FAMILY LAW

Drafting QDRO's: A Malpractice Waiting to Happen!

Part 1

This article will identify various ways a marital and family law attorney who drafts his or her own qualified domestic relations order (QDRO) can be committing malpractice. Part 1 of this article will show that payment made pursuant to a non-QDRO, notwithstanding that it has been qualified by the plan administrator, will expose both the participant and the nonparticipant spouse to extensive damage. It will show that the plan administrator has a vested interest in making certain that a domestic relations order (DRO) qualifies, and will help in every way possible to ensure that the order later be deemed qualified. It will also show that attorneys who rely upon the assistance of the plan administrator will often construct QDRO's which vary greatly from the terms of the dissolution order, and that plan administrators often construct self-serving rigid rules that must be met for qualification, often having more to do with their expenses in later administering the QDRO than with whether the DRO meets the specific requirements of law. Part 1 concludes by stating the client's rights and then demonstrating how these rights may be used to force the plan administrator into qualifying a good DRO.

Attorneys who rely upon plan administrators who do not understand the more complicated issues, yet offer advice, may be vulnerable to malpractice

by A. Matthew Miller and Jerry Reiss

Part 2 identifies optional provisions not required for qualification, but which form the nucleus of malpractice exposure to both the marital and family law attorney who drafts such QDRO's and the opposing counsel who consents to such QDRO's. This part specifically addresses issues that can affect benefit amounts that the QDRO will later provide. It will show that only drafters familiar with the day-to-day problems of plan administration are fully qualified to construct the benefit payment provisions of the QDRO. It will also identify when and how to properly provide surviving spouse's benefits, and under what circumstances the inclusion and the manner in which survivorship rights are included can affect the benefit amounts under the QDRO. It will also show that the payment of surviving spouse's benefits from a defined benefit plan can be extremely complicated even to the skilled ERISA attorney. It often requires understanding the underlying actuarial basis that will affect the benefit that results and how that result can be quite different from what the parties affected by the QDRO understood it would be.

Part 2 will also introduce a format choice to segregate benefits between the participant and the nonparticipant spouse, other than the sharing of benefits that some plans are now providing. It will show that this format, instead of simplifying things as intended, adds yet another dimension to the difficulty of construction of the QDRO because it can completely change the benefit amounts with the same language. It can also change the conditions of when to include surviving spouse's benefits. Marital and family law attorneys who rely upon the plan administrator for assistance could be especially vulnerable to malpractice exposure because the plan administrator to whom the attorney must turn for advice often does not understand the more complicated issues. Yet, this will not stop that plan administrator from offering the advice because it is often the goal of the plan sponsor that the plan administrator spend the least amount of time needed to ensure that the DRO qualifies at the least amount of future administration expense, and little else.

Qualified domestic relations orders were provided for by the Retirement Equity Act of 1984 as a means of distributing assets from a qualified pension or profit sharing plan to a nonparticipant in the plan, pursuant to a dissolution of marriage action, without destroying the qualified nature of the plan.[1] Domestic relations orders are orders entered by a family court having both subject matter jurisdiction as well as jurisdiction over the parties subject to the order. In order to be a QDRO, the DRO must meet certain conditions imposed by federal law.[2] Unless the order is a QDRO, the plan administrator cannot honor a court-ordered payment to a nonparticipant spouse[3] or former spouse.[4]

A DRO will be deemed to be a QDRO if it is entered by the family court and presented to the plan administrator for payment and it meets the terms of IRC

§414(p). This provision requires the order:

1) To clearly identify the name, last known mailing address, Social Security number, and date of birth of both the participant and alternate payee. (*An alternate payee is the nonparticipant spouse, former spouse, or child(ren) who will receive benefits pursuant to the terms set forth in the QDRO.*)

2) To clearly identify the plan to which the order applies. In order to do this, the order must state the legal name of the plan and its federal plan identification number.[5]

3) To clearly identify the name and address of both the plan administrator and the plan sponsor of the specific plan to which the order relates.

4) To clearly identify what benefit is to be paid to the alternate payee, and at what time.

Most of this information generally can be found in the summary plan description or a recent benefit certificate.

There are two additional mandatory requirements: The QDRO cannot ask the plan to pay benefits that are not available in the plan document; and the QDRO cannot require payment of benefits to an alternate payee which are required to be paid to another alternate payee.

