Study F-910 L-910 September 26, 1997

Memorandum 97-70

Termination of Beneficiary Designation by Dissolution of Marriage: Initial Issues

INTRODUCTION

In order to effectuate the likely intentions of divorcing parties, the Commission has decided that divorce should sever a joint tenancy between spouses. At the May 1997 meeting, the Commission decided to consider whether divorce should also affect other forms of nonprobate transfer to a spouse. This is the policy of Uniform Probate Code Section 2-804, which provides that divorce revokes a broad range of revocable nonprobate transfers to a spouse. A copy of Section 2-804 is attached as an exhibit. This memo considers the principal issues that would arise in implementing such a rule in California. A preliminary staff draft is attached for discussion purposes.

LIKELY INTENTIONS OF DIVORCING PARTIES

Death Before Property Division

The Commission's study of whether divorce should sever a joint tenancy between spouses was undertaken to remedy the problem presented by *Estate of Layton* — where a person dies after a judgment terminating marital status but before division of marital property. In such a case, joint tenancy property will pass to the decedent's former spouse by operation of survivorship, and not to the decedent's devisees or heirs. See Estate of Layton, 44 Cal. App. 4th 1337, 52 Cal. Rptr. 251 (1996). This result is contrary to the likely intentions of most divorcing parties.

This problem can also arise in the context of other forms of nonprobate transfer at death (hereinafter "nonprobate transfer"). For example:

> H insures his life and names W as beneficiary. H and W subsequently divorce. Before H and W reach an agreement on property division, H dies. The insurance policy pays W as the designated beneficiary.

In fact, the likelihood of this problem occurring is greater in these other contexts than with joint tenancy because, under Family Code Section 2581's community property presumption, most property acquired during marriage in joint form will be treated on divorce as community property and not as a joint tenancy. This substantially limits the number of cases in which an actual joint tenancy exists on divorce. There is no equivalent presumption against the existence of other forms of nonprobate transfer.

Furthermore, because a joint tenancy is often tangible property, such as the family home or car, and is titled in both spouses' names, it may be more likely to come before the court for disposal in a divorce proceeding than is an instrument making a nonprobate transfer. This means that the likelihood that a person will die after divorce but before revoking a nonprobate transfer to a spouse is greater than the likelihood of dying after divorce but before severance of a joint tenancy.

Ambiguous Marital Property Agreements

Another problem exists where marital property *has* been divided by agreement, with one person assigned exclusive ownership of an instrument making a nonprobate transfer (e.g., a life insurance policy), but with no specific waiver or renunciation of the other spouse's status as a named beneficiary under the instrument. Such an agreement has no effect on the status of the former spouse as beneficiary. See, e.g., Life Insurance Company of North America v. Cassidy, 35 Cal. 3d 599, 606, 676 P.2d 1050, 200 Cal. Rptr. 28 (1984).

This creates the following situation:

> H insures his own life and names W as beneficiary. H and W subsequently divorce. In the marital property agreement, H and W agree that H shall have exclusive ownership of the insurance policy. H remarries, but neglects to change the beneficiary designation. On H's death, the insurance policy pays W as the named beneficiary.

This seems contrary to the likely expectations and intentions of divorcing parties.

Evidence of Intent

In some cases, there may be clear evidence that a person designating a spouse as the beneficiary of a nonprobate transfer intends that the beneficiary designation continue despite a divorce. In such a case, a bright line rule that divorce invalidates a spousal beneficiary designation would not effectuate the transferor's intent.

Conclusion

In order to effectuate the likely intentions of most divorcing parties the staff recommends that a revocable nonprobate transfer to a spouse should be made ineffective by divorce, unless a court order or an express agreement of the parties provides otherwise, or there is clear evidence that the transferor intends the beneficiary designation to survive divorce. Such a rule is consistent with the treatment of wills, Public Employees' Retirement System (PERS) death benefits, spousal inheritance rights that depend on one's status as a surviving spouse, a designation of a spouse as attorney-in-fact, and the Commission's proposed law regarding joint tenancy.

SCOPE OF PROPOSED LAW

Nonprobate Transfers Generally

The proposed law would affect a revocable beneficiary designation in an instrument making a nonprobate transfer. Such instruments include life insurance, revocable trusts, and retirement death benefits. Section 5000 of the Probate Code provides a catalog of instruments that can make a nonprobate transfer:

> § 5000. (a) A provision for a nonprobate transfer on death in an insurance policy, contract of employment, bond, mortgage, promissory note, certificated or uncertificated security, account agreement, custodial agreement, deposit agreement, compensation plan, pension plan, individual retirement plan, employee benefit plan, trust, conveyance, deed of gift, marital property agreement, or other written instrument of a similar nature is not invalid because the instrument does not comply with the requirements for execution of a will, and this code does not invalidate the instrument.
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> (b) Included within subdivision (a) are the following:
>
> (1) A written provision that money or other benefits due to, controlled by, or owned by a decedent before death shall be paid after the decedent's death to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.
>
> (2) A written provision that money due or to become due under the instrument shall cease to be payable in event of the death of the promisee or the promisor before payment or demand.
>
> (3) A written provision that any property controlled by or owned by the decedent before death that is the subject of the instrument shall pass to a person whom the decedent designates either in the instrument or in a separate writing, including a will, executed either before or at the same time as the instrument, or later.
>
> …

Interests to be affected by the proposed law could easily be defined by reference to Section 5000. Its catalog of nonprobate transfers is quite comprehensive and subdivision (a) includes catchall language ("other written instrument of a similar nature") that should be adequate to address nonprobate transfers that are not expressly identified (e.g., spousal consent to a nonprobate transfer of community property, discussed below).

