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Stuck in the Middle: A Cautionary Tale About Beneficiary Designation Forms

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Recent developments in the United State Supreme Court's review of the case of *Kennedy v. Plan Administrator for DuPont Savings & Investment Plan*[1] highlight the need for care when administering beneficiary designation forms. The case involved the conflicting claims of a participant's ex-spouse and his daughter to the participant's profit sharing plan account. In this case, it was clear the divorcing couple had been careful to specify how the participant's retirement plan benefits were to be allocated, but the disposition of his profit sharing plan benefits was not as clear. "Caught in the middle" was the profit sharing plan administrator, with a beneficiary designation form listing the ex-spouse as beneficiary, IRS informal guidance insisting that plan administrators follow the terms of the plan or risk disqualification, and the daughter insisting that the "clear intent of the parties" be followed. This column describes this case and reminds plan administrators of steps they can take to avoid this situation.

Kennedy v. Plan Administrator for Dupont Savings & Investment Plan

William Kennedy was a participant in the DuPont Savings & Incentive Plan (SIP). William named his wife Liv as his sole beneficiary in the SIP. The Kennedy's divorced in 1994. The divorce decree awarded

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Liv Kennedy a portion of William Kennedy's rights in another DuPont retirement plan, the DuPont Retirement Plan. The divorce decree also awarded William Kennedy, and simultaneously divested Liv Kennedy, of all claims to all rights related to William Kennedy's pension plans, "except the portion awarded to Liv Kennedy." A qualified domestic relations order (QDRO) was executed and subsequently amended specifying Liv Kennedy's rights in the DuPont Retirement Plan. No QDRO was prepared for the SIP.

William retired in 1998 and died in 2001. He never changed the SIP beneficiary form designating Liv Kennedy as his beneficiary.

William's estate was represented by his daughter Kara. The estate demanded that Liv give up her rights to the SIP account (which was worth about $400,000). The estate argued that Liv had waived her right to the money by signing the divorce decree and was not entitled to the money in the account. The DuPont plan administrator refused to agree because the beneficiary designation for the SIP still listed Liv as the sole beneficiary of the SIP. Liv was paid the benefits. The estate filed a claim for benefits from the plan, stating that the divorce decree invalidated the beneficiary designation.

The Texas district court agreed that under federal common law Liv had waived her right to the SIP benefit by executing a divorce decree. The court said that under Fifth Circuit precedent, a beneficiary could waive rights to plan proceeds, as long as the waiver was explicit, voluntary, made in good faith, and did not violate any anti-assignment or anti-alienation provisions in the Employee Retirement Income Security Act (ERISA) or the Internal Revenue Code (Code).

The Fifth Circuit reversed. It stated that ERISA's and the Code's anti-assignment and alienation rules applicable to pension plans prohibited recognition of such waivers and that the common law precedent on waivers cited by the district court was not relevant because that precedent dealt with life insurance, not pension plans. Thus, the SIP properly followed the beneficiary designation and it could not be compelled to recognize the waiver because such a waiver conflicted with federal law.

The Supreme Court granted review on the question of whether the recognition of the waiver was barred by the anti-alienation clause of the Code and ERISA.

The issue sparked significant concerns in the pension community. The United States Solicitor provided an amicus brief on behalf of the government "in support of neither party," but making the argument that although the anti-alienation rules did not *prohibit* a waiver, under ERISA and the Code, a plan administrator is not required to give effect to a waiver that conflicts with plan documents. Plaintiffs, by contrast, continued to argue that the intent of the parties was clear and should govern.

After oral argument, where the Justices appeared sympathetic to the personal plight of the daughter, but concerned about imposing a standard that would require plan administrators to take into effect

documents contradicting the plan terms, the Court posed this new question: "Whether 29 U.S.C. 1104(a)(1)(D), mandating administration of a plan in accordance with plan documents, required that the distribution in question be made to Liv Kennedy, even on the assumption that a waiver of her interest was not otherwise subject to statutory bar." This issue has been described by the parties as "The Plan Documents" issue.

Analysis of the Plan Documents Issue

ERISA requires that "[a] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries, and…in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter."

The Solicitor's brief argued strongly that although a divorcing spouse's waiver might not violate ERISA's anti-alienation provision, it does not automatically follow that the plan administrator must recognize the waiver. Because ERISA requires a plan administrator to distribute benefits to the beneficiary designated by the participant or under the terms of the plan, a waiver that is not consistent with the provisions of the plan documents cannot trump the terms of the plan. It was argued that the appropriate mechanism for eliminating the beneficiary interest of an ex-spouse is for the participant to change the beneficiary designation in accordance with plan terms. "That process is generally not difficult," the brief stated. The brief noted too that in this case, the SIP actually provided for disclaimers that conform to the strict requirements and formalities of 26 U.S.C. Section 2518. Thus, had Liv Kennedy disclaimed her interest in the funds in William Kennedy's SIP account following his death, in a manner that complied with Section 2518, presumably the plan administrator could have honored that decision despite the beneficiary designation forms.

