VALUATION SERVICES

VALUING COMPLEX ORGANIZATIONAL AND CAPITAL STRUCTURES IN MARITAL DISSOLUTIONS

A GLOSSARY OF FINANCIAL TERMS AND CASES FOR LAWYERS

Valuing the assets of parties involved in divorce proceedings may require lawyers to deal with a variety of financial instruments and concepts. This guide is intended as a basic glossary of terms for divorce attorneys covering: options, warrants, hybrid securities and dilution.

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A. WHAT ARE "OPTIONS"?

- Options are contracts giving the owner the right to buy or sell an underlying asset at a fixed price on or before a specified future date.
- Options are derivatives (they derive their value from their underlying assets). The underlying assets can include, among other things, stocks, stock indexes, exchange-traded funds, fixed income products, foreign currencies, or commodities.
- Option contracts trade in various securities marketplaces between a variety of market participants, including institutional investors, professional traders, and individual investors.
- Option trades can be for a single contract or for several contracts.

Source: "Investor.gov" U.S. Securities and Exchange Commission Investor Bulletin: An Introduction to Options

Basic Options Terminology

Options trading uses terminology that an investor should understand before attempting to buy or sell options. The following example of a basic stock option contract quote will help explain some of this terminology:

"ABC DECEMBER 70 CALL $2.20"

This options quote contains five terms: "ABC," "December," "70," "Call," and "$2.20."

"ABC" – This represents the stock symbol for the underlying stock of the option contract.

"December" – This is the expiration date of the option contract. This date indicates the day that the option contract expires. Generally, the expiration date for an option contract is the Saturday after the third Friday of each month. However, certain option contracts may have an expiration date that occurs after only a week, a calendar quarter, or at some other specified time.

Investors should make sure they understand when an option contract expires since an option contract's value is directly related to its expiration date. If you need help determining an option contract's expiration date, ask your brokerage firm.

"Call" and "Put" – A call is a type of option contract. Two of the most common types of option contracts are calls and puts. A call option is a contract that gives the buyer the right to buy shares of an underlying stock at the strike price (discussed below) for a specified period of time. Conversely, the seller of the call option is obligated to sell those shares to the buyer of the call option who exercises his or her option to buy on or before the expiration date.

Example: An ABC December 70 Call entitles the buyer to purchase shares of ABC common stock at $70 per share at any time prior to option's expiration date in December.

A put option is a contract that gives the buyer the right to sell shares of an underlying stock at the strike price for a specified period. Conversely, the seller of the put option is obligated to buy those shares from the buyer of the put option who exercises his or her option to sell on or before the expiration date.

Example: An ABC December 70 Put entitles the buyer to sell shares of ABC common stock at $70 per share at any time prior to option's expiration date in December.

"70" – The number appearing in this part of the options quote is the strike price of the option contract. This is the price at which the buyer of the option contract may buy the underlying stock, if the option contract is a call, or sell the underlying stock, if the option contract is a put. The relationship between the strike price and the actual price of a stock determines whether the option is "in-the-money," "at-the-money," or "out of the money."

"In-the-money" and "out-of-the money" have different meanings depending on whether the option is a call or a put:

- A call option is in-the-money if the strike price is below the actual stock price;
- A put option is in-the-money if the strike price is above the actual stock price.

