FILED
15-0763
10/10/2016 1:09:20 PM
tex-13149547
SUPREME COURT OF TEXAS
BLAKE A. HAWTHORNE, CLERK

No. 15-0763

IN THE
SUPREME COURT OF TEXAS

MIGUEL ANGEL LOYA, Petitioner

vs.

LETICIA B. LOYA, Respondent

On Petition for Review from the
Fourteenth Court of Appeals at Houston, Texas
No. 14-14-00208-CV

RESPONDENT LETICIA LOYA'S BRIEF ON THE MERITS

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ABBREVIATIONS

Petitioner, Miguel Loya	Miguel
Respondent, Leticia Loya	Leticia
Supplemental Clerk's Record	SCR[#-#]
Decree of Divorce	Decree
Agreement Incident to Divorce	AID
Mediated Settlement Agreement	MSA

INDEX OF AUTHORITIES

Cases

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STATEMENT OF THE CASE

Respondent would add to Petitioner's Statement of the Case that the Court of Appeals was not divided on the sole question of law in this case, whether income received after divorce for work done during marriage can be community property (here it was a post-divorce bonus). The Court of Appeals also was not divided on the fact that the Decree of Divorce ("Decree") did not award the bonus to either spouse, or that the parties' Mediated Settlement Agreement ("MSA") did not expressly mention the bonus. The Court of Appeals Justices disagreed over what the parties' intended when they partitioned "future earnings" in their MSA.

Additionally, the central dispute in this case, whether the MSA partitioned compensation received after the MSA was signed for work done before the MSA was signed, was submitted to binding arbitration in the divorce, and the arbitrator ruled that the MSA partitioned earnings after June 13, but not between January 1 and June 13, 2010. SCR417, Appendix 1.

PROCEDURAL HISTORY

Leticia, the former wife, brought suit to divide the undivided community property portion of a $4.5 million employment-related bonus that her former husband, Miguel, received in March of 2011, the year after the divorce. Leticia filed under Family Code Section 9.201-ff. for post-divorce division of undivided community property. See Leticia's Original Petition for Post-Divorce Division of Property. (CR 5, 7). Miguel

filed a general denial and pled res judicata (CR 98). Miguel filed a Motion for Partial Summary Judgment, arguing that Leticia had no claim because his right to receive the bonus in question was not vested at the time of divorce and was not property that could be divided. (SCR9). Miguel also argued that the bonus had been partitioned to him in the MSA (SCR17), and that Leticia's claim was barred by res judicata. (SCR26-30). The trial court granted Miguel's Motion for Partial Summary Judgment without specifying the grounds. (CR 944).

STATEMENT OF REPLY ISSUES

1. **The Year-of-Divorce Bonus is Partially Community Property.** Under the time-allocation rule applied to other deferred compensation in Texas, an employment-related bonus received after divorce for work done during marriage is partially allocable to the community estate. In this case, the bonus paid in March of 2011 included compensation for work done between January 1 and June 13, 2010, when there was a community estate. That portion of the bonus was community property.

2. **The Bonus Was Not Included in the Property Division.** The Decree divided only assets listed in the unsigned AID that was incorporated into the Decree. It is uncontroverted that Miguel's March 2011 bonus was not listed in the AID. Therefore, the bonus was not divided in the property division.

3. **The Partition of "Future Earnings" Did Not Apply to the Bonus.** Miguel argues that the March 2011 bonus was partitioned to him as his separate property by a clause in the MSA partitioning "future earnings." Miguel raised this contention in binding arbitration at the time of divorce, and the arbitrator rejected this contention. The arbitrator ruled instead that the partition of "future earnings" applied only to compensation for work done after the MSA was signed. Miguel is bound by that arbitration ruling. Regardless, compensation received after the MSA was signed, for work done before the MSA was signed, is not *future* earnings.

4. **The Partition-for-Tax-Purposes Did Not Apply to the Bonus.** Miguel also claims that the March 2011 bonus was partitioned by a paragraph in the MSA that detailed how the parties would report their 2010 income on their 2010 tax returns. The bonus in question was not paid until 2011, and does not appear on Miguel's 2010 tax return, so the paragraph does not apply. Miguel raised this contention in the binding arbitration, and his contention was rejected by the arbitrator, who ruled that this partition language was "for tax purposes." The arbitrator also ruled that income from January 1 through June 13 "will have to be dealt with as undisclosed property or otherwise." Given the arbitrator's ruling, and the fact that this clause relates to the reporting of income received in 2010 and not the ownership of income received and reported in 2011, this partition clause does not support the summary judgment dismissing Leticia's claim without trial.

5. **Res Judicata Does Not Apply to the Bonus.** This Court has repeatedly held that res judicata does not apply where community property was not divided in the divorce decree. This principle is now codified in Chapter 9 of the Texas Family Code. The bonus paid in March of 2011 was not divided in the Decree, so res judicata does not preclude Leticia's claim.

6. **Post-Divorce Bonuses Are Divisible Upon Divorce.** Miguel argues that, because the bonus was discretionary, and he had no legally-enforceable right to compel payment, the bonus was therefore not divisible upon divorce. Forty years ago this Court eliminated the requirement that an employment-related benefit must be vested to be divisible upon divorce. *Cearley v. Cearley*, 544 S.W.2d 661, 662 (Tex. 1976). Family Code Section 7.003 now requires the court to determine the rights of both spouses in a bonus. It doesn't matter that the bonus is discretionary (as most bonuses are).

THIS CASE DOES NOT WARRANT FURTHER REVIEW

While there was a dissent in the Court of Appeals, the Justices of the Court of Appeals did not disagree on an important point of law. Instead, they disagreed on the interpretation of one paragraph (actually two words) of an MSA. There is no conflict

between the majority Opinion issued in this case and another court of appeals' opinion touching on an important point of law. There is no issue of interpretation or validity of a statute, and there is no constitutional issue raised or ruled upon. As to the Court of Appeals committing an error of law so important to the state's jurisprudence that it should be corrected, the Court of Appeals reversed a summary judgment denying the former wife a trial on the question of whether the former husband's post-divorce bonus had a community property component. Since the Decree indisputably did not award the bonus to either party, the issue that divided the Court of Appeals was whether a clause in the MSA partitioning "future earnings" applied to compensation subsequently received for work previously done. In binding arbitration at the time of divorce, the arbitrator ruled that income between January 1 and June 13, 2010, had *not* been partitioned, and that earnings for that period would have to be dealt with later. Appendix 1. That arbitration ruling is not subject to challenge in this appeal. But even if the arbitrator's ruling is ignored, this case turns on the parties' intent as reflected in the language of this MSA. That question is specific to this case, and will not recur in future cases. Only if this Court agrees that no partition occurred would the Court finally reach a principle of law: whether the community estate has an interest in a bonus received after divorce, for work done during marriage. That question has long been settled in Texas law, as to deferred compensation in the form of pensions, stock options, and restricted stock. Family Code Section 7.003 now requires divorce courts

to determine the rights of both spouses in bonuses, along with other forms of deferred compensation. Only if this Court wishes to issue an opinion saying that the common law time-allocation principle applied to pension benefits does not apply to bonuses, or saying that the time-allocation rule for dividing stock options and restricted stock in Family Code Section 3.001(d) does not apply to bonuses, or saying that the directive in Family Code Section 7.003 to divide bonuses upon divorce does not apply to discretionary bonuses, would this Court be deciding a question of law that is important to the jurisprudence of the state. The case law and the Family Code favor the community property position in this case, and the Court of Appeals followed this law in reversing the summary judgment and remanding this case for a trial. Barring this Court's making a profound change in Texas law, this case does not warrant further appellate review.

RHETORICAL ASSERTIONS IN PETITIONER'S BRIEF

This case does not involve a court that refused to enforce a mediated settlement agreement. No one is contending in this appeal that the MSA should not be enforced. See Petitioner's Brief, p. 1-2. Nor is this appeal about the number of lawyers each party had, or how much property each party received, or whether Leticia had buyer's remorse. See Petitioner's Brief, p. 1-2, 6. It doesn't matter when Leticia filed her post-divorce partition suit, see Petitioner's Brief, p. 2, since she filed within the time allowed by law. Tex. Fam. Code § 9.202(a). This is an appeal from a summary

judgment. The question before this Court is whether the Court of Appeals was wrong in concluding that Miguel failed to establish as a matter of law that Leticia had no community property interest in the year-of-divorce bonus received after divorce, and that he was entitled to judgment as a matter of law. The Court of Appeals determined Miguel did not make the required showing, and so remanded the case for a trial on the issue. That was the correct disposition of this appeal.

MIGUEL'S FOUR ARGUMENTS

It is uncontested that Miguel's March 2011 bonus was not specifically awarded to either party in the Decree. For this reason, Miguel seeks other ways to support his claim of separate property. Miguel raises four arguments. First, he argues that the clause in the MSA partitioning "future earnings" applies to compensation he received after the MSA was signed for work done before the MSA was signed. Second, Miguel argues that the clause in the MSA, partitioning income to be reported on his 2010 tax return "for tax purposes," changed the character of the community property portion of the bonus paid to him in March of 2011. Third, Miguel argues res judicata, saying that Leticia cannot modify the property division in the decree of divorce. Fourth, Miguel argues, in the alternative because it conflicts with his partition arguments, that because he had no legal right to require payment of the bonus, it was not property that could be divided at the time of divorce.

STATEMENT OF FACTS

The Remedy Sought. If a decree of divorce fails to divide community property, either spouse can bring a post-divorce proceeding to divide that property. Tex. Fam. Code § 9.201. In that proceeding, the court has the power to divide the property in a manner that the court deems just and right, just like in a divorce. *Compare* Tex. Fam. Code § 9.203 *with* § 7.001.

The Facts. Miguel worked for Vitol for many years during the marriage, and continued to work there after divorce. (SCR125 & 34). Miguel's employment agreement with Vitol provided for Miguel to receive annual bonuses as follows:

> You will continue to be considered for an annual bonus based on various performance parameters considered by the Company. Bonuses are completely at the discretion of the Company and, if paid, are typically paid in March/April each year.

SCR125, ¶ "Bonus." Miguel received annual bonuses throughout the marriage. SCR34, ¶ 4; 36, ¶ 11; 296; 375, lines 6-7.

Leticia initiated the divorce. CR 481; RR 9. On June 13, 2010, Leticia and Miguel signed an MSA, settling their case. SCR107. The property awarded to Miguel was listed on a spreadsheet attached to the MSA. SCR119-20. The spreadsheet awarded Miguel deferred compensation in the form of the Vitol Money Purchase Pension Plan, but made no mention of the deferred compensation under the annual bonus program described in Miguel's employment agreement.

In the process of drafting the AID and Decree, a dispute arose as to whether Miguel's prospective 2011 bonus should be awarded to him. In the MSA, Leticia and Miguel had agreed to arbitrate (i) drafting disputes, (ii) issues regarding interpretation of the MSA, and (iii) issues regarding the intent of the parties as reflected in the MSA. SCR109, ¶8. The mediator-turned-arbitrator was former Harris County District Judge Alvin Zimmerman. SCR109, ¶8. The parties submitted their dispute to Judge Zimmerman. SCR322-413. Miguel argued that the partition of "future earnings" in Paragraph 11 of the MSA made his entire March 2011 bonus his separate property. SCR375-76. Miguel also argued that the partition language in Paragraph Schedule C, subpara. 6 of the MSA made the entire bonus his separate property. This subparagraph said that for the purpose of reporting 2010 income on the parties' 2010 income tax returns, 2010 income was partitioned back to January 1. SCR375-76 & 38–82. In his arbitration ruling, Judge Zimmerman rejected both of Miguel's contentions. SCR417. Judge Zimmerman ruled that "All future income and earnings are partitioned as of June 12, 2010 however for tax purposes the partition of income for 2010, is as of Jan 1, 2010." SCR417, Appendix 1. He further ruled that "if there was undisclosed property that occurred in the period of January 1, 2010, through June 13, 2010, that will have to be dealt with whether as undisclosed property or otherwise." SCR417, Appendix 1.

An AID was prepared, but not signed by the parties. The trial court signed a final

Decree that incorporated the unsigned AID. CR 158. Nine months later, on March 15, 2011, Miguel received the $4.5 million annual bonus payment in contention. SCR34, 123, 146, 148. The question on appeal is whether that Miguel established, via summary judgment in the post-divorce proceeding, that there was no genuine issue of material fact regarding a community property interest in the March 2011 bonus, and that he was entitled to judgment as a matter of law.

SUMMARY OF THE ARGUMENT

The First Partition Clause. Turning to the first of the two partition clauses invoked by Miguel to support his separate property claim, the clause partitions "future earnings" "to the person providing the services giving rise to the earnings." The sentence does not say "to the person who provid**ed** the services . . . ." Miguel argues that earnings he received after signing the MSA were "future earnings," even though the bonus compensated in part work done before the MSA was signed (i.e., past earnings). Leticia argues that "future earnings" meant compensation for *work done in the future*, after the MSA was signed. The parties arbitrated this dispute at the time of divorce. The arbitrator considered the question and found that the partition of "future earnings" was effective as of June 13, 2010 (the date the MSA was signed). SCR417. The arbitrator expressly stated that this partition language did not apply to income and earnings between January 1 and June 13, 2010. The arbitrator's ruling was not appealed at the time of divorce and cannot be revisited in this appeal from the post-

divorce proceeding.

The Second Partition Clause. The second partition clause invoked by Miguel is contained in a section of the MSA that discusses the reporting and payment of income taxes, in a subsection that deals exclusively with the reporting of income in 2010, the year of divorce. The bonus was paid in March of 2011, and was therefore reportable in 2011, not 2010. The paragraph on reporting income in 2010 does not affect the bonus paid and reportable in 2011. Additionally, Miguel argued in arbitration at the time of divorce that this provision partitioned his March 2011 bonus, and the arbitrator ruled that "for tax purposes the partition of income for 2010, is as of Jan 1, 2010." SCR417, Appendix 1. The arbitrator then ruled that income earned between January 1 and June 13, 2010, must be dealt with as undisclosed property. SCR417. Because Miguel is bound by the arbitrator's ruling, he cannot now argue that the tax language extinguished the community property interest in the portion of the bonus allocable to work done between January 1 and June 13, 2010.

The Law of Interpreting Contracts. The MSA is a contract subject to the normal rules of contract interpretation. The MSA must be interpreted as a whole. Each part of the MSA should be given effect. No particular part of the MSA should be isolated from its setting or considered apart from the rest of the MSA.

The property division was limited to the listed assets. There was no residuary clause in the MSA that awarded unidentified property to either spouse. It is

inconsistent with this purpose, of limiting the property division to listed assets, to interpret the partition of "future earnings" in the MSA as an award the community property interest in the March 2011 bonus to Miguel. The MSA's partition of "future earnings" should be interpreted to apply to earnings for work done after the community estate was brought to an end with the signing of the MSA. This is what the arbitrator ruled at the time of divorce.

The same is true of the partition of 2010 income for purposes of reporting income on the parties' 2010 tax returns. It would be inconsistent with the property division portion of the MSA to interpret this tax provision as dividing an unlisted community property asset. Additionally, no phrase or sentence or section should be isolated from its setting. The meaning of a word or phrase must be considered in light of the context of the surrounding words. The arbitrator ruled that the partition of 2010 income was for tax purposes. The section containing this partition language related to the manner of reporting 2010 income on the 2010 tax returns, and was part of a larger paragraph relating to the reporting of income during marriage to the IRS. The March 2011 bonus was not received until 2011, and was not reported on the 2010 tax returns. To interpret this partition language to apply to income reportable on the 2011 tax returns would disregard literal words of the paragraph in question, and the context of the surrounding words, which was limited to the reporting of income on the 2010 tax returns.

The Claim of Res Judicata. Miguel next contends that the doctrine of res judicata

bars Leticia's community property claim. The three cases Miguel cites involve post-divorce suits that claimed to be dividing an undivided asset but that were in reality attempts to alter the property division. Texas law for three generations has said that a divorce decree is not res judicata as to the ownership of assets that are not divided in the decree. Chapter 9 of the Family Code anticipates this problem, and gives divorce courts jurisdiction to divide assets that were not divided in the divorce. The Decree does not mention the bonus paid in March 2011, and there is no residuary clause that would silently sweep the bonus to either spouse. The community property portion of the March 2011 bonus was not divided and res judicata does not apply.

A Discretionary Bonus is Property to be Divided Upon Divorce. Prior to 1976, divorce courts in Texas courts would not divide non-vested employment-related benefits. That changed with this Court's decision in *Cearley v. Cearley*, 544 S.W.2d 661, 665 (Tex. 1976), which announced that contingent property rights, including non-vested pension benefits, are part of the property to be divided upon divorce. Texas Family Code Section 7.003 now requires the divorce court to determine the rights of both spouses in a bonus. Miguel's claim that his bonus was not property is just pre-*Cearley* law brought forward.

ARGUMENT

Appeal From a Summary Judgment. This is an appeal from a summary judgment which denied Leticia a trial on the question of whether the work-related annual bonus,

paid to Miguel in March of 2011, contained an element of community property. To obtain a summary judgment on this issue, Miguel had the burden of showing that there was no genuine issue of material fact and that he was entitled to judgment as a matter of law. *Nixon v. Mr. Property Mgmt. Doc., Inc.*, 690 SW.2d 546, 548 (Tex. 1985). In deciding whether there is a disputed material fact, the evidence must be considered in the light most favorable to Leticia. *Morgan v. Anthony*, 27 S.W.3d 928, 929 (Tex. 2000). All reasonable inferences, including any doubts, must be resolved in Leticia's favor. *Nixon*, 690 SW.2d at 548-49 (Tex. 1985).

Rules of Contract Interpretation. The MSA, being a contract, is subject to the rules of contract interpretation. *See Milner v. Milner,* 361 S.W.3d 615, 619 (Tex. 2012). This Court said, in *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994), that "[t]he contract must be considered as a whole. . . . Moreover, each part of the contract should be given effect." In *Guardian Trust Co. v. Bauereisen*, 121 S.W.2d 579, 583 (Tex. 1938), this Court said: "No one phrase, sentence, or section should be isolated from its setting and considered apart from the other provisions." In *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996), this Court said: "We give terms their plain, ordinary, and generally accepted meaning unless the instrument shows that the parties used them in a technical or different sense." In *Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 750 (Tex. 2006), this Court said that the meaning of a word or phrase must be considered in light of the context of the surrounding words.

And in *CKB & Assocs., Inc. v. Moore McCormack Petroleum, Inc.*, 734 S.W.3d 653, 655 (Tex. 1987), this Court said: "The maxim expressio unius est exclusio alterius, meaning that the naming of one thing excludes another, though not conclusive, is applicable to these facts."

Issue 1

The Year-of-Divorce Bonus is Partially Community Property

Under the time-allocation rule applied to deferred compensation in Texas, a bonus received for work done in the year of divorce is partially allocable to the community estate. In *Boyd v. Boyd*, 67 S.W.3d 398, 404 (Tex. App.--Fort Worth 2002, no pet.), the court held that a bonus paid after mediation, that compensated work done before mediation, was community property. In *Sprague v. Sprague*, 363 S.W.2d 788, 802 (Tex. App.--Houston [14th Dist.] 2012, pet. denied), the court of appeals held that the marital property character of a bonus received shortly after marriage, compensating work done partly before and partly during marriage, was a fact issue. The same logic would apply to a bonus received after divorce compensating work done during marriage. This view has been expressed in continuing legal education articles. See Martin & Kraus, *Often Overlooked, Mis-Characterized or Mis-Valued Employee Benefits - Contracts, Bonuses, Vacation Pay, Golden Handcuffs, and Survivor Annuities*, State Bar of Texas' 40th Annual Advanced Family Law Course ch. 30, pp. 4-5 (2014), Appendix 2; Orsinger, *Compensation, Return on Capital and Return of*

Capital, State Bar of Texas' New Frontiers in Marital Property Course ch. 1.1, pp. 5-6 (2012), Appendix 3; and a legal treatise, Orsinger, *Marital Property*, Texas Family Law Service § 21:53, pp. 63 - 64, (Speer's 6th ed. 1988), Appendix 4, now at Melley, *Bonuses*, 3 Texas Family Law Service § 21:51 (2010), Appendix 5. In this case, a bonus was paid in 2011 for work done in 2010. The community estate ended on June 13, 2010. The portion of the bonus attributable to work done between January 1 and June 13, 2010 was community property. It was error to deny Leticia a trial on this issue.

Issue 2

The Bonus Was Not Included in the Property Division

The Decree of Divorce did not itself list property divided, nor did it contain a "Mother Hubbard" clause awarding Miguel all assets in his possession or control. The Decree awarded to Miguel "the property specified in the parties Agreement Incident to Divorce . . . ." SCR59. The Decree said that "any assets of the parties not awarded or divided by this Agreed Final Decree of Divorce are subject to future division as provided in the Texas Family Code." SCR60.

The unsigned AID contained no "Mother Hubbard" clause either. The AID specifically awarded "the following property . . . ," and it proceeded to list 41 items that were awarded to Miguel. The rule of contract interpretation, expressio unius est exclusio alterius, suggests that the award of assets to Miguel is limited to this list, as

does the wording of the MSA itself. SCR75-81. The March 2011 bonus was not on this list. SCR76-81. Like the Decree, the AID also said that "[a]ny assets of the parties not divided by this agreement will be subject to future division as provided in the Texas Family Code." SCR85.

The MSA was similar, describing the property division in this way: "Assets to each party are divided as set out on the attached spreadsheet." SCR108. The attached spreadsheet does not mention the 2011 bonus. Under the express language of the MSA, and under the rule of expressio unius, that omission is exclusionary. Nor did the MSA mention the March 2011 bonus anywhere else. The MSA did not contain a "Mother Hubbard" clause awarding to Miguel all property in his possession or control. In other words, neither the Decree, nor the unsigned AID, nor the MSA, awarded the community property interest in the 2011 bonus to either spouse. All indications in all three documents are that the list of assets divided was complete and exclusive. So Miguel turns to two partition clauses in the MSA and claims that they partitioned his 2011 bonus to him.

Issue 3

The Partition of "Future Earnings" Did Not Apply to the Bonus

The first partition clause Miguel invokes in support of his separate property claim is Paragraph 11 of the MSA which says:

All future income of a party and/or from any property herein awarded to a party

> is partitioned to the person to whom the property was awarded. All future earnings from each party are partitioned to the person providing the services giving rise to the earnings. These partitions are to be effective pursuant to Section 4.102 of the Texas Family Code, and in this respect, each waives further disclosure of property and debts of the other party.

SCR109-10. Miguel argues that the 2011 bonus constituted only "future earnings," but Miguel's employment agreement reflects that the annual bonus, paid in March or April of each year, was part of his compensation for work done during the previous year. SCR125, "Bonus." An annual bonus is a common form of deferred compensation, and Family Code Section 7.003 requires that a bonus be divided upon divorce, along with other forms of deferred compensation. There is more than a scintilla of evidence supporting Leticia's claim that part of the March 2011 bonus compensated work done prior to the MSA, which would not be future earnings.

Miguel argues that the arbitrator's divorce-related ruling supports his claim that the March 2011 bonus was "future earnings." Petitioner's Brief, p. 20. The arbitrator's ruling was just the opposite. The arbitrator's ruling stated:

> All future income and earnings are partitioned as of June 13, 2010[,] however for tax purposes the partition of income for 2010 is as of Jan 1, 2010. I want it to read that way. If there is undisclosed property that occurred in this period of January, 2010 through June 13, 2010, that will have to be dealt with whether as undisclosed property or otherwise.

SCR417. Thus, the arbitrator ruled that income from January 1 through June 13, 2010, was not partitioned and that "undisclosed property that occurred between January 1, 2010 through June 13, 2010, that will be dealt with as undisclosed property." *Id.* The

arbitrator was undoubtedly referring to Family Code Section 9.203, which provides for the post-divorce division of *undivided* property, without regard to whether that property is disclosed or undisclosed. The bonus paid in March of 2011 was not listed on the property schedules attached to the MSA or the AID and was never explicitly mentioned in the Decree or the AID or the MSA, and was thus undisclosed. But, regardless of the arbitrator's choice of words, it is beyond dispute that the arbitrator ruled that the future began after June 13, 2010 and that the claim to compensation for work done between January 1 and June 13, 2010 would have to be dealt with in some other manner.

Issue 4

The Partition-for-Tax-Purposes Did Not Apply to the Bonus

Miguel's other claim of partition rests on language governing the reporting of income on the parties' 2010 income tax returns. Miguel points to Schedule C, "Federal Income Taxes," Subparagraph 6, entitled "Income Tax Returns for the Year 2010." It reads:

> **6. Income Tax Returns for the Year 2010.** For 2010, each party shall file an individual income tax return in accordance with Internal Revenue Code sections 66(a) as if they were divorced on 12:01 a.m. on January 1, 2010. This Mediated Settlement Agreement shall serve as a partition of community income, setting aside to each spouse all income earned by each such spouse and/or attributable to property awarded to each such spouse or confirmed as each such spouse's separate property herein. For the entire year 2010, each spouse shall be solely entitled to take on his/her return any deductions attributable to properties awarded herein to him/her or

> confirmed as his/her separate properly. All overpayments from 2009, all estimated taxes paid relative to the parties' tax liability for 2010, all withholding relative to the parties' tax liability for 2010, plus any other tax deposits made or otherwise credited relative to the parties' tax liability for 2010 are allocated solely to Miguel Angel Loya.

SCR116. The bonus involved in this case was not paid until March of 2011, and was not reportable to the IRS until 2011, and thus is not governed by this subparagraph addressing how to report income on the 2010 tax return.

Additionally, Miguel is foreclosed from making this argument now because he made this argument to the arbitrator, and his argument was rejected. The arbitrator wrote:

> I have re-read the property rule 11 and have concluded as it relates to paragraph 11 on pg 3 and paragraph 6 on pg 10 as follows:
>
> I now believe that each can be read so as to reconcile. Put in the AID that: "All future income and earnings are partitioned as of June 13, 2010 however for tax purposes the partition of income for is as of Jan 1, 2010. I want it to read that way. If there is undisclosed property that occurred in this period of January, 2010 through June 13, 2010, that will have to be dealt with whether as undisclosed property or otherwise.["]
>
> Alvin L. Zimmerman

SCR417. Judge Zimmerman expressly ruled that the partition of future earnings was as of June 13, 2010, but that *for tax purposes* the partition of 2010 income was as of January 1, 2010. Judge Zimmerman ruled that claims to the income from January through June 13 of 2010 would have to be dealt with in some other manner.

Issue 5

Res Judicata Does Not Apply to the Bonus

Miguel's next argument is his claim that the doctrine of res judicata precludes Leticia's claim. Miguel cites threes cases: *Baxter v. Ruddle,* 794 S.W.2d 761 (Tex. 1990); *Brown v. Brown*, 236 S.W.3d 343 (Tex. App.--Houston [1st Dist.] 2007, no pet.]; and *Hagen v. Hagen*, 282 S.W.3d 899 (Tex. 2009). In all three cases, the decree of divorce expressly awarded the asset in question in the decree, and that award was challenged in a post-divorce proceeding. In our case, the asset was not expressly awarded in the decree. This Court ruled more than 120 years ago that the doctrine of transactional res judicata does not apply to community property that is not divided in a decree of divorce. *Gray v. Thomas*, 83 Tex. 246, 18 S.W. 721, 723 (1892); reaffirmed in *Busby v. Busby*, 457 S.W.2d 551 (Tex. 1970). The concept of res judicata that applies to property division upon divorce is this: "Since this property was not partitioned at the time of the divorce, we hold that the judgment entered in the divorce suit did not preclude the plaintiff from seeking a partition of the undivided community property sought to be partitioned here." *Busby*, at 554-555. The principle has now been codified in Section 9.203 of the Texas Family Code.

The decree of divorce did not divide the bonus received in March of 2011 for work done in 2010, and Leticia is entitled to a trial on the extent of the community property interest.

