Focus

The Practitioner Family Law

Rule of 75

'Oddino' Case Addresses Enhanced Pension Benefits

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Generally, if employees retire before normal retirement age (usually 62 or 65) their pension benefits are reduced. However, as an incentive to retire early, employees increasingly are offered their full pension benefit as if they had retired at normal retirement age. Division upon divorce of these increased pension benefits (referred to as enhanced benefits) has become an actively litigated issue. The California Supreme Court in *Marriage of Oddino*, 16 Cal.4th 67 (1997), has begun to address this issue.

In *Oddino*, the parties were divorced in 1983. The wife was awarded a portion of the husband's pension pursuant to a formula to be determined later. In 1989 the parties applied that formula to the husband's pension and stipulated that the wife would receive approximately 33 percent. They further stipulated that payments to the wife were to begin "as if [husband] had retired on April 1, 1988, and were to begin 'as of April 1, 1988.'"

April 1, 1988, was the husband's 55th birthday, and, on that day, he was still working. The order was submitted to the pension plan, which determined that the order was a qualified domestic relations order (QDRO), a state court order that, pursuant to federal law, require a pension plan to pay part of an employee's benefit to an "alternate payee," usually an ex-spouse as part of a divorce. If the order follows all the requirements of the applicable federal law, it is said to be "qualified."

The husband's pension plan provided, except as noted below, that if an employee started to receive pension benefits before age 65, the benefit would be actuarially reduced to be the equivalent of payments starting at age 65. This was because benefits would be paid for a longer time period. However, the plan allowed an employee who retired at age 55 or later, where the sum of the employee's age and years of service was 75 or greater, to receive the full unreduced pension. This is generally referred to by pension plans as the "rule of 75." The increased benefit amount is called the "early retirement subsidy."

Had the husband in *Oddino* retired on his 55th birthday, the rule of 75 would have applied and his benefits would not have been reduced. However, the plan determined that the rule did not apply to the wife's benefit payments. Since the wife decided to receive benefits before the husband was 65, the plan reduced the benefits from $3,618 per month to $1,564 per month.

The pension plan was joined to the divorce case, and the Superior Court granted the plan's request to have the rule of 75 not apply. The California Court of Appeal reversed, agreeing with the wife that the rule should apply. Finally, the California Supreme Court reversed the Court of Appeal and found for the plan.

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The first issue the Supreme Court discussed was whether federal courts have exclusive jurisdiction to determine if a state court domestic relations order is qualified. The court followed several appellate court opinions and ruled that state courts have concurrent jurisdiction with federal courts to decide this issue.

With respect to the issue of the rule of 75, the court first restated the holding of *Marriage of Gilmore*, 29 Cal.3d 418 (1981), which entitles the nonworking spouse to begin receiving community interest in a pension plan on the first date in which the employee is eligible to retire and begin receiving benefits. The nonworking spouse can begin receiving benefits even if the working spouse has not actually retired. The court noted in a footnote that it was dealing only with the issue of whether or not the pension plan could be ordered to pay the wife the full amount of the benefit. It was explicitly not deciding whether the husband could be ordered to pay the wife the early retirement subsidy.

> **Division** of **'enhanced benefits' upon divorce has become an actively litigated issue.**

When an ex-spouse receives part of an employee's pension before the employee retires, federal law places limits on the amount the ex-spouse can receive. The court held that the relevant provision in the Employee Retirement Income Security Act was the following: "[A]n order may be a QDRO even if it requires preretirement payment on or after the participant's earliest retirement age and 'as if the participant had retired on the date on which such payment is to begin under such order (*but taking into account only the present value of benefits actually accrued and not taking into account the present value of any employer subsidy for early retirement*)." See 29 U.S.C. Section 1056(d)(3)(E)(i)(II).

The wife argued that the early retirement subsidy was not an "employer subsidy for early retirement," but was the normal retirement benefit. The plan argued, and the court agreed, that the early retirement subsidy was an employer subsidy for early retirement and should not be included in the wife's benefits.

The court first reasoned that the section of ERISA at issue limits the wife's benefits, in this situation where the husband had not yet retired, to "the present value of benefits actually accrued." The accrued benefit of a participant, in turn, is defined as an annual benefit commencing at normal retirement age or as the "actuarial equivalent" of such benefit. See 28 U.S.C. Sections 1002(23) and 4054(c)(3). The normal retirement age is 65. Thus, the plan must, according to these provisions, actuarially reduce the benefits payable to the wife if benefits to her commence before the husband turns 65 years old.

The court then held that the same conclusion is reached by analyzing the term "employer subsidy." Although ERISA does not define "subsidy," the court adopted the definition set forth in a 1984 Senate report: "the excess of the value of a benefit over the actuarial equivalent of the normal retirement benefit." Applying this definition to the present case, the court reasoned that "whether Rule of 75 benefits are subsidized, therefore, depends on whether their value is greater than the actuarial value of a participant's normal retirement benefit."

The value of the rule-of-75 benefits is greater than the value of the actuarial equivalent of the normal retirement benefit for the following reason: Although the monthly payment pursuant to the rule of 75 is the same as the normal retirement benefit, payments made pursuant to the rule could start as early as 10 years before the normal retirement benefits start.

For example, assume that the monthly normal retirement benefit is $1,000 per month. These payments made at normal retirement would begin at age 65. However, these payments made pursuant to the rule of 75 could start as early as age 55, which represents an additional 10 years of $1,000-per-month payments.

The court also analyzed a treasury regulation, the terms of the plan, the legislative history of ERISA and several other cases and commentators, all of which supported its conclusion that the rule-of-75 benefits are a "subsidy."

The court noted that employers often offer this early retirement subsidy as "an incentive for specified groups of employees to leave the employer's work force voluntarily, so as to reduce its wage burden or avoid litigation that might result from laying off an employee." This benefit is a quid pro quo offered to the employee. If the nonworking spouse was able to receive the benefits of this bargain (i.e., receive rule-of-75 benefits), the employer would not receive its benefits: Rule-of-75 benefits would be paid to the nonemployee spouse while the employee spouse continued to work.

A related issue that occurs in several cases is this: If the husband retires before age 65, what portion of the subsidy can the wife receive as her share of the community property? The court stated ERISA does not prohibit the wife receiving part of the subsidy. "Nothing we say here, we note, precludes recalculation of [the wife's] payments if [the husband] actually takes early retirement."

The current law is not clear as to whether these subsidized benefits are community property or the separate property of the employee-spouse. There are two cases pending before the California Supreme Court that may address and clarify this issue, *Marriage of Lehman*, S062850, and *Marriage of Johnson*, S062848.

The nonworking spouse should pursue two things in light of *Oddino*. First, the nonworking spouse should try to collect the early retirement subsidy from the employee spouse since it cannot be collected from a pension plan. Second, if the employee spouse retires and actually receives an early retirement subsidy, the QDRO should specify what percentage the nonemployee spouse should receive.