

The Hazards of "In-Kind" Distributions of Closely-Held Stock in Divorce Actions

by
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I. Introduction

In an action for divorce, the court is faced with the responsibility of dividing the marital assets¹ of the parties equitably. As an example, New York's Equitable Distribution Law² is based on the concept that marriage is an economic partnership. The Court of Appeals, the highest court in the State of New York, has held that "consistent with this purpose, and implicit in the statutory scheme as a whole, is the view that upon dissolution of the marriage, there should be a winding up of the parties' economic affairs and a severance of their economic ties."³

In its decisions, the New York Court of Appeals has been careful to ensure that the assets accumulated either before the marriage *or* after the commencement of the divorce action are *not* to be treated as part of the economic partnership, which, of course, exists only during the marriage. Thus, in *Olivo v. Olivo*,⁴ the Court determined that the wife was not entitled to share in her husband's Social Security bridge payments and a separation

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¹ New York Domestic Relations Law (hereinafter "DRL") § 236B very broadly defines marital property as "all property acquired by either or both spouses during the marriage and before the execution of a separation agreement or the commencement of a matrimonial action, regardless of the form in which title is held, except as otherwise provided in agreement pursuant to subdivision three of this part. Marital property shall not include separate property as hereinafter defined."

² DRL § 236B.

³ *O'Brien v. O'Brien*, 489 N.E.2d 712 (N.Y. 1985).

⁴ 624 N.E.2d 151 (N.Y. 1993).

(from work) payment awarded to the husband contemporaneously with his accelerated pension, because his right to those payments had arisen entirely after the marriage ended.

So, too, in *DeJesus v. DeJesus*,⁵ the New York Court of Appeals made it abundantly clear that an ex-spouse was not entitled to share in stock options granted to the other spouse to the extent that the options were an incentive to obtain future services that would occur after the dissolution of the marriage.

All states follow some property distribution method upon divorce. California considers as community property any property that is acquired during the marriage, and as such, is distributable at dissolution.⁶ California considers includable as community property the retirement benefits “accrued by the employee spouse as deferred compensation for services rendered.”⁷ Retirement benefits represent a community asset because they were “acquired” during the marriage.

The California Supreme Court ruled in *In re Marriage of Lehman*⁸ that it is indisputable that the “wife owns a community property interest” in her husband’s retirement benefits. Not only does the California court allow the non-employee spouse interest in the retirement benefits, it allows the interest in the benefits as enhanced after separation.

The *Olivo* and *DeJesus* decisions are a continuation of the principles enunciated by the New York Court of Appeals in *Majauskas v. Majauskas*,⁹ where the court declined to allow an ex-wife to share in any post-divorce accumulations to a pension plan, since they would be outside the economic partnership.

Where one spouse in a matrimonial action is an officer in a closely-held corporation as well as the owner of shares of stock in that corporation, those shares of stock generally have minimal, if any, value due to the lack of a market for such shares. Thus, the owner spouse is in a position where the stock can only gain in value in the future due, in part at least, to his¹⁰ efforts as a critical

⁵ 687 N.E.2d 1319 (N.Y. 1997).

⁶ *In re Marriage of Lehman*, 18 Cal. 4th 169 (1998).

⁷ *Id.*

⁸ *Id.*

⁹ 463 N.E.2d 15 (N.Y. 1984).

¹⁰ For the sake of continuity, the owner spouse will be referred to in the male gender throughout this Article although the author certainly acknowl-

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officer in a private company – efforts to be rendered *after* the marriage is terminated. Thus, if a court were to distribute the stock “in-kind”¹¹ that would allow the non-officer/non-owner spouse to have an asset that increases after the termination of the marriage, contrary to prevailing law and equity. Since prevailing law prevents the non-owner spouse from benefiting from the owner spouse’s post-divorce efforts, an in-kind distribution of his stock would amount to egregious error.

The majority of jurisdictions - including Arkansas, California, Colorado, Illinois, Louisiana, Maryland, Minnesota, Missouri, New Jersey, New Mexico, Oregon, Virginia, Washington, West Virginia, Wisconsin - have held that stock options that are not exercisable at the time of dissolution of marriage constitute marital property subject to equitable distribution.¹² A minority of jurisdictions have ruled that stock options that are not exercisable at time of dissolution are not marital property and therefore are not distributable.¹³

This article will examine the dangers inherent in distributing shares of closely-held stock in-kind as opposed to awarding the non-owner spouse a distributive award representing the value of her share of the stock. The article will use a hypothetical fact pattern to illustrate these dangers.

edges the existence of female officers in a closely-held corporation and women who own shares of closely-held stock.

¹¹ The term “in-kind” refers to a distribution of a portion of the actual asset rather than a sum of money representing the value of that portion of the asset to which the non-owner spouse is entitled.

¹² Richardson v. Richardson, 659 S.W.2d 510 (Ark. 1983); In re Marriage of Hug, 154 Cal. App. 3d 780 (1984); In re Marriage of Miller, 915 P.2d 1314 (Colo. 1996); In re Marriage of Frederick, 578 N.E.2d 612 (Ill.App.Ct. 1991); In re Marriage of Moody, 457 N.E.2d 1023 (Ill.App.Ct. 1983); Goodwyne v. Goodwyne, 639 So.2d 1210 (La. Ct. App. 1994); Green v. Green, 494 A.2d 721 (Md. Ct. Spec. App. 1985); Lomen v. Lomen, 433 N.W.2d 142 (Minn. Ct. App. 1988); Salstrom v. Salstrom, 404 N.W.2d 848 (Minn. Ct. App. 1987); Smith v. Smith, 682 S.W.2d 834 (Mo. Ct. App. 1984); Pascale v. Pascale, 660 A.2d 485 (N.J. 1995); Callahan v. Callahan, 361 A.2d 561 (N.J. Super. Ct. App. Div. 1976); Garcia v. Mayer, 920 P.2d 522 (N.M. Ct. App. 1996); In re Marriage of Powell, 934 P.2d 612 (Or. Ct. App. 1997); Dietz v. Dietz, 436 S.E.2d 463 (Va. Ct. App. 1993); In re Marriage of Short, 890 P.2d 12 (Wash. 1995); Kapfer v. Kapfer, 419 S.E.2d 464 (W. Va. 1992); Chen v. Chen, 416 N.W.2d 661 (Wis. 1987).

