Defined Benefit Pensions: The Evolution of Advocacy Concerning What is Often the Most Valuable Marital Asset

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This article attempts to address the problems that arise in the distribution of future payable defined benefit pensions and how the approach to these assets has evolved over time. The issues reviewed below are not exhaustive. The authors believe court review will inevitably provide attorneys with additional guidance when addressing equitable distribution of these valuable assets, which are frequently given insufficient thought and attention when drafting marital settlement agreements.

In order to understand the division of retirement assets, it is essential to review the *Kikkert* decision.[1] The *Kikkert* decision involved equitable distribution of a vested private pension. The Appellate Division was "called upon to decide whether a 'vested' pension plan which will provide future monetary benefits to plaintiff husband is equitably distributable."[2] The court decided a pension is an asset acquired during the marriage, and is subject to equitable distribution. The measure of distribution of a defined benefit retirement plan is the coverture portion, which is the portion acquired during the marriage (the date of marriage through the date of complaint) versus the total years in service.[3]

Prior to *Kikkert*, there were conflicting decisions regarding the appropriateness of distributing a future benefit that may or may not be realized.[4] It became clear that the efforts of both spouses during a marriage contributed toward the acquisition of a deferred benefit, thus "both justifiably expect to share the future enjoyment of the pension benefits..."[5]

Courts are charged with effectuating an "equitable distribution of property, both real and personal which was legally and beneficially acquired" during the marriage.[6] The definition of assets acquired during a marriage is "comprehensive."[7]

The "vested" status of the asset was not dispositive:

> (T)he concept of vesting should probably find no significant place in the developing law of equitable distribution...These now customary usages of the concept of vesting are in no way relevant to the question of effecting an equitable distribution.[8]

The fair analysis was not whether the asset vested during the marriage, but whether it was acquired by either party during the marriage.[9]

From a reading of *Kikkert*, it is clear the "right to receive monies in the future is unquestionably...an economic resource subject to equitable distribution based upon proper computation of its present dollar value."[10] Future payable benefits earned during coverture "constitute distributable assets to the extent to which the anticipated benefits will have been generated by the mutual effort of the parties."[11] As far as a defined benefit pension: "Each spouse had the same expectation of future enjoyment with the knowledge that the pensioner need only survive to receive it."[12]

However, the *Kikkert* court also opined regarding the preferred method of distributing a future pension interest:

> Long-term and deferred sharing of financial interests are obviously too susceptible to continued strife and hostility, circumstances which our courts traditionally strive to avoid to the greatest extent possible.[13]

In other words, in situations where other assets were available for distribution, offsetting the known present value of a deferred distribution asset was preferable, provided the present value of the asset was ascertainable with the acknowledgment that "all appropriate consid-

erations, including the length of time the pensioner must survive to enjoy its benefits, to be satisfied out of other assets, leaving all pension benefits to the employee himself."[14]

Equitable distribution of a future payable pension can occur by any of the following methods: "(1) a present-value offset distribution; (2) a deferred-distribution; and (3) a partial deferred-distribution."[15] The present value of the pension is determined by valuing it at the assumed date of retirement and then establishing a discount to determine present value.[16] The most common reason for this approach occurs when, for example, the non-member spouse retains other property, such as a marital home, an IRA or any other asset of value in exchange for a waiver of the deferred distribution of a pension. If the offset method is used, serious thought must be given to tax consequences, such as tax-free equity in a home, when compared to assets held in a simple IRA, for example. Attorneys contemplating present-value offsets need to be mindful of the tax consequences of the assets used in the offset in order to adequately protect their client's interests.