Most QDRO's that initially fail qualification fail because of provisions in the QDRO that ask the plan to alter the benefits available in the plan.[6] This is the key feature of any QDRO. What benefits a plan can provide varies widely from plan to plan. In order to determine what is permitted, including when a payment is made, under what conditions, and how it is determined, one must read the plan document, not the summary plan description. This requires an in-depth understanding of ERISA, plans in general, and how they work.

A DRO that asks the plan to make a payment contrary to its terms (because the attorney who drafted the DRO did not understand the terms), and has boiler-plate language which prevents such payments from being made will fail to qualify because the DRO is ambiguous on its face. It fails to clearly identify what benefit is to be paid to the alternate payee, and at what time. Beware of the boiler-plate language customarily found in model form books of suggested model QDRO's. Boiler-plate language should never be blindly applied.

Qualifying an order is an important first step. It is a more difficult task, however, to draft the qualified order to say what needs to be said so it conforms to what was understood by both the alternate payee and the participant. Qualifying an order can work in harmony with drafting it to say what needs to be said, or it can compete with it. In order to understand this process, one needs to understand what common interest the practitioner, who prepares QDRO's, shares with the plan administrator, who is responsible for qualifying these orders and needs to know when these interests conflict. The common interests of the two should be examined.

Plan Administrator Often Provides Assistance

The plan sponsor who employs the plan administrator would have a great deal at stake if the plan administrator were to qualify an order that did not satisfy the federal requirements. If the plan administrator were to honor an order that failed to satisfy the federal requirements, it could expose the plan to disqualification under ERISA.[7] A plan disqualification would subject the plan's trust earnings to taxation, and would result in the disallowance, as deductible, of contributions that had been previously made to the trust,[8] as well as jeopardize future contributions.[9]

Plan disqualification impacts both the participant and alternate payee. For example, the alternate payee spouse could not roll the money to an IRA.[10] Any desired passing of tax liability to the alternate payee is not passed as contemplated, but becomes the liability of the participant just as if the participant received it individually.[11] It could result in the immediate recognition of income to the participant of the portion of the benefit retained by the participant.[12] Thus, the **participant, alternate payee, and plan administrator *all* have a stake in making** certain that the DRO meets the requirements of qualification before payment is made pursuant to its terms.

This Assistance Can Lead to Early Qualification

The shared responsibility between the parties to the dissolution and the plan administrator can be an asset in ensuring that the DRO does qualify under federal law. The plan administrator will often provide assistance to the marital and family law attorney in helping that attorney qualify a DRO that does not meet the conditions of IRC §414(p). Attorneys not familiar with ERISA will often rely on this assistance. Unfortunately, this reliance can work against their client's best interests.

How Much Assistance Should One Rely Upon?

Marital and family law attorneys must recognize that the participant and alternate payee have a greater stake in cooperating with each other than either has in cooperating with the plan administrator. The participant and alternate payee each have to abide by the terms of the court order. A prolonged fight costs both sides money. There is a specified amount of money to be divided, and no amount of fighting can change that. When a QDRO conforms to the dissolution order it protects both sides, ensuring that neither side will receive less than the amount that had been ordered by the family court or agreed upon by the parties.

The joint interest that the plan administrator has with the participant is that the order be deemed qualified. The plan administrator will often protect the plan's interest in that regard.

Battle Lines Are Drawn

The second most important concern of the plan administrator is the ultimate cost of qualifying the order. This cost includes initial qualification with the assistance of attorneys and actuaries. In some plans, there is a long period of waiting for benefit payments to begin. Record keeping and maintenance of separate liabilities could easily cost the employer several thousand dollars in increased costs during that waiting period. A monthly lifetime payment thereafter could add another several thousand dollars in expense. In larger companies, multiply this total expense by the number of participants who divorce each year and it is easy to understand why battle lines are drawn. This problem is why many companies offer model language limiting many options.[13]

Model language often eliminates choices that are more costly to admini-

ster, or will allow modified choices at great cost to both the participant and alternate payee (demonstrated below). Unfortunately for our clients, these choices can be very important. They include survivor's rights, early payment rights, and early retirement subsidies.

