When the Wrong Person gets the Money - The ERISA Federal Preemption Trap in Equitable Distribution

Dwight A. Ensley, JD, MBA, BBA, CVA
ValuePointe.biz
420 West Market Street
Greensboro, NC 27401

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I. Introduction

Under North Carolina's equitable distribution statutes, retirement benefits acquired during marriage and prior to separation are marital property.[1] This paper will deal with the dangers to three categories of martial retirement benefits when handled incorrectly under the federal common law "Plan Document Rule". The three categories of benefits covered by this paper that can be distributed by the North Carolina District Court judge are as follows: (1) Qualified plans, such as a 401(k)[2]; (2) Non-qualified plans, which are generally deferred compensation plans[3]; and (3) Individual Retirement Plans (IRAs).[4] These three categories of marital assets will be discussed hereafter in detail.[5]

The North Carolina District Court judge and the North Carolina family law practitioner are cautioned that the federal common law Plan Document Rule may render the work of the family judge or lawyer meaningless in the division of qualified plans, non-qualified plans and IRAs. The Plan Document Rule is a rule of federal common law that instructs the plan administration to look solely at "the directives of the plan documents" in determining how to distribute benefits.[6] A typical example of how the work of the North Carolina District Court

[1] N.C. Gen. Stat. § 50-20(a)(1) (LexisNexis 2011); *id.* § 50-20.1(a)(1).
[2] *See generally* 26 U.S.C.S. § 414(p) (LexisNexis 2012); *see generally* N.C. Gen. Stat. § 50-20.1(a)(1).
[3] *See generally* 26 U.S.C.S. § 409A(d) (LexisNexis 2012); *see generally* N.C. Gen. Stat. § 50-20.
[4] *See generally* 26 U.S.C.S. § 408 (LexisNexis 2012).
[5] Other categories of ERISA or IRC regulated benefits are beyond the scope of this paper.
[6] *Boyd v. Metro. Life Ins. Co.*, 636 F.3d 138, 140 (4th Cir. 2011).

judge in equitable distribution or the family law practitioner may be rendered inapplicable is demonstrated in the landmark United States Supreme Court case, *Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan,* 555 U.S. 285 (2009). In *Kennedy*, the divorce decree awarded the pension to the Husband, and the Wife waived rights to the pension.[7] After the divorce decree, Husband died without changing the beneficiary designation.[8] Wife (now ex-wife) received the pension under the federal common law Plan Document Rule, preempting the state court decree granting the Husband the pension plan.[9] This paper will discuss in depth the *Kennedy* case, the key cases leading up to *Kennedy*, and what has happened since *Kennedy*. Particular consideration will be given to what has happened since *Kennedy* in the Fourth Circuit Court of Appeals and the United States District Courts in the Fourth Circuit.

Finally, note ten[10] in the *Kennedy* decision suggests the possibility of remedies for the federal preemption trap. This paper will explore these possible remedies in two categories: first, the methods available under North Carolina law that might prevent the wrong person from getting the qualified, non-qualified, and IRA benefits at the death of the plan owner; and second, methods of retrieval of benefits from an unintended beneficiary, such as constructive trust and contempt, if the federal law preempts the divorce decree and the wrong person receives the benefit.

[7] *Kennedy*, 555 U.S. at 289.
[8] *Id.* at 289-90.
[9] *Id.* at 299-300.
[10] *Id.* at 299 n.10.

II. Beneficiary Designation Rules of Qualified Plans, Non-Qualified Plans, and IRAs under Federal Law

a. Introduction

The rules of beneficiary designation differ depending on the type of retirement plan. Two interlocking statutory frameworks, the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC), govern the employee benefits area. ERISA governs various vesting, funding, reporting, disclosure, and fiduciary requirements of employee benefit plans for the purpose of protecting employee retirement plans.[11] The IRC governs various vesting, funding, reporting, disclosure, and distribution requirements for the purpose of qualification for various taxation treatments.[12]

b. Qualified Benefit Plans.

A qualified benefit plan permits payment of compensation to an employee, as well as the tax on the compensation, to be deferred until after the employee's retirement. Unlike non-qualified deferred compensation plans, qualified retirement plans allow an employer to deduct contributions to a qualified plan when the contribution is made rather than when the employee is paid such benefits.[13] The employer's contributions to the qualified plan are placed into a trust which cannot be reached by the employer's creditors.[14] Further, because this qualified trust is tax exempt, interest earned on trust contributions accumulates tax free.[15]

[11] 29 U.S.C.S. § 1001 et seq (LexisNexis 2012).
[12] 26 U.S.C.S. § 1 et seq (LexisNexis 2012).
[13] 1-1 Federal Income Taxation of Retirement Plans § 1.02 (2012) *available at* www.LexisNexis.com
[14] *Id.*
[15] *Id.*

Qualified retirement plans are divided into defined benefit and defined contribution plans.[16] Each of these groups is subdivided into plans with different approaches to retirement funding.[17] The different types of plan designs include fixed benefit plans, cash balance plans, money purchase plans, 401(k) plans, profit sharing plans, stock bonus plans, and employee stock ownership plans (ESOPs).

Qualified plans require that the spouse be the primary beneficiary[18] and the designation of another beneficiary is prohibited without the written consent of the spouse.[19] Both ERISA and the IRC require that every qualified joint and survivor annuity include an annuity payable to a nonparticipant surviving spouse.[20] The survivor's annuity may not be less than 50 percent of the amount of the annuity which is payable during the joint lives of the participant and spouse.[21] Provision of the survivor's annuity may not be waived by the participant, absent certain limited circumstances, unless the spouse consents in writing to the designation of another beneficiary, which designation also cannot be changed without further spousal consent, witnessed by a plan representative or notary public.[22]

A Qualified Domestic Relations Order (QDRO)[23] is a type of domestic relations order (DRO)[24] which creates or recognizes an alternate payee's right to, or assigns to an alternate payee the right to, a portion of the benefits payable with respect to a participant under a plan.[25] A domestic relations order, in turn, is any judgment, decree, or order that concerns “the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child,

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[16] *Id.*
[17] *Id.*
[18] 26 U.S.C.S. § 401(a)(11) (LexisNexis 2012); 29 U.S.C.S. § 1055(a) (LexisNexis 2012).
[19] *Id.* § 1055(c) (LexisNexis).
[20] 26 U.S.C.S. § 401(a)(11); 29 U.S.C.S. § 1055(a).
[21] *Id.* § 1055(d)(1).
[22] *Id.* § 1055(c)(2).
[23] 26 U.S.C.S. § 414(p)(1)(A) (LexisNexis 2012).
[24] *Id.* § 414(p)(1)(B).
[25] 29 U.S.C.S. § 1056(d)(3)(B)(i) (LexisNexis 2012).

or other dependent of a participant" and is "made pursuant to a State domestic relations law (including a community property law)."[26] A domestic relations order must meet certain requirements to qualify as a QDRO.[27] QDRO's, unlike domestic relations orders in general, are exempt from both the pension plan anti-alienation provision,[28] and ERISA's general preemption clause.[29] In creating the QDRO mechanism Congress was careful to provide that the alternate payee, the "spouse, former spouse, child, or other dependent of a participant," is to be considered a plan beneficiary, which is to give enhanced protection to the spouse and dependent children in the event of divorce or separation, and in the event of death the surviving spouse.[30]

c. Non-qualified Benefit Plans.

