

**JANUARY 2014 NEWSLETTER**

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**FINANCIAL ISSUES IN DIVORCE:  
The Valuation of Unvested Stock Options In An  
Equitable Distribution Dissolution**

**NEWS ALERT:**

**Free Online CLE/CPE Credits:**

Pozzuolo Rodden, P.C. is pleased to announce the opportunity to obtain free CPE/CLE credits by viewing the LawLine webcast courses previously taught by Joseph R. Pozzuolo and/or Jeffrey S. Pozzuolo titled "The Negotiation and Documentation of Commercial

Financing Documents Including The Use of Convertible Loans With Put and Call Options”, “How Middle Income Families Should Plan for Retirement Including Ethics”, “The Fundamentals of Starting a Business” and “Estate Planning for an Aging Graying Population”.

- \* How Middle Income Families Should Plan For Retirement - <http://bit.ly/ZvgNbr>
- \* The Fundamentals of Starting a Business - <http://bit.ly/13Q8dei>
- \* The Negotiation and Documentation of Commercial Real Estate Loan Documents- <http://bit.ly/17jfXSN>
- \* Estate Planning For An Aging Graying Population - <http://bit.ly/19QPFJ7>

Any problems, feel free to contact Chrissy at: [chrissy@pozzuolo.com](mailto:chrissy@pozzuolo.com)

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### **QUESTION OF THE MONTH:**

**Are there any risks or disadvantages to my 80 year old father, who has a \$200,000 gross estate, drafting his own simple will from an online will kit?**

Answer-See Page 4 of this Newsletter

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### **FINANCIAL ISSUES IN DIVORCE:**

#### **The Valuation of Unvested Stock Options in an Equitable Distribution Dissolution**

Divorce between parties can often be complicated with numerous complex financial issues that need to be resolved. One such complex financial issue that may arise is the valuation and equitable distribution of unvested stock options.

As a benefit of employment, employees are sometimes offered stock options that can be exercised at a later date. Stock options are typically a form of compensation from an employer and allow an employee the option to buy a specific stock at a set price during a set period of time, regardless of shifts in the stock’s market value at that time. Stock options are unvested when they cannot be exercised due to conditions attached to the stock options. The stock options will become vested when the attached conditions are met allowing the stock options to be exercised. When couples are divorcing any unvested stock options that were acquired during the parties’ marriage, prior to separation, are considered to be marital property. As marital property, a spouse’s unvested stock options are subject to equitable distribution during a divorce.

In Fisher v. Fisher, 564 Pa. 586, 769 A.2d 1165, the Supreme Court of Pennsylvania first considered whether unvested stock options were marital property and how to address the equitable distribution of unvested stock options. The Court first held that unvested stock options are a type of deferred compensation which has been earned by the employee and that they qualify as marital property subject to equitable distribution, even if these unvested stock could not have been exercised at any point during the marriage. The Court then addressed how best to value the unvested stock options for the purposes of equitable distribution.

It is widely recognized that ascribing a set value to unvested stock options is a difficult, speculative, and imprecise task. The Court in Fisher, found such valuations could not be done reliably because it is impossible to reliably predict the value of any stock at a future date. The Court held that deferred distribution was the best option available to parties because even though options for valuing unvested stock options existed, the results were too speculative to enforce. The Court found that with deferred distribution the unvested stock options would be excluded from immediate distribution between the divorcing spouses and the case would be held open as long as necessary to ascertain the value of the stock options when they become fully vested allowing the stock option to be exercised. Once the stock is vested, the Court reasoned it would be in a better position to distribute the stock options in an equitable manner between the parties. The Court recognized this could lead to situations where one spouse acts spitefully and refuses to exercise the stock options once they become vested to limit distributions to the other spouse. However, the Court felt that the trial court could adequately address any situations involving spiteful spouses as they arose.

While deferred distribution permits divorcing couples to have the most accurate value assigned to unvested stock options, many couples do not wish for their case to remain open while waiting for the stock options to vest. Accordingly, many divorcing couples will elect to enter into a property settlement agreement governing how the unvested stock options will be distributed between them instead of through deferred distribution supervised by the Court.

If it is possible for the unvested stock options to be transferred or divided then parties may wish to distribute the actual stock options between them instead of attempting to set a value for the unvested stock options. Unfortunately, this is not often a feasible solution because many unvested stock options are granted to employees as a condition of continued employment and as such they are nontransferable and indivisible.

Property settlement agreements dealing with the distribution of unvested stock options allow for the parties to expediently resolve their divorce litigation and determine a mutually agreeable way to value the unvested stock options. However, no matter what valuation method is applied, the results are still speculative to some degree. This is because there can be no guarantee that the stock options will ever be exercised. Unforeseen circumstances, such as, the employee no longer working for the company or company could be the subject of a hostile takeover, can diminish an employee's ability to exercise the stock options once they become vested.

If parties wish to enter into a property settlement agreement, there are multiple valuation methods available to determine the value of unvested stock options. Some of the most common methods are, as follows:

1. Intrinsic Value

This method determines a stock option's value by looking at the differences between the strike price (the amount required to exercise the stock option) and the current market value of the stock. This method is considered highly speculative and is not necessarily a good indication of the unvested stocks option's potential value once it is fully vested and exercised.

2. Discount to Present Value

The Discount to Present Value Method begins similarly to the Intrinsic Value Method, by determining the difference between the strike price of the unvested stock options and the current market price for the stock. However, further discounts are applied to the difference to determine the present value which include, but are not limited to, taxes due upon exercising the stock options, lack of marketability and the risk of forfeiture.