Issue 6

Post-Divorce Bonuses Are Divisible Upon Divorce

Miguel argues that a post-divorce discretionary bonus is not property that can be divided in a divorce. Miguel is invoking an old rule that only vested property rights can be divided upon divorce. That rule was jettisoned by this Court in *Cearley v. Cearley*, 544 S.W.2d 661, 665 (Tex. 1976), which held that unvested pension benefits "earned during the months of coverture became contingent earnings of the community which may or may not bloom into full maturity at some future date." This Court continued: "We hold that such rights, prior to accrual and maturity, constitute a contingent interest in property and a community asset subject to consideration along with other property in the division of the estate of the parties...." In 1987, the Legislature amended the Family Code to require courts in a divorce to determine all rights of both spouses in any employment-related benefits in the nature of compensation, including bonuses. Acts 1987, 70th Leg., 2nd C.S., ch. 50, § 1, eff. Nov. 1, 1987, then-codified at Texas Family Code § 3.633. In 2005, the Legislature amended the Family Code to specify how to allocate between separate and community property interests in different types of compensation. Tex. Fam. Code § 3.007(d) (effective 9-1-2005) (pertaining to stock options and restricted stock) and § 3.008(b) (effective 9-1-2005) (pertaining to disability insurance and workers' compensation payments). The Family Code was later amended to require courts to divide all forms

of deferred compensation, including bonuses. Tex. Fam. Code § 7.003. ("In a decree of divorce or annulment, the court shall determine the rights of both spouses in a ... bonus....").

RECAPITULATION

Under current case law, and under the present Family Code, a bonus is treated like other forms of deferred compensation. Whether the bonus compensates work done in the year of marriage or work done in the year of divorce, the bonus has mixed character, and allocating that mix is a question of fact. *See Sprague*, 363 S.W.3d at 802 (where a bonus was received shortly after marriage, the portion allocable to premarital employment is a fact issue); Tex. Fam. Code § 7.003.

The divorce decree divided only specifically-listed assets, and the year-of-divorce bonus paid in March of 2011 was not on that list. Miguel invokes two paragraphs of the MSA that he says partitioned any community property interest in the bonus.

The first paragraph contains a partition of "future earnings." In binding arbitration at the time of divorce, the arbitrator ruled that partition applied only to income earned after the MSA was signed, and that earnings between January 1 and June 13 were not partitioned. SCR417, Appendix 1. Miguel is bound by that ruling. The Court of Appeals held that "future earnings" meant income earned after the MSA was signed, and this is the only interpretation that is consistent with the provisions in the Decree, the AID, and the MSA, each of which divided only property that was specifically

listed. To interpret the words "future earnings" to include compensation received in the future for work done in the past would divide a community property asset that was not on the property list. This interpretation would do violence to the rule that "the contract must be considered as a whole, "that each part of the contract should be given effect," and that "no phrase, sentence, or section should be isolated from its setting and considered apart from the other provisions." *Forbau*, 876 S.W.2d at 133; *Guardian Trust Co.*, 127 S.W.2d at 583.

The second paragraph invoked by Miguel described how the parties should report income on their 2010 tax returns. The year-of-divorce bonus received in March of 2011 did not appear on the 2010 tax return. So the paragraph in question does not apply to the bonus paid and reportable in 2011. Miguel raised this argument in binding arbitration in the divorce, and it was rejected. The arbitrator ruled that the partition of 2010 income in this paragraph was "for tax purposes." SCR417, Appendix 1. The arbitrator also ruled that neither partition paragraph divided earnings from work done between January 1 and June 13 of 2010. *Id.* The arbitrator's determination is not subject to revision in this appeal, but it should be noted that the arbitrator's determination that the partition was for "tax purposes" is consistent with the rules of contract interpretation that "the contract must be considered as a whole," and that "no one phrase, sentence, or section should be isolated from its setting and considered apart from the other provisions," and that the meaning of a word or phrase must be

considered in light of the context of the surrounding words. *Forbau*, 876 S.W.2d at 133; *Guardian Trust Co.*, 121 S.W.2d at 583; *Fiess*, 202 S.W.2d at 750.

The Majority Opinion in the Court of Appeals was consistent with: the arbitrator's ruling; the Decree's, AID's and MSA's division of only the listed assets; the rules of contract interpretation; community property principles applied to deferred compensation; and the directive in Family Code Section 7.003 that the court shall consider the spouse's interest in bonuses in a divorce. The doctrine of res judicata does not foreclose a post-divorce suit to divide community property that was not divided in a divorce. The contention that a future employment-related bonus is not property resurrects the long-dead idea that only vested rights are divisible upon divorce, and it directly contradicts the directive in Family Code § 7.003 that the divorce court shall determine the spouses' interest in deferred compensation, including bonuses. The trial judge should not have granted a summary judgment. It was proper to remand this case for a trial to determine what portion of the bonus received in March of 2011 was community property.

PRAYER

Respondent, Leticia Loya, prays that Petitioner Miguel Loya's petition for review be denied. Respondent prays for relief generally.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Texas Rule of Appellate Procedure 9.4(i)(3), I certify that this document was produced on a computer using Corel WordPerfect X8, and contains 4,621 words, as determined by the computer software's word-count function, excluding the sections of the document listed in Texas Rule of Appellate Procedure 9.4(i)(1).

/s/ Richard R. Orsinger
Richard R. Orsinger

CERTIFICATE OF SERVICE

I certify that a true copy of this Respondent's Brief on the Merits was served in accordance with rule 9.5 of the Texas Rules of Appellate Procedure on each party or that party's lead counsel as follows:

Date of service: October 10, 2016
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APPENDIX

App. 1 Arbitrator's ruling (6-22-2010) SCR417.

App. 2 Martin & Kraus, *Often Overlooked, Mis-Characterized or Mis-Valued Employee Benefits - Contracts, Bonuses, Vacation Pay, Golden Handcuffs, and Survivor Annuities*, State Bar of Texas' 40th Annual Advanced Family Law Course ch. 30, pp. 4-5. (2014)

App. 3 Orsinger, *Compensation, Return on Capital and Return of Capital*, State Bar of Texas' New Frontiers in Marital Property ch. 1.1, p. 5-6 (2012)

App. 4 Orsinger, *Marital Property*, Texas Family Law Service § 21:53, pp. 63-64 (Speer's 6th ed. 1988)

App. 5 Melley, *Bonuses*, 3 Texas Family Law Service § 21:51 (2010)

From: Alvin Zimmerman [mailto:azim[redacted]man@zimmerlaw.com]
Sent: Tuesday, June 22, 2010 7:56 AM
To: Lynn Kamin; Harry Tindall; Randall Wilhite
Subject: Loya

I have re-read the property rule 11 and have concluded as it relates to paragraph 11 on pg 3 and paragraph 6 on pg 10 as follows:

I now believe that each can be read so as to reconcile. Put in the AID that:
" All future income and earnings are partitioned as of June 13, 2010 however for tax purposes the partition of income for 2010, is as of Jan 1, 2010. I want it to read that way. If there is undisclosed property that occured in this period of January 2010 through June 13, 2010, that will have to be dealt with whether as undisclosed property or otherwise.

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EXHIBIT
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OFTEN OVERLOOKED, MIS-CHARACTERIZED OR MIS-VALUED EMPLOYEE BENEFITS - CONTRACTS, BONUSES, VACATION PAY, GOLDEN HANDCUFFS, AND SURVIVOR ANNUITIES

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State Bar of Texas
40TH ANNUAL
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San Antonio

CHAPTER 40

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OFTEN OVERLOOKED, MIS-CHARACTERIZED OR MIS-VALUED EMPLOYEE BENEFITS - CONTRACTS, BONUSES, VACATION PAY, GOLDEN HANDCUFFS, AND SURVIVOR ANNUITIES

I. INTRODUCTION

This paper addresses challenging and often overlooked issues arising in the context of employment compensation. The authors have divided the paper into the following portions: (1) an introduction; (2) a review of characterization principles; (3) Texas employment compensation characterization cases; (4) a discussion of the importance of recognizing that defined benefit plan survivor annuities and defined benefit plan reversionary interests must be identified and recognized to have value; (5) out of state employment compensation characterization cases; (6) a discussion of the inherent tension between the inception of title doctrine and proportional (or time-based) acquisition; (7) a discussion of types of employment compensation that are particularly challenging; and (8) specific examples of hypothetical scenarios.

The authors wish to express appreciation to Charla Bradshaw for permission to use portions of her paper entitled *Compensation, Contracts and Packages: A Case Law Analysis (Texas and beyond)* presented at the State Bar of Texas "New Frontiers Marital Property Law" course in San Francisco, California in October of 2006; to Michael P. Geary of Geary, Porter, & Donovan, P.C., for permission to use portions of his paper entitled *Characterization and Tracing of Marital Property in Texas - Developments, Proof and Arguments*, presented at the University of Houston Law Foundation "Family Law Practice Seminar" in November of 2006; and to Katherine Kinser for permission to use portions of her paper entitled *Guaranteed Pay, What a Deal or is It "Characterization of Unusual Employment Contracts,"* presented at the University of Texas School of Law "Family Law on the Front Lines" course in San Antonio, Texas in June of 2009; and to Charla Bradshaw for permission to use portions of her paper entitled *Tricky Retirement Issues* presented at the State Bar of Texas "Advanced Family Law Course" in August of 2012 in Houston, Texas.

II. THE COMMUNITY PROPERTY SYSTEM

A. In General. Texas utilizes the community property system to determine the property rights of a husband and wife. Marital property is separate, community or mixed. All property of whatever kind acquired by the husband and wife, or either of them, during the marriage is community property of the two spouses, except for that property which meets the definition of separate property.

Property acquired before marriage by any method, or during marriage by gift, devise, or descent, is separate property. Recovery for personal injuries is separate property, subject to narrow exceptions. Property purchased with separate funds is separate property. Property correctly specified as separate property in an enforceable premarital agreement, and community property partitioned in the manner provided by statute, also constitutes separate property. All other property, whether acquired by the husband or the wife or by their joint efforts during the marriage, is community property.

B. Community Property. Texas law does not define community property generally, any more specifically than all property acquired by either the husband or wife during marriage, except that property which is the separate property of either the husband or the wife. The Supreme Court has held that no other definition is necessary. *See* Lee v. Lee, 247 S.W. 828 (Tex. 1923). The principle at the foundation of the system of community property is that whatever is acquired by the efforts of either the husband or wife shall be their common property. This is true, even though one spouse contributed nothing to the acquisitions, and the acquisitions of properties were wholly attributable to the other spouse's industry. Graham v. Franco, 488 S.W.2d 390 (Tex. 1972).

1. Texas Constitution. No specific definition of community property is contained in Article XVI, Section 15 of the Texas Constitution. Rather, the Texas Constitution merely states the following:

> **. . .** laws shall be passed more clearly defining the rights of the spouse in relation to separate and community property **. . .**

2. Texas Family Code.[1] TFC Section 3.002 defines community property as follows:

> Community property consists of the property, other than separate property, acquired by either spouse during marriage.

Id.

All marital property, not specifically within the scope of the statutory and constitutional definition of separate property, is by implication excluded, and therefore, is community property regardless of how it is acquired. Hilley v. Hilley, 342 S.W.2d 565 (Tex. 1961); Arnold v. Leonard, 272 S.W. 799 (Tex. 1925); Lee, 247 S.W.2d at 832. In Lee, the Supreme Court stated an affirmative test: i.e. that property is community which is acquired by the work efforts, or labor of the spouses or their agents or as income from the property. Lee, 247 S.W.2d at 832. Property acquired by the joint efforts of the spouses was regarded as acquired by "onerous title" and belonged to the community. Graham, 488 S.W.2d 393. The rule is the same regardless of whether the new acquisition is the result of the husband's or wife's individual labor, skill, or profession. Norris v. Vaughan, 260 S.W.2d 676 (Tex. 1953); Lee, 247 S.W.2d at 832.

C. Separate Property

1. Texas Constitution. Art. XVI, Section 15 defines separate property as:

> All property, both real and personal, of a spouse owned or claimed before marriage, and that acquired afterwards by gift, devise, or descent, shall be the separate property of that spouse.

The 1980 amendment to Section 15 revised that section (added in 1948) to allow an agreement to partition community property to include partition of property existing or to be acquired, and to include income from separate property.

In Beck v. Beck, 814 S.W.2d 745 (Tex. 1991) the Supreme Court held that the 1980 constitutional amendment to article XVI, section 15, of the Texas Constitution was retroactive and, thus, negated contrary prior court decisions. Id.; *Compare* Williams v. Williams, 569 S.W.2d 867 (Tex. 1978) ([under prior law] agreement attempting to recharacterize income or property acquired during marriage as separate property was "void" under article XVI, section 15, of the Texas Constitution).

Beck, 814 S.W.2d at 749.

2. Agreements to Convert Separate Property. Marital property agreements can profoundly change Texas marital property law. In 1999, the final phrase was added to Article XVI, §15 of the Constitution to permit spouses to agree that their separate property would become community property. *See also* Sections 4.102 and 4.103 of TFC.

3. Texas Family Code. TFC §3.001 defines the separate property of a spouse:

> A spouse's separate property consists of:
>
> a. the property owned or claimed by the spouse before marriage;
>
> b. the property acquired by the spouse during the marriage by gift, devise, or descent; and
>
> c. the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.

D. The Importance of Characterization. The community property concept is treated in detail in Chapter 3 of the TFC. Characterization of property is necessary for the proper determination of the rights of each spouse upon divorce. Section 7.001 of the TFC provides for division of property in a suit for dissolution of marriage by divorce or annulment, and states that:

> In a decree of divorce or annulment, the court shall order a division of the estate of the parties in a manner that the court deems just and right, having due regard for the rights of each party and any children of the marriage.

Id.

The starting point in a contested property case is establishing the nature of the property to be divided as separate or community. Muns v. Muns, 567 S.W.2d 563 (Tex. Civ. App. - Dallas 1978, no writ); Cooper v.

Cooper, 513 S.W.2d 229 (Tex. Civ. App. - Houston [1st Dist.] 1974, no writ); Myers v. Myers, 503 S.W.2d 404 (Tex. Civ. App. - Houston [14th Dist.] 1973, writ dism'd w.o.j.). The trial court, pursuant to the mandate of Section 7.001 to divide the estate of the parties having due regard for the rights of each party, must determine the character of the marital property, in light of the definition provided by the constitution and the statutes.

While the trial court has broad latitude in the division of the community estate, it does not have the discretion to award separate real or personal property of one spouse to the other spouse. Eggemeyer v. Eggemeyer, 554 S.W.2d 137 (Tex. 1977) (real property); Cameron v. Cameron, 641 S.W.2d 216 (Tex. 1982)(personal property). The trial court has no authority to divest an interest in separate property even though the interest is small, and to require the spouses to maintain a tenancy-in-common is economically unrealistic and impractical. *See* Whorrall v. Whorrall, 691 S.W.2d 32 (Tex. Civ. App. - Austin 1985, writ dism'd) (husband owned a separate 9/10 of 1% interest in house as his separate property).

E. Doctrine of Inception-of-Title. The character of property as separate or community is determined at the time and under the circumstances of its acquisition. Ray v. United States, 385 F.Supp. 372 (S.D.Tex. 1974); Bradley v. Bradley, 540 S.W.2d 504 (Tex. Civ. App. - Fort Worth 1976, no writ). Hilley, 342 S.W.2d 565.

Property is characterized as separate or community at the time of "inception of the title". Saldana v. Saldana, 791 S.W.2d 316 (Tex. Civ. App. - Corpus Christi 1990, no writ). Under the inception of title doctrine, the character of property, whether separate or community, is fixed at the time of acquisition. Henry S. Miller Co. v. Evans, 452 S.W.2d 426 (Tex. 1970); Colden v. Alexander, 171 S.W.2d 328 (Tex. 1943); Hernandez v. Hernandez, 703 S.W.2d 250 (Tex. Civ. App. - Corpus Christi 1985, no writ). Villarreal v. Villarreal, 618 S.W.2d 99 (Tex. Civ. App. - Corpus Christi 1981, no writ); Bell v. Bell, 593 S.W.2d 424 (Tex. Civ. App. - Houston [14th Dist.] 1980, no writ);

The terms “owned and claimed” as used in the Constitution and the Texas Family Code mean that if the right to acquire the property accrued before the marriage, the property is separate, even though the legal title or evidence of the title might not be obtained until after marriage. Inception of title occurs when a party first has a right of claim to the property by virtue of which title is finally vested. *See* Jensen v. Jensen, 665 S.W.2d 107 (Tex. 1984); Welder v. Lambert, 44 S.W. 281 (Tex. 1898). The existence or non-existence of the marriage at the time of incipiency of the right by which title eventually vests determines whether property is community or separate. *See* Jensen, 665 S.W.2d 107; Creamer v. Briscoe, 109 S.W. 911 (Tex. 1908). The word “acquired” as used in the Constitution and TFC refers to the inception of the right, rather than the completion or ripening thereof. Where a contract to purchase was entered into before marriage, although the title is not finally obtained until after marriage, the property becomes the separate property of the purchaser-spouse. The case of Welder v. Lambert establishes the rule that title and ownership refer back to the time of making the contract. 44 S.W. at 287. Also, *see* Roach v. Roach, 672 S.W.2d 524 (Tex. App. - Amarillo 1984, no writ) where the court held: "it is a familiar principle of law that the separate or community character of property is determined not by the acquisition of the final title . . . but by the origin of title."

1. Property Acquired Before Marriage. Once character as separate property has attached, it is immaterial that part of the unpaid purchase price is thereafter paid from community funds, since the status of property as being either separate or community is determined at the time of acquisition and such status is fixed by the facts of the acquisition. Villarreal, 618 S.W.2d 99; Hilley, 342 S.W.2d 565; Lindsay v. Clayman, 254 S.W.2d 777 (Tex. 1952); Grost v. Grost, 561 S.W.2d 223 (Tex. Civ. App. - Tyler 1977, writ dism'd). In such a case, the community estate is entitled only to a claim from the separate estate. Welder, 44 S.W.2d 281; Colden v. Alexander, 171 S.W.2d 328 (Tex. 1943); Bishop v. Williams, 223 S.W. 512 (Tex. Civ. App. - Austin 1920, writ ref'd).

2. Property Acquired During Marriage. Property with respect to which inception of title occurs during marriage is community property unless it is acquired in one of the following manners, in which event it is the separate property of the acquiring spouse:

- by gift;
- by devise or descent;
- by a partition or exchange agreement or premarital agreement specifying that the asset is separate;
- as income from separate property made separate as a result of a gift, a premarital agreement or a partition and exchange

agreement;
- by survivorship;
- in exchange for other separate property; or
- as recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.

It is well established that a claim to real property can arise before the legal title or evidence of title has been attained. The Supreme Court in Welder, 44 S.W.2d 99, established the rule that title and ownership refer back to the time of making the contract. In Welder, a contract right giving the husband the right to acquire land was obtained before marriage, but the conditions of the contract were not met until after marriage, at which time title vested. The court held that the property was the husband's separate property because his claim to the property was acquired before marriage. Id.

When even a parol contract for purchase of land is made before marriage, and title to the land is received by the spouse after marriage, the parol contract constitutes such an equitable right to purchase prior to marriage as to establish the character as separate. Evans v. Ingram, 288 S.W. 494 (Tex. Civ. App. - Waco 1926, no writ).

III. TEXAS EMPLOYMENT CASES

A. Earnings of Spouses. The personal earnings of a spouse accrued during the marriage are community property. Moss v. Gibbs, 370 S.W.2d 452 (Tex. 1963); Uranga, 527 S.W.2d 761. Whatever is earned from the labor and effort of either spouse is community property. Graham, 488 S.W.2d 390.

A husband may not waive his claim to salary already in place and convert it into dividends, or some form of profit incident to stock ownership, and thereby convert the salary into separate property. Keller v. Keller, 141 S.W.2d 308 (Tex. Comm'n. App. 1940, opinion adopted).

Monies received by a spouse after marriage for services rendered prior to marriage are separate property. Moore v. Moore, 192 S.W.2d 929 (Tex. Civ. App. - Fort Worth 1946, no writ); Dessommes v. Dessommes, 543 S.W.2d 165 (Tex. Civ. App. – Texarkana 1976, writ ref'd n.r.e.). Monies earned by a spouse during marriage but received after dissolution of the marriage are community. Busby v. Busby, 457 S.W.2d 551 (Tex. 1970). Monies attributable to earnings after dissolution of marriage are not community property. McBride v. McBride, 256 S.W.2d 250 (Tex. Civ. App. - Austin 1953, no writ).

Notwithstanding the fact that a professional baseball player's employment contract was a "guaranteed contract," reviewing the contract as a whole, the court determined that the intent of the parties was that the husband must render skilled services as a baseball player in exchange for post-divorce payments. Accordingly, the sums that the baseball club paid to the husband after the divorce were his separate property. Loaiza v. Loaiza, 130 S.W.3d 894 (Tex. App. - Fort Worth 2004, no pet.).

B. Renewal Commissions. Cunningham v. Cunningham, 183 S.W.2d 985 (Tex. Civ. App. - Dallas 1944, no writ), holds that an insurance agent's future renewal commissions for insurance policies written by the husband during the marriage but not accruing to him until after divorce were a "mere expectancy". Id.; *see also* Vibrock v. Vibrock, 549 S.W.2d 775 (Tex. Civ. App. - Fort Worth 1977, writ ref'd n.r.e.); *but see,* the Supreme Court's remarks in refusing the application for writ of error n.r.e. per curiam at 561 S.W.2d 776 (Tex. 1977):

> The disposition of this case by this court indicates neither approval nor disapproval of the language contained in the opinion of the Court of Appeals which suggests that these renewal commissions are not community property.

Id. (citing Cearley v. Cearley, 544 S.W.2d 661 (Tex.1976)). *See* Bray v. Bray, 576 S.W.2d 664 (Tex. Civ. App. – Beaumont 1978, no writ) (Supreme Court caveat casts grave doubt upon Fort Worth Court's decision in Vibrock).

C. Bonuses. One case held that bonuses paid to a corporation president after rendition of judgment for divorce, but before entry of judgment, were not community property. Echols v. Austron, Inc., 529 S.W.2d 840 (Tex. Civ. App. -Austin 1975, writ ref'd n.r.e). Bonuses are community when received. *See* Jensen, 665 S.W.2d at 109.

Haggard v Haggard, however, holds that a bonus that the husband was entitled to receive, but was not quantified at the time of divorce, was community property. The appellate court noted that the trial court

was aware that husband was entitled to a bonus from his employer, but the amount of the bonus had not been determined at the time of trial. Haggard v. Haggard, 550 S.W.2d 374 (Tex. App. – Dallas 1977, no writ). The trial court did not divide the anticipated bonus. The appellate court held that, under these circumstances, the bonus, as a community asset that had not been awarded in the divorce, was owned jointly by the parties. Haggard, 550 S.W.2d at 378.

In Strenk v. Strenk, No. 03-01-00051-CV, 2001 Tex. App. LEXIS 7495 (Tex. App. – Austin 2001, no pet.) (not designated for publication), the Court considered a wife's claim of waste based upon the husband's instruction to his employer not to pay him a bonus in a particular year. All other employees in the company at husband's level of employment did receive a bonus for that year. The Court found waste based upon the undisputed testimony that the husband had explicitly asked his employer not to pay him a bonus. Id.

D. Employee Benefits Generally. The TFC specifically provides that, in a decree of divorce or annulment, the court shall determine the rights of both spouses in a pension, retirement plan, annuity, individual retirement account, employee stock option plan, stock option, or other form of savings, bonus, profit-sharing, or other employer plan or financial plan of an employee or a participant, regardless of whether the person is self-employed. TFC Section 7.003.

Employee benefits acquired by the employee spouse during marriage are community property. Herring v. Blakeley, 385 S.W.2d 843 (Tex. 1965). Employee benefits earned before marriage are separate property, and such benefits earned after dissolution of the marriage are separate property. *See* Hatteberg v. Hatteberg, 933 S.W.2d 522 (Tex. App. - Houston [1st Dist.] 1994, no writ). The same characterization applies even though none of the funds are available or subject to possession at the time of the divorce. Herring, 385 S.W.2d 843.

It is not necessary that the benefit be either "accrued" (i.e. necessary minimum number of years required for a pension for eligibility has been completed) or "matured" (i.e. denoting that all requirements have been met for immediate collection and enjoyment). Cearley v. Cearley, 544 S.W.2d 661 (Tex. 1976). The prospective rights prior to accrual and maturity constitute a contingency interest in property and are community assets subject to consideration along with other property in the division of the estate of the parties under TFC Section 7.003.

E. Retirement Benefits. Retirement benefits generally fall into one of two distinct types: defined benefit plans and defined contribution plans. Defined benefit plans are typically referred to as "pension" plans in which the participant is generally to receive upon retirement, a certain sum per month, based upon a calculation considering salary and length of years of service.

Defined contribution plans encompass plans typically known as 401(k)s, IRAs, profit sharing plans, and SEPs and often rely on both employee and employer contributions on a periodic basis to provide a fund for retirement.

1. Characterization - Defined Benefit Plans. Where the present value of the right is not subject to determination by reason of uncertainties affecting the vesting or maturation of the benefit, the community interest in a defined benefit plan can be mathematically ascertained by apportioning the benefit between the months accruing benefits in the plan during marriage and the total number of months necessary for accrual and maturity. Taggart v. Taggart, 552 S.W.2d 422 (Tex. 1977). Where the benefit is a contingent interest it has been suggested the apportionment to the nonemployee spouse be made effective if, as, and when the benefits are received by the employee spouse. Cearley, 544 S.W.2d 661; *also* Miser v. Miser, 475 S.W.2d 597 (Tex. Civ. App. – Dallas 1971, writ dism'd).

The community interest is generally based on the number of months in which the marriage coincides with employment (the numerator) divided by the total number of months of employment (the denominator), Taggart, 552 S.W.2d 422, based upon the value of the community interest at the time of divorce. Berry v. Berry, 647 S.W.2d 945 (Tex. 1983).

2. Characterization - Defined Contribution Plans. The methodologies used to characterize defined benefit plans as described in Berry, Taggart and Cearley are not applicable to defined contribution plans. Smith v. Smith, 22 S.W.3d 140, 149 (Tex. App. – Houston [14th Dist.] 2000, no writ). Many courts have utilized a simplistic approach to valuing the community interest in a 401(k) plan. Specifically, several courts have suggested that one need merely subtract the value of the 401(k) plan at the time of trial from the value of the plan at the time of marriage.

Smith, 22 S.W.3d at 148-49; Pelzig v. Berkebile, 931 S.W.2d 398, 402 (Tex. App. - Corpus Christi, 1996, no writ). Other decisions implied that it may be possible to trace assets within a 401(k) plan. *See* Hopf v. Hopf, 841 S.W.2d 898 (Tex. App. - Houston [14th Dist.] 1992, no writ). Iglinsky v. Iglinsky, 735 S.W.2d 536, 539 n.2 (Tex. App. - Tyler 1987, no writ). Still another case utilized an inception of title concept and held that a 401(k) plan that was fully funded prior to marriage should be treated as a trust and all income within the plan and increases in the value of the plan are separate property. Lipsey v. Lipsey, 993 S.W.2d 345 (Tex. App. - Fort Worth, 1998, no writ).

In 2005, the Legislature added Section 3.007 to the TFC. This Section defines and clarifies the characterization and tracing rules for defined contribution plans. The Section specifically permits the application of common tracing methods for defined contribution plans. The provisions of this section are as follows:

§ 3.007. Property Interest in Certain Employee Benefits

. . . .

(c) The separate property interest of a spouse in a defined contribution retirement plan may be traced using the tracing and characterization principles that apply to a nonretirement asset.

Section 3.007(c) may or may not permit the "before and after" method, that is discussed above. Section 3.007(c) now makes clear that it is acceptable to use traditional tracing methodologies when attempting to trace and characterize a defined contribution plan.

F. Employee Stock Options and Restricted Stock. Prior to 2005, Texas law was somewhat unsettled with regard to the characterization of employee stock options under various scenarios. Generally, the arguments centered around whether the court should apply a time apportionment standard such as applied in Taggart v. Taggart, 552 S.W.2d 422 (Tex. 1997) with respect to defined benefit plans, or whether the court should adopt a pure inception of title approach. Charriere v. Charriere, 7 S.W.3d 217 (Tex. App. - Dallas 1999, no writ) contains a significant discussion of this issue, and adopts an inception of title approach. In Charriere, the wife's employer granted her certain stock options which she could exercise at any time if she were still employed. The options, however, also included restrictions which rendered the stock valueless. These restrictions expired at the rate of 10% per year. The court ruled that the fact that the value of the options depended upon the wife's post-divorce continued employment did not affect the options' characterization. Id. The court specifically declined to adopt a percentage division approach as applied to defined benefit plans in Taggart. Similarly, in Bodin v. Bodin, 955 S.W.2d 380 (Tex. App. - San Antonio 1997, no writ), the court of appeals held that unvested stock options constitute contingent interests in property and are community property to be divided.