However, when there are insufficient assets to allow for the offset of the present value of the deferred distribution asset, or "where no present value can be established and the parties are unable to reach agreement, resort must be had to a form of deferred distribution based upon fixed percentages."[17]

The Participant's Disability Challenges the *Kikkert* Concepts

The concepts set forth in *Kikkert* become even more complicated in situations where a plan participant has vested in a deferred distribution/defined benefit retirement plan, such as a state pension plan, but becomes eligible for disability benefits. It is notable that the published cases addressing distribution of defined benefit disability pensions involve the Police and Fire Retirement System (PFRS), which generally permits the collection of the retirement benefit at the conclusion of a certain number of years in service, irrespective of age.[18] Unlike PFRS, the Public Employee Retirement System (PERS) provides for collection of regular benefits upon meeting both years of service and age requirements. A member of the PFRS pension (depending on his or her start date in the plan) is "eligible for 'special' retirement on the first of the month following the establishment of 25 years of creditable service, regardless of the member's age."[19] Whereas, a member of the PERS pension could achieve 25 years of service but not be eligible to collect benefits until age 60 or older, depending on the year the employment commenced.[20]

Thus, for a member of PERS who has 25 years of service at age 44 but cannot collect the benefit until age 60 or later, the disability component of the pension is significantly different than a PFRS member who becomes disabled after 24 years of service and does not have an age requirement for collection. The Appellate Division has addressed the division of the PFRS disability pension, but a comparable analysis regarding a PERS disability pension has never been undertaken in a published or unpublished opinion that the authors were able to locate.

Generally, a disability retirement allowance:

> has two components—one that represents a retirement allowance and is subject to equitable distribution to the extent attributable to marital efforts and another that represents compensation for disability and belongs to the disabled spouse alone.[21]

There is no set formula for determining the marital versus non-marital/disability component of a disability defined benefit pension:

> [T]he statute governing the pension plan does not set forth a procedure for determining what portion of a pensioner's benefit is intended to compensate exclusively for his disability. This omission, however, cannot result in unjustly and improperly subjecting the full amount of a disability pension to equitable distribution upon divorce. Confronted with this situation, a trial court should explore, with the assistance of expert analysis, other options, including limiting the amount subject to equitable distribution to defendant's contributions to his pension, which is what he would have received had he left the police department at the time.[22]

Limiting distribution to the disabled participant's actual contributions may result in an insignificant amount of equitable distribution compared to the total monthly disbursement. Limiting disbursement to the actual contributions of the parties is a seldom-made argument by attorneys representing the participant

disabled spouse despite the clear acknowledgment by the Appellate Division that such an approach was potentially reasonable.

The *Sternesky* court noted that even though the Appellate Division "encouraged the Board of Trustees of PFRS to provide information that would permit courts to identify the components of a disability pension...The board has not done so."[23] Because of the board's failure to act, the parties to such matters need "to present evidence that permits segregation of the component of a disability pension that is a retirement asset and part of the marital estate from the component that is designed to compensate the disabled spouse and is part of his or her individual property."[24]

To fill the void left by the state, the appellate court created a formula for when the plan participant is not yet ready for ordinary retirement:

> [T]he ordinary retirement allowance should be calculated at fifty percent of the member's final salary. Fifty percent of final salary is the amount of an ordinary retirement at the earliest date. N.J.S.A. 43:16A-5. Final salary is also the figure used to calculate the accidental disability benefit. Use of that percentage and salary, absent evidence or guidance suggesting otherwise, will recognize that reasonable expectation that the non-pensioner spouse has in sharing in a retirement benefit based on efforts during the marriage. The injury to the disabled spouse should neither enhance nor diminish the value of the investment interest anticipated on the basis of efforts during the marriage.[25]

Once the amount of the ordinary retirement allowance is identified, the next part of the analysis is preserving the excess allowance beyond what would be allocated to ordinary retirement as the disability component, which would not otherwise be subject to equitable distribution.

The *Sternesky* court was specifically addressing a PFRS matter where the plan participant could have elected retirement at 25 years of service, regardless of age. This approach does not necessarily work in the case of a PERS system employee who may have 25 years of service, but is not eligible to retire because he or she has not reached the required age. Implementation of the concepts established in *Kikkert* and expanded by *Sternesky* may very well result in an inequitable outcome in certain circumstances. If a participant spouse is eligible to collect a PERS disability pension 20 years before the standard retirement age, that individual is receiving a full 20 years of payment solely due to disability. It seems perfectly reasonable and appropriate for the non-participant spouse to commence receiving his or her equitable share of the pension at the pensioner's regular age for retirement eligibility. Conversely, there would likely be no disability component for a PFRS disability pension if the member spouse was disabled in the 25th year of service, even though he or she planned on working an additional 10 years to maintain their lifestyle or to support young children.