3. Black-Scholes Formula

The Black-Scholes formula is a complex mathematical formula, which can be used to predict the value of stock options. This formula is used to develop the estimated price of different stock options over a period of time. This formula is typically used by financial analysts when attempting to value stock options. The formula takes multiple factors into account, including, but not limited to, stock prices historically (whether variable or constant), the volatility of the stock's return, amount of time until the stock options become vested, interest rates, the strike price of the stock options, and the probability of the holder exercising the stock option.

If you are going through a divorce and have questions or concerns regarding unvested stock options and their valuation, or other complex financial issues in divorce, please do not hesitate to contact our offices and schedule a consultation with our experienced attorneys.

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**QUESTION OF THE MONTH:**

**Are there any risks or disadvantages to my 80 year old father, who has a \$200,000 gross estate, drafting his own simple will from an online will kit?**

Yes, there are risks and disadvantages to your father using an online will kit. Those risks and disadvantages may not be evident to your father when he uses the online will form, but they will become clear after he dies when his estate must be administered according his will. The risks and disadvantages include issues with flexibility and customization, incompleteness, outdated information, and a lack of education.

Flexibility and Customization. Online will forms and products may contain boilerplate language that may not be customizable. Your father may be locked into certain provisions and distribution schemes. While, given the size of your father's estate, it is doubtful he would have complex distribution schemes, if he wanted to add complexity, the online will kit may be limited in the types of provisions it allows. For example, if he were to want to distribute money in trust rather

than outright, an online product may provide only certain ages or circumstances under which the beneficiaries of the trust would receive distributions.

Another scenario an online will form may not be able to address is if your father has a pet that he wants to be taken care of. The online will product may have no provisions addressing pets. Essentially, the online will forms and products may not allow your father to distribute property as he wishes.

On the other hand, it may allow him add clauses that contradict other clauses within the will. Ultimately, this will cause ambiguity under the will and make the administration process more difficult.

Incompleteness. If your father wanted to create a trust or have a nuanced distribution provision, the online will product may not offer the proper terms. Online will forms may not allow your father to address certain other property he owns such as digital assets or pets. If your father wanted to leave property to a minor or incapacitated individual, that property may not be distributed outright to him or her. The online will product may not be able to provide alternatives.

Outdated Information. Some online will forms may lack up-to-date information. In August 2011, Consumer Reports reported that it tested three different electronic will forms and two referred to outdated federal estate tax limits. Although, as described above, your father's estate would not be subject to a federal estate tax given the size of his estate, the fact that some products are offering outdated information must be alarming and casts a shadow of doubt as to the reliability of the product as a whole. The state death tax laws may be even more nuanced and if the products are carrying outdated information for federal taxes, it is likely they are not up-to-date on state tax law. The problem, of course, is that unless your father was knowledgeable about estate and tax law, he would not even know if the products were outdated.

Lack of education. The biggest problem with using an online will form or product is that your father may not be provided the proper education about what exactly it is he is preparing. Wills are legal documents that are binding once the testator dies. Your father may not get the proper education as to what the provisions mean and how they will work. He may not learn, for example, that there may be problems under state law with his will if he does not provide a distribution to his spouse or child.

It is also doubtful that the online will form will explain other aspects of estate planning, such as the different types of jointly owned property and that certain types of jointly owned property is not administered according to the will. Thus, your father may want to bequest his share of jointly owned property to a child not realizing that when he dies, the entire property goes to the other joint owner. If your father's only asset is a house which he owns with his wife, who is still living at your father's death, then how he says he wants to leave the house under his will may be irrelevant.

The online will form may also not explain to him the importance of who he selects as executor. Will your father appoint his wife, who is also 80 years old? His estate is small enough that it may not require an executor with advanced financial knowledge or experience in handling estates, but administering the estate is still a legal process supervised by the court. Your father needs to consider that when appointing an executor.

Estate planning can be complex. Although your father has a small estate and may want to

provide outright distributions, there are still issues with executors and payments of fees, costs and taxes. He may not address all the issues using the online will form.

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- If there are any legal questions you would like this office to answer in the future, please email the question to us at [info@pozzuolo.com](mailto:info@pozzuolo.com). Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.
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## **PUBLICATIONS**

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: [http://pozzuolo.com/Pubs Articles.shtml](http://pozzuolo.com/Pubs%20Articles.shtml)

- **Corporate/Tax Articles**

- Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business
- Deferred Compensation Rewards And Retains Key Employees
- Design Buy-Sell Agreements For Maximum Utility
- How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend
- How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations
- How To Look, Act And Sound Like A Professional Corporation
- How to Structure a Suitable Buy-Sell Agreement
- How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool
- Money Purchase Pension Plan Falls Out Of Favor
- Protecting A Client's Business From Unfair Competition Using Restrictive Covenants
- Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules
- What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs
- Why An Employment Contract Is Mandatory

- **Estate Planning Articles**

- Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples
- College Funding Tool Offers Estate Planning Advantage

- Diversify Strategies For An Effective Estate Plan
- Divorce and Estate Planning
- Divorce Raises The Need For Performing An Estate Planning Review
- Drafting The Durable Power Of Attorney For Wealth Protection Purposes
- Estate Planning For Pet Owners
- Remarriage Situations Can Raise Special Estate Planning Considerations
- Six Proven Estate Planning Techniques
- Special Needs Trust - An Estate Planning Tool For The Disabled
- The Limited Liability Company -A Sophisticated Tool For Estate Planning
- Using Trusts To Maximize Family Protection And Minimize Estate Tax
- Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

***Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.***

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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