In 2005, the Texas Legislature enacted subsections (d) and (e) of Family Code Section 3.007, as amended in 2009. This statutory scheme rejected the inception of title approach as applied to stock options under Bodin and Charriere, but rather adopted a proportional time approach to the issue.

TFC Section 3.007 subsections (d)-(e) address the characterization of stock options and restricted stock, as follows:

(d) A spouse who is a participant in an employer-provided stock option plan or an employer-provided restricted stock plan has a separate property interest in the options or restricted stock granted to the spouse under the plan as follows:

(1) if the option or stock was granted to the spouse before marriage but required continued employment during marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which:

(A) the numerator is the sum of:

(i) the period from the date the option or stock was granted until the date of marriage; and

(ii) if the option or stock also required continued employment following the date of dissolution of the marriage before the grant could be exercised or the restriction removed, the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and

(B) the denominator is the period from the date the option or stock was

granted until the date the grant could be exercised or the restriction removed; and

(2) if the option or stock was granted to the spouse during the marriage but required continued employment following the date of dissolution of the marriage before the grant could be exercised or the restriction removed, the spouse's separate property interest is equal to the fraction of the option or restricted stock in which:

(A) the numerator is the period from the date of dissolution of the marriage until the date the grant could be exercised or the restriction removed; and

(B) the denominator is the period from the date the option or stock was granted until the date the grant could be exercised or the restriction removed.

(e) The computation described in Subsection (d) applies to each component of the benefit requiring varying periods of employment before the grant could be exercised or the restriction removed.

G. Disability Benefits. In 2005, the Texas legislature enacted Section 3.008 of the Family Code and reversed prior case law. Pursuant to Section 3.008(b), if a disabled or injured person receives disability insurance payments or workman's compensation payments, the statute characterizes those payments based upon the earnings that the payments are intended to replace. Accordingly, any such payments replacing earnings that would have been earned during the marriage are community and any such payments intended to replace pre-marriage or post-divorce earnings would be separate. This statute reversed prior law holding that disability benefits provided by an employer are community property even though they may be paid after divorce. Simmons v. Simmons, 568 S.W.2d 169 (Tex. Civ. App. - Dallas 1978, writ dism'd); Mathews v. Mathews, 414 S.W.2d 703 (Tex. Civ. App. - Austin 1967, no writ).

H. Early Retirement Payments. In Whorrall v. Whorrall, 691 S.W.2d 32 (Tex. App. - Austin 1985, writ dism'd), the husband received a "special payment", which was "strictly discretionary" and given by the company as an incentive to coax him into early retirement. The court held that to qualify as a retirement benefit capable of being apportioned between a spouse's separate and the community estate, the payment must be an earned property right which accrued by reason of years of service, or must be a form of deferred compensation which is earned during each month of service. Id. The "special payment", which the husband received in addition to his ordinary retirement from the employer, and which, rather than compensating the husband for past services, appeared to have been made as an incentive to the husband to retire early, was properly treated entirely as community property upon divorce.

I. State Statutory Plans. Benefits accruing under the various statutory retirement acts are divisible upon divorce. Collida v. Collida, 546 S.W.2d 708 (Tex. Civ. App. - Beaumont 1977, writ dism'd).

Lack v. Lack, 584 S.W.2d 896 (Tex. Civ. App. - Dallas 1979, writ ref'd n.r.e.) involves a dispute between a widow of a deceased fireman and the fireman's former wife over death benefits payable from the City of Dallas Pension Plan. The divorced wife claimed a pro rata share of the death benefits resulting from the contributions of community funds made to the pension plan during the marriage. The court held:

> Any inchoate interest of a spouse of a participant never ripens into a community property interest until occurrence of the contingency on which that interest depends . . . . Since the right to death benefits can never be established until the death of the participant, such benefits are not property acquired during the marriage and, therefore, are not community property.

Id.; *See also* Duckett v. Board of Trustees City of Houston Firemen's Relief and Ret. Fund, 832 S.W.2d 438 (Tex. App. - Houston [1st Dist.] 1992, writ denied).

Prior case law holds that worker's compensation benefits for an injury that accrues during marriage constitute community property. General Ins. Co. of Am. v. Casper, 426 S.W.2d 606 (Tex. Civ. App. - Tyler 1966, no writ); Piro v. Piro, 327 S.W.2d 335 (Tex. Civ. App. - Fort Worth 1959, writ dism'd). In Hicks v. Hicks, 546 S.W.2d 71 (Tex. Civ. App. - Dallas 1977, no writ), the court held:

> Where an injured worker is married at the time of injury and remains married throughout the period of disability, the workmen's compensation award is community property. This is so because

> compensation awards are intended to compensate an injured worker for his loss of earning capacity, and personal injury recoveries for loss of earning capacity during marriage are community property.

Id. However, the Texas legislature passed a statutory amendment to the Family Code designed to reverse this line of cases. Pursuant to Section 3.008(b) of the Family Code, disability insurance payments and worker's compensation payments are either community property or separate property depending on the nature of lost earnings that the payment is intended to replace. TFC § 3.008(b).

J. Social Security Benefits. Family law attorneys often avoid any discussions of social security benefits with their clients. But, recent case law suggests that this practice is not prudent.

The Texas courts have addressed social security benefits in a number of divorce cases. A recent case deals with the characterization of social security benefits received and held by the recipient spouse. In re Everse, No. 07-11-00220-CV, 2013 Tex. App. LEXIS 7424 (Tex. App.-Amarillo Jun. 18, 2013), *injunction denied,* 2013 Tex. App. LEXIS 9295 (Tex. App. Amarillo, Jul. 25, 2013) addresses the character of social security benefits that have been received. The appellate court upheld the trial court's separate property characterization of social security benefits that husband received during the marriage and traced.

The anti-assignment clause of the Social Security Act provides that:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the monies paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.

42 U.S.C. § 407(a) (1994).

The Everse court analyzed and adopted the analysis of other states regarding Social Security benefits that have been received. Concluding that social security benefits received are "monies paid" as described in the anti-assignment clause, the appellate court ruled that the trial court was correct to exempt previously received Social Security benefits from a just and right division. In re Everse, at 12.

Likewise, valid arguments exist that trial courts should consider the value of social security benefits as a factor in regard to a disproportionate division of the marital estate. Although social security benefits may not be divided in a divorce proceeding, per se, courts may consider a spouse's future social security benefits among the many factors bearing upon a just and right division of the community estate. Jackson v. Jackson, 2011 Tex. App. LEXIS 6109 (Tex. App. Austin Aug. 3, 2011); Prague v. Prague, 190 S.W.3d 31 (Tex. App. Dallas 2005, pet. denied); Phillips v. Phillips, 75 S.W.3d 564, 573 (Tex. App.-Beaumont 2002, no pet.).

IV. SURVIVOR ANNUITIES AND REVERSIONARY INTERESTS IN DEFINED BENEFIT PLANS

A. Survivor Annuities

1. Overview. As previously noted, defined benefit plans are often called "pension plans." A defined benefit plan is one in which the participant, generally, receives upon retirement a sum certain per month. The monthly benefit calculation is often based upon salary and length of years of service.

Defined benefit plans often involve three types of annuities. The first annuity is the single life annuity on the life of the plan participant. Upon retirement, this annuity will pay benefits during the life of the plan participant (generally the employee who earns the income). Upon the death of the plan participant, this annuity ends.

The second type of annuity is the pre-retirement survivor annuity. This annuity provides the participant's surviving spouse (generally) with payments should the participant die before the participant begins receiving retirement benefits. Pre-survivor annuities that meet specified requirements are referenced as a "qualified pre-retirement survivor annuity" ("QPSA"). Generally, defined benefit plans must offer a QPSA to employees who have participated in the defined benefit plan.

The third type of annuity is commonly called a

"survivor annuity." If the plan participant dies after the annuity on the participant's life has entered pay status, the survivor annuity pays benefits to the surviving spouse (generally) for the duration of the life of the surviving spouse.

Under federal law, defined benefit plans, generally, are required to provide both a survivor annuity and a qualified pre-retirement survivor annuity. 19 U.S.C. § 1055.

2. Irrevocable Survivor Annuities. The population of the United States is aging. Family law practitioners are increasingly encountering divorces involving older individuals. A corollary aspect of this phenomena is a marked increase in the number of divorces involving defined benefit plans in pay status.

When a defined benefit plan is in a pay status, even if the plan would, prior to entering pay status, recognize a separate interest QDRO, this option is generally not available for plans in pay status. Accordingly, a shared interest QDRO must be utilized.

Moreover, most plans provide that once a plan enters pay status, a previously made survivor annuity election becomes *irrevocable*. As a result, even if the parties might wish to agree that a husband is to receive all of the benefits under his defined benefit plan, such an agreement is virtually impossible to make if the defined benefit plan is in pay status.

Family law practitioners must be prepared to address the legal and economic consequences flowing from a survivor annuity that is in place and irrevocable.

3. Survivor Annuities Have Value

Too many attorneys representing plan participants agree that the opposing party shall receive a survivor annuity, without placing any value on that survivor annuity. This is a serious problem. The actuarial valuation of a survivor annuity analyzed in Appendix 2 to this paper was **$334,303.00**. In most cases, the spouse of the plan participant will be the beneficiary of the survivor annuity. This is not true in all cases. Speaking generally, under federal law, a plan participant may not designate someone other than the spouse as the beneficiary of the survivor annuity, unless the spouse of the plan participant consents. *See* 29 U.S.C. § 1055. When valuing a survivor annuity, one cannot overlook the identity of the person entitled to receive the benefits under the survivor annuity.

The authors were unable to locate any Texas cases addressing whether a trial court is required to assign a value to a survivor annuity awarded to a spouse. Multiple out of state cases, however, address this issue. For example, Moore v. Moore, 621 N.E.2d 239 (Ill.App.Ct.1993) involved a government pension for a postal worker. The parties agreed to the property division, with the exception of the division of the husband's federal pension benefits. The trial court ordered the husband to elect a survivor annuity for his wife, which resulted in the husband's annuity payments being lowered to pay the cost of the wife's survivor annuity. The trial court, however, awarded no additional asset or other offset in his favor to adjust for the cost of the wife's survivor annuity. The appellate court held that the trial court did not abuse its discretion in ordering the husband to elect a survivor annuity. The appellate court further held that the survivor benefit is a distinct property interest. The appellate court noted that the trial judge could properly order that the employee spouse must elect a survivor annuity and could compensate the employee spouse for the cost of the survivor annuity through other aspects of the marital property distribution. In the case under review, however, the parties had stipulated as to the division of the remainder of the estate of the parties. Accordingly, the appellate court ordered that the wife must financially bear the burden of the cost of the survivor annuity.

In a Missouri case, Weiss v Weiss, 702 S.W.2d 948 (Mo. Ct. App.1986), the trial court awarded wife a survivor annuity and considered the value of the survivor annuity as an asset awarded to her. Weiss also involved a federal retirement plan. In Weiss, the trial court concluded that eighty-eight percent (88%) of the husband's Federal Civil Service Retirement System benefits were subject to division as marital property, as being earned during marriage. Had the husband elected a single life annuity on his life only, his pension plan payments would have been $2,576.00 per month. However, the trial court ordered the husband to elect a survivor annuity and designate the wife as the beneficiary. The survivor annuity election reduced the annuity payment (during husband's lifetime) from $2,576.00 to $2,287.00, a reduction of $289.00 per month. The trial court performed a mathematical calculation that awarded to husband the portion of the retirement annuity that was not marital property, and then further awarded an additional interest in the pension payments to husband to offset the cost of the survivor

annuity election. As a result, the trial court awarded the pension payments to be received during husband's life as follows: 38.4% to wife and 61.6% to husband. The appellate court reviewed the mathematical calculations of the trial court and affirmed the award, including the trial court's decision that allocated the cost of the survivor annuity entirely to wife.

A New Mexico court reached a similar result in Irwin v. Irwin, 910 P.2d 342 (N.M. Ct. App. 1995), wherein the court held that survivor benefits must be valued to apportion each party's share of the retirement benefits. In Irwin, the trial court ordered husband to elect an option under the New Mexico Educational Board plan that would award a survivor annuity benefit to wife. This resulted in a reduction in husband's retirement annuity from $2,499.49 to $2,159.31. The trial court, however, did not adjust the property division to take into account husband's reduced pension payment attributable to the survivor annuity election. Husband argued on appeal that the trial court erred in denying his request to adjust the distribution of husband's pension in order to take into consideration the difference in the parties' respective life expectancies and the value of the survivor benefit cost that the trial court awarded to wife. The appellate court held that a community interest in the pension plan containing a survivor's benefit provision constitutes a community asset and the survivor's benefit provision should be considered in valuing and distributing the community interest in the retirement plan. The court continued by noting that, in order to properly allocate the community assets of the parties, the trial court is required to fully determine the value of the retirement plan, including the value of the survivor's benefits, and consider such value in apportioning each party's share of the total pension benefits. The appellate court reversed the trial court and remanded the case so that the trial court could consider the value of the benefits as a whole, including the value of the survivor benefit provision.

In Palladino, 713 A.2d 676 (1998), the Pennsylvania court held that a survivor annuity is a marital asset which has a value distinct from the primary pension and is subject to equitable distribution. Palladino involved a private pension plan sponsored by the teamster's union. At the time of trial, the plan was in pay status with the husband receiving an annuity during his life of $976.00 per month. The parties had previously elected a one hundred percent (100%) survivor annuity for wife's benefit. On appeal, wife first argued that characterizing the survivor annuity as marital property was error. The appellate court rejected this argument and held that the survivor annuity was a vested property interest of wife that was separate and distinct from husband's pension payments during his life. The appellate court also held that the wife's survivor annuity benefits are properly assessed to her in the equitable division scheme.

Wife then challenged the valuation of the survivor annuity. Wife argued that the value of her survivor annuity was equal to the difference between the value of the husband's retirement benefit prior to the survivor annuity election and the value of the present retirement benefits subject to the annuity election. The appellate court rejected this valuation approach (known as a "cost approach") as being unsupported by actuarial standards.

The actuaries calculated the value of the husband's single life annuity on his life based upon a hypothetical purchase of an annuity in one lump sum payment that would generate the $976.00 per month income, beginning at the time of divorce, based upon husband's age and life expectancy, and utilizing a present value discount rate and mortality tables. The actuary calculated this sum to be $98,850.00. Utilizing the same logic, the actuary calculated the cost to purchase wife's survivorship annuity as a single premium annuity would be $57,480.00. Therefore, the value of the wife's survivor annuity was held to be $57,480.00.

The Palladino case, therefore, expressly affirmed the actuarial valuation technique utilized in Appendix 2 attached to this paper. The authors of the paper believe that the actuarial valuation approach that was apparently utilized in Palladino is the correct one.

Utah has also ruled on this issue. In Bert v Bert, 799 P.2d 1166 (Utah Ct. App. 1990), the appellate court held that a trial court should treat a survivor annuity in the same way that a pension is treated, and assign a present value to the survivor annuity.

4. Valuation - Survivor Annuity *Flawed* simplistic approach.

A simplistic, though seriously flawed, approach to valuing a survivor annuity exists. This approach is as follows:

(a) Determine the life expectancy of the plan participant spouse;

(b) Determine the life expectancy of the non-

participant spouse;

(c) Determine the number of years that the non-participant spouse is expected to survive after the death of the participant spouse (simple subtraction);

(d) Calculate the present value of the income stream of the survivor annuity benefit payments from the estimated date of the death of the participant spouse to the estimated date of death of the survivor spouse;

(e) Reduce to current present value, as of the date of divorce, the payments that will theoretically begin at the time of the death of the participant spouse and continue until the date of death of non-participant spouse.

This calculation **is unsound**. The most obvious flaw appears when the life expectancy of the non-plan participant spouse (who would receive benefits under the survivor annuity) is less than the life expectancy of the spouse who is the plan participant. In other words, this obvious flaw appears when the spouse receiving the survivor annuity is likely to die before the planned participant spouse. Utilizing this approach would result in a zero value of the survivor annuity. (See Appendix 4).

5. Valuation of Survivor Annuity - Actuarial Approach

Under this approach, the following analysis is used:

(a) Determine the present value of a single life annuity (hypothetical) on the life of the non-participant spouse at the survivor annuity monthly payment rate. To perform this calculation, determine the value of the anticipated annuity payment (at the survivor annuity rate) for each year utilizing a present value interest discount factor and utilizing, for each year, a discount for mortality of the non-participant spouse. The value of the single life annuity for the life of the non-participant spouse is the sum of all those yearly values. Exhibit 1-B to Appendix 2 demonstrates how to perform this calculation;

(b) Determine the present value of the payments (hypothetically) to be made while both the participant spouse and the non-participant spouse are alive (at the survivor annuity rate). This calculation is performed on a yearly basis by taking the estimated annual survivor annuity payment, reducing the value of that payment for each year to present value using an interest discount factor, then reducing that value additionally by a mortality estimate for the participant and finally reducing the value further by a mortality estimate for the non-participant. The result for each year is added together. See Exhibit 1-C to Appendix 2;

(c) Subtracting the results of the calculation described above in paragraph (b), from the results of the calculation described in paragraph (a) above, results in the actuarial determination of the value of the survivor annuity.
(See Appendix 2).

6. Consideration of Longer Life Expectancy

An argument exists that the court should consider the needs of the spouse receiving the survivor annuity. Current mortality data indicates that women continue to outlive men. Accordingly, an argument exists that the court should consider this fact in making an appropriate division of property, including the survivor annuity. In Goren v. Goren, 531 S.W.2d 897, 899 (Tex. Civ. App. – Houston [1st. Dist.] 1975, writ dism'd), the appellate court held that, when making its determination of the division of the estate, the trial court was justified in considering the parties' respective financial obligations, future earnings capacity, and their probable needs for support. The court noted that: "an important factor, if not the most important factor, is the parties' probable respective need for future support." Another appellate court, Pickett v. Pickett, 401 S.W.2d 846 (Tex. Civ. App. – Tyler 1966), went even further, articulating that the probable future need for support seemed to "be the most important factor" in the court's exercise of discretion in dividing the community estate of the parties. Neither Goren nor Pickett address the specific issue of life expectancy and survivor annuities. However, the cases could be applied by analogy.

B. Reversionary Interest

1. Overview.

Another issue arising when addressing a defined benefit plan (or pension plan) is reversionary interests. This issue arises solely when a shared interest QDRO is utilized. Under a shared interest QDRO, the former spouses "share" in the annuity payable during the life of the plan participant. For example, assume that the husband is receiving an annuity on his life in the amount of $10,000.00 per month. Further assume that the

QDRO divides this annuity such that the former wife will receive $5,000.00 per month and the former husband will receive $5,000.00 per month. If the husband pre-deceases the wife, then the need for a survivor annuity arises (as addressed in the preceding section).

What happens, however, if the wife pre-deceases the husband? At such time, the plan is in pay status. The plan is paying wife $5,000.00 a month. The plan is paying husband $5,000.00 a month. The primary plan single life annuity is based on the husband's life. Wife then, however, dies.

Most plans, under this circumstance, provide that the *portion of the primary* single life annuity on the life of the husband that the wife is receiving pursuant to the QDRO reverts *back to the husband*. Therefore, if wife pre-deceases husband, under this shared interest QDRO approach, the plan would pay to husband the $5,000.00 that previously was paid to wife, in addition to the $5,000,00 per month that the plan was paying to husband.

2. Valuing a Reversionary Interest

One approach to valuing a reversionary interest would be as follows:

(a) Determine the present value of a single life annuity (hypothetical) on the life of the participant spouse at the rate of the contemplated reversionary payment. To perform this calculation, determine the value of the anticipated reversionary payment for each year, utilizing a present value interest discount factor and utilizing, for each year, a discount for mortality. The value of the single life annuity for the life of the participant spouse is the sum of all those yearly values.

(b) Determine the present value of the payments (hypothetically) to be made while both the participant spouse and the non-participant spouse are alive (at the anticipated reversionary rate). This calculation, again, is performed on a yearly basis by taking the estimated reversionary payment, reducing the value of that payment for each year to present value using an interest discount, then reducing that value additionally by a mortality estimate for the participant, and finally reducing the value further by a mortality estimate for the non-participant.

(c) Subtract the result of the calculation performed pursuant to paragraph (b) above from the calculation performed pursuant paragraph (a) above. The resulting difference is the value of the reversionary interest.

V. OUT OF STATE EMPLOYEE COMPENSATION CASES

A. Accrued Vacation and Sick Leave. Many states characterize accrued vacation and sick leave similar to retirement benefits – as a marital asset to the extent accrued during the marriage. This rule generally applies when the accrued time can be "banked" and later received as compensation upon termination or retirement. Other states reason that vacation and sick pay are marital assets because these benefits are subject to future cash payout and are employment compensation. Even though possibly paid after marriage, as in the case of retirement benefits, these payments have community character when earned during the marriage.

Depending upon the facts and circumstances of the accrued vacation or sick pay, arguments against community character exist. For example, to the extent the employee can merely "bank time" for later use, but does not have the right to receive a cash payout for the accrued time, the interest is much like a disability policy. In other words – the employee must use it or lose it. If the employee spouse cannot receive a "cash-out" financial benefit, the employee spouse may be able to experience illness or take time away from work in the future without losing regular compensation because of the accrued hours. The vacation or sick pay becomes merely a replacement for what would otherwise have been lost wages. To the extent this payout happens after divorce, those wages could be considered separate property.

1. Arnold v. Arnold (New Mexico). In Arnold v. Arnold, 77 P.3d 285 (N.M. Ct. App. 2003), the husband was employed by New Mexico State University. The University had a policy that a portion of vacation and sick pay benefits could be accrued through to retirement or termination. The policy did not allow all unused benefits to accrue and vest (a portion of unused benefits were forfeited). Historically, the husband had used all vacation and sick leave benefits before forfeiture and the amounts accumulated at the time of divorce were vested. At time of trial, the husband had 296.35 vacation hours and 812.35 hours of sick leave, with an assessed value of $26,608.80. Id at 286-87.

Like Texas, New Mexico defines community

property broadly as "property acquired by either or both spouses during marriage which is not separate property." N.M. Stat. Ann.§ 40-3-8(B) (1978). Additionally, New Mexico applies the community presumption that "property acquired during marriage by either husband or wife, or both, is presumed to be community property." N.M. Stat. Ann. § 40-3-12(A) (1978).

New Mexico characterizes nonvested and unmatured retirement benefits conditioned upon a spouse's continued employment for a stated period of time after divorce (but earned during marriage) as community property. *See* Garcia v. Mayer, 920 P.2d 522 (N.M. 1996) and Berry v. Meadows, 713 P.2d 1017, 1023-24 (Ct. App. 1986). Applying these rules, the Arnold court held:

> Accrued vacation pay and sick leave earned during marriage with the labor and effort of a spouse is a contractual benefit and should be treated no differently than retirement or pension benefits, or options.

Arnold at 290.

2. In Re Marriage of Nuss (Washington). Washington requires a fair and equitable distribution of the marital estate. Washington considers statutory factors when making a fair and equitable distribution, similar to the Murff v. Murff, 615 S.W.2d 696, 699 (Tex. 1981) factors that Texas employs. Under statute, the trial court must make a just and equitable disposition of property, considering all relevant factors, including the nature and extent of community and separate property, the duration of the marriage, and the economic circumstances of each party at the time of distribution. Wash. Rev. Code 26.09.080

Similar to Texas, Washington characterizes disability payments for future (in Washington - post-separation) wages as separate property. In Re Marriage of Nuss, 828 P.2d 627,632 (Wash. Ct. App. 1992). Washington also treats both accrued vacation and sick time when earned during the marriage as divisible assets. In Nuss, the wife worked at Boeing and participated in a reserved sick leave fund known as the Financial Security Plan (FSP). Under the plan, employees could "bank" up to 40 hours of unused sick leave per year for use in the event of a serious illness or injury that exhausts regular sick leave benefits. The employee was entitled to the dollar value of any unused FSP benefits that may be received upon death or retirement. At the time of separation, wife was 100 percent vested in her FSP. Id at 632. The Washington court held:

> The FSP contains elements of both deferred compensation and future earnings replacement. It is similar to vacation leave (which is definitely deferred compensation) in that it converts unused sick leave into something akin to vacation leave, which may be used as needed in the event of future illness, or else taken in cash upon termination of employment.

Id. The court characterized the fully earned portion of the asset as a community asset to be distributed.

3. Schober v. Schober (Alaska). Schober v. Schober, 692 P.2d 267 (Alaska 1984), holds that vacation rights are contract rights earned during the marriage. In Schober, husband's employer owed him over 400 hours of unused personal leave. Under a collective bargaining agreement, the husband could use the "leave" as paid vacation or convert it to cash. In holding that the vacation rights were divisible property, the Court ruled:

> The right to a paid vacation, when offered in an employer's policy or contract of employment, constitutes deferred wages for services rendered, and the "right . . . . vests as the labor is rendered." . . . . Moreover, it was an economic resource capable of being assigned a value by the trial court.

Id. *quoting* Suastez v. Plastic Dress-Up Co., 31 Cal. 3d 774, 647 P.2d 122, 128, 183 Cal. Rptr. 846 (Cal. 1982).

4. Kerr v. Kerr (Delaware). In Delaware, "property interests not yet reduced to possession can be acquired during marriage within the meaning of §1513, and, if such an interest still exists at the time of a divorce, the interest is to be regarded as marital property". Kerr v. Kerr, 1990 Del. Fam. Ct. Lexis 64, 1 *citing* Gregg v. Gregg, 510 A.2d 474, 480 (Del. Super. Ct. 1986) *appeal after remand*, 542 A.2d 357 (1988); *see* Robert C.S. v. Barbara J.S., 434 A.2d 383 (Del. Super. Ct. 1981) (non-vested pension held to be marital property).

In Kerr, the parties both worked under a union contract providing for the accumulation of sick-leave and vacation pay, which was characterized as a "reserve

hour" benefit. The benefit was payable upon either voluntary termination for reasons other than cause, voluntary resignation or retirement. Further, an employee accumulated the vacation leave or sick leave by working rather than using sick leave. Id. at 4. The court held that:

> Both components are deferred compensation, similar to a pension. Both are therefore divisible to the extent that they were earned during the marriage. However, to the event [sic] they are used [?] by the time the parties leave employment with the New Castle County the "if, when, and as the benefits are paid approach" shall control.

Id. at 10-11.

5. Thomasian v. Thomasian (Maryland). Maryland does not recognize accrued holiday and vacation entitlement as marital property. In Thomasian v. Thomasian, 556 A.2d 675, (Md. App. 1989) the Court considered whether accrued vacation pay was a marital asset. The Court determined that, while the definition of marital property under Maryland law is expansive, it does not necessarily include accrued holiday and vacation entitlement:

> Accrued holiday and vacation entitlement is not the same as a pension or retirement benefit, a form of deferred compensation; since it replaces wages on days when the worker does not work, it is really only an alternative form of wages. MEA/AFSCME Local 519 v. City of Sioux Falls, 423 N.W. 2d 164, 166-67 (S.D. 1988). It need not be liquidated by the payment of cash; it may be, and often is, dissipated when the person entitled to do so, takes vacation or holiday time. Thus, it is far from as tangible as, and much more difficult to value, not to mention more personal than, a pension or retirement benefits.

Id. at 678.

However, to the extent a spouse receives a payment during marriage for accrued time, those sums to reimburse spouse for unused annual and sick leave are considered to be marital property. Smith v. Smith, 996 A.2d 416, 422, (Md. App. 2010).

B. Severance Pay Packages. Foreign states characterize severance as community, separate or mixed based upon the facts and circumstances of the case. Some courts treat severance payments as compensation for work during the marriage. Other courts reject this approach and hold that severance packages are not a contractual right, but only a mere expectancy.