¹³ Hann v. Hann, 655 N.E.2d 566 (Ind. Ct. App. 1995); Hall v. Hall, 363 S.E.2d 189 (N.C. Ct. App. 1987); Ettinger v. Ettinger, 637 P.2d 63 (Okla. 1981).

II. Hypothetical Fact Pattern

For purposes of illustration, it is necessary to create a fact pattern to enable the reader to understand the nuances of the law. Thus, assume that a wife has initiated an action against her husband for divorce. The parties were married on August 14, 1974 and reside in New York. During the course of the marriage, Mr. Jones became Chief Financial Officer of ABC Widget Company (hereinafter "ABC") and the holder of 300,000 shares of ABC stock. A portion of the \$100,000 cost of Mr. Jones' initial investment in ABC's stock was funded by a monetary gift to him from his uncle, for which Mr. Jones claims a separate-property credit.¹⁴

Upon the commencement of this action on October 3, 1997, ABC was a publicly-traded corporation whose stock values fluctuated with the vagaries of the market even though Mr. Jones continued to be actively involved in the company as Chief Financial Officer. That being the case, Mr. Jones' interest in the company was given a net value of \$1,300,000 by a mutually-selected forensic accountant, as of June 20, 1999, a date close to the then-scheduled trial of the action. In arriving at that value for Mr. Jones' 300,000 shares of the ABC stock (approximately 2.2% of the corporation's then issued and outstanding stock), the accountant used the market value of the stock at the close of business on June 20, 1999, and then discounted the total unrestricted value for lack of marketability and for capital gains taxes.

In August 2000, shortly after the accountant submitted his evaluation, the corporation was acquired by a group of investors and became a privately-held company. The actual number of shares of stock constituting Mr. Jones' interest in the company was unaffected by the buy-out. Members of ABC's senior management, including Mr. Jones as Chief Financial Officer, were required to maintain their then-current investments as a condition of the sale and were not permitted to sell their stock to the group taking the company private. Thus, Mr. Jones' ownership interest in the publicly-held ABC was simply rolled over into the now privately-held corporation.

¹⁴ In most states, gifts to a spouse from a third party (i.e., not the other spouse) during the marriage are deemed separate property and not included in the "marital pot" for equitable distribution purposes. DRL § 236B(d).

Prior to ABC becoming a private company, Mr. Jones was unable to control or impact the value of the stock as it was traded on the stock market. After the group of investors acquired ABC, the situation became substantially different. Mr. Jones now holds a key position as an officer of a privately held company, and his income and the future value of the stock should be affected by his efforts.

At the time of the valuation, the stock was still a passive investment, i.e., unaffected by Mr. Jones' efforts, since the stock's value was determined by the price it commanded in the stock market and was thus market driven. However, as to the value of the stock thereafter, Mr. Jones is in a position that if he performs his job as expected he will have a salary and equity and his efforts should impact value. The question becomes whether Mrs. Jones should be entitled to share in the fruits of her soon-to-be-ex-husband's post commencement and post divorce efforts.

III. The Pitfalls of Making an In-Kind Distribution of Closely-Held Stock

In *Heine v. Heine*,¹⁵ the husband had shares of stock in a formerly public company that became privately held a year after the commencement of the action. To avoid rewarding the wife for appreciation of the stock that resulted from the husband's active participation in his company's strategic decisions after commencement of the action, the Appellate Division in *Heine* determined that the husband's stock should be valued for equitable distribution purposes at the date of commencement, when the company was still publicly traded. The Appellate Division further affirmed the lower court's granting of a distributive award to the wife to equalize the value of marital assets titled in or in the possession of each party.

As indicated by the *Heine* court, no basis exists for distributing the husband's stock in-kind after a trial in the instant action even if there was difficulty in calculating the current value of his now privately-held shares. The current value of the stock is irrelevant to any distribution in an action for divorce. The stock was

¹⁵ 580 N.Y.S.2d 231 (N.Y. App. Div. 1992), *appeal denied*, 600 N.E.2d 632 (N.Y. 1992).

valued by a jointly-retained appraiser when the company was still public and the value of the stock was market driven.

Likewise, the South Carolina court ruled in *Fields v. Fields*¹⁶ that the family court has discretion in its determination of the date of stock valuation, but in general, it is the date when the petition for dissolution of marriage is filed.

Maine does not follow this line of reasoning regarding the time of valuation of stock. The Maine Supreme Court ruled in *Austin v. Austin*¹⁷ that valuation should be at the time of distribution, and not of commencement. It awarded Mrs. Austin the value of fifty percent of the mutual funds at the time of distribution, but disagreed that she was entitled to in-kind distribution of 401(k), invested in stock, mutual funds, and money market funds.

In ruling that valuation of stock should be at the date of the actual division, and not of the divorce, the Maine court reasoned that to give the wife half of the stock's value at time of the decree would deprive her of the growth subsequent to the decree.

