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Speculating on Stock Options and Child Support: Long on Income and Short on Value (and Theory)—A Jurisprudential Attempt at a Butterfly Straddle?

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Speculating on Stock Options and Child Support: Long on Income and Short on Value (and Theory) – A Jurisprudential Attempt at a Butterfly Straddle?

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I. INTRODUCTION

A butterfly straddle is an investment hedging structure which, if perfectly executed and transaction cost free, enables the investor to end up at some later point in time in exactly the same situation as he or she started out in. The legal treatment of stock options in the context of formulating child support awards has all the hallmarks of a

1. The strategy is used in the context of tax planning. In theory the investor can shift current tax obligations into a subsequent year indefinitely. Needless to say it is a device which the Internal Revenue Service frowns upon, and its use routinely is disallowed if the principal goal behind the scheme is tax avoidance. However, at times, the butterfly straddle may constitute a legitimate hedging strategy. The following extracts from cases may be of assistance:

A single position calling for the purchase or the sale of a designated commodity is described as an “open contract.” However, if the same person acquires a position calling for the purchase of a specified commodity and a different position calling for the sale of the same commodity, his position is described as a straddle and each of such positions is referred to as a “leg” of the straddle. Whenever an open position is held, price changes in the commodity future directly affect the economic position of the holder. By contrast, in a straddle, the holder is economically affected only by changes in the spread, i.e., the difference between the market price of each leg of the straddle. If the prices of the short and long legs of the straddle move exactly in tandem so that the spread does not change, the holder will suffer no economic consequence since his unrealized loss in one leg will be offset by his unrealized gain in the other. However, if the spread widens or narrows, the holder will incur either an economic gain or loss. Whenever a leg of a straddle is closed out by the purchase of an exactly opposite position, or in any other manner, tax consequences normally will result to the holder in either a realized gain or loss. In such a case, where the straddle consists of only two positions, that position which is not closed out becomes simply an open contract. As a general rule in tax-motivated straddle trading, the loss leg will be closed out first in order to generate a tax loss for the holder. When this occurs, the remaining leg of the initial straddle containing an unrealized gain, which is usually almost identical to the amount of loss in the closed leg, constitutes an open position for the holder, and as such, is subject to the increased risk of being directly affected by the market. To minimize this risk, the holder would be expected to obtain a new position similar to the one in the closed loss leg except for a different month. This substitution of one position for a similar position in a different month (switching) of the loss leg in the initial year in order to generate a tax loss which is offset by the unrealized gain in the other leg of the straddle is a pattern usually found in the trading of tax straddles. Straddle transactions having as their principal objective “deferrals” (postponing to a later year an already realized gain in an unrelated transaction) or “conversions” (changing a short-term capital gain on an unrelated transaction to a long-term capital gain) are commonly referred to as “tax straddles” in the industry. A “butterfly straddle” is a straddle consisting of at least three legs. It is essentially a combination of two straddles that, when drawn schematically, resembles a butterfly. For example, the following would be a butterfly straddle with four legs:

Short July 1981    Short July 1981
jurisprudential attempt at a butterfly straddle. On the surface, the courts appear to apply a conventional analysis to determine the support obligation. However, anything more than a superficial analysis suggests that by and large the goal is to move the litigation along, while as far as possible allowing the jurisprudence to remain in the same situation it started out in, that is, without having to come to grips with the fundamental financial and legal characteristics of stock options. The result is that where reliance is placed upon “income” from stock options, any analysis underpinning the award of child support frequently tends to be flawed in one or more respects.

It would seem self-evident that a goal of a child support order is to provide support for a child. Behind this goal lies a broad and tangled spectrum of objectives. The purpose of the present Article is to examine the relationship between the achievement of these objectives and judicial efforts to make child support orders where a significant component of the resources used to determine the size of the award is in the form of stock options. The analysis is complicated by the fact that stock options are themselves inherently complex instruments. This complexity leads to a variety of problems. For example, it is difficult to characterize the role options play in a family’s domestic economy. In turn, this leads to an inability to assign to options a convenient analytical paradigm such as “asset” or “income.” This, coupled with the technical character of options, makes it problematic

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The middle position or “body” of a butterfly straddle is exactly twice the size of each outside position or “wing.” In a butterfly straddle, each straddle is traded separately.


In a perfect butterfly straddle, the number of contracts involved in each wing will be one-half of the number of contracts involved in the body.

A switch or rollover occurs when one leg of the straddle is closed out and is replaced by a new leg so that the straddle position is maintained. Whenever a switch occurs, tax consequences normally will result: either a realized gain or loss on the leg which is closed out. Thus, one can produce a loss for tax purposes by establishing a straddle and waiting for some movement in the price of the legs. Because the straddle trader has both a long position and a short position, fluctuation in the price of the underlying commodity typically will result in a gain in one leg and a loss in the other. The losing leg can then be closed out, recognizing the loss, and it can then be replaced with a similar position, at a new but lower cost, so that the risk of the overall position remains essentially the same. The gain on the other leg, of course, will eventually have to be recognized, but this can be deferred until a later year.


2. The American Law Institute, Principles of the Law of Family Dissolution: Analysis and Recommendations § 3.04 (2002) [hereinafter Principles] sets out several of these objectives. Those themes, and others, will be returned to in detail in due course.

3. This problem also arises in divorce in the context of the property division claim between spouses. See David S. Rosettenstein, The ALI Proposals and the Distri-
to identify a monetary amount to be attributed to the options for the purposes of calculating child support. This process, in turn, occurs in a context where it becomes necessary to understand whether, in reality, value ever will be able to be extracted from the option, or indeed, even if value can be extracted, whether it is appropriate to do so at any particular moment in time.

The Article commences with a brief overview of the objectives that can underpin a child support obligation. For this purpose, the Article will rely heavily on the analysis contained in the American Law Institute's "Principles of the Law of Family Dissolution," which reflect the vast majority of themes found scattered in buckshot fashion through the jurisprudence of the various states. This is followed by a similarly brief look at aspects of the conceptual underpinnings of the formulae used to calculate child support, again relying very heavily on the Principles. This leads to a consideration of the resources, actual or imputed, which may be looked to in order to determine the amount of any award and to satisfy the obligation. No effort is made to be comprehensive. Rather, the goal is to reflect the pressures and considerations that may come to bear on a child support determination in the context of a family's domestic economy where options are present—in particular as these considerations impact the triangulated tensions of the interests of the child and those of the parents

The Article then turns to the nature of options and how the characteristics of options tend to generate confusion when it comes to relying on options to provide "income" in formulating a child support award. In particular, the Article considers issues like the potentially protracted vesting period of option, the purpose behind the grant and the vesting period, the ability to defer the benefit, the varied and often-times inappropriate techniques used to value options, and the impact of these techniques, illiquidity issues and other problems associated with actually extracting any nominal value from the options.

The next Part of the Article considers the decided cases as they grapple with the theoretical and practical concerns just outlined. The treatment emerges as somewhat fragmentary, in part precisely because jurisdictions have been unable, or unwilling, to attempt to develop a comprehensive jurisprudence in the area.

The final Part of the Article attempts, with some broad brush strokes, to suggest considerations which might reduce the risk of judicial treatments that are theoretically untenable or which produce results which are inappropriate or unrealistic.

4. Supra note 2.
II. THE FOUNDATIONS OF THE CHILD SUPPORT AWARD

The American Law Institute (ALI) Principles (hereinafter the “Principles” or “ALI”), inter alia, consider that a child support order should seek to ensure that each child has a minimum decent standard of living, and a standard of living that is not grossly inferior to that of either parent, while ensuring that the child does not suffer a loss of important life opportunities that the parents are able to provide without undue hardship to themselves or their other dependents. Also, both residential and non-residential parents are to be treated fairly and the rules should not discourage the labor force participation of either parent and should take into account the child’s need for care. The rules should reflect popular understanding of the duties of parents to the child and to each other.5 The Principles also consider the administrative ramifications of any child support order and suggest that the rule should be readily comprehensible, and that awards should be enforceable and modifiable as the circumstances of the parties change and that the design and implementation of the rules should minimize conflict between the parents.6

A. Interests

The Principles acknowledge that the considerations that can be brought to bear on the issue of child support reflect competing values and interests. The entities with interests to be advanced are society, the child, the residential parent, and the non-residential parent.7 From society’s point of view, beyond the issue of avoiding having the child as a public charge, there is the need to advance the welfare of the next generation of citizens by providing for its care, nutrition and education.8 From the child’s perspective, ideally, he or she should emerge from the divorce economically unharmed. Ordinarily, this is not going to be possible as the fragmentation of a common household leads to economic inefficiencies. Accordingly, unless it is desired to relatively disadvantage the non-residential parent, to compensate for these inefficiencies the most any award scheme can plan to achieve, in the absence of a surplus of resources, is that the child’s economic interests do not suffer disproportionately to those of other family members.9 The Principles also acknowledge that, beyond a consumption based analysis, the child can lay claim to support for life opportunities, primarily education, when the parents can afford to provide them.10

5. See Principles, supra note 2, § 3.04b(1)-(7).
6. Id. § 3.04(7)-(9).
7. Id. § 3.04 cmts. a-f.
8. Id. § 3.04 cmt. b.
9. Id. § 3.04 cmt. c.
10. Id. § 3.04 cmt. c(ii).
One or other of the parents may have a relatively higher income. The Principles accept the proposition that such a parent has a legitimate interest in retaining the fruits of his or her labors, which the Principles accept translates into a proposition that that parent is entitled to enjoy a relatively higher standard of living. In the ALI's view, this perspective enjoys "considerable, although not unanimous, support in American culture" and is implicitly incorporated into all existing child and spousal support rules. But, precisely how much better off the advantaged parent is entitled to be emerges as the consequence of balancing the competing interests impacting child support awards. Unlike the ALI's formulaic approach when it comes to property division and compensatory awards, there is no objectively quantifiable safe harbor for post-divorce surplus wealth in the child support arena.

When it comes to the residential parent's interests, these primarily seek to ensure that this parent does not carry a disproportionate share of the out of pocket costs of rearing the child. Additionally, this parent should not suffer a relative financial disadvantage in terms of the opportunity costs suffered by assuming residential responsibility. These interests tie in with an interest to maximize this parent's labor force participation, to the extent that this is consistent with the child's needs.

The law long ago rejected the notion that the non-residential parent has no obligations towards the residential household. However, that obligation is reflected in the duty to pay child support. At its simplest, it could be argued that the non-residential parent's interest, as such, is contributing no more than he or she would have contributed to support the child in an intact two parent household. How- ever, this amount, as the Principles point out, does not hold the child harmless, prevent unequal suffering, or guarantee a minimum standard of living. On the other hand this measure does tend to ensure

11. Id. § 3.04 cmt. d.
12. See generally id. §§ 4.09, 5.01.
13. This issue is confronted routinely in the area of family law. However, the analysis is somewhat awkward since the proposition itself assumes that the financial detriment is suffered on an "involuntary" basis. If this is not the case, then the child care function embodies some element of opportunity exploitation which is not factored into the financial analysis. A search for simplicity would support this oversight, but simple solutions are not necessarily just solutions.
14. Principles, supra note 2, § 3.04 cmt. e.
15. Actually, as the Reporter's Notes to the Principles makes clear, the idea that the non-residential parent should be no worse off following payment of child support may mean no more than that his or her standard of living should not decline, even if he or she is paying more than previously. At least the Reporter suggests that this can be used as a benchmark of what is just. It does not imply that household living standards should necessarily be equalized. Id. § 3.04, Reporter's Notes, cmt. f.
that the reach of the benefit extends no further than the child. The ALI accepts that a non-residential parent has a legitimate interest in limiting his or her obligation to the extent of the parent's relationship with the child rather than as reflecting an obligation to the residential household, even though the household may benefit indirectly from benefits conferred on the child.\footnote{16} Despite this restricted conceptualization of the obligation, the Principles recognize that the non-residential parent's interests in this regard may be overridden by other child welfare objectives,\footnote{17} as well as by the residential parent's interest in not bearing a disproportionate share of the costs of residential responsibility.\footnote{18} Where the non-residential parent's resources are relatively sparse, the ALI accepts that this parent's obligation should not cause disproportionate suffering to the payor.\footnote{19}

Finally, the Principles note that they are unwilling to recognize a residential parent's losses in the form of leisure foregone, or in the acceptance of onerous responsibility. Neither is this group of parents credited with the benefits of enhanced relational opportunities with the child and correspondingly the non-residential payors receive no adjustment for any corresponding detriment. Finally, the potential impact on an opportunity to remarry due to child-rearing or the obligation to pay child support is not factored into the ALI's scheme.\footnote{20}

In due course we will return to these broad brush stroke interest descriptions as we observe the courts, often unknowingly, gloss the analysis as they seek to justify the extraction of support from stock option awards. For the moment, however, we turn to the ALI's analysis of the appropriate objectives to be achieved within this umbrella of interests.

**B. Objectives**

The ALI position seeks to avoid a gross disparity between the economic circumstances of the child and a non-residential parent with an income that is higher than that of the residential parent. Nevertheless, it disavows any attempt to equalize the standard of living of the two households in such a circumstance.\footnote{21} That said, the Principles acknowledge that custody almost always ends up in the hands of the historical primary caretaker. This individual potentially has suffered economic detriment in terms of the non-acquisition of market skills and experience, and will probably continue to do so by virtue of the custodial role assumed on divorce. The Principles accept that the his-

\begin{itemize}
  \item \footnote{16}{Id. § 3.04 cmt. f.}
  \item \footnote{17}{See supra text accompanying note 6-10.}
  \item \footnote{18}{PRINCIPLES, supra note 2, § 3.04 cmt. f.}
  \item \footnote{19}{Id.}
  \item \footnote{20}{Id. § 3.04 cmt. g.}
  \item \footnote{21}{Id. § 3.04 cmt. i.}
\end{itemize}
torical injury should be remedied in adjustments between the adults pursuant to the divorce, but that it may be necessary to address through child support any disparity in the child's post-divorce standard of living flowing from the handicapping of the custodial parent's earning capacity.22

Additionally, the Principles seek to ensure that the child does not lose important life opportunities that the parents are able to provide without undue hardships to themselves or other dependents.23 This consideration is likely to be of some significance in households whose support base includes stock options given where the option holders may well lie at the higher end of the income spectrum. In this regard, it is interesting to note that the ALI proposals seem to be structured somewhat narrowly. The primary objective is to advance the child and society's interests by trying to require that the parents continue to spend on the child's education and training what would have been spent if the family was intact, on the premise that a parent may under invest in the education of a child with whom he or she does not share a household.24 Beyond conventional educational opportunities the Principles contemplate musical, artistic or athletic training for a child with unusual gifts,25 that is, specialized education and training appropriate to the child's special talents and abilities.26 Further, the Principles indicate that while they specifically mention education as a component of the life opportunities to be supported, the concept should "not be limited to" the educational and training concerns specifically articulated in the Principles.27 Given the notion that all of life's experiences are in some sense educational, it would not be too surprising to see an analysis such as this stretched to near breaking-point by a court seeking to engage in inter-household wealth transfer.28 There is certain to be some point when the process becomes hard to reconcile with those objectives which disavow an intention to require that the non-custodial parent share earnings to the point of equalizing the standards of living of the households. And, this is apart from whether the process is consistent with any analytic baseline that the payor's

22. *Id.* Since the transfer flowing from such an analysis involves funds, not facts, it is hard to avoid an argument that the process involves a continuing post-divorce incremental wealth "top-up". After all, the measure is what the residential parent would have been able to contribute and not directly what the child's needs are. Potentially, there is a significant opportunity for judicial speculation here.

23. *Id.* §§ 3.04 cmt. j, 3.12(1).

24. *Id.* § 3.12 cmt. a.

25. See *id.*

26. *Id.* § 3.12(2)(c).

27. *Id.* § 3.12(2).