Plan administrators have little incentive to cooperate with attorneys who draft QDRO's except on their own terms: the model language they offer. Efforts to work outside these rules is often met with resistance, or outright refusal to qualify an otherwise lawful QDRO. Attorneys who work within the model language restrictions will often enter QDRO's which vary from the marital settlement agreement or final judgment of dissolution of marriage.[14]

The only recourse left to the attorney facing this refusal is to file a petition in a state or federal court asking the court to determine if the order meets the requirements for qualification.[15] This possible litigation poses little threat to the plan administrator because of the attorney's presumed limited knowledge of ERISA and plans in general, the participant's reluctance to sue his or her employer while employed, and overall lack of desire on the part of either the participant or alternate payee to engage in yet another court-related confrontation that can be both wearisome and expensive.

Faced with this adversary interest, can marital and family law attorneys qualify a DRO under the terms of the court, or must they yield to the plan administrator's preference? It has been the experience of the authors that there will be times when one must yield. The vast majority of cases can be dealt with successfully. However, the practitioner drafting the QDRO must have in-depth knowledge of ERISA and plans in general, or access to such knowledge. It is essential for the drafter to fully understand the rights of the participant and alternate payee, and what remedies are available to enforce these rights.

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What Are Your Client's Rights?

The Most Important Rights Are the Following:

1) Upon submitting any DRO to the plan administrator, whether qualified or not, the plan administrator *must* separately account for the assets that would have been payable pursuant to the DRO until qualification can be established, or until 18 months after payments under a QDRO are scheduled to begin, whichever is earlier.[16]

2) If the DRO fails to meet the terms required for qualification, the plan administrator *must* notify the parties to the DRO of the reasons for the deficiency.[17] If there is evidence within the freeze period that the parties are trying to correct the deficiencies, the plan administrator should extend this period.[18]

3) The plan administrator must have a written policy with respect to qualification of DRO's and must provide a copy of this policy upon request.[19]

4) The plan administrator must quickly respond to requests for qualification of an order.[20]

5) The plan administrator must furnish a summary plan description (describing the most recent plan) free of charge to all participants and certain beneficiary spouses.[21]

6) The participant has a right to a full copy of the plan document. The employer may charge a reasonable copy fee for its preparation.[22]

7) The participant has a right to annual benefit certificates which clearly indicate the amount of benefit that the participant has accrued, vesting rights to that benefit, and when the benefit is normally paid.[23]

These rights are administratively enforced by the Department of Labor. When enough complaints have been registered against an employer, the Department of Labor will investigate. It has the authority to assess huge fines for noncompliance. In addition, the participant and beneficiary may file suit in any court of competent jurisdiction seeking to enforce these rights. Special damages for noncompliance can be awarded.[24]

Misunderstood Components of Professional Exposure

An order which has been qualified by the plan administrator can pose professional liability to the attorney in two ways:

Smaller Company Risks

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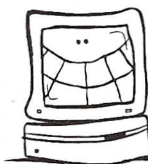

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though the plan administrator recognizes the DRO as a QDRO, and makes payments thereunder, it can still be determined later that it failed to meet the terms of IRC §414(p). This is a significant risk with less sophisticated smaller companies unwilling to pay the fees necessary to properly review these QDRO's.[25]

Larger Company Risks

While the same risk of later disqualification hangs over the larger plans, the more likely risk that needs to be addressed is that the QDRO can result in payments vastly different from what was understood by the affected parties. This result can occur because of incorrect advice provided by the plan administrator on the effects of using certain model language. It can also occur with QDRO's that fail to protect the rights of the alternate payee or participant by not preserving such rights in the QDRO due to a lack of understanding or due care by the domestic relations lawyer. From the perspective of the alternate payee, these issues can range from surviving spouse coverage (and exactly how that is accomplished) to when the alternate payee may first begin receiving benefits (and how much). From the perspective of the participant, these issues can range from the cost of providing surviving spouse coverage (and there are a host of factors involved) to limitation of benefits protecting future spousal interests. ❐

Part 2 of this article will be published in the March 1995 issue.

[1] A qualified domestic relations order, as opposed to a domestic relations order, is required by the Retirement Equity Act of 1984 (hereinafter REA) before a qualified plan may make payment to a nonparticipant spouse. *See* 29 U.S.C.A. §1056(d)(3)(A).

[2] All the conditions required for qualification of an order are set forth in §414(p) (1986), as amended.

[3] Rev. Rul. 80-77, 1980-1, C.B. 85 stated that a domestic relations order that provided a payment to a nonparticipant spouse at the actual retirement of the participant would not cause a plan to disqualify on account of the ERISA requirement that a plan cannot assign or alienate benefits. REA preempted this provision by imposing the only conditions under which a payment could be made. I.R.C. §414(p). It also liberalized it by allowing the nonparticipant spouse a right to receive benefits earlier than, and independent of, any decision to retire by the participant.

