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ACTING IN THE BEST INTERESTS OF THE CHILD: A SOLUTION TO THE PROBLEM OF CHARACTERIZING STOCK OPTIONS AS INCOME

Kristy Watson*

INTRODUCTION

Joe and Jill Smith have been married for ten years and have two children. Joe is an executive at Built Motor Company where he annually receives, in addition to his salary, options to buy Built stock at a set price. These non-transferable options have a set strike price, which is the market price of the stock on the date the options are issued, and they cannot be exercised for at least one year from the date of issuance. After that time, Joe can buy the Built stock at the set strike price, for up to ten years from the date of issuance.

Joe has been working at Built for four years and has not yet exercised any of his stock options. Following problems that developed in their relationship, Jill and Joe decide to divorce. Jill will have custody of the two children. The court determines that Joe's stock options are marital property to be divided between the two divorced spouses—Jill will receive one-third and Joe will receive two-thirds. Because the options are non-transferable, a constructive trust is impressed on Jill's behalf for her share of the options. Accordingly, when she decides to exercise the options, Joe, acting as her trustee, will have a duty to execute that decision on her behalf. In addition, the court determines child support and alimony payments based on

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1. The restriction on transferability of the option is imposed by the employee contract and provides that the option cannot be transferred to another. The restriction applies to all forms of transfer including sale, gift or trade. See infra note 109 and accompanying text.

2. See infra notes 115-18 and accompanying text for a description of the different methods courts use to determine whether or not stock options are marital property.

3. A constructive trust, unlike a regular trust which is brought into existence by agreement between two parties, is created by a court whenever the legal title to property is located in a person who cannot equitably remain in possession of it. See infra notes 136-55 and accompanying text for a discussion of the constructive trust and marital property cases using the constructive trust.
Joe's current salary without including any future benefit he may receive from exercising the remaining stock options.  

Three years later, Jill initiates court proceedings for a modification of the child support award, claiming that because the value of Built stock has skyrocketed since the divorce, her husband has more income at his disposal and therefore his child support payment should be increased. The court agrees, stating that the stock options should now be considered income and as such, they are subject to child support statutes. The court then computes the present value of the stock options and adds that value to Joe's income. Although Joe still has not exercised any of his options, Built's stock value has increased substantially and, therefore, the value of the stock options themselves has increased. This significantly increases the amount of child support he is legally required to pay. In effect, this forces Joe to exercise those options immediately so that he is able to meet his child support payments.

Joe had not exercised the options yet because as an executive of the company, he felt that the value of Built stock would only rise due to the popularity of the new super-SUV Built recently introduced on the market. It turns out that Joe was right. Twelve months after the court determination, Built stock went up 30%. Because the court had already given the options a lesser value and the options had been exercised, neither Joe nor the children were able to participate in this valuation increase.

This hypothetical, however, could have the opposite result. When Jill and Joe were married, Jill recalls that Joe and the other executives at Built were concerned with the design of some of the tires they were planning on utilizing on the super-SUVs they intended to introduce. At the time of the modification proceeding, Jill felt that Built would only have problems in the future and she wanted the court to base the child support on the present value of the options. It turns out that Jill's suspicions were well founded. One year later, Built stock is down 50% due to a recall of all of the super-SUVs and the onslaught of lawsuits stemming from Built's knowledge of the defective tire design. Joe's child support payments, however, were based on the value of the options a year earlier, and so did not reflect this steep decline in his income.

The scenario described above was inspired by a string of recent court decisions, the most important of which is Murray v. Murray.  

In Murray, the Ohio Court of Appeals decided that the stock options at issue in the case should be considered income under Ohio state child support formulas and therefore should be divided and distributed to

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4. For examples of state statutes setting out guidelines according to which courts are to determine amounts of child support, see infra note 41.  
the child regardless of whether the father had ever exercised those options. The court decided that the options should be valued at their current, intrinsic value. As a result, the father was, in effect, forced to exercise the stock options in order to pay child support.

Because stock options have become a popular method of compensation for all levels of employees over the past decade, the issues that arose in the Murray case will likely become more and more prevalent. This Note, therefore, analyzes the reasoning of the Murray court and asks whether future courts should follow the lead of the Ohio Court of Appeals and characterize stock options as income for the purposes of determining child support payments. This Note argues that the Ohio court correctly decided to identify the stock options as income instead of property because that decision made the value of those options available to the child. Yet, the court's method of valuation, which is the intrinsic valuation method, defeats its intended purpose of fulfilling the best interests of the child and ignores significant fairness and efficiency considerations. Instead, the court should have used a constructive trust, which would better address the needs and interests of all of the parties involved.

Part I describes the history and current state of the law regarding child support, and shows how child support policy has changed from being strictly concerned with marriage and protecting the public fisc, to focusing on protecting the best interests of the child. Part I also defines and discusses stock options, and explains the methods used to evaluate them. Part II summarizes the case law regarding the treatment of stock options in child support proceedings and the rationale behind courts' decisions to categorize stock options as income subject to child support formulas. Part II also outlines the criticisms of these decisions, which indicate that the courts did not consider all of the negative consequences that could result.

Finally, Part III argues that these decisions actually undermine the courts' attempts to serve the best interests of the child. If the value of a stock option increases, it would be in the best interests of the child to allow him to enjoy that increase. By valuing the stock options at their current, intrinsic value instead of considering the changing value of the options, however, the child cannot do so. The courts, therefore, should continue to characterize the options as income, but then divide them in kind, as though they were property. If the options cannot be

6. Id. at 294.
7. See id. at 299.
9. See infra note 86.
10. The intrinsic valuation method uses only the current market price to determine the value of the option. The intrinsic value is equal to the difference between the strike price of the option and its current market price. See infra notes 91-104 and accompanying text for a more thorough definition of this method.
divided in kind because of their non-transferability, the courts should impose, as an equitable remedy, a constructive trust for the benefit of the child upon the portion of the options to which the child is legally entitled. The constructive trust is a superior solution because it attempts to solve some of the most troublesome problems created by the courts, not only by considering the best interests of the child, but also by addressing issues of fairness and efficiency.

I. BACKGROUND

A. The Best Interests of the Child

The duty of parents to provide for the maintenance of their children, is a principle of natural law; an obligation... laid on them not only by nature herself but by their own proper act, in bringing them into the world; for they would be in the highest manner injurious to their issue, if they only gave their children life that they might afterwards see them perish.

The United States' child support laws originated in England, but the ideas expressed in this English legal authority's quote did not match the reality of child support and family law until very recently in American history. Family law began as an aspirational, patriarchal code with the goals of avoiding illegitimacy, divorce, and state responsibility to care for impoverished children of divorce. It has since developed into an approach recognizing that although marriages may end, parent-child relationships do not. As one commentator stated, "[c]hild support has come of age. Once the stepchild of family law, child support has moved onto center stage in the modern effort to define and enforce family obligation.”

Today, figures show that nearly 50% of couples who marry eventually decide to divorce, and that 60% of all children spend at least some of their childhood years in a household headed by a single

11. See infra notes 109 and accompanying text for a discussion of non-transferability.
12. The constructive trust has been used to address the distribution of stock options in the marital context. See the discussion of the Callahan case at infra notes 136-55 and accompanying text.
14. Id. at 1.
16. See id. at 3-4.
17. Id.
18. Id. at 3.
Since the development of no-fault divorce in the 1970s and 80s led to a large increase in the number of divorces, the law has had to reshape familial obligations to ensure that parents provide for their children after divorce. The law now recognizes that parent-child ties are independent of spousal ties: "Indissoluble marriage has been replaced by the indissoluble responsibility of parenthood."

For most of the history of Western civilization, permanent, lasting marriages were considered a virtue, regardless of how unhappy the husbands and wives were in the relationship. This sentiment had an effect on the enactment and enforcement of child support laws. For example, English taxpayers, like American taxpayers after them, did not want to pay for the support of children they believed were the result of "irresponsible behavior" by unmarried parents. This led to the enactment of child support laws with the narrow goal of persuading the couple to marry and become legitimate in the eyes of the community, without any real concern for the child's standard of living. The emphasis on encouragement of marriage existed in divorce laws as well, with financial allocations after divorce designed to punish the party responsible for the breakup. In fact, many American states either did not have child support laws at all or, if they did, they were seldom utilized. The principal goal of the domestic relations laws that did exist was to deter divorce, which helps to

19. Id.; Lieberman, supra note 13, at 11.
20. Carbone, supra note 15, at 6-7. No-fault divorce created an option for couples who could not or did not want to establish the grounds for a divorce based on fault. It usually still requires objective criteria proving that a marriage is irretrievable, but a specific time period in which the parties have lived apart is normally enough to fulfill that requirement. See Harry D. Krause, Family Law § 24.5 (2d ed. 1995).
22. Id. at 11 n.1 (quoting John Eekelaar, Regulating Divorce 90 (1991)).
23. Krause, supra note 20, § 19.1; see also Carbone, supra note 15, at 5 ("Divorce, like illegitimacy, was a misfortune to be deterred, and the primary element in the financial allocation was assignment of responsibility for the breakup.").
24. Carbone, supra note 15, at 5. Carbone describes society's attitude toward extramarital fornication and childbearing and states that the law ensured that the father was the one who had to pay for the support of any illegitimate children. She writes, "the purpose of the sanctions was to deter illegitimacy, increase the woman's leverage in securing a betrothal, and spare the public treasury, not to provide funds for the mother to raise the child on her own." Id.
25. Id. at 5-6. Mary Ann Mason argues that the English Poor Law Act of 1576, which "decreed that parents ... had to pay for the upbringing of a bastard, thus relieving the public of those costs," is a good example of a child support law with these particular goals. Mary Ann Mason, From Father's Property to Children's Rights: The History of Child Custody in the United States 25 (1994).
26. Carbone, supra note 15, at 5, 11 n.3 (citing Mason, supra note 25, at 25) (commenting that the earliest Massachusetts laws punished fornication and bastardy but that there was no law requiring child support until the 1600s).
27. Id. at 6 (noting that even into the 1980s less than half of couples had child support orders).
explain why, until the 1970s, divorce was available only if one of the parties was at fault.\textsuperscript{28}

In the 1970s and 1980s no-fault divorce changed the landscape of family law,\textsuperscript{29} and "the advent of no-fault divorces effectively rendered unenforceable the promise to remain married for a lifetime and remade the basis for financial allocations at divorce."\textsuperscript{30} The no-fault divorce reform, as reflected in the Uniform Marriage and Divorce Act (the "Uniform Act"), allowed a "clean break" between the former spouses while at the same time recognizing that child support remained an obligation for both parties.\textsuperscript{31} The Uniform Act provided support for the assertion that child support was "presumed appropriate in all cases involving children at the same time that spousal support was not."\textsuperscript{32} As such, child support gained an independent existence and was "born" in the sense we are familiar with it today.

The maturation of child support happened very slowly. In the late 1980s, child support laws were still confronting problems.\textsuperscript{33} Strained economic circumstances of single-parent families coexisted with the reality that child support awards were lower than the actual costs of raising the children and lower than the non-custodial parent’s ability to pay.\textsuperscript{34} In addition, society was concerned with the demands that

\begin{footnotesize}
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\item踄\textit{Id.} at 5; Krause, supra note 20, §§ 19.1-19.13 (describing the acceptable fault grounds for divorce and how they expanded from adultery and physical cruelty to mental cruelty, conviction of a felony, and venereal disease, and commenting that this expansion was a logical continuum between pure fault divorce and pure no-fault divorce).
\item踄Carbone, supra note 15, at 6-7; Krause, supra note 20, § 19.1. For a discussion of how no-fault divorce changed some approaches to the equitable division of marital property, see Jesse Dukeminier & James E. Krier, Property 377 (4th ed. 1998) (quoting The Uniform Marriage and Divorce Act § 307 (1973)) ("T\textquotesingle h\textquotesingle e court, without regard to marital misconduct, shall . . . finally equitably apportion between the parties the property and assets belonging to either or both. . . .") (alteration in original)).
\item踄Carbone, supra note 15, at 6-7; Dukeminier & Krier, supra note 29, at 377; Krause, supra note 20, ¶ 26.3. The basis for the financial allocations became one where the wife was entitled to alimony in an amount that allowed her to enjoy the same standard of living she enjoyed during the marriage. This, however, did not include any increased standard of living the husband enjoyed after the divorce. See infra note 53.
\item踄See The Uniform Marriage and Divorce Act § 307 (Alternative A) (1973); Carbone, supra note 15, at 7. Carbone describes the "clean break" principle and its goal to end marriages amicably with little recrimination for any misconduct by either party during the marriage and with no further relationship between the spouses. She also describes the Act’s purpose of achieving these goals through property division instead of long-term alimony payments. Carbone, supra note 15, at 7.
\item踄Carbone, supra note 15, at 7. "T\textquotesingle h\textquotesingle e court may protect and promote the best interests of the children by setting aside a portion of the jointly and separately held estates of the parties in a separate fund or trust for the support, maintenance, education, and general welfare of any minor, dependent, or incompetent children of the parties." The Uniform Marriage and Divorce Act § 307(b) (Alternative A) (1973).
\item踄Carbone, supra note 15, at 9.
\item踄\textit{Id.} at 9, 13 n.15 (citing Irwin Garfinkel, Marygold S. Melli & John G.
these impoverished children were placing on the public fisc.\textsuperscript{35} Because American divorce rates were at world highs and nonmarital birth rates continued to rise, the public favored increasing amounts of child support and giving teeth to child support enforcement laws.\textsuperscript{36} As a result, Congress enacted the Family Support Act of 1988 (the "FSA").\textsuperscript{37} The FSA’s central requirement was that each state develop mathematical guidelines to determine amounts of child support awards.\textsuperscript{38} Congress also required that the states review these guidelines at least once every four years to make sure that they produce an adequate amount of child support.\textsuperscript{39} Because determining the amount of child support was a complex task, federal regulations provided more specific directives, which included minimum requirements that "\textquoteleft\textquoteleft[t]ook into consideration all earnings and income of the non-custodial parent," \textsuperscript{40} and that based the guidelines on "specific descriptive and numeric criteria... result[ing] in a computation of the support obligation."\textsuperscript{41} The FSA itself states that "\textquoteleft\textquoteleft there shall be a rebuttable presumption... that the amount of the award which would result from the application of such guidelines is