Non-qualified deferred compensation arrangements are called "non-qualified" because they do not qualify for the special tax treatment accorded to "qualified benefit plans" under Section 401(a) of the Internal Revenue Code.[31] Arrangements that result in the deferral of income to the termination of employment or beyond are technically "pension plans" as defined in ERISA. However, most of ERISA's substantive requirements do <u>not</u> apply if an arrangement is unfunded, and is either an "excess benefit plan"[32] or maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees. Among the most popular non-qualified plans are Supplemental Executive Retirement

[26] *Id.* § 1056(d)(3)(B)(ii).
[27] *See id.* § 1056(d)(3)(C)-(E).
[28] *Id.* § 1056(d)(3)(A).
[29] *Id.* § 1144(b)(7).
[30] *Id.* § 1056(d)(3)(K).
[31] 26 U.S.C.S. § 409A(d).
[32] An excess benefit plan is a plan that provides benefits in excess of the limitations of a related tax-qualified benefit plan under 26 U.S.C.S. § 415 (LexisNexis 2012).

Plans, Excess Benefit Plans, Stock Options, Restricted Stock, Phantom stock, Performance Unit Plans, Rabbi Trusts, Split-dollar Life Insurance, and fixed payments at retirement.[33]

There are no beneficiary designation requirements for these plans in ERISA or the IRC. A QDRO is not available for non-qualified plans. Thus, beneficiary designations must be made in accordance with the terms of the plan. Generally, non-qualified plans allow the participant to change beneficiaries without the consent or knowledge of the other spouse.

d. <u>Individual Retirement Accounts (IRAs).</u>

i. <u>IRAs Governed by IRC only</u>

An Individual Retirement Account (IRA) is a tax-advantaged account held in the name of an individual for the purpose of providing income to the individual during retirement. There are three types of IRAs that are not covered under ERISA, but are created by IRC only: traditional, Roth, and education. The traditional IRA provides an immediate tax deduction for individuals who qualify for contributions, but is subject to taxes and perhaps penalties upon withdrawal.[34] The Roth IRA provides no immediate tax benefit, but withdrawals following retirement are generally tax free.[35] Education IRAs, also known as Education Savings Accounts, are not for retirement savings, but rather are for the kindergarten through high school or post-secondary education of the designated beneficiary.[36] As with non-qualified plans, IRAs allow the participant to change beneficiaries without the consent or knowledge of the other spouse.

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[33] Drake, Dwight, *Business Planning: Closely Held Businesses*, 399-401 (West 3rd ed. 2011).
[34] 26 U.S.C.S. § 408.
[35] *Id.* § 408A (LexisNexis 2012).
[36] *Id.* §§ 529-530 (LexisNexis 2012).

ii. IRAs Governed by IRC and ERISA

Three types of IRA accounts are covered by both the IRC and ERISA: Simple Retirement Accounts (SIMPLE), Simplified Employee Pension Accounts (SEP), and rollover plans. These plans are governed by ERISA because the plans are originally created by an employer. A SIMPLE IRA is an individual retirement account created by an employer for the benefit of an employee.[37] A SEP IRA is an individual retirement account or annuity generally used by a self-employed individual in a small business as retirement accounts for the owner and a small number of employees.[38] A rollover IRA is an IRA that is created to hold the funds transferred from another ERISA-qualified plan.[39] These accounts are covered under ERISA and are subject to the relevant minimum standards requirements as mandated under the act,[40] including ERISA beneficiary requirements.

IRC 408(d)(6) provides a method to divide all types of IRAs in a divorce, avoiding the unintended beneficiary problem. Under IRC 408(d)(6), the transfer of an individual's interest in an individual retirement account to his spouse or former spouse under a divorce or separation instrument is not a taxable transfer.[41] Further, the spouse who receives an IRA transfer in divorce is now the owner of the IRA in all respects.[42] Thus, the transferee spouse or former spouse receiving the IRA has the right to designate the beneficiaries.

[37] *Id.* § 408(p).
[38] *Id.* §§ 404(h), 408(k).
[39] *Id.* § 408(d)(3).
[40] 29 U.S.C.S. § 1003 (LexisNexis 2012).
[41] 26 U.S.C.S. § 408(d)(6).
[42] *Id.* § 408(d)(6).

III. The Plan Document Rule and *Kennedy*

a. Introduction

The Plan Document Rule specifically requires that the written provisions of an ERISA[43] regulated benefit plan preempt any state statute or court order.[44] In other words, the United States Supreme Court holds that a claim for benefits "stands or falls by the terms of the plan."[45] The Supreme Court construed 29 U.S.C. § 1104(a)(1)(D) (2006) as a "broad endorsement" of the "plan documents rule," under which plan administrators look solely at "the directives of the plan documents" in determining how to disburse benefits.[46]

ERISA is an intricate, comprehensive statute.[47] Its federal regulatory scheme governs employee benefit plans, which include both pension and welfare plans.[48] All employee benefit plans must conform to various reporting, disclosure and fiduciary requirements while pension plans must also comply with participation, vesting, and funding requirements.[49] The surviving spouse annuity and QDRO provisions are part of the statute's mandatory participation and vesting requirements.[50] These provisions provide detailed protections to spouses of plan participants which, in some cases, exceed what their spousal rights would be under state law.[51]

ERISA's express preemption clause states that the Act "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[52] Further, apart from a few enumerated exceptions, a plan fiduciary must "discharge his duties with respect to a

[43] 29 U.S.C.S. § 1001 et seq (LexisNexis 2012).
[44] 29 U.S.C.S. § 1144(a).
[45] *Kennedy*, 555 U.S. at 300.
[46] *Boyd*, 636 F.3d at 140.
[47] *Boggs v. Boggs*, 520 U.S. 833, 841 (1997).
[48] *Id.*
[49] *Id.*
[50] *Id.*
[51] *Id.*
[52] 29 U.S.C.S. § 1144(a).

plan solely in the interest of the participants and beneficiaries."[53] The assets of a plan, with certain exceptions, are "held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan."[54]

The policy behind ERISA and the Plan Document Rule is first declared in the ERISA statute itself, which states it "protects … the interests of participants in employee benefit plans and their beneficiaries"[55] by "improving the equitable character and the soundness of such [private retirement] plans."[56] A second policy objective of ERISA and the Plan Document Rule is to enable employers to establish a uniform administrative scheme across the fifty states for processing claims and disbursing benefits.[57] A third policy objective of ERISA and the Plan Document Rule, with regard to qualified plans only, is to ensure a stream of income to surviving spouses.[58]

b. *Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan,* 555 U.S. 285 (2009).

In *Kennedy* the United States Supreme Court unanimously held that the ex-wife's federal common-law waiver of her entitlement to ERISA benefits, embodied in a Texas divorce decree that was not a QDRO, was not invalidated by the anti-alienation provision of ERISA.[59] However, the plan administrator properly disregarded the waiver after the ex-husband's death because it conflicted with the husband's designation of beneficiary in accordance with plan documents.[60]

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[53] *Id.* § 1104(a)(1).
[54] *Id.* § 1103(c)(1).
[55] *Id.* § 1001(b).
[56] *Id.* § 1001(c).
[57] *Egelhoff v. Egelhoff*, 532 U.S. 141, 148 (2001).
[58] *Boggs*, 520 U.S. at 843.
[59] *Kennedy*, 555 U.S. at 304.
[60] *Id.*

i. Summary of the *Kennedy* Facts:

