Kennedy Progeny from the Third Circuit

Disputes Resulting from Beneficiary Designation Failures and the Importance of Keeping Them Current

By Stephen L. Ferszt and Lisa M. McIntyre

Just when the retirement plans community thought that the United States Supreme Court's decision in Kennedy v. Plan Administrator for DuPont Savings & Investment Plan, *555 U.S. 285 (2009) was the final word in settling disputes with respect to a deceased participant's account balance in the absence of any beneficiary designation changes post-divorce, the Third Circuit reported a novel twist in 2012.*

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The Supreme Court, in their infamous footnote number 10 nestled within the *Kennedy* decision, abstained from expressing any view as to whether an estate is permitted to bring an action in state or federal court against a designated beneficiary after the benefits have been distributed. In *Kensinger v. URL Pharma, Inc.,* 674 F.3d 131 (3d Cir. 2012), the Third Circuit finally addressed that question. That is, the key litigated issue in *Kensinger* was whether the estate of a participant in a 401(k) plan is permitted to commence an action against the designated beneficiary to recover the account balance where the designated beneficiary waived her right to the account balance as part of a divorce proceeding. The Third Circuit held that the estate of a 401(k) plan participant is permitted to commence a suit, in an ordinary contract action based on the designated beneficiary's common-law waiver, *after* the benefits have been distributed by the plan administrator so as not to interfere with the administration of the plan. In doing so, the Third Circuit distinguished *Kensinger* from *Kennedy* insofar as *Kennedy* involved an action commenced by an estate against a plan administrator who had *yet* to distribute the deceased participant's benefits.

Benefit dispute cases such as *Kennedy* and *Kensinger* clearly demonstrate that designating beneficiaries, and keeping them current, are some of the most important administrative steps that plan participants ought to take with retirement accounts. Indeed, problematic beneficiary designations will frequently lead to highly contested benefit disputes, which often result in disruption of families and a significant expenditure of time, expenses, and other resources by employers and plan administrators to identify and/or litigate who the correct beneficiary may be.

Accordingly, plan participants should periodically review, change, and/or update their beneficiary designations to account for changes that may be occasioned upon major life events such as marriage, divorce, death of the plan participant or beneficiary, or the birth or adoption of a child. Furthermore, there may be instances where the plan administrator loses record of the beneficiary designation, or unknowingly retains stale designations due to a change in plan service providers or a whole host of other reasons, which will

prevent plan benefits from flowing to the intended beneficiary. Since payments to erroneous beneficiaries may expose fiduciaries to liability, these types of situations often force those fiduciaries to, among other things, defend lawsuits, file interpleader actions in court, and locate the correct beneficiary.

While this article cannot highlight every scenario in which beneficiary designation failures may occur, one thing is certain—inadvertent errors concerning beneficiary designations impose substantial burdens of time, cost, and personnel. Thus, it is important to periodically review plan administrative files and records to ensure that the files and records are complete.

Below is an in-depth discussion of *Kennedy's* progeny from the Third Circuit and other federal case law that was born from the *Kensinger* decision throughout 2012.

Kensinger v. URL Pharma, Inc.

As briefly discussed at the outset of this article, *Kensinger* was a case of first impression in which the Third Circuit addressed the issue of whether, *after* a plan administrator distributes a deceased participant's 401(k) account balance to the designated beneficiary, the deceased participant's estate can *then* commence an action against the designated beneficiary to recover the account balance where the designated beneficiary waived her right to the account balance as part of a matrimonial property settlement agreement. The Third Circuit held that an estate *may* commence an action directly against the designated beneficiary after the benefits have been distributed by the plan administrator and distinguished the case before it from *Kennedy,* which, the Third Circuit explained, involved an action against a plan administrator who had *yet* to distribute retirement benefits.

In 2000, a plan participant named his wife as the primary beneficiary of his 401(k) account. Eight years later, the participant and his wife divorced. During the divorce proceedings, the parties entered into a property settlement agreement, and the wife waived her right to any distribution under the plan. Subsequently, the plan participant died intestate having failed to change his beneficiary designation. Both the deceased participant's estate and former spouse made a claim for his 401(k) account balance.