Much the same scenario is present in our hypothetical fact pattern as in *Heine*,¹⁸ although Mr. Jones, unlike Mr. Heine, was not a participant in the decision-making process to take the company private. Because the stock was publicly traded, it should be valued as close to the initial date of trial as possible.¹⁹

In our case, since Mr. Jones is, and continues to be, the Chief Financial Officer of ABC, if a court were to grant Mrs. Jones an in-kind distribution of his stock holdings in ABC after a trial of this action, she would receive the post-trial and post-divorce appreciation in value of an active asset.

New York's courts have consistently held that "assets whose values are affected by the active participation of the titled spouse should generally be valued as of the commencement of the action to reward that party's post-commencement efforts, to which the

¹⁶ 536 S.E.2d 684 (S.C. 2000).

¹⁷ 748 A.2d 996 (Me. 2000).

¹⁸ *Heine*, 176 A.D.2d at 77.

¹⁹ Thus, this is not a case such as existed in *Iacobucci v. Iacobucci*, 140 A.D.2d 412 (N.Y. App. Div. 1988) where an in-kind distribution was upheld based solely on the fact that a valuation would be based on "undue speculation and conjecture." In that case, there is no indication of a valuation of the stock as was present in both *Heine* and our hypothetical fact pattern.

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nontitled spouse did not contribute, either directly or indirectly."²⁰

In an analogous situation a similar line of reasoning has been applied. In *Greenwald v. Greenwald*,²¹ the court found that the husband's security accounts were not passive because he managed the account. The court found that the husband's asset in a limited partnership was passive because he had no say in its investments. As the First Department stated:

As to the valuation of the shares, courts have consistently recognized that assets such as undeveloped real estate or mutual funds, which appreciate in value strictly as a result of random market fluctuations or the efforts of others, constitute passive assets, while assets that appreciate due to the efforts of the titled spouse are active.²²

Georgia followed this reasoning in its *Halpern v. Halpern*²³ ruling. In this case, the Supreme Court ruled that the husband did not actively cause the value of the corporate stock to increase. Since this stock was acquired by the husband through gift and inheritance and is considered separate property, the appreciation that is not caused by his efforts during the marriage is not a marital asset and is not distributable at dissolution.

[T]he court during trial, stated that the Katz ESOP is "[c]learly an active asset" and that it would be cut off. . . at the very latest as of the commencement of the action. We agree that the ESOP is an active asset which should be valued as of the commencement of the action.²⁴

Assets acquired after the commencement of an action for divorce are deemed marital and are subject to distribution upon dissolution of the marriage *only* if they result from the passive appreciation of marital property.²⁵

New York courts have consistently held that any portion of a pension acquired either prior to the marriage or after commence-

²⁰ *Soule v. Soule*, 676 N.Y.S.2d 701, 704 (N.Y. App. Div. 1998) (emphasis added).

²¹ 565 N.Y.S.2d 494, 500 (N.Y. App. Div. 1991), *appeal denied*, 578 N.E.2d 443 (N.Y. 1991).

²² *Id.* at 500.

²³ 352 S.E.2d 753 (Ga. 1987).

²⁴ *Greenwald v. Greenwald*, 565 N.Y.S.2d 494, 500 (N.Y. App. Div. 1991), *appeal denied*, 578 N.E.2d 443 (N.Y. 1991).

²⁵ *See, e.g., Greenwald*, 565 N.Y.S.2d at 494. *See also*, *Suydem v. Suydem*, 610 N.Y.S.2d 976, 978 (N.Y. App. Div. 1994); *Harned v. Harned*, 585 N.Y.S.2d 780, 781 (N.Y. App. Div. 1992).

ment of a divorce action must be excluded from the total value by means of a specific equation prior to distributing a party's pension benefits. This is done to prevent the non-titled party from receiving clearly non-marital assets. New York State's highest court has approved exclusion of pension benefits earned subsequent to the commencement of the action.²⁶ Similar conclusions have been reached in a number of other jurisdictions that have addressed the issue.²⁷

The Louisiana court ruled that the employee spouse is entitled to the pension benefit that is "ascribable to his or her personal effort" after the termination of the marriage.²⁸ In the *Schlosser* case, husband and wife were divorced in 1976 and husband retired in 1996. Shortly after husband's retirement, wife appeared and wanted her share of the pension husband is now collecting. The court awarded wife half of the pension benefits for the years they were married and attributed the pension benefits for the years after divorce as husband's separate property.

Indiana has ruled in *Coffey v. Coffey*²⁹ that all assets including pension benefits are to be considered marital property subject to division at dissolution. This court ruled that in a divorce proceeding, "only property acquired after the final separation date of the parties is excluded from the marital assets."³⁰

Likewise, with regard to stock option plans acquired during the marriage, courts are required to consider whether the stock options represent consideration for *past* services performed during the marriage or whether they have been granted during the marriage in anticipation of a party's *future* services. In the latter event, an adjustment must be made to the total value of the plans so that only the portion actually earned *prior* to the commencement of the action is available for equitable distribution.³¹ In the *DeJesus* case, the New York Court of Appeals drew on the reasoning espoused by the Supreme Court of Colorado in *Miller*

²⁶ *Majauskas*, 463 N.E.2d at 15.

²⁷ *See, e.g., Schlosser v. Behan*, 722 So.2d 1129 (La. Ct. App. 1998); *Boyett v. Boyett*, 683 So.2d 1140 (Fla. Dist. Ct. App. 1996); *Petschel v. Petschel*, 406 N.W.2d 604 (Minn. Ct. App. 1987).