During the marriage the husband named the wife as survivor beneficiary of his savings and investment plan (SIP), an ERISA employment pension benefit plan, with E. I. DuPont de Nemours & Company.[61] The couple were divorced in 1994.[62] The Texas divorce decree, which was not a QDRO, provided that the wife waive all of her rights in all of the husband's retirement plans, pension plans, or like benefit programs existing by reason of his past or present or future employment.[63] The husband did not execute any documents removing her as the beneficiary on the SIP plan even though he executed a new beneficiary-designation form naming his daughter as the beneficiary of the company's other ERISA pension and retirement plans.[64]

The husband died in 2001 and the executrix, his daughter, requested that the plan distribute the survivor benefits to the estate, arguing that the wife's waiver was enforceable.[65] The plan administrator relied on the beneficiary designation filed by the husband naming the now ex-wife, which had never been revoked, and paid the survivor benefits to the ex-wife.[66] The estate then sued the plan to recover the benefits.[67]

The United States District Court for the Eastern District of Texas held for the estate, finding the waiver enforceable under federal common law.[68] The Fifth Circuit reversed, holding that any state court order regarding retirement benefits violates the anti-assignment provision of

[61] *Id.* at 289.
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *Id.* at 289-90.
[66] *Id.* at 290.
[67] *Id.*
[68] *Id.*

ERISA unless it constitutes a QDRO, and refusing to recognize any federal common law to the contrary.[69]

Addressing a conflict among federal courts of appeal and state supreme courts,[70] the United States Supreme Court granted certiorari to determine a divorced spouse's ability to waive pension plan benefits through a divorce decree not amounting to a QDRO; and to determine whether a beneficiary's federal common-law waiver of plan benefits is effective when that waiver is inconsistent with plan documents.[71]

ii. Holding in *Kennedy*:

The Supreme Court held that the plan administrator fulfilled its statutory duty under ERISA by paying the benefits to the ex-wife in conformity with the plan documents.[72] The Supreme Court disregarded the state court waiver and noted that ERISA requires every employee benefit plan to be established and maintained pursuant to a written instrument, specifying the basis on which payments are made to and from the plan.[73]

The Supreme Court also rejected the plan's assertion that the wife's waiver was prohibited by the ERISA anti-alienation provisions,[74] which applies to the creation, assignment, or recognition of a right to any benefit payable with respect to a participant pursuant to a DRO that is not a QDRO.[75] The Court stated that the ERISA anti-alienation provision[76] does not

[69] *Id.*
[70] *Kennedy*, 555 U.S. at 304 n.4 *compare Estate of Altobelli v. IBM*, 77 F.3d 78 (4th Cir. 1996) (federal common law waiver in divorce decree does not conflict with anti-alienation provision); *Fox Valley & Vicinity Constr. Workers Pension Fund v. Brown*, 897 F.2d 275 (7th Cir. 1990) (en banc) (same); *Keen v. Weaver*, 121 S.W.3d 721 (Tex. 2003) (same), with *McGowan v. NJR Serv. Corp.*, 423 F.3d 241 (3d Cir. 2005) (federal common law waiver in divorce decree barred by anti-alienation provision).
[71] *Kennedy*, 555 U.S. at 291.
[72] *Id.* at 304.
[73] *Id.* at 299-300.
[74] 29 U.S.C.S. § 1056(d)(3)(A).
[75] *Id.* § 1056(d)(1).

expand the scope of ERISA to govern or bar a state court waiver or DRO incorporating a waiver.[77]

c. History Leading up to *Kennedy*

i. Introduction

Kennedy was not the first time the Supreme Court had applied the Plan Document Rule to preempt a state statute or court decree. In 1997, the Supreme Court held in *Boggs v. Boggs,* 520 U.S. 833 (U.S. 1997) that ERISA's Plan Document Rule preempted a deceased spouse's Louisiana community property rights.[78] In 2001, the Supreme Court held in *Egelhoff v. Egelhoff,* 532 U.S. 141 (U.S. 2001) that ERISA's Plan Document Rule preempted a Washington state divorce revocation statute.[79] Following are summaries of these two important cases.

ii. *Boggs v. Boggs***, 520 U.S. 833 (U.S. 1997).**

Isaac Boggs worked for South Central Bell from 1949 until his retirement in 1985.[80] Isaac and Dorothy, his first wife, were married when he began working for the company.[81] They had three sons and they remained married until Dorothy's death in 1979.[82] Within a year of Dorothy's death, Isaac married Sandra, and they remained married until Isaac's death in 1989.[83] Isaac retired from South Central Bell in 1985 and received various benefits including a lump sum

[76] *Id.* § 1056(d)(3)(A).
[77] *Kennedy*, 555 U.S. at 297-98.
[78] *Boggs*, 520 U.S. 833.
[79] *Egelhoff*, 532 U.S. 141.
[80] *Boggs*, 520 U.S. at 836.
[81] *Id.*
[82] *Id.*
[83] *Id.*

distribution, which he rolled over into an Individual Retirement Account (IRA)".[84] When he died in 1989, the IRA was worth approximately $180,000.[85]

Isaac's second wife, Sandra, claimed she was entitled to the benefits because she was the plan's designated beneficiary.[86] Isaac's sons from his prior marriage to Dorothy claimed they were entitled to the proceeds under Louisiana community property law.[87] The sons' claim to a portion of the benefits is based on Dorothy's will that bequeathed to Isaac one-third of her estate, and a lifetime usufruct[88] in the remaining two-thirds.[89] She bequeathed to her sons the total ownership in the remaining two-thirds, subject to Isaac's usufruct.[90] All agreed that, absent preemption, Louisiana law controls and that under Louisiana law Dorothy's will would dispose of her community property interest in Isaac's undistributed pension plan benefits.[91]

A Louisiana state court ascribed to Dorothy's estate a community property interest in Isaac's Savings Plan account valued at the time at $ 21,194.29.[92] Sandra filed a complaint in the United States District Court for the Eastern District of Louisiana, seeking a declaratory judgment that ERISA preempts the application of Louisiana's community property and succession laws to the extent they recognize the sons' claim to an interest in the disputed retirement benefits. The District Court found that, under Louisiana community property law, Dorothy had an ownership interest in her husband's pension plan benefits built up during their marriage.[93] The District Court found that there was no assignment or alienation under ERISA because Dorothy's rights in the

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[84] *Id.*
[85] *Id.*
[86] *Id.*
[87] *Id.*
[88] A lifetime usufruct is the rough equivalent of a common-law life estate. See La. Civ. Code Ann., Art. 535 (West 1980).
[89] *Id.*
[90] *Id.* at 836-37.
[91] *Id.* at 837.
[92] *Id.*
[93] *Id.* at 837-38.

benefits were acquired by operation of community property law and not by transfer from Isaac.[94] The Fifth Circuit Court of Appeals affirmed.[95]

The Supreme Court reversed holding that Louisiana Community property law is preempted by ERISA.[96] The Court found that that the Louisiana law directly "clashed" with the objectives of ERISA such that allowing the sons' claim to stand would undermine the objective of "ensuring a stream of income to surviving spouses."[97]

iii. *Egelhoff v. Egelhoff,* 532 U.S. 141 (U.S. 2001).