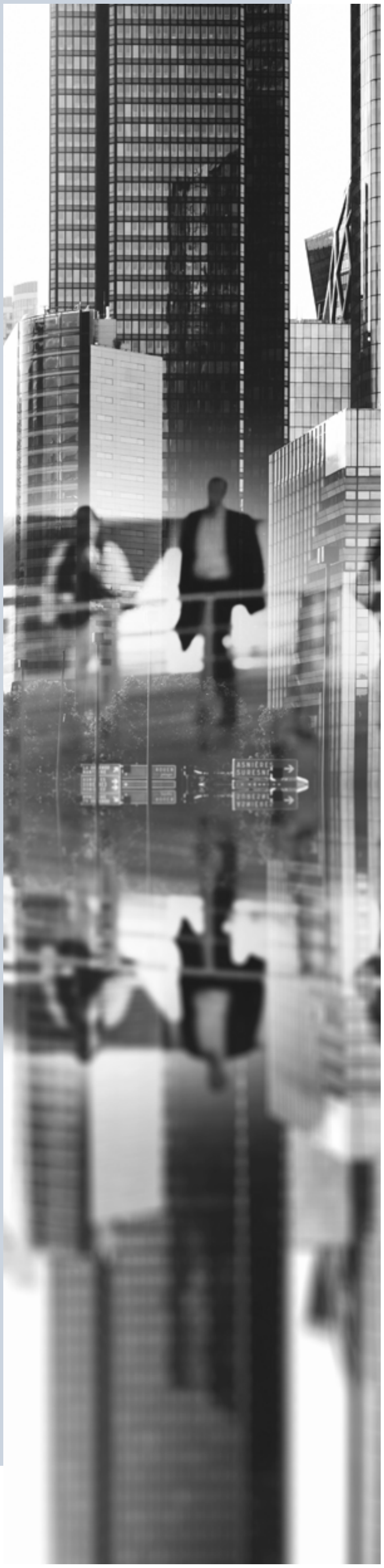
Example (in-the-money call option): An investor purchases an ABC December 70 Call and ABC's current stock price is $80. The buyer's option position is in-the-money by $10, since the option gives the buyer the right to purchase ABC stock for $70.

- A call option is out-of-the-money if the strike price is above the actual stock price;
- A put option is out-of-the-money if the strike price is below the actual stock price.

Example (out-of-the-money call option): An investor purchases an ABC December 70 Call and ABC's current stock price is $60. The buyer's option position is out-of-the-money by $10, since the option gives the buyer the right to purchase ABC stock for $70.

"At-the-money" has the same meaning for puts and calls and indicates that the strike price and the actual price are the same.

"$2.20" – The number appearing in this part of the options quote is the premium or the price per share you pay to purchase the option contract. An option contract generally represents 100 shares of the underlying stock. In this case, a premium of $2.20 represents a payment of $220 per option contract ($2.20 x 100 shares). The premium is paid up front to the seller of the option contract and is non-refundable. The amount of the premium is determined by several factors including: (i) the underlying stock price in relation to the strike price, (ii) the length of time until the option contract expires, and (iii) the price volatility of the underlying stock.



In addition to the terms above, investors should also be familiar with the following options terminology:

Exercise – When a buyer invokes his or her right to buy or sell the underlying security it's called "exercising" the right.

Assignment – When a buyer exercises his or her right under an option contract, the seller of the option contract receives a notice called an assignment notifying the seller that he or she must fulfill the obligation to buy or sell the underlying stock at the strike price.

Holder and Writer – A buyer of an options contract can also be referred to as a "holder" of that options contract. A seller of an options contract can also be referred to as the "writer" of that options contract.

<u>Options Trading</u>

Market Participants – There are generally four types of market participants in options trading: (1) buyers of calls; (2) sellers of calls; (3) buyers of puts; and (4) sellers of puts.

Opening a Position – When you buy or write a new options contract, you are establishing an open position. That means that you have established one side of an options contract and will be matched with a buyer or seller on the other side of the contract.

Closing a Position – If you already hold an options contract or have written one, but want to get out of the contract, you can close your position, which means either selling the same option you bought (if you are a holder) or buying the same option contract you sold (if you are a writer).

Now that we have discussed some of the basics of options trading, the following are examples of basic call and put option transactions:

Call Option: On December 1, 2014, ABC Stock is trading at $68 per share. You believe the price of ABC stock will rise soon and decide to purchase an ABC December 70 Call. The premium is $2.20 for the ABC December 70 Call. The expiration date of the option is the third Friday of December and the strike price is $70. The total price of the contract is $2.20 x 100 = $220 (plus commissions which we will not account for in this example).

Since the strike price of the call option is $70, the stock must rise above $70 before the call option is "in-the-money." Additionally, since the contract premium is $2.20 per share, the price of ABC would need to rise to $72.20 in order for you to break even on the transaction.

Two weeks later the stock price has risen to $80. As the value of the underlying stock has increased, the premium on the ABC December 70 Call has also increased to $10.20, making the option contract now worth $10.20 x 100 = $1020. If you sell the option now (closing your position) you would collect the difference between the premium you paid and the current premium $1020-$220 = $800 (minus any commission costs). Alternatively, you could exercise the option and buy the underlying shares from the writer of the call for $70 (the strike price); the writer is obligated to sell the buyer those shares at $70 even though their market value is $80.

