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A Common Denominator

A new amendment to the Divorce Code codifies distribution of defined benefit pension plans

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Only with the passage of a new Divorce Code in 1980 were pensions considered marital property in Pennsylvania. Since that time, the courts have struggled with the issue of deferred distribution of a defined benefit pension plan. Specifically, they had a difficult time ascertaining the benefit determination date. Without solid guidance on the exact time that pension benefits were locked in, it was guesswork for judges to figure out what percentage of the pension was marital property, and which was independently owned.

A new amendment enacted within the past year by the General Assembly promises to clear up that difficulty. But new legislation tends to invite new litigation. This article examines the judicial backdrop for the new amendments, and points out some problems likely to require review in the courts.

The Nov. 29, 2004 amendments to the Divorce Code of 1980, including Section 3501(c), pertaining to defined benefit pension plans, became effective on Jan. 29 of this year. The portion of that bill pertaining to defined benefit pension plans stated that the new legislation pertained to "all equitable distribution proceedings commenced on or after the effective date of this paragraph." Section 5 (7) of the Act of Nov. 29, 2004 (P.L. 1357, N. 175). However, Senate Bill 124, signed into law on June 15, amended Section 3501(c) by providing that the defined benefit pension section was applicable to all equitable distribution proceedings *pending* on or after June 15.

Section 3501(c)(1) provides that "[i]n the case of the marital portion of a defined benefit retirement plan being distributed by means of a deferred distribution, the defined benefit plan shall be allocated between its marital and non-marital portions solely by use of a coverture fraction. The denominator of the coverture fraction shall be the number of months the employee spouse worked to earn the total benefit and the numerator shall be the number of such months during which the parties were married and not finally separated. The benefit to which the coverture fraction is applied shall include all post-separation enhancements except for enhancements arising from post-separation monetary contributions made by the employee spouse, including the gain or loss on such contributions."

Subsection (c)(2) states that "[i]n the case of the marital portion of a defined benefit retirement plan being distributed by means of an immediate offset, the defined benefit plan shall be allocated between its marital and non-marital portions solely by use of a coverture fraction. The denominator of the coverture fraction shall be the number of months the employee spouse worked to earn the accrued benefit as of a date as close to the time of trial as reasonably possible and the

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numerator shall be the number of such months during which the parties were married and not finally separated. The benefit to which the coverture fraction is applied shall include all post-separation enhancements up to a date as close to the time of trial as reasonably possible except for enhancements arising from post-separation monetary contributions made by the employee spouse, including the gain or loss on such contributions."

The Dating Game

A divorcing party's pension was determined to be marital property in *King v. King*, 481 A.2d 913 (Pa. Super. 1984). But one area gave judges headaches, deferred distribution of a defined benefit pension plan. The major problem concerned the benefit determination date. The numerator of a coverture fraction was number of months the participant was employed during marriage; the question to be decided was what was the benefit determination date. Once that date was determined, the denominator would follow accordingly. Did the benefit for the ex-spouse include post-separation enhancements? If so, the denominator would include all years of employment by the employee spouse. The focal point, therefore, was the benefit determination date.

The 2005 amendment provides that when there is a deferred distribution of a defined benefit retirement plan, the marital portion will be determined by a coverture fraction where the numerator is the number of months of employment during marriage and prior to final separation and the denominator is the number of months the employee spouse worked to earn the total benefit. The benefit to which the coverture fraction is to be applied includes all benefits but for direct contributions made by the employee spouse.

A defined benefit plan can be distributed to the non-employee spouse in two ways. If there are enough other marital assets, there can be an immediate offset whereby the value of the marital portion of the pension plan is balanced with another asset having the same value. The employee spouse may keep all of the pension benefits by essentially trading off the other asset. Since Section 3506 of the new Divorce Code amendments allow courts to distribute different percentages of different marital assets, the immediate offset method is an attractive option, provided there are enough other assets of value in the marital estate. The valuation of the marital portion by the immediate offset method is set forth in Section 3501(c)(2) of the amendments.