The solutions offered by the appellate court were intended to address fact-specific scenarios that required immediate resolution. The court's call for other branches of state government to create an equitable formula has fallen on deaf ears, potentially to the detriment of litigants on both sides of the issue, especially those addressing how to divide a PERS disability pension.

Insurance for Benefits, Pre-retirement Death Benefits and Survivor Benefits as Security

Another common dilemma is securing pension benefits for a non-participant former spouse when there is no right to survivor benefits. The concept of pre-retirement death benefits is often confused with survivor benefits, even though they are vastly different. With many defined benefit government pensions, if the participant passes away before the pension is in pay status there is no survivor benefit provided to the non-participant former spouse. However, pre-retirement death benefits can be designated as security for such a situation. Securing the future pension payment with pre-retirement death benefits is often overlooked when marital settlement agreements are drafted.

Another dilemma is how to secure the pension benefit for the non-participant former spouse once the pension is in pay status. In some plans, like the New Jersey State Police (NJSP) pension or the PFRS pension, the non-participant former spouse is not eligible to receive benefits beyond the death of the participant. If there was no possibility the benefits would continue past the death of the participant spouse, there is no equitable distribution to insure. The non-participant former spouse's interest is a deferred distribution and

> amounts to a contingency distribution dependent upon the survival of the pensioner

spouse. Accordingly, if the pension does not provide survivor benefits to an ex-spouse, then her benefits cease when defendant dies...when he gets, she gets; when he dies, so does her benefit.[26]

Where the plan does not provide for survivor benefits to a spouse or former spouse, there is no legal support for the trial court's order for the participant spouse to maintain life insurance to secure the pension benefit for the non-participant spouse.[27]

This begs the question of whether a non-participant spouse who is divorced from the participant spouse after decades of marriage has any right to expect security for his or her interest in the pension. Each pension has different rules regarding survivor benefits. For example, the NJSP pension affords a 50 percent survivor benefit to the participant's surviving spouse, but not to a divorced spouse. If the plan administrator does not permit survivor benefits for a divorced spouse, logically there is nothing to secure.

However, it seems this approach may be too simplistic in long-term marriages. Defined benefit pension plans, especially for long-term government employees, in addition to Social Security benefits, are often the primary source of income for a couple upon retirement. Decades earlier, couples may consciously have decided one spouse would accept a job with lower pay but 'good benefits,' while the other spouse's contribution was limited to employment that offered no benefits but otherwise enhanced the marital enterprise. If a couple is married for a long duration and the non-member spouse depended on receiving the pension benefits and expected to receive a 50 percent survivor benefit as a married surviving spouse, it seems harsh and inequitable to not only take away the survivor benefit upon divorce but also the valuable healthcare insurance attached to the member spouse's retirement package. The *Larrison* precedent may be too harsh in certain factual circumstances.

Although the statute does not specifically provide that there should be security for equitable distribution, including a pension, "[t]he need for creation, now or in the future, of a trust fund to secure reasonably foreseeable medical or educational costs for a spouse...or children" is a factor the authors believe the courts must consider.[28] It seems equitable in some situations to extend this concept to ex-spouses who depend not only on the pension benefits, but on continued healthcare insurance coverage at no or minimal cost for the remainder of one's life. As a counterbalance, however, it should be noted the lack of survivor benefits afforded to a non-member former spouse increases the total monthly benefits paid out, since survivor benefits come at a cost.

Circumstances Where the Coverture Fraction is Inequitable

An example of when it is inequitable to apply the coverture fraction to a defined benefit pension would be when the marital portion consists of a short number of years early in a member spouse's career. By way of example, if a participant in the PFRS plan married during her third year of service and remained married for four years from the date of marriage through the date of complaint, roughly 16 percent of the pension is marital if the member worked for 25 years. This factual scenario renders the non-participant spouse's coverture interest as eight percent. If the member was a patrol officer when the parties married and earned $45,000 per year at the time of separation, but by her 25th year of service was retiring as the police chief with an annual salary of $125,000, it seems unfair and inequitable to calculate the marital coverture fraction based on the ending police chief's salary, since the non-member former spouse contributed relatively little to the enhancement of the member spouse's income.

