

The Practitioner Family Law

Pension Plus

Enhanced Benefits Can Be Community Property

By Mitchell A. Jacobs

In *Marriage of Lehman*, 98 Daily Journal D.A.R. 5539 (May 28, 1998), the California Supreme Court held that a nonemployee spouse who owns a community-property interest in an employee spouse's retirement benefits may profit from any postdissolution enhancement to that interest.

Jack R. Lehman had worked for Pacific Gas and Electric Co. for almost a year when he married Marietta on June 11, 1960. In 1962, he began to participate in the company's defined-benefit retirement plan and to accrue retirement benefits. The couple separated in 1977 and obtained a final judgment of dissolution in 1979.

In 1995, Jack Lehman elected to retire early under the company's "voluntary retirement incentive" program. Under the program, employees who had attained the age of 50 and had worked for at least 15 years could receive credit for three putative years of service and a waiver of the normal actuarial reduction of 18 percent for early retirement.

After Lehman's retirement, his ex-wife made various motions in Superior Court seeking orders that the enhancement to the benefits was a community asset. The Superior Court followed *Marriage of Gram*, 25 Cal.App.4th 859 (1994), and determined that by virtue of her community-property interest in the retirement benefits, Marietta was additionally entitled to receive a community-property interest in their value as enhanced.

The Superior Court determined apportionment of that community-property interest in the retirement benefits by applying the "time rule." By such a calculation, the community interest in the retirement benefits is a percentage representing a fraction whose numerator is the employee spouse's length of service during marriage before separation, and whose denominator is the employee spouse's total length of service. The court deviated from *Gram* to the extent that it did not add the putative years credited to the employee spouse to the denominator.

The Court of Appeal affirmed the lower court's characterization of the increase in retirement benefits as community property. However, it did not address the issue of apportionment because both parties agreed to the application of the time rule.

Thus, the central issue with which the California Supreme Court grappled was that of the characterization of the increase in pension benefits. Does a nonemployee spouse's community-property interest in retirement benefits entitle him or her to a community-property interest in their subsequent enhancement?

The court began its analysis by citing *Marriage of Brown*, 15 Cal.3d 838 (1976), and its progeny, for the proposition that retirement benefits can be

characterized as a community asset "to the extent that such a right derives from employment during marriage before separation."

The *Lehman* court then reasoned that the right to draw from this pension income begins at retirement, and that the amount of such income may depend on various events or conditions upon separation or dissolution, such as a change in the retirement-benefit formula or the basis on which this formula operates. Thus, the stream of income from which retirement benefits are paid may be less than or more than anticipat-

ment arose after the couple had already separated.

The *Lehman* court adopted the tests of the *Frahm* and *Brown* courts in determining the character of retirement benefits and their subsequent enhancement. It too based its determination of the property's character on timing. If the right to property arose during marriage, the property itself would thereon be stamped as a community asset despite a postdissolution increase or decrease in its value.

The court rejected Jack Lehman's argument that his enhanced retirement benefits stemmed from a postseparation contract that his employer offered as consideration for immediate retirement. The court found that Lehman did not accrue the right to such enhancement after separation but instead that this enhancement was derived from his pre-separation labor.

The court went on to reject his attempt to characterize the retirement

package he received as a separate property severance package rather than retirement benefits. Participation in the early retirement program was voluntary and thus did not alter his community-property interest in his retirement plan and its enhancement.

The court also distinguished this matter from previous cases such as *Marriage of Lawson*, 208 Cal.App.3d 446 (1989), and *Marriage of Nelson*, 177 Cal.App.3d 150 (1986), which found that a nonemployee spouse did not have a community interest in severance payments or stock options given to the employee spouse after separation. The court differentiated these cases based on the fact that unlike Lehman's ex-wife, the nonemployee spouses had not previously accrued a right to such benefits during the marriage.

The *Lehman* court also affirmed the Superior Court's apportionment of the community-property share of the benefits, and the employee's separate property interest in the benefits, by its application of the time rule. It found the use of the time rule produced an equitable result because the value of the retirement benefits was largely based on Lehman's number of years of employment. Thus, both spouses' relative contributions were accounted for.

The court also found that where the numerator in a time-rule calculation represents the employee spouse's years of service during marriage and the denominator accounts for the employee's total years served, adding any credited putative years given as consideration for early retirement in the denominator upsets the relative balance of both spouses' contributions.

Lehman has created a new pension benefit. Although this benefit may not be in existence when the parties are divorcing, practitioners representing the nonparticipant should include the potential division of this new enhanced benefit in the qualified domestic relations order should the participant, after dissolution, retire early and elect to receive benefits pursuant to an enhanced retirement program.

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The employee spouse may also voluntarily modify this stream of income available at retirement by his or her election of a specific retirement program. The court found that although the employee spouse is free to make such a modification, the nonemployee spouse shares an interest in what the employee spouse "chooses to do by owning an interest in the community." *Marriage of Gilmore*, 29 Cal.3d 425 (1981).

Thus, a nonemployee spouse who may enjoy a community-property share in the other's pension benefits may also share in their increase, because the underlying right to the pension benefits — and their enhancement — accrues in part during marriage before separation.

The court also reached this conclusion by comparing the results of two analogous cases in which employee spouses had elected to retire early because of an incentive plan. In *Gram*, years after the dissolution of his marriage, an employee spouse elected to retire early under a retirement program that credited five putative years of service and five years of age.

The *Gram* court held that the nonemployee spouse's community interest should be enhanced accordingly, because the increase in benefits was "a part of, and intended to be, the realization of the employee spouse's retirement expectation and thus a form of deferred compensation for the services rendered."

Unlike the plans in *Gram* and *Lehman*, the early retirement plan that the employee spouse elected in *Marriage of Frahm*, 45 Cal.App.4th 536 (1996), included a lump sum of both retirement benefits and a severance payment. The *Frahm* court found that *Gram*'s "past services or future compensation test [was] inapt for determining the character of the benefit." Rather, it based its characterization of the property on whether or not the right to such benefits accrued before or after separation (as in *Brown*). Thus, the court found the severance payment to be separate property, unlike the retirement benefits, because the right to this pay-

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