Now, suppose you believe the price of the stock will continue rising until the expiration date and you decide to wait to sell or exercise the option. Unfortunately, the stock price drops to $65 on the expiration date. Since this is less than the $70 strike price, the option is out-of-the-money and expires worthless. This means you will have lost the initial $220 premium you paid for the options contract.

Put Option: On December 1, 2014, ABC Stock is trading at $72 per share. You believe the price of ABC stock will fall soon and decide to purchase an ABC December 70 Put. The premium is $2.20 for the ABC December 70 Put. The expiration date of the option is the third Friday of December and the strike price is $70. The total price of the contract is $2.20 x 100 = $220 (plus commissions which we will not account for in this example).

Since the strike price of the put option is $70, the stock must drop below $70 before the put option is "in-the-money." Additionally, since the contract premium is $2.20 per share, the price of ABC would need to drop to $67.80 in order for you to break even on the transaction.

Two weeks later the stock price has dropped to $60. As the value of the underlying stock has decreased, the premium on the ABC December 70 Put has increased to $10.20, making the option contract now worth $10.20 x 100 = $1020. If you sell the option now (closing your position) you would collect the difference between the premium you paid and the current premium $1020-$220 = $800 (minus any commission costs). Alternatively, you could exercise the option and sell the underlying shares to the writer of the put for $70 (the strike price); the writer is obligated to buy those shares at $70 even though their market value is $60.

Now, suppose you believe the price of the stock will continue dropping up until the expiration date and you decide to wait to sell or exercise the option. Unfortunately, the stock price rises to $75 on the expiration date. Since this is more than the $70 strike price, the option is out-of-the-money and expires worthless. This means you will have lost the initial $220 premium you paid for the options contract.

These two examples provide you with a basic idea of how options transactions may operate. Investors should note that these examples are some of the most basic forms of options. Many options contracts and the trading strategies that utilize them are much more complex. The Additional Resources section below provides a hyperlink to additional publications you may review if you are interested in information on more complex options contracts and trading strategies.

What are some of the risks associated with trading options?

Options like other securities carry no guarantees, and investors should be aware that it is possible to lose all of your initial investment, and sometimes more. For example:

- Option holders risk the entire amount of the premium paid to purchase the option. If a holder's option expires "out-of-the- money" the entire premium will be lost.
- Option writers may carry an even higher level of risk since certain types of options contracts can expose writers to unlimited potential losses.

Other risks associated with trading options include:

- Market Risk – Extreme market volatility near an expiration date could cause price changes that result in the option expiring worthless.
- Underlying Asset Risk – Since options derive their value from an underlying asset, which may be a stock or securities index, any risk factors that impact the price of the underlying asset will also indirectly impact the price and value of the option.

B. WHAT IS "DILUTION" AND WHY SHOULD I BE WORRIED ABOUT IT?

Stock dilution is the result of the issuance of additional common shares by a company. When additional shares are issued, the increase in the number of outstanding shares can be driven by the straight issuance of more shares by the company (as a capital raising strategy), from employees exercising the stock options granted to them as compensation, or by the conversion by investors of warrants, convertible bonds or preferred shares into common shares. The effect of these events can be to change percentages of ownership, voting control or voting effect, reduction in the value of shares, or the amount of earnings per share attributable to a share.

- See the U.S. Securities and Exchange Commission: Final Rule

  "Disclosure of Equity Compensation Plan Information"
  https://www.sec.gov/rules/final/33-8048.htm

C. WHAT IS A "HYBRID SECURITY"?

A hybrid security is a security that serves to combine two or sometimes more different financial treatments of investment instruments. Hybrid securities can be thought of as combining the features of both equity as well as debt positions. A convertible bond is one that may be converted into shares of stock. Changes in stock price therefore can have an impact on the value of the convertible bond. Another hybrid is preferred stock. These interests have the right to receive payment (either cumulative or not) of a "preferred" return, and frequently have the additional right to be converted into shares of common stock.

Source: "Investor.gov": "Convertible Securities" (This can include preferred stock and hybrids)

A "convertible security" is a security—usually a bond or a preferred stock—that can be converted into a different security—typically shares of the company's common stock. In most cases, the holder of the convertible determines whether and when to convert. In other cases, the company has the right to determine when the conversion occurs.