28. The comments specifically provide that life opportunities may also include, for example, summer camps, cultural travel and support during nonpaying or low-paying apprenticeships. *Id.* § 3.12 cmt. a.
contribution should be no more than what the payor would have contributed if he or she was sharing a household with the child.\(^2^9\)

The ALI's objectives also include the goal of not discouraging the labor force participation of either parent.\(^3^0\) As far as payors are concerned, the analysis seems to accept, somewhat optimistically perhaps, that the payor's incentive continues so long as the payor's net benefit stays in the black.\(^3^1\) On the payee's side, the system cannot afford to allow the payee to not participate in the labor market and expect the resulting deficiency to be made up in the form of child support. This would be the result if the scheme simply sought to ensure equal

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29. See id. § 3.04 cmt. f. Indeed, the Principles seem to recognize that the court could find itself in a situation of resources which exceed the demands that legitimately can be imposed on the resources under the Principles. Thus, the court is specifically empowered to order funds placed in trust to provide for the child's future opportunities. Id. at § 3.12(4). Then, and at least superficially somewhat confusingly, the Principles specify that if the support obligation of high-income support obligor exceeds the amount required to comfortably support the child in a manner not grossly inferior to the obligor's standard of living, the court may require the obligor to place the excess in trust to provide for the child's future life opportunities. Id. § 3.12(5). The Comments provide a gloss to the effect that the initial provision reflects the idea that parents save for education of their children, but that this demand can be imposed upon them in addition to their conventional support obligations. Hence, apparently, the provision allows the court to impose this obligation on a "parent," not just an "obligor." The follow-up provision in contrast deals with the situation where the "obligor's" Principle-dictated payment cannot reasonably be used immediately. Here, the court can authorize any surplus to be deposited into a trust to cover future life opportunities. A provision such as this can have substantial utility in the context of an income stream grounded on stock options where the future availability of resources may be unreliable, and funds generated in any given period can produce a highly distorted view of what an obligor's income is. We shall return to a detailed analysis of these issues in due course. In any event, the Comments acknowledge that the court has to determine whether indeed the divorce brought about a "loss" of these future opportunities. To resolve this question, the court is called upon to use objective indicia, rather than the statements of the parents, specifically, "to do what residential parents of similar wealth and background ordinarily do." Id. § 3.12 cmt. b. Apparently, there is yet another role for an expert witness! Id. § 3.04 cmt. l.

30. Id. § 3.04 cmt. l.

31. The ALI seems to overlook the transaction costs, in personal terms, to the payor of producing the gross income. Arguably, a huge personal effort might only be justified by the gross return, or a significant portion of it. True the ALI does consider "negative effect[s]" but it then goes on to qualify this as meaning the earner keeps less than he or she benefits by. Id. § 3.04 cmt. l(i). However it may be that in reality the payor may have no choice. As the Principles' Reporter notes, full-time workers generally have little control over their hours of work and cannot reduce their hours of work without the risk of losing their jobs. Id. § 3.04, Reporter's Notes cmt. 1. Ordinarily, only if opportunities exist for overtime or an additional job may a child support burden affect a work incentive. Id. Whether this analysis holds true with the upper levels of option holders may be questionable. But at some point, an obvious effective wealth transfer in the form a child support claim against currently granted options may be an incentive for a wealthy employee to cease to work or at least not work as hard.
living standards in both households. But, a fixed contribution from the payor, not linked to the payee’s resources, would disadvantage the payor if the residential parent’s income increases. The ALI recognizes that the position is complicated by the fact that the residential parent potentially has a dual identity, namely as residential parent and labor market participant, and that this duality may increase the desirability of staying out of the workforce.32

Finally, as far as substantive concerns go, the Principles argue that any support structure should encourage investment in vocational training by the residential parent by making sure that that parent has sufficient resources and the potential for gains that are worthwhile to that parent and the residential household.33 Here we see a clear elision between funds notionally targeted directly at the child, and funds that ultimately might produce a benefit to the child in terms of the increased resources of the residential household, but which in the interim lead to a cash flow aimed at benefitting the custodial parent. A related theme obviously is the tension between this goal and the goal of workforce participation, and the recognition that a child may have a need for care, either parent or vendor provided. The Principles suggest that the child support scheme should enable the residential parent to make reasonable choices between gainful employment and the personal provision of child care.34 Unresolved is whether leaving the decision with the residential parent opens the door to abuse, given that the scheme is supposed only to not discourage workforce participation, rather than affirmatively encourage it.35

C. The Search for a Formula

The Principles start by asking the amount of the transfer that needs to take place to ensure that both parties will have the same standard of living if we assume that to start with they have equal incomes, but now the child is residing with just one of them.36 The Principles should be contrasted with various permutations of what the Principles describe as “first-generation Marginal Expenditure” formulae. These formulae start by seeking to identify what percentage of the joint household expenditure was devoted to the child. This value is then implanted into an Income Sharing analysis. This basically says that whatever percentage of the family income was devoted to the child in the combined household should continue to be contributed to the child from the combined income’s of the parents after the household breaks up. In the majority version of this approach the actual contribution of the obligor is to be weighted according to the proportion of the combined income that he or she actually produces. In the minority version of the approach, the residential parent’s proportional contribution to the income is not factored in. Whatever the marginal percentage of the combined family’s income

32. Id. § 3.04 cmt. l(iii).
33. Id. § 3.04 cmt. m.
34. Id. at § 3.04 cmt. n.
35. Id. § 3.04 cmt. 1.
36. The approach of the Principles should be contrasted with various permutations of what the Principles describe as “first-generation Marginal Expenditure” formulae. These formulae start by seeking to identify what percentage of the joint household expenditure was devoted to the child. This value is then implanted into an Income Sharing analysis. This basically says that whatever percentage of the family income was devoted to the child in the combined household should continue to be contributed to the child from the combined income’s of the parents after the household breaks up. In the majority version of this approach the actual contribution of the obligor is to be weighted according to the proportion of the combined income that he or she actually produces. In the minority version of the approach, the residential parent’s proportional contribution to the income is not factored in. Whatever the marginal percentage of the combined family’s income
principles express the view that that approach reflects "an obvious principle of justice" and achieves all the goals outlined earlier. This conceptual amount is then supplemented by an amount necessary to

was that was used to support the child, is the percentage of the obligor's income that must be contributed after the breakup. See generally id.; Glossary for Chapter 3. Child Support, at 572-74. Conceptually, an Income Shares analysis does not take into account the residential parent's actual income in determining the amount of the obligor's payment. It only concerns itself with the combined income of the parents for the purpose of determining the size of the obligor's obligation. In contrast, the ALI approach does concern itself with the residential parent's income. In particular, the model assumes that the obligor's payment should increase the child's residential household income, but that this payment should decrease as this household income increases. See id. at 573 n.8. These approaches can be distinguished from the so-called Equal Living Standards model which is not adopted in any American jurisdiction but which the Glossary notes is frequently advocated in feminist literature. This model seeks to ensure that any post-dissolution reduction in the standard of living of the child is no greater than that of the non-residential parent, and would use household equivalence scales to determine what transfers would be needed by households of different compositions to enjoy equal standards of living. Id. at 574. The Principles contain an Appendix which in turn contains a discrete analysis of a child support framework based on a Marginal Expenditure Formula. In this context, a Comment notes that this approach has shortcomings from the point of view of the child, because it does nothing to guarantee the standard of living of the child since it does not focus on the economies of the individual households and because it unduly may burden a parent to "contribute" a full percentage contribution despite a low underlying income and thus carry a proportionately higher burden. Id. § 3.05A cmts. g, h. Nevertheless, the Comments point out that the formula does have an advantage over the "substantially more redistributive" Equal Living Standards model and the "moderately more redistributive" ALI formula, because it is the only approach which can be developed to entirely avoid a work disincentive for the residential parent. Id. cmt. i. The ALI rejected the Equal Living Standard Model because of its potential to deter the residential parent from gainful employment, but saw the deterrent effect of its own proposals as "far more limited" and in part offset by the income exemption component of its formula, id., although this aspect may not advance the interests of the non-residential parent directly. See id. § 3.05(4)(a).

37. Id. § 3.05 cmt. d. This initial amount is analogized in the Principles to the marginal expenditure that a parent contributes to the support of the child in the intact household.

The Principles point out that this was the measure that most "first-generation child-support guidelines" tended to rely upon, but it is pointed out that when there is substantial income inequality between the parents, using this approach may mean that the articulated support goals are not achievable. Id. In particular, if the obligor is the higher earner using just this base amount may not ensure a minimum decent standard of living when both parents together are able to afford it, and/or the child may end up with a standard of living which is grossly inferior to that of one of the parents. If the obligor has the lower income, leaving this base amount intact may produce undue hardship for the payor without advancing any of the goals of the scheme since, for example, the child may now be enjoying a higher standard of living than if he or she resided with both parents. Id. The Comments to the Principles point out that restricting the award to the marginal expenditure in the common household does not tend serve any general principle of justice and the only real interest it advances is that of a higher in-
ensure that the child enjoys a minimum decent standard of living (if this result is achievable) and to ensure that the child does not have a standard of living grossly inferior to that of either parent.\textsuperscript{38} The award is then subjected to a technical adjustment downward once the residential parent’s income crosses the threshold of an amount necessary to sustain that parent at a minimum decent standard of living.\textsuperscript{39} The effect of this technical adjustment is that when both parents have equal incomes of “sufficient” amount any supplement disappears.\textsuperscript{40}

As was indicated, the goal of the supplement is to ensure that the child has a minimum decent standard of living when this can occur without impoverishing a parent, as well as to achieve a standard of living that is not grossly inferior to that of either parent. Beyond this, the challenge in limiting the supplement is to avoid defeating the higher-income parent’s interest in enjoying the benefits of his or her labor, even where these benefits are disproportionate relative to those enjoyed by the child’s other parent.\textsuperscript{41} Under the model developed in the Principles, no matter how many children were the beneficiaries of the support order, the order was capped so as to ensure that the obligor always retained more than half his net income.\textsuperscript{42}

D. Deviation from the Formula

Because, as will emerge, stock option compensation devices have the potential to produce high-risk-high-reward scenarios, coupled with great uncertainty until the benefit actually is realized, if at all, one of the issues that needs to be addressed is how much flexibility any formula permits. The Principles recognize this type of problem and make specific provision for deviation in some scenarios. Some of the situations are particularly relevant to our present concerns. The other aspect of this which will be reached in due course is the question of the extent to which the child support scheme will tolerate efforts to remedy inappropriate outcomes on an after the fact basis.

The Principles adopt the position that a formula based award is presumptively just and appropriate. This presumption is one affecting the burden of proof and is such that it creates an obligation to establish from the perspective of the interests of the child that an un-

\begin{itemize}
\item \textsuperscript{38} Id. § 3.05 cmt. b.
\item \textsuperscript{39} Id.
\item \textsuperscript{40} Id.
\item \textsuperscript{41} See id. at § 3.05 cmt. g.
\item \textsuperscript{42} Id.
\end{itemize}
just or inappropriate result flows from the adoption of the formula for
one or more of a number of reasons specified in the Principles.43

Among the articulated justificatory reasons for departure from the
formula, some are potentially more likely to be encountered in situa-
tions involving stock options. In particular, deviation is justified if the
obligor has an extraordinarily high income and the amount deter-
dined by the formula exceeds the amount necessary to insure that the
child enjoys a standard of living that is adequate and not grossly infer-
or to that of either parent and that the child’s life opportunities are
adequately secured.44 Deviation also is justified if the parents have
agreed to a lesser amount, if there are special medical or dental needs,
or other special needs or gifts of the child which require additional
expenditures, if the deferred sale of a residence results in additional
savings or expenses with respect to housing, or if deviation is required
to support the exploitation of the child’s life opportunities.45

The Principles start from the perspective that the formula provides
adequate support once the child enjoys economic adequacy, a standard
of living not grossly inferior to that of either parent, and is not being
deprived of important life opportunities that ordinarily would have
been available if the child had resided with the obligor.46 Where the
obligor has an extraordinarily high income, as distinct from a merely
high income, the Comments to the Principles say that the extraordina-
rily high income should be treated as a basis for rebutting the formula
rather than as a general limitation on the amount of income subject to
the formula. The Comments argue that states that have adopted the
latter approach have often cut off the application of the formula at
inappropriately low limits of obligor or total parent income. The Com-
ments’ position is that even if the parent enjoys a merely high income
there is no guarantee that an obligation expressed as a percentage of
that income will provide either similarly or adequately for the child.
The Comments view is that it is only when the obligor has an extraor-
dinarily high income that an amount which is appropriate according
to the formula will be factually excessive. Using the Principle’s illus-
trative numbers the Comments suggest that anomaly is likely to
emerge with a parental income in excess of $200,000.47 What we are

43. Id. § 3.07 (1), (2). Federal law requires the creation of a presumption in favor of a
44. PRINCIPLES, supra note 2, § 3.07(2)(a).
45. Id. § 3.07 (2)(d)-(f).
46. Id. at § 3.07 cmt. c. The Comments seem to suggest that it is acceptable for a
court to adopt a position that beyond meeting the obligations underpinning the
formula it also is acceptable for the court to adopt the view that additional income
should be shared with the child on the basis of some unqualified principle that
this view is appropriate. This does suggest that the barn door is somewhat more
than ajar in environments where there are surplus resources.
47. Id. § 3.07 cmt. c.
starting to encounter here is a classic boundary condition problem where issues of economic value meet issues of social value, or, in another sense, where we shift from a zone of clear economic necessity to one where the issue is economic acceptability. The complexity of the situation is compounded because once one proceeds beyond the realm of axiomatic consumption dictated need, the focus of the support becomes less directed and thus increases the risks of the support falling outside the parameters of acceptability provided by the underlying principles. In short, we run the risk that the payor is being called upon to pay amounts which are excessive and which end up being used for inappropriate purposes or enuring to the benefit of inappropriate beneficiaries. Perhaps appropriately, the Comments acknowledge that these extraordinarily high income cases are likely to require individualized treatment by the courts. Whether this individualized treatment is also demanded in option based award scenarios not just because the income is extraordinarily high but also because the resource on which the award is based is extraordinarily complex and problematic is something we shall return to when we come to consider how the parties incomes are to be determined and the extent to which orders are subject to modification.

The Principles contemplate deviation from a formulaic approach pursuant to an agreement between the parties, unless the deviation is substantially less than is contemplated by the formula. Even here however, the amount payable as a result of the Principles permit the court to accept the agreement, if when the child-support provisions are "read with the agreement as a whole," they are consistent with the interests of the child. The Comments suggest that a state could adopt substantive acceptable percentage deviations, such as ten or twenty percent, or could assess substantiality in terms of the total resources of the residential household taking into account income from all sources, since in such a situation, in the Comment's view, the law has little interest in insisting on the letter of the statute if the parties have agreed to the contrary.

The Comments further suggest that the agreement has to be looked at as a whole, because the various economic elements of the dissolution are interchangeable. In particular the parties may wish to increase one element and correspondingly diminish another, for example out of a desire to achieve tax savings or

48. See Jelinek v. Jelinek, No. 1-90-2550, 1992 Ill. App. LEXIS 1662, at *17-18 (Ill. App. Ct. Oct. 13, 1992) (citing In re Marriage of Stockton, 523 N.E.2d 573 (Ill. App. Ct. 1988) (holding that using portion of the household expenses associated with maintaining two residences awarded to the residential parent to determine the children’s needs for the purpose of determining child support led to an exaggerated figure of support and was to be condemned)).

49. PRINCIPLES, supra note 2, § 3.13(1).

50. Id. § 3.13 cmt. b.
motivated by circumstances or wishes peculiar to themselves. These last two viewpoints of the Comments are likely to be particularly significant in the context of the distribution of options in the context of a divorce. Technically the manipulation of options to extract a predetermined value such as is required by a prospective child support order, if it is even possible to do so, may evolve into a complex undertaking in which considerations like tax liability, both as to amount and responsibility, is but a component. As has been suggested elsewhere, options just aren't like the old family Ford. Accordingly, a system which readily defers to the efforts of the parties to optimize a solution should be welcomed. Ordinarily, if well advised, the parties should be much more motivated and capable than a hard-pressed divorce court to achieve an appropriately sensitive result.