The estate claimed that because the deceased participant's former spouse waived her right to the 401(k) account balance as part of the divorce proceeding, the account balance was property of the estate. The former spouse, on the other hand, claimed that ERISA requires that the proceeds must be paid to the beneficiary designated by plan documents, thereby trumping her common-law waiver. In November 2009, the estate filed a declaratory action in New Jersey state court against the former spouse and the employer. The employer subsequently removed the dispute to federal court.

The United States District Court for the District of New Jersey applied the reasoning in *Kennedy*, and concluded that, despite the former spouse's waiver, ERISA required the plan administrator to distribute the deceased participant's 401(k) account balance to the former spouse, as designated beneficiary, pursuant to the terms of the plan. In *Kennedy,* the Supreme Court determined that a former spouse who waived her right to a participant's 401(k) account balance as part of a divorce settlement was still entitled to the account balance where the deceased participant had failed to change his beneficiary designation. The Supreme Court explained that pursuant to the "plan documents rule," a plan administrator is required to distribute the account balance pursuant to the last valid beneficiary designation. Further, the Supreme Court relied on the following two policy concerns in support of the "plan documents rule" and distributing plan proceeds to the named beneficiary: (1) the need for clear rules to minimize the administrative and financial burdens on plan administrators; and (2) the avoidance of potential double liability on plan administrators since plan administrators could be sued by both the estate and the former spouse.

In *Kensinger,* the Third Circuit ruled that the *Kennedy* policy concerns would not be threatened by post-distribution litigation because the deceased participant's former spouse was sued after she received the plan proceeds. The Third Circuit held that in such circumstances, an action against the former spouse does not complicate plan administration, and it does not create the possibility of double liability for the plan administrator. Indeed, litigation of an "ordinary contract dispute" after the plan beneficiary has been paid does not undermine ERISA's core objectives.

Linder v. Delles

Recent *Kensinger* offspring, *Linder v. Delles,* involved Barbara White ("White") who was employed by the United States Army Corps of Engineers (the "Army"). Upon her death, White was entitled to certain retirement benefits. She died in 2011 leaving a will, which named Tracy Linder ("Linder") as her personal representative and beneficiary of the residuary estate. Except for a small gift, White devised her entire estate to Linder.

Subsequent to White's death, her parents received a letter from the Army, which included various information and forms to be completed for the distribution of benefits. Copies of these forms were sent to the attorney for White's estate, who, in turn, contacted the U.S. Office of Personnel Management ("OPM") and learned that the death benefit forms were sent to White's parents since OPM did not have a beneficiary designation form in White's personnel file. OPM advised that it would accept a disclaimer, or waiver, of the benefits from White's parents.

Prior to signing affidavits of disclaimer, White's parents were advised that in doing so they would be giving up any legal right they may have had to any portion of White's estate or government benefits. Nevertheless, the affidavits were executed and filed in the State of Oregon probate proceeding. In the end, the federal agencies refused to honor the affidavits and advised White's parents that they would have to follow protocol and disclaim the benefits solely through the use of the agencies' forms and procedures. Instead, White's parents submitted applications to obtain White's benefits for themselves, which were granted. Linder then commenced an action.

Linder argued, among other things, that, although federal agencies are permitted and/or required under law to distribute benefits in accordance with their procedures, including distributing benefits to designated beneficiaries, her claim against White's parents would not be precluded since the benefits had already been distributed. To prevail on this argument, Linder cited the *Kennedy* and *Kensinger* cases as her main support. White's parents countered by arguing that ERISA was inapplicable to the action and the waivers they executed were unenforceable as they were limited only to interests passing under Oregon state law rather than federal law.

