Family Law Section Mid-Summer Conference

July 21, 2017

THREE RADICAL DEVELOPMENTS AFFECTING THE DIVISION OF MILITARY PENSIONS

I. *HOWELL v. HOWELL*, 581 US _____ (2017), 2017 US LEXIS 2946

Decided on May 15, 2017, this U.S. Supreme Court case swept away state court attempts to compensate former spouses in cases where the service member waives all or a portion of military retired pay in order to receive disability benefits. To understand this decision we must first examine the case law and legislative history which preceded it.

A. *McCarty v. McCarty*, 453 US 210 (1981)

The issue before the U.S. Supreme Court in *McCarty* was whether ***any*** military retirement benefits earned by a service member could be considered marital property and divided by a state court in a divorce proceeding.

Holding: No. Federal legislation governing military retired pay indicates that these benefits are personal to the service member and that the legislative intent was for such benefits to reach their intended beneficiary (i.e., the service member). Since federal law preempts state law, state courts were precluded from awarding a former spouse any portion of the service member spouse's military retired pay.

B. Uniformed Services Former Spouses' Protection Act (USFSPA) 10 USC § 1408

In response to *McCarty*, Congress enacted the USFSPA in 1982 to provide some financial protection to former spouses of service members.

The timing was right as Congress was already debating whether to allow state courts to divide federally governed private pension plans in divorce cases by amending ERISA. This ultimately led to the enactment of the Retirement Equity Act of 1984.

The USFSPA authorized state courts in divorce cases to divide a service member's "disposable retired pay" which it defined as total retired pay to which a service member is entitled to receive ***less*** certain excluded amounts, the most common of which are deductions from retired pay for the cost of coverage under the Survivor Benefit Plan and ***deductions resulting from a waiver of retired pay in order to receive disability benefits***.

The upshot is that even after the enactment of the USFSPA, *McCarty* served to preclude the division of portions of military retired pay; most importantly, that which is waived to secure disability benefits.

C. *Mansell v. Mansell*, 490 US 581 (1989)

In this seminal case out of California, the service member was retired and receiving his military pension when the divorce was filed and had waived a portion of his retired pay to receive VA disability benefits. He was receiving both benefits at the time of divorce. The trial court awarded the former spouse 50% of the service member's total retired pay, *including the portion that was waived*. The service member appealed, arguing that the portion of retired pay that was waived must be excluded from division. The case made its way through California's appellate courts and ended up before the U.S Supreme Court.

Holding: Citing the USFSPA's specific exclusion of retired pay waived to receive military disability benefits from its definition of disposable retired pay, the court held that state courts lacked the authority to divide retired pay waived for this purpose.

D. The Next 28 Years - States Fight Back

In the 28 years since the *Mansell* case was decided, many state courts attempted to circumvent the harsh outcome it imposed on them using one or both of the following arguments:

(1) *Mansell* applies only to cases where the service member is already retired and has waived retired pay to receive disability benefits at the time of the divorce. Courts are therefore free to order the division of total expected retired pay in cases where the service member is still serving, or has retired and has not applied for disability benefits; or

(2) Even in cases where retired pay has already been waived to receive disability benefits, *Mansell* is not violated if, instead of directly ordering the division of the waived retired pay, the court orders the service member to reimburse or indemnify the former spouse from any funding source the service member chooses (i.e., not ordered to use disability pay).

This latter reasoning was employed by the Michigan Court of Appeals in *McGee v. Carmine*, 290 Mich App 551; 802 NW2d 669 (2010). Thus, we routinely find divorce judgments, settlement agreements and military pension division orders which include an indemnification provision obligating the service member to directly reimburse the former spouse for the portion of retired pay that was waived to receive disability benefits.

Then, the other shoe dropped.

E. The *Howell* Case

In *Howell*, the parties were divorced in an Arizona family court in 1991 while the service member was still actively serving in the Air Force. The divorce judgment awarded the former spouse "50% of [the service member's] military retirement when it begins." The service member subsequently retired in 1992 and began receiving his retired pay at which time the former spouse also began receiving her 50% share.

Then, in approximately 2005, the service member was deemed by the VA to be 20% disabled due to a service-related injury. The service member opted to receive roughly $250/mo. in VA disability pay which required a dollar-for-dollar waiver of military retired pay. The waiver reduced disposable retired pay by $250/mo. and thus reduced the former spouse's share by $125/mo.