E. Defining Income

For the purposes of establishing a child support order, the Principles start by defining income as income “from all sources,” subject to some exclusions none of which is relevant for our purposes. Certain classes of “income” are then dealt with specifically on the basis that they are more “problematic”. But, stock options escape this net. For our purposes, some of the provisions relating to the imputation of income relate to options in particular interest, as are some of the aspects of the thinking behind the process of imputation. This is because, as we shall see, compensatory stock options may produce no substantive yield for a significant period of time, and, indeed, may never produce a yield. Accordingly, as will emerge, the nature of stock options is such that they

51. Id. § 3.13 cmt. c.
54. PRINCIPLES, supra note 2, § 3.14(1)(a). However, within any given state system it might be possible to argue that contributions made to a stock option plan should be excluded for the purposes of determining an obligor’s net monthly income when calculating child support. See In re Marriage of Salmela, No. C8-90-1625, 1991 Minn. App. LEXIS 95 (Minn. Ct. App. Feb. 5, 1991) (appeal court rejects trial court’s earlier approach of excluding contributions to a stock option plan); In re Marriage of Dodd, 532 S.W.2d 885, 889 (Mo. Ct. App. 1976) (child support and maintenance awards not excessive, “especially . . . since his net monthly income does not include . . . contributions to a savings plan and a stock option plan). Apart from whether it is technically permissible under the jurisdiction’s rules, the legitimacy of the argument may hinge on what approach the jurisdiction takes to permitting an obligor some discretion in investment strategy. We will return to that theme in due course.
55. Id. § 3.14 cmt. a.
tend to invite a process which effectively involves the imputation of income, or at least the analog of the process of imputing income.

On the issue of the thinking behind the imputation of income, it is worth noting that the Principles are willing to recognize in-kind benefits to an employee as income. Ordinarily this would have no relevance to our concerns at all, except that, conceptually, it opens the door to the idea that support may assessed on a value which is not readily translateable into real money. Acknowledging this, the Principle's Comments suggest that the ultimate issue is the extent to which the benefit augments the parent's real income.

The Principles require that an ordinary rate of return be imputed to an asset that yields less than the ordinary rate of return; as an ordinary rate of return is the prevailing rate of return for secure investments. When it comes to dealing with assets which yield below an ordinary rate of return, the Principles' perspective is that a "parent may choose to invest in growth rather than income-producing assets, but that choice should not ordinarily limit the amount of income available for child support." This analysis becomes significant when we come to deal with issues relating to unvested, immature, and unexercised options, as well as with the issue of the relevancy of the role the employee played in the structuring the compensation package. After all, is the employee required to decline compensation in the form of options in order to maximize immediate cash flow, if not the total return? What if the employer insists on the option's component? Must the employee decline the job? The Comments give the illustration of one Linda who earns a substantial salary as manager of a closely held corporation which is owned entirely by her and her siblings. The stock is not publicly traded, but has value attributed to it. No dividends are paid. The example suggests that Linda needs to retain ownership of the stock to maintain her position and influence in the business. The Comments take the position that income should not be imputed, because of her need to maintain her job and influence in the firm which are concerns which ultimately benefit her children, but which at the same time make Linda unable to liquidate her asset. In due course

56. Additionally, it is one thing to assess an employee on the basis of the value of a benefit where that benefit represents a savings, that is, it represents funds that the employee would have spent in the ordinary course out of the salary paid. It is something else to assess an obligation where the salary offered is adjusted downward to reflect the value of the benefit conferred, especially where the benefit is for a good which household equivalency analysis would allow the obligor to expense in advance of determining income available for fixing child support. See id. § 3.14 cmt. c, ill. 2.
57. Id. § 3.14 cmt. d.
58. Id. § 3.14(4)(b).
59. Id. § 3.14 cmt. d.
60. Id. § 3.14 cmt. d, ill. 3.
we will take a look at these justification just outlined in the context of
the generality of option cases. Additionally, we will consider, in the
context of options, the ramifications which flow from an element of the
Comment’s example, namely the fact that Linda is a “relational
shareholder, that is, she is in a position, for example, to entrench man-
agement. 61 This fact opens the door to pre- and post-divorce collusive
behavior. 62

Notionally, the Principles accept the idea that earnings may be im-
puted to both the residential and non-residential parent. Neverthe-
less, different considerations are used to underpin the analysis. As far
as the non-residential parent is concerned, the premise is that imputa-
tion may be necessary to deal with an obligor who is concealing income
or shirking efforts to earn income. The Comments note that such im-
putation raises cause for concern if the obligor is saddled with obliga-
tions which cannot be met, even with the best of efforts, given that
there are serious legal consequences that flow from a failure to pay
child support. Accordingly, the Comments advise that a court should
exercise caution when considering the imputation of earnings in these
scenarios. 63

The Principles contain some safe havens from income imputation,
most of which have no relevance for our purposes. However, perhaps
noteworthy is the idea that income should not be imputed following a
change in occupation so long as the support produced through the
“new occupation does not unreasonably reduce the child’s standard of
living taking into account the child’s total economic circumstances.” 64
The ALI clearly had in mind a not atypical scenario of an obligor who
changes occupation and thus reduces his or her income. But, what of
the obligor who changes employment, or or even just status with the
same employer, and thus triggers a different compensation structure,
in particular one containing options. Here, short term benefits might
be waived in return for the possibility of higher long term yields. Is
this a circumstance for imputation, or freedom from imputation, or
conditional freedom from imputation, along the lines just indicated in
the quotation? These too are themes for later.

The residential parent is freed from the risk of imputation of in-
come so long as he or she is caring for a child under the age of six, and
thereafter the parent is only accountable for such income as is consist-
tent with the parent’s residential responsibility for a child of the par-

61. See generally Edward B. Rock, Controlling the Dark Side of Relational Investing,
62. Some courts base the analysis on whether the employee has control over the as-
sets and income of the employer. See Clark v. Clark, 779 A.2d 42, 52-53 (Vt.
2001) (Johnson, J., dissenting).
63. PRINCIPLES, supra note 2, § 3.14 cmt. e(i).
64. Id. § 3.14(5)(b).
ties. Here the immediate interests of the child provide the foundation for the protective umbrella. Beyond the example of Linda raised earlier, it is not clear whether, and how readily, in the instance of the non-residential parent, a deferred and perhaps enhanced benefit such as might be found in an option laden compensation package that could enure to the future advantage of the child, might by policy analogy be sheltered from imputation. In concept, the imputation of earnings to the non-resident parent is done with a view to advancing the interests of the child. The imputation of income to the residential parent after a point is done on the basis of an analysis of what is fair between the parties. Initially, the assumption is that with a child below six and not yet attending school, it is axiomatically in the child's interests to have the residential parent available—the Principles provide no scope for an economic analysis of the thesis. Thereafter,
subject to a consideration of a "parent's residential responsibility for
the children of the parties," a court is freed to impute income.

Does this lead to an analysis that produces fairness between the
parties? Maybe not. First, it should be remembered that the basic
structure of the ALI formula takes as an operating model that the
amount the obligor owes goes up as the residential household income
goes down. So a residential parent's inertia has the tendency to in-
crease the obligor's burden. Yet, the Comments accept that when the
law imputes gainful earnings to residential parents, it expresses a
judgment about how they should allocate their time between gainful
employment and child rearing, a matter normally left to the decision-
making of parents. But the Comments here ignore an awkward an-
alytical elision. It is one thing for the both parents to decide that one
should stay home. The analysis at least becomes questionable when
that authority is given to one parent alone. Moreover, that parent is
given the authority by virtue of the residential arrangements made for
the child, not necessarily because of any underlying legal authority
such as might be vested in a sole legal custodian. There has got to
be a point beyond which the child's reasonable requirements have
been met so that the extent and structure of the non-residential par-
ent's income should no longer primarily be evaluated in terms of as-
sumed interests of the child and should only be evaluated, if at all, on
the basis of what is fair between the parents. As the Comments note,
at some point it becomes necessary to recognize a "parent's autonomy
interest in determining the nature of his gainful employment." We
only should ensure that the child does not suffer unreasonably on ac-
count of the parent's choice, and this issue has to be evaluated in the
context of the child's total economic circumstances, rather than the
fact that the obligor's support payment may be lower than it otherwise
might have been.

69. Id. § 3.15(1)(a).
70. See supra note 36.
71. See Principles, supra note 2, at § 3.15 cmt. b. The comment also admonishes the
court to approach imputation of earnings to the residential parent with "even
greater circumspection" than it does the imputation of earnings to the obligor.
Id.
72. We will gloss over any issues relating to the conflict of interest that must arise
with respect to the decision-making of a residential parent in a household con-
taining children from a subsequent relationship.
73. See Principles, supra note 2, at § 3.14 cmt. e(iv).
74. See id.
F. Tax Considerations

The ALI Principles correctly acknowledge that in assessing a child support obligation we have to take into account the parent's tax obligation.\(^{75}\) The Principles accept that it does not matter whether one takes the pre- or post-tax income for use in the calculations as long as the percentage allocated for child support is adjusted accordingly. However, it is suggested that for practical implementation purposes it is easier to work with after-tax incomes. Up to this point there are no obvious problems. However, then the Principles go on to suggest that for administrative simplicity and fairness aimed at "insulating the child-support obligation from individual strategies to reduce income subject to income taxation and child support" the applicable rates of tax applied to reduce the gross income should be based on the average percentages of income payable in taxes at different income levels.\(^{76}\) Here the analysis runs into difficulty. To start with, it assumes that we know with a reasonable level of comfort what the pre-tax income of the obligor is, so that an appropriate average tax rate can be assigned to it. As we shall see when it comes to stock options this preliminary step it is not one that is easily taken. Second, it is may be possible to come up with scenarios which are tax minimizing and perhaps income-available-for-support maximizing so that the unsophisticated adoption of an average approach may short-change the child by a significant amount.\(^{77}\)

Option-holders simply do not necessarily fall into the mold of the obligor who leverages a tax-based subsidy to mortgage interest rates to enable him or her to purchase larger premises and in the process reduce after tax income. It may be that average rates do suffice for such a case. However, it seems somewhat ironic that a system which is concerned not to saddle an individual arbitrarily with imputed income because of the severe consequences that can flow from not satisfying the support obligation, is nevertheless quite happy to run the risk of doing just that by not recognizing the taxes that the individual obligor actually pays. And the tax burden imposed on option holders may be far from a straightforward question, both as to the amount owed as well as the identity of the person receiving the tax bill.\(^{78}\) Is the adoption of average tax bill to assess support obligations actually

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75. Id. § 3.14 cmt. j.
76. Id.
77. This is particularly true in the case of so-called Incentive Stock Options. If properly handled they are amenable to "capital gains" rather than an "ordinary income" tax treatment. See Rosettenstein, supra note 52. For a comparison of the underlying tax treatments of Incentive Stock Options and Non-Qualified Stock Options, see Jack E. Karns & Jerry G. Hunt, Should Unexercised Stock Options be Considered "Gross Income" Under State Law for Purposes of Calculating Monthly Child Support Payments?, 33 Creighton L. Rev. 235, 241-250 (2000).
78. See infra note 154; Rosettenstein, supra note 53.
a reflection of the fact that the ordinary family lawyer and/or administrative officer does not feel comfortable calculating true tax liabilities and hence true rates? In short do the proposals actually more reflect the participants' inadequacies rather than the dictates of fairness? What is a legitimate price to pay to achieve simplicity? Indeed, the efficiency determination may be made with a time horizon that is too proximate. After all, a simple result at the point of establishing the order can produce an obligation which the payor in fact is unable to meet, or conversely where the payor ends up with more after tax resources than was originally anticipated. Accordingly, we face the prospect of post-judgment modification proceedings in which we have to determine what the payor can or should pay. Presumably, at this point, we are entitled to consider what the obligor's actual tax bill is. In short, at least in some cases, by adopting an average tax rate, we have simply delayed the day on which a detailed analysis of the parties' actual circumstances has to be conducted. The wings of the butterfly start to flutter! Wouldn't it be more just to look at the issue of tax strategy in the context of imputation of income, where a court could examine the "legitimacy" of the obligor's tax plan. Finally, when it comes to stock options, unless the Internal Revenue Service clarifies the situation to the contrary, it is quite possible for one parent to receive the income and the other parent to receive the tax bill! In such a situation, the use of a notional tax liability can reach unique levels of absurdity.

G. Modification

The Principles permit the modification of child support orders under certain circumstances. Aspects of this process are of interest to our present concerns given the highly contingent characteristics of stock options—both as to the issue of whether the options will exist as a source of income at the relevant time and as to the amount of income that will be available from this source. On the premise that most support obligors are regularly employed for wages, the Principles advocate expressing child-support obligations as a percentage of the obligor's income from time to time and continuously and automatically updating the award.

79. The process also overlooks the injustice of saddling an obligor with a child-support liability which under-weights his or her tax bill. Beyond the tax bill itself, the obligor also carries the transaction costs of attempting to get the obligation modified. Indeed, depending on the presumptive force of the child-support guidelines in any jurisdiction there may be no ability to get a modification, so that the obligor is condemned to an oppressive payment regime until the point when he or she is unable to pay.
80. See Rosettenstein, supra note 53.
81. PRINCIPLES, supra note 2, § 3.18(1) cmts. b, c.
would be the provisions in the Principles permitting modification in terms of the order itself, even though this provision was envisaged as operating under the umbrella of a conventional automatic and continuous update scenario. Additionally, the Principles permit modification on the petition of either party if he or she is able to demonstrate a substantial change in circumstances, in particular if a re-application of the formula would yield a substantial change in the amount of the award. This element of the Principles could benefit either party. However a traditional overarching rule adopted under federal pressure is that child support orders are not retroactively modifiable. The Principles follow this rule. Given the unreliability of an income stream based on options, this represents a significant potential trap for obligors who are not diligent.

With this brief and highly selective survey of some of the considerations that go into determining the extent of support obligations under our belt we turn to look at the nature of stock options.

III. THE NATURE OF STOCK OPTIONS

A. The Structure of the Grant

A stock option entitles the option holder (the grantee) to acquire stock in a company at a pre-determined price, called the exercise price or the strike price. Generally the option remains exercisable for a finite period of time, which may be as long as ten years from the date of the grant of the option. Where the grant is made by an employer as part of a compensation package, the grant usually comes with strings attached. For example, the grant may be lost, in whole or part, if the grantee ceases to remain in the employ of the grantor for a specified period of time. Once that time has expired, the grant is said to be "vested". In common parlance vesting is the point in time after which the employee is free to exercise the option. In reality, the option vesting point may represent a moment of absolute entitlement of the employee, even though the option may not be able to be exercised until a

82. Id. §§ 3.17(1)(a), 3.18(1).
83. Id. §§ 3.17(1)(c), 3.20(1).
84. 42 U.S.C. § 666(a)(9).
85. PRINCIPLES, supra note 2, § 3.23(1), cmts. a, b.
86. JOSEPH W. BARTLETT, VENTURE CAPITAL 226 (1988). Usually, the exercise price is the market price of the underlying stock at the date of the grant. This is due to the fact that under current American accounting standards, if this approach is not adopted the granting corporation has to reflect the grant of the option as an expense in its balance sheet. In turn, this is because if the grant is a "fixed price" grant the reportable expense is the difference between the exercise price and the fair market value of the underlying stock at the date of the grant. See Opinions of the Accounting Principles Board No. 25, Accounting for Stock Issued to Employees, 471-72 (1972).
later point in time when it is said to "mature." However, for the purposes of our discussion, unless the context indicates otherwise, the term "vest" will be used to indicate the point at which the grantee is free to exercise the option and acquire the underlying stock. It is worth noting that the point at which the employee is free to exercise the option is not necessarily the point at which the employee is free to sell the underlying stock. The sale of the stock may be subject to delays or disincentives. These limitations may affect the "extractable" value. The delays may be imposed by the employer or by operation of law.

The vesting process itself may be subject to any number of contingencies. For example, beyond loss of the grant for failure to remain in the employer's employ, the grant also may provide that in certain other circumstances the option will be lost, such as, for example, where the employer undergoes a "change of control". In other instances, such an eventuality may produce only a partial loss of the grant. A change of control also may result in the partial or total "acceleration" of the vesting period. In this scenario the grantee is able

87. For further discussion of these classifications, see Rosettenstein, supra note 3, at 272.
89. These processes may operate in various ways. Thus, in Otley it seems (though the language of the report is confusing) that while the transfer of the stock was not restricted, it was subject to a right of preemption by the employer or other shareholders. 810 A.2d at 7. This case refers to the case of Klingenberg v. Klingenberg, 675 A.2d 551 (Md. 1996), in which there appears that there was a repurchase agreement to take effect on retirement, death or disability and where there was a structure in place for determining the value. Otley, 810 A.2d at 7.
90. A good example of how complicated the situation can get is provided by Burtman v. Technical Chemicals and Products, Inc., 724 So. 2d 672, 673-74 (Fla. Dist. Ct. App. 1999). An attorney received options as compensation for services. The options were placed in a trust to meet his alimony and child support obligations. When the options were exercised the issuer issued restricted stock. The ability to sell the stock was conditioned on registration with the Security and Exchange Commission (hereinafter the "SEC"), or on obtaining an opinion from the issuer's counsel that the stock could be sold without registration by virtue of falling under a statutory exemption from the registration requirement. That exemption should have been available under SEC Rule 144 (17 C. F. R. § 230.144) by virtue of the fact that the restricted stock had been held for a period of more than a year. However, the issuer's counsel declined to provide the opinion because the issuer was in litigation with the attorney over the services for which the options were compensation. Accordingly, the alimony and child support trust was unable to extract the underlying value.