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  \item \textsuperscript{35} Carbone, \textit{supra} note 15, at 8-9.
  \item \textsuperscript{36} \textit{Id.} at 9.
  \item \textsuperscript{37} Child support as a partial solution to the problems of single-parent families was uncontroversial because it did not appear to break new ground. That parents should support their children was axiomatic, and that there was a legal obligation to do so, notwithstanding the historical marginality of the obligation, was well established.
  \item \textsuperscript{39} 42 U.S.C. § 667(a) (1994); Friedman, \textit{supra} note 34, at 178-79 (noting that the incentive for states to comply was the federal funding of their Aid to Families With Dependent Children (AFDC) programs).
  \item \textsuperscript{40} 42 U.S.C. § 667(a); Melli, \textit{supra} note 37, at 113.
  \item \textsuperscript{41} 45 C.F.R. § 302.56 (2000).
\end{itemize}
the correct amount of child support to be awarded.”

The federal regulations then state that a situation where the guidelines “would be unjust or inappropriate in a particular case shall be sufficient to rebut the presumption in that case, as determined under criteria established by the State. Such criteria must take into consideration the best interests of the child.”

In order to fulfill these objectives, states have determined “income percentages that approximate the percentage of income that couples sharing a single household spend on their children.” When states base their awards on this determination their approach is often called a “continuity-of-expenditure” approach. The terminology reflects the goal of ensuring that children of divorced parents continue to receive the same amount of benefits they would have if their parents were married. This approximation of expenditure was expressed as a percentage because the main goal of child support laws shifted from basing support simply on the child’s need to guaranteeing that the child enjoyed support commensurate with the parents’ incomes, whether that income increased or decreased in the future. The majority of states execute the “continuity-of-expenditure” approach through an “income-shares” calculation that “bases each parent’s

42. 42 U.S.C. § 667(b) (1994).
43. 45 C.F.R. § 302.56(g) (2000).
46. Id. (noting that this policy goal is meant to reproduce the “typical” outlay to children residing in a two-parent family); see also Cal. Fam. Code § 4053 (West 1994) (“Children should share in the standard of living of both parents. Child support may therefore appropriately improve the standard of living of the custodial household to improve the lives of the children.”).
47. States have recognized that a child’s needs increase or decrease as the parents’ income changes because a child’s needs are often determined by the parents’ resources. In addition, children cost more as they age. See J. Thomas Oldham, New Methods to Update Child Support, in Child Support: The Next Frontier, supra note 15 at 134; see also Robert G. Williams, Guidelines for Setting Levels of Child Support Orders, 21 Fam. L.Q. 281, 321-24 (1987).
48. Principles of the Law of Family Dissolution §§ 3.03(1), 3.05 (ALI 1997) (stating that the “most important” goal of child support is “ensur[ing] that the child share equitably in the incomes of both parents” and adopting the “continuity-of-expenditure” approach through the “income-shares” calculation). This means, theoretically, that if the parents’ incomes increase, the amount of support will increase. The practical outcome depends, however, on the ease and efficiency of court modification procedures that take into account any changes and modify the amount of support accordingly. See infra notes 54-71 and accompanying text; see also Ohio Rev. Code Ann. § 3113.21.6 (Anderson 2000) (setting forth the extensive procedures for modification); Seither v. Seither, No. 98-02590, 1999 WL 1143770, at *3 (Fla. Dist. Ct. App. Dec. 15, 1999) (recognizing the high probability of modification in child support cases involving stock options).
portion of the total [support] on his or her income, varying with the number of children."

Two problems arise under these guidelines: defining income and how to handle substantial changes in income. The federal regulations do not define income. Many states expended considerable effort devising definitions of income because it is "one of the most litigated issues in child support enforcement," and because the amount of child support is directly affected by the income base used to calculate the award. If that base is "too limited and too many items are excluded, the amount of child support generated is less." Most states have proposed expansive definitions of income so that the child will enjoy any increase in the standard of living that the parents experience after the divorce.

49. Carbone, supra note 15, at 10. Assume, for example, that the state determines that the relevant percentage is 20%. Then assume that the total annual income of the spouses is $100,000, with the non-custodial parent earning $80,000 and the custodial parent only $20,000. The child would be entitled to $20,000 worth of support annually (20% of $100,000). The $20,000 would be divided between the custodial and non-custodial parents according to their share of the total $100,000. The custodial parent only earned 20% of that total so his or her responsibility would only be $4,000. The remaining $16,000 would be the responsibility of the non-custodial parent. See Cal. Fam. Code §§ 4050 to 4076 (West 1994 & Supp. 2000)(majority); Fla. Stat. Ann. § 61.30 (West Supp. 2001) (majority); Md. Code Ann., Fam. Law §§ 12-201 to 204 (1999) (majority); N.Y. Dom. Rel. Law § 240(1-b) (McKinney 1999) (majority); Ohio Rev. Code Ann. §§ 3113.21.5, 3113.21.6 (Anderson 2000) (majority). Alternatively, a minority of states have adopted a "percentage of income" or "Melson" standard whereby the court awards a fixed percentage of the non-custodial spouse's income no matter what the income of the custodial spouse. See Nev. Rev. Stat. Ann. 125B.070 (Michie 1998) (minority); see also Carbone, supra note 15, at 10.

50. Melli, supra note 37, at 116.
51. Id. (citing Laura Morgan, Child Support Guidelines: Interpretation and Application 2-5, 2-7 (Supp. 2000)).
52. Id.
53. Id.; see also Murray v. Murray, 716 N.E.2d 288, 293 (Ohio Ct. App. 1999) (stating that the definition of income, even though already expansive itself, was to be interpreted in an expansive fashion, otherwise the interests of the child would not be met). The statute used in Murray was the Ohio Revised Code Annotated § 3113.21.5(A), setting forth a broad yet detailed definition of income. See also N.Y. Dom. Rel. Law § 240(1-b)(b)(5) (McKinney 1999) (stating that "'[i]ncome' shall mean, but shall not be limited to" six specifically listed clauses, each of which is expansively worded: for example, "at the discretion of the court, the court may attribute or impute income from, such other resources as may be available to the parent. . . ." (emphasis added)). While discussing the different policy goals regarding child support versus alimony and the standard of living to be upheld through each, the court in Kerr v. Kerr stated:

[T]ying needs to the standard of living enjoyed during marriage has no place in child support as opposed to spousal support determinations. Adults who separate and dissolve their marriage do so with eyes open, each choosing a separate course and appreciating the possibility that the other will go on to attain a far more comfortable standard of living. Limiting increases in spousal support to the supported spouse's living standards during marriage justifiably holds the supported spouse to those expectations. The child, on the other hand, is an innocent victim of the dissolution, with no choice in the breakup but with reason to expect that both parents will continue to provide
States must also address the question of when an action for modification of an award can be brought. At the present time, most states, under the income shares method, determine a dollar amount (based on percentages of income) that remains fixed throughout the child's age of minority. In order to modify this amount one of the parents must bring an action for modification. The amount will be modified if the court decides that the circumstances of the parents or the child have substantially changed since the first determination. For example, if a non-custodial parent's income increases or decreases by a substantial amount, either parent can then go to court for modification. Courts could avoid these logistics by instead using the percentage of income method to determine an award. For example, the court could decide that a non-custodial parent is legally obligated to send 20% of his income to his child as child support. The actual dollar amount of the award would then fluctuate automatically as the parent's income went up or down, and there would be no need to go back to court every time the non-custodial parent's income changed.

There are two main benefits to the percentage of income method. First, this method results in low administrative costs because the dollar amount of the award is automatically recalculated when income fluctuations take place. Thus, there is no need for either parent to bring a suit for modification and no need for the court to decide the issue. Second, this method requires no further interaction between the divorced parents. In spite of these benefits, however, most courts are uncomfortable with the percentage of income method and are reluctant to proceed in this direction because this method considers neither the children's needs nor the earnings of the custodial parent. Some argue that the problems connected with the

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for him or her in whatever manner they can in life. Limiting increases in child support to the living standards enjoyed before the marriage ended would defeat that expectation for no good reason.

54. See Oldham, supra note 47, at 128.
55. Id.
56. Id.
57. Id.
59. Oldham, supra note 47, at 131, 133 (stating that even employers could compute the amount of child support when guidelines specify which employee benefits are income).
60. Id.
61. Id. at 131.
62. Id. at 132. In other words, this method does not recognize the possibility that the child's needs could increase due to illness, educational activities, age, or other reasons. In addition, if the custodial parent's income increases or decreases substantially, under this method, that change has no effect on the amount the non-custodial parent is obligated to pay, even though it may have an effect on the child's needs. Id.
percentage of income method are irrelevant because of the changing policy goals of child support. Because the needs of the child are no longer supposed to be the guiding issue when determining child support obligation amounts, courts should no longer have an aversion to the percentage of income method. Most courts, however, continue to use the income-shares method, which expresses the non-custodial parent's obligation in a specific dollar amount and is subject to modification.

Courts do use a version of the percentage of income method when they initially determine the non-custodial parent's obligation under the income-shares method. Courts determine the percentage of annual income that the child is legally entitled to receive and then calculate a specific dollar amount based on that percentage, allowing modification if there is any substantial change in parental income or the child's needs. This method avoids the pitfalls of the percentage of income method described above. As a result, however, the courts, and in turn, society, must bear the administrative costs imposed by the income shares method when the parent's or child's circumstances substantially change.

Child support has become an obligation independent of all other obligations recognized in family law, an obligation that depends on the income of the parents. Additionally, stock options are increasing in importance as marital assets subject to division during divorce proceedings. Discussing how courts value stock options in divorce proceedings helps us to understand why some courts consider them an issue in child support proceedings as well.

