

RISKY BUSINESS

HOW CALIFORNIA DIVORCE LAW
ENDANGERS YOUR RSUs



A White Paper Presented By

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When you are a Silicon Valley tech professional involved in a divorce or anticipating one, you already know you have to protect your assets strategically. What you may not realize, though, is that your equity compensation in the form of restricted stock units (RSUs) are also subject to division of marital assets under California law.

Even if your RSUs have not yet vested, the court can still view them as marital property subject to division in a divorce. That's right, you read that correctly: You can lose your RSUs in your divorce even if you think you don't have them yet.

If you did not realize your RSUs could be part of your divorce, then you are not alone. Across the country, tech professionals, entrepreneurs, employees and venture capitalists routinely hold RSUs as part of their asset portfolios without realizing those RSUs come into play when dividing assets during divorce proceedings.



Further, here in Silicon Valley — a hotbed for RSUs — few understand that those RSUs pose additional unique complications when it comes to the division of property during a divorce. Those unique complications include the way California divides marital property in general and how the RSUs themselves are valued specifically.

Because that lack of knowledge about RSUs is so widespread here among Silicon Valley tech professionals, and because that lack of knowledge holds such grave material consequences for holders of RSUs during their divorces, our firm believes it is essential to help build awareness among the industry we serve. To do so, we provide this white paper to help you understand how California law puts your RSUs at risk during a divorce.

To address the topic best, we approach it in this white paper as a three-part discussion. We begin by briefly setting out the general rule of property division in California during a dissolution of marriage.

RSUs themselves and consider how California courts treat them during a divorce. And we conclude with some general observations about other pitfalls to keep in mind when holding RSUs during a divorce in California.



CALIFORNIA LAW REGARDING THE DIVISION OF PROPERTY DURING DIVORCE

For most states, valuing and dividing RSUs during divorce is not terribly difficult. Most states consider property as belonging to the spouse who earned it (called

equitable division). In those states, RSUs that have not yet vested do not get divided as marital property; they stay with the spouse who received the RSUs. Other property considered to belong to the marital estate is divided in a way the court determines to be fair (i.e., equitable).

EARNINGS KEPT FROM MARRIAGE



**EQUITABLE DIVISION
MOST STATES**



**COMMUNITY PROPERTY
CALIFORNIA**

California, however, is one of the few states that does not follow the rule of equitable division. Instead, California is what is called a community property state. In a community property state, any property earned or acquired during the marriage is owned by *both spouses equally*.

On the face of it, the community property rule seems fairly simple, even easier than equitable division. A California divorce court would just divide the RSUs in half. Unfortunately, the devil is in the details. What seems so simple is anything but.



THE PROBLEM OF RSUs IN A CALIFORNIA DIVORCE

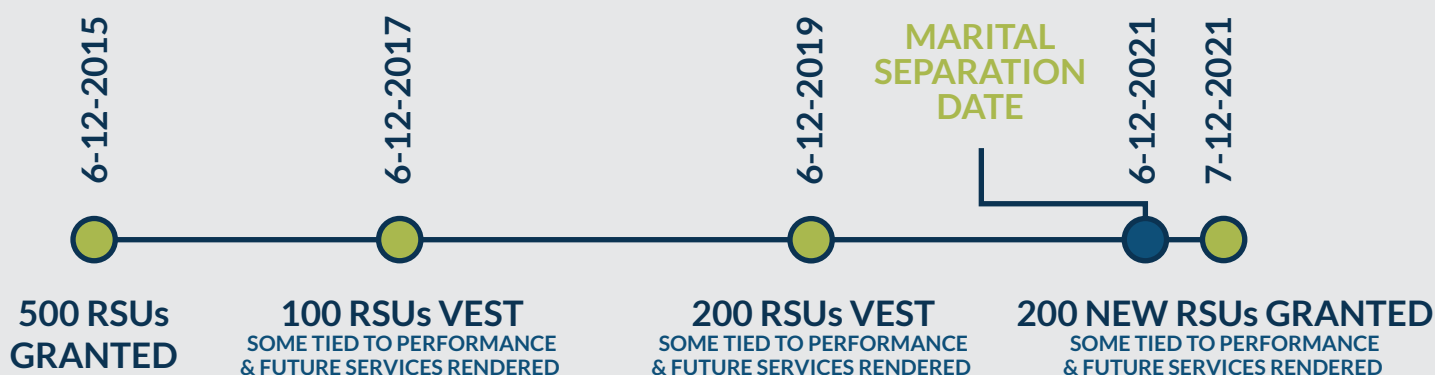
Part of the difficulty stems from the nature of RSUs themselves. When you are dividing a house, generally speaking, you are dealing with a single asset you are free to transfer to someone else.

