance my analysis from that historical meaning. The time rule does not include those jurisdictions that allocate the pension based on source of contributions rather than the length of employment.

18. *See, e.g.*, Laing v. Laing, 741 P.2d 649 (Alaska 1987); *In re* Marriage of Hunt, 909 P.2d 525 (Colo. 1995); Maslen v. Maslen, 822 P.2d 982 (Idaho 1991); *In re* Marriage of Benson, 545 N.W.2d 252 (Iowa 1996); Sims v. Sims, 358 So. 2d 919 (La. 1978); Franklin v. Franklin, 859 P.2d 479 (N.M. App. 1993); Bishop v. Bishop, 440 S.E.2d 591 (N.C. Ct. App. 1994); Hoyt v. Hoyt, 559 N.E.2d 1292 (Ohio 1990); Matter of Marriage of Richardson, 769 P.2d 179 (Or. 1989); Gordon v. Gordon, 681 A.2d 732 (Pa. 1996); Belton v. Belton, 481 S.E.2d 174 (S.C. Ct. App. 1997).

service the employee has at the time of distribution of the pension interest.[19] If the pension is to be distributed at the date of divorce, the denominator should be the total years of service up to the date of divorce. If deferred distribution is going to take place, the denominator should consist of the total number of years of employment up to the date of distribution.[20] The value of the pension at the time of divorce is multiplied by the resulting fraction to determine the marital property component of the pension plan. The time rule can be captured by the following formula:

# of years of marriage during pension plan × present value of plan = marital prop. interest in plan total # of years employed during plan.

A few courts, however, have calculated the marital fraction based not on the length of an employee's service but rather on the marital or non-marital source of the employee's contributions. In these jurisdictions, the marital fraction is calculated by dividing the value of the employee's marital property contributions[21] by the total value of the employee's contributions.[22] In those jurisdictions, the marital fraction test can be captured as follows:

$ contributions to plan during marriage × present value of plan = marital prop. interest in plan total $ contributions to plan.

The following simple examples illustrate the application of the marital fraction approach using a time rule as opposed to a contribution approach:

Example 1(a). A wife had worked for five years before the marriage occurred and thus had five years of credited service under a defined benefit plan at the time of marriage. She contributed an amount equal to 7% of her annual salary to the plan each year. The plan provides an annual

19. For recent applications of the time rule, *see, e.g., In re* Marriage of Gowan, 62 Cal. Rptr. 2d 453, 457–58 (Ct. App. 1997); *In re* Marriage of James, 950 P.2d 624, 627–28 (Colo. Ct. App. 1997); Croley v. Tiede, 2000 WL 1473854 (Tenn. Ct. App. 2000).

20. Confusion has arisen in cases utilizing deferred distribution and the marital fraction approach. Some courts have calculated the marital fraction in the deferred distribution setting by using the number of years employed to the date of divorce. As I argue in parts III.B.1 and 2, *infra*, this approach to the marital fraction test unfairly deprives the non-employee spouse of the appreciation and passive increases attributable to her or his shares of the pension during a time when she or he is also deprived of managerial control over the asset.

21. Generally any contribution made during the marriage will be considered marital property unless the contribution can be traced to a specific non-marital source.

22. *See, e.g., In re* Marriage of Benz, 518 N.E.2d 1316 (Ill. Ct. App. 1988), discussed in Bruce Gelman & Edward J. Mathis, *Pensions as Marital Assets: A Summary of the Issues*, 1 J. LEG. ECON. 22, 25 (1991); *see also In re* Marriage of Wisniewski, 675 N.E.2d 1362, 1367 (Ill. Ct. App. 1997) (citing *Benz* as an appropriate way to apportion a pension); Succession of Jackson, 402 So. 2d 753 (La. Ct. App. 1981).

benefit of 2% of an employee's annual compensation for her total years of employment. The wife and her husband are divorced after the wife retires with twenty years of credited service. Assuming the wife made $20,000 per year in salary at the end of five years, $25,000 at the end of ten years, and $35, 000 at the end of twenty years, her annual pension payment, if she retired at the date of divorce, is $11,500.[23] Using the time rule, at the time of the divorce the marital interest in the retirement benefits is 15/20 or $8625 annually.

Example 1(b). A wife had worked for five years before her marriage occurred and thus had five years of credited service under a defined contribution plan at the time of marriage. Assuming $1,500 was contributed to the retirement account each year and that the account averaged a 7% rate of return, compounded annually, the balance in the wife's retirement account is $61,492.50. Using the time rule, the marital property interest in the account is 15/20 times $61,492.50 or $46,119.37.

The contribution and time versions of the marital fraction approach can lead to significantly different results. The effect of the time rule is to treat the contributions to the plan as level over time. In fact, as most employees' salary and wages increase over time and as they rise to higher positions in their workplace, their contributions to the plan increase. The contribution fraction takes into consideration the increasing contribution to the plan over time whereas the time rule does not. Nonetheless, it is not entirely clear that the contribution fraction is a more appropriate approach to allocating the pension, especially with respect to a defined benefit plan.

The retirement benefit in a defined benefit plan is established by contract from the beginning of an employee's participation in the plan. The amount of the benefit is not directly related to the amount of consideration invested in the plan.[24] Moreover, the formula for determining the amount of the retirement benefit usually takes account of the increased salary made by an employee in the latter years of employment. Common defined benefit formulas base the employee's retirement benefit on the employee's highest salary years or on the last years of employment prior to retirement which tend to be the employee's highest salary years.[25] In these situations, if a contribution fraction is used and the defined benefit plan formula also accounts for the increased salary of the employee, the marital portion of the pension can be exaggerated.

23. (25,000 × 20) × .02.

24. Blumberg, *supra* note 4 at 1258. *C.f.* Treas. Reg. 1-401.1(a)(2)(ii) (as amended in 1976) (a defined benefit plan guarantees an employee a pre-determined payment amount).

25. *Id.* (''retirement payments [under a defined benefit plan] are often a function of years of employment and the employee's highest or most recent salary'').

This exaggerated impact can be illustrated by substituting a contribution formula instead of a time rule in the facts of example 1(a):

> A wife had worked for five years before her marriage occurred and thus had five years of credited service under a defined benefit plan at the time of marriage. She contributed an amount equal to 7% of her annual salary to the plan each year. The plan provides for an annual benefit of two percent of an employee's annual compensation for her total years of employment. The wife and her husband are divorce after the wife retires with twenty full years of credited service. Assuming the wife made $20,000 per year in salary at the end of five years, $25,000 at the end of ten years, and $35,000 at the end of twenty years, her annual pension payment, if she retired at the date of divorce, is $11,500. Using the contribution fraction, at the time of the divorce the marital interest in the retirement benefits is 83% or $9,545 annually.

