In the wake of Facebook's IPO and the new-found riches of employees of publicly traded companies such as Google, focus on dividing employee stock options upon divorce is likely to increase. Moreover, as awards of stock options and other forms of equity compensation become more standard for employees of all levels, courts will need to devise an effective means to divide such contingent property in a way that is equitable to both parties upon dissolution. In California, stock options are community property to the extent they are earned by the time, skill and effort of a spouse during marriage. In re Harrison (1986) 179 Cal. App. 1216, 1226. However, determining whether an employee stock option was earned during the marriage, or is instead meant to compensate for future, post-separation conduct, may prove difficult. Similarly, compensating a non-employee spouse for an option that may have little or no present value also presents unique obstacles.

Before highlighting the various formulas California courts have employed to calculate community interest in stock options, a brief discussion of relevant terms is useful. A *stock option* is a contractual right to purchase a specified number of shares of stock in the employer corporation at a specific price (the *strike price*, *grant price*, or *exercise price*), at a specific future time not earlier than the *maturity date* or later than the *expiration date*. Employee stock options are usually subject to certain restrictions on the employee's right to exercise the option, such as a period of years the employee must work for the employer corporation before the options may be purchased. If an employee leaves the company before such restrictions are met, s/he will lose the stock options. However, when the restrictions are met, the options become *vested*. Once vested, stock options can be purchased, or *exercised*, and are not subject to forfeiture, even if the employee leaves the employer corporation. Most employer vesting periods are within 2-5 years. After a longer period, frequently 10 years, the stock option expires and cannot be exercised.

A *restricted stock option* or *restricted stock award* and *restricted stock units* are slightly different than the traditional stock option. With a restricted stock award, the employee receives a number of shares outlined in a restricted stock agreement with their employer. The employee owns the stock. A restricted stock unit ("RSU") is instead a promise by the employer to deliver stock at a later date. The amount of shares, per unit, is usually outlined in the restricted stock agreement. Both the restricted stock award and the restricted stock unit are usually based on future events occurring, such as the length of the employee's time with the company or company performance obligations (such as revenue growth).

With a restricted stock award, an employee receives legal title to company stock at the time the grant is made, but faces substantial risk of forfeiture back to the employer company until certain conditions are fulfilled. The RSU is instead the right to stock ownership in the future. No stock is actually issued to the employee when the RSU is granted; the shares are not outstanding until they are released to the employee after certain conditions have been met. As such, an RSU is not transferable or actually owned by the employee until the vesting period has passed. Before vesting, the RSUs are simply an unfunded bookkeeping entry for the employee's company, rather than issued shares. Thus, an employee with RSUs does not have voting rights during the vesting period. However, although an RSU offers no ownership rights until vesting, it may provide for dividend payments depending on the provisions of the restricted stock agreement.

Although the tax implications of a grant of a restricted stock award are different from those associated with traditional stock options, the same marital versus non-marital issues apply to a division of restricted stock options upon divorce. That is, a court will likely consider when the restricted stock was granted (i.e. before or after separation) and whether the restrictions

lapsed before or after separation when determining the community share of such options. Sherry Chin, Employee Stock Options and Divorce, American Bar Association, Section of Family Law § X.A. However, because the employee actually owns a restricted stock award, some courts may ignore the forfeiture possibility and treat the stock as vested when allocating property. *Id.* Other courts will acknowledge the economic implications of restricted options and instead treat the stock like unvested stock options. *Id.*

Similarly, RSUs may be considered marital property if they were granted for services provided during the marriage. Darlys S. Harmon-Vaught, Restricted Stock Units and Divorce, Women Advisors Forum, 2011. However, if the RSU was instead issued for work which will be performed after the marriage, the RSU will be characterized as separate property. *Id.* It is thus essential to analyze the agreement awarding RSUs to determine how the award, or some portion thereof, relates to past or future services. If a court characterizes an RSU as marital property, it will then have to value such property, keeping in mind that the recipient of an RSU can't sell it until the units are vested or the contractually specified achievement level has been achieved. Moreover, because most agreements awarding RSUs do not allow an employee spouse to take receipt or ownership of restricted shares, a constructive stock trust document may need to be written to appoint the employee as a fiduciary of the RSU until the stock vests. *Id.* Once vested, the shares can be divided between the spouses, pursuant to court orders or a property settlement agreement. *Id.* Because RSUs are relatively new, a California court has yet to delineate a specific formula for division of such contingent stock upon divorce. However, given the popularity of RSUs, particularly in the aftermath of Facebook's award of RSUs to its employees, this issue will likely gain increased focus in future divorce cases.

By contrast, many California courts have considered the appropriate division of

traditional stock options upon divorce. In general, allocation of stock options upon divorce generally requires two steps. A court must first determine what portion of the option constitutes marital property, and must then decide the value to apply to this percentage. With respect to the first step, stock options both granted and vested during marriage generally constitute community property subject to allocation upon divorce. When stock options are granted during marriage but do not vest until after separation, some jurisdictions hold that the option is nothing more than an expectancy that is not subject to property division upon divorce. However, in California, stock options owned but not vested as of the date of separation may constitute community property to the extent such options are attributable to services rendered during marriage. See In re marriage of Brown (1976) 15 Cal. 3d 838, 844 (finding contractual rights to future benefits, though unvested and contingent, are property subject to allocation between community and separate interests). Similarly, options granted before, but vested during marriage, or granted after separation, but awarded for services rendered during the marriage, may also be subject to distribution.

Notably, California courts have broad discretion to fashion any apportionment of interests that is equitable. When a trial court determines property contains both separate and community interests, allocation of such property may be accomplished by any method or formula that will achieve substantial justice. In re Marriage of Steinberger (2001) 91 Cal. App. 4th 1449, 1459. There is thus no precise formula employed to divide spousal stock options, and the community share (if any) of such options will necessarily depend on the circumstances of each case. However, because options are considered community property to the extent they are attributable to work performed during the marriage, California courts attempting to divide stock options have generally relied upon various versions of the “time rule.” Though there is no

uniform computation, the time rule formula generally takes into account the number of years the employee spouse has worked for the company, the years of the marriage, the time lapse between granting and vesting, and the relation between such time periods and the date of separation. As a threshold issue, however, the time rule formula considers the nature of the option, or whether it constitutes deferred compensation for past or present services, or an incentive for future services, or a combination of both. An option serving as deferred compensation must be divided in accordance with marital status at the time it was earned. In re Marriage of Hug (1984) 154 Cal. App. 3d 780, 787. Where the option consists of both deferred compensation and future incentive, the apportionment test may be adjusted to focus more on the future services component. In re Marriage of Nelson (1986) 177 CA 3d 150, 153-54.