1. In Re Marriage of Lawson (California). The California case of In Re Marriage of Lawson, 256 Cal. Rptr. 283 (Cal. App. 1989) involved the divisability of a severance program offered to husband subsequent to the divorce. The court considered whether the purpose of the payments was a method of deferred compensation for services rendered or for compensating the employee for loss of earnings during the period of transition from employment to unemployment. Id. at 286-88.

The court considered such factors as: (1) the right to receive the payment was not contractual; (2) the right to receive the payments was within the employer's control; (3) termination had to occur within a three month period, and the plan was subject to the employer's revision or revocation; and (4) the employee's beneficiaries would not receive the separation allowance if the employee died before the termination date. Id. at 287-88. The court determined that the characteristics of husband's separation allowance established that the severance package was in the nature of future compensation to replace earnings during the transition period. The court stated that "undue emphasis should not be placed on the fact that one of the bases for determining the amount of the allowance is the employee's years of service. . . . even though the right to participate in the plan does not accrue from past services." Id. at 288. The Court held that the separation allowance was separate property.

2. In Re Marriage of Bishop (Washington). In re Marriage of Bishop, 729 P.2d 647, (Wash. Ct. App. 1986) primarily stands for the notion that, because severance pay is a mere expectancy, not a contract right and has no present value, it is not "property" in the true sense. The payment is completely dependent upon an involuntary termination. Id. at 648. Therefore, if no involuntary termination occurs, there is no contractual right to payment:

> Severance pay is intended primarily to alleviate financial loss, and that loss

> ordinarily will fall upon the marital community until it is dissolved and to that extent the payment should be considered community property. To the extent the payment will soften the blow upon the spouse enduring dismissal after dissolution, i.e., upon his or her future economic circumstances, including loss of wages, it should be considered separate property.

Id. at 648.

Bishop further analyzed the legislative intent of military separation pay to determine how to characterize non-military severance benefits and found that such benefits were not compensation for past service, but instead designed to provide financial assistance during a transition to non-military life. Id. at 648:

> If a marriage subsists at the time the service member is involuntarily discharged, the loss of employment becomes a community loss and separation pay serves to ameliorate this loss. If the service member is not married at the time of discharge, however, the adjustment to civilian life is his alone to make. Accordingly, the separation pay should be his separate property. Id. at 651 *quoting* In re Marriage of Kuzmiak, 176 Cal. App. 3d 1152, 1157, 222 Cal. Rptr. 644, *cert. denied*, (1986).

Id.

3. Perry v. Perry (Ohio). In Perry v. Perry, Ohio App. LEXIS 5260 (Ohio Ct. App. 1995), the husband received a severance package during marriage to compensate him for future lost income resulting from his cut in pay. Four days before trial, the husband received the severance pay from his former employer. The trial court held that the severance pay was marital property, rather than future income. The appellate court recognized one could view the severance as having been for the purpose of helping the husband adjust. One could also view the severance as a reward for his past service to his former employer. In holding that the severance was marital property, the Appellate Court utilized the latter approach. Id. at 5.

C. Stock Options and Stock Grants. Some states characterize stock options and grants based upon the intent of the employer to reward past or future performance when issuing the options or grants. Stock options or restrictive share grants may constitute compensation for future services (not deferred compensation) when awarded as an incentive to render continued and future services and as incentive for future productivity. On the other hand, options and stock may represent deferred compensation when awarded for past performance.

1. Ruberg v. Ruberg (Florida). In Ruberg v. Ruberg, 858 So. 2d 1147, (Fla. Dist. Ct. App. 2003) the court ruled:

> The status of unvested options turns on the factual issue of whether the unvested stock options and restricted shares were primarily awarded as deferred compensation for past service or as an incentive for future services. *See, e.g.*, Wendt v. Wendt, 757 A.2d 1225, 1235 (Conn. Super. Ct. 2000) (stating that determination of purpose for which stock options were awarded is question of fact); In re Marriage of Miller, 915 P.2d 1314, 1318 (Colo. 1996) (stating that, in determining character of stock options for purposes of equitable distribution, courts must consider whether options were awarded for past, present, or future services); In re Marriage of Short, 890 P.2d 12, 16 (Wash. 1995) (stating that, in characterizing as marital or nonmarital unvested stock options granted during marriage, courts must look to circumstances under which options were granted and determine whether they were rewards "to compensate the employee for past, present, or future employment services"); In re Marriage of Hug, 154 Cal. App. 3d 780, 201 Cal.Rptr. 676, 685 (Cal. Ct. App. 1984) (approving the use of a time rule to apportion stock options awarded during the marriage but unvested at the time of the divorce petition but stating "we stress that no single rule or formula is applicable to every dissolution case involving stock options"). Stock options or restrictive share grants constitute compensation for future services-and not deferred

> compensation-when they are awarded as an incentive to an employee to render continued and future services to a company and as incentive for future productivity. Miller, 915 P.2d at 1319-20; Short, 890 P.2d at 18; Hug, 201 Cal.Rptr. at 680; *see also* Thomas P. Malone, Employee Stock Options & Restricted Shares: Determining & Dividing the Marital Pot, 25 Colo. Law. 87, 91 (Oct. 1996).

Id. at 1154.

2. Jensen v. Jensen (Florida). Jensen v. Jensen, 824 So. 2d 315 (Fla. Dist. Ct. App. 2002), addressed whether stock options granted during a marriage but unvested on the divorce filing date constitute marital property. In Jensen, the husband worked for Cisco Systems. During the marriage, Cisco granted husband stock options. Id. at 316-17. The award contract stated that the award was "in recognition of past commendable service [but was] contingent upon [the husband's] continued service with either Cisco Systems or any of its subsidiaries." Id. at 317. Based upon the intent of the company to award the shares for past service, the court determined that the unvested options constituted marital property. Id.

3. In Re Marriage of Short (Washington). A Washington case, In re Marriage of Short, 890 P.2d 12 (Wash. 1995) involves an analysis of Microsoft employee stock options granted to the husband:

> A vested employee stock option is acquired when granted. An unvested employee stock option is not so easily characterized and requires a more complex analysis. An unvested employee stock option is one that provides no legal title or rights of absolute ownership over the stock option to the employee. *See* Black's Law Dictionary 1418 (6th ed. 1990). The Microsoft stock options, contingent upon Robert's continued employment at Microsoft, were unvested when granted.

Id. at 15.

Interestingly, Washington applies a slightly different stock option time rule than some other states:

> After determining whether employee stock options were granted to compensate the employee for past, present, or future employment services, the "time rule" is applied.
>
> > For future employment services, the "time rule" is applied to the first stock option to vest after the parties are found to be "living separate and apart". This is the lone stock option that includes both a community effort and a separate effort. We do not apply the "time rule" to every stock option that vests after the parties are found to be "living separate and apart" because to do so ignores the separate property provisions of RCW 26.16. Multiple stock options granted for future services vest consecutively, not concurrently. Such a ruling insures that stock options are characterized and apportioned to reflect their marital and nonmarital aspects. This interpretation of the "time rule" differs from that announced in In re Marriage of Hug, 154 Cal. App. 3d 780, 201 Cal.Rptr. 676, 685 (Cal. Ct. App. 1984).

Id. at 15.

D. Bonuses. With respect to bonuses, multiple states look to when the bonus was “earned” to determine whether the bonus is community or separate. Like options and grants, some states characterize bonuses based upon the intent of the employer when issuing the bonuses.

1. Byington v. Byington (Michigan). In Byington v. Byington, 568 N.W.2d 141 (Mich. App. 1997), the husband received a contingent bonus package well after the divorce suit had been filed and after the parties ceased living together. The parties had temporarily placed the divorce “on hold” as wife pursued a political office. In the fall of 1993, the parties resumed settlement negotiations and set an asset valuation date of July 1, 1993. In December 1993, husband became eligible to receive certain contingent compensation as

provided in his new employment agreement. This compensation ultimately totaled approximately $2 million.

The trial court ruled that the $2 million was not part of the marital estate, stating that because the assets were acquired by husband almost two years after this case began, those assets were earned by husband without a contribution from wife. Id. at 144. However, the rule applied by the trial court was misplaced. In Michigan, like Texas, the community estate ends upon divorce:

> Property subject to apportionment is referred to as "marital property," and it is this property that comprises the marital estate. 2 Curtis, Bassett & Kidder, Michigan Family Law (4th ed) (ICLE, 1993), § 14.9, p 14-12. Assets earned by a spouse during the marriage are properly considered part of the marital estate. *See* Vollmer v. Vollmer, 187 Mich. App. 688, 690; 468 N.W.2d 236 (1991). This is true where the assets are received during the existence of the marriage, *id.*, but also where the assets are received after the judgment of divorce.

Id. at 144. In Michigan, the court must first properly identify all marital assets. Thereafter, the court determines how to apportion or divide the assets. In determining an equitable division, the court may consider various factors:

> When dividing the estate, the court should consider the duration of the marriage, *the contribution of each party to the marital estate*, each party's station in life, each party's earning ability, each party's age, health, and needs, fault or past misconduct, and any other equitable circumstance. Sparks v Sparks, 440 Mich. 141, 158-160; 485 N.W.2d 893 (1992). The significance of each of these factors will vary from case to case, and each factor need not be given equal weight where the circumstances dictate otherwise. Id. p 159.

Id at 146. (emphasis added). The appellate court reversed the trial court's decision that the bonus was not marital property. While the trial court applied a well-known rule, it applied the rule at the wrong time in its analysis. The appellate court further discussed that, upon remand, the factors announced in *Sparks* should be applied to the $2 million marital asset to determine the equitable division of this asset.

2. In Re Marriage of Peters (Illinois). In re Marriage of Peters, 760 N.E.2d 586, (Ill. App. Ct. 2d Dist. 2001), addressed husband's contingent contractual right to a future stock bonus. In order for husband to receive the stock bonus, he must remain with the company for ten years and achieve a specific performance target. By the time of divorce, husband was consistently achieving results that exceeded target performance levels.

The Peters court discussed multiple approaches to the issue. Illinois applies the "total-offset" approach, the "reserved-jurisdiction" approach or the "alternative reserve jurisdiction" approach to dividing marital assets that will be paid out in the future. Under the "total-offset" approach, the court must determine a current present value of the award at the time of dissolution. This is generally calculated as the value of the community portion of the award discounted for the risk that the award will not vest. Next, an additional discount is applied to reduce the award to a present value. In Re Marriage of Peters, 760 N.E.2d at 591. Once the value is determined it is awarded to the employee spouse and the non-employee spouse is awarded other assets of the same value.

Under the "reserved-jurisdiction" approach the court *delays* actually dividing the asset and orders how the Court will divide the asset if and when it is paid out. Id. at 591. This method is used when it is difficult or impossible to determine the value of the asset characterized as a community asset. Difficulties arise when vesting and maturity are not readily determinable because conditions in the award are not absolute. Therefore, deciding how much of the award is attributable to efforts during the marriage will be dependent on how much effort is required after the marriage. The obvious disadvantage is that there is a delayed finality to the divorce. Under an "alternative reserve jurisdiction approach," the court pre-determines the method of apportionment to be implemented when

the asset is received. This is a preferable method as it provides for a final resolution to the case. Id.

The court ruled:

> Any portion of the stock bonus earned during the marriage should be considered marital property. The bonus is a contractual right that petitioner was working toward during the marriage and thus was more than a mere expectancy.

Id. at 588. The Appellate Court directed the trial court to reserve jurisdiction to later determine the award.

3. In Re Marriage of Griswold (Washington). A Washington case, In Re Marriage of Griswold, 112 Wn.App. 333, 48 P.3d 1018, (2002) *review denied* 148 Wn. 2d 1023 (2003) dealt with a discretionary bonus. Husband worked as an energy trader and was eligible to receive a bonus under an incentive plan. The bonus plan included factors based upon: (1) company performance goals; (2) a discretionary award; (3) employee's performance goals; and (4) an award based upon value of traders "book." To be eligible for the award, the employee had to be employed at the time the bonus was paid. Pursuant to the plan, Husband received a bonus of $980,772 a few months after the parties separated. In Washington, assets acquired during a marriage are presumed to be community property, but spouses earnings and accumulations during a permanent separation are considered separate property. Id. at 1021 *quoting* In Re Marriage of Short, 125 Wash.2d 865, 870-71, 890 P.2d 12 (1995). The Court applied a time rule:

> The "time rule" requires a trial court to determine, as a matter of fact, whether the benefit is conferred for past, present, or future services. The services were performed partly during the marriage and partly after the marriage.

Id. at 1022-1023.

Consequently, because the work was performed both during the marriage and after the parties separated, the court characterized the bonus as being mixed in character. The Court allocated the bonus as community or separate based upon the time between the bonus plan implementation and the time of payment. So, despite the rule that earnings and accumulations after separation are separate property, if the earnings are a result of past performance during the marriage, the asset will be community property subject to division.

4. Linton v. Linton (Michigan). In Linton v. Linton, 2005 Mich. App., 2005, Lexis 2874 (unpublished opinion), wife agreed to continue working for a company that was planning to close its facility within the year. As an incentive to stay through the closing, the company planned to pay a retention bonus and a severance package upon the loss of the job. Wife did not know the date that the facility would close or the amount of either the retention bonus or the severance package. Wife stated that the severance package would be based upon the number of years she had worked.

The trial court characterized both the retention bonus and the severance package as marital assets. However, the appellate court disagreed. Severance compensation earned entirely during the marriage is a marital asset subject to equitable division on divorce. Id. at 13 *quoting* McNamara v Horner, 249 Mich. App. 177, 187-188; 642 N.W.2d 385 (2002). Therefore, the severance pay is a marital asset subject to equitable division. The retention bonus however, does not accrue until the wife completes her final period of employment. Unlike the severance pay, the wife had not yet earned the retention bonus so it was not accumulated during the marriage.

5. Marcell v. Marcell (Florida). Marcell v. Marcell, 842 So.2d 945 (Fla. App. 1 Dist., 2003) discusses the characterization of a military re-enlistment bonus. Before filing for divorce, husband re-enlisted in the Air Force and became eligible to receive a retention bonus. He chose to receive half the bonus in a lump sum. He elected to receive the remainder of the bonus in five yearly installments, none of which had been paid as of the divorce. The trial court awarded one-half of the bonus to the wife, if, as, and when received. Because entitlement to the bonus vested upon re-enlistment, the asset was a community asset, even though the bonus was subject to forfeiture.

6. Hamza v. Hamza (New York). The Hamza v. Hamza, 247 A.D.2d 444, 668 N.Y.S.2d 677 (1998) case presents an interesting point applicable to determining character of marital assets. In this case, the trial court initially divided the incentive bonus of the husband one-third to wife and two-thirds to husband. The appellate court determined that the wife's

substantial contributions as spouse, homemaker, and parent throughout the marriage allowed the husband to continue his career. As a result, the incentive bonus should have been divided equally.

E. Forgivable Loan or Compensation. The issue of future earnings renders this a complicated subject. Often, these upfront "loans" are actually a signing bonus, and thus, perhaps, earned when received. One of the purposes of disguising the bonus as a loan with a "forgiveness stream" is to minimize the tax consequences by spreading the consequences over multiple years. Additionally, by designing these signing bonuses as loans, the company has an opportunity to re-coup some of this bonus if the employee leaves within a short period of time.

1. O'Neal v. O'Neal (Arkansas). In O'Neal v. O'Neal, 929 S.W.2d 725, 726 (Ark. Ct. App. 1996), the husband began working for Smith Barney less than one month before the divorce. Under the employment contract, Smith Barney paid him a $35,000 advance. The manager described the compensation as an advance to be used during the period of job transition as he developed clientele. The company manager further testified that money was a "forgivable loan" with 25% of the loan being forgiven each year. Each forgiven portion of the loan would become taxable income to the husband. The loan was part of the husband's compensation package. Id. The Court held:

> In considering whether property is marital, the determining factor is the time that the right to the property is acquired. Dunn v. Dunn, 35 Ark. App. 89, 811 S.W.2d 336 (Ark. C t. App. 1991). Here, even though husband acquired the right to the $35,000.00 during the marriage, he did not earn it during the marriage.

Id.

Acquiring the right to a $35,000 loan is different than acquiring a right to $35,000. The minute the husband accepts the $35,000, he also accepts a liability to repay $35,000, if husband leaves before obtaining complete forgiveness.

F. Social Security - Is It Really Off Limits? States are divided on the topic of how and what to do with social security benefits.

Some states have considered that social security benefits of a spouse should not be considered during the division of the marital estate in any way. They interpret the anti-attachment clause to mean that it prohibits the use of the anticipated social security benefits to be used either as an offset against other property to be given to the non-participating spouse or to be divided as if it were a community asset. Wolff v. Wolff, 929 P.2d 916, 921 (Nev. 1996); Olson v. Olson, 445 N.W.2d 1, 11 (N.D. 1989); In re Marriage of Swan, 720 P.2d 747, 751 (Or. 1986).

However, the majority of the states have held that, in order to achieve a just and right division, the social security benefits of a spouse require some consideration.

For example, consider the following scenario:

(1) Spouse A has a pension benefit plan that ***precludes*** the ability to collect any social security benefits (ie: certain civil pensions such as Law Enforcement Officers, some Teachers retirement plans, as well as others).

(2) Spouse B has a pension benefit plan but the plan also **allows** Spouse B to receive social security benefits.

The present value of the community portion of the pension benefits for Spouse A and Spouse B are determined and the marital estate is divided. Spouse A's pension benefit (in essence) includes a portion of the value that he is receiving "in-lieu of Social Security Benefits" while Spouse B's value does not include the additional benefit Spouse B will eventually receive as Social Security benefits. Consequently, the division of the two pensions could provide an unintended disproportionate division of the estate.

Social Security benefits are non-marital property, and are to be considered by the court when dividing the marital property, but not to such a degree that such consideration would have a material impact on the division of marital property. Litz v. Litz, 288 S.W.3d 753 (Mo. Ct. App. 2009).

In the context of an equitable distribution of marital property, a trial court may consider Social Security benefits without violating federal law. In re Marriage of Morehouse, 121 P.3d 264 (Colo. Ct. App. 2005).

The trial court cannot calculate a future value of

those monies and award that value as a precise property offset as part of its property distribution. However, the possibility that one or both parties may receive Social Security benefits is a factor the court may consider in making its distribution of property. In re Marriage of Rockwell, 141 Wn. App. 235 (Wash. Ct. App. 2007).

In Kelly v. Kelly, 9 P.3d 1046, 1048 (Ariz. 2000), the court explained the rationale for considering an offset for the amount of benefits that are in-lieu of social security benefits. If the social security contributions had not been withheld from the employees' earnings, the community estate would have received those earnings and spent or invested them for the benefit of the community estate. However, as a result of the anti-assignment clause, the future benefits that accrue from the withholdings are diverted from the community for the separate benefit of a spouse. Id.

To put the spouses in the same position for an equitable division, Spouse A's present value of social security benefits that he would have received had he participated in the social security system should be measured and set aside from the present value of the pension benefit of Spouse A. After setting this amount aside for the benefit of Spouse A, the remainder can then be divided. Id.

VI. THE GREAT DEBATE - INCEPTION OF TITLE VS. PROPORTIONAL CHARACTERIZATION

The inception of title rule is well established Texas law. Inception of title occurs when a party first has a right of claim to property by virtue of which title is finally vested. Welder v. Lambert, 34 S.W. 281 (Tex. 1898). The existence or non-existence of the marriage at the time of the incipiency of the right by which title eventually vests determines whether the property is community or separate. *See* Jensen v. Jensen, 665 S.W.2d at 109).

Texas law, however, is far from consistent. For example, if an employee begins accruing benefits in a defined benefit plan prior to marriage, quite clearly that employee's claim to that plan arose prior to marriage. However, the Texas Supreme Court has held that the court shall, at the time of the divorce, determine the community interest in a defined benefit plan by mathematical apportionment. One calculates the community property by dividing the number of months during the marriage in which the plan's interest was accruing over the total number of months of accrual. Taggart, 552 S.W.2d at 424. In other words, with regard to defined benefit plans, Texas law rejects the inception of title rule in favor of a concept of time apportionment rule.

The tension existing between these two principles is manifest.

In an analogous situation, in the mid 1980s the Texas courts considered the characterization of stock in a printing company that increased dramatically in value during marriage as a result of the expenditure of community time, toil and effort. Initially, the Tyler Court of Appeals held that, if the value of separate property stock increased because of the community time, talent and industry of a spouse (which exceeds that amount required to preserve the separate property) then the increase in value is community property. Jensen v. Jensen, 629 S.W.2d 222 (Tex. App. – Tyler 1982) *rev'd* 665 S.W.2d 107 (Tex. 1984). The Texas Supreme Court first affirmed this decision. 26 Tex. Sup. Ct. 480 (1983). On re-hearing, however, the Texas Supreme Court applied the inception of title rule to re-affirm the rule that all property held before marriage remains the separate property of a spouse as determined by the origin of the title to the property, irrespective of later events. 665 S.W.2d at 109.

In the employment law area, two cases highlight the inherent conflict between inception of title and proportional ownership.

The first such case involved stock options and applied the inception of title principle. Charriere v. Charriere, 7 S.W.3d 217 (Tex. App. – Dallas 1999, no pet.). In Charriere, during the marriage, wife's employer granted her options to purchase 80,000 shares of stock. These particular stock options, however, performed much like restricted stock. The wife could exercise the options at any time; however, the option agreement subjected the acquired stock to transfer restrictions that lapsed sequentially over a period of ten years. During this ten-year period, the husband filed for divorce. At the time of divorce, 64,000 shares remained subject to the restrictions. The trial court treated all of the stock options as community property and awarded fifty percent of those options to the husband.

On appeal, the wife argued that the options should not be classified as community property because their continued existence was contingent upon wife's post-

divorce continued employment with the company. The appellate court applied the inception of title rule in upholding the trial court's decision that the 64,000 remaining stock options were community property. Id.

At the other end of the spectrum is the decision of the Fort Worth Court of Appeals in Loaiza v. Loaiza, 130 S.W.3d 894 (Tex. App. – Fort Worth 2004, no pet.). Loaiza involved a professional athlete's contract. Loaiza contracted with the Toronto Blue Jays during the parties' marriage. The wife argued that the contract was a "guaranteed contract" under which the right to payments, including post-divorce payments, accrued upon execution, as opposed to when the services were performed. Wife asserted a classic inception of title argument.

Husband responded by directing the trial court and later the appellate court to provisions of the contract relieving the club from the duty to pay husband upon husband's voluntary retirement, labor dispute, suspension, self-injury, substance abuse, engaging in an inherently dangerous activity, incapacitation due to a criminal act or refusal to render services. 130 S.W.3d at 906. After reviewing the contract as a whole, the appellate court affirmed the trial court's judgment and ruled that "it is clear that it was the intent of the parties that appellee render skilled services as a baseball player in exchange for payment of $5,800,000 for the year 2002." 130 S.W.3d at 909. Accordingly, the appellate court upheld the trial court's judgment that the payments due after the date of divorce were husband's separate property.

Interestingly, the player's contract also contained a provision providing for the continuation of the payments to husband if the contract were terminated because the husband failed to exhibit sufficient skill, even in the case of death or physical or mental incapacity. The trial court awarded wife sixty percent of any monies received post-divorce pursuant to this specific provision of the contract, and the appellate court affirmed. 130 S.W.3d at 910.

VII. CHALLENGING TYPES OF COMPENSATION

Employers and high value employees commonly enter into complex compensation schemes involving a multitude of different compensation vehicles: Many of these fall under the description of "Golden Handcuffs." Golden Handcuffs are generally described as a system of financial incentives designed to discourage an employee from leaving a company. *See* In re Dondi Financial Corp., 4 Tex. Bankr. Ct. Rep. 332 (Bankr. N.D. Tex., Aug. 20, 1990) (referring to a stock purchase opportunity as a form of compensation to entice valuable employees to remain with the company). These programs include restricted stock, subsequently vesting stock options, performance units, phantom stock, and some forms of deferred compensation.

A "Golden Parachute" is distinct. The term "Golden Parachute" refers, generally, to agreements between a corporation and its top officers which guarantee these officers continued employment, payment of lump sums and other benefits in the event of a change of corporate ownership. Texas Federal and Loan Assn. v. Sealock, 737 S.W.2d 870 (Tex. App. - Dallas 1987) *rev'd*, 755 S.W.2d 69 (Tex. 1988). The company's obligations to the employee are triggered in the event that another firm acquires the company and the key employee is terminated as a result of the merger or takeover. Golden Parachutes have positive aspects and negative aspects. For example, Golden Parachutes reduce the risk to an executive taking a position with a company that may be a likely participant in a takeover or merger. This, arguably, enables the company to obtain and retain top executives. On the other hand, these packages may be so generous that a potential acquiring company or a potential merger partner is discouraged by the liability to the executives that a merger or acquisition would create.

The discussion below addresses issues arising in certain types of executive compensation.

A. Phantom Stock and Performance Units. Phantom stock is a form of employee benefit that awards to an employee the right to economic benefits of ownership of stock, without actually owning the stock. *See* Carbona v. CH Med, Inc., 266 S.W.3d 675 (Tex. App. – Dallas 2008, no pet.). "Performance Units" are a very similar concept.

Conflicting arguments exist with regard to performance units. Pursuant to the pre-2005 stock option case Charriere, 7 S.W.3d 217, an argument exists under the inception of title rule, that when an employer grants an employee performance units or restricted stock during marriage, they are entirely community property. However, these compensation vehicles are in many respects analogous to stock options and restricted stock

as addressed in TFC Section 3.007. Family Code Section 3.007 specifically addresses stock options and specifically addresses restricted stock. There is no "catch all" language in this section. The section makes no reference to either performance units or restricted stock.

B. Bonuses. Many companies routinely award bonuses periodically throughout the year or, even more common, at the end of a year. The question of how to treat a bonus that may (or may not) be paid in December, with respect to a trial being conducted in August, arises in many cases. Remarkably, the authors were not able to locate a Texas case specifically dealing with this issue. However, the section of this paper above discusses multiple out-of-state cases addressing bonuses.

C. Automatic Renewal Commission Contracts. Term life insurance contracts virtually always contain automatic renewal provisions. When these automatic renewals occur, the selling life insurance agent often receives a commission. Once the initial sale of life insurance has occurred, the renewal contract commission stream is set into place. Other types of sales often involve renewals or automatic renewals in a continuing stream of renewal premium commissions with or without the requirement of any additional expenditure of effort on behalf of the selling agent.

These contracts raise interesting issues as to the characterization of the renewal premiums, especially in the scenario common in life insurance where no additional action whatsoever on behalf of the agent is necessary.

In Texas, the law in this area is far from clear. The Vibrock decision from the Fort Worth Court of Appeals in 1977 held that the renewal commissions were not community property but were "a mere expectancy." Vibrock v. Vibrock, 549 S.W.2d 775 (Tex. Civ. App. – Fort Worth 1977, writ ref'd n.r.e. *per curiam*, 561 S.W.2d 776 (Tex. 1977)). The Supreme Court was critical of this holding when it reviewed the opinion at the time that a writ of error was sought. 561 S.W.2d at 776 (Tex. 1977).

Accordingly, while there is no clear authority in Texas on this issue at this time, the viability of the Vibrock decision is highly questionable at least.

D. Prepayments of Compensation. The concept of an employer paying an employee or an independent contractor in advance for services to be provided in the future is simple. Related fact patterns such as an employer advancing a loan to a new employee with an agreement to forgive the loan sequentially over a specified number of years, are also common. Remarkably, however, the authors were not able to locate any Texas case addressing either of these issues. Out-of-state cases addressing these issues are discussed above.

VIII. CONTRACT SCENARIOS SPECIFIC DISCUSSION EXAMPLES

A. Prepayment. Employer hires husband to perform services for a one-year period. Employer pays husband $120,000 in advance for these services. Husband is obligated to provide a set number of hours of services per month for each month (the same) during the contract period. The parties divorce two months into the twelve-month period.

B. Post-Termination Profit Sharing. Husband signs an employment agreement in early 2011. The employment agreement provides that husband shall participate in a profit sharing plan. If husband remains with the company for four years (through 2014), then for each of the following four years (2015 - 2019) (after termination of employment), he shall receive specified percentages of company profits for each of these four years. Three years into the four year employment period (2013), husband divorces. Husband claims that, since he will receive nothing unless he continues to work (after the divorce) through the end of year 2014, wife has no interest in any of the profit-sharing payments that accrue to him post-divorce.