Spousal Consent to a Nonprobate Transfer of Community Property

There is a form of nonprobate transfer that is not expressly identified in Section 5000, but should probably be subject to the proposed law — spousal consent to a nonprobate transfer of community property. A spouse must consent in writing to a nonprobate transfer of community property, or the transfer is ineffective as to the non-consenting spouse's interest and can be set aside. See Prob. Code §§ 5010-5032. Consent to a nonprobate transfer of community property does not effect a present transmutation of community property. Instead it is a revocable future gift of community property. "In effect, the consent is itself a nonprobate transfer which becomes irrevocable on the death of the spouse." See Prob. Code § 5023, Comment. For example, if H insures W's life, names himself as beneficiary, and pays the premiums with community funds, W must consent, or the nonprobate transfer of W's community interest in the policy is ineffective and can be set aside. If W does consent, W's interest passes to H on W's death.

The proposed law should apply in this context as well. If a typical divorcing person would revoke a disposition to a spouse in that person's will or will substitute, then that person would also revoke consent to a nonprobate transfer of community property in an instrument executed by the spouse. In the example above, if H and W divorce, W would probably intend to revoke consent to the transfer of her community property interest in the life insurance to H.

Nonprobate Transfer to a Spouse's Relative

Uniform Probate Code Section 2-804 provides that, in addition to revoking a revocable nonprobate transfer to a spouse, divorce also revokes a revocable nonprobate transfer to "a relative of the divorced individual's former spouse." See Unif. Prob. Code § 2-804(a)(5). This rule is based on the assumption that "during [the] divorce process or in the aftermath of the divorce, the former spouse's relatives are likely to side with the former spouse, breaking down or weakening

any former ties that may previously have developed between the transferor and the former spouse's relatives." Unif. Prob. Code § 2-804, Comment.

This assumption may be correct in many circumstances, but the staff is uncertain whether it represents the most likely situation. There may be many cases where a divorcing person's relationship with a relative of a former spouse is unaffected by divorce. Given the uncertainty as to the most likely intentions of a divorcing person in this regard, it may not be appropriate to extend the proposed law to affect the designation of a relative of a former spouse as a beneficiary. Note that other provisions of California law that revoke a disposition to a spouse on divorce do not affect a disposition to a relative of a spouse. See, e.g., Prob. Code § 6122 (revoking disposition to spouse in will on divorce).

FEDERAL PREEMPTION

One problem with the proposed law is the likelihood of federal preemption of the rule as applied to employee benefits. The Uniform Probate Code has devised a method to circumvent federal preemption of Section 2-804, but the method has serious shortcomings.

Federal Employees

Preemption is likely in the case of federally-provided employee benefits (such as federal civil service retirement benefits). Under such plans the revocation of a beneficiary designation may be subject to statutory procedures, which would be frustrated by a rule making the designation of a spouse as beneficiary ineffective after a divorce. For example, in order to revoke a death benefit beneficiary designation in the federal civil service retirement system, the member must submit a signed and witnessed writing or the purported revocation is without effect. See 5 U.S.C.A. § 8342(c). The proposed law would directly conflict with this requirement and would be preempted in this context.

Private Employees

Another likely source of preemption is the Employee Retirement Income Security Act (ERISA), which regulates private employee benefit programs. 29 U.S.C.A. §§ 1001-1461. In addition to preempting state law that conflicts with its terms, ERISA also expressly preempts any state law that "relates to" plans regulated under ERISA. 29 U.S.C.A. § 1144. This preemption provision has been read extremely broadly, such that a state law is preempted if it merely refers to, or is connected to an ERISA-covered plan, even if the law is not designed to affect

such plans and only indirectly affects them. See, e.g., Ingersoll-Rand Company v. McClendon, 498 U.S. 133 (1990) (state wrongful discharge claim is preempted if basis of claim is that employee was fired to avoid payment of ERISA-regulated benefits).

It is very likely that a state law making a nonprobate transfer to a spouse in an ERISA-covered plan ineffective after a divorce would be sufficiently connected to the plan to be preempted. This was the precise holding in a case that considered whether an Oklahoma statute providing that divorce revokes a nonprobate transfer to a spouse was preempted by ERISA when applied to employer-provided life insurance. See Metropolitan Life Insurance Company v. Hanslip, 939 F.2d 904 (10th Cir. 1991).

