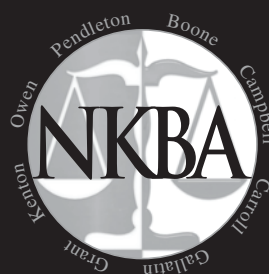


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*Unity is strength...when
there is teamwork and
collaboration, wonderful
things can be achieved.*

Mattie Stepanek



**Northern
Kentucky
Bar
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COLAS ARE THE REAL THING!

J. Eileen Zell



COST-OF-LIVING ADJUSTMENTS (COLAS) ALLOCATED TO THE "MARITAL PORTION" OF A PENSION MAY BE SUBJECT TO EQUITABLE DIVISION

The theme of my blog posts and speaking engagements is always getting Qualified Domestic Relations Orders (QDROs) out of academia and into something more practical – such as the practitioner's everyday caseload. This article is no different, and focuses on how a family law practitioner might handle pension Cost-of-Living Adjustments (COLAs) in his or her everyday practice. Specifically, when faced with a defined benefit retirement plan in a dissolution matter, the practitioner must:

- Understand the overall substantive effect that COLAs can have on a pension benefit;
- Identify early on, in each case, whether COLAs are indeed part of the pension that is being divided;
- Express the intended distribution of COLAs, if any, whether by agreement or trial order; and
- Ensure the expressed distribution is properly implemented through the property division order, if assignment of the pension is by deferred distribution.

Before we examine how the above plays out in your daily practice, let's review a definition and then a recently published Kentucky Court of Appeals case on point.

What is a COLA?

A COLA is an incremental change in one's monthly pension benefit to account for increasing prices. COLAs help to ensure that a pensioner's purchasing power remains the same no matter how long he or she may live, and how quickly prices might rise.

Brown and the Inclusion of COLAs in the Marital Estate

Among states that view COLAs as marital property, there is general

consensus that COLAs are part and parcel of the pension. After all, a plan's actuaries must fund for future COLAs on an ongoing basis. In that way, COLAs are as much deferred wages as the basic pension itself and should be considered marital property to the extent any portion of the pension is considered marital. This is particularly true when COLAs are awarded via deferred distribution (such as by QDRO), versus by immediate offset award wherein spirited debate continues when calculating a pension's net present value (specifically, those opposing inclusion of COLAs argue COLAs are too speculative in nature and often cite to recent government cutbacks on COLAs).

Further support for inclusion of COLAs is premised upon any increase in the marital portion of the retirement benefit that is not a direct result of the efforts of the employee after the divorce would be considered marital property. Since COLAs are granted in the same amount and at the same time to all retirees under a given plan, it is easy to determine that such increase does not relate to the job performance or efforts of the employee.

The recent Kentucky Court of Appeals decision *Brown v. Brown*, NO. 2013-CA-001515, 2015 Ky. App. LEXIS 3, (Ky. App. Jan. 16, 2015), squarely addressed the above suppositions head-on. The *Brown* decision arose from a trial court order directing simply that "the marital portion" of Husband's federal Civil Service Retirement System (CSRS) pension was to be divided equally between the parties. Almost ten years later, Wife pursued an order of division with regard to the CSRS benefit (called a COAP, or "Court Order Acceptable for Processing") that included an equal division of the pension earned during the marriage, along with a proportional share of COLAs Husband received after the marriage.

Husband argued Wife was not entitled to any COLAs, as they were received after the parties were divorced. Husband posited Wife's proposed order was equivalent to awarding Wife benefits earned post-

decease, in contradiction to Kentucky law. The trial court disagreed with Husband and determined Wife was entitled to the portion of COLAs that corresponded to her share of the marital portion of the pension.

In affirming the trial court's holding, the Court of Appeals also rejected Husband's contention, and after thorough review of applicable federal statutes and interpretative case law, observed:

Congress' purpose of providing COLAs was to prevent any significant loss of purchasing power due to inflation. *National Ass'n of Retired Fed. Emp. v. Horner*, 633 F. Supp. 511, 512 -13 (D.D.C. 1986). "COLAs do not increase the amount of the payments in real dollars but rather simply assure that inflation does not decrease the value of the payment." *Hong-Yee Chiu v. United States*, 18 Cl. Ct. 567, 571 (1989) *aff'd in part, rev'd in part sub nom. Chiu v. United States*, 948 F.2d 711 (Fed. Cir. 1991). "[T]here is no distinction between some 'underlying' annuity and the COLA. The COLA is merely part of the calculation of the current annuity." *Horner*, 633 F. Supp. at 513.

[. . .]