Companies generally issue convertible securities to raise money. Companies that have access to conventional means of raising capital (such as public offerings and bank financings) might offer convertible securities for particular business reasons. Companies that may be unable to tap conventional sources of funding sometimes offer convertible securities as a way to raise money more quickly. In a conventional convertible security financing, the conversion formula is generally fixed - meaning that the convertible security converts into common stock based on a fixed price. The convertible security financing arrangements might also include caps or other provisions to limit dilution (the reduction in earnings per share and proportional ownership that occurs when, for example, holders of convertible securities convert those securities into common stock).

By contrast, in less conventional convertible security financings, the conversion ratio may be based on fluctuating market prices to determine the number of shares of common stock to be issued on conversion. A market price-based conversion formula protects the holders of the convertibles against price declines, while subjecting both the company and the holders of its common stock to certain risks. Because a market price-based conversion formula can lead to dramatic stock price reductions and corresponding negative effects on both the company and its shareholders, convertible security financings with market price based conversion ratios have colloquially been called "floorless", "toxic," "death spiral," and "ratchet" convertibles.

Both investors and companies should understand that market price based convertible security deals can affect the company and possibly lower the value of its securities. Here's how these deals tend to work and the risks they pose:

i. The company issues convertible securities that allow the holders to convert their securities to common stock at a discount to the market price at the time of conversion. That means that the lower the stock price, the more shares the company must issue on conversion.

ii. The more shares the company issues on conversion, the greater the dilution to the company's shareholders will be. The company will have more shares outstanding after the conversion, revenues per share will be lower, and individual investors will own proportionally less of the company. While dilution can occur with either fixed or market price-based conversion formulas, the risk of potential adverse effects increases with a market price based conversion formula.

iii. The greater the dilution, the greater the potential that the stock price per share will fall. The more the stock price falls, the greater the number of shares the company may have to issue in future conversions and the harder it might be for the company to obtain other financing.

Before you decide to invest in a company, you should find out what types of financings the company has engaged in - including convertible security deals - and make sure that you understand the effects those financings might have on the company and the value of its securities. You can do this by researching the company in the SEC's EDGAR database and looking at the company's registration statements and other filings. Even if the company sells convertible securities in a private, unregistered transaction (or "private placement"), the company and the purchaser normally agree that the company will register the underlying common stock for the purchaser's resale prior to conversion. You'll also find disclosures about these and other financings in the company's annual and quarterly reports on Forms 10-K and 10-Q, respectively, and in any interim reports on Form 8-K that announce the financing transaction.

If the company has engaged in convertible security financings, be sure to ascertain the nature of the convertible financing arrangement - fixed versus market price-based conversion ratios. Be sure you fully understand the terms of the convertible security financing arrangement, including the circumstances of its issuance and how the conversion formula works. You should also understand the risks and the possible effects on the company and its outstanding securities arising from the below market price conversions and potentially significant additional share issuances and sales, including dilution to shareholders. You should be aware of the risks arising from the effects of the purchasers and other parties trading strategies, such as short selling activities, on the market price for the company's securities, which may affect the amount of shares issued on future conversions.

Companies should also understand the terms and risks of convertible security arrangements so that they can appropriately evaluate the issues that arise. Companies entering into these types of convertible securities transactions should understand fully the effects that the market price-based conversion ratio may have on the company and the market for its securities. Companies should also consider the effect that significant share issuances and below market conversions have on a company's ability to obtain other financing.