C. Performance Units. After 10 years of employment (all during the marriage), on January 1, 2012, Wife's employer grants her 100,000 performance units. The units cliff vest and become payable in 5 years. The value of each unit is equal to the increase in the value of the stock of the employer between the grant date and the vesting date. If wife's employment ends before the vesting date, Wife forfeits her entire interest. The performance unit award plan states that the units are awarded to reward key employees for their "past and future" service to the company. The divorce will be granted January 1, 2014.

D. Guaranteed Contract. Wife signs an employment contract during the marriage, which

guarantees her employment for five years at a fixed salary. The parties' divorce trial is held on the second anniversary of the signing of the contract.

E. Bonus - Discretionary. Wife's employer routinely awards discretionary end-of-year bonuses. Wife has worked for the employer for 10 years and has received a bonus every year. In January of 2013, husband files for divorce. The divorce case is tried in July of 2013. Husband claims 50% of wife's December 2013 bonus.

F. Bonus - Contractual. Husband signs an employment agreement that contained a contractual right to a bonus based upon a formula set forth in his employment contract. The bonus is payable every year on December 31st based upon husband's performance during the preceding calendar year. Wife files for divorce in January of 2013 and the parties try their divorce case on July 31, 2013.

G. Bonus – Paid Immediately - Divorce Prior to End of Contract Term. Husband signs an employment contract during the marriage, which guarantees him employment for five years at a fixed salary. The contract includes a million dollar bonus payable to husband at the signing of the contract and requires husband to work all five years or repay a pro-rata portion of the bonus. Upon execution, husband places the entire bonus into a new account, where it remains when the parties' divorce trial is held on the second anniversary of the signing of the contract.

H. Bonus Payment Delayed - Divorce Prior to End of Contract Term. Wife signs an employment contract during the marriage, which guarantees wife employment for five years at a fixed salary. The contract includes a million dollar bonus payable to wife at the end of the five-year contract period, provided wife has completed five years of employment. The parties' divorce trial is held on the second anniversary of the signing of the contract.

I. Signing Bonus Prior to Marriage- Bonus Paid Immediately. Prior to marriage, future husband signs an employment contract, which guarantees him employment for five years at a fixed salary. The contract includes a million dollar bonus payable to future husband at the signing of the contract and requires husband to work all five years or forfeit a pro-rata portion of the bonus. Upon execution, husband places the entire bonus into a segregated account and carefully withdraws each interest payment immediately upon receipt. The parties are subsequently married on the second anniversary of the signing of the contract. The parties' divorce trial is held on the fourth anniversary of the signing of the contract.

J. Signing Bonus Prior to Marriage - Bonus Payment Delayed. Prior to marriage, future wife signs an employment contract, which guarantees her employment for five years at a fixed salary. The contract includes a million dollar bonus payable to wife at the end of the five-year contract period. The parties are subsequently married on the second anniversary of the signing of the contract. The parties' divorce is pending on the fifth anniversary of the signing of the contract and the funds are placed into the registry of the court upon distribution by the employer company.

K. Signing Loan Forgiven Over Time. Husband signs an employment contract during the marriage, which guarantees husband employment for five years at a fixed salary. The contract includes a million dollar "loan" to husband at the signing of the contract. The contract provides that one-fifth of the loan will be forgiven each year on the anniversary of the signing of the contract. The contract further provides that, if husband does not complete the five-year term, he must repay the unforgiven portion of the loan within ninety days of the termination of his employment. Husband deposits the entire amount into a segregated account, where it remains as the parties' divorce trial is held on the second anniversary of the signing of the contract.

L. Informal Loan. Wife receives a million dollars from her employer in a lump sum during the marriage. Wife and her employer have an informal understanding that this lump sum is a "loan," but no formal contract is signed and no documents exist to evidence the agreement. The informal agreement between wife and her employer is that one-fifth of the loan will be forgiven each year on the anniversary of the payment of the million dollars. The agreement further provides that, if wife does not complete the five-year term, she must repay the unforgiven portion of the loan within ninety days of the termination of her employment. Wife deposits the entire amount into a segregated account, where it remains as the parties' divorce trial is held on the second anniversary of the delivery of the million dollars to wife.

M. Future Bonus - Determinative Period All Post-Divorce. Husband signs an employment contract during the marriage, which guarantees husband employment for six years at a fixed salary. The contract includes a bonus payable to husband on the sixth anniversary of the signing of the contract and requires husband to work all six years or forfeit any right to the bonus. The bonus is to be calculated by using a look-back provision, which entitles husband to a bonus in the amount of five percent of the cumulative gross revenues for the highest three consecutive years of gross revenue. The parties' divorce trial is held on the second anniversary of the signing of the contract. Husband continues to work for the company post- divorce. On the sixth anniversary of the signing of the contract, the company determines that the highest three consecutive years of gross revenue were the fourth, fifth and sixth years of the contract.

N. Future Bonus - Determinative Period Includes Both Pre- and Post- Divorce. Wife signs an employment contract during the marriage, which guarantees her employment for six years at a fixed salary. The contract includes a bonus payable to wife on the sixth anniversary of the signing of the contract and requires wife to work all six years or forfeit any right to the bonus. The bonus is to be calculated by using a look-back provision, which entitles wife to a bonus in the amount of five percent of the cumulative gross revenues for the highest three consecutive years of gross revenue. The parties' divorce trial is held on the second anniversary of the signing of the contract. Wife continues to work for the company post-divorce. On the sixth anniversary of the signing of the contract, the company determines that the highest three consecutive years of gross revenue were the first, second and third years of the contract.

CONCLUSION

Texas is an interesting state. While purporting to adhere to the "gold standard" rule of inception of title, in the last half century, Texas has adopted time proportional characterization rules, both by case law and by statute. In few areas of the law do these two principles collide more violently than in the area of employment compensation, benefits and contracts.

The interaction of employment compensation and marital property law is complex and confusing. As a result, overlooking, mis-characterizing, or mis-valuing these assets occurs too often. As just one example, the issues surrounding survivor annuities and reversionary interests pose challenges to family law attorneys. Opportunities for creative lawyering and creative arguments abound.

APPENDIX 1

[redacted] Defined Benefit Retirement Plan

Final

Early Retirement (55 & 10)

Name: [redacted]	BU:	0	Date of Hire:	07/06/1987
SSN: [redacted]			Termination Date:	06/30/2009
Age:	56.0833		Commencement Date:	10/01/2009
			Normal Retirement Date:	08/17/2018
Years of Vesting Service:	22.500		Date of Birth:	[redacted]
Years of Benefit Service:			Beneficiary Date of Birth:	[redacted]
Actual:	22.000			
Projected:	31.167		FAC at Termination:	[redacted]

		Pre 10/1/89	Post 9/30/89
	FAC up to Social Security CC:	$80,052.00	$80,052.00
	times %:	X 0.7%	X 1.3%
		560.36	1,040.68
Plus			
	FAC over Social Security CC:	145,948.00	145,948.00
	times %:	X 0.7%	X 1.7%
		1,021.64	2,481.12
Equals		1,582.00	3,521.80
	times Projected Benefit Service:	2.250	19.750
	Equals Projected Benefit:	3,559.50	69,555.55
	Maximum Benefit:	N/A	N/A
	Lesser of Projected and Maximum Benefit:	3,559.50	69,555.55
	Times length of service ratio:	1.0000	1.0000
	Equals Accrued Benefit:	3,559.50 +	69,555.55

1	Annual Benefit before Cash Balance Annuity		$73,115.05
2	Cash Balance Annuity:		0.00
3	Grandfathered Benefit at September 30, 1995 for International Directors:		0.00
4	Annual Benefit under Ernst & Young Defined Benefit Plan (Maximum of 1, 2, and 3):		$73,115.05
5	Offset		0.00
6	Monthly Benefit		$6,092.92
7	Months Early		107
8	Early Retirement Factor		0.554167
9	Reduced Monthly Benefit		$3,376.49
10	Age at Date of Lump Sum to be Paid		N/A
11	Interest Rate/Actuarial Factor	#N/A	N/A
12	Preliminary Lump Sum Payment		N/A
13	Cash Balance Account		#VALUE!
14	Lump Sum Payment (Maximum of 12 and 13)		#VALUE!

[redacted]DEFINED BENEFIT RETIREMENT PLAN
[redacted] OF PAYMENT SCHEDULE
[redacted]
WITHOUT OFFSET
COMMENCEMENT DATE: 10/01/2009

Forms of payments	To Participant	To Beneficiary
Life Annuity:	$3,377	N/A
Regular Joint & Survivor:		
25%	$3,302	$826
50%	$3,229	$1,615
75%	$3,161	$2,371
100%	$3,094	$3,094
Joint & Survivor With Pop Up:		
25%	$3,288	$822
50%	$3,204	$1,602
75%	$3,124	$2,343
100%	$3,048	$3,048
Certain and Life:		
5 year	$3,356	$3,356
10 year	$3,302	$3,302
15 year	$3,224	$3,224

The benefit options and monthly amounts are based, in part, on the following information which we have in your file:

Your Date of Birth:	08/17/1953	Date of Termination:	06/30/2009
Benefi. Date of Birth:	08/01/1949	Service Credits:	22.00000
Date of Hire:	07/06/1987	Final Average Comp:	[redacted]

APPENDIX 2

Rudd and Wisdom, Inc.

CONSULTING ACTUARIES

Steven T. Anderson, F.S.A.
Mitchell L. Bilbe, F.S.A.
Evan L. Dial, F.S.A.
Philip S. Dial, F.S.A.
Charles V. Faerber, F.S.A., A.C.A.S.
Mark R. Fenlaw, F.S.A.
Carl L. Frammolino, F.S.A.

Kenneth J. Herbold, A.S.A.
Christopher S. Johnson, F.S.A.
Robert M. May, F.S.A.
J. Christopher McCaul, F.S.A.
Edward A. Mire, F.S.A.

Rebecca B. Morris, A.S.A.
Michael J. Muth, F.S.A.
Khiem Ngo, F.S.A.
Coralie A. Taylor, A.S.A.
Ronald W. Tobleman, F.S.A.
Kenneth Torng, A.S.A.
David G. Wilkes, F.S.A.

October 3, 2013

Mr. Larry L. Martin
Geary, Porter & Donovan, P.C.
16475 Dallas Parkway, Suite 400
Addison, Texas 75001

Re: [redacted]

Dear Mr. Martin:

At your request and based on information you have provided, I have determined the present value of [redacted] accrued pension benefits. Mr. [redacted] is retired from [redacted] and he has pension benefits from two sources from that employment. The first source is the [redacted] Defined Benefit Retirement Plan, a qualified pension plan. The second source is the [redacted] U.S. LLP and Participating Firms Top-Hat Plan. The Top-Hat Plan is a nonqualified plan that pays benefits in excess of those allowed in qualified pension plans. In both plans Mr. [redacted] has elected a Joint and 100% to Survivor Annuity. Please note that I have determined the value of the Survivor Benefits for the Joint and Survivor option because that portion of the pension is paid to the beneficiary (i.e., Mrs. [redacted]). The present value of Mr. [redacted] accrued benefit in the defined benefit plan is $596,960. The present value of the survivor benefit from the defined benefit plan is $73,953. The present value of Mr. [redacted] accrued benefit in the Top-Hat plan is $2,698,541. The present value of the survivor benefit from the Top-Hat plan is $334,303.

Exhibits 1A, 1B, and 1C display the calculations performed to determine the present value of Mr. [redacted] Joint and Survivor benefit in the Defined Benefit plan. Exhibit 1A displays the present value of payments to be made while Mr. [redacted] is alive ($523,007). Exhibit 1B displays the present value of payments to be made while Mrs. [redacted] is alive ($511,949). Exhibit 1C displays the present value of payments to be made while Mr. [redacted] and Mrs. [redacted] are both alive ($437,996). The present value of the Survivor Benefit is the difference between the

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Austin, Texas 78759

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Austin, Texas 78720-4209

values obtained in Exhibits 1B and 1C ($73,953 = $511,949 - $437,996). The present value of the entire benefit is the sum of the value of the benefit Mr. [redacted] will receive while he is alive with the value of the benefit Mrs. [redacted] will receive while he is alive less the value of the benefit payable while they are both alive ($596,960 = $523,007 + $511,949 - $437,996).

Exhibits 2A, 2B, and 2C display the calculations performed to determine the present value of Mr. [redacted] Joint and Survivor benefit in the Top-Hat plan. Exhibit 2A displays the present value of payments to be made while Mr. [redacted] is alive ($2,364,238). Exhibit 2B displays the present value of payments to be made while Mrs. [redacted] is alive ($2,314,251). Exhibit 1C displays the present value of payments to be made while Mr. [redacted] and Mrs. [redacted] are both alive ($1,979,948). The present value of the Survivor Benefit is the difference between the values obtained in Exhibits 2B and 2C ($334,303 = $2,314,251 - $1,979,948). The present value of the entire benefit is the sum of the value of the benefit Mr. [redacted] will receive while he is alive with the value of the benefit Mrs. [redacted] will receive while he is alive less the value of the benefit payable while they are both alive ($2,698,541 = $2,364,238 + $2,314,251 - $1,979,948).

The determination of the present value of Mr. [redacted] accrued retirement benefits is based upon the following information and assumptions:

1. **Names:**
   a. ***Plan participant*** - [redacted]
   b. ***Beneficiary*** – [redacted]
2. ***Dates of birth:***
   a. [redacted]
   b. [redacted]
3. **Current ages:**
   a. [redacted] – 60 years, 1 month
   b. [redacted] – 64 years, 2 months
4. **Current health:**
   a. [redacted] – Average
   b. [redacted] – Average
5. **Applicable retirement plans** – both for Mr. [redacted]
   a. [redacted] Defined Benefit Retirement Plan
   b. [redacted] U.S. LLP and Participating Firms Top-Hat Plan.
6. **Post-retirement increases in benefit** – None

Mr. Larry Martin
Page 3
October 3, 2013

7. **Interest discount rate** – 4.00% per year

8. **Probability of death:**
   a. [redacted] – RP-2000 Mortality Table for Males.
   b. [redacted] – RP-2000 Mortality Table for Females.

9. **Monthly Benefits**
   a. [redacted] Defined Benefit Retirement Plan - $3,094.00
   b. [redacted] U.S. LLP and Participating Firms Top-Hat Plan - $13,986.33

Sincerely,

Charles V Faerber

Charles V. Faerber, F.S.A., A.C.A.S.

CVF: ms
N:\Clients\EW\WordDocs\2013\Martin\[redacted]

Exhibit 1A

Present Value of [redacted] Standard Retirement Benefits
Assuming Benefits Are Being Paid at Attained Age 60

Name - [redacted] *Attained Age* - 60
Mortality Basis - RP-2000 Mortality Table For Retired Males (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2013 -14	1	N/A	$ 37,128.00	4.00%	0.961538	1.000000	$ 35,700.00
2014 -15	2	0.00%	37,128.00	4.00	0.924556	1.000000	34,326.92
2015 -16	3	0.00	37,128.00	4.00	0.888996	1.000000	33,006.66
2016 -17	4	0.00	37,128.00	4.00	0.854804	1.000000	31,737.17
2017 -18	5	0.00	37,128.00	4.00	0.821927	1.000000	30,516.51
2018 -19	6	0.00	37,128.00	4.00	0.790315	1.000000	29,342.80
2019 -20	7	0.00	37,128.00	4.00	0.759918	1.000000	28,214.23
2020 -21	8	0.00	37,128.00	4.00	0.730690	1.000000	27,129.07
2021 -22	9	0.00	37,128.00	4.00	0.702587	0.892354	23,277.63
2022 -23	10	0.00	37,128.00	4.00	0.675564	0.874413	21,932.34
2023 -24	11	0.00	37,128.00	4.00	0.649581	0.854996	20,620.49
2024 -25	12	0.00	37,128.00	4.00	0.624597	0.833989	19,340.23
2025 -26	13	0.00	37,128.00	4.00	0.600574	0.811237	18,089.05
2026 -27	14	0.00	37,128.00	4.00	0.577475	0.786586	16,864.79
2027 -28	15	0.00	37,128.00	4.00	0.555265	0.759920	15,666.41
2028 -29	16	0.00	37,128.00	4.00	0.533908	0.731170	14,493.93
2029 -30	17	0.00	37,128.00	4.00	0.513373	0.700337	13,348.79
2030 -31	18	0.00	37,128.00	4.00	0.493628	0.667487	12,233.32
2031 -32	19	0.00	37,128.00	4.00	0.474642	0.632695	11,149.69
2032 -33	20	0.00	37,128.00	4.00	0.456387	0.596045	10,099.83
2033 -34	21	0.00	37,128.00	4.00	0.438834	0.557679	9,086.27
2034 -35	22	0.00	37,128.00	4.00	0.421955	0.517503	8,107.39
2035 -36	23	0.00	37,128.00	4.00	0.405726	0.475852	7,168.14
2036 -37	24	0.00	37,128.00	4.00	0.390121	0.433159	6,274.06
2037 -38	25	0.00	37,128.00	4.00	0.375117	0.389939	5,430.81
2038 -39	26	0.00	37,128.00	4.00	0.360689	0.346750	4,643.57
2039 -40	27	0.00	37,128.00	4.00	0.346817	0.304171	3,916.68
2040 -41	28	0.00	37,128.00	4.00	0.333477	0.262790	3,253.70
2041 -42	29	0.00	37,128.00	4.00	0.320651	0.223217	2,657.43
2042 -43	30	0.00	37,128.00	4.00	0.308319	0.186069	2,129.98
2043 -44	31	0.00	37,128.00	4.00	0.296460	0.151942	1,672.43
2044 -45	32	0.00	37,128.00	4.00	0.285058	0.121589	1,286.85
2045 -46	33	0.00	37,128.00	4.00	0.274094	0.095252	969.34
2046 -47	34	0.00	37,128.00	4.00	0.263552	0.072995	714.27
2047 -48	35	0.00	37,128.00	4.00	0.253415	0.054696	514.62
2048 -49	36	0.00	37,128.00	4.00	0.243669	0.040065	362.47
2049 -50	37	0.00	37,128.00	4.00	0.234297	0.028691	249.58
2050 -51	38	0.00	37,128.00	4.00	0.225285	0.020088	168.02
2051 -52	39	0.00	37,128.00	4.00	0.216621	0.013754	110.62
2052 -53	40	0.00	37,128.00	4.00	0.208289	0.009212	71.24
2053 -54	41	0.00	37,128.00	4.00	0.200278	0.006038	44.90
2054 -55	42	0.00	37,128.00	4.00	0.192575	0.003873	27.69
2055 -56	43	0.00	37,128.00	4.00	0.185168	0.002433	16.73
2056 -57	44	0.00	37,128.00	4.00	0.178046	0.001501	9.92
2057 -58	45	0.00	37,128.00	4.00	0.171198	0.000913	5.80
2058 -59	46	0.00	37,128.00	4.00	0.164614	0.000550	3.36

Exhibit 1A

Present Value of [redacted] Standard Retirement Benefits
Assuming Benefits Are Being Paid at Attained Age 60

Name - [redacted] *Attained Age* - 60
Mortality Basis - RP-2000 Mortality Table For Retired Males (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2059 -60	47	0.00	37,128.00	4.00	0.158283	0.000330	1.94
2060 -61	48	0.00	37,128.00	4.00	0.152195	0.000198	1.12
2061 -62	49	0.00	37,128.00	4.00	0.146341	0.000119	0.64
2062 -63	50	0.00	37,128.00	4.00	0.140713	0.000071	0.37
2063 -64	51	0.00	37,128.00	4.00	0.135301	0.000043	0.21
2064 -65	52	0.00	37,128.00	4.00	0.130097	0.000026	0.12
2065 -66	53	0.00	37,128.00	4.00	0.125093	0.000015	0.07
2066 -67	54	0.00	37,128.00	4.00	0.120282	0.000009	0.04
2067 -68	55	0.00	37,128.00	4.00	0.115656	0.000006	0.02
2068 -69	56	0.00	37,128.00	4.00	0.111207	0.000003	0.01
2069 -70	57	0.00	37,128.00	4.00	0.106930	0.000002	0.01
2070 -71	58	0.00	37,128.00	4.00	0.102817	0.000001	0.00
2071 -72	59	0.00	37,128.00	4.00	0.098863	0.000001	0.00
2072 -73	60	0.00	37,128.00	4.00	0.095060	0.000000	0.00

Total Present Value of Payments Made Annually	$ 505,990.28
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually	17,016.99
Total Present Value of Payments Made Monthly	$ 523,007.27

Exhibit 1B

Present Value of [redacted] Standard Spouse Benefits
Assuming Benefits Are Being Paid at Attained Age 64

Name - [redacted] *Attained Age* - 64
Mortality Basis - RP-2000 Mortality Table For Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2013 -14	1	N/A	$ 37,128.00	4.00%	0.961538	1.000000	$ 35,700.00
2014 -15	2	0.00%	37,128.00	4.00	0.924556	1.000000	34,326.92
2015 -16	3	0.00	37,128.00	4.00	0.888996	1.000000	33,006.66
2016 -17	4	0.00	37,128.00	4.00	0.854804	1.000000	31,737.17
2017 -18	5	0.00	37,128.00	4.00	0.821927	1.000000	30,516.51
2018 -19	6	0.00	37,128.00	4.00	0.790315	1.000000	29,342.80
2019 -20	7	0.00	37,128.00	4.00	0.759918	1.000000	28,214.23
2020 -21	8	0.00	37,128.00	4.00	0.730690	1.000000	27,129.07
2021 -22	9	0.00	37,128.00	4.00	0.702587	0.878438	22,914.62
2022 -23	10	0.00	37,128.00	4.00	0.675564	0.858260	21,527.18
2023 -24	11	0.00	37,128.00	4.00	0.649581	0.836411	20,172.25
2024 -25	12	0.00	37,128.00	4.00	0.624597	0.812903	18,851.24
2025 -26	13	0.00	37,128.00	4.00	0.600574	0.787730	17,564.90
2026 -27	14	0.00	37,128.00	4.00	0.577475	0.760865	16,313.31
2027 -28	15	0.00	37,128.00	4.00	0.555265	0.732260	15,096.17
2028 -29	16	0.00	37,128.00	4.00	0.533908	0.701867	13,913.06
2029 -30	17	0.00	37,128.00	4.00	0.513373	0.669666	12,764.18
2030 -31	18	0.00	37,128.00	4.00	0.493628	0.635660	11,650.01
2031 -32	19	0.00	37,128.00	4.00	0.474642	0.599876	10,571.34
2032 -33	20	0.00	37,128.00	4.00	0.456387	0.562380	9,529.39
2033 -34	21	0.00	37,128.00	4.00	0.438834	0.523285	8,525.90
2034 -35	22	0.00	37,128.00	4.00	0.421955	0.482759	7,563.08
2035 -36	23	0.00	37,128.00	4.00	0.405726	0.441060	6,644.05
2036 -37	24	0.00	37,128.00	4.00	0.390121	0.398570	5,773.06
2037 -38	25	0.00	37,128.00	4.00	0.375117	0.355802	4,955.38
2038 -39	26	0.00	37,128.00	4.00	0.360689	0.313407	4,197.04
2039 -40	27	0.00	37,128.00	4.00	0.346817	0.272137	3,504.20
2040 -41	28	0.00	37,128.00	4.00	0.333477	0.232785	2,882.19
2041 -42	29	0.00	37,128.00	4.00	0.320651	0.196094	2,334.52
2042 -43	30	0.00	37,128.00	4.00	0.308319	0.162673	1,862.16
2043 -44	31	0.00	37,128.00	4.00	0.296460	0.132936	1,463.23
2044 -45	32	0.00	37,128.00	4.00	0.285058	0.107079	1,133.29
2045 -46	33	0.00	37,128.00	4.00	0.274094	0.085087	865.90
2046 -47	34	0.00	37,128.00	4.00	0.263552	0.066773	653.39
2047 -48	35	0.00	37,128.00	4.00	0.253415	0.051819	487.56
2048 -49	36	0.00	37,128.00	4.00	0.243669	0.039829	360.33
2049 -50	37	0.00	37,128.00	4.00	0.234297	0.030371	264.20
2050 -51	38	0.00	37,128.00	4.00	0.225285	0.022935	191.84
2051 -52	39	0.00	37,128.00	4.00	0.216621	0.017098	137.52
2052 -53	40	0.00	37,128.00	4.00	0.208289	0.012549	97.05
2053 -54	41	0.00	37,128.00	4.00	0.200278	0.009047	67.28
2054 -55	42	0.00	37,128.00	4.00	0.192575	0.006395	45.73
2055 -56	43	0.00	37,128.00	4.00	0.185168	0.004427	30.43
2056 -57	44	0.00	37,128.00	4.00	0.178046	0.002998	19.82
2057 -58	45	0.00	37,128.00	4.00	0.171198	0.001986	12.63
2058 -59	46	0.00	37,128.00	4.00	0.164614	0.001288	7.87

Exhibit 1B

Present Value of [redacted] Standard Spouse Benefits
Assuming Benefits Are Being Paid at Attained Age 64

Name - [redacted] *Attained Age -* 64
Mortality Basis - RP-2000 Mortality Table For Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2059 -60	47	0.00	37,128.00	4.00	0.158283	0.000818	4.81
2060 -61	48	0.00	37,128.00	4.00	0.152195	0.000511	2.88
2061 -62	49	0.00	37,128.00	4.00	0.146341	0.000313	1.70
2062 -63	50	0.00	37,128.00	4.00	0.140713	0.000190	0.99
2063 -64	51	0.00	37,128.00	4.00	0.135301	0.000114	0.57
2064 -65	52	0.00	37,128.00	4.00	0.130097	0.000069	0.33
2065 -66	53	0.00	37,128.00	4.00	0.125093	0.000041	0.19
2066 -67	54	0.00	37,128.00	4.00	0.120282	0.000025	0.11
2067 -68	55	0.00	37,128.00	4.00	0.115656	0.000015	0.06
2068 -69	56	0.00	37,128.00	4.00	0.111207	0.000009	0.04

Total Present Value of Payments Made Annually	$ 494,932.34
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually	17,016.95
Total Present Value of Payments Made Monthly	$ 511,949.29

Exhibit 1C

Present Value of [redacted] Standard Retirement Benefits
To Be Paid While Both the Participant and the Beneficiary Are Living

Participant Name - [redacted] Participant Age - 60
Participant Mortality Basis - RP-2000 Mortality Table For Active & Retired Males (1.00 x Standard)
Beneficiary Name - [redacted] Beneficiary Age - 64
Beneficiary Mortality Basis - RP-2000 Mortality Table For Active & Retired Females (1.00 x Standard)

