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EXECUTIVE COMPENSATION & EMPLOYEE BENEFITS

CLIENT PUBLICATION

April 8, 2015

Non-Qualified Plan Sponsors: Beneficiary Designations May Require Attention

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A recent court decision highlights the importance of up-to-date beneficiary designations for participants in non-qualified retirement plans. Without up-to-date designations, the payment of the benefits of a deceased participant in a non-qualified plan may be contested, which can result in additional expense for the plan sponsor or the participant, and may also result in the benefit not being paid in accordance with the deceased participant's wishes. In this publication, we summarize steps that plan sponsors can take to mitigate the risks and costs related to beneficiary designations.

E & J Gallo Winery v. Rogers

The decision bringing attention to beneficiary designations in non-qualified plans is *E & J Gallo Winery v. Rogers*.[1] E & J Gallo Winery ("Gallo") filed an interpleader action in a California federal court to determine the beneficiary under the Gallo Key Executive Profit Sharing Retirement Plan (the "ERP") of Robert Rogers, a deceased participant in the ERP (the "Participant"). The Participant had designated his former spouse (the "Former Spouse") as the primary beneficiary and his brother (the "Brother") as the secondary beneficiary. Because the Former Spouse had waived her rights as the primary beneficiary, the district court found that the Brother was the proper beneficiary for the ERP benefit.

The Participant's spouse at the time of his death (the "Spouse") appealed the district court decision, claiming that the entire tax qualified Gallo Profit Sharing Retirement Plan (the "Qualified Plan") was incorporated by reference into the ERP.[2] Consistent with the requirements of the Internal Revenue Code of 1986, as amended (the "Code"), the Qualified

[1] Memorandum, No. 13-55327, D.C. No. 8:09-cv-00513-DMG-MLG (Ninth Circuit, Feb. 23, 2015) (the "Memorandum").

[2] The Spouse's claim was based on a 1988 letter from Gallo regarding the ERP stating that vesting, methods of payment and "all other matters" would be determined under the Qualified Plan.

Plan provided that, upon the death of a participant, benefits are provided to the surviving spouse, if any, or to a designated beneficiary, but only if there is no surviving spouse or if the surviving spouse has consented to the designated beneficiary.

The Ninth Circuit upheld the district court's decision, concluding that the Participant unambiguously designated the Former Spouse as his primary beneficiary and the Brother as his secondary beneficiary. The court stated that nothing in the ERP provided that the Participant's marriage to the Spouse would void his prior designation of the Former Spouse. Finally, the court noted that, as a non-qualified plan, the ERP is exempt from the Code's spousal consent requirements and that there was no indication that Gallo intended to incorporate the terms of the Qualified Plan into the ERP.

Considerations and Action Items for Plan Sponsors

For sponsors of non-qualified (as well as qualified) plans, filing an interpleader can mitigate the risk inherent in a beneficiary dispute, especially when the amount of the deceased participant's benefit is significant. But an interpleader action is not without cost.[3] Additionally, an interpleader action can delay payment of the benefit, which in a defined contribution plan where the amount of the benefit is affected by changes in the market, can create other risks for the plan sponsor.

Sponsors of nonqualified plans should be able to reduce the likelihood of needing to file an interpleader action by taking the following steps:

- Amend the Plan Document. Amending the plan document to clarify provisions relating to beneficiary designations should eliminate some of the questions and ambiguities that arise when a participant dies. With clear provisions, plan sponsors will be better able to assess the status of claims by "alleged" beneficiaries, and may not need the court's assistance in identifying the proper beneficiary. It appears that the ERP contained very little information regarding the status of beneficiary designations in the event of divorce.[4] If the ERP had stated that a participant's divorce did not automatically nullify a properly executed pre-divorce designation naming the former spouse as beneficiary, Gallo may have determined that filing an interpleader was not necessary. Additional beneficiary-related topics that plan sponsors should consider addressing in their non-qualified plans are: (1) payment of the participant's benefit in the absence of a beneficiary designation by the participant, (2) whether the Plan requires spousal consent to designate a non-spousal beneficiary,[5] and (3) when a beneficiary designation becomes effective—as of the date executed by the participant or upon receipt by the plan sponsor.
- Communicate Plan Provisions to Participants. Plan sponsors should explain plan provisions relating to beneficiary designations to participants. The explanation could be in the form of a written summary of these provisions. A statement that the beneficiary provisions in the non-qualified plan differ from those in the sponsor's qualified plan may

[3] Non-qualified plans typically provide that administrative expenses will be paid by the plan sponsor. However, such expenses, including the cost of an interpleader action, could be charged against the participant's benefit, if permitted under the terms of the plan.

[4] Par. 2 of the Memorandum states that "Nothing in the ERP governing documents provided that [the Participant's] marriage . . . would void his prior beneficiary designation."

[5] Even though the Code's spousal consent rules are not required in non-qualified plans, a plan sponsor can elect to apply similar rules to its non-qualified plan.

be helpful in alerting participants to the need for an up-to-date designation. Participants should also receive a copy of the non-qualified plan document.

- Encourage Participants to Review and Update Designations. As part of the communications program, plan sponsors should encourage participants to review their current beneficiary designations and update them regularly.
- Maintain Accurate Records. Plan sponsors should ensure that they have procedures and systems in place to maintain beneficiary designations from participants.

While taking any or all of the above actions may not eliminate the need for filing interpleaders, these actions should reduce the number that need to be filed.

Please feel free to contact us if you would like to discuss this matter further.

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