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Mastering executive compensation in divorce

Executive compensation is now more closely tied to performance than ever before, and goes well beyond simply a salary and bonus often including such components as equity compensation and deferred equity compensation, wherein the executive obtains an ownership interest in the company.

In addition to cash compensation (salary and bonus) and equity compensation (stock grants and options), executive compensation may include deferred compensation (restricted stock awards and unvested options), retirement, insurance and other perquisites. While all of these elements can play a part in a divorce — whether the division of property or the basis for a child support or maintenance award — they are not all treated equally.

The elements of cash compensation can be viewed differently when it comes to support payments.

The Illinois Appellate Court in *In re Marriage of Shores*, 2014 IL App (2d) 130151, held that the payor's bonus income, unlike salary, was speculative in nature. As such, while the bonus may have been earned over the course of a year, it is considered income only when paid. In *Shores*, the bonus was paid after the payor's support obligation had expired.

Although funds were conceivably earned during the period that the payor had an obligation, since the bonus was paid afterward, the recipient spouse was not entitled to any of it.

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Other courts have held it inappropriate when there is a percentage order not to cap the potential amount paid as maintenance from future bonuses.

In *In re Marriage of Micheli*, 2014 IL App (2d) 121245, the appellate court reversed an award of 20 percent of all future bonus income of the payor spouse because there was no cap on the total amount of maintenance. The court reasoned that maintenance should be based on the lifestyle the parties enjoyed during the marriage, and a support percentage with no cap could potentially result in a windfall to the recipient.

The court directed the trial court to cap the overall amount that could be paid from the bonus with the payor spouse keeping 100 percent of any excess. Interestingly, the trial court had capped child support, and while the appellate court questioned the appropriateness of that cap, it was not challenged on appeal and was left in place.

Equity compensation gives an employee an ownership interest in the company, often in the form of stock options or an outright stock grant. However, stock options or stock awards can be tied to future work and, as a result, be unvested or restricted stock awards. This is a form of deferred compensation because it is not payable presently.

In a divorce case, stock and vested options earned during the marriage are marital property and generally divided as part of the overall allocation of the estate. However, restricted or unvested awards may be treated differently.

While stock options may not vest until after the divorce, they are (and restricted stock may be) considered marital property, divisible by the court, even though the value may be indeterminate.

They are not necessarily divided like the rest of the estate, and a 50-50 division of unvested options or restricted stock may not be appropriate. Courts can and should consider whether any future effort, and how much effort, will be required.

An award of all of the unvested options to one party may constitute an abuse of discretion, as it did in *Micheli*, where the appellate court held that the trial court abused its discretion by awarding 100 percent of the unvested options to the husband.

Although the division of unvested options and restricted stock may be a part of the division of property, when those options vest and are exercised or stock become unrestricted and sold, even after the divorce, the proceeds can be considered income for child support

purposes.

In *In re Marriage of Pratt*, 2014 IL App (2d) 130465, even though the parties agreed in their marital settlement agreement that the future exercise of unvested options or sale of restricted stock awarded in the agreement would not constitute income for child support purposes, the appellate court disagreed, holding that it was not bound by the parties' agreement as to what was and wasn't considered income for child support purposes.

Despite the payor's claims of double-dipping (dividing the options between the parties as part of the overall allocation of property, and then forcing the husband to pay his wife a portion of that property award in the form of support, when it is finally cashed in), the court maintained that such income is appropriately considered for child support purposes.

Lawyers also should explore less common types of compensation such as "top hat" plans (deferred compensation in the form of a non-qualified plan that is an unfunded promise to pay in the future out of the general assets of the company), supplemental executive retirement plans or deferred savings plans that may be available to an executive.

Of course, this is not an exhaustive exploration of executive compensation, but it highlights the importance of identifying and understanding the different elements of executive compensation and how they may affect the divorce and your client's future.