In Otley, 810 A.2d 1, the options were Incentive Stock Options, as the concept is understood by section 422 of the Internal Revenue Code. The Code imposes constraints on the alienation of the options or resulting stock on pain of losing the ability to defer the incurring of a tax liability and also losing a favorable capital gains treatment.
92. See Otley, 810 A.2d at 3.
to exercise some or all of the options at a point in time which is earlier than ordinarily would have been the case. A similar acceleration may flow from the corporation meeting certain performance objectives such as, in a simple example, when the underlying stock achieves a specified price. Beyond employment continuity or performance related conditions or conditions relating to changes of control, the grantor generally is free to attach to the grant whatever conditions it chooses. Conceptually, it is important to understand that these grants may be subject to both conditions precedent and conditions subsequent, which in their most extreme manifestations may enable the granting employer to cancel the grant in its entirety, and which in any event have the potential to affect radically the performance characteristics of the grant.

B. The Rationale for the Grant and the Concept of Income

In its most common manifestation, the reason for the grant supposedly is to create an identity of interest between the stockholders and the employee. Further, any vesting period is designed to encourage the employee to remain in the employ of the employer. Arguably, during this period the employee is "earning" the option. But, if the underlying rationale is correct, that is that the grant is an incentive for the employee to exercise his or her best efforts to improve shareholder value, then in one sense, any enhanced value generated after the vesting period, due, say, to an appreciation of the underlying stock price, also was earned beyond the vesting date. Now, not all grants work this way, or only work this way in a limited sense. Thus, an employer may make an option grant to induce an employee to come and work for the employer and also possibly to compensate the job candidate for benefits from a previous employer that might be lost when the employee jumps ship. Here, the period during which the options are earned arguably may be identified as a particular moment in time. Or, this period may "capture" some historical time which may then run forward into the future employment up to the point of vesting, or even beyond. Some employers make grants to acknowledge the success of a particular project, so again the option may be earned at a particular point in time or over an identifiable period of time in the past. Some employers routinely make options part of their regular compensation package. Accordingly, employees, particularly at the mid and upper level of management, can expect to get options on, say, an annual basis. What significance does all of this have to us? The amount of a child support award is based on what "income" the indi-

93. See, e.g., In re Marriage of Powell, 934 P.2d 612, 613 (Or. Ct. App. 1997).
94. See, e.g., In re Robinson v. Thiel, 35 P.3d 89, 93 (Ariz. Ct. App. 2001) (holding that if option is not exercisable for a year, then 25% of the grant exercisable each year and any options not exercised at the end of ten years are lost).
Individual is expected to have available to support a household. It should be obvious that an isolated grant of options which produces a real cash flow in any given year after the options are exercised and the underlying stock is sold is likely to produce a highly distorted picture of the individual's income for the purpose of fixing the amount of an award, even though the cash flowing from the exercise and stock sale, in principle, would be a perfectly legitimate resource to look to in order to meet the obligations of an otherwise appropriately determined support order. In such a situation, would it be appropriate to look to the period over which the benefit from the option was or will be "earned" in order to calculate what the individual's "income" is or will be? For example, if the option takes three years from the date of grant to vesting should it be said that the "income" attributable to each of those three years is one third of the net proceeds flowing from the exercise of the option and the sale of the underlying stock?

The suggestion just made has a certain superficial appeal. After all, when the grantee receives what are essentially isolated grants, treating the proceeds of the exercise as income attributable to one year is bound to produce an unrealistic "spike" in the grantee's income for that year and presumably lead to an unreasonable prospective order. The effect of assigning the income to the number of years that it took to "earn" the resulting benefit has the effect of "smoothing" the apparent flow of income and thus the "income" used to determine the child support obligation. Of course, what we are attempting to do is establish a prospective order based on current income. Under the model just outlined, only income "earned" in the current year should be used to fix the amount of child support. Should we be free to expand the model and deem the grantee to have income for as many years in the future as we assume it took in the past to earn the benefit? Doing so would both smooth the amount of the income used to calculate the support and also would ensure that income "earned" in the past was not lost to the child—even if the process is logically at odds with what conventional child support formulae would seem to require. However, any analysis along these lines has to be conducted with some care. Beyond the fundamental point of the acceptability of using an historical, and perhaps isolated, grant to set a prospective obligation,95 considerable attention needs to be paid to the issue of the time "required" to earn the income. Additionally, there is a particular moment in time at which the grantee is free to exercise the option, but in the ordinary course of events is not required to do so, because the option will remain open for exercise for perhaps many

more years. To what extent should the grantee be entitled to defer the exercise?

Conventional option valuation theory suggests that the exercise of an option should be deferred until the last possible moment in order to extract the optimum value from the option. But, beside the question of optimization is the issue of obstruction. Potentially, it might be to the grantee's advantage to extend the point of realization further into the future and then argue that the "income" should be determined over the this extended period as well. In principle, this might have the effect of reducing the amount of any support order. Of course, this is not necessarily true since the actual appreciation in the value of the underlying stock during the extended period may lead to an order which is higher than previously would have been able to be made if the determination had been made at the moment of vesting. Nevertheless, the grantee's residual share of the option benefits also will be higher in such circumstances. Beyond the question of the allowing the grantee to reduce the amount of his or her notional income by extending the time over which the "income" is deemed to have been earned, the injection of time introduces into the analysis some other elements which may or may not operate to the grantee's advantage. First, the delay may give the obligor the opportunity to speculate with respect to the residential parent's future. After all, with time, the residential parent's financial situation may improve so that as long as that is a component of the analysis to determine the support obligation, the delay may result in the reduction of the relative burden carried by the grantee obligor. Indeed, as we saw with the ALI proposals, the residential parent's absolute entitlement to withdraw from the marketplace disappears with time. Time may work to the obligor's advantage in another respect as well. Child support is not an open-ended commitment. In many states it ends on the child attaining majority and, even where the state has extended the duty into the years of secondary education, the obligation is not limitless. Thus, it could be to an obligor's advantage to defer the option based support determination to as late in the day as possible so as to lead to the order hitting a mandatory cut-off boundary. Again, however, absolute arguments are not possible in this regard because it is quite likely that with the passage of time the child's needs may increase as may the yield from the options.

To summarize for a moment, there is one issue of the extent to which the options should be considered to be earned over a period of time, together with the related issue of how long that period should be considered to be. Additionally, there is the overarching question of at what moment in time, for the purpose of the court's analysis, income should be determined in fact to be earned, in the sense of appropriately being included in the support calculation.
SPECULATING ON STOCK OPTIONS

Given the potential ambiguities of the situation beyond the vesting point, it would seem to be appropriate to use this vesting as the earliest moment for the determination of what the obligor's income is.\textsuperscript{96} In reality this is the time when the obligor could extract cash from the grant and conceptually chooses not to do so. This would seem to be an investment choice, and the grantee should be saddled with this choice.\textsuperscript{97} But, again, care is needed. The grantee should be burdened for calculation purposes with no more than the grantee can actually extract from the option. It is unfair to determine a notional value for the option using a technique which enhances the option value by considering the time the option is supposedly able to remain open for exercise\textsuperscript{98} when we are dealing with a grant which the grantee is not free to trade on the open market. The need to focus on the grantee's actual ability to benefit from the grant raises other considerations. The conditions of the grant, the grantee's terms of employment, Securities Exchange Commission rules, or the rules of a stock exchange, may all affect the ability of the grantee to dispose of the underlying security obtained by exercising the option.\textsuperscript{99} And, unless the grantee is free to dispose of the option as such, it is only when the underlying security is sold that income can be realized from the grant. Accordingly, perhaps the grantee should also be credited with the period until the underlying security itself can be disposed of, and that this period as well should be included in the time taken to "earn" the benefit. This assumes that the relationship between the grantor employer and the grantee is at arms length. Clearly, where the grantee is in a position to have the grant structured in a way that would defeat support obligations there could be circumstances that would justify basing the support obligation on some imputed time frame rather than the apparent realities of the grant.\textsuperscript{100}

The existence of isolated grants, as distinct from a annual system of compensation grants, and a willingness to impute income to an obligor, raises the possibility of an entirely different mode of analysis. Obviously, we simply could treat the value of the option as "income." But, what if we treated the option's value not as a source of "income", but rather as a capital asset? This conceptual distinction has been made in the context of divorce cases where, in the ordinary course, options are distributed as part of the property division between the

\textsuperscript{96} As was done by the court in Mackinley v. Messerschmidt, 814 A.2d 680, 683 (Pa. Super. Ct. 2002).
\textsuperscript{97} See Mackinley, 814 A.2d at 682-83.
\textsuperscript{98} As occurs with the Black-Scholes valuation model. See infra text accompanying note 109.
\textsuperscript{100} See Dolan, 786 A.2d at 823; In re C. J., No. 05-98-01973-CV, 2001 Tex. App. LEXIS 3067, *6 (Tex. Ct. App. May 10, 2001) (no evidence that the obligor received the "options as compensation in lieu of income to defraud his children").
parties. Again, we should remind ourselves what we are about. The object of the exercise is to determine the obligor’s “income” for the purpose of setting child support. At this stage we are not charged with locating assets out of which any obligation can be met. As was suggested earlier, it is totally appropriate to use some or all of the value extractable from an option grant to meet the demands of an appropriate support order. The issue at this stage of the analysis is what is “appropriate.” To make this determination it would seem to be reasonable, once an option grant had reached the stage in its life when it could be classified as an investment choice, not to deem the option itself to be income, but rather to impute income to the grant based on some underlying value, and then use this imputed income as the basis for fixing the amount of any child support obligation.

There is a third possibility. This might involve a hybrid of the two previous approaches. Here there would be a consideration of the way the intact family or, perhaps, the obligor, had utilized option grants in their or his or her domestic economies in the past. Accordingly, if the family treated grants as an annual source of income, with each grant being cashed out as soon as it vested, it might be appropriate to continue assuming such a use in determining “income” for support purposes. In contrast, if the family realized the grant proceeds, invested them, and then consumed the resulting income, adopting an income analysis which assumed that such a strategy continued does not seem to be inappropriate. The prospect of a detailed facts and circumstances analysis replete with arguments of unique circumstances and special justifications may not be appealing, whether from the perspective of judicial or administrative efficiency, or even as matter of social aesthetics. But, it could conceivably produce a result which is more just, at least as between the parties. Of course, historical practice is not necessarily a legitimate premise for establishing a current obligation which now is encumbered with both the interests of the state and the interests of the child—advanced as a claimant in his or her own right, rather than as the haphazard beneficiary of whatever largesse parents in an intact family had chosen to dispense. Nevertheless, history reflects what the parents’ did and it would seem to have continued relevance unless the inefficiencies of the process, or the family disintegration itself, provide axiomatic justifications for ignoring prior use of the options in determining family support obligations.

Each of the strategies just outlined relies on an assumption that we reliably can determine a basic amount which is earned or deemed to be “earned” over the relevant years, or is deemed to be capable of being cashed out and spent. It is to some problems associated with these considerations that we now turn.
C. Income Versus Value

The reality of option grants is that in most instances it is virtually impossible to know\(^{101}\) the true value of the option until the proceeds from the grant are actually realized.\(^{102}\) The one notable exception is where the grantee is in possession of a grant whose terms and conditions exactly match the terms and conditions of options widely traded in the open market, and the holder of the grant is free to sell his or her holdings.\(^{103}\) Options held by employees usually would fail to cross both hurdles. Most grants aimed at compensating employees are subject to a variety of restrictions which are not found in generally traded options. Then, many employees are not free to sell their options on the open market, even if there is a market. After all, what employer wants to have an employee able to free himself or herself from the risks of an incentive scheme? In the same vein, the grant may pro-

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101. This proposition is true even if all available information is known. It glosses over the question of whether a non-grantee will be able to discover all the information that is available. Indeed, even though jurisdictions are increasingly imposing a duty to reveal on an asset holder, rather than an earlier approach which relied upon a duty to discover, this duty tends to be imposed in the context of divorce proceedings generically, rather than specifically in the context of child support claims. Of course, in the latter instance, the consequences flowing from non-disclosure may be less in as much as support obligations are modifiable. However, constraints on retroactive modification may mean that historical “losses” may not be able to be recaptured. One further wrinkle to the problem is provided by the fact that the employer may seek to obstruct the disclosure of information. See Schnabel v. Superior Court, 12 Cal. Rptr. 2d 63 (1992) (after balancing the interests in having the information against the employer’s privacy concern, the court orders an employer, in which a spouse had a 30% interest, to make extensive disclosure of financial information).

102. Thus, a jurisdiction may set up an operational preference for deferring the need to determine the value (at least for property division purposes) until the point when the value is actually liquidated. See, e.g., Md. Code Ann. Fam. Law. § 8-204(b)(1) (1999). In Kristy Watson, Note, Acting in the Best Interests of the Child: A Solution to the Problem of Characterizing Stock Options as Income, 69 FORDHAM L. REV. 1523 (2001), the author suggests imposing a constructive trust on a portion of the options for the benefit of the child as method of dealing with the often indeterminate benefit available from the options. The portion would be determined by the child support formula. Id. at 1564. However, the advantage of the proposal seems to be lost by requiring some sort of “value” for the options to be used in the formula in the first instance. Id. at 1564 n.335. Also, conceptually, this approach undermines a basic objective of child support which is to provide for the child’s current needs. The approach might be more helpful where the option proceeds are intended to cover some future use, such as education.

103. See Otley v. Otley, 810 A.2d 1, 10-11 (Md. Ct. Spec. App. 2002) (holding that while the “comparable market” approach is available in some instances, the fact that options usually are not divisible or transferable makes the “if, as, and when” approach desirable). See also Mackinley v. Messerschmidt, 814 A.2d 680, 683 n.2 (Pa. Super. Ct. 2002) (where the court accepted the possibility of using the “comparable market” approach, but appears to have overlooked the fact that the conditions attached to options aimed at compensating a grantee usually are not reflected in publicly traded warrants).
hibit the employee from locking in the value of a grant by adopting some hedging strategy, which in any event may be technically impossible to do because of tax or expense considerations. Then, there is the realm of closely-held corporations where the concept of a market value is generally an artificial construct which may have little relationship to reality, at least as it relates to an obligor’s ability to pay child support. In general, both with closely-held corporations and publicly traded entities, the grantee is likely to be holding an option package which is aggressively hemmed in by conditions precedent and subsequent, and where even if the options can be exercised, the holders ability to realize value may be constrained by a restricted ability to alienate the stock resulting from the exercise.

It is against this background that we turn to the context where the law seeks to identify income flowing from option schemes prior to the scheme being cashed out. This process involves assigning a “value” to the option.

There are a multitude of methods available for valuing options. Prior to 1973 the predominant method for determining the value of an option was to use a so-called empirical approach which involved attempting to obtain the value by means of a regression analysis from known data. While this method still has some following, at least in certain circumstances, since the emergence in 1973 of the Black-Scholes technique for valuing options, the predominant emphasis has been on what are usually described as theoretical techniques for calculating option values. Many of the techniques trace their roots in some respect or other to the Black-Scholes method, but then usually in-

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104. In Mackinley, 814 A.2d at 683 n.2, the court acknowledged that in the absence of a comparable market experts would be required to value the option which the court, somewhat naively, remarked would be a “simple task.”

105. As appears to be the case in In re Marriage of Palin, No. B148259, 2002 Cal. App. Unpub. LEXIS 4318, *5-6 (Cal. Ct. App. Jan. 31, 2002). This case highlights the need for care with the terminology in a particular context. Here “exercisability” was the point at which the underlying stock could be purchased, “vesting” the point at which the stock could be received. Since “exercisable” stock could still be forfeited if not “vested,” presumably, in most instances, rational employees did nothing until the grant “vested.” Even then, if “vested” stock were not “exercised” within three months of termination of employment they would be lost. Id. at *6.


