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CHANGING STOCK PLAN ADMINISTRATORS: HANDLING THE TRANSITION

by
John L. Utz
Utz, Miller & Kuhn, LLC
jutz@utzmiller.com

"A recent . . . court decision serves as a reminder of the confusion which can result when changing stock plan administrators,"

A recent federal appeals court decision serves as a reminder of the confusion which can result when changing stock plan administrators, and how to avoid liability as a result of that process. The case, *Sheils v. Pfizer, Inc.*, 2005 WL 2404536 (3d. Cir. 2005), concerned a former employee's claim that he was entitled to additional time to exercise stock options upon termination of his employment because he did not receive adequate information about the new process for exercising options.

In *Sheils*, the court applied California law, presumably due to a choice of law provision in the relevant stock option agreements, in deciding not to extend the option agreements' normal deadline for exercising options. Although courts frequently enforce time limitations for exercise despite employees' claims that they were promised a different deadline would apply, this decision is interesting because of the context it which it arose. The confusion occurred by reason of a change from in-house administration of the option plan to an outside stock plan administrator, Merrill Lynch.

Stock Option Agreements. The employee's stock option agreements explicitly set forth manner and time requirements for the exercise of options. The agreements required that all employees exercise their options by giving written notice to the company, and required that a terminated employee exercise his or her options within three months after the date on which his or her employment terminated.

Switch in Plan Administrator. Although the stock option agreements required that employees exercise their options in writing, they did not indicate more specifically how employees were to do so. In particular, they did not indicate what information employees should include in their exercise notice nor to whom employees should give their notice. At the time the plaintiff terminated employment, the appropriate process was to give a notice of exercise to the stock plan administrator, who was a particular individual at the company. This process changed, however, after the employee terminated employment and before the deadline for exercising his options. Under the modified process, employees were required to open an account with Merrill Lynch and exercise their options through that institution instead of through the individual who had been serving as in-house plan administrator.

The employee received a mailing from the company a few weeks before his employment was terminated, advising him as follows:

> Next week you will receive a Pfizer Stock Option Package in the mail. This kit will prepare you for the July 1, 2002 transition to the Merrill Lynch system. This kit will include important information about the new service, what you need to know to open an account and exercise your options and an invitation to . . . upcoming information sessions . . ..

The company claimed it sent the kit referred to in the mailing to all past and current employees and that it did so during the month in which the employee terminated. The employee said he never received the kit and therefore never saw instructions for exercising his options under the new system.

Helpful Factors. The company had done several things that helped it win the lawsuit. The first was sending to the employee the preliminary mailing announcing the switch to Merrill Lynch. Second, the company provided the employee with separation documents upon his termination of employment reminding him that his stock options were subject to the terms and conditions of the stock option agreements. The separation documents also included a Merrill Lynch phone number that terminated employees could call if they had questions regarding their stock options. That phone number was the same number provided to employees in the kit.

Employee's Complaints. The person who had been serving as plan administrator, and who continued to serve as administrator on the date the employee terminated employment, usually sent terminated employees a certified letter informing them of how many options they had, how to go about exercising their options, and the deadline for doing so. The employee claimed he did not receive such a certified letter. The employee also claimed he called the individual who served as stock plan administrator on the day he was terminated, asking for information about his stock options and how he could exercise them, but the administrator did not respond to his voicemail message.

The employee asserted that he called Merrill Lynch within the timeframe for exercising his options (using the number that was listed in the separation documents), and asked for information about his outstanding options. He said the person to whom he spoke told him Merrill Lynch could not help him because he did not have an account at Merrill Lynch. The employee claimed that he later called the in-house plan administrator again, before the switch to Merrill Lynch had become effective, but that she did not respond. The employee said he also did not receive an e-mail that the outgoing administrator sent on her last day of employment, reminding employees that she was leaving the company, and that they should contact Merrill Lynch to exercise their options.