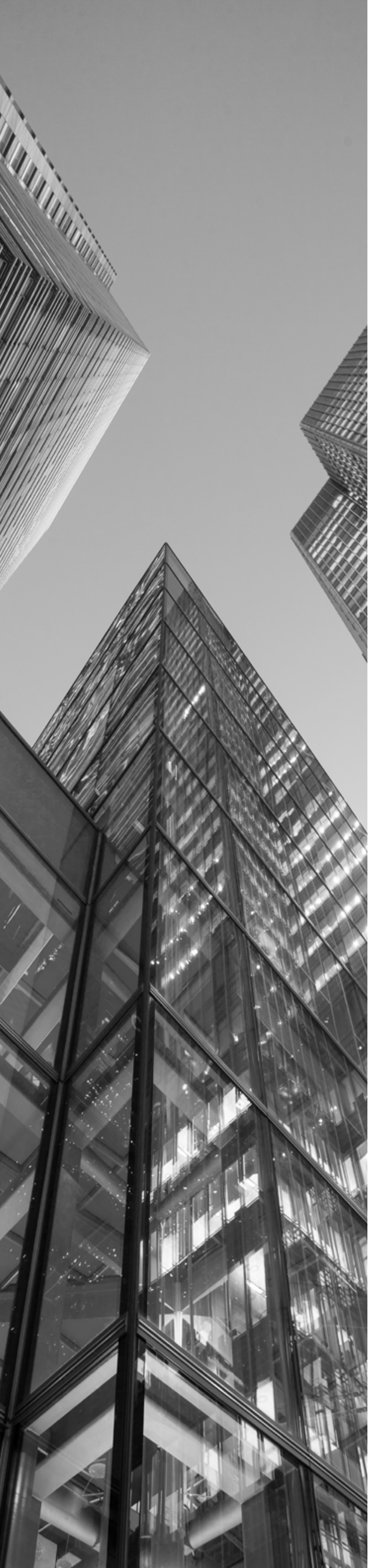
Companies or investors seeking to learn more about the SEC's registration requirements for common stock issuable upon conversion of unregistered convertible securities, including the timing of the filing of the resale registration statement and the appropriate form that the company may use to register the resale, should consult the Division of Corporation Finance's Compliance and Disclosure Interpretations.

D. WHAT IS A "WARRANT"?

A Warrant is similar to an option, meaning that the holder of a warrant has the right but not the obligation to purchase shares of a company's stock at a stated price within a stated period of time. The main difference between options and warrants is that an option is granted by the owner of the shares of stock while a warrant is granted by the company itself.

<u>Cases practitioners should know about:</u>

- *Callahan v. Callahan,* 142 N.J. Super 325 (Ch. Div. 1976)
- *In Re Marriage of Hug,* 154 Cal. App. 3d 780, 792, 201 Cal. Rptr. 676 (1984)
- *In re Marriage of Nelson,* 177 Cal. App. 3d. 150 (Ct. App. 1986)
- *In Re Marriage of Short,* 125 Wn. 2d 865, 872, 890 P. 2d 12 (1995)
- *Pascale v. Pascale,* 140 N.J. 583 (1995)
- *In Re Marriage of Miller,* 915 P. 2d 1314 (Colo. 1996)
- *DeJesus v. DeJesus,* 90 N.Y. 2d 643 (1997)
- *In re Marriage of Stachofsky,* 90 WN. App. 135 (Ct. App. 1998)
- *Murray v. Murray,* 128 Ohio App. 3d 662 (1999)
- *Wendt v. Wendt,* 59 Conn. App. 656, 757 A. 2d 1225 (App. Div. 2000)
- *In re Batra v. Batra,* 135 Idaho 388 (Ct. App. 2001)
- *Heller-Loren v. Apuzzio,* 371 N.J. Super. 518 (App. Div. 2004)
- *Robertson v. Robertson,* 381 N.J. Super. 199 (App. Div. 2005)
- *In re the marriage of Brebaugh v. Deane,* 211 Ariz. 95 (Ct. App. 2005)
- *In re Engel v. Landman,* 221 Ariz. 504 (Ct. App. 2009)
- *Ludwig v. Lamee-Ludwig,* 91 Mass. App. Ct. 36 (Massachusetts Appeals Court, February 7, 2017)
- *Hoegen v. Hoegen,* No. 14–P–149 (Massachusetts Appeals Court, January 22, 2016)
- *O'Brien v. O'Brien,* 161 Conn. App. 575 (Connecticut Court of Appeals, December 1, 2015)
- *Nadel v. Luttinger,* 168 Conn.App. 689, 147 A.3d 1075 (2016)
- *McKeon v. Lennon,* 321 Conn. 323, 138 A.3d 242 (2016)
- *In re Marriage of Micheli,* 2014 IL App (2d) 12124, 515 N.E.3d 512
- *Penner v. Penner,* 411 S.W.3d 775 (Ky. 2013)



***Callahan v. Callahan,* 142 N.J. Super 325 (Ch. Div. 1976)**

- Options acquired during the marriage were subject to equitable distribution even though (1) the options were potentially terminable; (2) the husband had to make an expenditure to exercise the options; and (3) the options were subject to various SEC regulations.
- The Trial Court impressed a constructive trust on the husband in favor of the wife, for a portion of the options. The Court reasoned that the imposition of a constructive trust would result in the most equitable outcome to the parties without creating undue financial and business liabilities.
- All of the options were granted during the course of the marriage. Although not specifically stated, however, it appears that some or all of the options were not fully vested because they were subject to divestiture under certain circumstances. This may be why the wife was awarded only 25% of the options at their maturation.