107. For a collection of material on the formula and its applications, see The Financial Derivatives Reader (Robert W. Kolb ed., 1992). For descriptions, which may be more manageable, see William A. Raabe, Gerald E. Whittenburg, and Martha Doran, Using the Black-Scholes Option Model in Tax Valuation, 2002 TNT 228-27 (November 26, 2002) and Damian Laurey, Untangling the Stock Option Cost Sharing Loophole, 55 Tax Law. 761, 772-75 (2002).
volve some embellishment or restructuring of the analysis in order to deal with problems that the basic Black-Scholes technique has difficulty with.  

108 Divorce courts have been offered various valuation models over the last decade and a half or so, but, by and large, there are only three techniques that seem to have made it out of the legal starting-gate, and only one of these, in the absence of agreement between the parties, appears, in the reported decisions, to make it to the finish line.

The three methods that the court has been willing to discuss in the context of property division determinations are the Black-Scholes method, the Binomial method, and using the Intrinsic Value of the option. The Black-Scholes method attempts to value the options as such, independently of the value of the underlying stock. The method conceptually involves an effort to determine what it would cost to hedge against anticipated oscillations in the future price of the underlying stock during the period the option remains open. To do this, the technique relies on using the historical volatility of the shares.  

109 Accordingly, the method breaks down when there is no or little evidence of historical volatility, such as in closely-held corporations, or in corporations which, while publicly traded, are not traded widely. Even in widely traded corporations, the model can run into trouble where other factors can cause historical trading patterns to be unreliable. This can occur with events like restructuring, acquisitions, or major product line changes.  

110 Indeed, the basic Black-Scholes model even has to be modified to handle dividend payments.  

111 Although the Black-Scholes model is widely used to value publicly traded options and is a permissible valuation device in many circumstances for both

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109. In certain circumstances, namely where the option price is known, it may be possible to determine an “implied volatility”. This can be obtained by performing a reverse calculation using the option formula to determine what volatility factor must have been used to reach the specified price. See Lawrence G. McMillan, Options as a Strategic Investment 411-12 (1986); Kimberly D. Krawiec, More Than Just “New Financial Bingo”: A Risk-Based Approach to Understanding Derivatives, 23 J. Corp. L. 1, 19-20 (1997). But, if no market price is available, the investor has to rely on historical volatility information, if that is available, no matter how inapplicable or unreliable it may be in the current circumstances, or the investor has to estimate an “implied” volatility based on whatever information or views the investor may have about future events.


accounting\textsuperscript{112} and taxation purposes\textsuperscript{113} it has not found favor with divorce courts. While the basic model is relatively easy to work with, the underlying theory and mathematics would be intimidating to most people – the judiciary included.

One of the difficulties with the Black-Scholes model is that for a variety of reasons it does not perform well for the extended periods, perhaps as long as a decade, that options created for compensation purposes remain open. A valuation model that does better over longer periods, and also offers somewhat more flexibility in dealing with non-standard patterns of market behavior, is the Binomial method of valuation. In principle, this method involves the technique of breaking down the period the option is to remain open into a series of discrete intervals and then working out what it would cost to hedge anticipated share price oscillations within each of those intervals.\textsuperscript{114} Again, the method depends on the availability of relevant information about historical volatility. This method currently is acceptable to the accounting profession, but again has not found favor with divorce courts. Perhaps, here too, the theoretical and mathematical underpinnings have proved overwhelming.

One method of valuing options that has found judicial favor for the purposes of property division on divorce is the so-called Intrinsic Value method.\textsuperscript{115} Here, the value that is assigned to the options is the difference between the exercise price of the options and the current market value of the underlying corporate stock.\textsuperscript{116} With this method, concerns about mathematics and theory magically disappear and are reduced to simple concerns with arithmetic. But, despite its simplicity, the technique displays some major warts. First, the date picked

\textsuperscript{112} Currently, the Financial Accounting Standards Board allows corporations the choice of reporting compensation options as an expense or just disclosing the option value in a footnote. For the latter purpose, a valuation method is acceptable if it takes into account the stock price at the date of the grant, the exercise price, the expected life of the option, the volatility of the underlying stock, expected dividends and risk free interest rates over the life of the option. Both variants of the Black-Scholes formula and the Binomial method will meet these requirements. \textit{See Fin. Accounting Standards Bd., Statement of Financial Accounting Standards No. 123: Accounting for Stock-Based Compensation} 4-7, §§ 11-22 (1995).

\textsuperscript{113} Raabe, Whittenburg, & Doran, supra note 107.


\textsuperscript{115} \textit{See, e.g.}, Davidson v. Davidson, 254 Neb. 656, 668-69, 578 N.W.2d 848, 858 (1998).

\textsuperscript{116} \textit{See Mackinley v. Messerschmidt}, 814 A.2d 680, 683 n.2 (Pa. Super. Ct. 2002) (court imputing the intrinsic value of the option to the holder as “income” for the purpose of calculating child support). The dissent in this case highlights one of the difficulties with the intrinsic value method, namely, that the court has to pick a specific date for valuing the underlying stock which could produce results based on “the daily vagaries of the stock market.” \textit{Id.} at 685.
for determining the underlying stock price becomes critical and the result can be totally arbitrary in a volatile market.117 Second, the technique fails to take into account the fact that the essence of an option is an entitlement to acquire stock at some time within the period that the option remains open. This is a valuable right, more valuable the further off the expiry date of the option is, and that value is not reflected in the difference between the exercise price and the stock price.118 Finally, and this criticism can be applied to all three methods of valuation just outlined, there is no guarantee that the option holder can extract the assigned value.

An option holder actually will be able to extract the value assigned to an option by the Intrinsic Value method, if, first, the option is free to be exercised and second, the resulting stock actually can be sold at the assigned market price, transaction costs aside. Accordingly, if the options are not vested, in the sense of not exercisable, the Intrinsic Value assigned is artificial.119 In practice the same result may follow if the option holder lacks the resources to pay the exercise price.120


118. For one thing, the grantee does not have capital tied up during this period — beyond the purchase price (in cash or labor) of the option itself. Also, the holder has a limited downside risk if the stock price falls below the option exercise price. See David M. Schizer, Executives and Hedging: The Fragile Legal Foundation of Incentive Compatibility, 100 COLUM. L. REV. 440, 448-49 (2000).


120. There are substantial issues of liquidity involved. Not only is there the question of the exercise price itself, but with the exception of so-called Incentive Stock Options (as they are understood by Internal Revenue Code section 422), the fact of exercise itself triggers a tax liability of the option holder on the difference between the exercise price and the market value of the underlying stock. This tax is on ordinary income basis. When the underlying stock is finally sold there is a further tax liability on the difference between the market value of the stock at the time of exercise and the market value at the time of sale. This latter transaction can be accorded capital gains treatment. Accordingly, in principle, in the first instance, the grantee has to come up with the exercise price of the stock and the tax arising from the exercise. Historically, a favored technique was for the employer to provide the employee a bridge loan to cover the period from the time of exercise until the underlying stock could be sold. See, e.g., Franco v. Franco, 81 S.W.3d 319, 326 (Tex. App. 2002). The stock would then be sold and the proceeds used to cover both the exercise price and the tax liability. However, at least with respect to certain employers and certain employees, such loans are now prohibited by the Sarbanes-Oxley Act. See Rosettenstein, supra note 53. Also, with greater concern about the propriety of decoupling employees from the risk associated with incentive compensation packages, corporate employers are increasingly reluctant to allow the sale of the stock obtained on the exercise of the option. Id. These sorts of considerations may make it difficult for the employee to either liquidate the holding or even to use the holding as collateral in order to secure a
The Intrinsic Value also may be artificial even if the option can be exercised, if the resulting stock cannot be sold, because of employer, SEC, or stock market restrictions on alienation. Alienation restrictions are particularly problematic because such limitations seem increasingly likely to occur in the present market climate.\textsuperscript{121}

With the Black-Scholes and Binomial methods the same problem of value extraction arises, but for a different reason. With these methods the assigned value is the value of the option itself. Importantly too, these techniques do not automatically supply a figure for the ultimate benefit that will enure to the option holder. Accordingly, we need to refine our conceptual analysis. Presumably, technically, the employees compensation is the value of the option itself. And if the option itself could be disposed of it may be appropriate to designate this amount as the employee’s “income”. However, not infrequently, the ultimate benefit to the employee is from exercising the option and selling the underlying stock. These would be the resources to look to in order to meet the child support obligation imposed by virtue of the “income” from the option. So, if disposing of the option itself is not a possibility, using the “intrinsic value” notionally may be an appropriate measure of “income” even if it is not theoretically really the income received by the employee which, as was just indicated, conceptually is the value of the option itself. Also, comfortably, the enhancement in value reflected in the Intrinsic Value method is a benefit the holder derives by way of compensation and so is in a sense “income.” In any event, to extract the value assigned by the Black-Scholes and Binomial methods, the holder has to be able to alienate the option itself which requires both the right to alienate and an available market at the assigned value. As was indicated, options received by way of compensation routinely are not transferable, and even if they were, ordinarily they would be encumbered with conditions that would not match their public market analogs, even if the latter were trading at a Black-Scholes formula based price.

In summary, the techniques which divorce courts are willing to contemplate for the purposes of property division may be capable of generating a value for an option grant, but there is a high likelihood that the generated value does not represent actual extractable cash. This difficulty can lead to two kinds of problems when it comes to fixing child support orders. First, if we assume for the moment that the

\textsuperscript{121} See Rossettenstein, supra note 53.
“value” of the option is to be treated as “income” for the purposes of fixing the child support order, there is a real possibility that the obligor will be treated as having an “income” where that “income” is an artificial construct. Indeed, if the options aren't vested, or if vested they cannot be traded, or if vested and even exercised, if the resulting stock cannot be sold, then the obligor will be treated as having income when in fact he or she does not have any income at all. Second, there is a real risk that a court might be comfortable with the notion that it can fix a child support order based on these formulae derived values, because the obligor has other liquid resources with which to meet any resulting child support order. The court may assume that in due course the conditions attached to the options will be discharged and the assigned value realized. Of course, this may be far from reality. With all this analysis behind us we now will take a look at what the courts in fact have done.

IV. THE CASES

A. Introduction

Because of federal mandates every state has in place some form of guideline structure for the determination of child support.\textsuperscript{122} Although notionally this structure exists in an area involving the trial court’s discretion, it has been recognized that in reality one is dealing with a highly regulated area of law where very often the discretion that is permitted the court is one that flows from statute or regulation.\textsuperscript{123} Generally, the calculation of child support requires the injection of data into a predetermined formula which generates a presumptively appropriate award.\textsuperscript{124} Often, states permit a departure from the guidelines in a variety of circumstances which may be more or less closely circumscribed by statute or regulation. That said, however, very few state statutes or regulations deal directly with stock options in the process of determining child support. Accordingly, state courts have to confront issues of whether it is appropriate to consider options at all, and, if so, how options should be taken into account. In particular, once the decision has been made that options are relevant to the determination of child support, the courts have to wrestle with the issue of how to determine the amount of income that

\textsuperscript{122} 42 U.S.C. § 667(a) (2003).


\textsuperscript{124} These calculations processes have not been met with universal judicial approval. One California court described that state's formula as involving a system which "is a kind of hybrid of quantum physics and Zen philosophy." \textit{In re Marriage of Schulze}, 70 Cal. Rptr. 2d 488, 492 n.2 (Cal. Ct. App. 1997).
can be used in the formula, whether there is a distinction between looking towards options as a source of income and looking to the options as a resource out of which any otherwise determined support obligation can be met, and whether the essentially unique characteristics of options in themselves justify departing from a presumptively valid formula determination. These themes and others will be visited in due course.

B. Interests to be Advanced

The cases recognize that the decision on whether to include options in any analysis for the purposes of child support is influenced by a broad sweep of policy considerations. First, the argument goes, options should be includable in income because otherwise we run the risk that the employee will chose to be compensated with options. This would defeat the goal of minimizing the economic consequences of divorce for children and specifically potentially deprive the child of a standard of living equal to that of the petitioner's subsequent family. Then, an option holder should not have the ability to prevent his children from having the benefit of possibly the most important element of his yearly compensation. Moreover, shielding income from the courts and depriving children of the standard of living they otherwise would have enjoyed would be contrary to the purpose of child support statues which is advancing the child's best interests. Further, the other parent and the child should not be burdened as a result of individual choices to invest for the future in lieu of a current benefit, presumably even if that choice is otherwise legitimate. On the other hand, requiring a court to evaluate the legitimacy of investment decisions may be burdensome. Finally, the entire analysis requires the court to deal with a financial instrument that does not lend itself to rote application of general principles. Accordingly, the litigation process can become complex, protracted and inefficient.

C. Options As “Income”

It is quite possible, of course, that in certain contexts the litigants might have an opportunity to provide their own definition of “income.” Thus, a divorce agreement might itself provide for future

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128. Clark, 779 A.2d at 47. The dissent's view was that the burden was no greater than that required to impute income to the unemployed or underemployed which was something the court already did. Id. at 57 (Johnson J., dissenting).
129. See Frazier v. Frazier, 72 S.W.3d 333, 334 (Tenn. Ct. App. 2001) (addressing a marriage settlement that excluded income from the realization of stock options for the purposes of calculating future increases in child support). Parties implic-
contributions or modifications based on the parties’ respective “incomes.” In the event of the parties failing to provide their own definition, the court will have to come up with a construction of its own, which might include determining whether or not to take into account the proceeds of stock options. One obvious fallback position for the court is to adopt the state’s guideline definition of income, since doing so immediately would enable the court to evaluate the substance of the parties agreement against the mandates of the guidelines.

Not infrequently, state definitions of “income” for the purposes of determining child support adopt a broad brush approach along the lines of “income means “income from whatever source”. After unhelpful circular definitions of this type, the statutes, or regulations, then proceed to a set of representative examples which usually are indicated as not being exhaustive. This leaves the courts to make individualized determinations as to whether a particular form of benefit, resource, or advantage, can be taken into account. Thus, the court

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131. In an inter-state context it is possible that the result may be determined by the prior application of the law of another state. See Frazier, 72 S.W.3d at 335-38 (using the doctrine of res judicata to cap a previously litigated Illinois order capping child support obligation at $50,000 per year and excluding proceeds from the realization of stock options from the formula to be used in calculating child support).

132. As was done in Tariff v. Tariff, No. 233425, 1996 Conn. Super. LEXIS 3265, at *6 (Conn. Super. Ct. March 29, 1996). However the court adjusted the guideline's definition of "income" to take account of alimony paid and received because the concept of "income" was to be used to determine the parties' obligation towards the "extreme expense of college". Id. The court excluded from the income calculation stock options held by one of the parties because they were "not a source of present disposable income". Id., at *7. It is not clear whether this means that they were not vested, that they had not been exercised, that the underlying stock was subject to restrictions, or that they were simply "under water".

133. See, e.g., CAL. FAM. CODE § 4058(a) (West 2004).

134. Thus, California courts have made the determination that predictable overtime and bonuses are relevant, as is the value of rent-free housing, the availability of a company car and a parent-employer’s rent subsidy, lottery winnings and an inheritance. But these courts excluded gifts and student loans. See Cheriton v. Cheriton (In re Marriage of Cheriton), 111 Cal. Rptr. 755, 766-76 (Cal. Ct. App. 2001). A Delaware court saw options as analogous to a bonus which was specifically mentioned in the statute and thus covered by the general statutory phrase, “any form of payment made by the obligor’s employer.” See Kenton v. Kenton, 571 A.2d 778, 782-83 (Del. 1990). An Arizona court held that stock options consti-
might conclude that "this additional income is part of his overall employment compensation and must be used to calculate child support." Once over this hurdle, the court can encounter the nuanced distinction that although the employee may have been compensated by options, he or she is not currently receiving options and may not receive any in the future. This opens up further lines of analysis. First, to what extent should options awarded in the past, as distinct from post-divorce grants, be included in the child support determination. One of the major sources of difficulty in this regard arises, not, as one might anticipate, from options provided by the em-

135. Kerr v. Kerr (In re Marriage of Kerr), 91 Cal. Rptr. 2d 374, 380 (Cal. Ct. App. 1999). The full implications of this must be understood. On this analysis the mere fact that an individual holds options does not automatically mean that the individual is in possession of "income". Thus, one case drew the distinction between options which were part of a compensation package and options which the other spouse had received by way of a property division settlement, even though she had cashed out the options and they were treated as taxable income to her. See Cheriton, 111 Cal. Rptr. 2d at 769; see also Murray v. Murray, 716 N.E.2d 288, 294-95 (Ohio Ct. App. 1999) (electing not to take pre-divorce options into account for child support purposes because they were dealt with as marital property). However, this analysis should not be pushed too far. Options received by way of compensation, clearly are "income". This does not mean that options not received or held by way of compensation are not income. Indeed, the Court in Cheriton conducted a facts and circumstances analysis that was somewhat disingenuous in its efforts to preclude the options held and exercised by the wife from being included in her income for support determination purposes. Id. The problem that this court had arose, presumably, from the fact that options inherently travel with the potential for dual classification. That is, they can be classified as either income or assets, see Robinson, 35 P.3d at 93; Seither v. Seither, 779 So. 2d 331, 332-33 (Fla. Dist. Ct. App. 1999); Dolan, 786 A.2d at 823-24, and the court was trying to find a safe harbor in some circumstances, while precluding obligors from always having a safe harbor merely by virtue of holding options.