²⁸ *Schlosser v. Behan*, 722 So.2d 1129 (La. Ct. App. 1998).

²⁹ 649 N.E.2d 1074 (Ind. 1995).

³⁰ *Id.* at 1079.

³¹ *DeJesus*, 687 N.E.2d at 1319.

v. Miller.³² In analyzing the issue of the distribution of stock options, the *DeJesus* Court observed:

The *Miller* court held that, to the extent that a stock plan is granted for past services, it is wholly marital property. Conversely, "an employee stock option granted in consideration of future services does not constitute marital property until the employee has performed those services" . . .

The *Miller* court thus recognized that a stock plan may have elements which are compensatory for past services and elements which are incentive for future services to the extent that a stock plan is compensation for past services rendered by the employee during the marriage and up until the time of the grant, it is marital property, and to the extent that a stock plan is granted as an incentive for future services, it is not earned until those services are performed.³³

The Oregon Court of Appeals recognized this same rule in its decision in *Powell v. Powell*.³⁴ In this case, the Court of Appeals decided that the wife was not entitled to fifty percent of the husband's stock options because evidence showed that the employer granted stock to the husband to keep him from leaving the company and it was not compensation for current employment. Because these were stock options that would not be vested until after dissolution, the court granted the wife a portion based on a formula.

In *In re Marriage of Walker*,³⁵ the California Court of Appeals ruled that parties to a marriage have a community interest in employment benefits that are earned during the marriage, whether those benefits are received before or after the separation. However, not all of the benefits that are vested after separation are allocated to the community. This court used a formula that accounts for the fraction of the benefits allocated before and after the separation.

The California Court of Appeals in *In re Marriage of Harrison*³⁶ held that "each spouse's time, skill, and labor are community assets, and whatever each spouse earns from them during marriage is community property."³⁷ This court counted fringe

³² 915 P.2d 1314 (Colo. Ct. App. 1996).

³³ *DeJesus*, 665 N.Y.S.2d at 40.

³⁴ 934 P.2d 612 (Or. Ct. App. 1997).

³⁵ 216 Cal. App. 3d 644 (1989).

³⁶ 179 Cal. App. 3d 1216 (1986).

³⁷ *Id.* at 1226.

benefits as compensation earned for employment as part of the community property. Employee stock options are fringe benefits that are rewards for the time, skill and effort of the employee spouse, and thus, are community property. Employment benefits and acquisitions after separation are separate property.

The *Miller* court of New York thus recognized that “a stock plan may have elements which are compensatory for past services and elements which are incentive for future services. To the extent that a stock plan is compensation for past services rendered by the employee during the marriage and up until the time of the grant, it is marital property, and to the extent that a stock plan is granted as incentive for future services, it is not earned until those services are performed.”³⁸

In adopting the reasoning of *Miller* and remitting the matter to the trial court to determine what portions of the husband’s stock plans constitute marital property, the *DeJesus* court directed that “the remainder would be separate property, not subject to equitable distribution, which the husband has the right to enjoy, as separate property traceable to the years outside of the marriage, the fruits of his sole labors.”³⁹

Washington follows the same time rule. The Supreme Court of Washington held that stock options are “part separate property and part community property.”⁴⁰ It went on to say that under Wash. Rev. Code § 26.16 it looks at when the stocks were acquired to determine whether they are separate or community property. The court defined a vested employee stock option as “acquired when granted” and unvested stock option is “one that provides no legal title or rights of absolute ownership over the stock option to the employee.”⁴¹

Texas is within the majority in determining that unvested stock options can be considered marital property to be divided at dissolution. The Court of Appeals of Texas ruled in *Bodin v. Bodin*⁴² that unvested stock options are “contingent interest in property and are a community asset subject to consideration.”

³⁸ *DeJesus*, 665 N.Y.S.2d at 40.

³⁹ *Id.* at 42 (*emphasis added*).

⁴⁰ *In re Marriage of Short*, 890 P.2d at 13.

⁴¹ *Id.* at 15.

⁴² 955 S.W.2d 380, 381 (Tex. App. 1997).

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In a further analogous situation, that of severance pay, the New York Court of Appeals has reached a similar result. In *Olivo v. Olivo*,⁴³ a post-commencement separation package received from the husband's employer was deemed not to be marital property because the husband's right to receive those payments arose after the end of the marriage. Similarly, in *Holmes v. Holmes*,⁴⁴ the court, apart from determining that severance pay is not marital property, distinguished it from such items as renewal commissions pursuant to an insurance agent's contract or contractually mandated severance pay (which the court likened to retirement benefits). Thus, courts clearly distinguish between benefits derived during the economic partnership and those to which only one spouse contributes.

Severance pay is not marital property because in general, it is replacement pay for loss of income. The Court of Appeals of Washington addressed the issue of severance pay in *In re Marriage of Bishop*⁴⁵ and ruled that severance pay is separate property and distinguishable from deferred compensation.

In the *Bishop* case, the former husband challenged the trial court's decision to award his former wife one-half of his severance pay. The appeals court reversed the lower court's decision because severance pay is replacement pay for an employee's loss of employment. Since this is not compensation for work performed, but a mere expectancy, it is considered separate property of the employee to which the non-employee spouse does not own an interest as a tenant in common. Severance pay would be considered marital property and subject to distribution only if it is collected during the marriage, because the expectancy is now changed to a right to collect.

