Now & Next

Labor & Employment Alert

April 26, 2024

California Court exempts stock options from "Wages" classification

By **Robert Pepple** and **Gabriel Mendoza**

The ruling simplifies compensation for employers, easing the regulatory burden on offering stock options.

What's the impact?

- Stock options are used to attract and lock in top talent, leaving industries that rely heavily on stock options, such as startups and technology, to rethink how they secure loyalty and drive performance.
- The ruling provides clarity that could reduce compliance issues, and potential disputes, surrounding how wages are documented—and contested.

In Silicon Valley, stock options are more than just a component of compensation—they are the golden handcuffs, a vital tool for startups and tech giants alike to attract and lock in top talent by aligning employees' financial futures with corporate success. However, a recent California Court of Appeal ruling in *Gautam Shah v. Skillz Inc.* has just redrawn the battle lines on what these options mean in the eyes of the law, declaring that stock options are not wages. This decision is set to ripple through the tech industry, shifting how companies devise their allure and employees' stake their claims.

Decoding the verdict: Stock options and the Labor Code

The court's decision addressed a critical issue: whether stock options, whose value can fluctuate, should be classified as "wages" under the California Labor Code. It determined that, "Stock options do not constitute wages under the conventional understanding within the California Labor Code due to their contingent value and speculative nature." (*Shah v. Skillz Inc.*, p. 8). This clarification resolves numerous compliance challenges related to how wages are recorded and contested. For tech companies or any employers in environments of rapid growth and fierce competition, this ruling provides significant relief and opens new avenues for structuring compensation packages.

Navigating compensation strategies across industries

This ruling is more than a mere legal clarification—it's a strategic pivot for compensation planning. By affirming that stock options are not wages, it opens the door for all companies, particularly in tech, to develop more innovative stock option packages aimed at boosting loyalty and enhancing performance. Employees across various sectors may need to reassess their compensation's risk-reward ratio, particularly in environments where the value of stock options can fluctuate dramatically. This decision continues to influence how companies attract and retain top talent, with a significant impact felt in the tech sector.

Court's approach to assessing stock option worth

In the ruling of *Shah v. Skillz Inc.,* the court delved into the intricate process of valuing stock options, particularly emphasizing the significance of the IPO lock-up period. This period, which imposes restrictions on stock sales following a company's public offering, emerged as a crucial factor in determining the options' worth.

The court's rationale for focusing on the post-lock-up period was rooted in the acknowledgment of the primary value of stock options: the opportunity to cash them out if the company achieves success and goes public. By considering the options' value at a juncture where they could be freely traded, the court aimed to provide a more accurate reflection of the financial loss incurred by the plaintiff, Shah, due to his inability to exercise the options.

This approach aimed to capture the essence of the speculative yet potentially rewarding nature of stock options in the tech industry, particularly in the context of rapid growth and market dynamics. By accounting for the opportunities that would have been available to Shah had he been able to participate in the market following the IPO, the court's methodology sought to offer a comprehensive understanding of the options' true value.

Thus, the court's decision to emphasize the IPO lock-up period in valuing the options not only provided clarity in assessing damages for lost options but also underscored the broader implications for both employers and employees in navigating the complexities of compensation and employment rights within the tech sector.

Future perspectives: stock option compensation post *Shah v. Skillz Inc.*

The aftermath of *Shah v. Skillz Inc*. reveals a significant shift in how employers approach compensation, particularly those using stock options. Beyond its legal implications, the ruling prompts a critical reassessment of how companies structure compensation. By reclassifying stock options, the court not only clarifies legal boundaries but also signals a change in compensation strategies across industries.

A paradigm shift in tech compensation

In the realm of modern compensation practices, the *Shah v. Skillz Inc.* ruling has far-reaching implications for all employers considering the use of stock options as part of their compensation packages. The decision prompts a reevaluation of how businesses across various sectors incentivize their workforce. As organizations contemplate the potential impact of this ruling on their compensation strategies, they are faced with the opportunity to explore innovative approaches to employee remuneration. In this era of continual transformation, staying abreast of legal developments and adapting compensation practices accordingly will be essential for employers seeking to attract and retain top talent.

Connect with us: Stay informed on evolving compensation strategies post *Shah v. Skillz* Inc.

Navigating the intricate terrain of modern compensation strategies post the *Shah v. Skillz Inc.* ruling? Our extensively experienced team is here to guide you through the evolving legal landscape and help you adapt your compensation practices effectively. Whether you're reassessing stock option packages or exploring new approaches to employee rewards, reach out to our team at [contact information] to ensure your strategies align with the changing dynamics of the workplace.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

Robert H. Pepple
213.629.6140
rpepple@nixonpeabody.com

Gabriel A. Mendoza
213.629.6122
gmendoza@nixonpeabody.com