On the day after his options expired, the employee received a status report from Merrill Lynch informing him that his options had expired on the previous day. He said he immediately called the number on the report and left a message. The next day, he called a representative of the company, who confirmed that the employee's options had expired and would not be reinstated.

Court's Conclusion. The court concluded that the employee did not exercise his options in the limited period of time set forth in the option agreement, and that this timeframe must be strictly enforced. The employee argued that the company had prevented him from exercising his options by failing to inform him how to exercise once Merrill Lynch replaced the in-house stock plan administrator. In particular, the employee complained that the in-house

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Utz Miller & Kuhn, LLC
13200 Metcalf
Suite 230
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Gregory B. Kuhn
gkuhn@utzmiller.com
Phone: 913.685.0774
Fax: 913.685.1281

Eric N. Miller
emiller@utzmiller.com
Phone: 913.685.8150
Fax: 913.685.1281

John L. Utz
jutz@utzmiller.com
Phone: 913.685.7978
Fax: 913.685.1281

Matthew J. Eickman
meickman@utzmiller.com
Phone: 913.685.0749
Fax: 913.685.1281

www.utzmiller.com

administrator had failed to send to him (1) the certified letter she customarily sent to terminated employees, and (2) the e-mail she sent to employees on her last day at the company, and Pfizer failed to provide him with (3) the kit with the promised Merrill Lynch materials and (4) the status report indicating when his stock options expired until after it was too late.

The court rejected the employee's argument that he was entitled to be excused from the time limitations under the stock option agreements, explaining that under California law no such relief is available where the failure to exercise results from the employee's own neglect or inadvertence and was not contributed to by the employer. In this regard, it was undoubtedly helpful that the employee admitted receiving an initial mailing indicating that the switch to Merrill Lynch would occur (and indicating the date on which it would occur), and that the employee's separation documents included a contact telephone number at Merrill Lynch. The company might have strengthened its position further if it had a clear protocol with Merrill Lynch requiring that Merrill Lynch provide information concerning exercise even prior to an employee establishing the necessary account for implementing a decision to exercise, and if Merrill Lynch had followed that protocol. (It should be noted that all of the employee's allegations were taken by the court as true for the purpose of its ruling, so it is possible there was such a protocol in place.)

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The court also rejected the employee's argument that improper notice of the exercise process was given because the stock option agreements provided that any notices or other communications "permitted or required" under the agreements had to be writing and had to be served personally or sent by registered or certified mail. Among other reasons, the court rejected this argument because the materials concerning Merrill Lynch were not *required* to be provided, and they were *permitted* to be provided to the employee only in the sense that the stock option agreements did not explicitly forbid the company from providing the materials. The court concluded that when referring to "permitted" notices or communications the agreements surely were not referring to every communication not explicitly forbidden by those agreements, but must instead be referring only to communications specifically mentioned in the agreements as optional (that is, communications affirmatively permitted under the agreements).

Lessons. The company did well by providing multiple forms of communication concerning the change in stock plan administrator (and therefore the change in the process for exercising options). It sent an initial mailing to employees, informing them that there would be a subsequent, more detailed, mailing to follow. In addition, the company provided an appropriate contact telephone number for the new stock plan administrator in the employee's separation documents. The company might have improved its position further if it had in place a clear protocol with the new stock plan administrator requiring that it address the option exercise requirements with participants even before those participants had established an account with the administrator for implementing any decision to exercise.

Companies may wish to minimize ambiguity in their option agreements concerning any requirement that notices or communications "permitted" under the agreements be provided in a particular form or fashion by deleting mention of "permitted" notices or communications if none are in fact contemplated. In that event, any process described in the agreement for providing notice or other communications would apply only where a communication is required.

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Utz Miller & Kuhn, LLC
13200 Metcalf
Suite 230
Overland Park, KS 66213

Phone: 913.685.0970
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Gregory B. Kuhn
gkuhn@utzmiller.com
Phone: 913.685.0774
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Eric N. Miller
emiller@utzmiller.com
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