As a result of applying the contribution fraction as opposed to the time rule, the marital property interest in the pension is increased by $920 annually. This effect is even more pronounced when an employed spouse's increase in earnings is more dramatic than in the hypothetical. It appears to be particularly inequitable when the marriage is of relatively short duration but during a high income portion of the marriage. This effect can be illustrated by again using the same facts as in example 1(a) but assuming that the marriage was only five years instead of fifteen years:

> The wife had worked for fifteen years before her marriage occurred and thus had fifteen years of credited service under a defined benefit plan at the time of marriage. She contributed an amount equal to 7% of her annual salary to the plan each year. The plan provided for an annual benefit of 2% of an employee's annual compensation for her total years of employment. The wife and her husband are divorced after the wife retires with twenty full years of credited service. Assuming the wife made $20,000 per year in salary at the end of five years, $25,000 at the end of ten years, and $35,000 at the end of twenty years, her annual pension payment, if she retired at the date of divorce, would be $11,500. Using the contribution fraction, at the time of the divorce the marital interest in the retirement benefits is 30% or $3,450 annually. Using the time rule the marital property interest is 5/20 or $2,875 annually.

As the example illustrates even after a relatively short five-year marriage, the contribution rule can result in a marital property interest that is seventeen percent greater than the time rule. Generally, because the value of a defined benefit plan is not related to the amount of consideration contributed to the plan and because the formulas for determining the amount of the pension benefit generally take into account rising

salary and years of service of the employee, the time rule, not the contribution fraction, should be used to value these types of plans.

B. The Accrual-of-Benefits Approach

The accrual-of-benefits approach[26] for calculating the marital property interest in a pension plan is generally simpler than the marital fraction approach. Under this method, the accrued benefit at the date of marriage is subtracted from the accrued benefit at the date of divorce to arrive at the benefit to be divided.[27] In jurisdictions in which the income on non-marital property is also treated as non-marital property, the accrual-of-benefits method becomes more complex. In these types of jurisdictions, the premarital component of the account consists not only of its balance on the date of marriage but also of the compounded income earned on the premarital contributions.[28] To use the accrued benefit approach, a practitioner also needs to know the value of the pension at the date of marriage and its value at the date of divorce. The value at the date of marriage is subtracted from the value at the date of divorce to arrive at the marital property component of the pension plan. The following examples illustrate the accrual-of-benefits approach:

> **Example 2(a).** Using the same facts as in example 1(a) and applying the accrual method, the pension calculation looks as follows: If the wife retired at the end of five years of employment under the plan, she would be entitled to an annual pension payment of $2,000. As calculated earlier, her pension entitlement at the date of divorce is $11,500. The marital property component of the pension under the accrual method is $9,500.

> **Example 2(b).** Taking the same facts as example 1(b), assume the jurisdiction recognizes that the income on property acquired before the marriage is marital property and is generally subject to equitable division. The wife had worked for five years before the marriage occurred and thus had five years of credited service under a defined contribution plan at the

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26. The case law has variously referred to this approach as the subtraction method or the accrual-of-benefits method.

27. Maslen v. Maslen, 822 P.2d 982 (Idaho 1991)(recognizing both the time rule and the accrual-of-benefits test as appropriate ways to divide a pension); Smith v. Smith, 22 S.W.3d 140 (Tex. Ct. App. 2000) (applying the accrual-of-benefits test to a defined contribution plan); *In re* Marriage of Hester, 856 P.2d 1048 (Or. Ct. App. 1993) (applying the accrual-of-benefits test to a defined contribution plan); Mann v. Mann, 470 S.E.2d 605 (Va. Ct. App. 1996) (applying accrual-of-benefits test to a defined contribution plan); Paulone v. Paulone, 649 A.2d 691 (Pa. Super. Ct. 1994) (applying accrual-of-benefits test to a defined contribution plan).

28. Steven R. Brown, Comment, *An Interdisciplinary Analysis of the Division of Pension Benefits in Divorce and Post-Judgment Partition Actions: Cures for the Inequities in Berry v. Berry*, 37 BAYLOR L. REV. 107 (1985). *See also* Moran v. Moran, 512 S.E.2d 834 (Va. Ct. App. 1999); Thielenhaus v. Thielenhaus, 890 P.2d 925 (Okla. 1995).

time of marriage. Assuming that $1,500 was contributed to the retirement account each year and that the account averaged a 7% rate of return compounded annually, the balance in the wife's retirement account on the date of marriage would have been $8,626.05. The wife and her husband are divorced after she retires with twenty full years of credited service. At the time of the divorce, the balance in the wife's account is $61,492.50. Using the accrual-of-benefits method, the marital property interest in the account is $58,866.45.

Example 2(c). Using the same facts as example 1(b), assume the jurisdiction recognizes that the income on property acquired before the marriage is non-marital property and is generally not subject to equitable division. The wife had worked for five years before the marriage occurred and thus had five years of credited service under a defined contribution plan at the time of marriage. Assuming $1,500 was contributed to the retirement account each year and the account averaged a 7% rate of return compounded annually, the balance in the wife's retirement account on the date of marriage is $8,626.05. If the wife had made no further contributions to the pension plan, the value of her interest on the date of divorce would have been $23,799.27. The wife and her husband are divorced after she retires with twenty full years of credited service. At the time of the divorce, the balance in the wife's account is $61,492.50. Using the accrual-of-benefits method, the marital property interest in the account is $37,693.23.

Assuming that the income on premarital property earned during the marriage is treated as marital property, the accrual rule can be illustrated by the following example:

The wife had worked for five years before the marriage occurred and thus had five years of credited service under a defined contribution plan at the time of marriage. Assuming $1,500 was contributed to the retirement account each year and the account averaged a 7% rate of return compounded annually, the balance in the wife's retirement account on the date of marriage is $8,626.05. The parties are divorced after the wife retires with twenty full years of credited service. At the time of the divorce, the balance in the wife's account is $61,492.50. Using the accrual-of-benefits method, the marital property interest in the account is $58,866.45.

Using the same numbers but assuming the jurisdiction does not treat the income on premarital property as marital property, the pension calculation can be illustrated as follows:

The wife had worked for five years before the marriage occurred and thus had five years of credited service under a defined contribution plan at the time of marriage. Assuming $1,500 was contributed to the retirement account each year and the account averaged a 7% rate of return compounded annually, the balance in the wife's retirement account on the date of marriage is $8,626.05. If the wife had made no further contribu-

tions to the pension plan, the value of her interest on the date of divorce would have been $23,799.27. The parties are divorced after the wife retires with twenty full years of credited service. At the time of the divorce, the balance in the wife's account is $61,492.50. Using the accrual-of-benefits method, the marital property interest in the account is $37,693.23.

