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CHANGES IN CONTROL: GOOD REASON AFTER AGREEMENT, BUT BEFORE CLOSING

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Lots of equity arrangements provide for vesting (or continued exercisability) when an executive terminates for good cause following a change in control. But what happens when an executive terminates for good reason after a change in control agreement is signed, but before closing? Often the answer is pretty clear. The executive does not vest (or enjoy continued exercisability) because no change in control will occur under the relevant equity plan until closing – that is, until consummation of the transaction. So, the executive in that circumstance who leaves before closing will leave before the change in control, and therefore will not vest or enjoy continued exercisability of his or her options, RSUs, or SARs.

But sometimes a plan will say that a change in control occurs when the employer has <u>agreed</u> to the change in control – that is, when it enters into a binding sale or merger agreement. In a recent unreported decision, a federal appeals court recently considered just such an arrangement. The twist, though, was that although the employer's action that gave the executive good reason occurred before closing (and after the merger agreement was signed), the executive did not terminate until after closing. The result was that the executive lost out on his ability to receive payment for restricted stock units merely because he gave notice of his voluntary termination after closing, and not before. If, in contrast, the executive had given notice before closing he would have received the value of his RSUs.

The case is *Young v. Merrill Lynch & Co.*, 658 F.3d 436 (5^{th} Cir. 2011). The Merrill Lynch long term incentive plan at issue normally provided that rights to awards that had not yet been exercised at termination of employment were lost. But in the event of a change in control, if the company were to terminate an executive's employment without cause, or the executive were to terminate his or her employment for good reason, the participant was to be paid in a cash lump sum the value of the participant's stock options, restricted shares, restricted stock units, stock appreciation rights, and certain other forms of equity or equity-like compensation.

In *Young*, an executive claimed that he was entitled to the value of RSUs following a change in control. Merrill Lynch had entered into a merger agreement with Bank of America on September 15, 2008. The merger occurred a few months later on January 1, 2009. One of the good reason triggers was the receipt of an annual bonus following a change in control that was lower than the average of the executive's three preceding annual cash bonuses. The executive in *Young* received just such a smaller bonus in December 2008, after the merger agreement had been signed but before the merger occurred.

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Therefore, upon resigning, the executive argued that he had resigned for good reason following a change in control. He was able to make this argument because the plan provided that if Merrill Lynch were to execute an agreement, the consummation of which would result in a change in control, then for purposes of the plan's good reason provisions a change in control would be deemed to have occurred as of the date of the execution of that agreement. So, the executive argued, the change in control occurred in September 2008 and the executive received after that date a bonus small enough to constitute good reason.

But the executive did not terminate employment prior to consummation of the merger. Instead, he terminated employment in February 2009. The compensation committee of the board administering the plan concluded that for executives leaving after the January 1, 2009 consummation of the merger, the executive's good reason event must also occur on or after that January 1, 2009, consummation date. This meant, according to the committee, that the smaller bonus the executive received in late 2008 did not constitute good reason because it occurred before the merger was consummated. This was so even though the plan deemed the execution of the merger agreement to be a change in control.

The committee acknowledged that there was, in fact, a change in control upon execution of the merger agreement. But it treated those who left prior to consummation of the merger differently than those who terminated on or after consummation of the merger. Specifically, the committee concluded that the deemed change in control upon execution of the merger agreement was of effect only for employees who "are terminated or resign for good reason prior to [the] closing of a transaction." That is, Merrill Lynch applied the date of the signing of the merger agreement, September 15, 2008, as the change in control date for individuals who left the company between the merger agreement's signing and the consummation of the merger. But the committee did not treat the date the merger agreement was signed as the change in control date for the executive bringing the lawsuit, since he resigned after the merger actually occurred.

The court seemed to acknowledge that the plan could be read as the executive argued – that is, that a change in control occurred upon execution of the merger agreement and the payment of a sufficiently small bonus after that date but before closing gave the executive good reason to terminate employment, even though that termination occurred after consummation of the merger. Very importantly, though, the plan provided for deferential review of the committee's determinations. And the court said where the committee has the sole interpretative authority for a plan of the type at issue, an executive seeking to argue for a different interpretation must show that "no honest tribunal could have construed the Plan in any manner" other than as the executive read the plan and that the employer had advanced an "arbitrary reading" of the plan. The court concluded that the executive failed to carry this "heavy burden."

Young was a split decision, 2 to 1. A vigorous dissent concluded that the unambiguous terms of the plan made clear that the executive had good reason to resign in February 2009, and that the compensation committee's reading of the plan was based on an interpretation that was contrary to the plan's unambiguous terms and therefore arbitrary under New York law.

Lesson. The lesson that comes through loudest in *Young* is the importance of plan language that gives a committee or other plan administrator sole authority to interpret the plan's provisions.

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