In contrast, when you received your RSU grant, your stocks did not vest (i.e., you were not able to transfer the stock) until certain conditions and benchmarks were met. Additionally, the stocks vested on a rolling basis. Perhaps 100 shares vested after two years. Perhaps another 200 will vest after three years. To further complicate matters, after your second year,

you may have received additional RSU grants. Those stocks may come with their own separate conditions and vesting schedule.

Now let's say you and your spouse separate after your second year of employment at the company granting you the RSUs. At that point, you will most likely have a mix of RSUs that have been granted during marriage but with some vesting during and after the marriage. You may also have RSUs granted to you after separation either for past performance that occurred during your marriage or for future services to be rendered. On top of that, you still have the RSUs granted to you subsequent to your second year of service, but none of them have vested yet.

EXAMPLE VESTING SCHEDULE








So which RSUs, if any, are considered community property under California law? Further, assuming any RSUs are considered community property, how are they valued under California law?

As is so often the case in law, the answer is, “It depends.” Here, however, that answer is particularly appropriate. No California court

has set out a single formula that applies in all situations to value and divide RSUs during a divorce. Neither has the state legislature enacted a formula or any guiding legislation. Instead, the analysis is highly fact-specific, each case potentially needing a rule created specifically to address the unique circumstances of its own particular situation.

FACTORS THAT INFLUENCE THE DIVISION AND VALUATION OF YOUR RESTRICTED STOCK UNITS

	Grant Date
	Vesting Date
	Potential Sale Date
	Right of Employee to Transfer RSUs
	Payment of RSUs for Past Performance vs. Future Performance

That state of affairs is reflected in the two guidepost California cases for attorneys assessing the legal exposure of RSUs during divorce: *In re Marriage of Hug*¹ and *In re Marriage of Nelson*².



THE HUG CASE



THE NELSON CASE

Each court crafted its own different formula for addressing the specific facts of the case it addressed. Further, each court emphasized that the principles of California law in fact require a case-by-case analysis when it comes to this form of compensation. *Nelson* favorably cited *Hug*, “... stress[ing] that no single rule or formula is applicable to every dissolution case involving employee stock options.”³ *Hug* came to that conclusion after observing “... that contractual rights to such benefits vary so widely as to preclude the accuracy of any but the most general characterization of them.”⁴ The *Hug* court continued:

Thus, there is no compelling reason to require that employee stock options must always be classified as compensation exclusively for past, present or future services. Rather, since the purposes underlying stock options differ, reference to the facts of each particular case must be made to reveal the features and implications of a particular employee stock option.⁵

Unfortunately, the appellant in *Nelson* did not heed *Hug*'s statement that each case could give rise to its own rule. Instead, she wanted the court simply to apply the same formula that was applied in *Hug*. The *Nelson* court declined to do so, observing the different facts to be dealt with in *Nelson* which were not present in *Hug*.⁶

You can easily see how additional and different facts could serve as pitfalls to the holder of the

RSUs, unpredictably affecting the formula applied by a court. For instance, how will the court value and divide the RSUs if the company that granted them has itself been acquired? What about tax issues in addition to those relied upon by the *Nelson* court as a distinguishing feature of its own case? Those are but two examples of many and, under California law as it currently exists, there are potentially as many examples as there are people getting divorced.



CONCLUSION

When it comes to dividing your RSUs during a divorce in California, no single clear formula exists under either case law or state statute. Instead, California law leaves a great deal of discretion to your divorce court. In fact, there is so much discretion left to your divorce court that the court may simply create a new formula solely to address what they see as the unique circumstances involved in your case. As *Hug* put it, “[T]he disposition of marital property is within the trial court’s discretion,

by whatever method or formula will ‘achieve substantial justice between the parties.’”⁷

For that reason, until the state’s higher courts take up the question or the state legislature enacts a uniform formula through legislation, Silicon Valley’s RSUs remain at risk during a divorce. An experienced attorney in these matters can properly advise you as to how the specifics of your situation could be handled successfully during your divorce.





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SOURCES

- ¹ In re Marriage of Hug, 154 Cal. App. 3d 781 (1st App. Dist. 1984).
- ² In re Marriage of Nelson, 177 Cal. App. 3d 151 (1st App. Dist. 1986).
- ³ Nelson at 155 (citation omitted).
- ⁴ Hug at 784.
- ⁵ Ibid.
- ⁶ Nelson at 154-55.
- ⁷ Hug at 791 (citation omitted).