C. Marital Fraction vs. Accrual of Benefits

Not all jurisdictions have recognized the accrual method of valuing and dividing a pension plan.[29] Even in jurisdictions that recognize this method, courts have been very vague on when it should be used as compared to the marital fraction method of dividing a plan.[30] In *Maslen v. Maslen*,[31] the court, after discussing both the marital fraction and the accrual-of-benefits approach, concluded that the trial courts should apply whichever test was "equitable" in any given case.[32] One Oregon Court concluded, "It appears to us to be impractical—if not impossible—to formulate a categorical rule about the treatment of retirement accounts in dissolution of marriage cases. Because there are so many variables, individual cases will have to be largely decided on their facts."[33] The failure of courts to articulate guidelines for the differing valuations of defined benefit and defined contribution plans has led to confusing litigation.[34]

Clear guidelines must be established for the application of the marital fraction and the accrual-of-benefits tests. While it is true that the terms of each pension plan vary in significant detail, some broad categori-

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29. *See, e.g., In re* Marriage of James, 950 P.2d 624 (Colo. Ct. App. 1997) (criticizing the subtraction method as "terribly misleading"); Humble v. Humble, 805 S.W.2d 558 (Tex. Ct. App. 1991); Parliament v. Parliament, 860 S.W.2d 144 (Tex. Ct. App. 1993). *See also,* William M. Troyan, *An Update on Pension Evaluations*, 31 FAM. L.Q. 5, 18 (1997) Cases such rejecting the accrual-of-benefits test as *James* and the early Texas cases, are troubling and often confusing. They appear to reflect the courts' failure to distinguish between defined contribution plans and defined benefits plans. In the case of Texas, more recent cases, although not overruling or questioning *Humble* and *Parliament*, have applied the accrual-of-benefits test to defined contribution plans. *See* Smith v. Smith, 22 S.W.3d 140 (Tex. Ct. App. 2000).

30. This confusion is perpetuated in the literature. *See, e.g.,* Troyan, *supra* note 29, at 14. Describing the accrual-of-benefits tests as the "differential coverture fraction" and illustrating is application to defined benefit plans).

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

32. *Id.* at 988. *See also In re* Marriage of Richardson, 769 P.2d 179 (Or. 1989); Ably v. Ably, 455 N.W.2d 632, 634 (Wis. Ct. App. 1990) (court not tied to any particular test, but may tailor its own solution so long as the method used is "reasonably calculated to produce a fair result").

33. *In re* Marriage of Rogers, 609 P.2d 877, 881 (Or. Ct. App. 1980).

34. *See In re* Marriage of James, 950 P.2d 642 (Colo. Ct. App. 1997) (rejecting trial court's application of the accrual-of-benefits test to what appeared to be a defined benefit plan); *In re* Marriage of Caudill, 912 P.2d 915 (Or. Ct. App. 1996) (rejecting trial court's application of accrual-of-benefits test to a defined benefit plan as "inequitable").

zations can be made. Most importantly, in general, the marital fraction test should be applied to defined benefit plans while the accrual-of-benefits approach should be applied to defined contribution plans. Many courts have recently recognized this categorization.[35]

These two types of plans work differently. To be simplistic, the defined benefit plan works like an insurance policy.[36] The insurance aspects provide an efficient way for individuals to save for retirement. Because not all participants in a plan will work until their interests vest and because some participants will die before the plan matures, it theoretically costs less to obtain a pension benefit than it would for the employee to save directly for retirement.[37] Contributions are made to obtain a contractually defined benefit. The amount of contributions is unrelated to the benefit itself. The entitlement to the benefit is triggered by a particular event: retirement.

In contrast, the defined contribution plan works like a savings or investment account.[38] No particular benefit is generally defined. The plan is worth the combined value of the contributions to it and the growth and earnings on those contributions. Barring a collapse in the investment of the plan, its value is directly related to the consideration provided to the plan and the time value of saving and investing that consideration.

The accrual-of-benefits test approximates the way a court would treat the valuation and distribution of an investment account owned by a married couple.[39] Assuming the couple could introduce adequate evidence of the account history and the source of deposits to the account, a court would simply subtract the premarital contributions to the account from the present balance and characterize the remaining amount

35. *See, e.g.,* Mann v. Mann, 470 S.E.2d 605 (Va. Ct. App. 1996) (recognizing that applying the time rule to a defined contribution plan would lead to "incongruous results"); Bettinger v. Bettinger, 396 S.E.2d 709 (W.Va. 1990) (rejecting the use of a discounted present value calculation for division of a defined contribution plan); Paulone v. Paulone, 649 A.2d 691 (Pa. Super. Ct. 1994) (rejecting the use of the coverture fraction and adopting an accrued benefits test for the distribution of a defined contribution plan); *In re* Marriage of Hester, 856 P.2d 1048 (Or. Ct. App. 1993). *See also* William L. Carew, *Retirement Benefits in Divorce: Mixing Matching and Offsetting*, 29 COLO. LAW. 67 n.19 (June 2000) ("the concept of a coverture fraction applies only to defined benefit plans. Because proration by contributions is always more accurate than proration by time, it is error to use a coverture fraction to determine the marital interest in a defined contribution plan").

36. Blumberg, *supra* note 4, at 1279 (characterizing retirement plans in general as a form of insurance against "superannuation—survival beyond the age normally designated for gainful employment").

37. *Id.* at 1291.

38. *In re* Marriage of Benson, 545 N.W.2d 252, 256 n.1 (Iowa 1996) ("defined contribution plans are essentially savings plans").

39. Hargrave, *supra* note 6, at 510.

as marital property. There is no good reason why a defined contribution plan should be treated any differently.

Application of the marital fraction approach to the defined contribution plan is inconsistent with the nature of the plan investment.[40] Embedded in the marital fraction approach is the assumption that every contribution to a pension plan contributes equally to the value of the plan. The effect of the formula is to treat each contribution to the plan equally. In fact, because of the compounding effect of interest, earlier contributions to the plan are disproportionately responsible for the overall growth in the plan. The time rule simply does not account for the time value of money.

Consequently, in a jurisdiction that treats the increase in value of non-marital property as non-marital property, the marital fraction approach has the effect of overvaluing the marital property interest in the plan. In a jurisdiction that treats the profits of non-marital property as marital property, the marital fraction has the opposite effect; it undervalues the marital property interest in the plan.

Just as the accrual-of-benefits approach should be applied to a defined contribution plan, the marital fraction approach should be applied to a defined benefit plan. The accrual-of-benefits approach does not fit with the nature of the defined benefit plan's investment.[41] The accrual-of-benefits approach is designed to give effect to the amount of contributions and the time value of money. Neither of these factors directly bears on the benefit in a defined benefit plan. Because the benefit is pre-defined by contract, the amount of consideration does not directly affect it nor does the earnings history of the plan's investments, except to the extent that a plan that does not receive enough consideration can become financially unstable because it is under-funded. However, each individual employee's benefit is not governed by the earnings history of the plan's investments. For that reason, it does not make sense to use the accrual-of-benefits method for dividing this type of plan.

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40. An example of the confusing treatment of defined contribution plans is *In re* Benson, 545 N.W.2d at 256 n.1. After recognizing the difference between a defined contribution and a defined benefit plan, the court nonetheless concludes that the present value method should be applied to defined contribution tests. In all likelihood, the court reached this conclusion because it preferred date of divorce distribution of defined contribution plans. However, it is simply not clear whether the court is advocating the application of a marital fraction test (necessitating the determination of present value) to defined contribution plans.