It is worthwhile remembering that the above analysis will be conducted in the context of some statutory umbrella. This means that what is good for the goose is not necessarily also good for the gander. Thus, while option receipts may be "income" for the purposes of child support they may not amount to "earnings" for the purposes of the Consumer Credit Protection Act, 15 U.S.C. § 1673 (2003). Thus, lump sum payments derived from the termination of an employee stock option plan may not be subject to the garnishment limits in the federal statute. See Colwell v. Jones, No. 14528, 1990 Ohio App. LEXIS 3189 (Ohio Ct. App. Aug. 1, 1990).

136. See Cheriton, 111 Cal. Rptr. 2d at 768.
137. See Kerr, 91 Cal. Rptr. 2d at 377.
ployer, but in connection with options distributed in the divorce by way of property division. The argument is made from time-to-time that such a distribution precludes "double-dipping" in the form of then using the options to establish a child support obligation. This argument certainly does have validity in the context of spousal support, where except in special circumstances, options left in one spouse's hands may not be treated as generating income for spousal support purposes. The analysis in the case of child support might, however, be somewhat different. The child never gets the "first dip." Accordingly, if one or both spouses end up with options the options should certainly be available as a resource from which an obligation could be met. However, ordinarily the options should not be used as a basis for determining the holder's "income" unless the value that was assigned to them in the property division phase is less than the value the options currently have (using the same valuation technique), in which case the additional value could be treated as income. However, "could" is not the same as "should." Thus, some jurisdictions have held that the extraction of value from the options at a later date represents no more than the conversion of an asset and thus should not be considered income, even if there has been appreciation in the value of the underlying asset since the divorce. The problem with this perspective is that it appears to fail to recognize that a former spouse will have received offsetting value at the time of the divorce, in particular, a value which presumably recognized that the options might appreciate. This should preclude him or her from asserting

139. See Hokin v. Hokin (In re Marriage of Hokin), 605 N.W.2d 219, 230 (Wis. Ct. App. 1999) (holding a share of pension funds distributed to a claimant could be used to impute income to her because a considerably older husband at age seventy-four could be anticipated to retire relatively soon, so court was doing what would likely have happened in the ordinary course of events, absent divorce).
140. See, e.g., Hamlin v. Hamlin (In re Marriage of Hamlin), No. CO-93-676, 1993 Minn. App. LEXIS 1113, at *4 (Minn. Ct. App. Nov. 16, 1993) (finding that the statute authorized maintenance payment from "future income or earnings," stock options divided in a property settlement were not available to support a maintenance obligation).
141. The analysis may be further complicated by the fact that after receiving options by way of property division pursuant to the divorce the recipient then has her alimony award terminated. See Hansel v. Hansel, 2000-1914 (La. App. 4 Cir. 11/21/01), 802 So.2d 875, 882.
144. Williams v. Williams, 485 S.E.2d 772, 775 (Ga. 1997).
that the appreciation was income for the purpose of alleging a change in circumstances that justifies modifying an alimony award. But, this logic does not extend to child support, because, as was just suggested, the child never got the underlying offsetting value in the first place. Care should be taken. A perspective which allows the exercise of an option to be viewed as generating "income" may go too far, if it allows the total net proceeds to be included as income in the support calculation, rather than what seems to be the more equitable approach of limiting "income" to the net realized appreciation since the divorce. This perspective would be undermined by acknowledging that a role of child support goes beyond mere support of the child but also is aimed at benefitting the residential parent, in which case that parent's foreclosure on a modification of alimony should also, at least to some extent, extend to child support.

Notice that if an analysis like that just outlined is not employed, it becomes very difficult to maintain a distinction that options granted before the divorce are ineligible for calculating child support, while those granted after the divorce can be treated as "income" for award purposes. This is particularly true if an intrinsic valuation method is used to determine income. But not all courts need despair.

A jurisdiction with an appropriate jurisprudential foundation might be able to duck any option appreciation issue using a technique employed in a case involving support obligations to an out-of-wedlock child. The court held that, while the exercise of the options might constitute a change in circumstances, since the existence of the obligations was discussed at the original child support hearings, the change in circumstances was a change contemplated at the time of the original order and this could preclude modification of the order under the jurisdiction's rules.

145. See Ayyad v. Rashid (In re Marriage of Ayyad), 38 P.3d 1033, 1037 (Wash. Ct. App. 2002). This case gives the claimant two bites at the apple. The proceeds of exercised options are to be considered income, but unexercised, query unvested, options can be included in a determination of the obligor's wealth which itself may then justify a deviation from the guidelines. Id. At the trial court level the court had concluded that since the proceeds from exercising the options merely had been shifted to other investments and had not contributed to a substantial increase in the obligor's standard of living, the exercise of the options should not be included in the income calculation. Id.

146. Yost v. Unanue, 671 N.E.2d 1374 (Ohio Ct. App. 1996). This approach appears to be required by Ohio statute. See Ohio Rev. Code Ann. § 3113.215(b)(4) (2003); Maio v. Maio, No. 2000-L-073, 2001 Ohio App. LEXIS 3927, *7 (Ohio Ct. App. Aug. 31, 2001). The argument, of course, cannot be made in a jurisdiction where the standard for modification of existing orders is something other than a change in circumstances. See Stacey v. Stacey, No. 02A01-9802-CV-00050, 1999 Tenn. App. LEXIS 668, at *5 (using the standard of whether there is a significant variance between what the guidelines would require and the amount previously ordered if this variance is not due to a court ordered deviation unless that deviation is no longer justified). In some jurisdictions a claimant may end up in a procedu-
Within the context of deciding whether options should be considered part of an obligor's income, courts have had to consider whether the fact that options are not awarded on a consistent basis,147 but only sporadically148 and, perhaps unpredictably, means that options as a resource class should not be considered in the calculation of the support obligation.149 Some courts have seen an analogy with bonuses and overtime, which can be taken into account for child support purposes. In this endeavor they may be aided by statutory provisions which enable the court to adjust the award if the guideline-produced figure does not match the actual or prospective income of the parties or where it is necessary to do so to accommodate fluctuating income.150 While such provisions superficially are helpful, in and of themselves they give no insight into whether this adjustment can be made prospectively. Although, presumably this was contemplated. But, if so, how is this adjustment to be made? Moreover, even if the

147. In contrast to the situation in Murray v. Murray, 716 N.E.2d 288, 293, 295 (Ohio Ct. App. 1999), where the evidence was that the options were awarded annually and constituted “recurring, sustainable compensation” which the obligor could expect to receive so long as the obligor continued to work in his position.


149. Thus, Ohio specifically excluded from its guideline calculations any “nonrecurring or unsustainable income or cash flow item”, which in turn was defined to be income which the parent receives for any period not to exceed three years which the parent does not expect to continue to receive on a regular basis. Interestingly, the concept also provided that the receipt would be included in income if it could be invested or utilized to produce income for a period of more than three years. OHIO REV. CODE ANN. § 3113.215(A)(11) (2003). See Murray, 716 N.E.2d at 292.

150. See Cheriton v. Cheriton (In re Marriage of Cheriton), 111 Cal. Rptr. 755, 768 (Cal. Ct. App. 2001) (citing CAL. FAM. CODE §§ 4060, 4064 (West 2004)). The court in this case, somewhat unhelpfully, slid past the fact that it relied on an authority dealing with predictable overtime and bonuses. Id. Some option awards would probably be capable of being classified as predictable, but others would not.
provisions allow adjustment with hindsight, how are the risks of a non-modifiable accumulated arrearage to be accommodated?  

Assuming one is willing to consider options as "income" for the purposes of determining the amount of support due under the state's guidelines, the character of option grants tend to throw up another analytical roadblock. In principle, the determination of whether an individual has relevant "income" is a time-specific issue. An obligor may have had income in the past, may currently be in receipt of income or may be expecting income in the future. All of these may be relevant to our concerns, but our analysis and understanding has to be premised on the foundation that income involves the concept of time specific receipts. As we saw, options give the employee the right to acquire stock at some point in the future by exercising the option. Suppose the options are freely exercisable at the moment of grant. Is this when the grantee receives "income"? If that is the case, then, since options conventionally are granted at the current market price of the underlying stock, there will be no net "income" to the grantee. Does such an approach then inoculate the grantee from future obligations once the options are in fact exercised? This seems to be an undesirable position to take, yet its logical consequence does exist. Courts do take the position that the employee will be treated as having income when the grantee has exercisable options which he or she declines to exercise.  

The argument is that the employee is now making an investment choice which the grantee should not be free to do to the detriment of his or her child support obligations. In essence, the argument is that when the grantee exercises the option the

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151. Indeed, a Court of Appeal in California has held that since modification is predicated on a demonstration of a change in circumstances courts are not able to anticipate what might happen and provide for future contingencies. See Cheriton, 111 Cal. Rptr. 2d at 776-77 (rejecting a trial court scheme for a computerized adjustment of child support based on an annual exchange of tax returns). But see Kenton v. Kenton, 571 A.2d 778, 781 (Del. 1990) (finding a prospective mechanism for recalculation acceptable). This type of situation only enhances the risk that a non-modifiable arrearage will be accumulated. On the other hand it might be possible for the parties by agreement, or the court by order, to describe a mechanism for recalculation of the award in the light of changed circumstances where the arrangement would not be construed as a retroactive modification. See Kenton, 571 A.2d at 781.  


153. Robinson v. Thiel (In re Marriage of Robinson), 35 P.3d 89, 94 (Ariz. Ct. App. 2001); Murray, 716 N.E.2d at 294-95. This issue may not be as straightforward as might appear. What approach should the court adopt if certain classes of investment trigger an employer "match"? See Robinson v. Robinson, Nos. 16613, 16614, 1998 Ohio App. LEXIS 2065, at *19 (Ohio Ct. App. May 8, 1998) (addressing a claim that pay reduction in the form of contributions to a 401(K) plan was justified because of employer match). Should the court, at least constructively, require the employee to turn his or her back on this match in order to provide immediate "income" for child support calculation purposes?
grantee acquires underlying stock at, presumably, a discounted price and this is the moment when the employee realizes income.\textsuperscript{154} However, in truth, at this moment no funds flow in. In the instance where the employee even fails to exercise the option, since we are dealing with the issue of whether to impute income, the fact that the employee fails to get income because the options aren't exercised, never mind the resulting stock sold, just adds another layer of fiction. The reality is that the process attributes the income that would be received if the option were both exercised and the stock sold.\textsuperscript{155} Thus, at least this

\textsuperscript{154} The judicial analysis is sometimes complicated by a failure to distinguish “income” as the concept is understood for child support purposes, and “income” as it is understood under tax law. Under federal tax law, unless we are dealing with a so-called Incentive Stock Option (ISO), which is regulated by Internal Revenue Code (hereinafter “IRC”) § 422, the grantee first is treated as having taxable income when he or she exercises the option. IRC § 83(a) (2003). With an ISO the grantee only has a taxable event when the stock resulting from the exercise of the option is finally sold and this event is taxed on a capital gains basis. Under § 83(a) the exercise is treated as the receipt of compensation and is taxed on an ordinary income basis. Thus, other than in the case of an ISO, tax law allows an individual to be liable for tax even though the taxpayer is not in receipt of actual funds. In the case of an ISO there may be a marginal increase in tax burden without the receipt of proceeds if the exercise of the ISO triggers alternative minimum tax treatment under IRC § 56(b)(3). There does not seem to be a compelling necessity to axiomatically follow the tax rule in determining when there is income for child support purposes. See Kenton, 571 A.2d at 782 n.5. To do so could lead the grantee to be in a position of having to pay both taxes and child support without the automatic ability to generate the necessary funds. Obviously, this argument becomes less compelling if the grantee is in a position to sell the stock resulting from the exercise, subject of course to the understanding that this latter step may generate a capital gain liability. This leads to a further tax-related issue that needs to be recognized, namely the extent to which tax obligations reduce the “income” identifiable as flowing from the options. Technically this issue will hinge on how the state guidelines are constructed, but it is appropriate to recognize that the grantee ultimately only has post-tax resources available to meet his or her obligations. See Cheriton, 111 Cal. Rptr. 2d at 769 n.9.

As was just noted, tax laws may produce a tax liability on exercise even though no funds are generated. Accordingly, grantees who seek to have no “income” recognized for child support purposes until the internal Revenue Code recognizes “income” may be doing themselves a disservice. See Mackinley, 814 A.2d at 682 n.1. In this case the grantee argued that income for support purposes should be identified when the option was exercised on the basis that this was the point when the Code recognized income. Hopefully, in pursuing this position the grantee knew, at least in her case, that after exercise the underlying stock readily could be alienated. In any event the court rejected the plea because the court saw the underlying interests as those of the child, not those of tax policy, and following the tax code would have enabled the grantee to defer using the resources to determine her support obligations.

\textsuperscript{155} In Kenton, 571 A.2d at 783, the Delaware Supreme Court said that the fact that the exercise of options produced a non-cash asset was an equitable consideration which had to be taken into account in deciding whether there had been a rebuttal of the presumption that the mathematical result produced by application of the guideline formula should constitute the order. In particular, the court said that if
method should not be employed if the underlying stock cannot be sold even if the options can be exercised. Or, turning the analysis around, the better argument is that income only is realized when the underlying stock is sold, or at least could be sold? This is perhaps the moment to remember that option grant structures contain a variety of benchmarks not all of which are necessarily under the employee’s control. The options may not be able to be exercised for some period of time, or even when exercised, the resulting stock may not be able to be sold until some point in the future. It would seem inappropriate to saddle an obligor with a liability based upon something

the obligor had other resources from which adequate child support could be paid, the obligor should not be required to liquidate the stock for the purposes of paying even more support. Additionally, the court noted that a paper profit was generated as “income” for tax purposes when the options were exercised, but that “income” was to be excluded from the guideline formula. Id. In summary, the court actually seems to be setting up a structural preference to include in the guideline formula only “income” generated once the underlying stock is sold. That is, that income should not be imputed to the obligor simply for the purposes of enhancing otherwise adequate support. However, the court did note that the equitable balance could change as the child’s needs change through minority. Id.

156. As in Hayden v. Hayden, No.FA93-0113097, 1995 Conn. Super. LEXIS 1967, at *6 (Conn. Super Ct. June 8, 1995), where the exercise of the options produced restricted stock that could not be sold for two years. Indeed, the parties’ financial position worsened as a result of the exercise, at least for a period of time, because the employee spouse was compelled to exercise the options when his employment terminated, on pain of losing them. He had to borrow money to fund the exercise. The loan was from a relative and apparently did not carry an interest obligation. But if it had, would a child support obligation permit the exercise of the options if the effect of any loan interest was to reduce the revenue available for a child support obligation? Even if a net benefit was expected when the underlying stock could be sold, should the risk of a downturn in the stock price and the potential inability to pay the loan be permitted in the face of child support obligation? In any event, in most instances, the evil deed will already be done at the time the court faces the consequences, so that the issue will usually boil down to one of whether it is appropriate to impute income to the obligor.