Similar rulings were reached in Colorado and New Jersey with the decisions in *In re Marriage of Holmes*⁴⁶ and *Ryan v. Ryan*.⁴⁷ The *Holmes* court ruled that although based on services provided during the marriage, severance payment is conditional on termination and replaces expected loss of income, and is thus separate property. The *Ryan* court ruled that severance pay is a

⁴³ 624 N.E.2d 151 (N.Y. 1993).

⁴⁴ 841 P.2d 388 (Colo. Ct. App. 1992).

⁴⁵ 729 P.2d 647 (Wash. Ct. App. 1986).

⁴⁶ 841 P.2d 388 (Colo. Ct. App. 1992).

⁴⁷ 619 A.2d 692 (N.J. 1992).

mere expectancy and has no value until it is realized. If the payment is realized during the marriage, then it would be marital property, but if the termination does not occur until after the marriage has ended, then it would be separate property.

In contrast, the Washington Court of Appeals ruled in *In re Marriage of Roarke*⁴⁸ that severance pay received by the husband when he was laid off was community property and subject to distribution. The court granted the wife interest in the severance pay because the husband did not prove that severance pay was intended to replace lost wages that would occur after dissolution.

It is axiomatic that a party's post-commencement and post-trial earnings cannot be deemed marital property even if they arise from a contract entered into during the marriage, because they result from the earner spouse's active efforts after the commencement of an action for divorce. Other jurisdictions that have considered the effects of an athlete's long term contract entered into during the course of the marriage on marital property subject to distribution have held that *future contract earnings for services to be performed* - as opposed to payments for past performance that took place during the marriage - are not marital property subject to equitable distribution.⁴⁹ All of the cases refer to professional athletes who entered into lengthy contracts with their teams during the marriage.

In *In re Anderson*,⁵⁰ earnings for future years were specifically excluded from distribution. In *In re Sewell*,⁵¹ the appellate court expressly held that the trial court had erred in including as marital property the husband's earnings subsequent to the effective date of dissolution of the marriage since the amounts had not been actually earned at that time. The court ruled in favor of the husband despite the fact that the contract that required these payments had been entered into prior to dissolution. Since, at the time of the dissolution of the marriages, none of the men had performed all of the services for which they had contracted while they were married, their later earnings were not considered mari-

⁴⁸ 659 P.2d 1133 (Wash. Ct. App. 1983).

⁴⁹ See, e.g., *Chambers v. Chambers*, 840 P.2d 841 (Utah Ct. App. 1992); *In re Marriage of Sewell*, 817 P.2d 594 (Colo. Ct. App. 1991); *In re Marriage of Anderson*, 811 P.2d 419 (Colo. Ct. App. 1991).

⁵⁰ *In re Marriage of Anderson*, 811 P.2d 819 (Colo. Ct. App. 1991).

⁵¹ *In re Marriage of Sewell*, 817 P.2d 594 (Colo. Ct. App. 1991).

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tal property subject to distribution. In so concluding, the Utah Court of Appeals stated in *Chambers v. Chambers*:

Mr. Chambers's future income will be derived from his playing basketball during the term of his contract, rather than from some past effort or a product produced during the marriage. . . . [H]is right to the benefit of that salary will accrue at that time and did not accrue during the marriage. . . . Thus the trial correctly determined that Mr. Chambers's future contract payments were post-marital income and not marital property rights subject to division.⁵²

Thus, it is the clear intent of equitable distribution laws not to include in the "marital pot" any assets realized by a party after commencement or after trial of the action. This applies to those assets that arise through the titled party's post-commencement and post-trial efforts. The other spouse would improperly benefit from the owner spouse's continuing active efforts even after the parties have been divorced. As the New York Court of Appeals stated in *Hartog v. Hartog*,⁵³ "By considering the extent and significance of the titled spouse's efforts in relation to the active efforts of others and any additional passive or active factors, the fact finder must then determine what percentage of the total appreciation constitutes marital property subject to equitable distribution."

Given the observation in *Hartog* regarding the difficulty in carving out the value of any appreciation in separate property to effectuate a distribution of marital property at the end of a trial, an in-kind distribution of closely-held stock such as that in the hypothetical fact pattern would raise a myriad of insurmountable questions after a divorce has been granted. Who will be able to determine when the value of the stock apportioned to the non-owner spouse in such distribution has appreciated to a point where its value cannot be deemed to result from active factors that occurred during the marriage, to which that spouse is clearly not entitled under existing law? How will the value be affected by the post-divorce active efforts of the owner spouse and his colleagues? Who would monitor the value of the stock to prevent the non-owner spouse from reaping a windfall if the stock appreciates far beyond its value at the date the parties are divorced as a result of the owner spouse's post-divorce efforts and

⁵² *Chambers v. Chambers*, 840 P.2d 841, 844-45 (Utah Ct. App. 1992).

⁵³ 647 N.E.2d 749, 756 (N.Y. 1995).

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those of the company's management team? No factor in the Equitable Distribution Law of New York State would entitle her to receive such a windfall.⁵⁴ Further, why should a private company be forced to consider the non-owner spouse's wishes as a holder of a substantial amount of company stock in making strategic decisions as to the company's future?

