

Stock Options and Post-retirement Maintenance Payments

According to the Wisconsin Appeals Court

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In *Heppner v Heppner* (No. 2008AP2020 Wis. Ct. App. May 5, 2009) [recommended for publication], the Wisconsin Court of Appeals District I evaluated:

a) whether income from the stock options awarded by an employer who also awarded cash bonuses is includable in income for maintenance and support payments, and

b) whether vested "underwater" options earned during the marriage are includable and divisible as property in the marital estate, even if both parties considered the options valueless at the time of the divorce.

In this case, the Court of Appeals concluded that the maintenance order should "encompass income... from the exercise of stock options" (Heppner, para. 19) and that the property division must include "[t]he options [that] were earned during the Heppner's [sic] marriage; they are part of the marital estate" (para. 24). In addition, the Court determined

c) whether the maintenance payments should end with the income-producing spouse's retirement or should continue for an indefinite term. The subject decision addresses a) the effect of stock options on income determination for a maintenance order (and the potential for double-counting stock options for both property division and main-

tenance payment purposes), b) the division of property deemed valueless by the contending parties at the time of the divorce, and c) the term of maintenance payments for the particular case.

In evaluating whether income from the exercise of stock options awarded to a corporate executive in addition to his income from cash bonuses is includable in income for maintenance and support purposes, the Appeals Court distinguished analysis for maintenance purposes from analysis for property division purposes. The Court noted that it "is obligated to consider *all sources of income* when establishing maintenance" (para. 17), and that "Mr. Heppner admitted during his testimony that his W2 forms included income received from his exercise of stock options" (para. 18). In addition, the Court reiterated a prior Wisconsin court's determination that "double counting of an asset for both property division and maintenance ... does not apply to *income* from assets awarded in a property division" (para. 18).

Furthermore, in evaluating whether vested "underwater" options earned during marriage are includable and divisible as marital property, the court determined that "the fact that neither the trial court nor the parties endeavored to give a value to those

options ... is a neutral consideration" (para. 22). In a footnote, the Court expanded upon this determination and stated, "Were we writing on a clear slate, [sic] we would not accept the conclusion that an underwater option necessarily has no value.

Thus, as one respected observer of the financial scene has noted, 'out of the money does not equal worthless. As long as the option has not expired, its potential value gives it value ... Indeed, there are various tools to ascertain the value of an out-of-the-money option'" (para. 21, fn 3). The footnote then refers the reader to *In re Zoran Corp. Derivative Litigation*, No. C 06-05503 WHA, 2008 WL 941897, at *6 (N.D. Cal. Apr. 7, 2008) which discusses the Black-Scholes method to value underwater options. In its opinion, the Court reviewed the facts and concluded, "It takes no special insight to recognize that whether the stock rebounds is largely, if not almost wholly, dependent on what the economy ... does before the options expire. The options were earned during the Heppner's [sic] marriage; they are part of the marital estate ... The trial court erroneously exercised its discretion by excluding the options from division because it erroneously viewed their potential value as being almost solely a function of what Mr. Heppner would do in his business after the divorce, and largely ignored the fact

that the options were earned while the Heppners were married” (para. 24). Moreover, in evaluating the term of the maintenance obligation to Ms. Heppner, the Court determined that “if Ms. Heppner is to be able to enjoy the life she would have enjoyed if the parties had not divorced, as *Hefty* [sic] teaches is the rule, she is entitled to maintenance even though Mr. Heppner is retired” (para. 15). The Court further included that “[i]f circumstances change so that the fifty-fifty split of Mr. Heppner’s income is no longer fair or warranted, the parties may return to court for a modification” (para. 15).

The case timeline is summarized in the following paragraphs.

John and Susan Heppner were married in May of 1974, and John filed for divorce in September of 2006.

For the marriage of over 33 years, the Trial Court in March of 2008 granted Ms. Heppner limited-term maintenance to end when Mr. Heppner turns sixty on May 30, 2012, irrespective of whether or not he is retired. The Trial Court excluded income from the exercise of stock options Mr. Heppner earned while married to Ms. Heppner in determining Mr. Heppner’s maintenance obligation to Ms. Heppner. Similarly, the Trial Court did not include “underwater” (option grant price exceeding underlying stock value) stock options in the divisible marital property since neither contending party assigned the options a value at the time of the divorce.

Ms. Heppner appealed the Trial Court’s decisions outlined above, and on May 5, 2009, the Court of Appeals issued an opinion which modified in part, reversed in part and remanded with directions the original order rendered in the spring of 2008.

First, Ms. Heppner contended that the trial court erred in deciding that maintenance payments shall end when Mr. Heppner turns sixty on

May 30, 2012. The Court of Appeals agreed with Ms. Heppner and, under Wis. Stat. § 808.09, modified the Trial Court’s maintenance order to extend it beyond May 30, 2012, for an indefinite term.

Second, Ms. Heppner argued that the Trial Court improperly excluded the aforesaid stock options from the income pool from which the maintenance obligations would be drawn. The Court of Appeals again agreed with Ms. Heppner and, under Wis. Stat. § 808.09, modified the maintenance order to encompass the income Mr. Heppner received from the exercise of the stock options earned during the marriage.

Last, Ms. Heppner contended that the Trial Court erroneously exercised its discretion in refusing to divide as part of the marital estate those stock options deemed as having no value as of the time of the divorce (“underwater” options). The Court of Appeals found that the Trial Court erroneously viewed the options’ potential value as being almost solely a function of Mr. Heppner’s performance in his business after the divorce, and the Trial Court largely ignored the fact that the options were earned during the marriage. The Court of Appeals agreed with Ms. Heppner and reversed the Trial Court’s judgment and remanded the matter to the Trial Court for an ensuing inclusion of “underwater” options in the marital estate.

Mr. Heppner filed a Motion for Reconsideration (“Motion”) of the May 5, 2009 Court of Appeals decision, and Ms. Heppner’s counsel filed a formal response to Mr. Heppner’s Motion. On June 4, 2009, the Appellate Court issued a judgment on that Motion modifying the section pertaining to the allocation of the percentage split of income for the maintenance obligation.¹ On the same date, Mr. Heppner filed a Petition for Review (“Petition”) to the Wisconsin Supreme Court, and Ms. Heppner’s counsel followed with a

response explaining why the Wisconsin Supreme Court should not accept Mr. Heppner’s Petition.

As of the date of this publication, the Wisconsin Supreme Court has yet to decide to review the case. [Recently, the Wisconsin Supreme Court denied review of the appellate court’s decision. Ed]

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¹ The language in Paragraph 15 as revised on June 4, 2009, reads as follows – revised language is underlined: “By ending maintenance on May 30, 2012, the trial court ignored the *Hefty* [sic] principles we have discussed, and, accordingly, erroneously exercised its discretion. If Ms. Heppner is to be able to enjoy the life she would have enjoyed if the parties had not divorced, as *Hefty* [sic] teaches is the rule, she is entitled to maintenance even though Mr. Heppner is retired. Accordingly, under our authority under WIS. STAT. §808.09 to modify a circuit court order, we modify the trial court’s maintenance order to extend beyond May 30, 2012, for an indefinite term. In light of the trial court’s setting the fifty-fifty split based on its imposition of the limited-term maintenance, we remand to the trial court for an evaluation whether, consistent with this opinion, the fifty-fifty split should be modified. The parties may, of course, return to court for a modification of whatever maintenance division it ultimately sets. See [sic] WIS. STAT. §767.59. Upon remand, the trial court shall enter a revised judgment to conform to our ruling.”