David Egelhoff was employed by the Boeing Company, which provided him with a life insurance policy and a pension plan.[98] Both plans were governed by ERISA, and David designated his wife, Donna, as the beneficiary under both.[99] In April 1994, the Egelhoffs divorced in the state of Washington.[100] A decree of dissolution was entered on April 22, 1994 and in a document incorporated in the decree, David A. Egelhoff was awarded "100 percent of his Boeing retirement 401K and IRA."[101]

Just over two months later, David died intestate following an automobile accident.[102] At that time, Donna, his now ex-wife, remained the listed beneficiary under both the life insurance policy and the pension plan; the life insurance proceeds, totaling $ 46,000, were paid to Donna, the ex-wife.[103] David's children from a previous marriage were his statutory heirs under a

[94] *Id.* at 838.
[95] *Id.*
[96] *Id.* at 844.
[97] *Id.* at 843.
[98] *Egelhoff*, 532 U.S. at 144.
[99] *Id.*
[100] *Id.*
[101] *Egelhoff v. Egelhoff (In re Estate of Egelhoff)*, 139 Wash. 2d 557, 561 (Wash. 1999).
[102] *Egelhoff*, 532 U.S. at 144.
[103] *Id.*

Washington law.[104] The children sued Donna in Washington state court to recover the life insurance proceeds under a Washington state divorce revocation statute.[105]

The Washington state court, concluding that both the insurance policy and the pension plan "should be administered in accordance" with ERISA, granted summary judgment to Donna in both cases.[106] The Washington Court of Appeals reversed concluding that the Washington statute was not preempted by ERISA.[107] The Supreme Court of Washington affirmed holding that the state statute, "although applicable to 'employee benefit plans,' does not 'refer to' ERISA plans to an extent that would require preemption, because it 'does not apply immediately and exclusively to an ERISA plan, nor is the existence of such a plan essential to operation of the statute.'"[108] The Washington Supreme Court further held that the Washington statute "lacks a 'connection with' an ERISA plan that would compel preemption," emphasizing that the statute "does not alter the nature of the plan itself, the administrator's fiduciary duties, or the requirements for plan administration."[109]

The United States Supreme Court reversed and found that ERISA expressly preempted the Washington statute to the extent it applied to ERISA plans because the statute directly conflicted with ERISA's requirements that plans be administered, and benefits be paid, in

[104] *Id.*
[105] *Egelhoff*, 532 U.S. at 144 ("If a marriage is dissolved or invalidated, a provision made prior to that event that relates to the payment or transfer at death of the decedent's interest in a non-probate asset in favor of or granting an interest or power to the decedent's former spouse is revoked. A provision affected by this section must be interpreted, and the non-probate asset affected passes, as if the former spouse failed to survive the decedent, having died at the time of entry of the decree of dissolution or declaration of invalidity." Wash. Rev. Code § 11.07.010(2)(a) (1994)) .
[106] *Id.* at 145.
[107] *Id.*
[108] *Id.*
[109] *Id.*

accordance with plan documents.[110] In addition the Court found that the Washington state statute interfered with nationally uniform plan administration, one of the principal goals of ERISA.[111]

d. Post-Kennedy in the Fourth Circuit and District Courts in the Fourth Circuit

i. Introduction

Since *Kennedy*, the Fourth Circuit Court of Appeals followed and explained *Kennedy* in *Boyd v. Metro. Life Ins. Co.*, 636 F.3d 138 (4th Cir. S.C. 2011).[112] In 2011, the Fourth Circuit held in *Boyd* that ERISA's Plan Document Rule preempted a South Carolina property settlement agreement where the decedent had failed to change the beneficiary of the life insurance policy.

The Fourth Circuit District Courts have cited *Kennedy* six times as of August, 2012, of which three of these cases are relevant to the federal preemption trap in equitable distribution.[113] In July of 2011, the District Court for the Eastern District of Virginia, Richmond Division, held in *Metro. Life Ins. Co. v. Leich-Brannan*, 812 F. Supp. 2d 729 (E.D. Va. 2011) that pursuant to *Boyd* and *Kennedy*, the Plan Document Rule governed the distribution of benefits, and benefits were properly paid to the designated beneficiaries notwithstanding a Virginia divorce decree to the contrary.[114] In January of 2012, the District Court for the District of South Carolina held in *Companion Life Ins. Co. v. Hopson*, 2012 U.S. Dist. LEXIS 19480, (D.S.C. 2012) that ERISA's Plan Document Rule preempted a South Carolina property settlement agreement and order of

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[110] *Id.* at 147-48.
[111] *Id.* at 148.
[112] *Boyd*, 636 F.3d 138.
[113] Fourth Circuit cases after *Kennedy* that are beyond the scope of this paper are as follows: *Boyd v. Metro. Life Ins. Co.*, 2010 U.S. Dist. LEXIS 106296 (D.S.C. 2010) (prior case to Boyd v. Metro. Life Ins. Co., 636 F.3d 138 (4th Cir. S.C. 2011)); *Valderrama v. Honeywell TSI Aero. Servs.*, 2010 U.S. Dist. LEXIS 70573 (D. Md. 2010) (involving a terminated employee's claim for early retirement benefits); *Dunlap v. Ormet Corp.*, 2009 U.S. Dist. LEXIS 22346 (N.D.W. Va. 2009) (court held that the "plan document rule" preempts claims against plan administrator for negligence and breach of fiduciary duty where the plan administrator paid benefits to the named beneficiaries).
[114] *Metro. Life Ins. Co. v. Leich-Brannan*, 812 F. Supp. 2d 729 (E.D. Va. 2011).

general release of claims where the decedent had failed to change the beneficiary of the life insurance policy.[115] In May of 2012, the District Court for the Eastern District of Virginia, Alexandria Division, held in *Andochick* that where the participant had failed to change beneficiaries, the unintended beneficiary that received the benefits was in contempt of the Maryland State Court's Judgment of Absolute Divorce and ordered to waive and renounce the benefits.[116] The state courts of North Carolina will generally follow the decisions of the fourth circuit federal courts, thus the following section discusses in the Fourth Circuit Court of Appeals case and the three Fourth Circuit Federal District Court Cases.

ii. *Boyd v. Metro. Life Ins. Co.*, 636 F.3d 138 (4th Cir. S.C. 2011).

Emma Boyd was an employee of Delta Airlines, Inc. who participated in a life insurance plan administered by Metropolitan Life Insurance Company (MetLife) and governed by ERISA.[117] In 2001, Emma named Robert Alsager, her husband, as the primary beneficiary.[118] Emma and Robert separated in February, 2008,[119] and on April 4, 2008 the South Carolina Family Court issued an "Order Approving Separation and Property Settlement Agreement."[120] The property settlement agreement provided that "[e]ach party relinquishes and disclaims all right, claim or interest . . . that she or he may acquire in the property or estate of the other, including without limitation . . . the right to receive proceeds, funds or property as a beneficiary under any life insurance policies."[121] Emma died on November 8, 2008.[122] Robert and Emma's

[115] *Companion Life Ins. Co. v. Hopson*, 2012 U.S. Dist. LEXIS 19480 (D.S.C. 2012).
[116] *Andochick v. Byrd*, 2012 U.S. Dist. LEXIS 65903, at *5 (E.D. Va. 2012).
[117] *Boyd*, 636 F.3d at 138-39.
[118] *Id.* at 139.
[119] *Boyd*, 2010 U.S. Dist. LEXIS 106296.
[120] *Boyd*, 636 F.3d at 139.
[121] *Id.*
[122] *Id.*

estate both submitted claims to MetLife for the life insurance benefits payable by reason of her death.[123] Because Emma had never changed the Designation of Beneficiary, Robert remained the primary beneficiary.[124] Accordingly, MetLife paid the life insurance benefits to Robert.[125]

The Fourth Circuit Court of Appeals held that pursuant to ERISA[126] and the Plan Document Rule, the administrator was required to look solely at the directives of the plan documents in determining how to disburse benefits.[127] Thus, the administrator complied with his obligations under ERISA.[128] The fact that the plan at issue contained no formal means for a beneficiary to renounce an interest in benefits did not prevent the Plan Document Rule from applying; the plan did not prevent a beneficiary from refusing to take benefits, and the ex-husband chose to accept the benefits.[129] For the administrator to have given effect to the waiver in the separation agreement would have contravened ERISA, the Plan Document Rule, and the terms of the plan. [130] The Fourth Circuit Court also noted that its holding was consistent with an Eighth Circuit holding regarding the same issue.[131]

iii. *Metro. Life Ins. Co. v. Leich-Brannan*, 812 F. Supp. 2d 729 (E.D. Va. 2011).