157. See Cheriton, 111 Cal. Rptr. 2d at 769 (“At the very latest . . . income is realized when the underlying stock is sold for gain.”). It is not clear that courts fully understand the potential difficulties. Thus, in Mackinley, 814 A.2d at 683 n.2, the court said that an option holder “would have no difficulty in accomplishing the purchase and sale in a single transaction.” Even if that was true in the circumstances of that particular case it is not universally true, particularly at a point in time when stockholders are increasingly concerned to keep option grantees exposed to the same risks as investors. See Rosettenstein, supra note 53.

that he or she has not received\footnote{159} and the receipt of which he or she is no position to expedite.\footnote{160}

Seemingly, in some acknowledgment to the above discussion, there are courts which appear to take the position that there is no income for consideration until the options actually are exercised.\footnote{161} Then, there are courts which take the position that it “is not the role of the

\footnote{159. The lack of control may be illusory and courts are concerned not to allow the obligor to “hide behind the shield of corporate business decisions” where the effect of doing so is to prevent a child from enjoying the standard of living which the child would have enjoyed if the marriage had continued. See Murray, 716 N.E.2d at 293.}

\footnote{160. In New Hampshire, the position would seem to be that this sort of problem can be dealt with under the statutory authority to adjust awards dictated by the support guidelines where the application of the guidelines would result in a “confiscatory support order.” See In re Dolan, 786 A.2d 826, 824 (N.H. 2001). Interestingly, the New Hampshire court revisited this decision, in passing, in the course of its decision in In re Valence, 798 A.2d 35, 38 (N. H. 2002), where it took the position that for child support purposes “the gain recognized upon exercising the stock options is properly viewed as income” and is “properly included when calculating a parent’s child support obligation.” At a technical level this comment is confusing. No “gain” is realized when an option is “exercised.” The gain occurs when the underlying stock is sold. Was the court confused by the fact that there is taxable event when non-qualified options are exercised, and did it assume that this was a tax on a “gain”, although it is technically a tax on compensation and is taxed as ordinary income? Was the court thinking that the taxable amount should be treated as income, even if the option holder receives nothing at that moment in time? Perhaps the court is comfortable with the idea that because there is already one obligation to meet with no funds in hand, there is not problem with adding an additional burden. Of course the obligor may be in a position to immediately realize the “gain” by selling the underlying stock, but in this day and age that should not be treated as a certainty. But, perhaps the court’s language was just a little loose. It may be that it meant that the “gain” and the income became manifest when the underlying stock was sold or at least could be sold. The position is made even more obscure because the Supreme Court in Dolan appears to let stand the trial court’s approach of determining the obligor’s income; an approach which reduced the “value” of the exercised stock options by twenty percent to reflect the capital gains tax rate. Dolan, 786 A.2d at 822. If the option scheme involved Incentive Stock options, as recognized by I. R. C. § 422, the use of a capital gains rate is appropriate, but this type of option scheme is one which specifically requires minimum retention periods of the option and the resulting stock in order to get this rate, making it even less likely that the obligor would actually be in receipt of funds when the income was attributed to him or her. Some clarification from the New Hampshire Supreme Court would be helpful.}

\footnote{161. See In re Marriage of Campbell, 905 P.2d 19, 20 (Colo. Ct. App. 1995). This approach at a simplistic level also avoids problems with quantifying the income. It simply can be “limited to the difference between his purchase price of the optioned stock and the price at which he then sold [the stock.]” Id., at 21; see also Yost v. Unanue, 671 N.E.2d 1374 (Ohio Ct. App. 1996). Here, the court held that a child support obligation established after a paternity action would not have a claim to “income” with respect to options held by the obligor until such time as the value of underlying stock exceeded the exercise price of the options and the grantee sold the stock. Id. at 1376.}
judiciary to second guess personal investment decisions or to micro-manage investment portfolios; even while the court seeks to preserve a second bite at the apple by recognizing that there may be circumstances where it is appropriate to require a parent to reinvest or liquidate certain assets to provide for his or her children. The un-

162. A rather bizarre effort in this direction was attempted by the trial court in *Mackinley*, 814 A.2d at 681. This court chose not to include the mother’s vested but unexercised options in her “income”, but required the mother to exercise the options at some point “during the children’s minority.” *Id.* In the event that she did not do so, the father was authorized to petition the court for enforcement. Clearly, the prospects of the mother legitimately being held in contempt may be limited. The window might even be restricted to twenty four hours, or less, unless the term “children” is taken at face value.

163. Clark v. Clark, 779 A.2d 42, 46 (Vt. 2001). In this case, which did not deal with stock options, the father sought to impute income to the mother’s under-performing investments and to her decision to maintain inheritances in the trusts in which she had received them. The court felt that to have to carefully examine investments in each case would be overly burdensome. *Id.* at 47. The Vermont statute also did not authorize the court to impute income, except where the assets were “nonincome producing”, as distinct from poorly performing. VT. STAT. ANN. tit. 15 § 653 (5)(A)(I) (2003). The dissent saw this as providing parents with an opportunity to invest in growth assets while insulating the assets from being considered for child support purposes. *Id.* at 49. For our purposes, is an option “non-income producing” prior to vesting, or only after exercise, or after exercise and maturity, or after exercise and maturity and when it is under water, or after exercise and maturity and if it is above water and the grantee declines to sell the underlying stock? Or, can we take a broader view and say that an employee who receives stock options by way of compensation is using his labor on a non-income-producing basis? Or, if he receives other forms of compensation beyond the options, is his labor capacity merely performing poorly? Of course, with hindsight, we may know that the performance actually was good. The problem is that we are called upon to judge the performance of the grant based upon the deferral of an uncertain benefit. This is fundamentally an impossible task. Accordingly, using the degree of performance as a trigger for the imputation of income would seem to be undesirable. However, imputing income based on the value that could actually be extracted from the options where this isn’t being done seems less objectionable. Here the timing of the imputation of the income and the amount to be imputed can be derived directly from the grant itself. The Vermont scheme identifies a trigger, the failure to produce income, and then specifies an amount to be imputed where the nonperforming assets have a market value in excess of $10,000, namely the current rate of return on long-term treasury bills. VT. STAT. ANN. tit. 15 § 653 (5)(A)(I) (2003). This amount may not come close to reflecting the value in the option holdings, although it might be seen as a reasonable compromise between extracting some benefit, while leaving the grantee with the ability to perform a residual risk/reward calculation. Clark, 779 A.2d at 51, 54 (Johnson J., dissenting). Of course, this might suggest that even in the absence of statutory standard it is inappropriate to impute the “full” value in the option to the holder. In this case the dissent wished to adopt the ALI standards where there are underperforming assets and generate a presumption that imputed income to the obligor unless the obligor could demonstrate that the purpose of investing in the assets was to benefit the children. The level of imputation also would be according to the ALI proposals, namely, the prevailing rate of return for secure investments. *Id.* at 53-4. Finally, the dissent in Clark felt that the con-
willingness to consider portfolio strategies apparently can be applied in reverse. At least one court has refused to allow the obligor to assert that the exercise of his options and investing the proceeds in other investments while not substantially increasing his standard of living, was an attempt to diversify his portfolio such as would justify precluding consideration of the option proceeds as income.164

D. Value and “Income”

If an option is exercised and the resulting underlying stock sold the revenue extracted from the option is readily determinable. Accordingly, some courts defer the point in time for including options in the income calculation until these conditions have been satisfied.165 Whether or not it is appropriate to allocate the net benefit in its entirety to a given income year is a matter we shall return to. But, if the options are not exercised and the underlying stock sold, we still need to establish some value for the options that can be treated as income. In particular, this need becomes acute where the jurisdiction takes the position that income should be imputed to the option holder by virtue of the holder’s failure to realize benefits from options that are exercisable.166 The cases recognize a variety of methods for establishing the value. Interestingly, one of the earliest cases to tackle the issue took the view that as long as the market value of the underlying stock was below the option exercise price, the option had “no tangible value”.167 As the Black-Scholes valuation method recognizes, in terms of option theory itself this case’s position technically is incorrect due to the fact that the option embodies the right to exercise the option during the time the grant still remains open and during this time the stock price may rise above the exercise price. This potential has a value. But, unless the options themselves are publicly traded, the value may be difficult to ascertain, and it may suit the court’s interest in simplicity and economy to treat an “under water” option as having no value. The good news would be that the court has adopted an absolute standard,

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165. As was done in In re Marriage of Campbell, 905 P.2d 19, 20-21 (Colo. Ct. App. 1995). This approach also was attempted by the trial court in Robinson v. Thiel (In re Marriage of Robinson), 35 P.3d 89, 94 (Ariz. Ct. App. 2001). These efforts were overturned on appeal in favor of an imputed income approach.
166. See Robinson, 35 P.3d at 94.
the bad news is that the standard is wrong, at least as to the concept of the option’s “value.” However, if the issue is one of time specific “income” and the obligor holds exercisable but “under water” options, then to say that the option grantee has no income probably is correct.

Some courts decline to decide that any particular method of valuing options is appropriate. One court took the position that which method was appropriate would depend on factors like “the nature of the stock options, market conditions, tax consequences, ease of application, and other facts and circumstances peculiar to each case.”\textsuperscript{168} This hardly seems to be a standard which advances the goals of certainty, consistency, efficiency, and stability of the income determination process. After all, even if these factors are relevant to the method of valuing the options, there is no indication of their significance, relative or otherwise, in determining the method to be used, beyond giving the court that articulates a concern for these factors a shelter for the method it actually employs. Could it be that the generalizations are no more than an effort to avoid having to come to grips with the complex jurisprudence that necessarily is required to deal with options in the child support context? The issue gets left for another court at a later time. As with a butterfly straddle, the piper may have to be paid, just not now.

Other courts rely on a variety of other techniques to try to resolve the issue. First, there is the possibility of not identifying income until the options are liquidated.\textsuperscript{169} Or the intrinsic value is used, localizing the underlying stock price to the “most recent date on which an option could be exercised.”\textsuperscript{170} Or, one might use a “net present value method,” that is one of the empirical or theoretical methods such as the Black-Scholes technique described earlier.\textsuperscript{171} But, in this respect, no judicial consensus seems to have emerged, or even started to emerge, as to a preferred technique. Certainly, at least one court sought to “question the practicality of these models for determining a parent’s child support obligation.”\textsuperscript{172} This court went on to leave it up to a lower court to consider whether the use of the intrinsic valuation method might be appropriate, based on the “facts and circumstances.”\textsuperscript{173} This is not the most useful of appellate guidance.

Once the court has settled on the amount that is to be attributed to the option grant, it has to come to grips with the fact that, as we saw, this amount might be attributable to the grantee’s labors over a signif-

\textsuperscript{168} Robinson, 35 P.3d at 95.
\textsuperscript{169} As the trial court attempted to do in Robinson, 35 P.3d at 94.
\textsuperscript{170} As was the case in Murray v. Murray, 716 N.E.2d 288, 298 (Ohio Ct. App. 1999). For a criticism of this case, see Karns & Hunt, supra note 77, at 259-63.
\textsuperscript{171} Discussed, but rejected, in Robinson, 35 P.3d at 95.
\textsuperscript{172} Robinson, 35 P.3d at 95.
\textsuperscript{173} Id.
icant period of time, often longer than the time frame the guidelines require to be considered in determining the obligor’s income for use in the guideline formula. This issue will be dealt with next.

E. Annualizing the “Income”

A feature of options is that after a number of years of holding the grant, the grantee is in a position to cash out the options and generate funds at one particular moment in time. The question then arises as to whether it is “appropriate to allocate some of those proceeds to other periods besides the year of receipt,"\(^{174}\) or to put it another way, do we need to “annualize” the income?\(^{175}\) Of course, we could ignore this issue entirely, as has been done.\(^{176}\) Or, the jurisdiction might conclude, after due consideration, that an approach based on some sort of averaging is inappropriate.\(^{177}\)

If it is appropriate to annualize, how should we go about doing so? To start with, the parties might agree to annualizing.\(^{178}\) If so, care should also be taken to stipulate the technique to be employed. In the absence of such a stipulation, the trial court would have a number of possible approaches available to it.\(^{179}\) Thus, the court could look backward and spread the earnings over the entire period of employment, or over the time between vesting and exercise or over the time between grant and vesting.\(^{180}\) Or the court could look forward,

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\(^{175}\) See *Robinson*, 35 P.3d at 95 (where Arizona’s statute required that “fluctuating” income had to be annualized and that this would cover option-derived income).

\(^{176}\) As apparently was done by the court in *Mackinley v. Messerschmidt*, 814 A.2d 680, 683 n.2 (Pa. Super. Ct. 2002). The court was willing to impute the entire income resulting from the notional exercise of options and sale of the resulting stock, even though the options had taken a period of time to vest.

\(^{177}\) As has New Hampshire. See *In re Feddersen*, 816 A.2d 1033, 1037-38 (N.H. 2003).


\(^{179}\) In some cases it is not possible from the reports to determine on what theory the trial court acted. Thus, in *Coleman v. Coleman*, Nos. 229976 & 230995, 2002 Mich. App. LEXIS 1720, at *3 (Mich. Ct. App. Nov. 19, 2002), the trial court spread the income generated by exercising the options and selling the underlying stock over a two year period. Why this time frame was picked is not clear. The situation is made even more confusing because the grantee “usually” was awarded options each year, but it is not clear from the report whether the options exercised were received in any given year, over a period of two years, or over a longer period of employment.

\(^{180}\) See *Maciejewski*, No. D037304, 2002 Cal. App. Unpub. LEXIS 3478, *21 (Cal. Ct. App. February 28, 2002). Another possibility not mentioned specifically by the court would be the time between the grant and exercise. In this case, the selection of the time period as being the entire period of employment was held not to be an abuse of discretion. Additionally, the court took the view that even if the parties had not agreed to the annualizing of the income, the trial court would
and spread the income over the period between the petition for support and the child attaining majority.\textsuperscript{181}

An Arizona Court of Appeal took the position that a trial court would have a discretion to adopt whatever technique "works best under the facts and circumstances of each case",\textsuperscript{182} thus postponing indefinitely a resolution of the underlying issue, and thus, continuing the metaphor in the title, allowing the butterfly to flutter once more. However, the court did find it acceptable for the trial court to make a prospective order requiring the option holder to turn over a predetermined percentage of the actual or presumably imputed income attributable to the options.\textsuperscript{183} No indication was given as to how that percentage was to be determined and the clear acceptability of the technique was further undermined by requiring that the percentage not yield a result that was beyond the needs of the child as determined by the parents' abilities and standard of living.\textsuperscript{184} Other courts have

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\textsuperscript{183} This approach was accepted in Yost v. Unanue, 671 N.E.2d 1374, 1377-78 (Ohio Ct. App. 1996). The courts see the advantage of a percentage-based award as being one of judicial economy. Potentially limitless future hearings otherwise would involve detailed analysis of issues such as income, expenses, investment successes and failures, tax considerations and issues of fairness. See Kerr v. Kerr (In re Marriage of Kerr), 91 Cal. Rptr. 2d 374, 379 (Cal. Ct. App. 1999).