Avoidance of Preemption

The Uniform Probate Code attempts to sidestep federal preemption with the following language:

> § 2-804(h)(2). If this section or any part of this section is preempted by federal law with respect to a payment, an item of property, or any other benefit covered by this section, a former spouse, relative of the former spouse, or any other person who, not for value, received a payment, item of property, or any other benefit to which that person is not entitled under this section is obligated to return that payment, item of property, or benefit, or is personally liable for the amount of the payment or the value of the item of property or benefit, to the person who would have been entitled to it were this section or part of this section not preempted.
>
> **Comment**. … [Subsection (h)(2)] imposes a personal liability for pension payments that pass to a former spouse or relative of a former spouse. This provision respects ERISA's concern that federal law govern the administration of the plan, while still preventing unjust enrichment that would result if an unintended beneficiary were to receive the pension benefits. Federal law has no interest in working a broader disruption of state probate and nonprobate transfer law than is required in the interest of smooth administration of pension and employee benefit plans.

Although several states have adopted Section 2-804, the effectiveness of the language above has not yet been tested in a reported opinion. The staff sees a number of problems with this approach.

(1) Federal protection of beneficiary rights. The Uniform Probate Code approach assumes that the only relevant federal interest is to avoid state intrusion

into the uniform administration of federally-regulated employee benefit plans. In fact, federal regulation is also intended to protect the rights of employees and their beneficiaries under those plans. To the extent that the proposed law deprives a beneficiary of the value of property transferred under a federally-regulated plan, it might well be preempted, whether it affects plan administration or not. See, e.g., Boggs v. Boggs, 117 S.Ct. 1754 (1997) (action for accounting of disbursed pension benefits preempted despite the fact that administration of the pension plan would not be affected). See also Ingersoll-Rand, 498 U.S. at 137 (broad preemption is intended to "completely secure the rights and expectations" protected under ERISA).

(2) Relation to ERISA. Even though the language purports only to affect the interests of beneficiaries and not the administration of a plan, it may still "relate to" an ERISA plan, in that the amount to be reimbursed is measured directly by reference to the amount to be received under the ERISA-covered plan. This degree of relation to an ERISA plan is probably sufficient to trigger preemption. See, e.g., District of Columbia v Greater Washington Board of Trade, 506 U.S. 125 (1992) (statute that required employers who provide health benefits to provide equivalent coverage to employees eligible for workman's compensation preempted because required coverage was measured by direct reference to ERISA-covered plans).

(3) Annuities. The distinction between a statute that interferes with plan administration and one that simply readjusts ownership rights after the plan distributes property might make sense in the context of lump sum benefits, but would be difficult to implement in the context of annuities. If a former spouse "improperly" receives a survivor annuity, should the "proper" beneficiary bring separate actions for reimbursement after each payment, or would the court impose a lifelong obligation of reimbursement on the former spouse? The latter would likely be preempted by ERISA's prohibition of assignment or alienation of plan benefits. 29 U.S.C.A. § 1056(d).

Alternatives

There are at least three possible approaches to addressing the question of federal preemption:

> (1) Implement the proposed law without any accommodation for federal preemption other than the Probate Code's general severability clause. The scope of the proposed law would then be limited by the scope of federal preemption as defined by Congress and the courts.

(2) Implement the proposed law with the Uniform Probate Code's preemption circumvention language.

(3) Expressly exclude employee benefits from the scope of the proposed law.

RETROACTIVITY OF PROPOSED LAW

Retroactive application of the proposed law may create problems in two situations: (1) Where applied to a contract in existence prior to enactment of the proposed law. (2) Where applied to nonprobate transfers already completed as a consequence of the transferor's death, prior to enactment of the proposed law. These issues are discussed more fully below.

Impairment of Contract

Two statutes similar to the law considered in this memorandum have been held to unconstitutionally impair the obligation of contracts when applied to contracts in existence prior to the enactment of the statute. See Aetna Life Insurance Company v. Schilling, 616 N.E.2d 893 (1993) (Ohio Supreme Court held retroactive application of statute revoking spousal beneficiary designation on divorce violated Ohio Constitution's prohibition on laws impairing obligation of contracts); Whirlpool Corporation v. Ritter, 929 F.2d 1318 (8th Cir. 1991) (similar Oklahoma statute violated impairment of contracts clause of U.S. Constitution).

The *Ritter* decision has been sharply criticized by the Joint Editorial Board for the Uniform Probate Code (JEB). See 17 ACTEC Notes 184 (1991). The JEB's argument rests on the following points:

(1) "A life insurance policy is a third-party beneficiary contract. As such it is a mixture of contract and donative transfer.... In *Ritter* and in comparable cases, there is never a suggestion that the insurance company can escape paying the policy proceeds that are due under the contract.... The divorce statute affects only the donative transfer, the component of the policy that raises no Contracts Clause issue. The precise question in these cases is which of the decedent's potential donee-transferees should receive the proceeds.... The JEB believes that there is no justification for extending Contracts Clause concerns to a statute that only affects the donative transfer component of a life insurance policy, since the statute works no interference with the contractual component of the policy, the company's obligation to pay." *Id.*

(2) "The Contracts Clause protects contractual reliance. Because statutes such as Uniform Probate Code § 2-804 serve to implement rather than to defeat the insured's expectation under the insurance

contract, the premise for applying the Contracts Clause is wholly without foundation." *Id.*

(3) Statutes such as Uniform Probate Code § 2-804 are mere constructional default rules. "The JEB is aware of no authority for the application of the Contracts Clause to state legislation applying altered rules of construction or other default rules to pre-existing documents in any field of law[.]" *Id.*

Despite the persuasiveness of the JEB's argument, the fact remains that application of statutes similar to Uniform Probate Code § 2-804 to contracts in existence prior to the enactment of the statute has been held to unconstitutionally impair contracts in every case the staff could find that considered the question. It is therefore quite possible that similar application of the proposed law in California would also be held unconstitutional. On the other hand, only the State of Ohio and the Tenth Circuit have considered the issue, and the question might be decided differently by California courts or by the Ninth Circuit.

