



## Divorce, Pensions and Retirement Benefits

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### WHEN IS A QDRO THE WRONG SETTLEMENT TOOL?

#### Introduction:

While this column is usually supportive of the use of a Qualified Domestic Relations Order (QDRO) when settling a divorce case involving retirement assets, there are situations where their use can be an invitation for major, unanticipated, future problems for you and your client. Knowing how to identify these situations and what alternative distribution methods are available is critical for the long-term success of your Family Law practice. The situations that preclude the use of a QDRO are usually out of your control so recognizing them up front can avoid creating expectations in the mind of your client than can cause you both having to rethink your strategy late in the settlement process.

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#### Tip of the Month:

**To maintain some control of the expenses of preparing and settling a divorce case; work out some practical guidelines with your opposing counsel at the very beginning of the process.**

Most attorneys today know that a divorce action is really an exercise in identifying and valuing marital property and then coming to terms as to what constitutes an equitable settlement for their client. This means that much of the costs will involve third party experts and appraisers. If there is substantial real estate, business assets, personal property, retirement assets, antiques, etc., these costs can break the bank if one of the parties has greater access to financial resources than the other party. When each party hires their own expert who is willing to provide favorable reports to the employing attorney you have a recipe for a divorce action whose costs will quickly get out of control. The process can become like a no-limits poker game where the player with the deep pockets almost always winds up "winning" but in this case he or she will still be broke in the end because of the costs incurred. Also if the parties can not come to agreement on values, many courts will require the party with the deeper pockets to bear some of the litigation costs incurred by the less financially endowed party. This then becomes a real lose/lose exercise for everyone involved and increases the likelihood that the attorneys will not be completely compensated for their time and work.

To avoid some of these costs the attorneys can agree up front to use mutually acceptable objective valuation sources and stipulate to the values provided. Many courts will allow telephone testimony and/or the introduction of deposition evidence in those areas where the parties really cannot agree. An agreement up front by the attorneys to allow this evidence can greatly reduce the overall cost of the settlement.

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## WHEN IS A QDRO THE WRONG SETTLEMENT TOOL?

I Almost every state, either by statute or case law, has decided that retirement assets earned during the marital period are marital property and subject to distribution at the time of a divorce. The problem is that not every retirement asset is created equal and in many states subsequent appellate cases have destroyed equity in Defined Benefit pension distributions by not really understanding how pensions work and how statutory or case law dictated distribution processes can be totally unfair to the non-participant spouse. A number of my previous articles have spelled out exactly what I mean by this statement. Still, even if the existing case law is unfair, as an attorney you have to deal with the distribution of the marital property portion of a pension asset.

What I am addressing in this article applies to Defined Benefit pension schemes (private company pensions, GM, IBM, GE, many union plans, most older Fortune 500 companies, military pensions, federal, state and local pensions, etc.). These are the plans that provide monthly income for life commencing on a specific plan defined retirement date based on a formula using final salary, years of service, and a multiplier. Defined Contribution Plans (401k's, ESOP's, Retirement Savings Plans, Federal Thrift Plans, etc.) are not subject to the same problems. It is usually easy to identify the marital component of a Defined Contribution Plan on the marital property cut-off date and with a QDRO distribute it in an immediate tax-free lump sum roll-over to the non-participant spouse with any gains or losses between the marital property cut-off date and the distribution date included in the portion being awarded. As a general rule you should always use a QDRO to effect the distribution of funds to the alternate payee from a Defined Contribution Plan. It is the only way the plan can pay the alternate payee his or her share.