Adolph Leich was employed by Mobile Oil Company that provided him with a life insurance policy as an employee welfare benefit governed by ERISA.[132] MetLife was the claims

[123] *Id.*
[124] *Boyd*, 636 F.3d 138.
[125] *Id.*
[126] 29 U.S.C.S. § 1104(a)(1)(D).
[127] *Boyd*, 636 F.3d at 140-41.
[128] *Id.* at 139.
[129] *Id.* at 143.
[130] *Id.*
[131] *Id.* at 144 (“We need not rest our ruling merely on our interpretation of Kennedy, for the Eighth Circuit addressed this very issue in Matschiner v. Hartford Life & Accident Insurance Co., 622 F.3d 885 (8th Cir. 2010)”).
[132] *Metro. Life Ins. Co.*, 812 F. Supp. 2d at 733.

fiduciary for the ERISA plan.[133] On July 2, 1984, Adolph and his wife, Patricia, divorced in Virginia.[134] Their property settlement agreement, made a part of their Judgment for Dissolution of Marriage, stated that "[Adolph] agrees to make [Patricia], his irrevocable beneficiary on all of his personal and group life insurance, to maintain all such insurance in force and to produce proof of such irrevocability for [Patricia]."[135] Pursuant to the property settlement agreement, Adolph submitted a beneficiary designation form naming Patricia as the primary beneficiary and Julius as the contingent beneficiary under the Plan.[136] In 1987 Adolph, having remarried, changed the designation naming his new wife, Lois, and his children, Julius and Gwendolyn, as the primary beneficiaries, and removing Patricia as a beneficiary.[137] Adolph died in 2008 and MetLife paid out the full policy benefits to the designated beneficiaries, Lois, Julius, and Gwendolyn.[138] In 2009, Patricia sent a letter to the Exxon Mobil Benefits Service Center stating that she was the proper beneficiary of the plan benefits.[139] Patricia included the divorce decree which incorporated the separation agreement in which Adolph promised to keep Patricia as the beneficiary on his insurance.[140] MetLife contends it received a copy of this letter from the Plan's record-keeper on or around May 4, 2009.[141] MetLife, having already paid the benefits to Lois, Julius, and Gwendolyn, filed suit seeking a declaratory judgment as to the proper beneficiary or beneficiaries of the policy.

The United States District Court for the Eastern District of Virginia, Richmond Division, in the Fourth Circuit, held that pursuant to *Boyd* and *Kennedy*, the Plan Document Rule governed

[133] *Id.*
[134] *Id.*
[135] *Id.* at 733-34.
[136] *Id.* at 734.
[137] *Id.*
[138] *Id.*
[139] *Id.*
[140] *Id.*
[141] *Id.*

the distribution of benefits and MetLife properly paid the benefits to the designated beneficiaries, Lois, Julius, and Gwendolyn.[142] Further, the Fourth Circuit District Court found that the benefits did not fall under the Plan Document Rule exception for QDROs because the divorce decree failed to meet the requirements of a QDRO.[143]

iv. *Companion Life Ins. Co. v. Hopson*, 2012 U.S. Dist. LEXIS 19480, (D.S.C. 2012).

Clark Hopson's former employer, Orthopedic Reconstruction, PA established and maintained group life insurance coverage with Companion Life Insurance for the benefit of its employees as part of its ERISA governed employee welfare benefit plan (Plan).[144] Companion provided a life insurance policy in 2001 (Policy) covering Clark, for the face amount of $10,000.[145] Clark's wife, now former wife, Nancy Alexander, was named beneficiary under the Policy.[146] In 2005 Clark and Nancy entered into a Settlement Agreement in connection with their divorce in South Carolina.[147] In 2007, Clark and Nancy divorced and signed a consent order in which the Court ordered that Nancy and Clark "shall execute mutual general releases of claims in favor of each other that shall preclude any further suits or claims by either against the other for conduct or happenings occurring prior to the date of this hearing."[148] In 2007, Nancy and Clark signed a general release of claims providing that:

> [This release] specifically includes, without limitation, the claims raised, or which could have been raised in the above-captioned action. This is intended to be a complete global general release.

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142 *Id.* at 735.
143 *Id.* at 736.
144 *Companion Life Ins. Co.*, 2012 U.S. Dist. LEXIS 19480, at *3.
145 *Id.*
146 *Id.*
147 *Id.*
148 *Id.* at *3-4.

> The intent is that any and all claims whether known or unknown described above be fully released and forever ended.[149]

Clark died September 6, 2009, and Nancy, his ex-wife, was the named beneficiary on the Companion policy.[150] The biological children and natural heirs, (Hopsons) contend that they are entitled to all policy proceeds based on the Settlement Agreement and the subsequent Release.[151]

The United States District Court for the District of South Carolina held that the Hopson's claims are foreclosed by the Supreme Court's decision in *Kennedy* because the action arises out of and is governed by ERISA.[152] The District Court followed *Kennedy* in applying the Plan Document Rule.[153] Thus, the District Court recommended that the proceeds of the policy, which were deposited with the Court, be disbursed to Nancy, the ex-wife.[154]

v. *Andochick v. Byrd*, 2012 U.S. Dist. LEXIS 65903, (E.D. Va. 2012).

Erika Byrd was an attorney at Venable.[155] She participated in the Venable Retirement Plan (401(k)) and obtained insurance through the Venable Life Insurance Plan (Life Insurance).[156] Dr. Scott Andochick and Erika married on February 25, 2005, separated on July 7, 2006, and entered into a Marital Settlement Agreement on August 20, 2007.[157] The marital separation agreement was comprehensive and included, among other terms, the following: 1) Dr. Andochick's waiver of any interest or survivorship rights in Erika’s 401(k); 2) a release of present and future rights “as a beneficiary under any life insurance policy . . . or any other

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149 *Id.* at *4.
150 *Id.* at *7.
151 *Id.*
152 *Id.* at *8.
153 *Id.*
154 *Id.* at *11.
155 *Andochick*, 2012 U.S. Dist. LEXIS 65903, at *1.
156 *Id.* at *1-2.
157 *Id.* at *2-3.

beneficiary designation," including an agreement to execute and deliver releases upon the request of the other; and 3) an agreement to execute documents "required to carry out provisions of this Agreement."[158] On December 31, 2008, the couple divorced pursuant to a Judgment of Absolute Divorce incorporating the marital settlement agreement in Montgomery County, Maryland.[159] Erika passed away approximately two-and-a-half years later on April 10, 2011.[160] The plan administrator of Erika's 401(k) and Life Insurance policies determined that the policies would be paid to Dr. Andochick, because he remained the named beneficiary on the plan documents at the time of Erika's death in spite of the marital settlement agreement.[161]

Dr. Andochick brought suit against Erika's parents, the Byrds, in their capacity as co-administrators of Erika's estate seeking declaratory judgment that ERISA preempts the marital settlement agreement and any claim the Byrds might have to the ERISA plan benefits.[162] The Byrds brought suit against Dr. Andochick in Maryland State Court claiming contempt of the marital settlement agreement incorporated into the Judgment of Absolute Divorce, and seeking an order for Dr. Andochick to waive his interest in Erika's 401(k) and life insurance proceeds. The Byrds also filed an administrative appeal with the plan administrator.[163]