***In Re Marriage of Hug,* 154 Cal. App. 3d 780, 792, 201 Cal. Rptr. 676 (1984)**

- Seminal case where the Trial Court expressed the options that were part of the marital estate in terms of a fraction.
- The fraction was expressed as follows: The numerator represented the difference in months between the spouse's commencement of employment with the company and the date of the parties' separation. The denominator was established by first determining the difference, in months, between commencement of employment and the date when the first option was exercisable.
- The fraction was then multiplied by the number of shares that could be purchased and the date the option was first exercisable.
- The remaining options were determined to be separate property of the employed spouse.
- Although the employed spouse agreed that a coverture fraction should be used, he argued that the proper time rules should incorporate the date when the option was granted rather than the date he commenced employment because the options were not granted as an incentive to accept such employment.
- In supporting the "date of employment" as the start date in the fraction, the Court examined the various reasons why corporations give stock options to employees and found that so single characterization could be given to employees' stock option grants. Thus, the Court determined that whether they are properly characterized as compensation for past, present or future services, or all three, is fact specific. Therefore, the Trial Court concluded that, given the facts of that particular case, the two-year period of employment preceding the company's distribution of options contributed, at least in part, to the underlying reasons for the grant at issue.

<u>Cases Questioning or Criticizing: In Re Hug, 154 Cal. App. 3d 780 (1984)</u>

In re Marriage of Nelson, **177 Cal. App. 3d. 150 (Ct. App. 1986)**

- Issue: Whether the trial court erred in (1) holding that stock options that were granted and became exercisable before the parties separated were wholly community property; (2) Whether the trial court erred in holding that stock options that were granted before the parties separated but were not exercisable until after they separated were partly community property and partly husband's separate property; and (3) holding that stock options granted after the parties separated were wholly husband's separate property.
- Holding: No. The trial court did not err in varying from the Hug formula when determining distribution of those stock options that were granted before the parties separated but were not exercisable until after the separation since only prospective increases in the value of the stock could result in a profit. It was therefore appropriate to place more emphasis on the period following each grant to the date of the separation, as the trial court did, than on the employee's entire tenure with the company up to the time of separation as the Hug court did.

In Re Marriage of Short, **125 Wn. 2d 865, 872, 890 P. 2d 12 (1995)**

- This case has an expansive discussion of the coverture factor, noting its reemergence into divorce litigation as a mechanism for apportioning between spouses the benefit or value of unvested stock options, retirement plans or other benefits that were earned partially during and partially after the marriage.
- Evidence of the purpose for the award of the option (i.e., compensation for past, present or future services) is usually found in the language of the option grant or employment agreement.

Pascale v. Pascale, **140 N.J. 583 (1995)**

- The employed spouse (wife) was granted the option to purchase 5,000 shares of her new employer's stock, three years before the Complaint, which was filed on October 28, 1990. As of the trial date, the wife had acquired and owned 20,069 stock options, all of which were awarded by her employer between April 14, 1987 and November 15, 1991. Seven thousand three hundred (7,300) of those options were granted, subsequent to the filing of the divorce complaint. The dispute arose in response to two separate options awards granted on November 7, 1990, one for 4,000 shares and another consisting of 1,800 shares. The disputed options were awarded approximately 10 days after the wife filed for divorce.
- The wife argued that the 1,800 options were not subject to distribution because they were "issued in recognition of past performance." In addition, she had asserted that the remaining 4,000 shares were also excluded from the martial estate because they were issued in anticipation of increased employment responsibilities resulting from a promotion. The wife relied on her company's transmittal letters to support her arguments.
- The Trial Court, however, held that neither of the two blocks of options could be excluded from the marital estate and that they were both subject to distribution. The Appellate Division found that only one of the two sets of options constituted part of the marital estate. The Supreme Court reversed the Appellate Court's ruling.
- The Supreme Court's holding made it clear that the determining factor, in stock option distribution cases, is whether the assets result from the parties' joint efforts put forth "during the marriage." To refute the presumption that the assets result from a joint effort, the party seeking exclusion of the assets bears "the burden of establishing such immunity (from equitable distribution) as to any particular asset."