41. *See* Wolfgang W. Franz, *Valuing the Marital Portion in Defined Benefit Plans in Dissolution Cases Consistent with the Concept of Community Property*, 6 J. LEGAL ECON. 39, 48 (1997).

The marital fraction approach makes the most sense for a defined benefit plan. First, if the common formulas in such plans are examined, it becomes clear that the longer an employee participates in a plan and the higher the employee's salary at or near retirement, the more valuable the pension benefit under the plan.[42] Therefore, the single most substantial factor influencing the value of a defined benefit plan to the employee is the time served under the plan. Even the amount of an employee's salary, the other important factor in determining the value of a defined benefit plan's benefit, is often a factor of the employee's years of service. Therefore, allocating the plan's value based on the length of the marriage relative to the length of employment makes sense.

III. Distribution of the Marital Property Interest in Pensions

In the earlier examples, the application of the marital fraction and accrued benefits approaches to allocating the marital property interest in a pension are fairly straightforward because the pensions in the examples were fully vested and mature at the date of divorce and because the employed spouse had already retired. Special issues arise with the marital fraction approach, in particular as it applies to defined benefit plans in which the pension is not mature, in which some of the pension is not vested, and in which the employed spouse has not yet retired. In these situations, courts have adopted two general approaches.

Under the first approach, a court must determine the present value of the future pension payment and make a division of assets at divorce based on the estimated present value.[43] Under the second approach, a present value determination usually is not made; rather, some sort of

42. Defined benefit plans commonly use one of four basic formulas to calculate benefits: (1) a flat amount formula which provides a flat benefits that is unrelated to either the length of service of the employee's compensation; (2) a flat percentage of earnings formula under which the benefits is related to the amount of earnings but not to the length of service; (3) a flat per year of service formula under which the benefits is related to the length of service and not the amount of earnings; and (4) a percentage of earnings per year of service formula which incorporates both earnings and length of service. *See* Brown, *supra* note 28, at 1141–42, cited *In re Benson*, 545 N.W.2d at, 254–55.

43. *See, e.g., In re* Marriage of Wisniewski, 675 N.E.2d 1362, 1365 (Ill. App. 1997) ("under the [cash-out] approach the court . . . compute[s] the present value of the pension . . . determines the marital interest in the pension and divides it between the spouses just like any other marital property"); *In re Benson*, 545 N.W.2d at 255 ("one method is to determine the present value of the benefits and allocate a share to the pensioners spouse . . . .[T]his method has the advantage of immediate distribution . . .").

deferred determination takes place when the pension is mature. When a deferred determination is made, courts have sometimes determined at the date of divorce the formula by which the pension will be distributed in the future when it becomes mature.[44] Other courts have reserved jurisdiction over the pension leaving open the formula by which the pension will ultimately be divided.[45] Each of these approaches presents problems.

First, the case law is extremely confusing in this area. Many cases merge the conceptual process of allocating marital and non-marital interests in a plan with the question of how the plan will be distributed in any given case.[46] While the issues overlap substantially, the confusion in the case law has led to fuzzy analysis by courts and a failure to clearly articulate the issues in any given case clearly. To some extent, the proverbial chicken-and-egg problem is raised. Should the court determine the method of distribution (present v. reserved) and then determine how to allocate the interests in the plan, or should the court allocate the interests in the plan and then determine the method of distribution? Allocation issues should be driven by the type of plan involved and not by the method of distribution. Consideration of

44. *See, e.g., In re Benson*, 545 N.W.2d at 255 (''the second method is to award the spouse a percentage of the pension payable when the benefits become matured''); Taylor v. Taylor, 329 N.W.2d 795, 799 (Minn. 1983) (''a second method requires the determination of a fixed percentage for the non-employee spouse of any future payments the employee receives under the play, payable when paid to the employee''); Schaffner v. Schaffner, 713 A.2d 1245 (R.I. 1998) (''the deferred distribution method, permits the trial court to determine the non-pensioned spouse's percentage interest in the pension benefits at dissolution of the marriage but to defer distribution of that spouse's share until the pensioned spouse retires'').

45. *See, e.g., In re* Marriage of Gowan, 62 Cal. Rptr. 2d 453 (Ct. App. 1997) (court retained jurisdiction in 1978 but did not determine formula for dividing pension at that time); Cox v. Cox, 1999 WL 58098 (Ohio Ct. App. 1999) (court entered decree dividing pension in 1989 but did not determine formula for division); Schaffner v. Schaffner, 713 A.2d 1245 (R.I. 1998) (''the reserve jurisdiction method allows the trial court to reserve jurisdiction to determine what the non-pensioned spouse will be entitled to once payment begins''); *In re* Marriage of Kelm, 878 P.2d 34, 36 (Colo Ct. App. 1994) (*aff'd* in part, *rev'd* in part. 912 P.3d 545 (Colo. 1996), (''alternatively, reserve jurisdiction permits a trial court to wait until the benefits are actually received and to divide them at that time'').

46. *See, e.g.,* Krafick v. Krafick, 663 A.2d 365 (Conn. 1995) (''there are three widely approved methods of valuing and distributing pension benefits. The first [is] called the present value or offset method. . . . The second and third recognized methods of valuing and distributing pensions involve delaying distribution. . .''); *In re* Marriage of Wisniewski, 675 N.E.2d 1362 (Ill. App. Ct. 1997) (''there are two alternate procedures for apportioning unmatured pensions upon dissolution. First a court can 'cash out' the pension . . . . [I]f the 'cash out' approach is otherwise impractical, a court may use a reserved jurisdiction approach''); Fastner v. Fastner, 427 N.W.2d 691 (Minn. Ct. App. 1988) (''there are two ways to divide a pension, either the present value method or the fixed percentage method. In deciding whether retirement benefits should be divided at the time of dissolution of upon future receipt by the employee spouse, the trial court should consider the advantages and disadvantages of each method. . .'').

whether to make a date-of-divorce distribution or to defer distribution should focus on the equities between the parties and the reliability of the pension valuation if present distribution is considered.

A. Date-of-Divorce Distribution

1. Problems with Present Value Calculations

Court determinations of present value are a source of significant litigation around pension plans. Generally requiring expert testimony, the present value calculation on a plan can vary wildly. In one Colorado case, two competing experts valued the marital property component of a pension plan at $50,000 and $190,000, respectively.[47] The present value determination is sensitive to a number of risk factors including whether and to what extent the plan is vested; the employee's health, age, and life expectancy; and the interest rate at which the plan is discounted.