63. Id. at 131.
64. See supra notes 47-48 and accompanying text.
65. Oldham, supra note 47, at 132 ("Recognizing that a child's needs are to a large extent determined by parental resources, all states have moved away from a needs-based model toward guidelines based on the income of one or both parents.... all divorced parents have the duty, postdivorce, to allocate to a child the same portion of their income that would have been allocated while the family was intact." citing Robert G. Williams, Guidelines for Setting Levels of Child Support Orders, 21 Fam. L.Q. 281-324 (1987)).
66. See Oldham, supra note 47, at 131; see also supra note 49 and accompanying text (discussing the income-shares method).
67. See supra note 49 and accompanying text.
68. See supra note 49 and accompanying text.
69. See supra notes 55-58 and accompanying text.
70. See supra note 62 and accompanying text; see also Newsome v. Newsome, 227 S.E.2d 347, 348-49 (Ga. 1976); Grover v. Grover, 839 P.2d 871, 873 (Utah Ct. App. 1992) (holding that percentage of income method is invalid where modification is only allowed under a substantial change test because not all increases or decreases would be substantial).
71. For an explanation of the income-shares method and the costs associated with it, see supra notes 44-49, 54-58 and accompanying text.
73. See supra notes 44-53 and accompanying text.
B. Stock Options as Marital Assets

Some courts characterize employee stock options as property subject to equitable division during divorce proceedings. Alternatively, other courts have recently begun to characterize options as income instead of property during child support proceedings. In both cases, however, courts must place a value on the stock options, a task that proves daunting.74

1. Definition and Valuation of Stock Options

An option, whether from the perspective of a financial market or a divorce court, is a choice. A stock option is a derivative instrument, the value of which is dependent on the value of the underlying stock of a company.75 A stock option can either be a call option or a put option.76 A call option gives its owner the option to buy the underlying stock at a specified price until a specific date,77 while a put option gives its owner the option to sell the underlying stock at a specified price until a specific date.78 The owner has the right to choose whether or not to exercise his option to buy or sell.79 The owner usually buys this right from an option writer for an option premium and in exchange is granted the right to either buy or sell at a specified price.80 If and when the owner has decided that he would like to exercise his option to buy the underlying stock at the specified price, he must first pay that amount, the strike price, to the option writer to acquire the underlying stock.81 The option owner then becomes an owner of the underlying stock and can sell, hold, or trade the stock at his own choosing.82

Stock options have been used for many years as a form of compensation for corporate senior executives.83 Instead of paying

74. Parts II and III of this Note address the valuation of options characterized as income.
76. Id. at 3.
77. Id.
78. Id.
79. Id. at 4. This type of option is created through a contract giving the owner contractual rights and the seller of the option contractual obligations. Id.
80. Id. at 4, 282 (describing an example of an option). Since this Note deals specifically with call options, the references are to call options unless otherwise noted.
81. Id. at 282.
82. The owner must always remain aware of insider trading rules and regulations that restrict the trading of a company’s stock by an “insider” who may have information that members of the general public do not have. For example, the Securities and Exchange Act restricts these “insiders” from engaging in short-term trading in that corporation’s securities in order to prevent them from taking advantage of their superior access to information. See Thomas Lee Hazen, The Law of Securities Regulation § 13.9, at 598-600 (3d ed. 1995).
83. Jill Bettner, Firms Give Stock Options to Wider Range of Workers in Effort to
money to the option writer, the executive agrees to work in exchange for the corporation granting the executive the option to buy stock in the company at a specified price until a specified date. Furthermore, "[t]he primary purpose of a company stock-option plan is the attraction and retention of executive, key or qualified personnel, and the granting of that option is considered a form of compensation." Increasingly, however, companies have started to offer their rank-and-file employees the opportunity to receive stock options as well. In addition, "stock options have become the compensation method of choice for employees of start-up companies, particularly technology companies." This phenomenon logically led to an increase in the frequency of stock options at issue in divorce and child support proceedings.

When courts are forced to deal with stock options in divorce proceedings, the value of those options becomes an important issue. Courts must divide marital property in an equitable fashion, and to do so, the court must know the value of that property, whether it be a stock option, a home, a bank account, or a family heirloom. Three basic factors play a role in determining the value of a stock option: the current market price of the underlying stock; the level of fluctuation in the stock price, or its volatility; and the amount of time.


84. 5A Fletcher Cyclopedia of the Law of Private Corporations § 2143.50, at 148 (1995) (stating "there must be a reasonable relationship between the value of the benefits passing to the corporation and the value of the options granted").

85. Id. (citations omitted).


88. Id.; Andrew C. Littman, Valuation and Division of Employee Stock Options in Divorce, Colo. Law., May 2000, at 61.

89. See N.Y. Dom. Rel. Law § 236 Part B (5)(c)(McKinney 1999) ("Marital property shall be distributed equitably between the parties, considering the circumstances of the case and of the respective parties." (emphasis added)). This section will deal strictly with the traditional methods of valuation of stock options and the additional methods courts have utilized to value options during divorce proceedings. As a precursor to valuation, however, the court must categorize the options either as marital property or as income. See infra notes 115-18 and accompanying text for a discussion of how the court decides whether the options are marital property or not. See infra Part II.A. for a discussion of how the courts' characterization of stock options as income has affected their methods of distribution and valuation.

90. See Green v. Green, 494 A.2d 721, 726 (Md. Ct. Spec. App. 1985) (stating that the second step of the three step process to determine the monetary award of marital property is determining the value of all of the marital property).

the owner of the option has to exercise that option. Only the current market price factor is used in order to determine the intrinsic value of an option. This method is the easiest, yet least accurate way to value a stock option. The intrinsic value of a stock option is equal to the difference between the strike price of the option and its current market price. Once the current market price is higher than the strike price, the option has a positive intrinsic value. The intrinsic value of the option is, however, only a portion of its value.

In order to value an option accurately, volatility and the amount of time the owner of the option has to exercise that option must also be considered. Volatility, or a high level of fluctuation in the market price of the stock, makes the stock option more valuable. The owner of the option has a right (but not an obligation) to purchase the stock at the specified strike price—the price that the option owner has agreed to pay the option writer in order to acquire the underlying stock. The value of the option itself, therefore, can never fall below zero because the option owner has no obligation to buy when the stock price is less than the strike price. The value, however, increases “dollar for dollar” with any increase in the stock's price above the strike price. If the market price of the stock goes up the option will have a positive value. The average of zero value and a possible future positive value is always a positive value. Therefore, even if an option has no intrinsic value when it is issued (the strike price is equal to the market price) the time value of the option, or the ability to take advantage of future possibilities of market price increases (which are more likely if a stock price is volatile), gives the option a positive value. The more time the option owner has before his option expires, the more time he has to take advantage of future possibilities of market price increases, and the value of the option will increase accordingly.

92. Id. For a thorough mathematical explanation of the valuation of a stock option see Kolb, supra note 75, at 459-85.
94. Id.
95. Id. The owner can then exercise the option and come into possession of the underlying stock by paying the strike price, which is lower than the current market price of the stock. The difference between that lower strike price and the current market price of the stock is the positive value of the option.
96. Id.
97. Id.
98. Id.
99. Id. This is the value of the option without taking into account the price an individual paid to acquire those options rights. Those prices are considered in the models discussed below.
100. Id.
101. Id.
102. Id.
103. Id.
104. Id. at 7.
Economists have developed a number of different ways to value options that attempt to consider all of these factors.¹⁰⁵ These methods are broadly broken down into econometric and theoretical models.¹⁰⁶ Although many different methods are in use, the Black-Scholes model is the most widely used model in finance. The Black-Scholes model is a theoretical model¹⁰⁷ which utilizes "option price, option term, market value of the underlying security, risk-free rate of return, and underlying volatility" in order to determine the present value of an option.¹⁰⁸ Notably, however, all of these models were designed to value options that are tradable in the marketplace without any restrictions on transferability.¹⁰⁹ Stock options granted to employees are generally not tradable in the marketplace because they are often nontransferable and, in addition, sometimes require a vesting period.¹¹⁰ Because any restrictions of this type are likely to reduce the value of the option, a discount for these factors must be applied.¹¹¹

2. Valuation Methods Used by Courts in Divorce Proceedings

Courts use a number of unique methods to value stock options in divorce proceedings. When parties divorce, the court must divide the property that was acquired during the marriage between the spouses.¹¹² Courts follow a rule of "equitable division" when dividing this marital property,¹¹³ which means that any property categorized as marital property is divided according to the court's discretion based on equitable principles.¹¹⁴ Some states identify all property acquired during the marriage as marital property, while others include only

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¹⁰⁵. See id. at 6; Kolb, supra note 75, at 381-413; Littman, supra note 88, at 62; Michael J. Mard & Jorge M. Cestero, Stock Options In Divorce: Assets or Income?, Fla. B.J., May 2000, at 62-63.


¹⁰⁷. Littman, supra note 88, at 62; Mard & Cestaro, supra note 105, at 63.

¹⁰⁸. Littman, supra note 88, at 62; Mard & Cestaro, supra note 105, at 63.

¹⁰⁹. Jones, supra note 86, at 7; Littman, supra note 88, at 63. An employee option that is non-transferable is one that the employee cannot transfer (sell, give or trade) to another. This places an obvious restriction on transferability that these models do not consider.

¹¹⁰. Jones, supra note 86, at 7. Vesting will be discussed infra notes 120-22 and accompanying text.

¹¹¹. Jones, supra note 86, at 7; Littman, supra note 88, at 62. For an example of a court that approved of the use of the Black-Scholes method without discounting, see Davidson v. Davidson, 578 N.W.2d 848, 858-59 (Neb. 1998). For an example of a court that disapproved of using the Black-Scholes model in a marital context, see Murray v. Murray, 716 N.E.2d 288, 298 (Ohio Ct. App. 1999); see also infra Part II.A. (discussing that case in relation to the characterization of stock options as income).

¹¹². See Dukeminier & Krier, supra note 29, at 377-78.

¹¹³. Id.

¹¹⁴. Id.
property acquired from the earnings of either spouse.115 Basically, courts have developed three approaches to answer the question of whether stock options are marital property subject to division. The first approach states that stock options that are not exercisable as of the date of separation and that are contingent on events occurring after that date are never marital property.116 Under the second approach, stock options granted at any time during the marriage are always marital property, whether or not they are contingent on later events.117 Under the third approach courts use a time formula or rule to allocate some portion of the options as marital property and not others.118

Once a court finds the options at issue in a divorce proceeding to be marital property subject to division,119 it generally follows one of four different methods of valuation and division. Whether or not the options have vested at the time of the dissolution proceedings is a factor that will affect the court's choice of method.120 Essentially, "[a]n employee stock option is vested and matured if the employee has an absolute right to exercise the option immediately; the option is vested and unmatured if the employee cannot exercise the option yet but has an absolute right to do so at some future date; the option is unvested if it cannot yet be exercised" and if future vesting is based upon the occurrence of a certain contingency.121 If an option is unvested it is almost impossible to value because no strike price has yet been set, and therefore one cannot know even the intrinsic value of the option.122

a. Net Present Value Method

The first method that courts utilize is the net present value method, which means that the court determines the net present value of the

115. Id.
117. Id. (citing Green v. Green, 494 A.2d 721 (Md. Ct. Spec. App. 1985)).
118. Id. (citing In re Marriage of Hug, 201 Cal. Rptr. 676 (Cal. Ct. App. 1984)).
119. Littman, supra note 88, at 61. The time rule used in Hug determined that the number of options classified as marital property subject to division was "a product of a fraction in which the numerator is the period in months between the commencement of the spouse's employment by the employer and the date of separation of the parties, and the denominator is the period in months between commencement of employment and the date when each option is first exercisable, multiplied by the number of shares which can be purchased on the date the option is first exercisable." Hug, 201 Cal. Rptr. at 678.
120. Littman, supra note 88, at 61-62.
122. Jones, supra note 86, at 6 (explaining that the intrinsic value of an option is a necessary, but not sufficient factor when determining the value of a stock option).
future benefits of the stock options and then divides them based on that value. Valuation by the court that depends on either the intrinsic valuation method or any financial model, including the Black-Scholes model, falls into this category. Essentially, the court looks at the option on a given date, and by using one of the models mentioned, determines the value of the stock option on that date. The court then uses that value to determine the amount the employee spouse must transfer to the non-employee spouse. This amount must compensate the non-employee spouse for the amount of the stock options to which she is legally entitled. Most courts only use the net present value method if the value can be offset by other marital property, or if the value of the option is easily ascertainable. Otherwise, courts often turn to the deferred distribution method.

123. Littman, supra note 88, at 62.

124. See In re Marriage of Hunt, 909 P.2d 525, 531 (Colo. 1995) (discussing the net present value method of distribution of pension benefits and how this method results in immediate distribution to the non-employee spouse because of "immediate offset" where the sum that represents the present value of the future benefit may be offset by the value of other property in the marital estate); see also Hug, 201 Cal. Rptr. at 685-86 (finding the most equitable solution to be determining the value of the options at the date of separation and distributing the interests to the employee spouse and offsetting those interests with property of equivalent value to be given to the non-employee spouse); Bornemann v. Bornemann, 752 A.2d 978, 994 (Conn. 1998) (holding that even though the options at issue were unvested, the court reasonably estimated the present value of those options against the defendant's claims that they were worth nothing based on the definite vesting dates, the definite exercise price, and the current stock price); Davidson v. Davidson, 578 N.W.2d 848, 858-59 (Neb. 1998) (utilizing the Black-Scholes method to calculate net present value); Hall v. Hall, 363 S.E.2d 189, 196 (N.C. Ct. App. 1987) (holding that since the value of the vested options in this case was easily calculated, the trial court must value them and provide for their distribution in accordance with North Carolina domestic relations law).

125. See Littman, supra note 88, at 62 (describing the method); see also Murray v. Murray, 716 N.E.2d 288, 296-98 (Ohio Ct. App. 1999) (for an application of the method to value stock options for child support distribution purposes).