The critical issue before the Court was whether ERISA preempts the Byrds' enforcement of the waiver provision within the marital settlement agreement once the benefits are distributed, or in the alternative, whether ERISA does not affect post-disbursement funds.[164] As indicated in the Supreme Court's *Kennedy* decision, note ten, it remains an open question as to whether an

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[158] *Id.*
[159] *Id.* at *3.
[160] *Id.*
[161] *Id.*
[162] *Id.* at *15.
[163] *Id.* at *3.
[164] *Id.* at *19-20.

action in state or federal court may be brought against an unintended beneficiary to obtain the benefits after they are distributed.[165]

The Plan Administrator for Venable LLP reached his decision and advised the Co-Administrators, the Byrds and Dr. Andochick that the 401(k) proceeds and life insurance proceeds would be payable to Dr. Andochick as required by ERISA and the ERISA-governed plan documents.[166]

The United States District Court for the Eastern District of Virginia, Alexandria Division, in the Fourth Circuit, found Dr. Andochick to be in contempt of the Maryland State Court's Judgment of Absolute Divorce and ordered Dr. Andochick to "execute any documents and take all actions necessary and required . . . to waive and renounce any interest he has in the . . . 401(k) Plan and [L]ife [I]nsurance benefits."[167]

The federal District Court held that ERISA, under *Kennedy,* only controls the disbursement of the benefit proceeds at the plan administrator level and the plan administrator correctly distributed the benefits to the named beneficiary.[168] The Court further held that once the proceeds are within named beneficiary's control, he is obligated to fulfill his responsibilities under the marital settlement agreement, as ordered by the Maryland State Court.[169] The federal District Court found this holding to be consistent with many other cases,[170] including Third Circuit's decision in *Estate of Kensinger.* [171]

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[165] *See Kennedy*, 555 U.S. at 299 n.10.
[166] *Andochick*, 2012 U.S. Dist. LEXIS 65903, at *8.
[167] *Id.* at *5.
[168] *Id.* at *29.
[169] *Id.*
[170] *Id.* at *21-23 (*compare Sweebe v. Sweebe*, 474 Mich. 151, 712 N.W.2d 708, 710 (2006) ("While a plan administrator is required by ERISA to distribute plan proceeds to the named beneficiary, the named beneficiary can then be found to have waived the right to retain those proceeds."), *Pardee v. Pers. Representative for Estate of Pardee*, 2005 OK CIV APP 27, 112 P.3d 308, 316 (Okla. Civ. App. Div. 2 2004) ("[T]he pension plan funds were no longer entitled to ERISA protection once the plan funds were distributed," and the divorce decree could control the allocation of ERISA funds after disbursement.), and *Alcorn v. Appleton*, 308 Ga. App. 663, 708 S.E.2d 390, 392

IV. *Kennedy* Note Ten and Remedies that may be available to North Carolina District Court Judges and Family Law Attorneys.

a. Introduction

In *Kennedy*, the Supreme Court left open the possibility of remedies to recover benefits distributed to unintended beneficiaries. Note ten[172] in *Kennedy* states:

> Despite our following answer to the question here, our conclusion that § 1056(d)(1) does not make a nullity of a waiver leaves open any questions about a waiver's effect in circumstances in which it is consistent with plan documents. Nor do we express any view as to whether the Estate could have brought an action in state or federal court against Liv to obtain the benefits after they were distributed. *Compare Boggs*, 520 U.S. at 853 ("If state law is not pre-empted, the diversion of retirement benefits will occur regardless of whether the interest in the pension plan is enforced against the plan or the recipient of the pension benefit"), with *Sweebe v. Sweebe*, 474 Mich. 151, 156-159, 712 N.W.2d 708, 712-713 (2006)(distinguishing *Boggs* and holding that "while a plan administrator must pay benefits to the named beneficiary as required by ERISA," after the benefits are distributed "the consensual terms of a prior contractual agreement may prevent the named beneficiary from retaining those proceeds"); *Pardee v. Pardee*, 2005 OK CIV App. 27, PP20, 27, 112 P. 3d 308, 313-314, 315-316 (2004) (distinguishing *Boggs* and holding that ERISA did not preempt enforcement of allocation of ERISA benefits in state-court divorce decree as "the pension plan funds were no longer entitled to ERISA protection once the plan funds were distributed").

(2011) ("ERISA does not preempt claims against funds already distributed from an ERISA plan.), with *Staelens v. Staelens*, 677 F. Supp. 2d 499 (D. Mass. 2010) (noting that post-ERISA disposition lawsuits to enforce waiver provisions "would appear to go against the various interests which the Supreme Court deemed served by a uniform administrative scheme"), *In re Estate of Kensinger*, No. 09-6510, 2010 U.S. Dist. LEXIS 116078, 2010 WL 4445752, at *7 (D.N.J. 2010) (finding that permitting an estate to "assert a claim directly against [the beneficiary] to enforce the putative waiver in the Property Settlement Agreement . . . would directly undermine ERSIA's [sic]stated objectives and run contrary to the Supreme Court's precedent interpreting ERISA"), *overruled by Estate of Kensinger*, 674 F.3d 131.))

[171] *Id.* at *23("The Third Circuit considered whether ERISA preempted a waiver provision in a property settlement agreement, after the plan proceeds had been distributed by the administrator."); *Estate of Kensinger v. URL Pharm., Inc.*, 674 F.3d 131, 134 (3d Cir. 2012) (Answering this question in the negative, the court explained that permitting suits against beneficiaries after benefits have been paid does not implicate any concern of expeditious payment or undermine any core objective of ERISA. 26 U.S.C. § 137 (2006) (emphasis in original)).

[172] *Kennedy*, 555 U.S. at 299 n.10.

Note ten tells us that ERISA does not foreclose actions against unintended beneficiaries who have received the benefits of an ERISA governed plan. The Plan Document Rule merely states that plan administrators must follow the plan documents and pay benefits to the designated beneficiaries and are not liable because an unintended beneficiary received the benefits contrary to a state order or statute. Thus, other remedies under state law are available to recover the benefit proceeds (which may have been spent by the unintended beneficiary) from an ERISA governed plan. However, avoiding the ERISA Plan Document trap is the first strategy that should be implemented.

b. Preventing the wrong person getting the qualified, non-qualified and IRA benefits at the death of the participant.

i. TRO and Preliminary Injunction

North Carolina family law judges and lawyers can minimize the possibility of ERISA preempting a divorce decree or settlement agreement with certain court orders that require the participant to designate the proper beneficiary to qualified, non-qualified and IRA benefits during the pendency of the equitable distribution action and thereafter. This is important because if there is an unexpected death with an unintended beneficiary, the plan will pay the unintended beneficiary; if the unintended beneficiary spends the money, note ten remedies may be only theoretical. There are three orders that should be pursued. First, the non-participant should request a temporary restraining order and preliminary injunction requiring the participant to have the non-participant as the designated beneficiary of the plans in the event of the non-participant's death before the participant's death.[173] Second, pursuant to N.C. Gen. Stat. § 50-20, the Court

[173] N.C. Gen. Stat. § 50-20(i).

should enter an Order compelling the participant to prove the beneficiary status of all plans.[174] Finally, the Court should enter an Order compelling the participant to designate and keep the non-participant as beneficiary of his or her presumptive 50 percent share[175] of all plans.

ii. Qualified Domestic Relations Order

A Qualified Domestic Relations Order ("QDRO") is a judgment or order made pursuant to state domestic relations law that establishes the right of an alternate payee to receive benefits payable under an ERISA qualified plan.[176] In effect, a QDRO is an exception to the Plan Document Rule, pursuant to which a plan trustee can pay directly the plan benefits described in the QDRO. The ERISA preemption trap arises in the absence of a QDRO where the participating spouse dies and the beneficiary designated on the ERISA plan is in conflict with terms of a divorce decree, settlement agreement, or state revocation-by-divorce statute.