The first risk factor in valuing a pension plan is whether and to what extent the plan is vested. Most jurisdictions have recognized that an employed spouse's interest in an unvested pension plan is marital property.[48] However, the speculative nature of valuing distributing unvested interest continues to be a source of litigation. The reasons for this are several. First, the goal of most family courts is to arrive at a final distribution of marital property assets at the time the divorce is granted.[49] Such a final resolution is important because it eliminates the potential of ongoing litigation as the court reserves jurisdiction over the pension.[50] In addition, in many cases there is some pressure to capture assets such as a pension into the property settlement in an attempt to provide flexibility for an economically disempowered spouse.[51]

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47. *In re* Marriage of James, 950 P.2d 624 (Colo. Ct. App. 1997); Maslen v. Maslen, 822 P.2d 982 (Idaho 1991); *In re* Marriage of Benson, 545 N.W.2d 252 (Iowa 1996); Sims v. Sims, 358 So. 2d 919 (La. 1978).

48. The majority of jurisdictions treat both vested and unvested pensions as marital or community property. *See* J. Thomas Oldham, Divorce, Separation And The Distribution of Property §§ 7.10[4] (1996) (noting in some states, unvested pension rights are not divisible).

49. Many of the cases state this preference for a final resolution of property issues. *See, e.g.*, Shill v. Shill, 599 P.2d 1004 (Idaho 1979) (lump-sum distribution at date of divorce, preferred method of distribution).

50. The fear of ongoing litigation is not speculative, the case reports are rife with situations in which reserved jurisdiction has resulted in continued litigation over the disposition of a pension. *See, e.g., In re* Marriage of Gowan, 62 Cal. Rptr. 453 (Ct. App. 1997); Franklin v. Franklin, 859 P.2d 479 (N.M. Ct. App. 1993); Cox v. Cox, 1999 WL 58098 (Ohio Ct. App. Feb. 1, 1999); Croley v. Tiede, 2000 WL 1473854 (Tenn. Ct. App. Oct. 5, 2000).

51. *See, e.g.* Balderson v. Balderson, 896 P.2d 956, 959 (Idaho 1995) ("the magistrate court awarded the [pension] benefits to be paid in installments because there

To some extent, this conflict over the speculative nature of valuing an unvested pension plan and the need to effectuate a final judgment of divorce may be exaggerated. Most plans today vest within a five- to seven-year period of time,[52] so prior to maturity, generally the plan will be partially vested and partially unvested. However, the longer the employee works, the greater the vested portion of the plan, compared to the unvested portion.[53]

In order to effectuate such a distribution where a plan is partially unvested, however, actuarial information is used to determine the probability that an employee will remain employed until the date of vesting. This calculation does not take into account happenings other than the death of the employee that may lead to the plan not vesting, such as the employee being laid off or the company going out of business.[54] The further away from vesting the plan is, the more speculative the determination of present value.

While valuing unvested plans has clearly presented the greatest challenge to courts, a number of other factors can affect the present value of even a vested plan. An employed spouse's age and health affect the present value determination. It is necessary to predict the probability that the employee will reach retirement, and because most pension plans consist of a stream of future payments, it is necessary to predict the employee's life expectancy.[55] The employee's health can also affect

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were insufficient assets to make an off-setting lump sum award to [the wife] and because this award gave [the wife] immediate control over her community share in the retirement benefits. . ."); Taylor v. Taylor, 329 N.W.2d 795, 798 (Minn. 1983) (overturning the award of the pension as "spousal maintenance" in part because the wife had few work skills and other assets).

52. ERISA imposes stringent vesting requirements on employers. *See supra* note 4. An employer can comply three ways. Either a plan may vest immediately or the employer may utilize a cliff-vesting or graduated vesting approach. *See* John H. Langbein & Bruce A Wolk, Pension and Employee Benefit Law 93–94 (1990). Cliff-vesting refers to a situation in which the employees benefits are wholly unvested until she or he satisfies a minimum number of years of service at which time the plan become wholly vested. ERISA sets the maximum allowable period of service for cliff-vesting at five years. ERISA § 203 (a)(2)(A), 29 U.S.C. § 1053(a)(2)(A) (2001). In a graduated-vesting situation the maximum allowable vesting period is seven years. ERISA § 203(a)(2)(B). *See* Langbein & Wolk, *supra* at 94. As a result of these requirement, it is rare to see pension plan with long period in which the plan is completely unvested.

53. *See* Gelman & Mathis, *supra* note 22, at 25–6.

54. Some courts have applied a formula to discount an unvested pension's value. *See, e.g.*, Kalinoski v. Kalinowki, 9 Fam. L. Rptr. 3033, 3037–39 (Pa. Ct. Common Pleas 1982) (to estimate the probability of non vesting, multiply the present value of the plan by a fraction whose numerator is the number of years the employee has worked as of the date of valuation, and whose denominator is the total number of year he must work for rights to vest.). *See also* Bishop v. Bishop, 440 S.E.2d 591 (N.C. Ct. App. 1994) (applying a similar approach).

55. Gelman & Mathis, *supra* note 22, at 24, citing as an example, Gibbons v. Gibbons, 306 N.W.2d 528 (Mich. Ct. App. 1981).

the value of the plan since it determines whether the employee will reach retirement age and how long the pension payments are likely to continue once the employee retires.[56] The interest rate at which the future pension benefit is discounted can make a significant difference in the present valuation of the pension. As one economist explained, the difference in one interest rate point in the discount rate on a pension with a future value of $500,000 can make a difference of almost $30,000 in the present value of the plan.[57] In many cases, the discount rates chosen by the disputing parties can vary radically. In one Alaska case, testimony was introduced supporting discount rates ranging from five percent to fourteen percent.[58] Some writers have suggested that this uncertainty can be eliminated if a court refers consistently to a published rate such as the Pension Benefit Guaranty Corporation's rate.[59] However, few courts do so and even these published rates can be notoriously out of step with the actual market interest rates.

The most significant impact of these uncertainties regarding the present value of a pension plan is that the risks of inaccurate valuation are placed entirely on the employed spouse. These risks can result in a complete loss of an employed spouse's marital property interest if the plan does not vest and/or become mature.

2. Other Disadvantages and Advantages of Date-of-Divorce Distribution

In addition to problems in the determination of present value, date-of-divorce distribution of an unmatured or unvested defined benefits pension can raise other equitable issues. In many cases, the pension is the single most valuable asset of the marriage, yet it is not presently possessable.[60] A number of methods of distributing the interest at the date of divorce are available, each with their own pros and cons. It may be possible to make an offsetting distribution of the marital assets in which the employed spouse receives the present value of the pension

56. *See In re* Marriage of Bergman, 214 Cal. Rptr. 661 (Ct. App. 1985) (rejecting Husband's argument that a present distribution of the pension plan was inappropriate because his health made the value too speculative, but noting that husband's health was a factor affecting the present value of the pension). *See also* Fastner v. Fastner, 427 N.W.2d 691, 697 (Minn. Ct. App. 1988) (reversing trial court consideration of husband's alleged reduced life expectancy based on inadequate record).

57. Gelman & Mathis, *supra* note 22, at 24.

58. Matson v. Lewis, 755 P.2d 1126 (Alaska 1988).

59. David V. Launey & George V. Launey, *Valuation of Vested Pension Benefits in Divorce and Wrongful Death Actions: Using PBGC Tables*, 3 J. of Legal Econ. 110 (1993); Gelman & Mathis, *supra* note 22, at 24.