126. See Bornemann, 752 A.2d at 984 ("[M]arriage is, among other things, a shared enterprise or joint undertaking in the nature of a partnership to which both spouses contribute directly and indirectly . . . the fruits of which are distributable at divorce." (internal quotation marks omitted)); see also, Legal Research Group, Stock Options, supra note 121, at 77 (giving an overview of an equitable division case where the court first had to determine whether stock options were marital property or not, using the "time-rule" and second, had to value those options in order to distribute them according to the outcome of the "time-rule" calculation).

127. See Littman, supra note 88, at 62. One commentator argues that this type of valuation is compelling for courts when the value of the options is minimal as compared to the overall marital estate. Under these circumstances, the court can offset the value of the options with other marital property so that the options do not actually have to be exercised. If these circumstances do not exist or if the value of the option is too hard to ascertain, other methods may be preferable. Id.; see also Hunt, 909 P.2d at 531 (discussing that this method is normally used when the pension value is low).
b. Deferred Distribution Method

Under the deferred distribution method, or the “if, as and when” method, the non-employee spouse only receives his or her share of the benefits from the stock options when those benefits are actually paid to the employee-spouse. The court simply determines the percentage of the benefit to which the non-employee spouse is entitled once the options are exercised. For example, in Green v. Green, the court decided to use the deferred distribution method because in “formulating an equitable monetary award, the court must take into consideration the nature of the [employee’s] property right in the options.” The court defined this interest as “the right to choose whether or not to purchase 5,000 shares of Network Systems stock on certain dates at specified prices.” The court, therefore, decided that it could not adopt an approach to valuation and distribution that would, in essence, compel the employee to exercise his options since that would deprive him of his “right to make a choice.” The court held that the “if, as and when” approach best addressed the situation because the employee would not be compelled to exercise his options and the non-employee spouse would still receive her equitable interest in those options.

c. Reserve Jurisdiction

Reserve jurisdiction is often called the “wait and see” method because the court waits to determine and distribute the non-employee’s percentage share until the options are exercised, if they are at all. This method differs from the deferred distribution method because the court waits to make any ruling in the case until the options are exercised, whereas in deferred distribution situations the court has already determined the percentage that will be due to the non-employee spouse if and when the options are exercised.

129. Littman, supra note 88, at 62; see also Green, 494 A.2d at 729 (holding that the court may determine a present value and, using that value, set a percentage at which the profits should be divided “if, as and when” they are exercised); In re Marriage of Chen, 416 N.W.2d 661, 663-64 (Wis. Ct. App. 1987) (upholding the use of a “time-rule,” similar to the “if, as, and when” method because the options were neither transferable nor assignable and therefore no reasonably accurate value could be determined).
130. Green, 494 A.2d at 729.
131. Id. (emphasis in original).
132. Id.
133. Id.
d. Constructive Trust

A constructive trust is a trust created in equity "whenever title to property is found in one who in fairness ought not to be allowed to retain it."\(^{136}\) As one commentator explains, "[t]he court merely uses the constructive trust as a method of forcing the [employee] to convey [property] to the [non-employee]."\(^{137}\) Unlike a regular trust, which the parties bring into existence by agreement, the courts create a constructive trust.\(^{138}\)

In *Beatty v. Guggenheim Exploration Co.*,\(^{139}\) Justice Cardozo established that a constructive trust was an equitable measure that the court can decree in cases where "the holder of the legal title may not in good conscience retain the beneficial interest" in the property at issue.\(^{140}\) In those types of cases equity converts the legal holder of the title into a trustee,\(^{141}\) for "[a] constructive trust is the formula through which the conscience of equity finds expression."\(^{142}\) Recently, courts have chosen to decree constructive trusts in many areas of the law besides the marital context, reasoning that "[a] constructive trust arises where a person who holds title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it."\(^{143}\)

*Callahan v. Callahan*\(^{144}\) provides an excellent example of a court's application of a constructive trust in the marital context. In *Callahan*, a New Jersey court held that creating a constructive trust on behalf of the non-employee spouse was the best way to distribute stock options between the parties.\(^{145}\) The court had determined that the stock options at issue were marital property subject to division and

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137. *Id.*
138. *Id.*
139. 122 N.E. 378 (N.Y. 1919).
140. *Id.* at 380.
141. *Id.*
142. *Id.*
145. *See id.* at 563-64.
recognized that they were not transferable or assignable.\textsuperscript{146} Nevertheless, the court realized that the options had to be distributed as marital property in order for an equitable division of the marital assets to be achieved.\textsuperscript{147} Even though the court stated that the options had a "reasonably discernible value," it held that "it is appropriate . . . to utilize the trust device in this case where actual transfer of the options (or exercise and transfer of the stock) may be neither possible, profitable, nor convenient."\textsuperscript{148}

The \textit{Callahan} court viewed the constructive trust as a device to avoid "unconscionable advantage" by the legal possessor of title,\textsuperscript{149} and it granted the non-employee spouse a 25\% ownership interest in the options at issue.\textsuperscript{150} The employee spouse was to act as trustee for that percentage of those options and was required to exercise the non-employee spouse's share at her discretion.\textsuperscript{151} The non-employee spouse had to cover the strike price herself, but could require the employee spouse to pledge her share of the underlying stock in order to finance the transaction.\textsuperscript{152} The court imposed further restrictions on the non-employee spouse's actions after exercising the option in order to avoid "insider trading" issues and unfair tax liability distribution.\textsuperscript{153} The court determined that this was the best way to distribute the options, while at the same time being fair to both parties.\textsuperscript{154} This method provided the non-employee spouse with all of

\textsuperscript{146} \textit{Id.} at 562-63.
\textsuperscript{147} \textit{Id.}
\textsuperscript{148} \textit{Id.} at 562-64. The court recognized that there were "insider trading" issues that could affect the employee's ability to trade the stock as well as issues regarding the fact that the defendant employee would have to raise the money necessary to exercise the options in the first place. \textit{Id.} at 564. For more information regarding insider trading, see \textit{supra} note 82.
\textsuperscript{149} \textit{Id.} at 563.
\textsuperscript{150} \textit{Id.} at 564.
\textsuperscript{151} \textit{Id.}
\textsuperscript{152} \textit{Id.}
\textsuperscript{153} \textit{Id.} The stock would remain in trust for the plaintiff after she exercised the option to buy it. She could require the defendant to transfer the stock to her or to sell it for her and transfer the proceeds, but there were two restrictions imposed on these actions. First, the plaintiff could not force transfer to herself within six months of the acquisition of the underlying stock in order to avoid violating the 'insider trading' rules developed by the Securities and Exchange Commission. \textit{See supra} note 82. Second, the plaintiff was required to take responsibility for any tax liabilities accruing to the defendant on account of the plaintiff's requests. \textit{Callahan}, 361 A.2d at 564. For a case with a similar concern about tax liabilities and a similar outcome, see Smith v. Smith, 682 S.W.2d 834 (Mo. Ct. App. 1984). The \textit{Smith} court required that the employee spouse give the non-employee spouse thirty days notice before exercising any of his options. During that time the non-employee spouse could elect to provide the funds to buy her share of the interest in the options and agree to share in any tax burden resulting from the exercise of the option. Alternatively, she could forfeit the rights to the interest in those options. \textit{Id.} at 837.
\textsuperscript{154} \textit{Callahan}, 361 A.2d at 563.
the benefits of the options while avoiding "undue financial and business liabilities" upon the employee spouse.\textsuperscript{155}

As this part has discussed, once courts have determined that stock options are marital property, they proceed to divide that property equitably between the husband and wife based on the circumstances in the particular case and the policy goals they want to achieve. Due to the increased prominence of stock options, courts have also been forced to address them in child support proceedings, and have instead tended to characterize them as income subject to the requisite support formula in each state statute. The next part will describe this recent trend and concentrate on the court's rationale for characterizing the stock options as income rather than property in each case. It will also analyze how courts have valued those options once that characterization is made, and will discuss some criticisms of these cases.

\section*{II. Stock Options and Child Support Proceedings}

Part I provided an overview of the definition of stock options and their treatment by courts in the marital property context. Courts have developed a number of different ways to value employee stock options that have been categorized as marital property during the 'equitable division' stage of the divorce proceeding.\textsuperscript{156} In the 1990s, however, due to both the proliferation of stock options as compensation\textsuperscript{157} and major increases in stock values,\textsuperscript{158} courts began to look at stock options differently. Specifically, they began to consider whether stock options were a form of income that should be considered when determining alimony and child support payments.\textsuperscript{159}

The three cases discussed in Part A below outline the still novel approaches of courts to the issue of stock options in the child support context.

Part B summarizes some criticisms of these courts' approaches. Critics have taken issue with courts' willingness to categorize stock options as income subject to child support statutes as well as their

\textsuperscript{155} Id.
\textsuperscript{156} See supra Part I.B.1.
\textsuperscript{157} Zipkin, supra note 8.
\textsuperscript{159} This Note focuses on the issue of child support instead of alimony. The general purpose of alimony awards is to allow the receiving spouse to retain the standard of living that he or she enjoyed during the marriage. Kerr v. Kerr, 91 Cal. Rptr. 2d 374, 378 (Cal. Ct. App. 1999). By contrast, the general purpose of child support awards is to allow the child to enjoy a lifestyle in line with the parents' standard of living after dissolution of the marriage. \textit{Id.} at 380. Therefore, only the determination of child support will be affected by any increase in income enjoyed by the non-custodial parent.
methods of valuation. Specifically, they are concerned that the methods the courts use to value the options ignore the economic fundamentals of stock options. In addition, they worry that the courts are ignoring the potentially unfair tax burden that may be impressed upon the non-custodial spouse by these decisions. Their arguments highlight the concern that an unfair outcome may result if these cases are used as precedent for future child support proceedings involving stock options.

A. Case Law Addressing Stock Options in the Child Support Context

One of the first courts to treat stock options as income for purposes of determining child support was the California Court of Appeals in Kerr v. Kerr.160 Richard and Deedee Kerr were married for twenty years.161 They separated on August 21, 1993.162 Richard was the vice-president of engineering at Qualcomm during the time of separation, had an annual income of $110,427, and also received yearly stock options from the company.163 After their separation, their two children resided primarily with Deedee, and a court-supervised agreement set child support payments from Richard to Deedee at $2,166 per month.164

Shortly after this agreement, Deedee filed for a modification of child support based on what she asserted was a significant increase in her ex-husband's income, and the parties allowed the trial court to determine the issue.165 The trial court increased the child support to $2,806 per month.166 More importantly, however, the trial court found that any grant of stock options would be considered "part of Richard's overall compensation package" and would be considered when determining child support.167 Therefore, in addition to the $2,806 per month, the trial court decided that, under the California guidelines, 40% of the beneficial ownership of any stock options exercised in the future must be transferred to Deedee and the children.168 This is an application of the "if, as and when" valuation method in the child support context because Deedee and the children would not get their

161. Id. at 376.
162. Id.
163. Id.
164. Id.
165. Id.
166. Id.
167. Id. at 377.
168. Id. Beneficial ownership is the amount of value realized after exercising the option, buying the shares, and selling them for a profit on the open market. This amount is determined after any transaction costs and taxes are subtracted from the profit. See id. at 379. The court based its percentage award on both the alimony and child support payments that were owed Deedee. The amount would drop to 25% when both children were no longer minors. See id. at 377. Therefore the percentage awarded strictly for child support was 15% of the beneficial ownership.
40% share until Richard decided to exercise his options. The trial court had “consider[ed] all income from employment, including stock option income, in order to meet the needs of the family.”

On appeal, Richard argued that it was an abuse of discretion for the trial court to award Deedee 40% of whatever his future stock option income might be, even though it was based on the California guidelines, because that figure did not take into account the children’s needs, which is also a factor that must be considered under the guidelines. Before agreeing with Richard on this point, the Court of Appeals made a clear statement supporting the trial court’s holding that any realized income from stock options granted after dissolution must be used in calculating the child support determination. The court recognized that the 40% decision was made according to the guideline formulas of California’s family code, and that any determination under those guidelines is presumed to be correct. Nevertheless, the court held that special circumstances made application of that formula unjust in this case, especially because Richard had such an “extraordinarily high income that the guideline amount would exceed the child’s needs.” The appellate court remanded and held that a percentage award would be acceptable if the trial court also determined “a maximum [dollar] amount that would not exceed the children’s needs.”