Year	Dur	Payment Increase Rate	Estimated Annual Payment	Int Rate	Interest Discount Factor	Discount for Mortality		Present Value of Payments During Year
						Participant	Beneficiary	
2013 -14	1	N/A	$ 37,128.00	4.00%	0.961538	1.000000	1.000000	$ 35,700.00
2014 -15	2	0.00%	37,128.00	4.00	0.924556	1.000000	1.000000	34,326.92
2015 -16	3	0.00	37,128.00	4.00	0.888996	1.000000	1.000000	33,006.66
2016 -17	4	0.00	37,128.00	4.00	0.854804	1.000000	1.000000	31,737.17
2017 -18	5	0.00	37,128.00	4.00	0.821927	1.000000	1.000000	30,516.51
2018 -19	6	0.00	37,128.00	4.00	0.790315	1.000000	1.000000	29,342.80
2019 -20	7	0.00	37,128.00	4.00	0.759918	1.000000	1.000000	28,214.23
2020 -21	8	0.00	37,128.00	4.00	0.730690	1.000000	1.000000	27,129.07
2021 -22	9	0.00	37,128.00	4.00	0.702587	0.892354	0.878438	20,447.95
2022 -23	10	0.00	37,128.00	4.00	0.675564	0.874413	0.858260	18,823.65
2023 -24	11	0.00	37,128.00	4.00	0.649581	0.854996	0.836411	17,247.20
2024 -25	12	0.00	37,128.00	4.00	0.624597	0.833989	0.812903	15,721.72
2025 -26	13	0.00	37,128.00	4.00	0.600574	0.811237	0.787730	14,249.29
2026 -27	14	0.00	37,128.00	4.00	0.577475	0.786586	0.760865	12,831.82
2027 -28	15	0.00	37,128.00	4.00	0.555265	0.759920	0.732260	11,471.89
2028 -29	16	0.00	37,128.00	4.00	0.533908	0.731170	0.701867	10,172.81
2029 -30	17	0.00	37,128.00	4.00	0.513373	0.700337	0.669666	8,939.23
2030 -31	18	0.00	37,128.00	4.00	0.493628	0.667487	0.635660	7,776.23
2031 -32	19	0.00	37,128.00	4.00	0.474642	0.632695	0.599876	6,688.44
2032 -33	20	0.00	37,128.00	4.00	0.456387	0.596045	0.562380	5,679.95
2033 -34	21	0.00	37,128.00	4.00	0.438834	0.557679	0.523285	4,754.71
2034 -35	22	0.00	37,128.00	4.00	0.421955	0.517503	0.482759	3,913.92
2035 -36	23	0.00	37,128.00	4.00	0.405726	0.475852	0.441060	3,161.58
2036 -37	24	0.00	37,128.00	4.00	0.390121	0.433159	0.398570	2,500.65
2037 -38	25	0.00	37,128.00	4.00	0.375117	0.389939	0.355802	1,932.29
2038 -39	26	0.00	37,128.00	4.00	0.360689	0.346750	0.313407	1,455.33
2039 -40	27	0.00	37,128.00	4.00	0.346817	0.304171	0.272137	1,065.87
2040 -41	28	0.00	37,128.00	4.00	0.333477	0.262790	0.232785	757.41
2041 -42	29	0.00	37,128.00	4.00	0.320651	0.223217	0.196094	521.10
2042 -43	30	0.00	37,128.00	4.00	0.308319	0.186069	0.162673	346.49
2043 -44	31	0.00	37,128.00	4.00	0.296460	0.151942	0.132936	222.33
2044 -45	32	0.00	37,128.00	4.00	0.285058	0.121589	0.107079	137.80
2045 -46	33	0.00	37,128.00	4.00	0.274094	0.095252	0.085087	82.48
2046 -47	34	0.00	37,128.00	4.00	0.263552	0.072995	0.066773	47.69
2047 -48	35	0.00	37,128.00	4.00	0.253415	0.054696	0.051819	26.67
2048 -49	36	0.00	37,128.00	4.00	0.243669	0.040065	0.039829	14.44
2049 -50	37	0.00	37,128.00	4.00	0.234297	0.028691	0.030371	7.58
2050 -51	38	0.00	37,128.00	4.00	0.225285	0.020088	0.022935	3.85
2051 -52	39	0.00	37,128.00	4.00	0.216621	0.013754	0.017098	1.89
2052 -53	40	0.00	37,128.00	4.00	0.208289	0.009212	0.012549	0.89
2053 -54	41	0.00	37,128.00	4.00	0.200278	0.006038	0.009047	0.41
2054 -55	42	0.00	37,128.00	4.00	0.192575	0.003873	0.006395	0.18
2055 -56	43	0.00	37,128.00	4.00	0.185168	0.002433	0.004427	0.07
2056 -57	44	0.00	37,128.00	4.00	0.178046	0.001501	0.002998	0.03

Exhibit 1C

Present Value of [redacted] Standard Retirement Benefits
To Be Paid While Both the Participant and the Beneficiary Are Living

Participant Name - [redacted] Participant Age - 60
Participant Mortality Basis - RP-2000 Mortality Table For Active & Retired Males (1.00 x Standard)
Beneficiary Name - [redacted] Beneficiary Age - 64
Beneficiary Mortality Basis - RP-2000 Mortality Table For Active & Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*		*Present Value of Payments During Year*
						Participant	*Beneficiary*	
2057 -58	45	0.00	37,128.00	4.00	0.171198	0.000913	0.001986	0.01
2058 -59	46	0.00	37,128.00	4.00	0.164614	0.000550	0.001288	0.00
2059 -60	47	0.00	37,128.00	4.00	0.158283	0.000330	0.000818	0.00
2060 -61	48	0.00	37,128.00	4.00	0.152195	0.000198	0.000511	0.00
2061 -62	49	0.00	37,128.00	4.00	0.146341	0.000119	0.000313	0.00
2062 -63	50	0.00	37,128.00	4.00	0.140713	0.000071	0.000190	0.00
2063 -64	51	0.00	37,128.00	4.00	0.135301	0.000043	0.000114	0.00
2064 -65	52	0.00	37,128.00	4.00	0.130097	0.000026	0.000069	0.00
2065 -66	53	0.00	37,128.00	4.00	0.125093	0.000015	0.000041	0.00
2066 -67	54	0.00	37,128.00	4.00	0.120282	0.000009	0.000025	0.00
2067 -68	55	0.00	37,128.00	4.00	0.115656	0.000006	0.000015	0.00
2068 -69	56	0.00	37,128.00	4.00	0.111207	0.000003	0.000009	0.00
Total Present Value of Payments Made Annually								$ 420,979.21
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually								17,017.00
Total Present Value of Payments Made Monthly								$ 437,996.21

Exhibit 2A

Present Value of [redacted] Top-Hat Retirement Benefits
Assuming Benefits Are Being Paid at Attained Age 60

Name - [redacted] *Attained Age* - 60
Mortality Basis - RP-2000 Mortality Table For Retired Males (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2013 -14	1	N/A	$ 167,835.96	4.00%	0.961538	1.000000	$ 161,380.73
2014 -15	2	0.00%	167,835.96	4.00	0.924556	1.000000	155,173.78
2015 -16	3	0.00	167,835.96	4.00	0.888996	1.000000	149,205.56
2016 -17	4	0.00	167,835.96	4.00	0.854804	1.000000	143,466.88
2017 -18	5	0.00	167,835.96	4.00	0.821927	1.000000	137,948.93
2018 -19	6	0.00	167,835.96	4.00	0.790315	1.000000	132,643.20
2019 -20	7	0.00	167,835.96	4.00	0.759918	1.000000	127,541.54
2020 -21	8	0.00	167,835.96	4.00	0.730690	1.000000	122,636.09
2021 -22	9	0.00	167,835.96	4.00	0.702587	0.892354	105,225.78
2022 -23	10	0.00	167,835.96	4.00	0.675564	0.874413	99,144.43
2023 -24	11	0.00	167,835.96	4.00	0.649581	0.854996	93,214.26
2024 -25	12	0.00	167,835.96	4.00	0.624597	0.833989	87,426.91
2025 -26	13	0.00	167,835.96	4.00	0.600574	0.811237	81,770.98
2026 -27	14	0.00	167,835.96	4.00	0.577475	0.786586	76,236.73
2027 -28	15	0.00	167,835.96	4.00	0.555265	0.759920	70,819.53
2028 -29	16	0.00	167,835.96	4.00	0.533908	0.731170	65,519.37
2029 -30	17	0.00	167,835.96	4.00	0.513373	0.700337	60,342.77
2030 -31	18	0.00	167,835.96	4.00	0.493628	0.667487	55,300.32
2031 -32	19	0.00	167,835.96	4.00	0.474642	0.632695	50,401.83
2032 -33	20	0.00	167,835.96	4.00	0.456387	0.596045	45,655.96
2033 -34	21	0.00	167,835.96	4.00	0.438834	0.557679	41,074.21
2034 -35	22	0.00	167,835.96	4.00	0.421955	0.517503	36,649.22
2035 -36	23	0.00	167,835.96	4.00	0.405726	0.475852	32,403.33
2036 -37	24	0.00	167,835.96	4.00	0.390121	0.433159	28,361.70
2037 -38	25	0.00	167,835.96	4.00	0.375117	0.389939	24,549.81
2038 -39	26	0.00	167,835.96	4.00	0.360689	0.346750	20,991.10
2039 -40	27	0.00	167,835.96	4.00	0.346817	0.304171	17,705.25
2040 -41	28	0.00	167,835.96	4.00	0.333477	0.262790	14,708.24
2041 -42	29	0.00	167,835.96	4.00	0.320651	0.223217	12,012.82
2042 -43	30	0.00	167,835.96	4.00	0.308319	0.186069	9,628.50
2043 -44	31	0.00	167,835.96	4.00	0.296460	0.151942	7,560.15
2044 -45	32	0.00	167,835.96	4.00	0.285058	0.121589	5,817.18
2045 -46	33	0.00	167,835.96	4.00	0.274094	0.095252	4,381.88
2046 -47	34	0.00	167,835.96	4.00	0.263552	0.072995	3,228.84
2047 -48	35	0.00	167,835.96	4.00	0.253415	0.054696	2,326.34
2048 -49	36	0.00	167,835.96	4.00	0.243669	0.040065	1,638.53
2049 -50	37	0.00	167,835.96	4.00	0.234297	0.028691	1,128.21
2050 -51	38	0.00	167,835.96	4.00	0.225285	0.020088	759.53
2051 -52	39	0.00	167,835.96	4.00	0.216621	0.013754	500.05
2052 -53	40	0.00	167,835.96	4.00	0.208289	0.009212	322.05
2053 -54	41	0.00	167,835.96	4.00	0.200278	0.006038	202.97
2054 -55	42	0.00	167,835.96	4.00	0.192575	0.003873	125.17
2055 -56	43	0.00	167,835.96	4.00	0.185168	0.002433	75.62
2056 -57	44	0.00	167,835.96	4.00	0.178046	0.001501	44.86
2057 -58	45	0.00	167,835.96	4.00	0.171198	0.000913	26.23
2058 -59	46	0.00	167,835.96	4.00	0.164614	0.000550	15.18

Exhibit 2A

Present Value of [redacted] Top-Hat Retirement Benefits
Assuming Benefits Are Being Paid at Attained Age 60

Name - [redacted] *Attained Age* - 60
Mortality Basis - RP-2000 Mortality Table For Retired Males (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2059 -60	47	0.00	167,835.96	4.00	0.158283	0.000330	8.76
2060 -61	48	0.00	167,835.96	4.00	0.152195	0.000198	5.05
2061 -62	49	0.00	167,835.96	4.00	0.146341	0.000119	2.92
2062 -63	50	0.00	167,835.96	4.00	0.140713	0.000071	1.68
2063 -64	51	0.00	167,835.96	4.00	0.135301	0.000043	0.97
2064 -65	52	0.00	167,835.96	4.00	0.130097	0.000026	0.56
2065 -66	53	0.00	167,835.96	4.00	0.125093	0.000015	0.32
2066 -67	54	0.00	167,835.96	4.00	0.120282	0.000009	0.19
2067 -68	55	0.00	167,835.96	4.00	0.115656	0.000006	0.11
2068 -69	56	0.00	167,835.96	4.00	0.111207	0.000003	0.06
2069 -70	57	0.00	167,835.96	4.00	0.106930	0.000002	0.04
2070 -71	58	0.00	167,835.96	4.00	0.102817	0.000001	0.02
2071 -72	59	0.00	167,835.96	4.00	0.098863	0.000001	0.01
2072 -73	60	0.00	167,835.96	4.00	0.095060	0.000000	0.01

Total Present Value of Payments Made Annually	$ 2,287,313.25
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually	76,924.82
Total Present Value of Payments Made Monthly	$ 2,364,238.07

Exhibit 2B

Present Value of [redacted] Top-Hat Spouse Benefits
Assuming Benefits Are Being Paid at Attained Age 64

Name - [redacted] *Attained Age -* 64
Mortality Basis - RP-2000 Mortality Table For Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2013 -14	1	N/A	$ 167,835.96	4.00%	0.961538	1.000000	$ 161,380.73
2014 -15	2	0.00%	167,835.96	4.00	0.924556	1.000000	155,173.78
2015 -16	3	0.00	167,835.96	4.00	0.888996	1.000000	149,205.56
2016 -17	4	0.00	167,835.96	4.00	0.854804	1.000000	143,466.88
2017 -18	5	0.00	167,835.96	4.00	0.821927	1.000000	137,948.93
2018 -19	6	0.00	167,835.96	4.00	0.790315	1.000000	132,643.20
2019 -20	7	0.00	167,835.96	4.00	0.759918	1.000000	127,541.54
2020 -21	8	0.00	167,835.96	4.00	0.730690	1.000000	122,636.09
2021 -22	9	0.00	167,835.96	4.00	0.702587	0.878438	103,584.81
2022 -23	10	0.00	167,835.96	4.00	0.675564	0.858260	97,312.95
2023 -24	11	0.00	167,835.96	4.00	0.649581	0.836411	91,188.04
2024 -25	12	0.00	167,835.96	4.00	0.624597	0.812903	85,216.45
2025 -26	13	0.00	167,835.96	4.00	0.600574	0.787730	79,401.57
2026 -27	14	0.00	167,835.96	4.00	0.577475	0.760865	73,743.83
2027 -28	15	0.00	167,835.96	4.00	0.555265	0.732260	68,241.76
2028 -29	16	0.00	167,835.96	4.00	0.533908	0.701867	62,893.57
2029 -30	17	0.00	167,835.96	4.00	0.513373	0.669666	57,700.08
2030 -31	18	0.00	167,835.96	4.00	0.493628	0.635660	52,663.52
2031 -32	19	0.00	167,835.96	4.00	0.474642	0.599876	47,787.39
2032 -33	20	0.00	167,835.96	4.00	0.456387	0.562380	43,077.30
2033 -34	21	0.00	167,835.96	4.00	0.438834	0.523285	38,541.05
2034 -35	22	0.00	167,835.96	4.00	0.421955	0.482759	34,188.66
2035 -36	23	0.00	167,835.96	4.00	0.405726	0.441060	30,034.21
2036 -37	24	0.00	167,835.96	4.00	0.390121	0.398570	26,096.93
2037 -38	25	0.00	167,835.96	4.00	0.375117	0.355802	22,400.62
2038 -39	26	0.00	167,835.96	4.00	0.360689	0.313407	18,972.59
2039 -40	27	0.00	167,835.96	4.00	0.346817	0.272137	15,840.62
2040 -41	28	0.00	167,835.96	4.00	0.333477	0.232785	13,028.85
2041 -42	29	0.00	167,835.96	4.00	0.320651	0.196094	10,553.14
2042 -43	30	0.00	167,835.96	4.00	0.308319	0.162673	8,417.83
2043 -44	31	0.00	167,835.96	4.00	0.296460	0.132936	6,614.48
2044 -45	32	0.00	167,835.96	4.00	0.285058	0.107079	5,122.98
2045 -46	33	0.00	167,835.96	4.00	0.274094	0.085087	3,914.26
2046 -47	34	0.00	167,835.96	4.00	0.263552	0.066773	2,953.61
2047 -48	35	0.00	167,835.96	4.00	0.253415	0.051819	2,204.00
2048 -49	36	0.00	167,835.96	4.00	0.243669	0.039829	1,628.87
2049 -50	37	0.00	167,835.96	4.00	0.234297	0.030371	1,194.29
2050 -51	38	0.00	167,835.96	4.00	0.225285	0.022935	867.20
2051 -52	39	0.00	167,835.96	4.00	0.216621	0.017098	621.63
2052 -53	40	0.00	167,835.96	4.00	0.208289	0.012549	438.70
2053 -54	41	0.00	167,835.96	4.00	0.200278	0.009047	304.12
2054 -55	42	0.00	167,835.96	4.00	0.192575	0.006395	206.71
2055 -56	43	0.00	167,835.96	4.00	0.185168	0.004427	137.58
2056 -57	44	0.00	167,835.96	4.00	0.178046	0.002998	89.59
2057 -58	45	0.00	167,835.96	4.00	0.171198	0.001986	57.08
2058 -59	46	0.00	167,835.96	4.00	0.164614	0.001288	35.59

Exhibit 2B

Present Value of [redacted] Top-Hat Spouse Benefits
Assuming Benefits Are Being Paid at Attained Age 64

Name - [redacted] *Attained Age* - 64
Mortality Basis - RP-2000 Mortality Table For Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*	*Present Value of Payments During Year*
2059 -60	47	0.00	167,835.96	4.00	0.158283	0.000818	21.74
2060 -61	48	0.00	167,835.96	4.00	0.152195	0.000511	13.04
2061 -62	49	0.00	167,835.96	4.00	0.146341	0.000313	7.70
2062 -63	50	0.00	167,835.96	4.00	0.140713	0.000190	4.49
2063 -64	51	0.00	167,835.96	4.00	0.135301	0.000114	2.60
2064 -65	52	0.00	167,835.96	4.00	0.130097	0.000069	1.50
2065 -66	53	0.00	167,835.96	4.00	0.125093	0.000041	0.86
2066 -67	54	0.00	167,835.96	4.00	0.120282	0.000025	0.50
2067 -68	55	0.00	167,835.96	4.00	0.115656	0.000015	0.29
2068 -69	56	0.00	167,835.96	4.00	0.111207	0.000009	0.17
Total Present Value of Payments Made Annually							$ 2,237,326.06
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually							76,924.76
Total Present Value of Payments Made Monthly							$ 2,314,250.82

Exhibit 2C

Present Value of [redacted] Top-Hat Retirement Benefits
To Be Paid While Both the Participant and the Beneficiary Are Living

Participant Name - [redacted] Participant Age - 60
Participant Mortality Basis - RP-2000 Mortality Table For Active & Retired Males (1.00 x Standard)
Beneficiary Name - [redacted] Beneficiary Age - 64
Beneficiary Mortality Basis - RP-2000 Mortality Table For Active & Retired Females (1.00 x Standard)

Year	*Dur*	*Payment Increase Rate*	*Estimated Annual Payment*	*Int Rate*	*Interest Discount Factor*	*Discount for Mortality*		*Present Value of Payments During Year*
						Participant	*Beneficiary*	
2013 -14	1	N/A	$ 167,835.96	4.00%	0.961538	1.000000	1.000000	$ 161,380.73
2014 -15	2	0.00%	167,835.96	4.00	0.924556	1.000000	1.000000	155,173.78
2015 -16	3	0.00	167,835.96	4.00	0.888996	1.000000	1.000000	149,205.56
2016 -17	4	0.00	167,835.96	4.00	0.854804	1.000000	1.000000	143,466.88
2017 -18	5	0.00	167,835.96	4.00	0.821927	1.000000	1.000000	137,948.93
2018 -19	6	0.00	167,835.96	4.00	0.790315	1.000000	1.000000	132,643.20
2019 -20	7	0.00	167,835.96	4.00	0.759918	1.000000	1.000000	127,541.54
2020 -21	8	0.00	167,835.96	4.00	0.730690	1.000000	1.000000	122,636.09
2021 -22	9	0.00	167,835.96	4.00	0.702587	0.892354	0.878438	92,434.32
2022 -23	10	0.00	167,835.96	4.00	0.675564	0.874413	0.858260	85,091.73
2023 -24	11	0.00	167,835.96	4.00	0.649581	0.854996	0.836411	77,965.41
2024 -25	12	0.00	167,835.96	4.00	0.624597	0.833989	0.812903	71,069.56
2025 -26	13	0.00	167,835.96	4.00	0.600574	0.811237	0.787730	64,413.47
2026 -27	14	0.00	167,835.96	4.00	0.577475	0.786586	0.760865	58,005.84
2027 -28	15	0.00	167,835.96	4.00	0.555265	0.759920	0.732260	51,858.30
2028 -29	16	0.00	167,835.96	4.00	0.533908	0.731170	0.701867	45,985.87
2029 -30	17	0.00	167,835.96	4.00	0.513373	0.700337	0.669666	40,409.49
2030 -31	18	0.00	167,835.96	4.00	0.493628	0.667487	0.635660	35,152.21
2031 -32	19	0.00	167,835.96	4.00	0.474642	0.632695	0.599876	30,234.86
2032 -33	20	0.00	167,835.96	4.00	0.456387	0.596045	0.562380	25,676.02
2033 -34	21	0.00	167,835.96	4.00	0.438834	0.557679	0.523285	21,493.54
2034 -35	22	0.00	167,835.96	4.00	0.421955	0.517503	0.482759	17,692.74
2035 -36	23	0.00	167,835.96	4.00	0.405726	0.475852	0.441060	14,291.82
2036 -37	24	0.00	167,835.96	4.00	0.390121	0.433159	0.398570	11,304.12
2037 -38	25	0.00	167,835.96	4.00	0.375117	0.389939	0.355802	8,734.87
2038 -39	26	0.00	167,835.96	4.00	0.360689	0.346750	0.313407	6,578.76
2039 -40	27	0.00	167,835.96	4.00	0.346817	0.304171	0.272137	4,818.25
2040 -41	28	0.00	167,835.96	4.00	0.333477	0.262790	0.232785	3,423.85
2041 -42	29	0.00	167,835.96	4.00	0.320651	0.223217	0.196094	2,355.64
2042 -43	30	0.00	167,835.96	4.00	0.308319	0.186069	0.162673	1,566.30
2043 -44	31	0.00	167,835.96	4.00	0.296460	0.151942	0.132936	1,005.02
2044 -45	32	0.00	167,835.96	4.00	0.285058	0.121589	0.107079	622.90
2045 -46	33	0.00	167,835.96	4.00	0.274094	0.095252	0.085087	372.84
2046 -47	34	0.00	167,835.96	4.00	0.263552	0.072995	0.066773	215.60
2047 -48	35	0.00	167,835.96	4.00	0.253415	0.054696	0.051819	120.55
2048 -49	36	0.00	167,835.96	4.00	0.243669	0.040065	0.039829	65.26
2049 -50	37	0.00	167,835.96	4.00	0.234297	0.028691	0.030371	34.26
2050 -51	38	0.00	167,835.96	4.00	0.225285	0.020088	0.022935	17.42
2051 -52	39	0.00	167,835.96	4.00	0.216621	0.013754	0.017098	8.55
2052 -53	40	0.00	167,835.96	4.00	0.208289	0.009212	0.012549	4.04
2053 -54	41	0.00	167,835.96	4.00	0.200278	0.006038	0.009047	1.84
2054 -55	42	0.00	167,835.96	4.00	0.192575	0.003873	0.006395	0.80
2055 -56	43	0.00	167,835.96	4.00	0.185168	0.002433	0.004427	0.33
2056 -57	44	0.00	167,835.96	4.00	0.178046	0.001501	0.002998	0.13

Exhibit 2C

Present Value of [redacted] Top-Hat Retirement Benefits
To Be Paid While Both the Participant and the Beneficiary Are Living

Participant Name - [redacted] Participant Age - 60
Participant Mortality Basis - RP-2000 Mortality Table For Active & Retired Males (1.00 x Standard)
Beneficiary Name - [redacted] Beneficiary Age - 64
Beneficiary Mortality Basis - RP-2000 Mortality Table For Active & Retired Females (1.00 x Standard)

Year	Dur	Payment Increase Rate	Estimated Annual Payment	Int Rate	Interest Discount Factor	Discount for Mortality		Present Value of Payments During Year
						Participant	Beneficiary	
2057 -58	45	0.00	167,835.96	4.00	0.171198	0.000913	0.001986	0.05
2058 -59	46	0.00	167,835.96	4.00	0.164614	0.000550	0.001288	0.02
2059 -60	47	0.00	167,835.96	4.00	0.158283	0.000330	0.000818	0.01
2060 -61	48	0.00	167,835.96	4.00	0.152195	0.000198	0.000511	0.00
2061 -62	49	0.00	167,835.96	4.00	0.146341	0.000119	0.000313	0.00
2062 -63	50	0.00	167,835.96	4.00	0.140713	0.000071	0.000190	0.00
2063 -64	51	0.00	167,835.96	4.00	0.135301	0.000043	0.000114	0.00
2064 -65	52	0.00	167,835.96	4.00	0.130097	0.000026	0.000069	0.00
2065 -66	53	0.00	167,835.96	4.00	0.125093	0.000015	0.000041	0.00
2066 -67	54	0.00	167,835.96	4.00	0.120282	0.000009	0.000025	0.00
2067 -68	55	0.00	167,835.96	4.00	0.115656	0.000006	0.000015	0.00
2068 -69	56	0.00	167,835.96	4.00	0.111207	0.000003	0.000009	0.00
Total Present Value of Payments Made Annually								$ 1,903,023.30
Adjustment to Reflect Additional Value of Payments Made Monthly Instead of Annually								76,924.80
Total Present Value of Payments Made Monthly								$ 1,979,948.10

APPENDIX 3

In the Matter of the Marriage of Mr. and Mrs. Wannabesingle
Date of Analysis 10/3/2013

Facts Applicable to Calculations		
Date of Birth		10/3/1953
Date of Retirement		10/3/2013
2000 Life Expectancy Table for White - Male current age 60		20 years
Joint with Survivor Benefits Monthly Payment	$	3,094

Present Value of a Single Life Annuity for Husband's Life Electing the Joint with Survivor Payout Amount			
Annuity Payout Factors			
Husband's Age Today		60.00	
	Years Until Annuity Begins		0.00
Age when Annuity Payments Begins		60.00	
	Years Annuity is Received		20.00
Estimated Life Expectancy		80.00	
Present Value of Cumulative Annuity Payout			
Future Value of Cumulative Annuity Payout			742,560
Estimated Return Rate			4.0%
Present Value of Joint with Survivor Benefit			**$ 514,574**

APPENDIX 4

In the Matter of the Marriage of Mr. and Mrs. Wannabesingle
Present Value of Cost of Survivor Benefit
Date of Analysis 10/3/2013

Facts Applicable to Calculations		
Date of Birth - Husband		10/3/1953
Husband's Current Age		60 years
2000 Life Expectancy Table for White - Male current age 60		20 years
Date of Birth - Wife		10/1/1950
Wife's Current Age		64 years
2000 Life Expectancy Table for White - Female current age 64		20 years
Date of Retirement Start		10/3/2013
Joint with Survivor Benefits Monthly Payments	$	3,094

Survivor Benefit Calculation		
Annuity Payout Factors		
Husband's Life Expectancy from Today		20.00
Wife's Life Expectancy from Today		20.00
Number of year's wife will out-survive husband		0.00
Present Value of Cumulative Annuity Payout		
Future Value of Cumulative Annuity Payout		-
Estimated Return Rate		4.0%
Present Value of Survivor Benefit	$	-

This is a flawed approach and produces inaccurate results

COMPENSATION, RETURN ON CAPITAL AND RETURN OF CAPITAL

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State Bar of Texas
NEW FRONTIERS IN MARITAL PROPERTY LAW
October 4-5, 2012
New Orleans

CHAPTER 1.1

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COMPENSATION, RETURN ON CAPITAL, AND RETURN OF CAPITAL

by

Richard R. Orsinger
Board Certified in Family Law
& Civil Appellate Law by the
Texas Board of Legal Specialization

I. INTRODUCTION. Texas law is inconsistent in the way it treats different kinds of compensation for services rendered. And surprisingly, there are many areas where the proper way to characterize compensation is uncertain. Where a spouse is both an owner and an employee of a business, there can be difficulties discerning whether money or assets received from the business are compensation, or a return *on* invested capital, or a return *of* invested capital. This can create problems when valuing the business. If the ownership interest in the business is separate property, issues arise whether distributions from the business are compensation (i.e., community property), or return *on* capital (i.e., community property), or return *of* capital (i.e., separate property). This paper explores some of these issues.

II. COMPENSATION. As used in this Article, "compensation" means earnings from employment. One perspective on compensation is the term "personal service income." Personal service income is described in IRS Publication 570 (2011) in this way:

> Income from labor or personal services includes wages, salaries, commissions, fees, per diem allowances, employee allowances and bonuses, and fringe benefits. It also includes income earned by sole proprietors and general partners from providing personal services in the course of their trade or business.

<http://www.irs.gov/publications/p570/ch02.html#en_US_2011_publink1000221205>. The IRS has another concept that applies to owners of sole proprietorships and partnerships, called "earned income." Earned income consists of "net earnings from self-employment" which is "your gross income from your trade or business (provided your personal services are a material income-producing factor) minus allowable business deductions." <http://www.irs.gov/publications/p560/ch01.html>. Earned income is probably synonymous with the second sentence in the definition of personal service income given above. Be that as it may, in this Article "compensation" includes both personal service income and earned income.