When looking at stock options, the Colorado Court in *In re Marriage of Miller*⁵⁵ used the time-rule formula that is followed in most jurisdictions. This rule looks at the extent the unvested employee stock options at issue were granted for past, present, or future services and then what percentage thereof was earned during the marriage and what percentage was earned prior to the marriage and/or subsequent to its dissolution. Similar in their views are the Court of Appeals of Oregon,⁵⁶ the Court of Ap-

⁵⁴ Under DRL § 236B(5)(d), the court shall consider the following factors when determining an equitable distribution of property:

(1) the income and property of each party at the time of the marriage, and at the time of the commencement of the action; (2) the duration for the marriage and the age and health of both parties; (3) the need of a custodial parent to occupy or own the marital residence and to use or own its household effects; (4) the loss of inheritance and pension rights upon dissolution of the marriage as of the date of dissolution; (5) any award of maintenance under subdivision six of this part; (6) any equitable claim to, interest in, or direct contribution made to the acquisition of such marital property by the party not having title, including joint efforts or expenditures and contributions and services as a spouse, parent, wage earner and homemaker, and to the career or career potential of the other party; (7) the liquid or non-liquid character of all marital property; (8) the probable future financial circumstances of each party; (9) the impossibility or difficulty of evaluating any component asset or any interest in a business, corporation or profession, and the economic desirability or retaining such asset or interest intact and free from any claim or interference by the other party; (10) the tax consequences of either party; (11) the wasteful dissipation of assets by either spouse; (12) any transfer or encumbrance made in contemplation of a matrimonial action without fair consideration; (13) any other factor which the court shall expressly find to be just and proper. DRL § 236B(5)(d).

⁵⁵ 915 P.2d 1314 (Colo. 1996).

⁵⁶ *Powell v. Powell*, 934 P.2d 612 (Ore. 1997).

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peals of New Mexico,⁵⁷ the Supreme Court of Washington,⁵⁸ and the Court of Appeals of California.⁵⁹

Because of the clear distinctions between marital, post-commencement and post-trial property in New York and other jurisdictions and the inability of a future court to answer questions such as those posed above, a non-owner spouse such as Mrs. Jones should not be awarded an in-kind distribution of the owner spouse's stock. To make such an in-kind distribution would give her a greater share of the value of the stock than she would otherwise be entitled to under DRL § 236B.

While the New York court clearly disfavors in-kind distribution of closely-held stocks because of the possible difficulties for the parties, other jurisdictions are not so resolute. The Texas court ruled in *Braswell v. Braswell*⁶⁰ that the trial court has discretion to determine if community property could be distributed in-kind and if it can be done, then it shall be done.

In *Josephson v. Josephson*⁶¹ the lower court in Idaho divided the shares of a corporation in kind and did not value the stock. The husband had managed a closely-held corporation during the marriage. The wife complained that she had been given a valueless minority interest by being given the stock in kind. On appeal, the Idaho Court agreed with the wife and stated that an equal division can be achieved with an in-kind division of stock only when the stock is publicly traded. With a closely held business, the same value did not exist because the majority interest or control lay in the hands of only one ex-spouse. The statutes, the court reasoned, contemplate a complete division of property, leaving the parties free of entangled interests and here the interests would be entangled. The wife needed income producing assets and the husband would have the power to prevent the payment of dividends in the name of providing working capital for the business after the divorce. The decision of the lower court was reversed and the court ordered to value the stock and provide an offset in property.

⁵⁷ *Garcia v. Mayer*, 920 P.2d 522 (N.M. 1996).

⁵⁸ *In re Marriage of Short*, 890 P.2d 12 (Wash. 1995).

⁵⁹ *In re Marriage Walker*, 216 Cal. App. 3d 644 (1989).

⁶⁰ 476 S.W.2d 444 (Tex. 1972).

⁶¹ 772 P.2d 1236 (Idaho Ct. App. 1989).

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Likewise, the Pennsylvania court has ruled in *Ryan v. Ryan*⁶² that in-kind distribution should take precedence over buy-out. In this case, the spouses acquired twenty shares of a closely-held Pennsylvania corporation. The trial court forced the husband to buy-out his spouse's shares of the stock, but the Supreme Court of Pennsylvania awarded the wife 50 percent of the shares and ruled that the dividends can be distributed in-kind or buy-out.

The Supreme Court of Pennsylvania went on to say that "prior to a court making or approving a buy-out remedy, it is required to make specific findings as to why a division of the property cannot be effectuated."⁶³ Justice Larsen wrote in his concurring opinion to emphasize that "a distribution 'in kind' should take precedence over a 'buy-out' distribution. . ."⁶⁴ Pennsylvania would only allow valuation if in-kind distribution cannot be done.

The Pennsylvania court allowed a buy-out in *In re Brugger*⁶⁵ because of the specialized nature of the business. The Bruggers owned stocks in a software company which they formed during their marriage, servicing the flavor and fragrance industry. Because this is such a specialized business, the court allowed the buy-out.

The Wisconsin Court of Appeals refused to allow the husband a distribution in-kind even though he argued that transfer of stock would weaken his position in the corporation.⁶⁶ Robert Trecker inherited from his father 57,840 shares of Kearney & Trecker Corporation, a publicly traded corporation. At dissolution, the trial court awarded his ex-wife 17,250 shares, or 29.8 percent of the stock to provide her with a cushion against inflation and a form of retirement program.

Although the court ruled in *Trecker* that an in-kind distribution was appropriate, it did acknowledge that where it would create extreme hardships on the parties, distribution in-kind would not be mandated. This Court recognized that the Wisconsin Su-

⁶² 596 A.2d 140 (Pa. 1991).

⁶³ *Id.* at 193.

⁶⁴ *Id.* at 192.

⁶⁵ 254 B.R. 321; 2000 Bankr. LEX 1298 (May 15, 2000).

⁶⁶ *Trecker v. Trecker*, 300 N.W.2d 79 (Wisc. Ct. App. 1980).