Although the Kerrs eventually settled their dispute before the trial court had the opportunity to decide this issue on remand, this Court of Appeals decision categorizing stock options as income is still good precedent in California. The court’s holding is a narrow one,

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169. See supra notes 128-33 and accompanying text for a definition of the deferred distribution or “if, as and when” method.
170. Kerr, 91 Cal. Rptr. 2d at 377.
171. Id. Richard did not contest the trial court’s holding that the future grant of these options were part of his overall compensation, and he conceded that they should be taken into account when determining child support payments.
172. Id. at 380.
173. Id.
174. Id; see also supra notes 42-43 and accompanying text (discussing the requirement that the criteria used to rebut the presumption that the amount of child support determined under the state guidelines was correct must reflect a concern for the best interests of the child).
175. Kerr, 91 Cal. Rptr. 2d at 380; Cal. Fam. Code § 4057(b)(3) (West 1994). The statute lists other special circumstances, including: if “[t]he parties have stipulated to a different amount of child support;” “[a] party is not contributing to the needs of the children at a level commensurate with that party’s custodial time;” and “[a]pplication of the formula would be unjust or inappropriate due to special circumstances” including when “parents have different time-sharing arrangements for different children,” when a time-sharing is equal but the income of one parent is much higher or lower than the other, and when children have medical needs that may require more child support. § 4057 (b)(1), (4), (5).
176. Kerr, 91 Cal. Rptr. 2d at 380 (citing Cal. Fam. Code § 4057(b)(3)).
177. Id. at 381.
178. Zipkin, supra note 8.
however, because it only applies to stock options received after
dissolution and only allows the award to be affected after the benefits
of the options have been realized by the non-custodial parent. The
Kerr court did not attempt to value the options, and it allowed the
non-custodial spouse to deduct all taxes and transaction costs before
sending the requisite percentage to the custodial household.

Similarly, the Ohio Court of Appeals in Murray v. Murray also
characterized stock options as income in child support proceedings.
Graeme and Susan Murray were divorced in 1994, and they entered
into an agreement under which Susan was granted custody of their son
and Graeme was to pay child support in the amount of $1,810 per
month. They also divided the marital property, including stock
options Graeme had already received as an executive at Proctor &
Gamble ("P&G"). In 1997, Susan filed for modification arguing
that Graeme's income had increased substantially, due to both an
increase in salary and in the value of the employee stock options he
acquired after the divorce, and therefore a recalculation of the child
support award was necessary. Graeme stipulated an increase in his
income that did not include the stock options he had received after
the divorce and offered to pay $2,754 per month. Susan refused to
accept that offer and the matter went before a magistrate of the trial
court for a hearing.

The issues before the magistrate were "whether appellant's
unexercised P&G stock options should be included in his 'gross
income' for purposes of determining child support, and, if so, how to
value the stock options." The magistrate decided that under the
Ohio statute guiding determination of child support awards, the value
of the unexercised options should be included in Graeme's "gross
income." The magistrate calculated that Graeme's child support
obligation based on this new measure of income would increase to
$7,494.10 per month. Graeme brought an appeal on three separate
grounds.

179. See Kerr, 91 Cal. Rptr. 2d at 377.
180. Id. at 379.
182. Id. at 290.
183. Id.
184. Id.
185. Id.
186. Id. at 290-91.
187. Id. at 291.
188. Id.
189. Id.; see also Ohio Rev. Code Ann. § 3113.21.5 (Anderson 2000) (defining
gross income' for child support determinations).
190. Murray, 716 N.E.2d at 291. The trial court later found fault with the
magistrate's valuation of the options and recalculated the obligation at $6,821.27 per
month. Id.
191. Id.
Graeme first argued that the trial court magistrate incorrectly included the value of his unexercised P&G options in the definition of “gross income” when they should have been categorized as property, as they had been in the past. The appellate court stated that this was an issue of first impression. The appellate court disagreed with Graeme's argument and held that "the appreciation in the value of the options is to be included in 'gross income' as defined by R.C. 3113.21.5(A)(2) [Ohio's child support statute]." The appellate court's decision hinged on a number of factors: the trial court's broad discretion in child support matters; the appellate court's literal interpretation of Ohio's law governing child support awards; the definition of "gross income" under that law, which is meant to be "broad and flexible;" the nature of the executive stock options addressed in the case; and the overarching concern for the best interests of the child.

The last two factors are the most important for this Note's analysis. With regard to the nature of the executive stock options, the court found that the options at issue were "an integral part of appellant's annual compensation." The court based its determination on the

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192. Id.
193. Id.
194. Id. at 293.
195. Id. at 291. This standard is derived from Ohio case law, which precludes a lower court decision unless it is "unreasonable, arbitrary, or unconscionable." Id.; Pauly v. Pauly, 686 N.E.2d 1108, 1111 (Ohio 1997); Blakemore v. Blakemore, 450 N.E.2d 1140, 1142 (Ohio 1983).
196. Murray, 716 N.E.2d at 291. The court claims that this literal interpretation is necessary to serve the overriding concern of the statute—the best interests of the child. Adhering to this literal interpretation means that the court must strictly follow the child support guidelines, worksheet, and schedule unless the facts of the case, in combination with the requirements of the statute, demand otherwise. Id. at 291-92; see also Ohio Rev. Code Ann. § 3113.21.5 (Anderson 2000) (listing circumstances where the statute may demand a deviation from the guidelines).
197. Murray, 716 N.E.2d at 292. Ohio’s Revised Code Annotated § 3113.21.5(A)(2) defines gross income as “the total of all earned and unearned income from all sources during the calendar year, whether or not the income is taxable, and includes, but is not limited to ... potential cash flow from any source.” Ohio Rev. Code Ann. § 3113.21.5(A)(2) (Anderson 2000). The court claimed that the broad and flexible or expansive interpretation standard is necessary “to ensure that the best interests of children, the intended beneficiaries of child support awards, are protected.” Murray, 716 N.E.2d at 292 (quoting McQuinn v. McQuinn, 673 N.E.2d 1384, 1387 (Ohio Ct. App. 1996)). In addition, the court analogized employee stock options to other non-traditional forms of compensation that have been included in this definition, for example, interest on a public employee retirement plan, interest on a loan given to a corporation owned by the obligor, and retained earnings of a corporation where the obligor was a majority shareholder in that corporation. The important factor in the analogy is that these forms of compensation represent investment choices made by the obligor where he could have chosen to do otherwise. Id. at 293.
198. Id. at 292-93.
199. Id. at 294.
200. Id. at 293.
trial testimony of P&G’s Director of Global Compensation, who stated that the options are given every year and are non-transferable. The witness also testified that the options "mirrored deferred compensation," that the increase in value of the options was the "single most important element of appellant’s complete compensation package, and that the options are recurring, sustainable compensation." The court also stated that because Graeme had complete discretion over the options, the decision not to exercise them was an investment choice and as such their value should be considered part of his "gross income."

Also underlying this view was the court’s concern for the best interests of the child. The court reasoned that "one of the purposes of the ‘potential cash flow’ provision in R.C. 3113.21.5(A)(2) [is] to prevent a parent from avoiding child support obligations by shifting present income to a cash flow expected to be enjoyed at some future time, when the children have become emancipated[,] and ‘[a] choice to defer income will not justify deferring or avoiding child support.’" The court noted that if it were to hold that the options could not be categorized as income, the option holder would be allowed to "shield a significant portion of his income from the courts, and deprive his children of the standard of living they would otherwise enjoy. This would directly contradict the very purpose of the child support statute, the child’s best interest."

Graeme next argued that the trial court did not base its determination of his child support obligation on the needs of the child, but the appellate court also rejected this argument. The appellate court stated that the appropriate standard for child support awards is "[the] amount necessary to maintain for the children the standard of living they would have enjoyed had the marriage continued," and it held that the trial court did not abuse its discretion when it made the determination of child support.

201. Id. at 293-94.
203. Murray, 716 N.E.2d at 294.
204. Id.
205. Id. at 293 (quoting Sizemore v. Sizemore, No. 13673, 1994 WL 558917, at *8 (Ohio Ct. App. Oct. 14, 1994) (alteration in original)).
206. Id. at 294. This was a very real concern in this case because Graeme claimed that the income from any exercised stock options would be “nonrecurring” and would therefore be excluded from the definition of gross income under R.C. 3113.21.5(A)(2)(e). Id. Under his argument, none of the value realized from any of his options would ever reach his child. Id.
207. Id. at 295.
208. Id. at 296.
209. Id. at 295 (quoting Birath v. Birath, 558 N.E.2d 63, 70 (Ohio Ct. App. 1988)).
210. Id. at 296.
trial court imposed the same percentage obligation on Graeme's $481,109.60 income as it would on a $150,000 income, even though the Ohio child support guidelines state that when the non-custodial parent's income is over $150,000, the court may decide whether to continue increasing the amount of the child support on a "case-by-case basis." Furthermore, the court noted that the courts "shall consider the needs and the standard of living of the children who are [the] subject of the child support order and of the parents." The appellate court specifically held that the trial court did not abuse its discretion when it imposed the same percentage upon Graeme's higher income because the resulting child support award was not an "unjust or inappropriate" amount to pay in light of Graeme's sufficient resources.

Third, Graeme argued that the trial court used an incorrect method to value the unexercised options, and the appellate court agreed. The trial court used a net present valuation method, more specifically, the intrinsic valuation method, often used in Ohio to divide marital property—it chose a reasonable date on which to value the stock options based on the facts and circumstances of the case. The appellate court decided that the date the trial court chose "had no relevant relation to the case" and that to value Graeme's options on that date was an abuse of the trial court's discretion. The court agreed with Graeme that "had the trial court picked a different date, the value of the stock options could have been greatly reduced or inflated, and that the difference could amount to over $300,000 in aggregated income."

The appellate court then developed its own method of valuation for the trial court to apply on remand, which was also a version of the intrinsic valuation method. The yearly grant of stock options was valued "according to the stock price on the most recent date on which

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211. Id. at 295 (quoting Ohio Rev. Code Ann. § 3113.21.5 (B)(2)(b) (Anderson 2000)).
212. Id.
213. Id. at 295-96.
214. Id. at 296.
215. Id.
216. Id.
217. For a definition and discussion of the net present valuation method, see supra notes 123-27 and accompanying text.
218. See supra notes 123-27 and accompanying text. The case the trial court in Murray relied on to justify this method of valuation has nothing to do with stock options. See Berish v. Berish, 432 N.E.2d 183, 185 (Ohio 1982) (dividing a joint savings account).
220. Id. at 299.
221. Id. at 298.
222. Id. at 298-99.
223. See supra notes 91-104 and accompanying text for a discussion and definition of the intrinsic valuation method.
an option could be exercised minus the [stock] price on the day that option was granted."224 This method was described only after the court recognized the difficulty of valuing stock options.225 Moreover, it noted that although there are financial models for valuing options, these models exist to value options in the marketplace and they "may not be reliable for purposes of litigation."226 The court instead preferred to measure the appreciation in the value of the options according to the date on which the option holder could make the investment choice of whether or not to exercise the options.227 If after that date he decided not to exercise them, he made a choice and "should not be allowed to benefit from such a choice by depriving his child of the substantial growth in the stock options' values."228 It also reasoned that this method would avoid the "gamesmanship" between the obligor and the obligee.229 For example, the obligor could no longer choose a low market day upon which to exercise the options and the obligee a high market day in order to decrease or increase child support awards accordingly. The court held that its method was "relevant to the purposes of child support and will reliably reflect the imputed income from restricted stock options for the period of time at issue."230

The Murray court spoke boldly on the issue of stock options as employee compensation,231 and it clearly regarded the options, exercised or unexercised, as income subject to child support calculation.232 This is a novel decision that will, in addition to Kerr, most likely create significant precedent in the child support context for the categorization of employee stock options as income. In addition, the Murray court decided to value the options on its own, instead of waiting until the options were exercised. The court determined the intrinsic value of the options at issue233 instead of simply utilizing the "if, as, or when" method applied by the Kerr court.