In *Barr v. Barr*, the Appellate Division looked to the specific language of the marital settlement agreement for direction.[29] The parties in *Barr* were married in 1968 and divorced in 1987.[30] The parties entered into a settlement agreement that provided:

> The Wife will receive 50% of Husband's pension benefits attributable to his 11 years in the military service only. Such benefits are to be distributed when Husband commences receiving same.[31]

In *Barr*, the husband joined the Air Force Reserves after the divorce and achieved the rank of major upon retirement, resulting in a significant increase in the value of his retirement benefits.[32] At the time of the parties' separation, the husband had reached the rank of captain.[33]

The ex-wife in *Barr* claimed she was entitled to 42 percent of the member spouse's benefits. The ex-husband argued the ex-wife's "interest must be calculated without consideration of the increased benefit directly attributable to his post-dissolution promotion."[34]

While there are certainly some unique features to military pensions, including the fact that there are no member contributions whatsoever, the language of the party's agreement was critical to the analysis:

> We first review the PSA to discern whether its terms unambiguously resolve this dispute. As noted, the terse provisions of the parties' agreement afforded plaintiff a fifty-percent interest in defendant's pension benefits "attributable to his 11 years in the military service only."[35]

The language of the *Barr* settlement agreement was ambiguous and was subject to "two reasonable alternative interpretations."[36] The Appellate Division focused on the "modifier 'only,'" which arguably could "mean only that portion of the asset defined by the time of the marriage," which could have been interpreted as years or active duty, excluding the time in the reserves and the later promotion from captain to major.[37] The Appellate Division reversed the trial court's application of a simple coverture fraction approach and remanded the matter for "a plenary hearing as necessary, to discern the intent of the parties when drafting the PSA provision distributing defendant's military pension."[38]

The holding in *Barr* was not an aberration. Post-divorce efforts, to the extent they can be quantified, may not be subject to equitable distribution:

> Thus far, we have considered the "coverture fraction" as sufficient to carve out the marital value of the asset and have not required that the value of the benefits as of the date of retirement be analyzed to determine, and subtract out, any enhancement due to post-divorce work effort. We do not foreclose that possibility in the event, on remand, the parties choose to pursue that issue and establish an appropriate record.[39]

In *Menake*, the determination of post-divorce efforts included the ability to mathematically quantify those efforts.[40] While it may be difficult to reconcile this notion with *Reinbold v. Reinbold*,[41] there are

> some extraordinary post-judgment pension increases that may be proven to be attributable to post-dissolution efforts of the employee-spouse, and not dependent on the prior joint efforts of the parties during the marriage. In such instances, these sums must be excluded from equitable distribution and the application of the coverture fraction may be insufficient to accomplish this purpose.[42]

The burden is on the employee-spouse seeking exclusion "proving with calculable precision what portion of the increase in the pensions value is immune from equitable distribution."[43] In order to prevail, the employee-spouse in *Barr* was required to make a "showing that the promotion was awarded solely through his post-judgment work efforts, rather than related to past efforts."[44]

The key to properly analyzing intent of the parties' years post-judgment lies in providing detailed factual background in the settlement agreement itself. Such detail must exceed mere rank and title. It must include specific identification of the retirement plan and the way benefits are calculated, whether or not overtime is a basis, and whether there is a possibility of a return to an already vested pension.

The conflicts in the above cases arose because of ambiguous provisions in marital settlement agreements, which are subject to different interpretations. In order to better protect clients and effectuate the intent of the parties, careful drafting of pension provisions is critical.