Kennedy instructs that for a non-participant spouse to have any enforceable rights whatsoever against a retirement plan, it is absolutely fundamentally necessary to have a QDRO.[177] Without a QDRO, the non-participant spouse has only the rights granted by the plan document,[178] and retirement plans almost never give rights to the spouses of plan participants. Thus, the trap may be triggered if the participating spouse dies at any time before a QDRO is served on, and qualified by, the plan administrator.

A QDRO is not affective against a non-qualified plan. Non-qualified plans are not subject to many of the provisions of ERISA or the Internal Revenue Code that apply specifically to qualified plans. In particular, these plans are not divisible by means of a QDRO. Further, most

[174] *Id.* § 1A-1
[175] *Id.* § 50-20(c).
[176] 29 U.S.C.S. § 1056(d)(3)(B)(i).
[177] *Kennedy*, 555 U.S. at 300-03.
[178] *Id.* at 300.

non-qualified plans incorporate very strict anti-assignment provision that preclude division of the non-qualified plan. Where a QDRO is not possible, upon the death of the participating spouse the plan administrator must distribute the death benefit to beneficiaries designated by the participating spouse regardless of the requirements of any divorce decrees, separation agreements, or state statutes.[179]

c. Retrieval of marital benefits from an unintended beneficiary under North Carolina law.

i. Civil Contempt of Court

A motion for civil contempt of court may be filed against an ex-spouse who has received benefits from an ERISA governed benefit plan contrary to an equitable distribution court order or separation agreement incorporated into a court decree, if the court decree grants the plan benefits to someone other than the beneficiary under the plan documents rule and if the unintended beneficiary is a party and subject to the court decree. Further, a third party may be made a party to an equitable distribution action in North Carolina where a third party holds legal title to property which is claimed to be marital property.[180] In *Kennedy*, the Supreme Court indicated that ERISA does not foreclose actions against unintended beneficiaries who have received the benefits of an ERISA governed plan.[181] In *Andochick*, the Fourth Circuit District Court for the Eastern District of Virginia, Alexandria Division, found the ex-spouse who was an unintended

[179] 29 C.F.R. § 2560.503-1 (2011).
[180] *Upchurch v. Upchurch*, 122 N.C. App. 172, 176, 468 S.E.2d 61, 63-64 (1996) (stating that, "when a third party holds legal title to property which is claimed to be marital property, that third party is a necessary party to the equitable distribution proceeding, with their participation limited to the issue of the ownership of that property"), *disc. review denied*, 343 N.C. 517, 472 S.E.2d 26 (1996); *see* N.C. Gen. Stat. § 1A-1.
[181] *Kennedy*, 555 U.S. at 299 n.10.

beneficiary to be in contempt of the Maryland State Court's Judgment of Absolute Divorce and ordered the ex-spouse to waive and renounce any interest in the benefits he received.[182]

North Carolina Gen. Stat. § 5A-21 provides that failure to comply with an order of a court is a continuing civil contempt as long as:

> (1) The order remains in force;
>
> (2) The purpose of the order may still be served by compliance with the order;
>
> (2a) The noncompliance by the person to whom the order is directed is willful; and
>
> (3) The person to whom the order is directed is able to comply with the order or is able to take reasonable measures that would enable the person to comply with the order.[183]

The North Carolina Courts have upheld motions for contempt where a party has failed to comply with an equitable distribution order. Further, the North Carolina Supreme Court established in *Walters* that a marital separation agreement that is approved by the court will not be treated as a contract but will be treated as a consent judgment that is enforceable by the contempt powers of the court.[184] In *Romulus*, the North Carolina Court of Appeals held that an equitable distribution order will still be subject to proceedings for contempt after the appeals are concluded.[185] Several unpublished North Carolina Court of Appeal's cases have also recognized

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[182] *Andochick*, 2012 U.S. Dist. LEXIS 65903, at *5.
[183] N.C. Gen. Stat. § 5A-21(a) (LexisNexis 2012).
[184] *Smith v. Smith*, 334 N.C. 81, 85 (1993) (citing *Walters v. Walters*, 307 N.C. 381, 298 S.E.2d 338 (1983) (this Court established the rule that whenever the parties bring their separation agreements before the court for the court's approval, it will no longer be treated as a contract between the parties. All separation agreements approved by the court as judgments of the court will be treated similarly, to-wit, as court ordered judgments. These court ordered separation agreements, as consent judgments, are modifiable, and enforceable by the contempt powers of the court, in the same manner as any other judgment in a domestic relations case.))
[185] *Romulus v. Romulus*, 715 S.E.2d 889, 895 (N.C. Ct. App. 2011).

motions for contempt where a party has failed to comply with an equitable distribution order.[186] Thus, where an ex-spouse is an unintended beneficiary receiving benefits from an ERISA governed plan contrary to an equitable distribution order, a motion for contempt of court is an appropriate action to recover the benefits.

ii. Specific performance or breach of contract

An action for specific performance, or in the alternative breach of contract for damages, may be filed against an ex-spouse who has received benefits from an ERISA governed benefit plan contrary to a separation agreement that is not incorporated into a North Carolina divorce decree. Further, a Rule 65[187] motion for injunctive relief may be filed and granted to protect the benefits from expenditure or creditors during litigation.

North Carolina recognizes a valid separation agreement which releases rights in marital property as a contract. In *Anderson*, the North Carolina Court of Appeals held:

> Husband and wife, upon divorce, may determine for themselves how to divide their marital estate by entering into a valid separation agreement in lieu of an equitable distribution by judicial determination. *Hagler v. Hagler*, 319 N.C. 287, 290, 354 S.E.2d 228, 232 (1987). Further, "[N.C. Gen. Stat. §] 52-10 allows a husband and wife to enter a separation agreement which 'releases and quitclaims' any property rights acquired by marriage, and . . . a release will bar any later claim on the released property[, and such an agreement] is an enforceable contract between husband and wife." *Blount v. Blount*, 72 N.C. App. 193, 195, 323 S.E.2d 738, 740 (1984).[188]

[186] See unpublished cases: *Sutton v. Sutton*, 2011 N.C. App. LEXIS 2330, at *1 (N.C. Ct. App. 2011) (affirming that trial court properly found plaintiff to be in contempt of court for failing to execute stock certificates transferring her interest in a corporation to defendant in violation of a judgment of equitable distribution.); *Callanan v. Walsh*, 2012 N.C. App. LEXIS 189, at *5-6 (N.C. Ct. App. 2012) (affirming that trial court adjudged plaintiff to be "in continuing civil contempt of Court for failure to comply with the provisions of the 2004 Judgment requiring her to execute a note and deed of trust for benefit of Defendant."); *Turner v. Turner*, 2012 N.C. App. LEXIS 684, at *1 (N.C. Ct. App. 2012) (affirming that trial court's findings of fact lack adequate evidentiary support for contempt of equitable distribution order).
[187] N.C. Gen. Stat. § 1A-1 (LexisNexis 2012).
[188] *Anderson v. Anderson*, 145 N.C. App. 453, 457 (2001).