224. Murray, 716 N.E.2d at 298.
225. See id. at 297-98.
227. Id. at 298.
228. Id. at 299.
229. Id.
230. Id. at 298.
231. "[I]t would be grossly inequitable to allow [the obligor] to sit upon his assets, hide behind the shield of corporate business decisions, and prevent his children from enjoying the standard of living they would have enjoyed had the marriage continued." Id. at 293 (quoting Williams v. Williams, 600 N.E.2d 739, 742 (Ohio Ct. App. 1991) (alteration in original)). The Murray court stated that if they did not categorize the stock options as income "an employee receiving such options would be able to shield a significant portion of his income from the courts.... This would be in direct contradiction of the very purpose of the child support statute, the child's best interest." Id. at 294.
232. Id. at 294-95.
233. See id. at 294.
where the amount the child was legally entitled to was only distributed if and when the father chose to exercise the options. It took this approach because of its overriding concern for the best interests of the child.234

In Seither v. Seither, a Florida court further developed this area of the law by addressing whether all types of employee stock options should be considered income.235 The Seither court also addressed whether modification of child support awards should be allowed on the grounds of a substantial increase or decrease in the value of the stock at issue.236

Albert and Kathryn Seither were married for twenty years.237 At the dissolution hearing the court held that Albert, an employee of Southwest Airlines, was obligated to pay Kathryn and their one minor child $4,000 per month in alimony and child support.238 The court based its holding on the needs of Kathryn and the child tempered by Albert's ability to pay.239 The main issue on appeal was the legality of the court's categorization of Albert's employee stock options as income for purposes of determining whether or not he had the ability to pay.240

Albert represented himself during the dissolution hearing.241 Most of the evidence regarding the nature of the stock options at issue in the hearing had been received through the testimony of Kathryn's accountant.242 This evidence, presented at the hearing, showed that 8,415 options were granted to Albert in lieu of a salary increase, and that these options were to vest at the rate of 1,403 options annually for five years with the remainder vesting in 2003.243 The accountant had determined the value of the options by subtracting the price of each option (price on the date they were granted, not vested) from the market value of the stock a few days before the hearing.244 He then multiplied that number by the number of options that were to vest each year and determined that Albert would receive $18,900 per year if he were to exercise those options.245 No one from Southwest Airlines had testified at the hearing and no documents explaining the

234. See id.
236. Id. at *1.
237. Id.
238. Id.
239. Id.
240. Id.
241. Id. at *2.
242. Id.
243. Id.
244. Id. This is a method of intrinsic valuation. See supra notes 91-104 and accompanying text for a thorough description of intrinsic valuation.
245. Id.
details of Albert's employment had been admitted.\textsuperscript{246} In addition, no specialist had testified regarding how to value stock options.\textsuperscript{247}

The appellate court recognized that stock options are difficult to work with in a dissolution proceeding\textsuperscript{248} because options can resemble both property and income, which makes them difficult to characterize.\textsuperscript{249} The court further noted that if a court decides to use the intrinsic valuation method\textsuperscript{250} there is always a risk "that the stock price will be significantly higher or lower when the options are actually exercised."\textsuperscript{251}

Because the trial court had broad discretion regarding the determination of child support issues during hearings, the appellate court ultimately decided that it would be inappropriate to overrule the trial court's decision on this incomplete record.\textsuperscript{252} The appellate court cited two cases as support for the trial court's decision\textsuperscript{253} and finally held that "[t]he condition of this record is such that, unless the trial court was required as a matter of law to treat the options as an asset, it would be impossible to hold that the trial court erred in treating them as income."\textsuperscript{254} The court went on to state that if the price of Albert's stock fell substantially below what Kathryn's accountant testified it was, this decrease could be a potential ground for modification.\textsuperscript{255}

The Kerr, Murray, and Seither cases show that courts have recently adopted different approaches in order to classify stock options as income for the purposes of determining child support obligations. In Kerr, employee options, \textit{when exercised}, became income subject to child support obligations.\textsuperscript{256} The Murray court also discussed characterizing stock options as income and decided that the value of \textit{unexercised} options could be considered income subject to support obligations.\textsuperscript{257} The Murray court, in addition, developed a formula for valuing those options, based on the underlying stock price on the day the options become exercisable.\textsuperscript{258} The Seither court, however, took

\begin{itemize}
\item \textsuperscript{246} \textit{Id.}
\item \textsuperscript{247} \textit{Id.}
\item \textsuperscript{248} \textit{Id.}
\item \textsuperscript{249} \textit{Id.}
\item \textsuperscript{250} \textit{See supra} notes 91-104 and accompanying text (discussing the intrinsic valuation method).
\item \textsuperscript{251} \textit{Seither}, 1999 WL 1143770, at *2.
\item \textsuperscript{252} \textit{Id.} at *3.
\item \textsuperscript{253} One of these cases was \textit{Murray v. Murray}, 716 N.E.2d 288 (Ohio Ct. App. 1999), which is discussed at \textit{supra} notes 181-234 and accompanying text. The other case dealt strictly with alimony issues. \textit{See} Milo v. Milo, 718 So. 2d 343 (Fla. Dist. Ct. App. 1998).
\item \textsuperscript{254} \textit{Seither}, 1999 WL 1143770, at *3.
\item \textsuperscript{255} \textit{Id.}
\item \textsuperscript{256} \textit{See supra} notes 168-69 and accompanying text.
\item \textsuperscript{257} \textit{See supra} note 204 and accompanying text. The Murray case was decided in February of 1999, before the Kerr case decision in December of 1999. Kerr did not cite Murray. For the Kerr judge's opinion about the Murray case, see \textit{infra} note 295.
\item \textsuperscript{258} \textit{See supra} note 224 and accompanying text.
\end{itemize}
both a step forward and a step back from these two decisions. While the Seither court upheld the trial court's decision to categorize unexercised stock options as income and allowed the parent to return to the court for modification if the stock price decreased substantially, it retreated from the Murray decision by clearly stating that the record in the case did not provide enough evidence to determine whether the stock options at issue were properly categorized as income. It is therefore unclear whether the Seither court agreed with the decision in Murray, or whether it found characterizing all employee stock options as income problematic.

These three court decisions treating stock options as income because it was in the best interests of the child have been met with criticism. Some legal scholars maintain that these decisions will negatively affect future child support proceedings.

B. Criticisms of Courts' Characterizations of Stock Options as Income

Commentators have sharply criticized the courts' willingness to characterize stock options as income in child support proceedings. For example, in an article discussing the Murray case, Jack Karns and Jerry Hunt attack that decision from two angles. First, they argue that the court ignored the economic fundamentals of stock options by choosing to characterize them as income and using an intrinsic valuation method. Second, they argue that the court ignored federal tax law in its decision to characterize the options as income and it also ignored any negative consequences that the tax law might have upon the employee spouse. Ultimately, they conclude that the

259. See supra note 254 and accompanying text.
261. See id. at 259-64; see also infra notes 284-91 and accompanying text (describing the criticisms of the intrinsic valuation method).
262. Karns & Hunt, supra note 260 at 257; see also infra note 269-283 and accompanying text (discussing tax implications of the categorization of stock options as income). Different types of stock options receive different tax treatments. With “Non-Qualified Stock Options,” the employee spouse must claim any difference between the option price and the market price at the time he exercises the option as taxable income subject to ordinary income tax rates. “Incentive Stock Options,” on the other hand, are subject to a tax consequence upon exercise only if the underlying stock is sold at a profit. If sale occurs within one year of exercise, any profit is subject to ordinary income tax rates. If the option is held for longer before it is sold the profit will be taxed at generally lower capital gains rates. See Douglas A. Kahn, Federal Income Tax §§ 2.1570, 2.1573 (4th ed., 1999) (stating the requirements for qualified stock option plans); see also Rehfeldt v. Rehfeldt, No. C-850056, 1986 WL 1818, at *2 (Feb. 12, 1986) (discussing the different types of plans). When an employer pays an employee with options that qualify as incentive stock options or qualified stock option plans, those contributions made by that employer are not taxable during the year they are made. See Karns & Hunt, supra note 260, at 241.
outcome in *Murray* was completely unfair.  

Karns and Hunt begin by stressing that although the Ohio court’s reasoning in *Murray* may seem sound because “it may be reasonable to assert that the potential wealth of an executive is increased when executive stock options are issued—and the market price of the common stock increases—there is always some risk that the stock price might decline instead.” In addition, they charge the court with misunderstanding the nature of an option when it decided that the employee spouse should be held to his investment choice not to exercise the option as soon as he is able. Because an option’s value is critically dependent on time, they argue that the court’s decision to penalize the employee spouse for not exercising the option sooner rather than later cuts against the fundamental characteristics that make an option a valuable instrument. They conclude that ignoring the economic fundamentals of the stock option and adopting

[t]he most convenient valuation solution may provide the greatest, immediate economic benefit to the minor, but the result makes bad law. Well established principles of financial, economic, and taxation theory cannot be abandoned or ignored simply to achieve a preordained, desired result. Stated more simply, ends, not means and certainly not equity, were fully evaluated before pen was put to paper in this decision.

Karns and Hunt’s argument that the court should not characterize these options as gross income also rests on the tax implications of this classification. Gross income is subject to income tax but property is

264. *Id.* at 252-53.
265. *See id.*
266. *See supra* notes 91-104 and accompanying text for an explanation of option valuation and the importance time plays in that valuation.
267. Karns and Hunt state:

The question of when to exercise the options is partly personal, partly practical, and partly theoretical . . . . The single most important argument for waiting to exercise an option, once the effective grant date of the option is delineated, is the long-run, secular trend in common stock prices . . . . a failure of stock prices to increase over the entire period [given a hypothetical five year holding period] would be of historic precedent and, therefore, extremely unlikely.

Karns & Hunt, *supra* note 260, at 253-54. For the more theoretical reasons for waiting to exercise an option, see Gary L. Gastineau, *The Options Manual* 310-14 (3d ed. 1988). For another criticism from the point of view of a compensation specialist who argues that the executive at issue could be seen as harming the company if forced to exercise at an inconvenient time, see Zipkin, *supra* note 8 (“‘It could be construed by top management under certain circumstances as not being beneficial to the company. . . . If the stock goes down, there’s risk of loss if he’s forced to exercise; if the stock goes up, then there’s gain foregone.’”).

268. Karns & Hunt, *supra* note 260, at 264. This article also criticized the “paucity of legal rationale in the opinion” addressing why the stock options should be considered income and not property. *Id.* at 263.
269. *Id.* at 236.
subject to capital gains treatment. Generally, when the owner of property sells property after having owned it for more than one year, the profit realized from that sale is considered a long-term capital gain. If the owner had held the asset for less than a year the profit is considered a short-term capital gain. One of the real advantages to having the profits from the sale of property placed in the capital gains category is that deductible capital losses can be subtracted from the capital gain profit, whereas they cannot be if that profit is categorized as ordinary income.

The *Murray* court decided to characterize these stock options as income even though for tax purposes they are considered property and are not taxed until the options are exercised and the underlying shares are sold at a profit. The court determined that this outcome was acceptable because the Ohio statute stated that income under the statute was subject to child support formulas "whether or not the income is taxable." Karns and Hunt argue that this leads to an inequitable outcome. Forcing the employee to exercise the options and receive their present value by trading the stock on the market for profit is a "taxable event." In other words, the employee spouse who exercised the options would be responsible for paying the requisite tax upon any profit realized. Child support is not deductible for tax purposes—the employee cannot subtract the amount of child support he pays from his gross income when calculating his taxes. The employee, therefore, would be subject to

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270. *Id.*
271. See *supra* note 262.
272. See *Kahn,* *supra* note 262, § 18.2100. “For example, in 1998, the maximum marginal rate on an individual’s income is 39.6% while the maximum rate on an individual’s net capital gain typically will be 20%.” *Id.* § 18.1000. The difference between the percentage placed on ordinary income and capital gains can be as much as 19.6%. *Id.* § 18.2310. However, if the normal rate applied to that income is typically less than the maximum capital gains rate, the lower rate will be applied. *Id.* § 18.2321.
273. *Id.* § 18.2410.
275. *Id.* at 258 & n.119. Karns and Hunt argue that regardless of the statute’s wording, the state’s “policy cannot rest on principles that are not based on sound, viable theory and equity.” *Id.* at n.119.
276. Karns and Hunt summarize why these issues concern them: “[p]erhaps the most disturbing aspect of the *Murray* decision is the conclusion reached by the Ohio Court of Appeals: that just because the definition of ‘gross income’ was written broadly by the Ohio state legislature, unexercised stock option appreciation ought to be included therein.” *Id.* at 240.
277. *Id.* at 238.
278. In addition, if the employee spouse needed the profits to pay the child support, he would have to trade the stock on the market right away, which means that he may not receive the benefit of categorizing that profit as a long term capital gain. See *supra* notes 272-73 and accompanying text.
tax liability for the whole amount he pays to the child, while it would be a "nontaxable" event for the non-employee custodial spouse in whose care the support payments are placed. The custodial spouse would be able to add the support to any income she receives and would not be forced to pay income tax on that amount. Karns and Hunt argue that this result is inequitable.