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preme Court ruled a distribution in-kind is an abuse of discretion in *Wetzel v. Wetzel*.⁶⁷

The *Wetzel* court stated:

In small estates it may be that such a division is the only possible division, but when there are sufficient assets as in the instant case it would seem that any form of joint control or ownership of assets by divorced persons should be avoided. The elimination of the source of strife and friction is to be sought and the financial affairs of the divorced parties separated as far as possible. If the parties cannot get along as husband and wife it is not likely that they will get along as partners in business.⁶⁸

In New Mexico, the disadvantage of an in-kind distribution is evident in the courts decision in *McCauley v. Tom McCauley & Sons, Inc.*⁶⁹ The spouses together owned 60% of the stock of the husband's family business during an acrimonious divorce left the stock divided in kind. The ex-wife was fired from the board of directors and denied some personal benefits received by other shareholders. The ex-wife sued the corporation for fraud and oppressive conduct, seeking damages while the divorce was still pending. The trial court found in her favor and offered the corporation one of 3 courses: to liquidate, partition and reorganize or buy back her shares. The corporation chose the last option and the trial court valued her interest with a minority discount, using traditional valuation methods. Both parties appealed. The appellate court affirmed the right to the ex-wife's claim and the alternatives offered by the trial court, affirmed the minority discount and the valuation method. Both parties won and lost.

IV. The Wisdom of Making a Distributive Award to the Non-Owner Spouse

In distributing marital property after a divorce, it is within the court's discretion to fashion a distributive award of its value if it is inappropriate to divide the asset itself.⁷⁰ It is well-settled, both statutorily and by case law, that a distributive award is warranted:

⁶⁷ 150 N.W.2d 482 (Wis. 1967).

⁶⁸ *Id.* at 485.

⁶⁹ 724 P.2d 232 (N.M. Ct. App. 1986).

⁷⁰ DRL § 236B(5)(e).

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In any action in which the court shall determine that an equitable distribution is appropriate but would be impractical or burdensome or where the distribution of an interest in a business, corporation or profession would be contrary to law, the court in lieu of such equitable distribution shall make a distributive award in order to achieve equity between the parties. The court, in its discretion, also may make a distributive award to supplement, facilitate or effectuate a distribution of marital property.⁷¹

Following the statutory language, courts have particularly directed a distributive award where any other distribution method of a portion of one spouse's business interests or corporate holdings to the other spouse is deemed to be "burdensome," "impractical," or not otherwise feasible. The lower court in *McDicken v. McDicken*⁷² inappropriately found that the business was the husband's separate property, when it was founded with two other partners during the marriage. The appellate court, which remanded the matter to adduce evidence of an accurate value of the husband's share of a business, held that: "As actual division of the business . . . would be impractical, Special Term should have made a distributive award to plaintiff."⁷³

Similar holdings have been made in *Bisca v. Bisca*⁷⁴ and *Markel v. Markel*.⁷⁵ In *Bisca*, the Appellate Division of the Second Department observed:

Although the court stated in its decision that it had considered the 10 factors set forth in subdivision 5 (par. d) of part B of Section 236 of the Domestic Relations Law, it is clear to us that the court was overly influenced by its view that it was difficult to award the Wife a share in the husband's corporate holdings or pension and profit-sharing plans. While this difficulty may have existed, an equal division could have been accomplished by giving the Wife a distributive award. Subdivision 5 (par. e) of Part B of section 236 of the Domestic Relations Law provides: "In any action in which the court shall determine that an equitable distribution is appropriate but would be impractical or bur-

⁷¹ *Id.* See also, e.g., *Kobylack v. Kobylack*, 465 N.E.2d 829 (N.Y. 1984); *Majauskas v. Majauskas*, 463 N.E.2d 15 (N.Y. 1984).

⁷² 486 N.Y.S.2d 52 (N.Y. App. Div. 1985).

⁷³ *Id.* at 53. See also, e.g., *Meikle v. Perret-Meikle*, 574 N.Y.S.2d 71 (N.Y. App. Div. 1991), where the wife's 50% interest in the husband's real estate and contracting businesses was conveyed to her by means of a distributive award, citing to *McDicken*, *supra*, and *Herrmann v. Herrmann*, 518 N.Y.S.2d 501 (N.Y. App. Div. 1987).

⁷⁴ 485 N.Y.S.2d 302 (N.Y. App. Div. 1985).

⁷⁵ 602 N.Y.S.2d 477 (N.Y. App. Div. 1985).

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densome or where the distribution of an interest in a business . . . would be contrary to law, the court in lieu of such distribution shall achieve equity between the parties. The court in its discretion, also may make a distributive award to supplement, facilitate or effectuate a distribution of marital property."⁷⁶

The *Bisca* court made a determination that the lower court properly valued stock received by the husband during the marriage as of the date the action was commenced and that a distributive award of its value was expressly warranted because actual distribution of the stock would be impractical.

South Carolina reached a similar conclusion regarding in-kind distribution, but added that in-kind distribution is unwarranted where the nature of the parties' relationship to the asset would make it inequitable.⁷⁷

Utah has a parallel view of in-kind distribution. In its ruling in *Savage v. Savage*,⁷⁸ the Utah Supreme Court declared that "whenever possible, continued joint ownership by divorced spouses of closely held corporate stock should be avoided."⁷⁹ Although this court favored discontinuing joint ownership of closely held stock, it allowed for in-kind distribution in this case because distribution by way of an offset would have done more harm than good to the parties. In-kind distribution was proper to avoid injustice to the parties and considerable problems of valuation for the court.

Tennessee is similar in its rule of in-kind distributions, but it also takes into consideration the contributions made by each party during the marriage in the accumulation of the stock. In *Brock v. Brock*,⁸⁰ the court awarded the husband fifty-five percent of shares of common stock because he provided seed money to the marital wealth.

