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Courts Reiterate: Beneficiary Designation Review Is Critical for Estate and Retirement Planning

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A recent federal court case, Proctor & Gamble U.S. Business Services Company v. Estate of Rolison, No. 3:17-CV-00762 (M.D. Pa. April 29, 2024) ("Rolison"), serves as an important reminder of the need to be vigilant in reviewing and updating beneficiary designation forms for qualified retirement plans, employer life insurance programs, deferred compensation plans and individual retirement accounts ("IRAs"), as well as other benefits arrangements.

When starting employment, new hires are typically required to complete a number of forms, including those for enrolling in employer-sponsored retirement plans, deferred compensation arrangements, and group life insurance policies.

However, as significant life events occur—such as getting married, divorced, welcoming a child, or the death of a loved one—updating beneficiary designations is often ignored. This oversight can lead to unintended consequences, with benefits being awarded to previously named individuals.

In the Rolison case, a Proctor & Gamble ("P&G") employee enrolled in the company's investment plan in 1987, designating his then-girlfriend as the sole beneficiary. The relationship ended in 1989. Notwithstanding having received several routine notifications from P&G about updating his beneficiary designations, he left his original designation in place. When Rolison passed away in 2015, his former girlfriend received over $750,000 from the P&G plan. Rolison's estate filed a lawsuit, arguing that Rolison never intended for his ex-girlfriend to remain the beneficiary and accusing P&G of breaching its fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The estate also sought to impose a constructive trust on the funds that had been distributed to the ex-girlfriend.

The court ruled against Rolison's estate, finding that P&G had met its fiduciary obligations under ERISA by adhering to the beneficiary designation on record, issuing multiple notices about updating beneficiary designation and providing plan participants online access for changing designated beneficiaries.

Additionally, the court held that there was no basis for imposing a constructive trust on the distributed funds because there was insufficient evidence that Rolison's original beneficiary designation was erroneous.

Among ERISA's stated purposes was to address the public's concern that private pension plans were being mismanaged and to provide plan administrators with a uniform set of rules to administer ERISA-covered plans. Congress recognized the need to ensure that covered plans operate efficiently and that federal, not state law, needed to regulate their operation and included a broad federal standard that preempts state laws that relate to the administration of plans. To illustrate this strict rule, consider the U.S. Supreme Court case Egelhoff v. Egelhoff ex rel. Breiner, 532 U.S. 141 (2001).

In that case, a plan participant passed away shortly after divorcing his wife without updating the beneficiary designations for his ERISA-covered plans, leaving his

ex-wife as the named beneficiary. His children from a previous marriage argued that a state statute that automatically revoked such designations upon a divorce entitled them to his plan's proceeds.

The U.S. Supreme Court ruled that ERISA specifically preempted state laws that would invalidate a beneficiary designation, and that the designation remains valid unless explicitly changed. Similar to the ruling in Rolison, the Egelhoff Court emphasized that ERISA requires a plan fiduciary to administer the plan in accordance with the documents governing the plan, including beneficiary designations.

Another recent U.S. District Court case highlights the importance of not only updating beneficiary designations but also following the plan's procedures. In Liu v. Kaiser Permanente Employees Pension Plan for Permanente Medical Group, Inc., No. 23-CV-03109-AMO (N.D. Cal. June 20, 2024), the court addressed a situation where a deceased participant's sister claimed she was entitled to her sibling's ERISA-covered pension plan benefits after the participant passed away without any surviving spouse, children, or dependents. An online application to designate a beneficiary was initiated on the participant's behalf, but the application was never completed. Thus, no beneficiary was effectively named. The sister argued that initiating the application constituted "substantial compliance" with the plan's rules or, alternatively, sought to receive the benefits through equitable remedies. The court disagreed, ruling that the procedures in this case to name a designated beneficiary were not properly followed, and therefore the surviving sister was not entitled to the benefits.

As mentioned above, ERISA preempts state laws that relate to covered plans. However, there are instances in which courts have held that individuals other than a "designated beneficiary" may be entitled to plan benefits. For instance, in Central States, Southeast & Southwest Pension Fund v. Howell, 227 F.3d 672 (6th Cir. 2000), a participant was enrolled in an employer-sponsored life insurance policy governed by ERISA.

Despite a state court order barring the participant from altering his beneficiary designations during his divorce proceedings, the participant changed the beneficiaries to his children from a previous marriage. The U.S. Court of Appeals for the Sixth Circuit, finding that a state court-imposed constructive trust on the life insurance policy was preempted by ERISA, sent the case back to the district court to decide whether a federal court should impose a constructive trust for the benefit of the wife.

Similarly, in Matter of Estate of Petronaci, No. A-3842-21 (N.J. Super. Ct. App. Div. Jan. 10, 2024), cert. denied, 310 A.3d 1254 (2024), the ex-wife of a participant appealed an order requiring her to return the proceeds she received from the participant's ERISA-governed 401(k) plan. Despite a Marital Settlement Agreement ("MSA") in which both parties waived all claims to each other's retirement accounts, the participant failed to update his beneficiary designation, resulting in the plan administrator distributing the funds to his ex-wife. The executors of his estate subsequently sought to enforce the MSA and recover the distributed funds. The ex-wife contended that, under ERISA, she was the rightful beneficiary due to the doctrine of federal preemption. However, the appellate court held that ERISA preemption applied only to the plan administrator's duty to distribute the funds and did not invalidate the MSA's waiver of claims. Consequently, the court affirmed that the estate could enforce the contractual waivers set forth in the MSA.

These cases underscore the critical, yet frequently overlooked, importance of regularly reviewing and updating beneficiary designations. Beneficiary designations for ERISA-covered plans are legally binding, and ERISA preempts state statutes that relate to employer-sponsored plans. As these cases demonstrate, remedies such as the imposition of a constructive trust or enforcement of divorce order may be available but can only be sought after the proceeds have been distributed by a plan administrator to the designated beneficiary—and through what may likely be a costly and lengthy court battle.

To avoid these unintended consequences, it is important to keep beneficiary designations up to date. This means regularly reviewing and updating designations, particularly after significant life events such as marriage, divorce, the birth or adoption of a child, or the death of a loved one.

Adhering to the specific procedures set forth in the plan for designating or changing beneficiaries is not just a formality, but an essential step in ensuring that your assets are distributed according to your wishes. Seeking guidance from legal and financial professionals will provide additional assurance that your beneficiary designations are aligned with your broader estate planning objectives.

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