The second method of distribution of the non-employee spouse's share of the marital portion of the defined benefit pension plan is the deferred distribution method whereby a portion of the employee's pension benefit is distributed to the non-employee spouse when the employee retires, which could be many years subsequent to divorce. When the plan administrator approves a Domestic Relations Order (DRO), concerning the non-employee's benefit, the Order becomes a Qualified Domestic Relations Order (QDRO). The QDRO insures the non-employee's benefit for deferred distribution.

The case law prior to the amendment regarding deferred distribution of defined benefit pensions concerned the issues of whether enhancements to the employee spouse's pension post-separation or post-divorce should be included for the non-employee spouse; whether a coverture fraction

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should be used; and what is the benefit determination date. The argument against including post-separation or post-divorce enhancements was that after the marriage is over, the fruits of the employee spouse's efforts should not accrue to a former spouse. The argument for including post-separation enhancements was that because the non-employee spouse would have to wait for her benefit, the non-participant spouse should accrue the benefits afforded to the pension plan while she waited for her distribution.

In *King v. King*, the Superior Court said that while it agreed "with the [trial] court's order of a deferred distribution, we would so order without assessing a present value to the pension." The *King* court went to that that it agreed "that when a deferred distribution is used, present value should not be employed because there are too many variables projected into the future for this calculation to have any merit. Instead, the 'coverture' fraction is to be applied to the benefit when it enters pay status. We believe that this approach should be used in the present case where it is undisputed that there are insufficient assets to offset the pension immediately."

The Superior Court applied the coverture fracture to the benefit when it entered pay status. In that same year, the Superior Court in *Braderman v. Braderman*, 488 A.2d 613 (Pa. Super. 1984), confirmed the valuation and distribution methodology set forth in *King*.

Seven years later, the Superior Court determined in *Holland v. Holland*, 588 A.2d 58 (Pa. Super. 1991), that when using the deferred distribution method for a defined benefit plan, the non-employee spouse who must wait until "some indefinite time in the future to receive the marital share" should be compensated by being permitted to "enjoy increases in value occasioned by continued employment of the worker."

The *Holland* court emphasized that both parties benefit from such a distribution in that "the employed spouse increases the non-marital share of the benefits since continuing service enlarges the denominator. Further, later year wage increases are a product of experience and longevity, which were developed during the marriage" and a "former spouse is entitled to share in any increase in value of the marital share which may occur by Appellant's continued employment."

The Kiss of Death

The state Supreme Court entered the fray in *Berrington v. Berrington*, 633 A.2d 589 (Pa. 1993), holding "that in a deferred distribution of a defined benefit pension, 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."

Berrington was the "kiss of death" to the benefit period including any post-separation enhancements to be received by the non-employee spouse. *Berrington* set a cut-off point of the retirement benefit to the non-employee spouse based on the participant's salary at the date of separation. Any increases in "retirement benefits based on post-separation salary increases,

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incentive awards, or years of service" were the property of the employee spouse only. Many saw *Berrington* as affording a bonanza to the employee spouse.

The new amendment, at Section 3501(c)(1) applies a coverture fraction that does include as part of the benefit "all post-separation enhancements except for enhancements arising from post-separation monetary contributions made by the employee spouse, including the gain or loss on such contributions." The defined benefit retirement plan amendment effectively overrules *Berrington* by defining the benefit determination date to include "all post-separation enhancements" except for contributions made post-separation by the employee spouse, including the gain or loss on such post-separation contributions.

There are, however, opportunities for lawyers to ask the courts for needed guidance on the new amendment. For instance, if there is a defined benefit plan that existed during marriage set up by the employer, which also has employee contributions, how do we account for the language of the amendment "except for enhancements arising from post-separation monetary contributions made *by the employee spouse* [emphasis added]?" Is a matter resolved by agreement of the parties on the effective date of the amendment without a QDRO or divorce decree in place "pending"? Although one war is over, there are still many battles yet to be fought.

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