The court in Murray also held that the intrinsic valuation method was the best method to value the options at issue in that case, which some commentators criticize as being an inadequate method of valuation. Courts using the intrinsic valuation method argue that, because employee options are normally non-transferable and hence non-marketable, the financial models that are usually used to value options traded in the market are not appropriate for use in this context. Critics of the intrinsic valuation method disagree, arguing that neglecting the "fundamental economic principles regarding futures and options transactions," even in situations where the option is non-transferable, defeats the true purpose of a stock option. Furthermore, some of these critics regard any net present valuation method, even the financial models used to value options traded in the market, as potentially risky in a courtroom setting. This criticism is

280. Id. at 239.
281. Id.
282. Id.
283. Id. at 238.
285. See supra notes 94-95 and accompanying text (defining intrinsic value).
286. Davidson v. Davidson, 578 N.W.2d 848, 858 (Neb. 1998) (holding that the Black-Scholes method of valuation was acceptable in determining the present value of the options at issue); see Jones, supra note 86, at 6-7 (describing stock option valuation methods and how the time value of an option often adds value to any intrinsic value of the option); Karns & Hunt, supra note 260, at 240 (arguing that the way the Murray court valued these options "defeats the purpose of the stock option" and that "[t]he logic used in the Murray decision is absolutely stunning with respect to the court's handling of fundamental economic and financial principles regarding futures and options transactions."); Kolb, supra note 75.
287. See Murray, 716 N.E.2d at 298, 299 (rejecting the Black-Scholes financial model as the appropriate way to value the options at issue and determining that the best method is to value the options according to the stock price on the most recent date upon which the option could be exercised less the strike price of the option).
288. See id. at 298 (citing Chammah v. Chammah, No. PA 95145944S, 1997 WL 414404, at *6 (Conn. Super. Ct. July 11, 1997)) (stating that the financial models that exist for calculating the value of a stock option may not be reliable for litigation purposes).
289. See supra note 286.
290. See supra notes 123-27 and accompanying text for an overview of the net present valuation method and the models included under that title. The critics of the net present valuation method include some courts. See Seither v. Seither, No. 98-02590, 1999 WL 1143770, at *2 (Fla. Dist. Ct. App. Dec. 15, 1999) (discussing the risk that the stock price will be substantially higher or lower when the option is actually exercised when a court relies on a current valuation method); Green v. Green, 494 A.2d 721, 728-29 (Md. Ct. Spec. App. 1983) (recognizing the complex nature of
based on the inherent risk that the option may be worth substantially more or less when it is actually exercised, even if that is only a day or a week later.  

Additionally, some “commentators” consider the “if, as and when” method problematic in the child support context. The court in Kerr v. Kerr utilized the “if, as and when” approach to the valuation and distribution of an option, similar to the method used in Green v. Green. The Murray court recognized that the “if, as and when” method from Kerr was not appropriate in child support proceedings because it allowed employee spouses to “hide” income from their children and spouses by having their companies pay them in stock options. The employee could potentially refuse to exercise those options until his or her children reached majority age so that they would not enjoy the value, a situation which does not serve the best interests of the child.

Clearly, many commentators are concerned about the impact of the Murray decision and the fact that courts may continue to characterize stock options as income in the child support context. As Karns and Hunt state, “[in terms of the treatment of options theory, this case grossly simplifies complex issues... that transcend the boundaries of Ohio, and which may become the basis for decisions in other jurisdictions.” Additionally, the increasing use of stock options for employees makes the Murray case even more important. According valuation of options and deciding that immediate valuation is inequitable since the right to choose when to exercise the option is integral to the purpose of the option as a unique instrument); Littman, supra note 88, at 62 (arguing that valuation should never be based on one model because the court is sacrificing accuracy, and reminding the reader that unless the circumstances warrant immediate valuation the options should not be valued for distribution); Karns & Hunt, supra note 260, 257-58 (arguing that stock options should not even be characterized as income due to the fact that they then must be valued and divided). One commentator noted:

The new terrain these courts are exploring has pitfalls, of course. Ms. Ahlers [Mr. Murray’s lawyer] believes the Ohio court failed to grasp the nature of stock volatility. In March, after Proctor & Gamble warned that it would not meet its earnings forecasts, the stock dropped from $89.87 a share on the grant anniversary date to $61.68 eight days later. ‘Now he’s overpaying,’ she said.

Zipkin, supra note 8.

292. 91 Cal. Rptr. 2d 374 (Cal. Ct. App. 1999). For a thorough overview of this case, see supra notes 160-80 and accompanying text.
293. 494 A.2d at 729; see also supra notes 128-33 and accompanying text (describing the deferred distribution, or “if, as, and when” method).
295. See Zipkin, supra note 8, at C1 (quoting the Judge from Kerr who commented on the decision in Murray (even though that decision had come down before the decision in Kerr) by saying, “I see it as a logical extension of Kerr...[s]mart companies and industries can find creative ways to compensate employees and camouflage income as something other than income. Children and spouses are entitled to the fruits of those labors. Our job is to unmask the camouflage.”)
to Laura Morgan, the chair of the ABA Family Law section’s Child Support Committee, “[a]s stock options become more and more prevalent as a means of compensation, the principle of law [developed in Murray] will apply to more and more people...[t]hat’s where [the case] will have an impact.”

The Murray decision may be a dangerous precedent in some ways, but it also made some significant strides in the child support context. The next part argues that courts that have characterized stock options as income have taken a positive step towards achieving the goal of the best interests of the child, but that these courts, through their methods of valuation, have also made it less likely that these interests will be fulfilled. Courts should continue to characterize stock options as income. Instead of valuing the options using traditional financial models, however, courts should use a constructive trust, which requires no valuation and therefore avoids the pitfalls of most of the methods discussed above.

III. CONSTRUCTIVE TRUSTS—A POTENTIAL SOLUTION

This part argues that the courts that have characterized stock options as income rather than property in the child support context were correct in doing so, and other courts should follow their lead. It then argues that, although courts have properly classified stock options as income in the child support context, they have used improper methods to value those options and have effectively defeated the goal of fulfilling the best interests of the child. Neither the “if, as and when” method nor the intrinsic valuation methods (as a form of the net present valuation method) that these courts have utilized protect the best interests of the child because these methods lead to an unfair outcome for both the child and the non-custodial parent, and they also lead to problems with administrative efficiency. Finally, this part argues that in a child support determination involving stock options, the court should impose a constructive trust on the options and divide the options between the parties based on the percentages in the child support formula. This method provides a better solution to valuation because it addresses the problems of fairness and efficiency better than currently employed methods, and most importantly, it achieves the goal of finding a solution that is in the best interests of the child.

Courts have recently begun to characterize stock options as income in the child support context, reasoning that otherwise, employees could choose options instead of salaries as a preferred method of

298. See supra Part I.B.2.
compensation, and therefore avoid inclusion of the value of those options in child support formulas.\textsuperscript{299} Courts have used two methods to value stock options in this context—the net present value method and the “if, as and when” method.\textsuperscript{300} The courts assume that categorizing these options and valuing them in one of these two ways is in the best interests of the child because it gives the child access to the value of the options as part of the non-custodial parent’s income when otherwise the child would have no access to that value.\textsuperscript{301} This practice, according to the courts, is the best method to achieve the goal of allowing the child to enjoy the same standard of living that he would if his parents had remained married, including any income increases enjoyed by either parent after the divorce.\textsuperscript{302}

Courts should continue to categorize stock options as income in the child support context because it will ensure that the best interests of the child are being properly considered. If stock options are categorized as property by a court during divorce proceedings they are subject to equitable division at the time of dissolution, but any options earned after the dissolution and child support hearings would be unavailable to the custodial household. This may be acceptable in the context of marital property and alimony proceedings because in those areas the underlying policy is that the spouse should enjoy the same standard of living that she did while married.\textsuperscript{303} In the child support context, however, if stock options are categorized as property the child is deprived of the standard of living she would have enjoyed if her parents had remained married. This categorization directly conflicts with the policy goal that children should enjoy any increase in their parents’ standard of living.\textsuperscript{304} It makes the stock options unavailable to the child because child support awards are based solely on income.\textsuperscript{305} If the stock options are categorized as property then they will not be considered under the child support laws.\textsuperscript{306} Accordingly, stock options should be considered income to meet child support policy goals.

The critics who believe that stock options should not be categorized as income base their argument on two fundamental problems.\textsuperscript{307} First, the federal and state income tax laws often do not categorize the

\begin{itemize}
  \item \textsuperscript{299} See Murray, 716 N.E.2d at 293.
  \item \textsuperscript{300} See id. at 298 (net present value method). For a discussion of the “if, as and when” method, see supra notes 128-33 and accompanying text.
  \item \textsuperscript{301} See supra notes 204-06, 222-30 and accompanying text.
  \item \textsuperscript{302} See supra notes 205-14 and accompanying text.
  \item \textsuperscript{303} See the quote from the opinion of the Kerr court, supra note 53.
  \item \textsuperscript{304} See supra note 53 and accompanying text.
  \item \textsuperscript{305} See supra notes 51-53 and accompanying text.
  \item \textsuperscript{306} See id.; see also supra note 206 and accompanying text (discussing how, in the Murray case, if the options at issue were not categorized as income, the child would receive none of the benefits from their increased value).
  \item \textsuperscript{307} See supra notes 261-62 and accompanying text.
\end{itemize}
increased value of options as income, and therefore it is unfair to do so in this context.\textsuperscript{308} Second, once the options are categorized as income they must be valued. Critics argue that the processes courts use to value these options ignore the fundamental nature of the options and lead to an inequitable outcome for the non-custodial spouse.\textsuperscript{309}

The first concern of the critics is understandable, but misplaced in the child support context. The most important goal during child support proceedings is ensuring the best interests of the children involved.\textsuperscript{310} Child support laws have clearly evolved to represent a policy that recognizes that divorce is widespread, but the main goal of these laws is still preventing divorce from having a negative effect on the financial status of the children involved.\textsuperscript{311} In the child support context, therefore, the critics' complaint that the categorization of stock options as income does not reflect the tax code and is unfair to the non-custodial parent is easily outweighed by the more important goal of ensuring the best interests of the child.

The second concern of the critics is a serious one not only because of the fairness issues it raises, but also because the courts' incorrect valuation of stock options in child support proceedings could jeopardize their goal of ensuring the best interests of the child. This part argues that this problem can be solved through the use of the constructive trust. Utilization of a constructive trust addresses both concerns of the critics because the stock options can be categorized as income while still retaining their fundamental characteristics and remaining fair to all of the parties involved. In addition, the courts' concern for ensuring the best interests of the child is more likely to be met.

In the child support context, the first valuation option available to the court is the "if, as and when" method by which the court decides what percentage of the proceeds of a stock option will go to the child if the non-custodial parent exercises it before the child reaches majority. This method, however, does not force the non-custodial parent to exercise the option.\textsuperscript{312} As the Murray court stated, the concern with this method of valuation is that the employee spouse will "hide" his income and fail to exercise the options due to a desire to create discord between himself and the custodial spouse.\textsuperscript{313} The "if, as, and when" method better protects property rights because it allows

\textsuperscript{308} See supra notes 274-83 and accompanying text.
\textsuperscript{309} See supra notes 265-68 and accompanying text.
\textsuperscript{310} See supra note 43 and accompanying text.
\textsuperscript{311} See supra Part I.A.
\textsuperscript{312} For a description of the "if, as or when" method as applied to stock options in the marital property context see supra notes 128-33 and accompanying text. For an application in the child support context see the discussion of the Kerr case at supra notes 160-80 and accompanying text.
the child to realize the increased valuation of the options over time, which is a fundamental characteristic of an option as a financial instrument. However, the policy goal of protecting the best interests of the child will not be met if the non-custodial employee spouse waits until the child turns eighteen to exercise his options since he will no longer be obligated to support his child. In addition, choice is an important characteristic of the nature of an option, and this method prevents the child from recognizing the benefits of the options right away if he chooses to. The Murray court addressed this problem by using a different method of valuation, the net present valuation method. This method uses either intrinsic valuation or a financial model to determine the net present value of the future benefits of the stock options and to divide those benefits right away, avoiding the negative consequences of the "if, as, and when" method for the child.

There are three problems with the net present value method as applied in the child support context. The first problem involves fairness to the child. The Murray court employed intrinsic valuation as a net present valuation method. Intrinsic valuation does not account for the time value and the volatility of the underlying stock, two factors that can increase the option's value. Therefore, it is possible that because these factors were not taken into account, the child is undercompensated as a result of the court undervaluing the future stream of income available from the stock options. When the court uses the intrinsic valuation method, or any net present valuation method, it does not value the options a manner that is sufficient to achieve the best interests of the child. The child is either entitled to more because the value of the options is higher than the court determines or the child is entitled to less when the court uses a financial model that overvalues the options.

The second problem therefore relates to fairness to the non-custodial spouse. As the critics complain, when the court overvalues the options in the child support context, the non-custodial parent is forced to pay more than he is obligated to pay. In addition, the non-

314. See supra note 267.
315. For a definition of each method see supra notes 123-33 and accompanying text.
316. See supra notes 222-24 and accompanying text.
317. See supra notes 91-104 and accompanying text.
318. The financial models also would not be appropriate because those models do not completely apply in the child support context. See supra notes 941-111 and accompanying text for an explanation of why the intrinsic valuation method results in an incorrect value, and notes 265-68 for why that outcome is unfair and results in bad law.
319. See supra notes 961-111 and accompanying text for a discussion of the valuation of options and how different methods can lead to over- or under-valuation of the options.
320. See supra note 290.
custodial spouse bears all of the financial risk and all of the tax consequences. For example, if the court overvalues the options using a financial model or determines the intrinsic value according to a specific date, it is possible that the non-custodial spouse will receive less than that value on the date that he actually exercises those options. The *Murray* court stated that the non-custodial spouse should be held responsible for his investment choice not to exercise the options on the first date he is eligible to do so. This judgment is problematic, however, because of the fundamental nature of a stock option. An option is a choice, and because of the time value of the option, the holder often chooses to postpone the exercise of that option on the chance that it will increase in value. Depriving the option holder of that choice defeats the purpose of the option itself.