The district court relied on the reasoning applied by the Third Circuit in *Kensinger* and agreed with Linder that her action could be maintained since the benefits had been paid to White's parents. Further, the court determined that Linder was entitled to her right to enforce the affidavits waiving the parents' right to White's benefits. While the federal agencies were not required to honor the affidavits with respect to the manner in which they distributed the benefits, the court held that the federal administrative procedures did not determine the validity of any waiver as between Linder and White's parents. Finally, the district court noted that ERISA was irrelevant to the underlying issue of whether Linder could maintain an action against the recipient of the benefits to enforce a waiver and cited to *Andochick v. Byrd,* 2012 WL 1656311, at *1 (E.D.Va. May 9, 2012), another case (discussed below) born from the Third Circuit's holding in *Kensinger.* In addition to holding that beneficiaries are not precluded from making a claim against recipients of distributed monies, the district court also held that: (1) under Oregon law, the affidavits were effective; and (2) the affidavits were not voidable.

Andochick v. Byrd

Erika Byrd ("Byrd"), an attorney at Venable LLP ("Venable"), participated in Venable's 401(k) and life insurance plans. Prior to her death, Byrd and her former spouse, Scott Andochick ("Andochick"), divorced and entered into a marital settlement agreement in which Andochick waived any interest or survivorship rights in Byrd's Venable benefits. Shortly after Byrd's death, and in spite of the marital settlement agreement, the plan administrator of Venable's 401(k) and life insurance plans determined that the benefits should be paid to Andochick since he remained the named beneficiary on the plan documents at the time of Byrd's death. Byrd's parents, as co-administrators of Byrd's estate, appealed the plan administrator's decision and Andochick filed suit arguing that ERISA preempted the waiver provisions of the marital settlement agreement.

The critical question before the district court was whether ERISA preempted enforcement of the waiver provision under the marital settlement agreement once the benefits were distributed. The district court noted that the United States Supreme Court had left this question open in *Kennedy.* That is, the Supreme Court's ruling in *Kennedy* only went so far as to hold that the initial ERISA plan administrator's decision to disburse the benefits could not be altered due to waiver language within a divorce decree. Indeed, plan administrators have a statutory duty to pay benefits in strict conformity with plan documents thereby establishing a straightforward and easily administrable scheme with standard procedures.

Yet again, another district court relied on and adopted the reasoning applied by the Third Circuit in *Kensinger,* against the backdrop of the *Kennedy* decision, since the facts were virtually identical. Andochick was determined to be the proper beneficiary as designated by the plan documents, but then upon receipt, he would have to waive his right to these funds and distribute them to Byrd's estate.

Conclusion

The authors would be remiss if they failed to recognize that even the most diligent plan participant may nevertheless be subject to inadvertent beneficiary designation failures due to the legal requirements and historical practices that constrain plan administrators. Beneficiary designations are one of the few administrative practices in today's highly technological corporate environments that remain almost entirely paper-based. This presents unique and significant administrative challenges for both plan sponsors and service providers who are focused on meeting the needs of participants under retirement plans. For example, a beneficiary designation may remain on file for several years, decades even, without review by the plan participant. Lack of review will increase the likelihood that the original designation may not reflect the current intent or life circumstances of the participant. Indeed, plan participants may be unaware of when they should consider changing their beneficiary designations and/or the steps that they must take in order to effectuate such changes.

In response to the beneficiary designation failures that frequently arise with the current system of paper-based record-keeping practices throughout the retirement community, the 2012 ERISA Advisory Council (the "Council") received reports and testimony from various ERISA professionals during the Council's June 14, 2012 hearing on alternative forms of record-keeping practices for beneficiary designation forms. The testimony presented reflected that a large majority of these professionals would prefer to transition to an electronic record-keeping platform. [Steven B. Gorin, Memorandum to 2012 ERISA Advisory Council, "Current Challenges and Best Practices Concerning Beneficiary Designations in Retirement and Life Insurance Plans," Aug. 29, 2012] The question arises as to whether this alternative system would be a practical and sufficient method of maintaining beneficiary designation records. To date, the Council is currently considering the feasibility of electronic record retention.

Until alternative forms of record-keeping practices can be utilized by plan administrators—systems designed to reduce the frequency of beneficiary designation failures—the overriding lesson that can be derived from cases such as *Kennedy, Kensinger,* and their progeny, is the following: If plan participants are encouraged to periodically review, change, and/or update their beneficiary designations to account for significant life changes such as marriage, divorce, or death, the substantial and protracted litigation that inevitably ensue, can be avoided. ■