

CLIENT ALERT

Supreme Court Weighs in on Plan Documents Rule and Effect of Non-QDRO Divorce Decree on Retirement Benefits

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On January 26, 2009, the U.S. Supreme Court, in a 9-0 decision, ruled in *Kennedy v. Plan Administrator for DuPont Savings and Investment Plan* that the terms of the plan documents will trump an otherwise valid state-court order waiving entitlement to benefits. The Court held that, although ERISA did not prevent a plan beneficiary from waiving entitlement to plan benefits through a general waiver, such a waiver is unenforceable against an ERISA plan where the waiver does not comply with the plan's provisions for changing or altering beneficiary designations.

Background & Case History

William Kennedy was an employee working for E.I. DuPont de Nemours & Company and, through his employment, participated in the savings and investment plan (SIP) of DuPont, an ERISA-governed retirement plan. Under the terms of the SIP plan document, the plan administrator could prescribe the method for designating beneficiaries and revoking such designations. The SIP plan document stated that if the participant died with no surviving spouse and no beneficiary designation in effect, the participant's benefit would be distributed according to the directions of the executor of the participant's estate. The SIP plan also permitted a beneficiary to submit a qualified disclaimer of benefits as defined under the Internal Revenue Code, which would have the effect of switching the beneficiary to an alternate beneficiary determined according to a valid beneficiary designation made by the deceased.

Many years after signing a form designating his wife Liv as his beneficiary under the SIP (with no alternate or contingent beneficiary named), William divorced Liv, and, as part of the divorce decree, Liv purported to waive any interest she might have in William's SIP benefits. However, William never submitted to the SIP plan administrator any documents either removing Liv as his beneficiary or naming any other beneficiary under that plan. After William's death, his estate requested that his SIP benefits be distributed directly to the estate. The SIP plan administrator, however, relied on William's beneficiary designation form and paid the benefits to Liv, rather than to the estate. The estate then sued the SIP plan sponsor and plan administrator, claiming that, because Liv had waived her right to SIP benefits, they had violated ERISA by paying the benefits to Liv rather than the estate.

The U.S. District Court for the Eastern District of Texas entered summary judgment for the estate, ordering the plan administrator to pay the value of William's SIP benefits to the estate. The District Court relied on precedent from the U.S. Court of Appeals for the Fifth Circuit ("Fifth Circuit") to hold that a beneficiary can waive the rights to the proceeds of an ERISA plan, provided that the waiver is explicit, voluntary and made in good faith.

The Fifth Circuit reversed the District Court decision, distinguishing the precedent cited by the District Court as inapplicable to William's situation, and holding that Liv's waiver constituted an assignment or alienation to William's estate of her interest in the SIP benefits, which violated ERISA's requirement that plan benefits may not be assigned or alienated (hereinafter, the "antialienation provision"), and therefore her waiver could not be honored. The Fifth Circuit acknowledged that a qualified

domestic relations order ("QDRO") is a statutory exemption from the antialienation provision but found that the divorce decree in this case was not a QDRO and, therefore, the court could not give effect to the waiver incorporated in the divorce decree.

Waiver vs. "Assignment" and "Alienation"

The first section of the Supreme Court's analysis was dedicated to examining whether Liv Kennedy's waiver violated ERISA's antialienation provision. The Court began by stating legal dictionary definitions of the terms "assign" ("[t]o transfer; as to assign property, or some interest therein") and "alienate" ("[t]o convey; to transfer the title to property"). Based on those definitions, the Court stated that it was "fair to say that Liv did not assign or alienate anything to William or to the Estate later standing in his shoes." The Court noted that the Fifth Circuit had treated Liv's waiver as an indirect arrangement whereby the Estate gained an interest enforceable against the plan, but rejected the notion that such an "indirect arrangement" could have arisen in this situation. In doing so, the Court relied on the common law of trusts and specifically the notion thereunder of a spendthrift trust. Under the law of trusts as it pertains to spendthrift trusts, the beneficiary of such a trust, although they lacked the means to transfer their beneficial interest to anyone else, did have the power to disclaim their interest in the trust, so long as they did so prior to accepting any benefit and so long as they made no attempt to direct their interest to a beneficiary in their place. However, the Court cautioned that it was not finding that Liv's waiver was a valid disclaimer at common law, but rather was finding only that "reading the terms of [ERISA's antialienation provision] to bar all non-QDRO waivers is unsound in light of background common law principles." The Court concluded that, because the waiver here did not attempt to direct Liv's interest in the SIP benefits to any other party, the waiver did not constitute an assignment or alienation and, thus, was not void under ERISA's antialienation provision.