Further, in *Patterson*, the North Carolina Court of Appeals held that:

> Separation agreements incorporated into court decrees are construed and interpreted in the same manner as other contracts, *Britt v. Britt*, 49 N.C. App. 463, 468 (1980), as are assignment clauses, *Martin v. Ray Lackey Enters.*, 100 N.C. App. 349, 354, 396 S.E.2d 327, 330 (1990). When parties use clear and unambiguous terms, a contract can be interpreted by the court as a matter of law.[189]

Thus, an action for specific performance, or in the alternative breach of contract for damages, combined with a Rule 65 motion for injunctive relief may be successful in recovering or protecting the marital benefits from an unintended beneficiary provided the separation agreement is written with specificity and unambiguous terms.

iii. Unjust enrichment and constructive trust

Many times the unintended beneficiary is not a party to the divorce, e.g. the new spouse. Under these circumstances, an action for unjust enrichment and constructive trust may be filed against the beneficiary who has received benefits from an ERISA governed benefit plan contrary to a separation agreement or equitable distribution decree. Further, a Rule 65[190] motion for injunctive relief may be filed to protect the benefits from expenditure or creditors during litigation.

The North Carolina Supreme Court has defined a constructive trust as:

> a duty, or relationship, imposed by courts of equity to prevent the unjust enrichment of the holder of title to, or of an interest in, property which such holder acquired through fraud, breach of duty or some other circumstance making it inequitable for him to retain it against the claim of the beneficiary of the constructive trust.[191]

[189] *Patterson v. Patterson*, 137 N.C. App. 653, 665-66 (2000).
[190] N.C. Gen. Stat. § 1A-1.
[191] *Variety Wholesalers, Inc. v. Salem Logistics Traffic Servs., L.L.C.*, 723 S.E.2d 744, 751-52 (N.C. 2012) (citing *Wilson v. Crab Orchard Dev. Co.*, 276 N.C. 198, 211, 171 S.E.2d 873, 882 (1970)).

In 2011, the North Carolina Court of Appeals in *Jessee v. Jessee,* 713 S.E.2d 28 (N.C. Ct. App. 2011) held that a District Court has the authority to join third parties to an equitable distribution case to return marital property to the divorcing parties.[192] In *Jessee* the Court cited *Sharp* stating that "[a] judge in an equitable distribution action may recognize both legal and equitable interests in property and distribute such interests to the divorcing parties, even if such distribution requires an interest be wrested from the hands of the legal titleholder by the imposition of a constructive trust".[193]

The recipient of ERISA plan benefits contrary to an equitable distribution action or marital separation agreement has not necessarily committed a fraudulent act, but is still subject to an action for unjust enrichment and constructive trust.[194] In 2011, the North Carolina Court of Appeals in *Myers v. Myers,* 714 S.E.2d 194, 201 (N.C. Ct. App. 2011) held that the distribution of ERISA plan benefits contrary to a consent order did not constitute fraud on the part of the beneficiaries, but still subjected the beneficiaries to a constructive trust in favor of an intended beneficiary named in the consent order.[195] The court stated that fraud need not always be present to impose a constructive trust.[196] Fraud need not be shown if legal title has been obtained in

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[192] *Jessee v. Jessee*, 713 S.E.2d 28 (N.C. Ct. App. 2011)(*quoting Upchurch*, 122 N.C. App. at 176, 468 S.E.2d at 63-64 (stating that, "when a third party holds legal title to property which is claimed to be marital property, that third party is a necessary party to the equitable distribution proceeding, with their participation limited to the issue of the ownership of that property"), *disc. review denied*, 343 N.C. 517, 472 S.E.2d 26 (1996)).

[193] *Jessee v. Jessee*, 713 S.E.2d 28 (N.C. Ct. App. 2011)(*quoting Sharp v. Sharp*, 133 N.C. App. 125, 128, 514 S.E.2d 312, 314 (stating that "[a] judge in an equitable distribution action may recognize both legal and equitable interests in property and distribute such interests to the divorcing parties, even if such distribution requires an interest be 'wrested from the hands of the legal titleholder by the imposition of a constructive trust'") (quoting *Upchurch v. Upchurch, 128 N.C. App. 461, 463, 495 S.E.2d 738, 739, disc. review denied, 348 N.C. 291, 501 S.E.2d* 925 (1998)), *rev'd on other grounds*, 351 N.C. 37, 519 S.E.2d 523 (1999), *Mugno v. Mugno*, 695 S.E.2d 495, 498 (N.C. Ct. App. 2010) (stating that "[w]hile third-party entities, whether corporations or individuals, holding marital assets in trust or whom are transferees defrauding a creditor spouse may be subject to legal action to secure marital property in an equitable distribution action, there are no findings here to suggest that such subterfuge was present")).

[194] *Myers v. Myers*, 714 S.E.2d 194, 201 (N.C. Ct. App. 2011).

[195] *Id.*

[196] *Id.*

violation of some duty owed to the one equitably entitled.[197] Furthermore, a constructive trust "may be imposed against anyone who in any way against equity and good conscience, either has obtained or holds the legal right to property which he or she ought not, in equity and good conscience, hold and enjoy."[198] In other words, if the "imposition of a constructive trust is appropriate on the facts, a court need not determine whether actual fraud has been established."[199] Thus, whether the action is brought under an equitable distribution claim, or a breach of contract claim, a claim for a constructive trust against the unintended beneficiary may recover the marital assets.

V. Conclusion

The Plan Document Rule and the ERISA preemption provisions of state divorce decrees, marital separation agreements, or state statutes create a trap for the unwary North Carolina District Court judge and the North Carolina family law practitioner. Judges and lawyers may make mistakes on behalf of the equitable distribution client that can be to the client's determinant and have counter-intuitive results. This area of law is complex and somewhat convoluted. Thus, it is extremely important that judges and family law practitioners have a basic understanding of the issues at play and not hesitate to seek outside expert advice when confronted with complex retirement or deferred compensation plans.

Generally, for qualified pension plans, non-qualified pension plans, and IRA's, the plan administrator must pay the death benefits of the participant to the designated beneficiary pursuant to the Plan Documents Rule, part of federal common law and emphasized by the United States Supreme Court in *Kennedy*, regardless of a state court decree, marital separation

[197] *Id.*
[198] *Id.*
[199] *Id.*

agreement, or state statute to the contrary. The only exception to the rule is a valid QDRO that has been filed and qualified with the plan administrator, which does not help with non-qualified plans.

Temporary restraining orders and preliminary injunctions to control beneficiary designations on retirement plans should be used to avoid an unintended beneficiary receiving the benefits in the event the participant dies during separation or divorce proceedings. Even where the parties have agreed to a QDRO, these actions should be initiated to protect the intended beneficiary until the QDRO is accepted by the plan administrator.

If the worst case scenario happens, judges and family law practitioners may pursue retrieval of marital benefits from an unintended beneficiary under North Carolina law through three types of action. A motion for <u>contempt</u> of court may be filed against a party to an equitable distribution action, a party to a separation agreement incorporated into a court decree, or a third party joined to an equitable distribution action that fails to comply with a court order to disgorge of marital property. An action for <u>specific performance</u> may be filed against a party to a marital separation agreement. Finally, an action for <u>unjust enrichment and constructive trust</u> may be filed against unintended third party beneficiaries.

North Carolina District Court judges and the North Carolina family law practitioners who have an understanding of the complexity of these benefit plans can navigate the ERISA federal preemption trap in equitable distribution. The goal is to avoid equitable distribution with an inequitable result.