- Does not address the majority rule (i.e., application of coverture fractions or time rule formulas).
- Assets or property acquired after the termination of the marriage, but as a result of efforts expended during the marriage, will generally be included in the marital estate and are, therefore, subject to equitable distribution.
- Assets acquired after a marriage is dissolved, resulting solely from the earner's post complaint efforts, constitute the employed spouse's separate property.
- The problem is telling the difference. Pascale does not assist us in this regard except by way of introduction of testimony or evidence to allow the trier of fact to conclude whether or not the asset was awarded based wholly or in part upon marital effort.

In Re Marriage of Miller, **915 P. 2d 1314 (Colo. 1996)**

- It should be noted that options clearly given to the employee spouse as compensation or incentive for future services are wholly non-marital property. Similarly, options obviously granted exclusively for past or present services are fully marital property. Thus, there is no need for the court to utilize a coverture factor or time rule fraction for either category to determine the marital interest since they are entirely either marital or non-marital property. Problems arise when: (1) the reasons for the options' grant are unclear; (2) when the options are unvested; or (3) when the options include an indiscernible mass of pre- and post- marital efforts. See generally In re Marriage of Miller, 915 P.2d 1314 (Colo. 1996).

DeJesus v. DeJesus, **90 N.Y. 2d 643 (1997)**

- Follows majority rule (at that time).
- Four step procedure implemented:
    1. Determine the portion of shares issued for past and future services;
    2. Determine the shares related to compensation for past services to the extent that the marriage coincides with the period of the titled spouse's employment up until the time of the grant. This would be the marital portion;
    3. Determine the portion granted as an incentive for future services; the marital share of that portion will be determined by a time rule; and
    4. Calculate the portion found to be marital by adding:
        i. that portion that is compensation for past services; and
        ii. that portion of the future services deemed to be marital after application of the time rule.
- The Court concluded that this analysis best accommodated the tensions that often arise when attempting to determine how options should be distributed in cases where the reasons for the grant are unclear or competing.

In re Marriage of Stachofsky, **90 WN. App. 135 (Ct. App. 1998**

- **Issue:** Whether the trial court erred in failing to utilize the time rule applied in Short when determining distribution of shares of stock and stock options that were granted, vested and/or purchased at various times before, during and after the marriage.
- **Holding:** No. The trial court did not err since the time rule established in Short does not apply to shares purchased during the parties' marriage since such options are presumptively community property unless the presumption is rebutted.

Murray v. Murray, **128 Ohio App. 3d 662 (1999)**

- This was the first case in the United States which deliberately treated an executive's unexercised stock options as income for child support purposes.
- The wife moved to modify child support on the ground that her ex-husband's income had increased, in part, from the increase in value of the stock options.
- Her husband argued that the appreciation in value of his options should not be considered because it was non-recurring income.
- The Court held that where employees have complete discretion to exercise the options, the appreciation in stock value should be included as gross income even if the employee chooses not to exercise the options in each year.
- The Court reasoned that since the employee had complete discretion to exercise the options, "the option then becomes an investment choice, and its value may be imputed as part of appellant's gross income." This precludes the employee from shielding a significant portion of his income from the Court and depriving his children of the standard of living they would otherwise enjoy.

Wendt v. Wendt, **59 Conn. App. 656, 757 A. 2d 1225 (App. Div. 2000)**

- Adopts the intrinsic valuation method.
- Acknowledges that a coverture factor has no application where benefits are granted entirely in recognition for past or present services.
- The Court overruled the wife's argument and began the analysis of the formula as of the date of the grant of the options and not the date of the husband's employment. This was based on the Trial Court's determination that the purpose of the unvested stock options was to compensate the husband for performance occurring after the date of the granting of the options.
- The Appellate Court also found that the Trial Court's selection of the date of separation as the end date in the coverture factor was appropriate because it found that the wife had ceased contributing to the marital assets on that date.

In re Batra v. Batra, **135 Idaho 388 (Ct. App. 2001)**

- **Issue:** Whether the trial court erred in applying the modified Short time rule when distributing the husband's stock options instead of the Hug time rule.
- **Holding:** No. The trial court did not err in applying the modified Short time rule when distributing the husband's stock options since the modified Short time rule is the appropriate rule where unvested stock options are granted to the employee spouse and vesting occurs in whole or in part during marriage.