The amicus brief emphasized that requiring plan administrators to act in accordance with plan documents serves one of the principal goals of ERISA—it allows employers to establish a uniform administrative scheme that can compy with a set of standard procedures to guide processing of claims and disbursements of benefits. This uniformity would be lost if plan administrators could ignore the plan documents.

The American Association of Retired Persons (AARP) filed a statement in response to the Supreme Court's request for comments, supporting a plan administrator's obligation to administer the plan in accordance with plan documents. The focus here appears to be to protect the argument that the law requires adherence to the terms of the plan document. It was argued that ERISA requires a plan administrator to administer plans according to their documents and instruments, and to pay benefits to a person who is a beneficiary as defined in the document. Thus, ERISA leaves no room for courts to require a plan administrator to recognize such a waiver.

Representatives of the daughter, by contrast, argued that the "plan documents" rule is not a clearly defined doctrine, and, in any event, does not require adherence to an outcome that is not intended by the parties. They argued further that even if the plan sponsor must adhere to "plan documents," it is not clear that the beneficiary form itself is a "plan document" that must be followed. Moreover, in this case the plan administrator had an alternative. The administrator knew that the beneficiary of the plan was being contested, so could have filed an interpleader suit and held the funds in escrow until a court determined the proper beneficiary. Instead, "[a]lthough aware of the circuit split regarding waivers, DuPont nonetheless gave a spendthrift ex-spouse a windfall…."[2]

The point was made that a doctrine requiring blind adherence to the terms of the documents would have an even greater impact and create more unintended outcomes in the future. It is becoming increasingly more difficult to reconcile ERISA's requirements with the very complicated domestic relations issues. More widespread divorce (including low cost divorces) makes it likely that unsophisticated parties may be preparing and reviewing pension documents. Finally, the breadth of recognized civil unions is expanding, which may raise more difficult issues for plan administrators to resolve and create uncertainties with respect to beneficiary forms and procedures designed for more "traditional" marriages.

Issues for Plan Administrators

Plan administrators are indeed, caught in the middle. It is easy in hindsight to suggest that the DuPont plan administrator in this case should have allowed a court to adjudicate this issue before paying claims. Such a statement is easy to make in the abstract, but is not always workable when parties that need pension payments to survive after a participant's death are pressing for timely pension plan payouts.

Nonetheless, this case suggests a few practical steps that could be taken to avoid such a dilemma. Annual reminders to participants to update beneficiary forms can be helpful. A plan might initiate a practice of circulating new forms to participants on a periodic basis or after a certain period of years. Another possible solution would be to provide in the plan document that upon a participant's divorce, any beneficiary designation forms will be invalid, although this suggestion could also lead to unintended consequences unless the provision is clearly communicated (*e.g.*, on the forms themselves, in the SPD). In all events, plan administrators would be well-advised to be cautious before paying out claims if more than one party argues it is a beneficiary, and might consider interpleader or another form of dispute resolution.

But even if a plan administrator adjudicates carefully the parties' intent, it could risk "violating the terms of the plan." IRS officials and pension right advocates have long maintained that unless the terms of the plan are enforceable, plan participants have no protection. IRS

officials have argued that adherence to documents is a plan qualification requirement. Most scholars and commentators would agree that plan sponsors cannot and should not be allowed to "reinterpret" basic plan promises such as benefit formulas and rights by ignoring plan terms (although some might argue that this conclusion goes too far when IRS spokespersons maintain that a true "scrivener's error" that all parties know is incorrect can never be acknowledged as such when interpreting plan provisions).

On the other hand, the "plan documents" rule, if applied to every feature of the plan, creates a significant strain on plan administration as more and more pension plans adopt "prototype" or "standard" documents of over 100 pages that recite all Code and ERISA rules at great length, and recite procedures, timing, and other technical requirements in minute detail. It will be impossible for plan administrators to follow every detail to the letter, and impossible for the IRS to enforce such a strict "plan documents" rule.

Conclusion

Clearly, plan administrators need to communicate the importance of beneficiary designation forms to participants, and make those forms and the choices clear. No matter the outcome, the *Kennedy* case illustrates this need. It will be interesting, however, to see how the Supreme Court ultimately resolves the "plan documents" argument, and whether it will go so far as to require adherence to every facet of the plan terms or to provide some type of "rule of reasonableness." Depending on how the case is decided, the case could have a larger impact on plan procedures than the mere administration of beneficiaries' designation forms.

Notes

1. Kennedy v. Plan Administrators for DuPont Savings & Investment Plan, 497 F.3d 426 (5th Cir. 2007).

2. Brief for Petitioners at p. 28.

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