Let me begin by showing an example of an equitable settlement of a defined benefit pension. The alternate payee should receive 50% of the marital portion of the pension as determined on the date the participant stops working (either terminates or retires) and payable beginning at the time those payments to the participant begin. The marital portion is determined by dividing the number of months the parties were married (up to the marital property cut-off date) while the participant was earning pension credit, by the total number of months of credited service the participant has at the time he retires. To protect the alternate payee in the event the participant predeceases, the pension should be paid in the form of a 50% pre and post retirement Joint and Survivor annuity with the alternate payee named as beneficiary for the marital portion of the survivor annuity as determined by the same monthly ratio formula. A subsequent spouse could receive the balance of the survivor annuity but as the benefit is based on the life of the first spouse all payments to the subsequent spouse survivor would stop upon the death of the alternate payee. This is the asset the parties were accruing during the marriage and what each anticipated would be available to them in their later years.

The actual pension amount earned by the participant at the time of his or her retirement is based on his or her final salaries at that time to account for the reality that inflation erodes the purchasing value of the pension. If the amount awarded to the alternate payee is based on the accrued benefit earned on the marital cut-off date, and then not paid out for 10, 20 or 30 years in the future, it is totally unfair. The participant's share of the marital portion is continuously adjusted because the formula uses his or her actual salary at the time they stop working and applies that formula to each year worked (including those years he or she was married to the alternate payee). Most employee salary increases are in fact simply adjustments for inflationary factors. If the alternate payee's share is not adjusted in the same way then the portion awarded actually decreases in real terms every year. In a defined benefit plan there is no way to adjust a benefit if you identify it as i.e. "50% of the marital portion on August 13, 2000". Whatever that was is all that will be paid

to the alternate payee whether payment begins 5, 10 or 20 years in the future. A Defined Benefit plan does not have an individual account to earn interest. The benefit is simply the application of the formula to the salary on the date it is computed. No interest is ever earned.

Using the foregoing as an example of an equitable QDRO distribution you can look at the facts in your own case and the case law in your state to see if a QDRO is the right tool for settlement. Do not use a QDRO if the following facts apply: Your state case law only awards the alternate payee 50% of the marital portion of the pension as determined on the marital property cutoff date and the participant is years away from retirement eligibility. Your case law allows for the example distribution but your opposing counsel won't budge on survivor benefits and it is doubtful you can prevail in litigation for one reason or another (short marriage, fault, etc.). If there are no survivor benefits and your client is female and somewhat younger than the participant the reduction in her benefit necessary to pay her a lifetime income could erode her share by 50% or more (see my October, 2002 newsletter - HOW TO AVOID UNEXPECTED SURPRISES WHEN USING A QDRO AS YOUR SETTLEMENT TOOL WITH A DEFINED BENEFIT MONTHLY INCOME PENSION).

1. The plan is a government (federal, state, local or military) plan that has no provisions for continued payment to the alternate payee if the participant should predecease (some state Public Employees pensions) or it is doubtful you will prevail in having the alternate payee named as beneficiary of a survivor benefit. Public plans are not covered by ERISA and do not offer single life annuity options to alternate payees so if the participant dies all funds stop unless a 50% Joint and Survivor annuity is used. You cannot use a QDRO for a military pension unless the parties were married for ten years or more during which time the participant was in the military for ten years.

In those situations where a QDRO does not look like the solution, you have to value to pension and have the non-participant spouse compensated either by receiving a greater share of the available marital assets or an amortized monthly payout of the value of the pension asset that is owed over a 5 or 10 year period.. When the parties are years away from retirement and the spouses anticipate a possible remarriage this can be an attractive alternative.

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### **[Model Property Settlement Language](#)**

Download our settlement language form and let the experts at LawDATA, Inc. [draft model property settlement language](#) (<http://www.lawdatainc.com/SetLanForm.pdf>) that deals specifically with the pension plan to which the order is addressed and the facts of your case.

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Mr. Commerford has been active in the valuation of pensions and the preparation of Domestic Relations Orders for his attorney clients since the founding of LawDATA, Inc. in 1984. He has presented Continuing Legal Education programs, dealing with the valuation and distribution of retirement assets incident to divorce cases, for State Bar Associations throughout the country and written many articles on the subject for legal publications.

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