The issue then is whether the proposed law should anticipate the possible unconstitutionality of the statute as applied to existing contracts by precluding such application, or should instead rely on the Probate Code's general severability clause to preserve operation of the statute in other contexts if application to existing contracts is held unconstitutional.

Vested Interests

The proposed law should not affect a nonprobate transfer that has been completed by the death of the transferor. Revocation in such circumstances would upset settled property interests and would probably constitute an unconstitutional impairment of a vested property interest without due process of law. This is consistent with the Commission's decision not to retroactively sever a marital joint tenancy after the death of one of the joint tenants.

OTHER ISSUES

Payor Protection

Potential Harm to Third Party Payors. Revocable nonprobate transfers other than joint tenancy create expectancies only during the life of the transferor. Consequently, the problems raised by severance of joint tenancy by divorce, where a third party acquires an interest in property that is adversely affected by the severance of survivorship, are not present in this context. There are, however, third parties who might be adversely affected — payors.

Most forms of nonprobate transfer involve an intermediary who holds the property to be transferred and is responsible for its distribution according to the terms of the governing instrument. The proposed law invalidates the beneficiary designation without changing the terms of the governing instrument. This creates potential liability for a payor who distributes property to a named beneficiary who, after a divorce, is no longer entitled to the property.

If payors are not protected from liability for payments made in accordance with the terms of the governing instrument, payors will need to expend additional time and resources determining who is the proper beneficiary. This would necessarily slow payment, undermining the benefit of nonprobate transfer as a simple, quick means of transferring property on death.

Payor Protection. The Uniform Probate Code addresses this problem by immunizing payors from liability for payments made in accordance with the terms of the governing instrument, unless the payor has received written notice of a revocation by divorce. Any dispute as to the proper beneficiary is then with the designated beneficiary, and not the payor. Similar protections already exist in the Probate Code. See Prob. Code §§ 5003 (nonprobate transfer of community property), 5305 (multiple party accounts). The staff recommends that such protection be provided in the proposed law. See proposed Section 5502.

Lapsed and Failed Transfers

One question that must be addressed is how to dispose of property when a beneficiary designation has been made ineffective by operation of the proposed law and no alternative beneficiary is designated in the governing instrument.

California's existing statute governing failed nonprobate (and probate) transfers is not particularly helpful in this context. It provides that in the event a transfer fails, the property to be transferred "becomes a part of the residue transferred under the instrument." See Prob. Code § 21111. It isn't clear what this means as applied to a nonprobate transfer that does not provide for the transfer of a residue. For example, if a life insurance policy names a spouse as sole beneficiary, and makes no provision for what to do if that beneficiary designation fails, how would Section 21111 operate if the beneficiary designation is made ineffective after a divorce? The failed transfer cannot become a part of the residue transferred under the policy because there is no provision for transferring a residue.

This defect in Section 21111 appears to be general, rather than specific to the context of the proposed law. That is, the same problem exists regardless of why the transfer failed. For example, if a life insurance policy payment fails because the beneficiary died before the transferor, and the policy makes no provision for such an event, it is not helpful to provide that the payment becomes part of the residue transferred under the policy.

In amending Section 21111 for the purposes of the proposed law, we can also correct this general defect in the statute. The staff recommends the following changes:

> § 21111. Except as provided in Section 21110:
>
> (a) If a transfer, other than a residuary gift or a transfer of a future interest, fails for any reason, and the transferring instrument provides for the transfer of a residue, the property transferred becomes a part of the residue transferred under the instrument.
>
> (b) If a transfer, other than a residuary gift or a transfer of a future interest, fails for any reason, and the transferring instrument does not provide for the transfer of a residue, the property is transferred to the decedent's estate.
>
> ~~(b)~~ (c) if a residuary gift or a future interest is transferred to two or more persons and the share of a transferee fails for any reason, the share passes to the other transferees in proportion to their other interest in the residuary gift or the future interest.

Determining Effectiveness of Divorce

Another issue that must be addressed is how to determine when a divorce is effective to affect a nonprobate transfer to a spouse under the proposed law. This question is answered in similar provisions of the Probate Code by reference to whether the divorce is effective to terminate the survivor's status as a "surviving spouse" under Probate Code Section 78. If a person is not a "surviving spouse" then that person's spousal inheritance rights are terminated. This is also the approach recommended for determining whether a divorce is effective to sever a joint tenancy under the law proposed in Commission Study H-603. See Memorandum 97-50.