\textsuperscript{184} See Robinson v. Thiel, 35 P.3d 89, 96 (Ariz. Ct. App. 2001). This court followed the approach of the court in Kerr, 91 Cal. Rptr. 2d at 380-81. In this case the underlying stock had appreciated twentyfold and the enormous appreciation in
objected to the use of a percentage based award structure since it effectively allows the obligor to manipulate his or her own support obligation which has the potential to lead to conflict and litigation. Additionally, a definite amount enables the obligor to plan and readily enables the court to determine whether the obligor is in compliance.\textsuperscript{185}

An Ohio appellate court devised a method for dealing with the problems just described. The trial court adopted a technique which valued the price of the underlying stock on a particular date, subtracted from this the exercise price of the option, and divided the result by the number of months that the option had been open and multiplied the result by twelve to produce an average annual deferred income.\textsuperscript{186} This was the jurisdiction's approach for dealing with over-time and bonuses. The appellate court objected to the fact that the method had no standard technique for determining the date on which the underlying stock was to be valued. This hiatus undermined the value of the underlying stock led a percentage based order to generate a child support award that apparently was beyond the child's requirements in terms of maintaining the child's standard of living. But care is in order. In California, if the non-residential parent's standard of living improves after the marriage, the child is entitled to participate in that improvement, see id. at 377 (citing In re Marriage of Catalano, 251 Cal. Rptr. 370 (1988) and so needs would be assessed on that basis rather than on a pre-divorce standard of living. Indeed, In re Marriage of Palin, No. B146259, 2002 Cal. App. Unpub. LEXIS 4318, at *35 (Cal. Ct. App., Jan. 31, 2002), accepted the Kerr position as being that a minor child has the right to be maintained in a lifestyle consistent with the parent's position in society after the dissolution of the marriage. Presumably, the spill-over effect of the enhanced order to the benefit of the residential parent is unavoidable, unless the enhancement can directed to a uniquely child specific advantage such as current education or a trust for future use, such as higher education. In any event, one California court pointed out that great disparities in living standards between the parents will be noticed by the children who will discern any resulting unfairness. See Ostler v. Ostler (In re Marriage of Ostler), 272 Cal. Rptr. 560, 573 (Cal. Ct. App. 1990). This sort of analysis suggests that the proposition that the child should enjoy the lifestyle he would have had if the parents had not separated should not be taken too literally. See Williams v. Williams, 485 S.E.2d 772, 775 (Ga. 1997); Hansel v. Hansel, 2000-1914 (La. App. 4 Cir. 11/21/01). It may be comforting for obligors to note that at least one court seems to have accepted that the child is not entitled to a lifestyle more lavish than its parents. See Ayyad v. Rashid, 38 P.3d 1033, 1037 (Wash. Ct. App. 2002). And at least one court acknowledged the "spill-over" effect directly. Setting the child support above the maximum specifically provided for in the guidelines, but permitted as an exercise of discretion by the trial court, was justified, in part, because the increase was offset by a lowering of spousal maintenance, albeit, not in the amount of the increase. Nolan v. Nolan, No. 42247-2-I, 1999 Wash App. LEXIS 1524, at *16-17 (Wash. Ct. App. Aug. 23, 1999).


goal of using the most accurate and equitable method of valuation possible. The appellate court then went on to reject standard financial models for valuing options, even though used in the marketplace, because they are “designed to reflect market forces under certain conditions and may not be reliable for purposes of litigation.” Instead, the court decided that the most important dates as far as the grantee is concerned would be the grant date and the date that the option first became exercisable. Accordingly, the income that would be attributed to the option holder would be the appreciation in value of the underlying stock between the grant date and the exercise date, or, if the option had not been granted in the year immediately preceding the determination, then the “income” would be the appreciation in the underlying stock between the anniversary of the grant date in the preceding year and the anniversary of the exercise date in the year for which the support obligation was being determined. All this analysis was to occur with respect to options which were exercisable, because the premise of the method of imputing the income was that the grantee had made an investment choice not to exercise the option. In contrast, a Tennessee court felt that the income to be included in the guideline formula could be obtained by the simple technique of averaging the gross income received from options in prior years. Indeed, another Tennessee court specifically concluded that it would be inappropriate to average the option generated income over the standard period employed in the averaging of bonuses and commissions for support purposes. Instead, it thought that it might be equitable to average the income over the entire period that options were being accumulated, or to “prorate [the income] in some way.”


188. Murray, 716 N.E.2d at 298-99.


Clearly, this is not guidance that would be particularly helpful to trial courts, especially when encountering a set of staggered grants with staggered vesting and exercise dates, or, indeed, in most other circumstances.\textsuperscript{191} The primary beneficiary of the analysis in the short term was the appellate court, deferring a definitive decision on the annualizing process to some point in the future – if ever. After all, there is potentially no limit on the number of jurisprudential butterfly straddles that could be performed.

Finally, not to leave a stone unturned, it is possible that funds flowing from the exercise of options may in turn themselves produce income (or be deemed to do so) and this income also may have to be taken into account in determining the extent of any child support obligation.\textsuperscript{192} Presumably, this income should be annualized as well. But, there does seem to be a limit to fiction. However, so far, no court seems to have imputed income to the sum notionally arising from the imputed exercise of options.

\section*{F. Obligations Beyond Income}

Virtually every state accepts that actual income should be used to determine a support obligation. But, for our purposes, it is relevant to note that a significant number of states are willing to determine an obligation through a process which involves a consideration of the individual’s “wealth,” “lifestyle,” or “standard of living.” The question of how the year’s income and calculating a weighted average income for each of the four years, it, either deliberately or by oversight, used the un-weighted average to calculate the support obligation. To add further to the obscurity of the situation, no rationale for the weighting structure was provided.


\textsuperscript{192} See W. Virginia \textit{ex rel} Dept. Of Heath & Human Res. v. Baker, 557 S. E.2d 267, 272 (W. Va. 2001); Williams v. Williams, 485 S.E.2d 772, 775 (Ga. 1997). In a case involving a one-time capital gain, not options, a Colorado court held that the after tax proceeds could be considered to be an asset to which a “reasonable” rate of return by way of income could be imputed. See \textit{In re Marriage of Zisch}, 967 P.2d 199, 202 (Colo. Ct. App. 1998). We could end up with a situation where the court is directed by statute to take into account the tax consequences of any property division order, then presumably does so, but fails to direct that each party is responsible for the tax liability for the options he or she receives, so that the grantee retains the tax liability for the entire grant, see Rinner v. Rinner, No. M2001-02307-COA-R3-CV, 2003 Tenn. App. LEXIS 101, at *22-23 (Tenn. Ct. App. Feb. 6, 2003), and still is liable to have income imputed to him or her on the basis of any options retained, either on a before or after tax basis, depending on how any given state guideline approaches the issue. In another permutation on this theme, a court has acknowledged the tax consequences to one party and declined to take them into account with respect to the other party. This was justified according to the appellate court because of the first party’s “immediate receipt” of the options. See Watters v. Watters, 959 S.W.2d 585, 590-91 (Tenn. Ct. App. 1997). It is not clear what makes the distinction tenable.
for us is the extent to which it is appropriate to do so by virtue of the option holdings of the obligor. At the outset, it is worth clarifying the distinction between saying that by virtue of option holdings the obligor has the resources to meet an otherwise determined child support obligation, and using the existence of those holdings in and of themselves to determine the extent of the obligation. We are concerned with the latter case.

As a preliminary point, we need to recognize that some analytical tension is produced because of the fact that ordinarily a child support obligation is premised on the obligor's income and the child's needs. Obviously, it is quite possible for the needs to outstrip the income, and the issue then is to what extent it is permissible to turn to the capital resources of the obligor to meet the "needs." In the context of support guidelines, the argument can lead to a circular analysis since the guidelines essentially assume a "need" based on available income. But, if actual "income" isn't available the system has to generate some artificial construct which justifies extending the analysis to reach the capital assets of the obligor. This can occur in contexts where the obligor's income is low and resources are relatively few. Here, the "total wealth" of the obligor (as well as the ability and willingness to work) may be considered to justify using capital in lieu of actual income. Thus, in an Ohio case, the court allowed an upward departure from the amount provided for in the guidelines after considering the relative financial resources and assets of the parties and noting that the obligor received yearly bonuses and stock options. The court justified the departure on the construct that the residential parent's income, where her household included four children, would be about two-thirds of the income of the obligor after the guideline-dictated amount had been deducted. There was no justification on the basis of "need," although in abstract such an argument could have been made. The underlying problem is that the guidelines failed to recognize any such "need" because of the apparent antecedent exclusion of the stock options from the category of "income." Obviously, even at lesser levels of income, this type of approach opens up the possibility of "inappropriate" post-divorce wealth transfer.

196. Id. at 907
198. Id. The relative incomes were $18,670 and $27,095.
The issue also arises at the other end of the income spectrum. Option holdings can be used in two distinct ways. First, the holder is determined to be say, "wealthy," or some similar classification, by virtue of a value assigned to his or her holdings, by one technique or another. This classification is then used to justify a support obligation flowing from application of the guidelines in a way which produces a support obligation, which on its face seems inordinately large, especially relative to a first blush evaluation of the child's needs. Thus, for example, the rules may require that in determining the support obligation, where the parents' combined incomes exceed an amount tabulated in the guidelines, the same (or even a larger) percentage as was used for the maximum guideline income amount should continue to be used for any higher amount of actual income. This approach could produce an inordinately high award. Of course the jurisdiction might permit a departure from the analysis produced result if that result could be shown to be "unjust, inappropriate, or not in the child's best interest." A variation on this approach allows the income to generate an obligation based on a percentage allocation for child support, but then allows the court to make a downward deviation if the obligor's income exceeds a specified amount, such that a downward adjusted order would still provide a reasonable amount of support based on the best interest of the child and the circumstances of the parties.


200. "Needs" as used in child support determinations occurs with tantalizing ambiguity. On the one hand, it can be used to cover the child's reasonable expenses. On the other it can reflect a child's claims to the lifestyle potential of a wealthy parent. See Cheriton v. Cheriton (*In re Marriage of Cheriton*), 111 Cal. Rptr. 2d 755, 776 (Cal. Ct. App. 2001). This "lifestyle" may include a parent who stays at home, even if a nanny is available. See Hansel v. Hansel, 802 So. 2d 875, 880-1 (La. Ct. App. 2001). This in turn provides a mechanism for sheltering the residential parent from the possible imputation of income due to unemployment or underemployment. The concept of "need" may be critical to the analysis. Thus, Texas precludes the obligor from being required to pay more than the maximum presumptive amount specified by the guidelines unless an additional amount is required to meet the "proven needs" of the child. See In the Interest of C. J., No. 05-98-01973-CV, 2001 Tex. App. LEXIS 3067, *9-10* (Tex. Ct. App. May 10, 2001).


202. Some jurisdictions allow the guidelines to be employed up to the maximum amount of combined family income tabulated and then require any additional support sought on the basis of "excess" income to be evaluated using the underlying statutory considerations. See Pascale v. Pascale, 644 A.2d 638, 644 (N.J. Super. Ct. App. Div. 1994).


There is evidence that jurisdictions have started to have second thoughts about a structural preference in favor of open-ended commitment to high levels of child support. Thus, Tennessee used to have a system which required the obligor to prove that an order in excess of the maximum specified in the guidelines “was not reasonably necessary to provide for the needs of the child”. This has been replaced by a requirement that the burden is now on the claimant to establish that the excess support is “reasonably necessary “ to provide for those needs.205

Some jurisdictions may be more open-ended in their approach. Thus, at “high income levels” they may conclude that the best approach is to leave the level of support to judicial discretion, perhaps subject to, as in Maryland,206 a floor award of the highest amount provided for in the guidelines, unless going below this floor can be specifically justified. However, in this case and in the others just described, it is in the nature of guidelines to create a rebuttable presumption of appropriateness.207 Effectively, the process can be seen as one which involves the quasi-imputation of need starting with a premise of lifestyle, or wealth, except that the lifestyle itself may be imputed.208 Not infrequently, this process then is combined with one which involves the actual imputation of income.

V. THE CASES AND THE ALI PERSPECTIVE

The cases for the most part suggest that no center of gravity has developed as to how options should be dealt with. True, most of the cases seem to accept the principle that income from whatever source should be reached to determine and satisfy a child support obligation. After all, as we saw, there are important interests at stake. Thus, “finding” income in options certainly enables a court to advance the interests of the child and the residential parent. The risks associated

207. Murray, 716 N.E.2d at 296.
208. See Cheriton v. Cheriton (In re Marriage of Cheriton), 111 Cal. Rptr. 755, 772 (Cal. Ct. App. 2001). Here the court actually assembled both lines of analysis, id. at 770-72. The court was faced with an obligor who “live[d] rather modestly, maintaining a standard of living far below his means.” The court said that the obligation should be determined on the basis of the obligor’s resources, not his lifestyle, because it was appropriate for the children to share in the lifestyle of a high earner even if the obligor actually spent little on “lifestyle” himself. Id. at 772 n.13. The court ended up by concluding that the obligor’s wealth could be considered even though there was no California authority that expressly mandated consideration of the parent’s assets in awarding child support. Id. at 772.
with the process, for the most part, seem to fall on the non-residential obligor. The fact is that we are operating in an arena where it is debatable as to whether there is indeed "income." And, even if one accepts the income's existence, the analysis almost inevitably confronts uncertainty as to the amount of income, either in terms of gross amounts, or current availability, or simply as to the particular sum that it is appropriate to inject into a guideline formula for the purpose of determining the actual obligation. Where this uncertainty operates disadvantageously towards the obligor, it tends to undermine the Principles' interest in seeing that one parent does not carry a disproportionate share of the burden. It also tends to expose the boundary between meeting a child's legitimate needs and unwarranted wealth transfer between households. As to the former, enhanced "income" identification tends to promote the Principle's goal of ensuring that post-divorce the child does not miss out on "life opportunities." But, given that the Principles provide no safe harbor as to the sweep of the concept, in the absence of a principled analysis of what the options legitimately can be called upon to provide, the burden of risk exposure rests on the obligor. On the issue of wealth transfer, the Principles accept that the obligor owes no duty to the residential household as such, and in particular avows no objective to equalize the household's standard of living. However, given the Principles' view that the child should not be called upon to live a lifestyle grossly inferior to that of the obligor, as well as not being denied "opportunities", and given that both of these elements embody no specific benchmarks, there is significant potential for the erosion of the Principles' interests and goals in the face of a "fluid" approach to income determination. As was pointed out, particularly in the presence of substantial resources, the cases are operating on the boundary between economic necessity and the trial court's vision of social acceptability, generally subject only to an abuse of discretion standard. This is not a scenario calculated to bring comfort to the option holding obligors of world.

The Principles encourage courts to recognize income from all sources, leading the net to encompass options. Nevertheless, this process drives the courts to grapple with a financial instrument without ever fully coming to terms with the inherent complexities of options. In this regard, the Principles devote some attention to the issue of the imputation of income. When it comes to the residential parent the goal is to ensure that residential parent-child relationship, as such, is not subordinated to the pressure to produce income. Supposedly, this advances the child's interests, which is a proposition that is not rebuttable. In the absence of the economic quantifiability of the value of the relationship, alternate visions of what advances the child's interests cannot be promoted. The Principles suggest another approach with respect to the non-residential parent. Here, they seem to accept that
the advantages of one economic vision of the child’s interests can be evaluated against another. In contrast the option cases tend to take another tack. It is mostly in vain that obligor’s attempt to assert that maintaining a position in options, as distinct from recognizing income, will advance the child’s interests relatively. This argument is simply overwhelmed by a need to identify “income,” a concern with self-dealing on the part of the obligor, and, it seems likely, by a fundamental lack of understanding of the character of options. The burdens of erratic grant structures, inappropriate valuation, a confusion between value and income and associated issues of liquidity, or lack thereof, all tend to be deposited at the door of the obligor, except in rare cases where this path is foreclosed by statute. Virtually everywhere the labor inherent in achieving equity, fairness and just outcomes tend to be displaced in favor of the efficiency of simplicity. Of course, this is the extract of relatively few reported, mostly appellate, cases which reflect any form of detailed analysis. It can only be left to the imagination whether highly informed legal representatives are inducing equally informed busy trial courts (mostly unguided by detailed principled analysis at the appellate level) to do any better.

VI. CONCLUSION

In the ordinary course, the broad sweep of not necessarily consistent interests to be acknowledged and objectives to be achieved within the process of awarding child support make that process intrinsically problematic. But, when this process requires the identification and extraction of funds from stock options in an amount that might be considered appropriate and fair relative to those interests and objectives, the nature of options can elevate the complexity of the task to a level that is almost overwhelming.

There is evidence that courts faced with the prospect making a technically sound evaluation of options in the context of awarding child support routinely opt for simple and immediately pragmatic solutions. Certainly, little effort is made to fabricate coherent comprehensive treatments. Such solutions as are adopted seem calculated to achieve support orders that are likely to lie on the generous side. As the title to the Article suggests, it is almost inevitable that they will produce results that are “long” on income. In part, this seems to be because many courts fail to extricate the analysis from the realm of finance so that concepts of income remain hopelessly enmeshed in concepts of value. Few courts seem willing or able to be grab the bull by the horns and determine in a coherent way how much money actually would be available, or actually could be available (in the context of imputed income), and dare one add should be available (when it comes to issues like standards of living and investment choices). The absence of sound theoretical underpinnings adds to the problem. It is
very easy for a child's (and at times it seems the residential household's) supposed needs to overwhelm any attempt to conceptualize options as an asset resource. It is true that in many instances (though not all) options readily may be conceived as income to the obligor. But, at least in the intact household, the options may not have functioned as such. A lot more stability in the analysis could be achieved if the court ordering support were required to justify metamorphosing the options from their role of asset in the household economy to one of current income used to determine the amount of child support. At the very least there is ample evidence to suggest that it is inappropriate to apply child support guideline formulae on a rote basis where it is alleged that some of the income is supplied by stock options. As much as this applies to trial courts, it seems even more compellingly so with respect to the myriad of jurisdictional administrative and other efforts to achieve pre-trial settlement, at least where the procedure does not encompass individuals with a sound understanding of option theory.

Is a coherent treatment likely to evolve? Probably not in a hurry. There are just too many opportunities for courts, particularly at the appellate level, to seek to achieve a jurisprudential butterfly straddle.