Compensation can be current, deferred, or advanced. Current compensation is paid at the end of a pay-period, with no further delay. When compensation is deferred or advanced, marital property disputes can arise. This Article suggests that there are three approaches to characterizing compensation: (i) the inception-of-title approach (with or without offsetting reimbursement); (ii) the time-allocation approach; or (iii) the valuation approach (on date of divorce). The three approaches could be called the *Boden*, *Taggart*, and the *Berry* approaches, based on cases that espoused each approach. It must be noted that TEX. FAM. CODE § 3.007(c) adopts the time allocation *Taggart* approach for employee stock options and restricted stock. However, other deferred benefits are not included in the statue, so the proper characterization is a matter of common law.

A. WAGES, SALARY AND BONUSES. Current income for services rendered by an employee is normally paid as wages, salary, tips, and bonuses. The employer is supposed to issue a Form W-2, setting out the income and the employee is supposed to report such income on Line 7 of the Form 1040 Personal Tax Return. Under Texas law, such income earned during marriage is community property.

B. DEFERRED COMPENSATION. The IRS defines "deferred compensation" as compensation that is earned in one tax year but is paid in another tax year. Under Texas marital property law, deferred compensation is compensation for labor that is not paid until some time after the services are rendered. Exactly how long a delay is required before the compensation is deferred is subjective. Deferred compensation could be deferred a few months, or until the next calendar year, or until retirement. And deferred compensation can be dependent upon, or contingent upon, subsequent events.

C. FRINGE BENEFITS. "Fringe benefits" are a form of compensation, but most employers treat them differently from wages, salary, and bonuses. Some owner-employees cause the business to provide fringe benefits without reporting them as income for tax purposes. Fringe benefits are addressed in the IRS publication *Executive Compensation - Fringe Benefits Audit Techniques Guide* (02-2005).<http://www.irs.gov/Businesses/Corporations/Executive-Compensation---Fringe-Benefits-Audit-Techniques-Guide-(02-2005)>. The IRS considers fringe benefits to be taxable income. Examples given in the Audit Techniques Guide of fringe benefits include:

- Athletic Skyboxes/Cultural Entertainment Suites
- Awards/Bonuses
- Club Memberships
- Corporate Credit Card (unreimbursed)
- Executive Dining Room
- Loans (No Cost/Low Cost)
- Outplacement Services
- Qualified Employee Discounts
- Security-Related Transportation
- Spousal/Dependent Life Insurance
- Transportation
- Employer-Paid Parking
- Transfer of Property
- Employee Use of Listed Property
- Relocation Expenses
- Non-Commercial Air Travel
- Employer-Paid vacations
- Spousal or Dependent Travel
- Wealth Management
- Qualified Retirement Planning

D. HOW IS CURRENT COMPENSATION CHARACTERIZED? Under Texas Family Code Section 3.001, separate property consists of "property owned or claimed by the spouse before marriage," or "acquired by the spouse during marriage by gift, devise, or descent . . . ." Under Texas Family Code Section 3.002, "[c]ommunity property consists of all property, other than separate property, acquired by either spouse during marriage. "It is well settled that a person's earnings after divorce are separate property and therefore not subject to division." *Murray v. Murray*, 276 S.W.3d 138 , 147 (Tex. App.--Fort Worth 2008, no pet.).

Current income, paid daily, weekly, bi-monthly, or monthly, is community property if received during marriage and separate property if received before marriage or after divorce. Uncertainty arises when a marriage or divorce occurs during a pay period. How do you characterize compensation received just after marriage or just after divorce? The easy answer is to say that compensation received during marriage is community property, regardless of when the work was done that gave rise to the compensation. And that compensation received after the divorce is separate property, even if the work that gave rise to the compensation was done during marriage. However, an argument can be raised that such compensation should be attributed to the period of time when the work was done. This is the approach taken by the Supreme Court in *Keller v. Keller*, 141 S.W.2d 308 (Tex. Comm'n App. 1940, opinion adopted), where the Supreme Court held that salary earned during marriage was community property, even though it was not paid until after the divorce. It seemed important to the Court's decision that the salary was reported as income on the husband's tax return during marriage, even though the salary was not actually paid until after the divorce. *Id.* at 311. Would the result have been different if the husband had not reported the salary as income until after the divorce? The Court said: "Whether the salaries were drawn during the current year is immaterial. When paid they were paid for that year and were paid as salaries." *Id.* at 311. So *Keller* is a case of current compensation paid after divorce for work done prior to divorce.

Where the marriage or divorce occurs during a pay period, it raises the question of whether there should be an allocation of a paycheck or bonus between separate and community portions based on some allocation method, like time allocation. That policy of allocation has been applied in the context of deferred compensation (i.e., pension plans and employee stock option and restricted stock plans). Should the same principle be applied to characterizing current compensation?

E. HOW IS DEFERRED COMPENSATION CHARACTERIZED? The marital property character of deferred compensation differs, depending on the form of deferred compensation. The courts have developed three different approaches to characterizing deferred compensation: (i) the inception of title rule (without reimbursement); (ii) time-allocation; and (iii) the valuation approach.

1. Defined Contribution Plans. Defined contribution plans are considered to be a form of deferred compensation. Under existing case law, defined contribution plans are characterized just like other financial accounts. The contents of the plan account are

presumed to be community property. Tex. Fam. Code § 3.003(a). The burden to prove separate property is by clear and convincing evidence. Tex. Fam. Code § 3.003(b). Where the beginning balance of the account is known, the court subtracts the value in the account on the date of marriage from the value of the account on the date of divorce, and the difference is presumed to be community property, as having been earned or contributed during marriage. *See* e.g., *Iglinsky v. Iglinsky*, 735 S.W.2d 536, 538 (Tex. App.--Tyler 1987, no writ). Tex. Fam. Code § 3.007(c) permits a spouse to trace commingled assets in a defined contribution plan account, just like any other financial account. Defined contribution plans are usually not deferred in the sense that the contributions are delayed. They are "deferred" in the sense that the deposits and income inside a defined contribution plan are held in trust for the benefit of the employee, and are not taxed until they are withdrawn from trust; so they are "tax deferred." Because they are not really deferred and they are treated like regular financial accounts, defined contribution plans will not be further discussed in this Article.

2. Defined Benefit Plans. In *Baw v. Baw*, 949 S.W.2d 764, 768 n. 3 (Tex. App.--Dallas 1997, no writ), the court said that "[a] 'defined-benefit' plan promises employees a monthly benefit beginning at retirement. A 'defined-benefit' plan calculates benefits by plan-specific factors, such as years of service, age, and salary. *An Interdisciplinary Analysis of the Division of Pension Benefits in Divorce and Post–Judgment Partition Actions*, 37 BAYLOR L. REV. at 115."). Defined benefit plans (i.e., pensions) typically are a right of the employee to receive monthly payments in a set amount paid over the retiree's lifetime. The amount of each payment is the same (subject to a cost-of-living adjustment), and is determined according to the retirement plan's formula. The formula is usually the product of multiplying the number of months of total employment, times a set number (like 1, or 1.5, or 2, etc.), times average final compensation (as defined in the plan).

a. *Taggart* Time-Allocation. Under *Taggart v. Taggart*, 552 S.W.2d 422 (Tex. 1977), defined benefit pension plan benefits are characterized based on pure time-allocation alone. The community property interest in each pension payment is a fraction, in which the number of months that the pension benefit accrued during marriage is divided by the total number of months the pension benefit accrued overall. However, when the spouse will continue to accrue more pension benefit after divorce, it is necessary to do a *Berry* valuation, which requires a different denominator for the fraction. See Section II.E.2.b below.

Defined benefit pensions used to be covered by TFC § 3.007, but that statutory provision has been repealed.

CAUTION: Many old cases, including *Taggart*, say that the denominator of the fraction is the total number of months worked. That was true when pension benefits accrued over an employee's entire period of employment. That is not a safe approach in modern times. In the current environment, many defined benefit pension plans have been capped, or suspended, and no further benefits accrue even when the employee continues to work. So a better way to describe the components of the fraction is the "number of months during which the benefit accrued."

b. *Berry* Valuation. In *Berry v. Berry*, 647 S.W.2d 945 (Tex. 1983), the Texas Supreme Court revisited the *Taggart* time-allocation formula and said that the *Taggart* formula could not be used to divide a pension where the employee spouse would continue to accrue a benefit under the plan for work done after the divorce. The Court in *Berry* said that, in order to protect the employee's separate property interest resulting from post-divorce labors, the divorce court should divide only the value of the community estate's interest in the retirement benefits as of the time of divorce. *Id.* at 947. Under *Berry*, the time-allocation is through the date of divorce, and the numerator of the fraction is the number of months that the retirement benefit has accrued during marriage while the denominator of the fraction is the total number of months during which benefits have accrued through the date of divorce. That community fraction is multiplied times the retirement benefit that would be available if the employed spouse could retire on the date of divorce. The *Berry* court specifically said that it was not overruling a *Taggart* time-allocation formula "for determining the extent of the community interest in retirement benefits" for cases where the value of the community's interest at the time of divorce was not an issue, like when divorce follows retirement. *Id.* at 947. The following courts of appeals have said that the *Taggart* formula applies, without a *Berry* determination of value, when the spouse has retired before divorce: *May v. May*, 716 S.W.2d 705, 710 (Tex. App.--Corpus Christi 1986, no writ); *Hudson v. Hudson*, 763 S.W.2d 603, 605 (Tex. App.--Houston [14th Dist.] 1989, no writ); *Humble v. Humble*, 805 S.W.2d 558, 561 (Tex. App.--Beaumont 1991, writ denied); *Parliament v. Parliament*, 860 S.W.2d 144, 145-46 (Tex. App.--San Antonio 1993, writ denied); *Albrecht v. Albrecht*, 974

S.W.2d 262, 263-64 (Tex. App.--San Antonio 1998, no pet.); *Limbaugh v. Limbaugh*, 71 S.W.3d 1, 16 (Tex. App--Waco 2002, no pet.); *Stavinoha v. Stavinoha*, 126 S.W.3d 604, 616 (Tex. App.--Houston [14th Dist.] 2004, no pet.); *Prague v. Prague*, 190 S.W.3d 31, 39 (Tex. App.--Dallas 2005, pet. denied); *In re Marriage of Jordan*, 264 S.W.3d 850, 854 (Tex. App.--Waco 2008, no pet.).

c. Qualified vs. Non-Qualified Plans. The distinction between qualified and non-qualified retirement plans does not affect characterization. A retirement plan is "qualified" when it meets the requirements of the Internal Revenue Code that allows the employer to deduct contributions to the plan as an expense during the year the contribution is made to the plan, while the employee is not taxed on the benefit until the benefit is distributed to the employee, sometimes years later. Additionally, the deferred payment is not subject to payroll tax. Both defined contribution plans and defined benefit plans can be qualified. The IRS Publication *A Guide to Common Qualified Plan Requirements* discusses the criteria that make a plan qualified. *See* <http://www.irs.gov/Retirement-Plans/A-Guide-to-Common-Qualified-Plan-Requirements>.

Federal law caps the maximum amount that can be distributed to an employee under a qualified plan. Because these caps are too low to entice top executives, many companies offer benefits to high-ranking employees through non-qualified plans. The most delicate part of designing a non-qualified plan is to avoid the Economic Benefit Doctrine. The Economic Benefit Doctrine is a tax law principle saying that a benefit is taxable to the employee when the economic benefit is conferred, even if the employee does not have actual or constructive receipt of the benefit. To avoid the Economic Benefit Doctrine, the deferred benefit must be subject to a substantial risk of forfeiture. This has been taken to mean that the non-qualified plan must be unfunded, and the employee's claim must be as a general creditor of the company.

3. Options/Restricted Stock. Initially, Texas courts characterized employee stock options using the inception of title rule. *See Boyd v. Boyd*, 67 S.W.3d 398, 410 (Tex. App.--Fort Worth 2002, no pet.) (recognizing that the ability to sell the options was limited); *Charriere v. Charriere*, 7 S.W.3d 217, 220 (Tex. App.--Dallas 1999, no pet.) (holding that the community nature of options granted during marriage was not altered by the fact that vesting of the options was contingent on continued employment after divorce); *Kline v. Kline*, 17 S.W.3d 445, 446 (Tex. App.--Houston [1st Dist.] 2000, pet. denied) (holding that the stock options granted during marriage were community property even if not vested before divorce). Nowadays, employee stock options and restricted stock must be characterized under Tex. Fam. Code Sec. 3.007(d). Under the statute, these benefits are characterized on a time-allocation basis, as in *Taggart*, with no *Berry* valuation even where continued post-divorce employment is required for the options or restricted stock to vest. Under Section 3.007(c), the community interest in options or restricted stock is determined by a fraction, where the numerator is the portion of the vesting period for the benefit that accrues during marriage, and the denominator is the entire vesting period for the benefit. Example: an unmarried employee receives an employee stock option on day 1. The option says that the employee must work at the company for a three year period before the option vests. Assume the employee marries at the start of year 2, and divorces on the last day of year 2. Section 3.007(d) says that the community interest in the option is 1/3, since only the middle year of the 3-year vesting period accrued during marriage, and the first and last years accrued outside the marriage. There is no perception, in dealing with options and restricted stock under Section 3.007(d), that a *Berry* valuation should be undertaken, when the employed spouse must continue to work after the divorce in order for the option or restricted stock to vest. Therefore stock options and restricted stock, which are a form of deferred compensation, are treated differently from pensions, which are another form of deferred compensation, in situations where the spouse owning the deferred compensation claim will continue to work after the divorce. Does Section 3.007(d) violate the principle behind *Berry*? Should we be attacking Section 3.007(d) as unconstitutional? Should *Berry* be overruled based on the approach used in Section 3.007(d)? Would a *Berry* valuation approach even be possible, or fair, given that stock prices are volatile and no one can calculate what an option or restricted stock will be worth in a year or two. And how would you discount for the risk of non-vesting?

a. Cliff Vesting vs. Vesting in Tranches. The proper application of Section 3.007(d) can be affected by the way that the benefit plan is constructed. "Cliff vesting" occurs when all of the benefit vests on the final day of the vesting period, rather than gradually vesting over time. Imagine two stock option plans, one with cliff vesting and one where the options vest in stages.

Hypothetical:

The Plans–Husband received two option grants on January 1 of Year 1. Option Plan No. 1 gives husband an option right to acquire 300 shares of the company's stock. The husband must be employed at the company for 3 years after the grant date, in order for the options to vest, and they all vest on the last day. Option Plan No. 2 gives husband an option right to acquire 300 shares of the company's stock, with the first 100 shares vesting at the end of one year, another 100 shares vesting at the end of two years, and the last 100 shares vesting at the end of three years.

The Marriage–husband and wife marry on January 1 of the Year 2 of the Plans. They divorce on December 31 of Year 2. So they are married for one year.

The Calculation

Option Plan 1 (Cliff Vesting)--Under Section 3.007(d), when the husband divorces at the end of Year 2, his Option for 300 shares is 1/3 community property and 2/3 separate property. This is because 1/3 of the vesting period occurred prior to marriage, 1/3 during marriage, and 1/3 after divorce. The community total under Plan 1 is 100 shares.

Option Plan 2 (Staged Vesting)--Under Section 3.007(d), the first 100 shares that vest at the end of Year 1 are entirely husband's separate property because they were granted and vested before marriage. The second 100 shares that vest at the end of Year 2 are 50% separate property and 50% community, because ½ of the two-year vesting period occurred during marriage. The third 100 shares, which will vest one year after the divorce, are 1/3 community and 2/3 separate, because only 1/3 of the three-year vesting period occurred during marriage. Adding this up, at the time of divorce, of the 200 shares received during marriage, 150 are husband's separate and 50 are community property. Of the 100 shares that may vest in the future, 66-2/3 are husband's separate property and 33-1/3 are community property. The community total under Plan 2 is 83-1/3 shares.

4. Other Deferred Compensation. The characterization of pensions is controlled by common law principles stated in the *Taggart*/*Berry* line of cases. Employee stock options and restricted stock are governed by Section 3.007(c). Other forms of deferred compensation include delayed bonuses, phantom stock, performance units, stock appreciation rights, incentive payments, etc. They do not fall under either approach. How are other forms of deferred compensation handled? Do we (i) time-allocate according to the total accrual period (*Taggart*)? Do we (ii) time allocate up to the date of divorce and multiply times the value on the date of divorce (*Berry*)? Or do we do a third thing, which is what the case law did with options before Section 3.007 was adopted, and that is to (iii) apply the inception of title rule (i.e., phantom shares, or PUs, or SARs granted before marriage are 100% separate, and those that are granted during marriage are 100% community, even if post-divorce employment is required for vesting). If we go the inception of title route, is there a *Jensen*-like reimbursement claim for enhancement in value of separate property benefits due to work done during marriage, or for the enhancement of community property benefits due to work done after divorce? If there is reimbursement, is it measured by the amount of enhancement or by the value of the services contributed to increase the value of the benefit? If there is some enhancement measure, what if the value of the benefits drops after divorce, due to stock price going down, or performance targets not being met, etc.?

a. Bonuses. Bonuses can be deferred compensation if their payment is delayed. Some companies have bonus plans that say bonuses accrue over time. Most bonuses are paid after the fact for work done before the bonus is declared and paid. *Echols v. Austron, Inc.*, 529 S.W.2d 840, 846 (Tex. Civ. App.--Austin 1975, writ ref'd n. r. e.), held that a bonus received shortly after divorce is separate property, because the rights of the parties were fixed at the time the divorce judgment was rendered, which was before the bonus was received. On the other hand, in *Boyd v. Boyd*, 67 S.W.3d 398, 404 (Tex. App.--Fort Worth 2002, no pet.), the appellate court found that a bonus that was yet unpaid at the time of mediation was still community property that needed to be disclosed to the other spouse. The Court explained:

> Randall's receipt of a $60,000 bonus in 1996 was disclosed at mediation. He does not deny that he failed to disclose an additional $230,000 bonus—also earned during 1996—at the mediation, nor does he challenge the trial court's finding that the undisclosed bonus was community property. To the contrary, Randall testified as follows regarding the bonus:
>
> [Q] If someone had asked you during the time of that mediation what your incentive pay for that pay that you had earned for 1996 was, would you know what that amount of dollars would have been?

> [A] Yes, I could have. I had been paid the sixty and I knew the two thirty was coming. I just didn't know when, so—
> ....
> [Q] You knew that at the time of mediation?
>
> [A] Right.
>
> [Q] And you knew the specific dollar amount at the time of the mediation?
>
> [A] Yeah. I was pretty clear on the dollar amount, yes.

Should the bonus be determined by the employee's marital status on date the bonus is declared or received, or should it be characterized based on the time period over which it was earned? Also, in some instances bonuses are paid before the work is done. See Section II.G below.

b. Delayed Payments Based on Performance. A number of highly-compensated employees are given deferred compensation that is dependent on economic performance of the business. These include performance units, stock appreciation rights, and phantom stock, to name a few. Some publicly-traded corporations peg the benefit to the increase in price of the company's stock. Performance units might be measured against a benchmark that involves profitability, or might be measured against the performance of competing corporations in the same industry. Generally they all require that the employee continue to be employed by the company up to the time the benefit matures or vests. Sometimes you can say that the individual's performance influenced the outcome, but in some organizations there may be too many employees to tie the outcome to the spouse's individual labors.

c. Is a *Berry* Valuation Even Possible, at the Time of Divorce? The values of stock options and restricted stock and phantom stock and stock appreciation rights are derivative of the underlying value of the company's stock. When the court wants to value non-vested benefits not governed by *Taggart/Berry* or Section 3.007, as of the date of divorce, who can predict the value of a company's stock 1 year, or 2 years, or 3 years in the future? Do you use Black-Scholes (designed for short term European options traded on an open market), or the binomial or "lattice" binomial method, or by gutting a goose and reading the entrails? The same problem exists for performance awards that are based on meeting profitability targets, etc.

A *Berry* approach would have the court value the deferred benefit as if it were vested on the day of divorce and could be converted to cash. In *Berry* that approach worked because the employed spouse's post-divorce earnings invariably caused the pension account to increase. However, using a *Berry* valuation-on-the-day-of-divorce approach on other deferred compensation leads to trouble if the value of the benefit actually declines after divorce, due to market forces, or poor performance. In that situation, valuing the benefit as if it could be converted to cash on the date of divorce would give too much value to the community's interest. In actuality, if the value is to be determined by stock price on the date of divorce, there should be a discount for the time value of money, a discount for lack of liquidity, a discount for possible reduction in value of the underlying stock, and a discount for the possibility of forfeiture of the benefit, applied to whatever value is proposed.

Applying a *Berry* approach to valuing stock options was addressed in *Boyd v. Boyd*, 67 S.W.3d 398, 411-12 (Tex. App.--Fort Worth 2002, no pet.) . The Court said this:

> Randall also contends that the trial court should have valued the stock options as of the date of divorce rather than giving Ginger the benefit of the value of the options attributable to his post-divorce employment. Thus, Randall lodges the same complaint regarding the stock options as he did concerning the retirement benefits: Ginger was not entitled to 50% of the future increases in the value of the stock options.
>
> Randall's company was privately held, not publicly traded. If Randall left his employment before he was 100% vested in his stock options, he could sell the options to the company for the price he paid for them. But Randall's ability to exercise his stock options for a profit was contingent upon his employer becoming a publicly traded company or being wholly or partially acquired by a third party. In either of these circumstances, Randall would have the opportunity to sell his stock options for the price the company received for its shares.
>
> Randall's stock options vested at the rate of 1% per year from 1998 through 2006, after which they became entirely vested. However, if Randall's company went public or was substantially acquired by a third party, vesting was accelerated to 20% per year. If there was a total sale of the company,

Randall would be treated as if he were 100% vested.

The trial court determined that Randall's fair value stock options had a contingent value at divorce of $5,628,776. This value was determined by using a formula that did not take into account Randall's post-divorce work for his company or the company's future productivity. The formula was fixed at the time of the divorce.

The contingent value of the stock options could not be realized, however, until between 2002 and 2004, during which time a third-party corporation had the option to acquire all of the remaining stock in Randall's company. If Randall was not employed by the company at that time, he would not make any more profit on his fair value stock options because he would no longer be a company stockholder. In addition, even if his employment continued after divorce, Randall would not make any more profit on the stock options if the sale did not occur or if his company's stock did not become publicly traded after 2004.

To date, no Texas court has considered how to determine the community property value of stock options at divorce. The cases have only addressed whether stock options are community property. See *Kline*, 17 S.W.3d at 446; *Bodin*, 955 S.W.2d at 381; *Demler*, 836 S.W.2d at 699; *see also Charriere*, 7 S.W.3d at 220 n. 6 (holding that stock options that could be purchased but not sold without company consent during marriage were community property, even though value of options was dependent upon employee spouse's post-divorce employment). The factors presented here cause us to conclude that the contingent value of the stock options was community property. The method for calculating this contingent value was fixed at divorce, and the minimum price for the stock options was also fixed. Randall would either be able to exercise the stock options in the future for their contingent value (if he was employed and the stock sale took place or the company went public), or he would only be able to recover what he paid for them. Further, the contingent value of the options was not dependent on Randall's post-divorce work for his company, even though he had to be employed to receive it.

The trial court awarded Ginger one half of the contingent value of the stock options as her 50% share of the community estate. If Randall is no longer employed when the stock options are sold, Ginger's contingent community property interest will be extinguished. Any post-divorce increases or decreases in the value of these stock options that are not attributable to Randall's post-divorce work will not be his separate property. Ginger will be entitled to 50% of the increases, and the contingent value of her interest will be reduced by any decreases. Ginger will not be entitled to any post-divorce increases in the value of these stock options that are attributable to Randall's post-divorce work for the company because these post-divorce increases will be his separate property. However, the divorce decree does not contain any language purporting to give Ginger an interest in these latter post-divorce increases. Therefore, the trial court's division of the contingent value of the stock options was not an abuse of discretion. We overrule point nine.

d. How Would *Jensen* Reimbursement be Calculated? If a deferred compensation benefit is granted before marriage, and the inception of title rule is applied to make the benefit separate property, but community labor is expended during marriage that enhances the value of the benefit, is a *Jensen* reimbursement claim available? How do you prove a causal link between the services and the increase in value? What if the value of services exceeds the increase in value of the deferred benefit? Is the increase in value during marriage a cap on a *Jensen* claim? What if the benefit actually declines in value, due to a drop in stock prices, poor performance, or whatever? Is a *Jensen* claim extinguished if the asset goes down in value during marriage.

Similar questions can be asked about a *Jensen*-like claim for post divorce labor enhancing the value of a community property benefit. An even bigger problem is the fact that the added value would have to be determined prospectively, not retrospectively as in the *Jensen* case. How can someone determine what value will be added by post-divorce labors, when it is essentially impossible to value stock in advance of some future date.

F. POST-DIVORCE INCOME FROM PRE-DIVORCE WORK. Complications can arise with future income that compensates for work done before divorce. As noted in *Murray*: “It is well settled that a person's earnings after divorce are separate property and therefore not subject to division.” *Murray v. Murray*, 276 S.W.3d 138 , 147 (Tex. App.--Fort Worth 2008, no

pet.). That is more easily said than applied.

1. Future Personal Earnings. In *Smith v. Smith*, 836 S.W.2d 688, 692 (Tex. App.--Houston [1 Dist.] 1992, no pet.), the appellate court rejected the valuation testimony of an expert who valued an unincorporated business by determining the present value of future after-tax earnings. The court held this was a measure of the husband personal future earning capacity, not the value of the business. *Id.* at 692. The court said: "A spouse is not entitled to a percentage of his or her spouse's future income. A spouse is only entitled to a division of property that the community owns at the time of the divorce. " *Id.*

In *Loaiza v. Loaiza*, 130 S.W.3d 894 (Tex. App.--Fort Worth 2004, no pet.), the court of appeals considered a major league pitcher who signed a lucrative employment agreement during his marriage that required him to perform services after divorce. *Id.* at 906–07. The appellate court held that, despite the fact that the employment agreement was signed during marriage, and despite the fact that future payments were guaranteed if the player is cut from the team for lack of "sufficient skill or competitive ability," the post-divorce payments constituted compensation for future services that did not accrue until he performed those services. They were, therefore, his separate property.

2. Personal Goodwill. In *Nail v. Nail*, 486 S.W.2d 761, 764 (Tex.1972), the Supreme Court considered whether the goodwill of a sole proprietor doctor was an asset to be divided upon divorce. The Court said:

> In any event, it cannot be said that the accrued good will in the medical practice of Dr. Nail was an earned or vested property right at the time of the divorce or that it qualifies as property subject to division by decree of the court. It did not possess value or constitute an asset separate and apart from his person, or from his individual ability to practice his profession. It would be extinguished in event of his death, or retirement, or disablement, as well as in event of the sale of his practice or the loss of his patients, whatever the cause. *Cf. Busby v. Busby*, 457 S.W.2d 551 (Tex.1970), and the cases there referred to with approval, where the husband's existing entitlement to future military retirement benefits was held to constitute a vested property right. The crucial consideration was the vesting of a right when the husband reached the requisite qualifications for retirement benefits; the fact that the benefits were subject to divestment under certain conditions did not reduce the right to a mere expectancy. The good will of the husband's medical practice here, on the other hand, may not be characterized as an earned or vested right or one which fixes any benefit in any sum at any future time. That it would have value in the future is no more than an expectancy wholly dependent upon the continuation of existing circumstances. Accordingly, we hold that the good will of petitioner's medical practice that may have accrued at the time of the divorce was not property in the estate of the parties; and that for this reason the award under attack was not within the authority and discretion vested in the trial court by Section 3.63 of the Texas Family Code.

The Court went on to say that "we are not concerned with good will as an asset incident to the sale of a professional practice, or that may exist in a professional partnership or corporation apart from the person of an individual member . . . ." *Id.*

3. Contingent Fee Contracts. In *Licata v. Licata*, 11 S.W.3d 269 (Tex. App.--Houston [14 Dist.] 1999, pet. denied), a divorcing lawyer complained about the court awarding his wife an interest future money received as referral fees on cases the lawyer referred out to other lawyers. The appellate court said:

> here the trial court made an implied finding that Joseph's right to receive amounts under the referral agreements had fully vested based on the evidence introduced at trial. Joseph has not referred us to any record evidence which contradicts or rebuts that implied finding. Without any clear and convincing evidence to overcome the trial court's implied finding regarding the vesting of the right to the income under the referral contracts, we do not find the trial court abused its discretion in awarding Linda a percentage of Joseph's income from referred cases. It is undisputed that the benefits from a vested property right are community property even though they may be paid after divorce.