Reference to Section 78 to determine whether a divorce is effective to affect a nonprobate transfer to a spouse has the following benefits:

> (1) Consistency with existing provisions in the Probate Code. See, e.g., Prob. Code § 6122.
>
> (2) Exclusion of an invalid divorce, except where circumstances are such that the survivor should be estopped from denying the

validity of the divorce (for example, where the survivor obtained the invalid divorce or consented to it).

(3) Exclusion of a valid divorce if the former spouses have remarried each other and are married to each other at the time of the decedent's death.

For these reasons, the staff recommends using the same approach as that recommended for severance of a joint tenancy in this proposed law.

Execution of Instrument Before Marriage

A final issue is whether divorce should affect a beneficiary designation that is executed before the transferor and beneficiary are married to each other. Different provisions of the Probate Code treat this issue differently.

Probate Code Section 6227, revoking a disposition to a "spouse" in a California statutory will on divorce, appears to affect only wills that are executed during the testator's marriage to the former spouse. This is because "spouse" is defined for the purposes of that section as "the testator's husband or wife at the time the testator signs a California statutory will." Prob. Code § 6202.

Probate Code Section 6122, revoking a disposition to a spouse in a regular will on divorce, does not appear to distinguish between wills executed before or during marriage. This reading of the statute has been affirmed in one reported case. See Reeves v. Reeves, 233 Cal. App. 3d 651 (1991). The court in *Reeves* reasoned as follows:

> The Legislature changed the law to protect a spouse who neglects to change his or her will following divorce or annulment. This purpose is no less compelling where, as here, the decedent executes his will before he and his former spouse are married. The significant fact is the couple was married and subsequently divorced. It is this change in legal status which triggers the protections of section 6122.

The staff finds this position persuasive. This is the approach taken by the Uniform Probate Code and in the preliminary staff draft.

Respectfully submitted,

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Exhibit

UNIFORM PROBATE CODE SECTION 2-804 (1993)

§ 2-804. (a) [Definitions.] In this section:

(1) "Disposition or appointment of property" includes a transfer of an item of property or any other benefit to a beneficiary designated in a governing instrument.

(2) "Divorce or annulment" means any divorce or annulment, or any dissolution or declaration of invalidity of a marriage, that would exclude the spouse as a surviving spouse within the meaning of Section 2-802. A decree of separation that does not terminate the status of husband and wife is not a divorce for purposes of this section.

(3) "Divorced individual" includes an individual whose marriage has been annulled.

(4) "Governing instrument" means a governing instrument executed by the divorced individual before the divorce or annulment of his [or her] marriage to his [or her] former spouse.

(5) "Relative of the divorced individual's former spouse" means an individual who is related to the divorced individual's former spouse by blood, adoption, or affinity and who, after the divorce or annulment, is not related to the divorced individual by blood, adoption, or affinity.

(6) "Revocable," with respect to a disposition, appointment, provision, or nomination, means one under which the divorced individual, at the time of the divorce or annulment, was alone empowered, by law or under the governing instrument, to cancel the designation in favor of his [or her] former spouse or former spouse's relative, whether or not the divorced individual was then empowered to designate himself [or herself] in place of his [or her] former spouse or in place of his [or her] former spouse's relative and whether or not the divorced individual then had the capacity to exercise the power.

(b) [Revocation Upon Divorce.] Except as provided by the express terms of a governing instrument, a court order, or a contract relating to the division of the marital estate made between the divorced individuals before or after the marriage, divorce, or annulment, the divorce or annulment of a marriage:

(1) revokes any revocable (i) disposition or appointment of property made by a divorced individual to his [or her] former spouse in a governing instrument and any disposition or appointment created by law or in a governing instrument to a

relative of the divorced individual's former spouse, (ii) provision in a governing instrument conferring a general or nongeneral power of appointment on the divorced individual's former spouse or on a relative of the divorced individual's former spouse, and (iii) nomination in a governing instrument, nominating a divorced individual's former spouse or a relative of the divorced individual's former spouse to serve in any fiduciary or representative capacity, including a personal representative, executor, trustee, conservator, agent, or guardian; and

(2) severs the interests of the former spouses in property held by them at the time of the divorce or annulment as joint tenants with the right of survivorship [or as community property with the right of survivorship], transforming the interests of the former spouses into tenancies in common.

(c) [Effect of Severance.] A severance under subsection (b)(2) does not affect any third-party interest in property acquired for value and in good faith reliance on an apparent title by survivorship in the survivor of the former spouses unless a writing declaring the severance has been noted, registered, filed, or recorded in records appropriate to the kind and location of the property which are relied upon, in the ordinary course of transactions involving such property, as evidence of ownership.

(d) [Effect of Revocation.] Provisions of a governing instrument are given effect as if the former spouse and relatives of the former spouse disclaimed all provisions revoked by this section or, in the case of a revoked nomination in a fiduciary or representative capacity, as if the former spouse and relatives of the former spouse died immediately before the divorce or annulment.

(e) [Revival if Divorce Nullified.] Provisions revoked solely by this section are revived by the divorced individual's remarriage to the former spouse or by a nullification of the divorce or annulment.

(f) [No Revocation for Other Change of Circumstances.] No change of circumstances other than as described in this section and in Section 2-803 effects a revocation.

(g) [Protection of Payors and Other Third Parties.]