The former spouse successfully persuaded the Arizona family court to restore her full benefit by ordering the service member to directly reimburse the former spouse the value of the benefit that was reduced due to the disability waiver. The Arizona Supreme Court ultimately affirmed the family court's decision finding that, unlike *Mansell*, this case involved a waiver *after* the divorce and that the family court neither attempted to directly divide waived retired pay nor did it order the service member to reimburse the former spouse using his disability pay.

Holding: The U.S. Supreme Court **reversed** the Arizona Supreme Court, holding that *Mansell* controls and specifically finding:

(1) That it makes no legal difference whether the waiver occurred before or after the divorce; and
(2) That ordering the service member to "indemnify" or "reimburse" the former spouse instead of directly dividing the waived retired pay also violates *Mansell* as this is a distinction without a difference.

F. What to Do Now?

The *Howell* court left open the possibility that the state court may take into account the waiver or potential waiver of military retired pay to qualify for disability benefits when calculating or recalculating the need for spousal support. Below are three potential remedies recently suggested by Attorney Mark E. Sullivan, a nationally recognized expert in the division of military pensions, which track what many family law practitioners in Michigan have proposed:

(1) In cases where the service member is already in pay status and has waived a portion of retired pay, award spousal support in an amount sufficient to make

up the "lost" benefit. ***CAUTION: A dollar-for-dollar award may be struck down on appeal as too transparent an attempt to circumvent*** **Howell.**

(2) In cases where the service member is still serving or has retired but not waived retired pay, reserve spousal support in the event the service member later elects to waive retired pay for disability benefits. Here, too, a dollar-for-dollar award may be problematic.

(3) Calculate the present value of the former spouse's awarded share and offset it against other marital assets.

II. NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 2017

A. Prior Awards Under the USFSPA

As originally enacted in 1982, the USFSPA allowed state courts to divide a service member's ***entire*** disposable retired pay in accordance with each state's domestic relations laws provided that, with some exceptions, the former spouse's share did not exceed 50% of total disposable retired pay.

Most states have laws mandating the use of what is commonly known as the "time rule" when dividing pensions in divorces. Under the time rule a former spouse receives 50% of a fraction of the entire pension benefit earned at retirement. The fraction is years (or months) of credited service during the marriage divided by total years of credited service. For example, if W worked at Ford for 30 years, with 5 years worked prior to marriage, 10 years worked during the marriage and 15 years worked after the divorce, H would receive 16.67% [50% x (10/30)] of W's total benefit at retirement.

Michigan has adopted no specific formula to be used when dividing a pension in a divorce case. Regarding military pensions we are therefore free to assign any portion (under 50%) of a service member's entire disposable retired pay as may be negotiated by the parties and approved by the court. The Defense Finance and Accounting Service (DFAS), which administers this plan and processes Military Pension Division Orders (MPDOs), accepts a wide range of awards and hypothetical formulas provided the information necessary to calculate the award is included in the MPDO.

Then, everything changed with a stroke of the pen.

B. National Defense Authorization Act for Fiscal Year 2017

Signed into law on December 23, 2016, the National Defense Authorization Act for Fiscal Year 2017 amended the USFSPA to dramatically redefine "disposable retired pay."

For divorce judgments entered on or after December 23, 2016, DFAS will divide only the retired pay attributable to the service member's pay grade, years of service and retired pay base on the date of divorce.

The amended language makes no allowance or exception in cases where parties agree to a different formula or award. The award to the former spouse is "frozen" and will not take into account perhaps years of subsequent military service and promotions, while the former spouse is not permitted to receive her share until the service member retires.

This change will have no effect in cases where the service member is retired at the time of divorce as the full retired pay amount has already been fixed. In all other cases this revision to federal law preempts state law and imposes a single method of dividing military pensions across all 50 states. As you might imagine, this has caused chaos in those states which require the time rule method of division.

Though Michigan law does not require a specific method of pension division, family law practitioners must now be sure that an award of a portion of a service member's military pension does not run afoul of this revised legislation.

BEST PRACTICE: Be sure to obtain all data required by DFAS to calculate the award and avoid further litigation after entry of the judgment:

(1) **Rank** (pay grade) on the date of divorce;

(2) **Years of creditable service** as of date of divorce for active duty members or reserve retirement points as of date of divorce for reserve component members; and,

(3) **Retired Pay Base** - A service member's pension is calculated as 2.5% x years of service x retired pay base. For service members who enlisted on or after 9/8/80, retired pay base is generally the average of the highest 36 months of continuous service ("High-3") which is typically the three years immediately preceding the date of divorce. Counsel must be sure to obtain complete pay records for such periods as DFAS now requires the High-3 figure to be calculated and included in the MPDO.