60. *See, e.g.*, Bender v. Bender, 758 A.2d 890 (Conn. Ct. App. 2000) (after 24 years of marriage, the "sole substantial asset of the marriage" was the husband's unvested pension).

as his/her share of the marital property and the unemployed spouse receives a distribution of other offsetting assets.[61] The problems with this type of offsetting distribution are several. There may not be offsetting assets available that are equal to the present value of the pension.[62] Even where such assets are available, the offsetting distribution can leave the employed spouse with no liquid assets upon divorce.[63] Aside from the offsetting distribution, it may be possible for the employed spouse to buy out the unemployed spouse's interest in the pension through periodic payments over a period of time.[64] Of course, this method of distribution requires court supervision of the payment process and may subject the unemployed spouse's share of the pension to the risks of default and bankruptcy.[65]

The decision of whether to require immediate distribution of a pension interest at the time of divorce should be equities of the parties' present valuation, preferring lump-sum allocates burden of proof unfairly.

B. Deferred Distribution

As a result of the problems of calculating present value and the problems associated with making a present distribution of many pensions, courts have opted for some form of a deferred distribution of the

61. *See, e.g., In re* Marriage of Bergman, 214 Cal Rptr. 661, 663 (Ct. App. 1985) ("the trial court possesses broad discretion to choose to dive [the pension] in kind between the spouses, *or* to award it to the employee spouse at its present value and accomplish an equal division of community property by an offsetting award of other assets"); *In re* Marriage of Kelm, 912 P.2d 545 (Colo. 1996) ("in particular, pensions of relatively low value are well-suited for immediate distribution and offset").

62. *See, e.g.* Maslen v. Maslen, 822 P.2d 982, 989 (Idaho 1991) ("however, there are time such as in the case at bar, that the pension rights represent the only significant marital asset owned by the community. Accordingly in that situation, the trial court cannot enter an immediate award of equivalent property to the non-employee spouse in exchange for his or her interest in the pension benefits simply because there is no equivalent property to award").

63. *See, e.g.,* Taylor v. Taylor, 329 N.W.2d 795, 798 (Minn. 1983) (affirming a deferred distribution by the trial court because "to award the house to [the wife] and the full pension benefits to [the husband] would have caused undue hardship to [the husband because]. . . the only assets of the marriage immediately available to [him] other than the proceeds of the house are a few personal possessions" and a small amount of cash).

64. *See, e.g.,* Balderson v. Balderson 986 P.2d 956, 960 (Idaho 1995) (affirming the trial court holding that "the lump sum method paid in installments was the most equitable manner for valuing and dividing the marital portion of [the] pension benefits").

65. For discussions of the dischargeability of obligations under a property settlement agreement in bankruptcy, *see* Bernice B. Donald & Jennie D. Latta, *The Dischargeability of Property Settlement and Hold Harmless Agreements in Bankruptcy: An Overview of § 523 (a)(15),* 31 FAM. L.Q. 409 (1997); Allen M. Parkman, *The Dischargeability of Post-Divorce Financial Obligations Between Spouses: Insights from Bankruptcy in Business Situations,* 31 FAM. L.Q. 493 (1997).

pension. These deferral approaches involve anything from leaving the pension issue completely open for determination if and when the pension matures to determining the spouse's interest in the pension by deferring payment until the pension matures. Although, deferred distribution appears to relieve the court of the difficulty of calculating present value, particularly for unvested pensions, deferred distributions raise issues of their own.

Three basic approaches to deferred distribution have emerged. In the first, the amount of the unemployed spouse's benefits is fixed at the date of divorce, but payment is postponed until the plan matures or until the employed spouse retires. Under the second approach, the formula by which the unemployed spouse's benefit will be calculated is determined at the time of divorce, but the formula is not applied to the actual pension benefit, and the benefit is not paid until the pension is mature or the employed spouse retires. In the third approach, the court reserves jurisdiction to determine the division of the pension when it is mature or when the employed spouse retires.

1. DEFERRED PAYMENT/FIXED FORMULA

Courts applying this approach calculate the unemployed spouse's share of the pension at the time of divorce but defer payment of the share until the pension is actually received by the employed spouse.[66] The advantage of this method of distribution is that it avoids the inequities associated with distributing a large asset that is not yet possessive. It also eliminates the necessity of calculating the present value of the pension at the date of divorce.[67] In most jurisdictions applying this approach, the unemployed spouse's share of the pension is calculated using the marital fraction approach. The marital property interest in the pension is calculated as follows:

 # years employed during marriage × value of pension at date of maturity
total # years employed at pension's maturity[68]

The major disadvantage of the deferred payment/fixed formula approach is that it unfairly freezes the unemployed spouse's interest in

66. *See, e.g., In re* Marriage of James, 950 P.2d 624, 626 (Colo. Ct. App. 1997) (describing three ways to divide a pension including the "deferred distribution method [under which] the marital percentage of the pension is determined at the time of dissolution, but the benefits are not distributed until the benefits actually are paid"); *In re* Marriage of Wisniewski, 675 N.E.2d 1362, 1366–67 (Ill. App. Ct. 1997) (describing two variants of the reserved jurisdiction approach including one in which the court "devise[s] a formula that will later determine both the marital interest and the non-pensioner's share in the benefits"); Taylor v. Taylor, 329 N.W.2d 795 (Minn. 1983).

67. *See Taylor*, 329 N.W.2d at 798.

68. *See, e.g., Wisniewski*, 675 N.E.2d at 1367; *In re* Marriage of Benson, 545 N.W.2d 252, 255 (Iowa 1996).

the pension plan. Even though the spouse's interest in a defined benefit plan is not based on the earnings of the funds invested in the plan, the economic integrity of the plan is assured in part because of the marital property contributions to the plan.[69] Moreover, when the unemployed spouse's interest is frozen at the time of the divorce but not distributed until mature, that spouse loses the ability to earn a reasonable rate of return on the investment in the pension.[70]

Also extremely problematic, is the fact that the often very large pension asset is left in the exclusive management and control of one of the former spouses. Although issues regarding post divorce management of pension have not often arisen, they are not unheard of. In one California case, the husband failed to make available to his former wife the right to redeposit monies borrowed from the plan during marriage. The right to redeposit was a one-time offer made by the plan administrator in an effort to shore up the funding base of the plan. It had the effect of substantially increasing the value of the plan.[71]

2. RESERVED JURISDICTION

In the second approach to reserved jurisdiction, the courts have deferred not only the distribution of the spouse's share of the pension but also the determination of the formula for determining that share. This approach has the same advantages of the fix percentage approach—it avoids the inequities of distributing a non-possessory asset and obviates the need to calculate present value at the date of divorce. In addition, the reserved jurisdiction approach enables the court to consider a return on the investment of an unemployed spouse's share and the role played by early pension payments in the ongoing integrity of the plan itself.[72]

Nonetheless, the reserved jurisdiction approach has its own disadvantages. In cases in which the court exercises its power to make an unequal division of marital property, the process is disrupted when a major asset is essentially taken off the equitable table. More commonly, the reservation of jurisdiction has sometimes led to a new spate of litigation at the time the pension plan matures and is to be distributed.[73]

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69. This argument is made most persuasively in Brown, *supra* note 28, at 1188–89.