(1) A payor or other third party is not liable for having made a payment or transferred an item of property or any other benefit to a beneficiary designated in a governing instrument affected by a divorce, annulment, or remarriage, or for having taken any other action in good faith reliance on the validity of the governing instrument, before the payor or other third party received written notice of the divorce, annulment, or remarriage. A payor or other third party is liable for a payment made or other action taken after the payor or other third party received written notice of a claimed forfeiture or revocation under this section.

(2) Written notice of the divorce, annulment, or remarriage under subsection (g)(2) must be mailed to the payor's or other third party's main office or home by registered or certified mail, return receipt requested, or served upon the payor or other third party in the same manner as a summons in a civil action. Upon receipt of written notice of the divorce, annulment, or remarriage, a payor or other third

party may pay any amount owed or transfer or deposit any item of property held by it to or with the court having jurisdiction of the probate proceedings relating to the decedent's estate or, if no proceedings have been commenced, to or with the court having jurisdiction of probate proceedings relating to decedents' estates located in the county of the decedent's residence. The court shall hold the funds or item of property and, upon its determination under this section, shall order disbursement or transfer in accordance with the determination. Payments, transfers, or deposits made to or with the court discharge the payor or other third party from all claims for the value of amounts paid to or items of property transferred to or deposited with the court.

(h) [Protection of Bona Fide Purchasers; Personal Liability of Recipient.]

(1) A person who purchases property from a former spouse, relative of a former spouse, or any other person for value and without notice, or who receives from a former spouse, relative of a former spouse, or any other person a payment or other item of property in partial or full satisfaction of a legally enforceable obligation, is neither obligated under this section to return the payment, item of property, or benefit nor is liable under this section for the amount of the payment or the value of the item of property or benefit. But a former spouse, relative of a former spouse, or other person who, not for value, received a payment, item of property, or any other benefit to which that person is not entitled under this section is obligated to return the payment, item of property, or benefit, or is personally liable for the amount of the payment or the value of the item of property or benefit, to the person who is entitled to it under this section.

(2) If this section or any part of this section is preempted by federal law with respect to a payment, an item of property, or any other benefit covered by this section, a former spouse, relative of the former spouse, or any other person who, not for value, received a payment, item of property, or any other benefit to which that person is not entitled under this section is obligated to return that payment, item of property, or benefit, or is personally liable for the amount of the payment or the value of the item of property or benefit, to the person who would have been entitled to it were this section or part of this section not preempted.

Comment. Purpose and Scope of Revision. The revisions of this section, pre-1990 Section 2-508, intend to unify the law of probate and nonprobate transfers. As originally promulgated, pre-1990 Section 2-508 revoked a predivorce devise to the testator's former spouse. The revisions expand the section to cover "will substitutes" such as revocable inter-vivos trusts, life-insurance and retirement-plan beneficiary designations, transfer-on-death accounts, and other revocable dispositions to the former spouse that the divorced individual established before the divorce (or annulment). As revised, this section also effects a severance of the interests of the former spouses in property that they held at the time of the divorce (or annulment) as joint tenants with the right of survivorship; their co-ownership interests become tenancies in common.

As revised, this section is the most comprehensive provision of its kind, but many states have enacted piecemeal legislation tending in the same direction. For example, Michigan and Ohio have statutes transforming spousal joint tenancies in land into tenancies in common upon the spouses' divorce. Mich.Comp.Laws Ann. § 552.102; Ohio Rev.Code Ann. § 5302.20(c)(5). Ohio, Oklahoma, and Tennessee have recently enacted legislation effecting a revocation of provisions for the settlor's former spouse in revocable inter- vivos trusts. Ohio Rev.Code Ann. § 1339.62;

Okla.Stat.Ann. tit. 60, § 175; Tenn.Code Ann. § 35-50-115 (applies to revocable and irrevocable inter-vivos trusts). Statutes in Michigan, Ohio, Oklahoma, and Texas relate to the consequence of divorce on life-insurance and retirement-plan beneficiary designations. Mich.Comp.Laws Ann. § 552.101; Ohio Rev.Code Ann. § 1339.63; Okla.Stat.Ann. tit. 15, § 178; Tex.Fam.Code §§ 3.632-.633.

The courts have also come under increasing pressure to use statutory construction techniques to extend statutes like the pre-1990 version of Section 2-508 to various will substitutes. In Clymer v. Mayo, 473 N.E.2d 1084 (Mass.1985), the Massachusetts court held the statute applicable to a revocable inter-vivos trust, but restricted its "holding to the particular facts of this case--specifically the existence of a revocable pour-over trust funded entirely at the time of the decedent's death." 473 N.E.2d at 1093. The trust in that case was an unfunded life-insurance trust; the life insurance was employer-paid life insurance. In Miller v. First Nat'l Bank & Tr. Co., 637 P.2d 75 (Okla.1981), the court also held such a statute to be applicable to an unfunded life-insurance trust. The testator's will devised the residue of his estate to the trustee of the life-insurance trust. Despite the absence of meaningful evidence of intent to incorporate, the court held that the pour-over devise incorporated the life-insurance trust into the will by reference, and thus was able to apply the revocation-upon-divorce statute. In Equitable Life Assurance Society v. Stitzel, 1 Pa.Fiduc.2d 316 (C.P.1981), however, the court held a statute similar to the pre-1990 version of Section 2-508 to be inapplicable to effect a revocation of a life-insurance beneficiary designation of the former spouse.