Awarding [Wife] the COLAs with respect to the marital portion of [Husband's] retirement is not tantamount to awarding her a benefit earned by [Husband] after the marriage. Rather, consistent with the purpose of federal COLAs including the COLAs in [Wife's] portion of the marital property, is necessary to ensure that the value of her marital portion of the retirement benefits keeps pace with inflation and equals the value of [Husband's] marital portion of the retirement. Excluding the COLAs from

[Wife's] portion of the payout would actually devalue her marital interest and result in [Husband] receiving a greater percentage of the marital portion than [Wife] in direct contravention of the dissolution decree.

Why Should I Consider COLAs in My Daily Practice?

In many government-sponsored plans, COLAs can be a substantial part of the actual accrued pension itself. This is true with many state government plans – in both Kentucky and Ohio – which have built-in COLA features that constitute a significant portion of the pension benefits (but see Kentucky Senate Bill 2 as it relates to COLAs and the Kentucky Retirement System). Also, the Civil Service Retirement System (CSRS, as in *Brown*), Federal Employees Retirement System (FERS), Military, and Railroad Retirement Board all offer COLAs to their members. For private-employer sponsored ERISA-based pensions, however, COLAs are becoming a moot point because most plans simply no longer include COLAs for their retirees.

In fact, COLAs can be such a significant part of the pension benefit that the failure to address COLAs in the equitable division of the pension can have a profoundly devastating effect on the non-employee spouse (and bring to the participant a windfall). I have borrowed an example, which I've updated over the years to keep up with the Consumer Price Index (CPI), that illustrates this scenario with perfection. For purposes of the example below, you should assume that the plan's COLAs are tied to the CPI, and are compounded annually. You should also assume that COLAs were neither negotiated nor expressly allocated in the parties' agreement, and that the non-employee spouse was not awarded a share of any plan COLAs in the resulting QDRO.

An employee divorced and retired in 1994. At the time of her retirement, her total accrued pension was \$1,000 per month. Because the entire pension

was earned during the marriage, her former spouse was awarded 50% (\$500 in 1994) as his equitable share of the pension. The COLA average between 1994 and 2014 was approximately 2.5% per year. By 2014, the retiree would be receiving **\$1,139 a month**, while her former spouse would still be receiving **\$500 a month**.

As you can see, we are not talking chump change.

As for the other side of the coin, keep in mind that COLAs are an especially important part of the pension benefit for those employees who do not participate in Social Security (such as with Kentucky Teachers' Retirement System, the Ohio systems, and the federal systems mentioned above), because they are likely to have no other retirement income that increases with inflation.

How Should I Treat COLAs in My Daily Practice?

Once you've ascertained that COLAs are part of the plan's provisions by looking at the plan's Summary Plan Description, benefits handbook, or controlling law (for government-sponsored plans), you must next determine whether such COLAs are marital property subject to equitable division, and then implement any distribution thereof accordingly. This is generally a matter of state domestic relations law, so it should be easy enough, right? I'm hoping my sarcasm jumped off the page.

Admittedly, under *Brown*, in Kentucky the job will now be a bit easier. Keep in mind, however, *Brown* was limited to the context of a federal pension divided via deferred distribution (we will save the conversation of COLAs in the context of the immediate offset method, and resulting net present valuation, for another day), and when the Decree did not expressly prevent allocation of COLAs in dividing the "marital share."

When dealing with a plan that provides its members post-retirement COLAs, the best practice is to always expressly

account for the allocation COLAs, whether in settlement negotiation and/or the litigation of a marital pension. Once you expressly account for any COLAs in the parties' agreement or trial order, you must next determine how to draft an appropriate property division order, if you are utilizing the deferred distribution approach.

BEWARE: As for ERISA pension plans, many employer model-based QDRO forms do not address COLAs, and this may inadvertently deprive the non-employee spouse of his or her marital share of any COLAs. Once a division of COLAs is expressly agreed to by the parties or expressly awarded by the court, make sure to get the allocation in the QDRO (and likewise to the contrary, if COLAs have been expressly forbade, make sure the QDRO so reflects).

A FINAL WORD OF CAUTION: You must always be on the lookout when dealing with government-sponsored plans. Kentucky and Ohio both use mandatory forms that cannot be altered. For instance, the Kentucky Retirement System's statutory QDRO form automatically includes COLAs for percentage-based awards, and Ohio's DOPO form mandates COLAs for all awards. Also, federal plans have tricky default rules (which I affectionately dub "silent killers") that are triggered by certain language or the omission of certain language. For instance, with CSRS/FERS, a percentage award will automatically trigger COLAs, unless expressly stated to the contrary.

Remember, COLAs can be a significant marital asset. Always account for any pension plan COLAs. If the plan permits COLAs, negotiate and expressly allocate them. Then make sure when dividing the pension via deferred distribution that the chosen allocation of COLAs is properly reflected in the property division order.

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