70. *See Benson*, 545 N.W.2d at 257.

71. *See, e.g., In re* Marriage of Lucero, 173 Cal. Rptr. 680 (Ct. App. 1981).

72. *See e.g. Benson*, 545 N.W.2d at 257 (recognizing the spouse's right to a reasonable return on investment, and the role played by the spouse's interest in the economic viability of the plan).

73. *See e.g.*, Franklin v. Franklin, 859 P.2d 479 (N.M. Ct. App. 1993) ("this case involves the formula for dividing periodic payments of a retirement plan that was being

Perhaps the most controversial aspect of the reserved jurisdiction approach has been the appearance that pension distribution accords an interest in the post divorce earnings of the employed spouse to the unemployed spouse. The issue arises because many courts using the reserved jurisdiction approach base the value of the marital property interest in the pension on the value of the pension at the date of maturity in order to avoid a speculative present value determination at the date of divorce. These courts multiply the value of the pension at divorce by a fraction that is based on the employed spouse's *total* years of service as opposed to the spouse's years of service during the marriage. The fraction usually used is the total years of service during the marriage divided by the total years of service as of the maturity of the pension. When calculated this way, the marital property component includes a proportion of the post divorce growth in the value of the pension.

Courts have split widely on whether the inclusion of this post divorce increment is appropriate. The Pennsylvania Supreme Court concluded, "In a deferred distribution of a defined benefit plan, the spouse not participating may not be awarded any portion of the participant spouse's retirement benefits which are based on post-separation salary increases, incentive awards or years of service. Any retirement benefits awarded to the non-participant spouse must be based only on the participant spouse's salary at the date of separation."[74] The court's ruling was based on the a rigid interpretation of the Pennsylvania law prohibiting the distribution of post-divorce income to a former spouse.

Other states confronted with a statutory framework similar to Pennsylvania's have reached opposite results. The Iowa Supreme Court concluded that fixing value at the time of divorce would prevent the unemployed spouse from earning a reasonable rate of return on his or her interest in the pension plan.[75] Likewise, courts have recognized that the earnings and contributions to a pension plan make the future growth of the plan possible. The Colorado Supreme Court reasoned, "The employed spouse's ability to enhance the future benefit [in the pension plan] after the marriage frequently builds on the foundation of work and efforts undertaken during the marriage."[76]

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distributed pursuant to a 'pay as it comes' basis as provided in an earlier divorce decree"); Cox v. Cox, 1999 WL 58098 (Ohio Ct. App. 1999) (addressing the distribution of pension benefits awarded in a decree entered ten years earlier).

74. Gordon v. Gordon, 681 A.2d 732, 734 (Pa. 1996).

75. *See In re Benson*, 545 N.W.2d at 257.

76. *In re* Marriage of Hunt, 909 P.2d 525, 534 (Colo. 1995). *See also* Croley v. Tiede, 2000 WL 1473854 (Tenn. Ct. App. 2000) (relying on *Hunt*).

There are several disadvantages of not fixing the amount of the marital property interest at the time of the divorce. The most significant one is that the point at which the pension matures has proven to be a point of significant litigation over exactly what the original divorce court decided and how it should be implemented, given the development of the facts in the interim.[77] The questions that have arisen are many and various. For example, should the fact that the employed spouse was diagnosed with a debilitating condition that affects length of employment service and life expectancy but was unknown at the date of divorce serve as a basis for a re-evaluation of the pension valuation? Where the pension was not valued in the original decree, should such facts be considered now in valuing the pension?[78] How would early retirement provisions or an employed spouse's decision to retire early affect valuation? Where a plan's formula bases a pension payment on the highest three or five years of salary and those years all came after the divorce, should they be considered in valuing the pension?

3. Reserved Jurisdiction vs. Deferred Payment/ Fixed Formula

If a court is going to defer jurisdiction on the distribution of a pension, it should not fix the amount of the marital property interest. The unfairness of this approach to an unemployed spouse is so significant that it outweighs the benefits of avoiding future litigation over the division of the pension. When a court defers distribution of an interest in a pension plan and fixes the formula for such distribution at the time of divorce, it deprives the unemployed spouse of all management and control of the asset and of any rate of return on the growth of the asset.

As indicated earlier, the primary analytical reason courts have advanced for fixing a percentage at the date of divorce is that to do otherwise would be to give the unemployed spouse an interest in the post divorce earnings of the employed spouse. This reasoning is a red herring. The growth in value of the unemployed spouse's interest that is allowed to take place when a court reserves jurisdiction over a pension but does not fix the amount of the marital property interest should be more properly viewed as the passive increases, appreciating and changes due to changed plan administration rather than a distribution of post divorce contributions to the plan. As the Tennessee Court of Appeals concluded, "While [some courts classify] these post-divorce

77. *See* cases cited *supra* note 73.

78. *See, e.g., In re* Marriage of Bergman, 214 Cal. Rptr. 661, 664–65 (Ct. App. 1985).

enhancements as 'marital property,' we think such classification is unnecessary. The court has simply divided the marital property which existed at the time of divorce. The enhancements follow the assigned marital property as interest follow principle. Only the percentage of the retirement benefit changes with the increasing denominator."[79]

Finally, not only does fixing a percentage at the date of divorce deprive an unemployed spouse of growth appreciation and growth in the value of his or her interest in the pension plan, it ascribes such growth to the employed spouse. There is simply no justification for allowing the employed spouse all the management and control of the asset and all the growth in the value of the asset post-divorce while at the same time fixing the value of the employed spouse's interest in the plan.

C. Qualified Domestic Relations Orders

For ERISA-qualified plans, the pension interest may also be distributed through a qualified domestic relations order (QDRO). The QDRO, authorized by the ERISA,[80] is an exception to the general provisions of the ERISA that prohibit the assignment or attachment of a participant's interest under the plan.[81] A QDRO is defined as any judgment or decree of a state court that "creates or recognizes the existence of an alternate payee's[82] right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to participants under the plan."[83] The QDRO must contain the name of the pension plan, the names and addresses of the employed and unemployed spouses, the formula to be used to determine the unemployed spouse's share of the plan (that is, the actual amount to be paid), the method of payment, and when the payments are to begin or end.[84] It is important to note that a QDRO does not resolve the question of whether a court will fix the amount of an unemployed spouse's interest in the plan at the date of divorce or will establish a formula for distribution that permits the amount of that spouse's interest to continue to grow.

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79. Croley v. Tiede, 2000 WL 1473854 (Tenn. Ct. App. 2000).

80. *See* ERISA § 206(d)(3); I.R.C. § 414(p).

81. *See* ERISA § 206(d)(1).