Revoking Benefits of the Former Spouse's Relatives. In several cases, including Clymer v. Mayo, 473 N.E.2d 1084 (Mass.1985), and Estate of Coffed, 387 N.E.2d 1209 (N.Y.1979), the result of treating the former spouse as if he or she predeceased the testator was that a gift in the governing instrument was triggered in favor of relatives of the former spouse who, after the divorce, were no longer relatives of the testator. In the Massachusetts case, the former spouse's nieces and nephews ended up with an interest in the property. In the New York case, the winners included the former spouse's child by a prior marriage. For other cases to the same effect, see Porter v. Porter, 286 N.W.2d 649 (Iowa 1979); Bloom v. Selfon, 555 A.2d 75 (Pa.1989); Estate of Graef, 368 N.W.2d 633 (Wis.1985). Given that, during divorce process or in the aftermath of the divorce, the former spouse's relatives are likely to side with the former spouse, breaking down or weakening any former ties that may previously have developed between the transferor and the former spouse's relatives, seldom would the transferor have favored such a result. This section, therefore, also revokes these gifts.

Consequence of Revocation. The effect of revocation by this section is that the provisions of the governing instrument are given effect as if the divorced individual's former spouse (and relatives of the former spouse) disclaimed all provisions revoked by this section (see Section 2-801(d) for the effect of a disclaimer). Note that this means that the antilapse statute applies in appropriate cases in which the divorced individual or relative is treated as having disclaimed. In the case of a revoked nomination in a fiduciary or representative capacity, the provisions of the governing instrument are given effect as if the former spouse and relatives of the former spouse died immediately before the divorce or annulment. If the divorced individual (or relative of the divorced individual) is the donee of an unexercised power of appointment that is revoked by this section, the gift-in-default clause, if any, is to take effect, to the extent that the gift-in-default clause is not itself revoked by this section.

ERISA Preemption of State Law. The Employee Retirement Income Security Act of 1974 (ERISA) federalizes pension and employee benefit law. Section 514(a) of ERISA, 29 U.S.C. § 1144(a), provides that the provisions of Titles I and IV of ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" governed by ERISA.

ERISA's preemption clause is extraordinarily broad. ERISA Section 514(a) does not merely preempt state laws that conflict with specific provisions in ERISA. Section 514(a) preempts "any and all State laws" insofar as they "relate to" any ERISA-governed employee benefit plan.

A complex case law has arisen concerning the question of whether to apply ERISA Section 514(a) to preempt state law in circumstances in which ERISA supplies no substantive regulation.

For example, until 1984, ERISA contained no authorization for the enforcement of state domestic relations decrees against pension accounts, but the federal courts were virtually unanimous in refusing to apply ERISA preemption against such state decrees. See, e.g., American Telephone & Telegraph Co. v. Merry, 592 F.2d 118 (2d Cir. 1979). The Retirement Equity Act of 1984 amended ERISA to add Sections 206(d)(3) and 514(b)(7), confirming the judicially created exception for state domestic relations decrees.

The federal courts have been less certain about whether to defer to state probate law. In Board of Trustees of Western Conference of Teamsters Pension Trust Fund v. H.F. Johnson, Inc., 830 F.2d 1009 (9th Cir. 1987), the court held that ERISA preempted the Montana nonclaim statute (which is Section 3-803 of the Uniform Probate Code). On the other hand, in Mendez-Bellido v. Board of Trustees, 709 F.Supp. 329 (E.D.N.Y. 1989), the court applied the New York "slayer-rule" against an ERISA preemption claim, reasoning that "state laws prohibiting murderers from receiving death benefits are relatively uniform [and therefore] there is little threat of creating a 'patchwork scheme of regulations' " that ERISA sought to avoid.

It is to be hoped that the federal courts will continue to show sensitivity to the primary role of state law in the field of probate and nonprobate transfers. To the extent that the federal courts think themselves unable to craft exceptions to ERISA's preemption language, it is open to them to apply state law concepts as federal common law. Because the Uniform Probate Code contemplates multistate applicability, it is well suited to be the model for federal common law absorption.

Another avenue of reconciliation between ERISA preemption and the primacy of state law in this field is envisioned in subsection (h)(2) of this section. It imposes a personal liability for pension payments that pass to a former spouse or relative of a former spouse. This provision respects ERISA's concern that federal law govern the administration of the plan, while still preventing unjust enrichment that would result if an unintended beneficiary were to receive the pension benefits. Federal law has no interest in working a broader disruption of state probate and nonprobate transfer law than is required in the interest of smooth administration of pension and employee benefit plans.