[4] Parties need not be divorced for entry of a QDRO. I.R.C. §414(p)(8) (1986).

[5] Combination plans with one trust can require special care. It will be necessary to give separate consideration to each plan by identifying that plan by its segregated account. For example, an ESOP can have 401(k) features, or there can be a money purchase plan and a profit sharing plan stated as one plan.

[6] Except for the earliest retirement age (payment) rule of I.R.C. §414(p)(4), which is the only permissible plan alteration that can be made.

[7] Except for QDRO's, there cannot be assignment or alienation of benefits. I.R.C. §401(a)(13)(B) and I.R.C. §414(p) (1986).

[8] An employer contribution made to a retirement plan is deductible under I.R.C. §404(a) to the extent it satisfies I.R.C. 401(a). *Also see* Treas. Reg. §1.404(a)-3.

[9] This could jeopardize the plan sponsor's continuation of the plan. Such an action would cause great injury to all the plan participants.

[10] Only a participant or the spouse of a participant can roll benefits from a qualified plan to an IRA. A distribution pursuant to a non-QDRO could only be a distribution to the participant. A spouse can only roll benefits that were received directly from the plan. I.R.C. §402(c)(1); I.R.C. §402(a)(5)(A)(i)(1986).

[11] Payments made pursuant to a non-QDRO would be taxed as income to the plan participant as if the participant distributed the sums therein to make a payment pursuant to a court-ordered DRO. *See Hawkins v. Commissioner*, 102 T.C. No. 3 (1994).

[12] I.R.C. §402(b)(2)(A)(ii) (1986).

[13] If the DRO meets the conditions of I.R.C. §414(p), it must be qualified. ERISA remedies to force qualification are found under §502(a)(1) and (e). The participant or alternate payee also has a right to a fair review by a plan fiduciary. *See* 29 CFR §2560.503-1(g).

[14] A family court can direct that payment be made to a nonparticipant spouse with or without survivorship features on any portion of the participant's benefit it sees fit to award. The only authority the plan administrator has in such matters is to make certain the order conforms to the requirements of I.R.C. §414(p). *See* I.R.C. §414(p)(1)(A)(i) & (ii); I.R.C. §414(p)(5)(A); Treas. Reg. §1.401(a)-13(g)(4)(iv).

[15] The alternate payee is a beneficiary under ERISA §206(d)(3)(J). Any determination by the plan administrator is subject to judicial review in either a federal or a state court on either the institution of the participant or alternate payee under ERISA §502(a)(1) and (e).

[16] Unless the participant is eligible to receive payment before that date, in which case the issue of qualification must be resolved before the date the participant is eligible to receive benefits. *See* ERISA §206(d)(3)(H), I.R.C. §414(p)(7).

[17] I.R.C. §414(p)(6)(A) (1986).

[18] *See* the conference committee report on the Tax Reform Act of 1986.

[19] ERISA §206(d)(3)(G) & (H).

[20] I.R.C. §414(p)(A)(ii). The legislative history of "REA" authorizes the secretary to promulgate regulations defining a reasonable period. *See* H.R. Rep. No. 655, 98th Cong., 2d Sess. 20 (1984); and S. Rep. No. 575, 98th Cong. 2d Sess. 22 (1984). **No rule has yet been published, but the Pension** Welfare Benefits Administration of the Department of Labor published on 10/21/93 request for public comment. (58 FR 54444.)

[21] Labor Law Reg. §2520.104b-2.

[22] ERISA §104(b)(4) (1974); and Labor Law Reg. §2520.104b-30.

[23] Labor Law Reg. §2520.104b-1.

[24] ERISA §502(c); ERISA §502(3)(B)(i) and (ii) (1974).

[25] In *Hawkins v. Commissioner*, 102 T.C. No. 3 (1994), the plan administrator made payments pursuant to a DRO that was later determined to be nonqualified.

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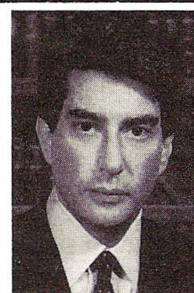
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This column is submitted on behalf of the Family Law Section, Judge Mark E. Polen, chair, and William D. Palmer and Edna Y. Elliot, editors.

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