Hawaii is consistent with these holdings regarding severing the parties' ties by discontinuing joint ownership of closely held stock. In *Frandsen v. Frandsen*⁸¹ the Hawaii Supreme Court granted the husband ownership of closely-held stock and awarded wife cash value. The Hawaii court reasoned that since

⁷⁶ *Bisca*, 485 N.Y.S.2d at 304.

⁷⁷ *Fields v. Fields*, 342 S.C. 182 (2000).

⁷⁸ 658 P.2d 1201 (Utah 1983).

⁷⁹ *Id.* at 1205.

⁸⁰ 941 S.W.2d 896 (Tenn. Ct. App. 1996).

⁸¹ 564 P.2d 1274 (Haw. 1979).

husband has a direct effect on the value of the stock because of his position as president of the corporation, it would be more practical to award control of the stock to husband.

In the Utah case of *Berry v. Berry*,⁸² although the Supreme Court stated that it is preferable to sever all ties between the parties at divorce, the court granted in-kind distribution for the parties' interest in a part-time farming operation. The court's decision was based on the fact that no value existed for the partnership interest as divided. The lower court's decision to force the husband to buy-out his wife was an abuse of discretion because of the burden that it would cause him. Although it is against public policy to have former spouses continue joint ownership interest, it is the logical choice if forcing buy-out would be unduly burdensome to one party.

The use of the concept of a distributive award in circumstances involving a business whose stock is not publicly traded has been approved by various courts in other states. In a similar situation, the California Supreme Court observed:

In particular cases, strict "in kind" divisions, such as Wife now urges, may cause, rather than avoid, financial inequities. A spouse with a high income may be able to afford to retain high-risk assets while an unemployed spouse wholly dependent upon spousal support may not. By dividing "in kind" high-risk assets such as the Amdahl stock, a court may, for purposes of fairness, divide the risk of loss disproportionately. The exercise of a trial court's sound discretion is best preserved by maintaining a maximum degree of allowable flexibility.

* * *

This uncertain, non income-producing stock might be a valuable holding for an individual who was otherwise financially secure, but a court or counsel might well conclude that a less-risky, more assured income-producing investment such an interest-bearing note with a fixed principal would more appropriately serve an unemployed woman with custody of two minor children.⁸³

In another case, also emanating from California, the court observed:

The trial court may divide community property where warranted by methods such as awarding an asset to one spouse conditioned on later payments or by making offsetting awards of community assets. . . . Strict in-kind division may cause, rather than avoid, financial inequity. . . . Further, it has been said that, although the determination

⁸² 635 P.2d 68 (Utah 1981).

⁸³ *In re Marriage of Connolly*, 591 P.2d 911 (Cal. 1979).

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whether division is possible without impairment must be flexibly made, if the stock holdings are in a close corporation, an award of an entire block of stock to the husband may be justified.⁸⁴

The *Lotz* court then proceeded to reject an in-kind distribution, finding that in the typical dissolution situation, the interpersonal hostility between former spouses is such that it renders a post-divorce business association "impossible."⁸⁵ Similar results rejecting an in-kind distribution of stock in a closely held corporation can be found in *In re Marriage of Russell*⁸⁶ and in *In re Marriage of Clark*.⁸⁷

In our hypothetical case, Mr. Jones actively participated in ABC after the commencement of the divorce action (and even more so since the company has gone private). It is economically desirable for Mr. Jones to retain an intact interest in this now private corporation after the dissolution of the marriage, free and clear of any claim by his former wife. Thus Mrs. Jones should receive a distributive award representing her share of the marital portion of that interest, valued as of June 30, 1999, while ABC was still a public company and thus a passive asset, particularly since sufficient liquidity exists in the marital estate to pay the same. Once the company became privately-held after the commencement of the action, any appreciation in the stock resulted only from Mr. Jones' active participation in running the company.

To make an in-kind distribution of the ABC stock would not only cause Mrs. Jones to reap the fruits of Mr. Jones' post-commencement and post-trial efforts in the corporation, but also would place an additional outside shareholder (and a potentially disruptive force) in what is now a private company. To distribute the asset in any manner other than a distributive award would clearly be "impractical" and "burdensome."

⁸⁴ *In re Marriage of Lotz*, 174 Cal. Rptr. 618, 621-22 (Cal. Ct. App. 1981).

⁸⁵ See also, *Lewis v. Lewis*, 785 P.2d 550 (Alaska 1990) (awarding the husband all stock in the company in which he was employed and granting the wife a monetary award as to one-half the value, finding that such distribution was "important, necessary and instrumental" in the husband's continued employment).

⁸⁶ 473 N.W.2d 244 (Iowa Ct. App. 1991).

⁸⁷ 145 Cal. Rptr. 602 (Cal. Ct. App. 1978).

V. Conclusion

In the hypothetical fact pattern, there can be no question that Mrs. Jones should receive a distributive award representing her share of the marital property portion of Mr. Jones' interest in ABC at the value determined by the joint appraiser, and not an in-kind distribution of the number of his shares of stock that existed at the date of commencement of this action. Any distribution in-kind would be patently inequitable and contrary to statutes and prevailing case law. An in-kind distribution would force the remaining shareholders of this now private corporation to accept an outsider holding a substantial amount of stock. This is sure to prove impractical and unduly burdensome to the company in making future decisions. Such a distribution of the ABC shares of stock to Mrs. Jones would also give her a share of any increase in the value of the stock that has resulted from Mr. Jones' post-commencement, post-trial and post-divorce active participation in the company, clearly prohibited by the statute.