PROPOSED LEGISLATION

Prob. Code §§ 5500-5502 (added). Effect of Dissolution or Annulment of Marriage on Nonprobate Spousal Dispositions

SECTION 1. Part 3 (commencing with Section 5500) is added to Division 5 of the Probate Code, to read:

PART 3. EFFECT OF DISSOLUTION OR ANNULMENT OF MARRIAGE ON NONPROBATE SPOUSAL DISPOSITIONS

§ 5500. Joint tenancy

[see Memorandum 97-50]

§ 5501. Beneficiary designations

5501. (a) Subject to the limitations of this section, the designation of a former spouse as beneficiary of a nonprobate transfer is ineffective if the transferor designated the former spouse as beneficiary of the nonprobate transfer before or during their marriage, and the former spouse is not the transferor's surviving spouse at the time of the transferor's death.

(b) The designation of a former spouse as beneficiary of a nonprobate transfer is not made ineffective by operation of this section in any of the following circumstances:

(1) The beneficiary designation is irrevocable.

(2) A court order or written agreement of the transferor and the former spouse provides otherwise.

(3) There is clear and convincing evidence that the transferor intends the beneficiary designation to continue regardless of whether the beneficiary is the transferor's surviving spouse at the time of the transferor's death.

(c) As used in this section:

(1) "Former spouse" means both a person who is no longer married to the transferor at the time of the transferor's death and a person who is married to the transferor at the time of the transferor's death but who is excluded as a surviving spouse of the transferor under Section 78.

(2) "Nonprobate transfer" means a provision for a transfer of property on death of a type described in Section 5000.

(d) This section governs the effectiveness of a nonprobate transfer on the death of a transferor occurring on or after January 1, 1999.

Comment. Section 5501 establishes the rule that a beneficiary designation in an instrument making a nonprobate transfer to a former spouse is ineffective if the beneficiary is not the transferor's surviving spouse. See Sections 78 (surviving spouse), 5000 (instruments effecting a nonprobate transfer). Note that spousal consent to a nonprobate transfer of community property is a form of nonprobate transfer. See Section 5023, Comment.

Paragraph (1) of subdivision (c) makes clear that a present spouse who does not qualify as a surviving spouse under Section 78 is included within the coverage of the section. For example, a present spouse is not a surviving spouse if the present spouse obtains or consents to a final decree of dissolution or annulment of marriage that is not recognized as valid in this state, or marries a third person after the decedent has obtained a final decree of dissolution or annulment of marriage that is not recognized as valid in this state. See Prob. Code § 78.

Subdivision (d) makes clear that this section does not affect nonprobate transfers that have been completed by the transferor's death before January 1, 1999.

Note that Section 5502 may protect a holder of property under an instrument of a type described in Section 5000 from liability for transferring the property to the beneficiary designated in the instrument, even if the beneficiary designation has been made ineffective by operation of this section.

If a beneficiary designation is made ineffective by operation of this section and the instrument making the nonprobate transfer does not designate an alternate beneficiary and does not provide for disposition of the property in the absence of a designated beneficiary, the property is transferred pursuant to Section 21111.

The provisions of this section are severable. See Section 11.

§ 5502. Protection of property holder

§ 5502. (a) A holder of property under an instrument of a type described in Section 5000 may transfer the property in compliance with a provision for a nonprobate transfer on death that satisfies the terms of the instrument, whether or not the transfer has been made ineffective by operation of section 5501.

(b) Except as provided in this subdivision, no notice or other information shown to have been available to the holder of the property affects the right of the holder to the protection provided by subdivision (a). The protection provided by subdivision (a) does not extend to a transfer made after either of the following events:

(1) The holder of the property has been served with a contrary court order.

(2) The holder of the property has been served with a written notice of a person claiming an adverse interest in the property.

(c) The protection provided by this section does not affect the rights of the designated beneficiary and other persons having an interest in the property or their successors in disputes among themselves concerning the beneficial ownership of the property.

(d) The protection provided by this section is not exclusive of any protection provided the holder of the property by any other provision of law.

Comment. Section 5502 is drawn from portions of Section 5003 (protection of property holder who transfers community property consistent with terms of instrument effecting a nonprobate transfer). A holder of property that is the subject of a nonprobate transfer is not obligated to determine whether a beneficiary designation has been made ineffective by operation of Section 5501. Unless the holder of property has been served with a contrary court order or notice of an adverse claim, the holder may transfer the property in accordance with the terms of the instrument, and any adverse rights of a beneficiary must be asserted against the recipient of the transferred property, not against the holder of the property.

CONFORMING REVISIONS

Prob. Code § 21111 (amended). Failed transfer

SEC. 2. Section 21111 of the Probate Code is amended to read:

21111. Except as provided in Section 21110:

(a) If a transfer, other than a residuary gift or a transfer of a future interest, fails for any reason, and the transferring instrument provides for the transfer of a residue, the property transferred becomes a part of the residue transferred under the instrument.

(b) If a transfer, other than a residuary gift or a transfer of a future interest, fails for any reason, and the transferring instrument does not provide for the transfer of a residue, the property is transferred to the decedent's estate.

~~(b)~~ (c) If a residuary gift or a future interest is transferred to two or more persons and the share of a transferee fails for any reason, the share passes to the other transferees in proportion to their other interest in the residuary gift or the future interest.

Comment. Section 21111 is amended to clarify the treatment of a failed transfer by will, trust, life insurance policy, or other instrument transfering property at death, where the transferring instrument does not provide for the transfer of a residue.