In addition, extensive tax implications will likely arise for the non-custodial spouse. If the non-custodial spouse is forced to exercise the options and trade the underlying stock in order to meet his child support payments, he is fully responsible for the tax implications of those actions even though he did not freely choose to take them. Even worse, if a non-custodial spouse had to borrow or otherwise acquire the money to exercise the options at the same time he was faced with the tax liability, he could potentially be placed in a very unstable financial situation.

321. See supra notes 274-83 and accompanying text for a discussion of the tax ramifications.
323. See supra note 2687 and accompanying text.
324. Green v. Green, 494 A.2d 721, 729 (Md. Ct. Spec. App. 1985) (refusing to compel the employee to exercise his options because that would deprive him of his right to make a choice); Callahan v. Callahan, 361 A.2d 561, 563 (N.J. Super. Ct. Ch. Div. 1976) (using the constructive trust in the equitable division context because this was the only method that provided the non-employee spouse with all of the benefits of the options while refraining from inflicting "undue financial and business liabilities upon the [employee spouse]"; see also supra note 267 (stating that the long run trend of increasing stock prices is a good argument for waiting to exercise an option).
325. See supra notes 274-83 and accompanying text.
326. For example, the father in *Murray* probably could not have paid the increased amount of child support with his salary alone. Before he could meet his child support obligations, he would have had to exercise the options by paying the strike price, and realize the increased value of the stock by selling shares and paying short-term capital gains tax on that value. See supra note 272.
327. See supra note 2798-80 and accompanying text.
328. This situation becomes even more likely if the non-custodial parent is simply a regular employee and not an executive of the company, because he probably will not be able to afford the child support payments without exercising the options. This may have been of less importance when executives were the only employees to receive stock options because one could assume that executives had enough money and financial advice from experts that they would be able to avoid any instability. However, now that regular employees are more likely to receive stock options as compensation they will often find themselves in this situation without enough money and without any expert financial advice. See supra note 86.
The third problem that arises with the net present value method in the child support context involves administrative efficiency. Recognizing the possibility of an unfair burden on the non-custodial spouse if a stock price decreases or increases dramatically, courts have acknowledged that they would accept a modification hearing under those circumstances. Because most courts refuse to determine child support obligations as a percentage, and instead determine the obligations as a dollar value based on a percentage, every time there is a "substantial" change the parties can file for modification. Due to the volatility of the stock market, it is likely that both parties will be eligible to bring modification suits on a regular basis. For example, the court could hold on Monday that the non-custodial parent was obliged to pay a certain amount based on the stock price that day. When the non-custodial parent attempts to exercise the options on Wednesday that price may be significantly lower, prompting the parent to file for modification. Modification proceedings, therefore, could become more and more frequent, which could result in very high administrative costs including overworked courts and higher litigation costs. These costs, in turn, will be paid by the court employees, the parties involved, and society at large, and the parties may suffer emotionally from the lack of closure that results from the ever present possibility of modification. Additionally, the child may be burdened because of the negative effects resulting from the potential continuation of hostility between her parents, a result not in the best interests of the child.

How then should courts value stock options in child support proceedings? Courts should continue to characterize stock options as income subject to child support obligations, but they should discontinue the valuation methods currently in use and turn instead to a constructive trust. A court can create a constructive trust if it believes that the employee non-custodial parent is unfairly holding property that should belong to the child. In child support cases then, the court should impose a constructive trust granting the required ownership interest in the options at issue to the child, as determined by child support statutes. The non-custodial parent would then act as trustee for that percentage of the options and would be

330. See supra notes 54-71 and accompanying text.
331. See supra notes 302-06 and accompanying text.
332. See supra notes 136-55 and accompanying text for an overview of the constructive trust and its application in the marital context.
333. Bogert, supra note 136, § 77; Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919). For example, the Murray court decided that Mr. Murray could not in good conscience retain the beneficial interest of all of his stock options and to be fair, had to share this income with his children. See supra note 206 and accompanying text.
required to exercise the child's share at the discretion of the non-employee spouse to avoid unjust enrichment.334

If the court were to impose a constructive trust on the options in the child support context, it would divide the options between the parties based on the percentages in the child support formula.335 In other words, the court would actually give the child an ownership interest in his share of the stock options instead of merely valuing the options and basing the child support determination on that number. Moreover, a constructive trust avoids an actual legal transfer of ownership, which is significant because employee options are often non-transferable.336 The trust transfers the interest as an equitable remedy, not as a substantive legal change in ownership.337 The child, however, still retains the equitable benefits of ownership of those options.338 As such, the non-custodial parent would be ordered to hold the child’s options for his benefit until the child, acting through the custodial parent, chooses to exercise them. Because the non-custodial parent would then have a legal duty to exercise those options at the request of the custodial parent, the problem of possible recriminatory behavior on the part of the non-custodial spouse would be eliminated.339

The constructive trust also gives flexibility to the court because it allows the court to impose special requirements upon the constructive trust if it finds that remedy necessary to produce a more equitable outcome.340 For example, the court could require that the custodial


335. For example, the court would first determine the value of the options. Using a financial formula would be more appropriate than the intrinsic value method since it is more accurate. See supra notes 961-111 and accompanying text. The court would then apply the child support formula to determine the percentage of income that the non-custodial spouse owes to the child, and this percentage would be used to divide the options in kind between the non-custodial parent and the child, meaning that the child would get a certain percentage of the number of stock options the non-custodial parent owned. This percentage would apply to all of the future options the non-custodial parent would earn as they vest, until the child reached maturity.


337. See id.

338. See the discussion of Callahan v. Callahan at supra notes 144-55 and accompanying text.

339. Because the power to exercise lies with the custodial parent, the custodial spouse could potentially abuse this power which would lead to a detrimental outcome for the child. Nevertheless, courts regularly leave decisions regarding the way child support awards will be spent in the control of the custodial parent. See supra Part I.A. (describing the general approach to child support in the United States).

The court could also mandate that the non-custodial parent use the underlying stocks as collateral for a loan in the amount of the exercise price to be paid back by the custodial household if the custodial household did not have the funds available to exercise the options. Furthermore, the court could impose rules restricting trading of the underlying shares for a particular period of time to avoid insider trading issues that might result in a negative outcome for the non-custodial spouse. Additionally, the court could require that any tax liabilities be allocated appropriately between the parties.

A constructive trust would be the best remedy for several reasons. First, the stock options are still characterized as income subject to child support obligations, which makes it impossible for the non-custodial parent to hide income from his children by receiving income in stock options instead of salary. The options are, however, treated as property and divided in kind, so that the financial benefits resulting from options as financial instruments can be fully enjoyed by both parties. The concerns of the Murray court are therefore satisfied because the best interests of the child are met.

Second, the constructive trust avoids the pitfalls of valuation, which includes the danger that the court may undervalue or overvalue the future stream of income from the options. A custodial parent who believes that the option will increase in value will wait to exercise that option, or if that parent believes the option's value is at its height, she can exercise right away. Therefore, the choice of when to exercise the options, the fundamental factor that gives an option its value, is guaranteed. Moreover, the constructive trust retains the positive aspects of the net present value method, leaving less room for discord between the parents to affect the child's interest in receiving the support he is due since the decisions of the custodial spouse are legally required to be respected by the non-custodial spouse at the issues. Id.

341. In the child support situation, it may seem as if the non-custodial spouse should have to pay the exercise price himself since he owes the value of the option to the child. The exercise price of the option is calculated into its value, however, so the custodial household should have to shoulder the burden in order to enjoy that value.
342. See supra note 82.
343. See Callahan, 361 A.2d at 564.
344. See supra note 206 and accompanying text.
345. See the discussion of Callahan at supra notes 144-55 and accompanying text.
346. See supra note 206 and accompanying text.
347. See supra note 290.
348. See supra notes 265-68, 284-91 and accompanying text.
349. See supra notes 222-30 for the Murray court's view of the positive aspects of using a net present value method.
time that spouse makes those decisions.350

Third, the constructive trust would guarantee fairness better than the current remedies. As the court in Callahan stated, the constructive trust is an equitable remedy that serves the interests of all parties involved when stock options are at issue.351 The non-custodial spouse no longer bears the risk that the value of the underlying stock will fluctuate substantially.352 In addition, because the court can impose tax restrictions on the trust, the non-custodial spouse no longer bears the risk of unfair tax liability.353 While optimizing the benefits for everyone involved, this solution also considers the economic theory underlying stock options and allows the child to benefit from the true value of that financial instrument, instead of being undercompensated through the use of the intrinsic valuation method.354

One risk associated with using a constructive trust is that in some cases, a child could receive less than she would have if the court had not imposed the trust at all. According to the statistics stated above, however, the stock option, because of its time value, normally increases instead of decreases in value.355 Because the child, and therefore the custodial household, is entitled to the benefits of the options as a financial instrument, then it is only fair that the custodial household also bear the risk. Moreover, the custodial household could use a number of risk-averse approaches, such as exercising some or all of the options immediately based on need. In addition, the custodial spouse could obtain the services of a financial advisor to assist him in minimizing his risks.

Finally, the constructive trust promotes administrative efficiency. When the custodial household already has property rights to the value of the option it assumes the risk of increases and decreases in value, and therefore has no reason to go back to the court for modification. After determining the percentage of options to which the child is entitled, the court would have no further role in the case.

As this part has suggested, courts that have recently characterized stock options as income were correct in doing so because their

350. See supra note 339.
352. See supra notes 320-28 and accompanying text.
353. See supra note 153 and accompanying text.
354. The company issuing the stock options may be concerned that the child will then control the voting rights over the stock when the option is exercised. A detailed discussion of the repercussions of this concern is beyond the scope of this Note. It is likely, however, that this concern will only present itself in a few cases (when a closely-held corporation is involved, or very large grants of options to officers in large corporations), and if the number of options granted to the child is enough to be of real concern to the company it may be possible to address that concern through the flexible nature of the constructive trust.
355. See supra note 267.
decisions made the value of the non-custodial parents’ stock options available to the child.\textsuperscript{356} These same courts, however, have used improper methods to value the stock options, thereby defeating the goal of fulfilling the best interests of the child.\textsuperscript{357} The methods these courts used have led to an unfair outcome for both the child and the non-custodial parent, and they also create potential problems of administrative efficiency.\textsuperscript{358} In a child support determination involving stock options, the court should instead impose a constructive trust on the options, dividing the options between the parties based on the percentages in the child support formula.\textsuperscript{359} This method is a better solution because it addresses the problems of fairness and efficiency, and most importantly, it fulfills the goal of ensuring the best interests of the child.\textsuperscript{360}

**CONCLUSION**

The recent *Murray* decision raised several important issues in the context of child support law, including whether or not stock options should be categorized as income and made subject to child support statutes and, additionally, how to value those options if they are considered income. These issues should be addressed in a manner that ensures the best interests of the child while remaining fair to the parties and preserving administrative efficiency. A constructive trust that holds the stock options granted to the child, and is operated to the benefit of the child by the non-custodial parent would be the best solution to this problem.

The courts’ greatest concern is ensuring that a parent completely fulfills his or her obligation to support the child after the marriage is dissolved. The decision of some courts to characterize stock options as income properly reflects this concern. These same courts, however, undermine their own efforts, as well as fairness and efficiency, by valuing the options based on the intrinsic value method. Courts, therefore, should instead embrace the constructive trust as a remedy that will give them the tools to address all of these problems and still remain true to their greatest consideration—the best interests of the child.

\textsuperscript{356} See *supra* notes 302-11 and accompanying text.

\textsuperscript{357} See *supra* notes 312-31 and accompanying text.

\textsuperscript{358} See *supra* notes 312-31 and accompanying text.

\textsuperscript{359} See *supra* notes 332-43 and accompanying text.

\textsuperscript{360} See *supra* notes 344-56 and accompanying text. Some may argue that the same outcome would result, with fewer costs, through prior contracting between the parties, for example, agreeing on an exercise date for the options in the dissolution agreement. Further explanation of this argument and a sufficient counter-argument are beyond the scope of this Note. Since the parties to a divorce often have enough problems agreeing on dissolution terms when there are no child support issues involved, this approach seems to underestimate the complexities and transaction costs that would likely be involved with prior contracting in this context.