82. The alternate payee is usually the unemployed spouse of the participant in the pension plan. ERISA §206(d)(3)(K) ("the term 'alternate payee' means any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant").

83. *See* ERISA § 206(d)(3)((B)(i)(I); I.R.C. § 414(p).

84. *See* ERISA § 206(d)(3)(C).

In addition to establishing the requirements for a QDRO, the ERISA also places limits on the scope of any given QDRO. The QDRO generally may not violate any of a plan's provisions limiting the form of benefits, the amount of benefits, and the persons to whom benefits are paid.[85] Therefore, if a play provides for benefits in the form of a lump-sum payment upon retirement, the QDRO cannot provide for payment in the form of a joint and survivorship annuity.[86] Furthermore, a QDRO cannot require a plan to provide an actuarially greater amount of benefits than the participant is entitled to.[87] Thus, a QDRO cannot provide for the distribution of the unvested portion of a participants interest in a plan prior to vesting.[88] Finally, a QDRO cannot require the payment of benefits to an alternate payee that are required to be paid to another alternate payee under a prior QDRO.[89]

Within these limitations, the advantages of using a QDRO where it is available are substantial. For unvested and/or non-mature plans, the QDRO effectuates a form of deferred distribution. As a result, it has the same advantages discussed previously for deferred distributions. Because there will be no distribution of pension benefits at the date of divorce, the QDRO eliminates the necessity of determining the present value of the pension and the inequitable results of date-of-divorce distribution, such as allocating all risk of non-payment to the employed spouse.

The QDRO also has advantages over other types of deferred distribution. First, use of a QDRO relives the court of ongoing supervisory responsibility over the pension.[90] The effect of the QDRO is to require the plan administrator to create a separate account within the pension plan for the alternate payee. This segregates the interests of the employed spouse and the alternate payee yet permits the alternate payee to obtain the advantage of passive growth and appreciation in the value of the pension plan. Moreover, because the terms of an unemployed spouse's participation in the plan are established finally in the QDRO, the problems of litigation at the time of distribution are eliminated.

A number of unique advantages are associated with the use of QDROs. The first unique feature of a QDRO is that because it segregates the interests of the two spouses, it can provide for an unemployed

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85. *See* ERISA § 206(d)(3)(D)(i).
86. Alan H. Kandel, *Handling Retirement Benefits When a Coupe Divorce*, 18 ESTATE PLANNING 268 (1991).
87. *See* ERISA § 206(d)(3)(D)(ii).
88. Kandel, *supra* note 86, at 269.
89. *See* ERISA § 206(d)(3)(D)(iii).
90. Prather, *supra* note 14, at 462.

spouse to make withdrawals from the plan at an employed spouse's earliest date of retirement as opposed to when the employed spouse actually retires.[91] This is important since the unemployed spouse, who is not working or continuing to contribute to the plan, has an incentive to begin receiving payments at the earliest possible date, even if those payments will be reduced in amount from what they would have been if the unemployed spouse had waited. On the other hand, the employed spouse, who is working and has an economic incentive to continue to work, thus receives the benefit of her salary and simultaneously maximizes the value of the pension payments she will receive upon retirement.[92]

Another unique advantage of using a QDRO is that the order can often specify the form in which benefits may be received from a plan.[93] This is true where the plan allows participants (an employed spouse) to elect among different options as to the form of the benefits. In such a case, a QDRO can elect any form of payment provided to participants in the plan. Therefore, an unemployed spouse may be permitted to elect a lump-sum payment or may chose between various forms of annuities.

A QDRO may also include provisions requiring the plan to treat the divorced spouse as the participant's surviving spouse for purposes of paying all or a portion of the participant's death benefits in a plan. This type of provision can protect the unemployed spouse from the accidental loss of interest in the pension due to the premature death of the plan participant.

IV. Deferred Distribution vs. Date-of-Divorce Distribution

The decision whether to require distribution of a pension at the time of divorce or whether to defer distribution of the pension is one that should be made on a case-by-case basis. In making the decision, a court should consider both the equities between the parties[94] and the reliability of evidence regarding the value of the pension plan.[95] Courts concluding that one type of distribution is preferred in all cases[96] place an unfair burden on the party arguing against the distribution of the

91. *See* ERISA § 206(d)(3)(H)(iii) and ERISA § 206(d)(3)(E).
92. Kandel, *supra* note 86, at 270–72 for a detailed discussion of early retirement and QDROs.
93. *See* ERISA § 206(d)(3)(E)(i)(III).
94. *See supra* notes 60–65 and accompanying text.
95. *See supra* notes 47–60 and accompanying text.
96. *See e.g.* Cross v. Cross, 407 S.E.2d 720 (W.Va. 1991); Balderson v. Balderson, 896 P.2d 956 (Idaho 1995).

pension. In particular, this burden can affect the balance of bargaining power as the spouses negotiate a settlement. Moreover, such a preferred approach unnecessarily restricts the ability of a trial court to fashion a distribution that best effectuates equity in a given case.

With respect to the equities between the parties, a court should consider whether adequate resources are available at the time of divorce to make a lump-sum distribution of the unemployed spouse's interest in pension or whether adequate marital property exists to make an offsetting distribution of marital property. A court should also consider the importance to the parties (particularly the unemployed spouse) of obtaining the cash-flow benefit of a present distribution of pension interest. Finally, a court should consider the impact on an employed spouse's ability to be economically solvent in the wake of the divorce if a present distribution of the pension is made.

With respect to the reliability of the valuation of the pension, a court should consider the problems with developing a reliable present value, such as probability that the plan will vest and mature and the ability to determine an appropriate discount rate for valuing the plan.

V. Conclusion

Despite the complexity and confusion in the case law of pension distribution, a number of guidelines emerged:

1. A court must determine whether a plan is a defined contribution plan or a defined benefit plan.
2. If a plan is a defined contribution plan, a court should apply the accrual method to determine the marital property interest in the plan.
3. If a plan is a defined benefit plan, a court should apply the marital fraction test to determine the marital property interest in the plan.
4. In either type of plan and regardless of whether the marital fraction or accrual test are applied, a court must decide whether to make a date-of-divorce distribution or a deferred distribution of the unemployed spouse's interest in the plan.
5. General considerations in any case to determine whether to defer distribution include equitable considerations such as whether marital assets exist to offset the interest in the plan and whether the property distribution will leave each spouse with adequate liquid assets.
6. With respect to a defined benefit plan, specific additional factors governing the determination of whether to make a deferred dis-

tribution should focus on whether and to what extent a plan is vested and/or mature such that a reasonably reliable present value determination can be made. If the present value is too speculative, a court should consider deferring distribution of the plan.

7. If distribution is deferred and the plan is an ERISA-qualified plan, a court should use a QDRO as the preferred method of distribution the pension interest to the unemployed spouse.
8. In making a deferred distribution of the interest in a pension plan, a court should avoid fixing the amount of the specific fractional interest in the plan at the date of divorce. Instead, the court should establish a formula that permits the unemployed spouse's interest in the plan to appreciate until the eventual distribution of the interest.