When addressing future payable defined benefit retirement plans in marital settlement agreements it is critical to carefully draft the intent of the parties and contemplate future scenarios. It is not offensive or contrary to existing precedent to set forth clear limits for a member early in his or her career, or to ask for concessions for a non-member spouse after many years of marriage. The simple coverture fraction and concepts established in *Kikkert* have evolved into a more fluid scheme that requires skilled advocacy in the proper circumstances. ■

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Endnotes

1. *Kikkert v. Kikkert*, 177 N.J. Super. 471 (App. Div. 1981).
2. *Id.* at 473.
3. *Marx v. Marx*, 265 N.J. Super. 418 (Ch. Div. 1993).
4. *See Mueller v. Mueller*, 166 N.J. Super. 557 (Ch. Div. 1979); *Weir v. Weir*, 173 N.J. Super. 130 (Ch. Div. 1980).
5. *Sternesky v. Salcie-Sternesky*, 396 N.J. Super. 290, 298, (App. Div. 2007), *citing Whitfield v. Whitfield*, 222 N.J. Super. 36, 46 (App Div. 1987).
6. N.J.S.A. 2A:34-23.
7. *Kikkert, supra*, 177 N.J. Super. at 474, *citing Painter v. Painter*, 65 N.J. 196, 215 (1974).
8. *Id.* at 474-475, *citing Stern v. Stern*, 66 N.J. 340, 348 (1975).
9. *Id.* at 475, *citing Pellegrino v. Pellegrino*, 134 N.J. Super. 512, 515-516 (App. Div. 1975) (citations omitted).
10. *Id.* at 475, *citing Kruger v. Kruger*, 73 N.J. 464, 468 (1977).
11. *Id.* at 475, *citing McGrew v. McGrew*, 151 N.J. Super. 515, 518 (App. Div. 1977).
12. *Id.* at 476-477.
13. *Id.* at 479.
14. *Id.* at 478.
15. *Claffey v. Claffey*, 360 N.J. Super. 240, 255 (App. Div. 2003) (citation omitted).
16. *Id.* at 255-256, *citing Menake v. Menake*, 348 N.J. Super. 442, 448 (App. Div. 2002).
17. *Kikkert, supra*, 177 N.J. Super. at 478.
18. N.J.S.A. 43:16A-6.
19. N.J.A.C. 17:4-6.11, *see also* N.J.A.C. 17:9-6.9(a)(1)(iii).
20. N.J.A.C. 17:1-17.8.
21. *Sternesky, supra*, 396 N.J. Super. at 295 *citing Larrison v. Larrison*, 392 N.J. Super. 1, 17 (App. Div. 2007).
22. *Larrison, supra*, 392 N.J. Super. at 18.
23. *Sternesky, supra*, 396 N.J. Super. at 296.
24. *Id.* at 296, *citing Larrison, supra*, 392 N.J. Super. at 16-18; *Avallone v. Avallone*, 275 N.J. Super. 575, 584 (App. Div. 1994).
25. *Sternesky, supra*, 396 N.J. Super. at 302.
26. *Larrison, supra*, 392 N.J. Super. at 18, *citing Claffey v. Claffey*, 360 N.J. Super. 240, 261 (App. Div. 2003) (citation omitted) (internal quotation marks omitted).
27. *Larrison, supra*, 392 N.J. Super. at 19.
28. N.J.S.A. 2A:34-23.1(n).
29. *Barr v. Barr*, 418 N.J. Super. 18 (App. Div. 2011).
30. *Barr, supra*, 418 N.J. Super. at 29.
31. *Id.*
32. *Id.* at 37.
33. *Id.*
34. Id. at 30.
35. *Id.* at 36-37.
36. *Barr, supra*, at 37, *citing Chubb Custom Ins. Co. v. Prudential Ins. Co. of America*, 195 N.J. Super. 231, 238 (2008).
37. *Id.*
38. *Id.* at 38.
39. *Barr, supra*, 418 N.J. Super. at 40, *quoting Menake v. Menake*, 348 N.J. Super. 442, 454 (App. Div. 2002).
40. *Menake, supra*, 348 N.J. Super. at 454.
41. *Reinbold v. Reinbold*, 311 N.J. Super. 460 (App. Div. 1998).
42. *Barr, supra*, 418 N.J. Super. at 41.
43. *Id.*
44. *Id.*

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