Id. at 279.

In *Von Hohn v. Von Hohn*, 260 S.W.3d 631, 642 (Tex. App.--Tyler 2008, no pet), the appellate court found that a plaintiff's-lawyer-husband's right to receive money from cases that had been settled but not funded constituted divisible community property, because "Edward's right to receive these proceeds is contractual

and the amounts to be received are fixed or readily ascertainable . . . ." *Id.* at 642. The appellate court found no community interest in pending but unsettled cases, saying that "[r]evenue from these cases is no more than an expectancy interest and any money to be received constitutes future earnings to which Susan is not entitled." *Id.*

4. Renewal Commissions. Insurance agents are typically compensated based on a percentage of the premiums the insurance company receives from the agent's sale of insurance policies. The percentage applies not only to initial premiums, but also premiums generated by the renewal of existing policies. In *Cunningham v. Cunningham*, 183 S.W.2d 985 (Tex. Civ. App.--Dallas 1944, no writ), the agent's wife claimed that the community estate upon divorce included the husband-agent's right to receive a percentage of future renewal premiums on policies sold by the husband during marriage. The court of civil appeals rejected that argument, based on two considerations: (i) the decision to renew would be made by customers at some time in the future; and (ii) the husband's agency agreement with the insurance company provided that his right to receive renewal commissions would terminate if the agency relationship terminated. Because the right to receive commissions was contingent on the customers renewing their policies and the husband's continued employment by the agency, the renewal commissions were not a vested right, but instead were a mere expectancy. *Id.* at 986. Under Texas law at the time, only vested rights could be divided on divorce–law that changed in *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976).

The later case of *Vibrock v. Vibrock*, 549 S.W.2d 775 (Tex. Civ. App.–Fort Worth), *writ ref'd n.r.e.*, 561 S.W.2d 776 (Tex. 1977), involved another divorcing insurance agent. The husband's agreement with the insurance company provided:

> On provisions of Vibrock's contracts with Fidelity Union Life Insurance Company: After the portion thereof which set forth the Agent's entitlement (Vibrock's) on "first year commissions on premiums"; the same for "second year commissions"; and the same for "subsequent years" was a provision as follows: "Agent agrees that for so long as this contract shall remain in force and effect, he will not enter the service of any other insurance company . . .."
>
> Further contractual provisions: "No renewal commission shall be payable on the business produced during any contract year not fully completed by the Agent while in the service of the Company. . . . Renewal commissions are paid in recognition of continuous full time service and as compensation for services rendered in keeping the business in force." Further, "If for any reason this contract should be terminated within three (3) years, no renewal commissions shall be paid to the Agent thereafter."

Id. at 778. The court of civil appeals concluded:

> We are of the opinion that by the contract of Vibrock with Fidelity Union Life Insurance Company the liability of the latter was made contingent upon conditions precedent as applied to Vibrock's entitlement to any renewal premiums, both before and after date of the parties' divorce; that by contract not only would Vibrock be obliged to continue this contract itself in force, but also to service the business he had placed on the books. The contract provided that his entitlement was (or would be) ". . . in recognition of continuous full time service and as compensation for services (to be) rendered in keeping business in force." (Emphasis supplied.)
>
> For the trial court to award plaintiff the interest she sought would be to award her a personal judgment which would not be referable to property in existence upon divorce.

Id. at 778.

What is very, very interesting is that the Supreme Court denied review of the court of civil appeals' decision in *Vibrock*, but they said this in a per curiam opinion:

> PER CURIAM.
>
> The application for writ of error is refused, no reversible error.
>
> Wendell Vibrock sold insurance policies for Fidelity Union during his marriage to Lynda Vibrock. Under his employment contract with Fidelity Union, Wendell Vibrock was to receive renewal commissions when these policies were renewed. Lynda Vibrock sued Wendell Vibrock claiming an interest in certain of these renewal commissions. She asserts these commissions are community property which were not considered in the partition of the parties' property upon divorce.

> The court of civil appeals reversed the summary judgment rendered by the trial court in favor of Wendell Vibrock and remanded the cause for trial. 549 S.W.2d 775.
>
> The disposition of this case by this court indicates neither approval nor disapproval of the language contained in the opinion of the court of civil appeals which suggests that these renewal commissions are not community property. *See Cearley v. Cearley*, 544 S.W.2d 661 (Tex.1976).

Vibrock v. Vibrock, 561 S.W.2d 776, 776-77 (Tex. 1977).

5. Residual Income. Residual income is income that is to be received in the future based on work done in the past. The issue of residual income was addressed in *Murray v. Murray*, 276 S.W.3d 138 (Tex. App.–Fort Worth 2009, pet. denied). This post-divorce case involved a husband who worked as an independent broker for a multi-level marketing company that provided discount health services. *Id.* at 141. His job involved getting customers to sign up for monthly memberships and to enlist brokers to sign up members, and he received a percentage of the membership fees generated by himself and by brokers he originally enlisted. *Id.* In the divorce decree, the wife was awarded 60% of residual income based on business generated prior to the date of divorce and upon the book of business as of the date of divorce. *Id.* at 143. On appeal from a post-divorce law suit, the appellate court said that the former wife was entitled to continue to receive 60% of the money that comes in from the members and brokers that were in place, but not from members or brokers added after the date of divorce. *Id.* The members and brokers are called the "downline." The Court said: "Whereas, the monthly income from the downline in existence at the time of divorce is already earned, the income resulting from new members and brokers being added after divorce is not." *Id.* at 147. Note that the Court said the income from the existing downline was "already earned," even though the future membership fees were not yet due or received. Importantly, the appellate court was not influenced by the fact that the former husband had to recruit one new member or broker each month in order to receive the income from the downline. Even though the future income had not yet been *received*, it had already been *earned*. *Id.* at 147. The former husband did get to keep 100% of income from members or brokers added after divorce. The Court said: "Because the addition of new members and brokers is not a guarantee, the growth in income resulting from new member and brokers is merely an expectancy." *Id.* at 148.

6. Disability Payments. The case of *Simmons v. Simmons*, 568 S.W.2d 169, 170 (Tex. Civ. App.–Dallas 1978, pet. dism'd), held that long-term monthly disability benefits provided by an employer and payable to a former husband after divorce are community property, because the right to the payments was part of the husband's compensation for services during marriage. That law has been overturned by the adoption of Texas Family Code Section 3.008(b), which characterizes disability payments based on whether the lost income being replaced occurred during marriage or not. However, the original argument remains in other domains, that contractual rights arising from employment during marriage are community property. This is sort of an inception of title approach.

G. HOW IS ADVANCED COMPENSATION CHARACTERIZED? Characterization problems can arise when compensation is paid in *advance* for future services. Sometimes an employee is paid a "signing bonus" for agreeing to come to work. This happens often with professional athletes. If the signing bonus is received during marriage, but is contingent upon employment continues after the divorce, is the signing bonus entirely community property or is it to be pro rated between community and separate according to the number of months of employment during marriage vs. the number of months after divorce? In *Loaiza v. Loaiza*, 130 S.W.3d 894 (Tex. App.--Fort Worth 2004, no pet.), the spouse-athlete received such a signing bonus about a year before divorce. Unfortunately for us, no contention was raised that the signing bonus should be prorated.

An article from the Journal of the American Academy of Matrimonial Lawyers presents this analysis of the issue:

> The argument that a signing bonus actually constitutes future income is based on equitable considerations. The court then must be persuaded to recognize the realities of the NFL salary cap. In other words, the argument is one of substance over form.
>
> First, it must be conceded that a court is likely to consider a signing bonus that has already been received by the parties a vested marital property right. A Texas court has defined the word "vested" as "a fixed right of present or future enjoyment." [FN23] Therefore, although the court is going to

view the signing bonus as a vested asset, it is up to the advocate to show the court that this should be characterized as future income. In the case of a retirement benefit, courts often look to see if the benefit was earned during the course of the marriage to determine if it is divisible. [FN24] The court must be shown that the signing bonus was not earned during the marriage. Although the signing bonus actually may be received during the marriage, it may be in exchange for the athlete agreeing to take less salary in the future. The NFL's own salary cap policy takes this into consideration and distributes the signing bonus salary cap impact over the lifetime of the contract.

This kind of reasoning might appeal to a court. Ask the court to consider applying the effect of the signing bonus the same way it is calculated by the NFL. If this argument were successful, only a portion of the signing bonus would be divisible marital property. The remainder of the signing bonus would be allocated over the remaining years of the contract as future income, just as the base salary is allocated.

Acceptance of a signing bonus in return for accepting a lower base salary during the early years of the contract can be compared to a corporation offering employees a lump sum payment to retire early. Often a company will offer a highly compensated employee some type of subsidy to induce the employee to take an earlier retirement. This is not a mere altruistic gesture by the company, but an attempt to induce a highly compensated employee to retire early, so a less costly employee can replace him or the position can be eliminated altogether.

Similarly, NFL teams do not pay players large signing bonuses because they want to reward the player for signing the contract. They pay a signing bonus to maneuver around the NFL salary cap and free up more money to sign other skilled players, thereby making the team more competitive. The player has to forgo the right to earn more money under the base salary because he accepted the signing bonus. Texas case law supports the position that a payment to induce an employee to retire early is not a benefit which is earned or accrued during the employee's tenure, but is merely an incentive to get the employee to retire early, thereby benefitting the company financially. [FN25] The court may be persuaded to view a signing bonus the same way. The player is giving something up in the future to get the bonus. The court needs to understand that the signing bonus was not to reward past or current services, but actually to compensate the athlete for future services.

The main obstacle in successfully arguing that a signing bonus is not marital property is the fact that the marital estate has already received payment. Even if a signing bonus is subject to forfeiture, a court is likely to still view the bonus as a vested property right. A Texas court has stated “the possibility that a property right may be subject to total or partial forfeiture, does not destroy its character as a vested property right for the purposes of division on divorce.”

Katherine A. Kinser & R. Scott Downing, *Family Law Issues That Impact the Professional Athlete*, 15 J. Am. Acad. Matrim. Law. 337, 345-47 (1998). The authors note possible complications if the bonus can be forfeited at a later time. *Id.* at 347.

H. COMPENSATION IN CONNECTION WITH SELLING THE BUSINESS. In some business sales, the buyer pays not only a purchase price, but also agrees to pay the selling owner to continue to work for, or consult with, the business. If such payments exceed the value of services to be rendered, they might be disguised sales proceeds to the extent of the excess. Covenants not to compete are discussed in Section III.E.3 below.

III. RETURN ON CAPITAL/RETURN OF CAPITAL.

A. MUTATIONS OF OWNERSHIP INTEREST. Shares of stock acquired through stock splits have the same character as the original stock. *Harris v. Harris*, 765 S.W.2d 798, 803 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Horlock v. Horlock*, 533 S.W.2d 52 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd).

In *Carter v. Carter*, 736 S.W.2d 775 (Tex. App.--Houston [14th Dist.] 1987, no writ), the parties married on December 7, 1974. Husband testified that in 1970 he received 159 shares of stock in MPI, a family-owned business, as a gift from his father. He corroborated this testimony by showing dividends reflected on his 1974 tax returns, coupled with his testimony that MPI declared dividends at the end of the year and paid them in the following year. In 1976, MPI was acquired by Stauffer Chemical Company, and

husband received 4,645 shares of Stauffer in exchange for his MPI stock. In 1979, Stauffer had a 2-for-1 split, raising husband's shares to 9,290 in number. In 1981, husband sold 1,156 plus 1,000 shares of Stauffer, and expended the proceeds. Husband acquired 166 shares of Stauffer stock as a Christmas gift from his father in 1981 which he later sold, and participated in six short sales in 1982 and 1983. The trial and appellate courts held that the stock was proven to be husband's separate property.

In *Horlock v. Horlock*, 533 S.W.2d 52, 59 (Tex. Civ. App.--Houston [14th Dist.] 1975, writ dism'd), husband owned stock in a corporation prior to marriage. During marriage, that corporation merged with two other corporations to create yet another corporation. The court found that the new stock was husband's separate property--this despite the fact that he and the other owners of the old corporation put $200,000 into the merger.

B. CASH DIVIDENDS. Cash dividends from corporate stock are community property. *See Hilliard v. Hilliard*, 725 S.W.2d 722, 723 (Tex. App.--Dallas 1985, no writ); *Bakken v. Bakken*, 503 S.W.2d 315, 317 (Tex. Civ. App.--Dallas 1973, no writ).

C. STOCK DIVIDENDS. Stock dividends deriving from separate property stock are separate property. *See Duncan v. U.S.*, 247 F.2d 845, 855 (5th Cir. 1957). Stock dividends arising from community property stock are community.

D. PARTNERSHIP DISTRIBUTIONS. Partnership profits distributed to a partner during marriage are community property, regardless of whether the partnership interest is separate or community property. *Harris v. Harris*, 765 S.W.2d 798, 804 (Tex. App.--Houston [14th Dist.] 1989, writ denied); *Marshall v. Marshall*, 735 S.W.2d 587, 594 (Tex. App.--Dallas 1987, writ ref'd n.r.e.). What about distributions of capital? See Section III.G.b below.

E. SELLING AN OWNERSHIP INTEREST.

1. Character of Sales Proceeds. The proceeds from selling a business have the same character as the ownership interest. This is an application of the law of mutations.

2. Post-Sale Employment and Consulting Agreements. It is not uncommon, in the purchase of a business, for the buyer and seller to agree for the seller to remain employed by the business for a period of time after the purchase/sale. This facilitates the transfer of goodwill, and makes for a smoother transition to new ownership with customers, suppliers, and employees. Sometimes the seller agree to a consulting agreement as an alternative to an employment agreement. Because money paid to buy a business must be capitalized over time, whereas compensation paid to an employee or consultant is deductible to the business as an expense, when paid, sellers have a tax motive to move part of the purchase price into a compensation agreement. In any sale of a closely-held business, the terms of the sale and any related payments or agreements should be scrutinized to see if purchase price is being disguised as compensation for future employment.

3. Covenants Not to Compete. The right to compete after divorce is a separate property right. *See Ulmer v. Ulmer*, 717 S.W.2d 665, 667 (Tex. App.--Texarkana 1986, no writ), which held:

> An individual's ability to practice his profession does not qualify as property subject to division by decree of the court. *Nail v. Nail*, 486 S.W.2d 761 (Tex.1972). Thus, the trial court further erred in enjoining Rufus Ulmer from engaging in his chosen profession as part of the property division.

A covenant not to compete signed during marriage, being a contract right arising during marriage, and payments received under the agreement could be characterized as 100% community. On the other hand, an argument can be made that the payments represent foregone wages, and that foregone wages after divorce are separate property.

Another potential concern can arise with a covenant not to compete that extends past the date of divorce. When a business is sold, they buyer wants to get the seller"s covenant not to compete, since it protects the buyer's investment in the business, assuring the buyer that the seller will not try to lure away suppliers, customers, or employees. Some have argued that the covenant not to compete represents the embodiment of the seller's personal goodwill, and as such all payments attributable to the covenant not to compete are separate property under *Nail v. Nail*, neither received before or after divorce.

A similar issue arises when a deferred compensation benefit, to be paid after retirement, is conditioned upon the retiring employee not competing against the company. Some have argued that, since the covenant not to compete would prohibit post-divorce employment, the

deferred benefit is not entirely attributable to pre-retirement employment, but is also attributable to post-retirement foregone employment, and thus has a separate property component.

F. PARTIAL AND TOTAL LIQUIDATIONS. Controversy exists about the extent to which distributions made from separate property entities to a married spouse are separate or community property.

1. Distributions of Profits. All would probably agree that distributions of profits to a married owner are community property, absent a partition and exchange agreement or a spousal income agreement. The trouble starts when the distributions might be distributions of capital and not profits.

Partnership profits distributed to a married partner are community property, regardless of whether the spouse's partnership interest is separate or community property. *Harris v. Harris*, 765 S.W.2d 798, 804 (Tex. App.–Houston [14th Dist.] 1989, writ denied); *Marshall v. Marshall*, 735 S.W.2d 587, 594 (Tex. App.–Dallas 1987, writ ref'd n.r.e.).

2. Complete Liquidation. In *Fuhrman v. Fuhrman*, 302 S.W.2d 205, 212 (Tex. Civ. App.–El Paso 1957, writ dism'd), the court held that stock issued to a married shareholder upon dissolution of the holding corporation was received by the spouse as separate property. However, the character of distributions in liquidation of a corporation was questioned in *Legrand-Brock v. Brock*, 2005 WL 2578944, *2 (Tex. App.–Waco 2005, no pet.) (memorandum opinion) ("*Brock I*"), where a divided court suggested that payments in complete liquidation of a corporation might be community property to the extent that the distributions represent retained earnings and profits. In his dissent, Chief Justice Grey cited three cases indicating that proceeds from the liquidation of an ownership interest in a business have the same character as the ownership interest. The view of the Waco majority was rejected on appeal after remand by the Beaumont Court of Appeals in *Legrand-Brock v. Brock*, 246 S.W.3d 318 (Tex. App.–Beaumont 2008, pet. denied) ("*Brock II*"), which held that all distributions by a corporation in liquidation of separate property shares were received by the spouse as separate property.

3. Partial Liquidation. A controversy surrounds partial distributions from a separate property business, as to whether the are, separate property.

In *Legrand-Brock v. Brock*, 246 S.W.3d 318 (Tex. App.--Beaumont 2008, pet. denied) ("*Brock* II"), the court said:

> A liquidating distribution includes a transfer of money by a corporation to its shareholders in liquidation of all or a portion of its assets. See BLACK LAW'S DICTIONARY 508 (8th ed. 2004) (A "liquidating distribution" is "[a] distribution of trade or business assets by a dissolving corporation or partnership."); see also TEX. BUS. CORP. ACT. ANN. art. 1.02(A)(13)(c) (Vernon Supp. 2007) (" 'Distribution' means a transfer of money ... by a corporation to its shareholders ... in liquidation of all or a portion of its assets.").

Brock II, at 323. The *Brock II* court also cited the U.S. Supreme Court in *Hellmich v. Hellman*, 276 U.S. 233, 235, 48 S.Ct. 244, 72 L.Ed. 544 (1928), a tax case:

> A distribution in liquidation of the assets and business of a corporation, which is a return to the stockholder of the value of his stock upon a surrender of his interest in the corporation, is distinguishable from a dividend paid by a going corporation out of current earnings or accumulated surplus when declared by the directors in their discretion, which is in the nature of a recurrent return upon the stock.

Brock II, 246 S.W.3d at 324.

From an accounting or financial standpoint, corporate distributions are treated as coming first out of current earnings, then out of retained earnings, and finally out of capital. For federal income tax purposes, every distribution of a corporation to its shareholders is deemed to be made out of earnings and profits, to the extent there are any. See Treas. Reg. § 1.316-2(a). The distribution is deemed to come from current earnings first, and then from accumulated earnings from prior years. *Id.* After current and retained earnings are exhausted, what is left, by process of elimination must be a distribution of capital.

Marshall v. Marshall, 735 S.W.2d 587 (Tex. App.–Dallas 1987, writ ref'd n.r.e.), is frequently cited in support of the view that all distributions from a partnership during marriage are community property. In *Marshall*, the husband owned an interest in a partnership at the time of marriage. The partnership owned mineral leases that were acquired prior to husband's marriage. The court of appeals held that the mineral interests were

not separate property, because they belonged to the partnership and had no marital property character. The court rejected the idea that the husband retained an ownership interest in his capital contribution, or that partnership distributions were a mutation of his capital contribution. *Id.* at 594. The court also rejected the idea that the partnership's production of oil and gas was subject to characterization as either separate or community property. *Id.* at 594-95. Under the partnership agreement, it was agreed that all distributions to the husband in excess of his salary "shall be charged against any such distributee's share of the profits of the business." *Id.* at 595. On its books, the partnership allocated husband's draws that were in excess of the other partner's draws to husband's salary, and on the partnership tax returns the excess draws were reported as "guaranteed payments for partners." *Id.* at 594. The husband reported the distributions as ordinary income on his personal tax return. *Id.* The court noted that "all monies disbursed by the partnership were made from current income." *Id.* at 595. The court concluded:

> The withdrawals nevertheless were distributions of partnership income or profits and, thus, community. We hold that all distributions by the partnership to Woody during the course of the second marriage were community property.

Id. at 595. *Marshall* clearly states that distributions of current income or profits are community property. However, the opinion does not expressly say that all distributions from a partnership are community property. *Marshall* establishes that separate property capital, once contributed to the partnership, loses its character as separate property, so that distributions cannot be mutations of the separate property contribution. The significance of *Marshall* to a great degree depends on whether you read some of the statements in the Court's Opinion as broad principles of law, or whether you read them as conclusions drawn from the facts in the particular case (in particular, the language of the partnership agreement and the fact that all distributions were from current income).

In *Lifshutz v. Lifshutz*, 199 S.W.2d 9, 27 (Tex. App.–San Antonio 2006, no pet.) ("*Lifshutz II*"), a subsidiary corporation was transferred directly from a separate property family partnership to a separate property family corporation in a tax-free business recapitalization. *Id.* at 24-28. The trial court found this to be a "non-liquidating community distribution" from the partnership, and held the stock of the subsidiary to be community property of the husband. *Id.* at 24. After an extensive analysis of the facts and citation to *Marshall*, a 2-to-1 majority of the court of appeals wrote:

> Accordingly, since partnership property does not retain a separate character, distributions from the partnership are considered community property, regardless of whether the distribution is of income or of an asset.

The court recognized that a Louisiana appellate court had "drawn a distinction between distributions of income and distributions of a capital asset," but commented the Louisiana court did not analyze the effect of the entity theory of partnerships and further noted that in the present case, "the accumulated profits of [the partnership] exceeded the aggregate distributions, which included the [subsidiary] stock distribution." *Id.* at 27 n. 4.

G. TEX. BUS. ORG. CODE § 153.208. It is clear that the Texas Legislature believes that partial distributions from a limited partnership can be a return of capital, because Section 153.208 of the Business Organization Code specifically covers them. The statute says:

> § 153.208. Sharing of Distributions
>
> (a) A distribution of cash or another asset of a limited partnership shall be made to a partner in the manner provided by a written partnership agreement.
>
> (b) If a written partnership agreement does not provide otherwise, a distribution that is a return of capital shall be made on the basis of the agreed value, as stated in the partnership records required to be maintained under Section 153.551(a), of the contribution made by each partner to the extent that the contribution has not been returned. A distribution that is not a return of capital shall be made in proportion to the allocation of profits as determined under Section 153.206.
>
> (c) Unless otherwise defined by a written partnership agreement, in this section, "return of capital" means a distribution to a partner to the extent that the partner's capital account, immediately after the distribution, is less than the amount of that partner's contribution to the partnership as reduced by a prior distribution that was a return of capital.

Chapter 153 applies to limited partnerships, not

corporations, general partnerships, or limited liability companies.

TEXAS FAMILY LAW SERVICE

SPEER'S 6TH EDITION

Marital Property

CHAPTER 21
Business Interests

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1988

BANCROFT-WHITNEY CO.

[IT-041]

happens that the seller of a business will enter into a consulting agreement which is really nothing but another form of payment for the sale of the business. This is desirable to the seller, since payments made under a consulting agreement are deductible as expenses, whereas the purchase price of assets can only be depreciated.

In such a situation, it might be advantageous for a spouse to argue that the consulting agreement, and payments thereunder, have the same character as the business sold.

§ 21:53 Bonuses

Bonuses paid by an employer to an employee are compensation for the employee's labors, and as such they are community property to the extent they accrue during marriage. Difficulties can arise where a bonus received during marriage relates to a period of time falling partly or wholly before marriage. A similar problem exists where a bonus received after divorce relates to a period of time falling partly or wholly during marriage. Income earned before marriage but received during marriage is separate property [Moore v Moore (1946, Tex Civ App) 192 SW2d 929]. Income earned during marriage but received after divorce is community property [Busby v Busby (1970, Tex) 457 SW2d 551]. Income earned after divorce is separate property [Berry v Berry (1983, Tex) 647 SW2d 945 (disagreed with by multiple cases as stated in Iglinsky v Iglinsky (Tex App Tyler) 735 SW2d 536)].

In Echols v Austron, Inc. (1975, Tex Civ App Austin) 529 SW2d 840, writ ref n r e, a bonus paid to a spouse shortly after divorce was held to be his separate property. Although the court did not explain its reasoning, it appears that the fact that the bonus was not received during marriage was of controlling significance. Echols was decided before the Cearley case, which abandoned the requirement that the right to receive property after divorce had to vest before the right became divisible upon divorce [see Cearley v Cearley (1976, Tex) 544 SW2d 661].

While no other Texas cases indicate how a bonus is to be characterized, there is some logic to treating it like retirement benefits [see Ch 22]. The bonus could be apportioned equally over time, absent

evidence that the bonus accrued in increments based upon performance.

Not all bonuses are paid after the fact. Professional athletes, for example, may receive a bonus for signing an employment agreement which is referrable to the entire length of the contract. Treating such a bonus as purely separate or purely community depending on when it is received would be inconsistent with the law's treatment of other forms of compensation for services.

If the bonus is retrospective, and not guaranteed, an "if, when and as" division would cause both spouses to share the risk that no bonus is received. Where the employee spouse controls the amount of the bonus, the issue of dividing a possible future bonus is more complex.

Since a possible future bonus is not possessed by a spouse during marriage, the presumption of Fam C § 5.02 does not by its express terms apply. An attorney representing the non-employee spouse who suspects the possibility that a bonus will be received after divorce should either try to have the possible bonus divided in kind in the divorce, or at least avoid the assignment of such an interest to the employee-spouse, whether expressly or in a "Mother Hubbard" clause. A post-divorce partition would then be available.

VII. VALUING BUSINESS INTERESTS

§ 21:54 Fair market value

It is often assumed that assets should be valued for purposes of divorce at "fair market value." "Fair market value" has been defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts" [26 CFR § 20.2031-1(b) (estate tax); 26 CFR § 25.2512-1 (gift tax); United States v Cartwright (1973) 411 US 546, 36 L Ed 2d 528, 93 S Ct 1713, 73-1 USTC P 12926, 31 AFTR 2d 73-1461; Pearland v Alexander (1972, Tex) 483 SW2d 244].

Fair market value is used for federal tax purposes, for ad valorem tax purposes, for condemnation purposes, for insurance purposes, and for tort purposes. In some instances, however, using fair market value for purposes of divorce can be unfair.

3 Tex. Fam. L. Serv. § 21:51

Texas Family Law Service
Database updated February 2007

By Anne E. Melley, J.D. *

Marital Property
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VII. Other Business Interests

Summary

§ 21:51. Bonuses

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In Echols v. Austron, Inc., 529 S.W.2d 840 (Tex. Civ. App. Austin 1975), writ refused n.r.e., a bonus paid to a spouse shortly after divorce was held to be his separate property. Although the court did not explain its reasoning, it appears that the fact that the bonus was not received during marriage was of controlling significance. Note, however, that the Texas Supreme Court later abandoned the requirement that the right to receive property after divorce had to vest before the right became divisible upon divorce [Cearley v. Cearley, 544 S.W.2d 661 (Tex. 1976)].

Not all bonuses are paid after the fact. Professional athletes, for example, may receive a bonus for signing an employment agreement which is referable to the entire length of the contract. Treating such a bonus as purely separate or purely community depending on when it is received would be inconsistent with the law's treatment of other forms of compensation for services.

If the bonus is retrospective, and not guaranteed, a clause apportioning it to the spouses if, when, and as received would cause both spouses to share the risk that no bonus will be received. Where the employee spouse controls the amount of the bonus, the issue of dividing a possible future bonus is more complex. Because a possible future bonus is not possessed by a spouse during marriage, the presumption that property possessed by either spouse upon dissolution of the marriage is community property does not apply. An attorney representing the nonemployee spouse who suspects that the employee spouse may receive a bonus after the divorce should try to have the possible bonus divided in kind in the divorce, or at least avoid the assignment of such an interest to the employee-spouse, leaving open the possibility of a postdivorce partition.

Footnotes

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