The Court noted the Fifth Circuit's finding that the waiver in this case was not a QDRO, but gave no significance to that finding, because of the Court's conclusion that a QDRO cannot be used to waive benefits. The Court stated that a QDRO, by definition, requires that it create or recognize the existence of an alternate payee's right to certain benefits, which are otherwise attributable to a participant, under an ERISA plan. Because a simple waiver does not contain a "succeeding designation of an alternate payee," and because QDROs are not "a mechanism for simply renouncing a claim to benefits," a simple waiver cannot be accomplished through a QDRO.

Finally, the Court then addressed several other arguments regarding the validity of the waiver, including an argument that the plan could not recognize a waiver of benefits in a non-QDRO divorce decree because it was a state-court order that would be preempted by ERISA. The Court rejected this argument, finding that, because any waiver of ERISA benefits would involve application of federal common law, recognizing a waiver contained in a state court order "would merely be applying federal law to a document that might also have independent significance under state law."

The Plan Documents Rule

Although the Supreme Court found that a simple waiver of ERISA plan benefits did not violate ERISA's antialienation provision, it nonetheless concluded that the plan in this case acted properly in paying the benefits to Liv, rather than to William's estate. The Court noted that ERISA requires that a plan administrator act solely in accordance with plan documents, and the Court stated that the estate's claim "stands or falls by 'the terms of the plan.'" The Court found that this principle, i.e., the "Plan Documents Rule," "giv[es] a plan participant a clear set of instructions for making his own instructions clear" and allows a plan to follow certain, concrete rules, those preventing them from having to examine "nice expressions of intent." However, the Court stated that "this guarantee of simplicity is not absolute" and specifically noted enforceability of QDROs as an example of an instance where the plan may have to look outside of actual plan documents. However, the Court noted that examinations of QDROs are

directed by statute, and are not, in any case, the type of "factually complex and subjective determinations" which the Plan Documents Rule seeks to avoid.

The Court concluded by noting what it found to be the most salient facts of this case, that Liv was William's designated beneficiary under the plan, that William never changed his beneficiary designation, and that Liv never disclaimed her interest in accordance with plan procedures. The Court thus found that the plan administrator did his duty by paying benefits to Liv, in accordance with the beneficiary designation.

Impact of *Kennedy* Decision

The Supreme Court's opinion in the *Kennedy* case is complex, and it is difficult to say how it will be interpreted by other courts. However, plan sponsors and plan administrators should take note of the following:

Plan Documents Rule: The Court's opinion strongly backs uniform, simple administration of a plan through the Plan Documents Rule. Plan sponsors and plan administrators should carefully examine their plan documents and attempt to remove any ambiguities, especially as to beneficiary designation matters, because this opinion places direct responsibility on the plan sponsor to include explicit plan provisions concerning the method of changing a beneficiary designation (as well as placing direct responsibility on plan participants to review their beneficiary designations when they get married, divorced, etc.). Courts are likely to apply this approach in other contexts, with the likely result that plan sponsors and plan administrators will have less flexibility where the plan has clear written directions on an issue.

Waivers and QDROs Are Separate Legal Instruments: The Court's opinion appears to disturb settled practice whereby an ex-spouse's waiver of an interest in a pension plan could only be accomplished through a QDRO. The Court appears to be stating that whether or not a waiver is contained in a domestic relations order, the validity of that waiver does not depend on whether the domestic relations order is deemed to be a QDRO. Rather, plan administrators must carefully examine and separately evaluate all waivers (whether or not contained in a QDRO) to determine their validity.

Waivers of Benefits: Although the Court ultimately held that the waiver at issue could not be enforced against the plan (because of the Plan Documents Rule), the Court specifically stated that it was not making any rulings on whether a waiver would be effective if it were otherwise consistent with plan documents. Plan administrators will therefore have to struggle with the issue how and under what circumstances to permit benefit waivers when not specifically precluded by applicable plan documents.

Preemption: The most significant uncertainty arising from the Court's opinion relates to the Court's statement (made without any explanation) that a state court document or opinion may not be preempted where its significance can otherwise be determined under federal law. Historically, the operation of state law to give effect to a contract, requirement or document in the area of plan administration was preempted. The Court has now suggested that federal common law may provide a way to enforce such documents or requirements in a way previously not contemplated under preemption analysis. While it remains to be seen whether the Court's approach to preemption in this case is expanded, prior conclusions about the preemption of state court documents may have to be reexamined.

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