Heller-Loren v. Apuzzio, 371 N.J. Super. 518 (App. Div. 2004)

- **Issue:** Did the trial court err in interpreting the parties' Property Settlement Agreement ("PSA") as excluding from defendant's gross earned income for purposes of child support Husband's stock options and proceeds from sale of stock options?

- **Holding:** No. Although "the law generally holds that income is generated by the exercise of an option earned and acquired post-divorce if exercised at a price below fair market value or if sold at a profit", the law "does not support the contention that stock options should be treated as income upon mere vesting". Id. at 522. Despite this law, however, the parties' PSA specifically excluded such stock options, or the exercise of same, from income for purposes of child support. Accordingly, the trial court did not err in excluding same from any calculation concerning defendant's income for purposes of child support. In reaching this conclusion, the Appellate Court "emphasize[d]" that the "decision [was] based on the particular PSA in question". Id.

***Robertson v. Robertson,* 381 N.J. Super. 199 (App. Div. 2005)**

- **Issue:** Did the trial court err in the distribution of Husband's stock options to Wife that were awarded to him as a signing and retention bonus by his new employer three days prior to the date of the Complaint for Divorce?
- **Holding:** Yes. Despite being awarded three days prior to the Complaint for Divorce, the stock options were provided as an incentive for Husband's future employment, not his past performance and, as such, were not the result of effort expended by either party during the marriage. Accordingly, they were exempt from equitable distribution.

***In re the marriage of Brebaugh v. Deane,* 211 Ariz. 95 (Ct. App. 2005)**

- **Issue:** Whether the trial court erred when including 100% of husband's unvested stock options as part of community property.
- **Holding:** Yes. The trial court erred in its conclusion that all unvested stock options granted during marriage but vesting after the dissolution petition was served are community property. The Appellate Court remanded so that the trial court could consider the reasons husband received the unvested options and the most appropriate time rule formula, if any, to divide them.

***In re Engel v. Landman,* 221 Ariz. 504 (Ct. App. 2009)**

- **Issue:** Whether the trial court erred in utilizing the Murray method of distribution when determining the valuation of husband's stock options for purposes of child support.
- **Holding:** Yes. The inherent problem with the Murray method is that it makes the interest of the child dependent on market fluctuations that have no actual effect on the funds available to support the children. Child support obligation should not be governed by the volatility of the marketplace, and the implicit assumption in Murray that options will appreciate year to year does not comport with the realities of the market.

<u>Discovery Requests:</u>

In every instance when you are involved in a case in which one or the other of the parties has a holding in a complex organization or capital structure, it is essential that your discovery requests be focused on obtaining all relevant information and documentation. The valuation expert cannot complete their engagement assignment without this information, and the attorney will be unable to prosecute his or her case without this evidentiary basis. Think in terms of two goals: supporting the valuation expert and having the appropriate exhibits at trial.

At a minimum, seek the following in discovery:

- The company stock option/RSU plan (the applicable plan for each grant);
- Each letter or other document awarding stock options/RSU's to the employee;
- All documents referring, relating or pertaining to any and all incentive compensation plans, profit sharing plans, stock option plans, vesting plans and vesting targets or thresholds;
- All statements of accounts for any and all incentive compensation plans, profit sharing plans, stock option plans and vesting plans;
- All company documents summarizing the grants (date, vesting schedule, number of options/RSU's, amount exercised to date, ISO vs. NQO, etc.);
- The minutes of the meeting of the board of directors, compensation committee, or executive committee at which the options /RSU's were granted;
- The company's annual report and K-1;
- Stock split information;
- The employee's performance reviews.

OUR DIVORCE SERVICES

Alvarez & Marsal Valuation Services partners with family law attorneys to help their clients involved in complex, high-value cases to understand their current financial position and its trajectory to protect their financial future. We provide reliable and supportable values of business interests, real estate and any other identifiable assets. In addition, we gather and preserve evidence for trial and deliver written and verbal opinions, rebuttal opinions and cross-examination assistance, always with a commitment to objectivity, quality and integrity.

Our financial analysis and expert witness services include:

- Valuing business interests and stock compensation programs
- Analyzing and calculating spending, annual cash flows and taxable income
- Identifying and tracing marital assets
- Preparing net worth statements and financial affidavits
- Providing financial interrogatories, document tracking and discovery requests

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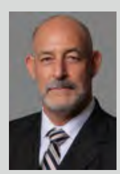

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With over 3000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, help organizations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

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