III. BLENDED RETIREMENT SYSTEM

Under the current military retirement system, a service member becomes entitled to receive a defined benefit pension upon attaining 20 years of active duty service or its reserve component equivalent. The monthly pension benefit is generally calculated as:

2.5% x years of service x retired pay base

Service members may also voluntarily open and make pre-tax or after-tax contributions to a Thrift Savings Plan (TSP) account. This is a federal government-sponsored defined contribution plan. Participation in the TSP is optional under the current system.

A major restructuring of the military retirement benefit system called the Blended Retirement System ("BRS") will go into effect on January 1, 2018. Not all service members will be enrolled in the BRS. **Whether a service member enters the BRS will depend on which of these 3 groups he or she falls into as of December 31, 2017:**

(1) **Must keep current system** – all service members with at least 12 years of active duty service or reservists with 4,320 or more reserve retirement points.

(2) **Must enroll in BRS** – all service members who enlist after December 31, 2017.

(3) **Can opt to enroll in BRS** – service members with less than 12 years active duty service or reservists with less than 4,320 reserve retirement points are grandfathered under the current system but have the option of switching to the BRS that must be exercised during calendar year 2018.

The BRS is comprised of both defined benefit and defined contribution components, and service members may also elect to receive Continuation Pay and a Lump Sum Option. Each of these is summarized below.

A. Defined Benefit Plan

The defined benefit component of the BRS remains the same as that under the current system with one major exception: ***The retirement multiplier is reduced from 2.5% to 2.0%***.

An example will highlight the difference. Take a service member with 20 years of service whose retired pay base (High-3) is $4,000/mo. Under the current system

the pension benefit is $2,000/mo. (2.5% x 20 x $4,000) but under the BRS that same service member will receive a monthly benefit of only $1,600 (2.0% x 20 x $4,000).

B. Defined Contribution Plan

To both offset the reduced pension benefit and to provide some retirement benefits to those service members who do not attain at least 20 years of service, the BRS provides for automatic enrollment in the TSP with an individual contribution of 3% of basic pay. Individual contributions are not required and service members may modify their contribution level at any time.

Not only will the government open the account, it will contribute an amount equal to 1% of the service member's basic pay and, after 2 years, it will also match the service member's individual contribution up to a maximum of 5% of basic pay.

C. Continuation Pay

Under the BRS, service members will be offered "Continuation Pay" in exchange for a commitment to serve 3 additional years. This offer will be made between 8 and 12 years of service, depending on the service member's branch of service.

Those who elect this option will receive a payment of 2.5 to 13 times their monthly basic pay if active duty and 0.5 to 6 times basic pay for reservists. Payment can be made as a lump sum (or in up to 4 annual installments).

D. Lump Sum Option

Lastly, service members in the BRS who become eligible for retired pay (20 years) can elect to take a portion of their retired pay as a lump sum payment at retirement.

Instead of receiving their full monthly retired pay, service members may elect to receive a reduced monthly benefit in exchange for receiving the discounted present value of 25% or 50% of the retired pay that would be due to them prior to becoming fully eligible for Social Security. Payment will be made in the form of a lump sum payment (or in up to 4 annual installments). Service members will receive the reduced benefit (i.e., 75% or 50% of the full benefit depending on the lump sum option elected) until attaining eligibility for Social Security benefits at which time their full retired pay will be restored.

E. Protecting the Former Spouse

If representing the former spouse of a service member who is eligible to opt into the BRS, a well-crafted indemnification clause is essential to protecting the benefit awarded to your client. Here is a sample clause to consider including in the divorce judgment or settlement agreement:

The award of retired pay to the former spouse is based on retired pay to which the service member would be entitled based only on length of creditable service as calculated under the applicable laws and regulations in effect at the time of entry of the divorce judgment. This Court specifically reserves jurisdiction in order to provide a remedy for the former spouse in the event the service member's retired pay is reduced for any reason or purpose, including, but not limited to: the service member's election to opt into the Blended Retirement System; any waiver made in order to qualify for Veterans Administration or other disability pay or benefits; election to receive Combat-Related Special Compensation (CRSC); election to receive CSB/REDUX lump sum payments; election to receive lump sum payments under the Blended Retirement System; election to receive voluntary separation incentive pay (VSI); or receipt of special separation benefit (SSB).

In order to compensate the former spouse for the loss of all or part of the full benefit awarded to him/her, the Court may adjust the pension division or property division and may also order the service member to make direct payments to former spouse (either as property award or spousal support) in an amount sufficient to restore the value of the lost benefit.