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# STOCK OPTIONS: THE POWER OF THE PLAN DOCUMENT

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A recent federal trial court decision suggests that recipients of stock option grants had better read the terms of their grants and the related plan documents! In *First Marblehead Corp. v. House*, 401 F.Supp.2d 152 (D. Mass. 2005), a financially sophisticated former executive was required to exercise his stock options within three months following his termination of employment, as required under the terms of the stock option plan document and grant, even though the executive had previously received a two-page memorandum setting forth the principal terms of the grant, which had indicated only that the options "must be exercised within 10 years of the date of grant." There had been no mention in the memorandum of any three-month deadline for exercise following termination of employment.

After the executive received the memorandum of principal terms (and a "compensation review" worksheet, which listed the executive's items of compensation), the company prepared the executive's actual stock option grant. The executive asserted, and the court took as true for purposes of the employer's motion for summary judgment, that the executive never saw the specific grant of incentive stock options nor the complete plan document prior to his leaving the company. The executive contended that he believed he could exercise his stock options at any time within the 10-year period. He indicated that no one at the company ever told him anything about time limits for exercise upon termination of employment (and the employee did not inquire about any such limits).

The court rejected the executive's breach of contract argument that the written terms of the grant, and in particular the three-month deadline for exercise following termination, did not apply because the memorandum the executive received stated that the options had a 10-year duration. The court held that under Delaware law (which applied because the company was a Delaware corporation) the terms of the instrument approved by the company's board of directors granting the option must control, despite any conflicting terms in the memorandum or worksheet provided to the executive. As an alternative ground for rejecting the executive's breach of contract argument, the court concluded that the memorandum the employee received dealt only with the duration of the options, not exercisability. The court reached this conclusion even though the memorandum stated that the options "must be *exercised* within 10 years of the date of grant." (Emphasis added)

The executive not only argued that requiring exercise within three months of termination was a breach of contract, he also argued under a promissory estoppel theory that he was entitled to exercise his options beyond the three month deadline. The executive asserted that he relied on the language

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of the worksheet and memorandum, and in particular, their failure to state a deadline for exercise following termination. The court rejected this argument as well. Although the court acknowledged that under the doctrine of estoppel, *minor* extensions of an option exercise deadline may be permitted to deal with last minute emergencies, no corporate officer had made affirmative misrepresentations with respect to exercisability of the options. In addition, the court said the executive, as a sophisticated individual, should have known there was a written grant, yet he never asked for that document nor inquired about the terms of the incentive stock option upon leaving the company. The court noted as well that the memorandum described the options as "ISOs," which the court said should have raised a red flag for the executive to further investigate the terms of the options.

In similar fashion, the court rejected a negligent misrepresentation claim made by the executive. The court concluded that this sophisticated executive had not shown that he justifiably relied on the omission from the memorandum and worksheet of information concerning the deadline for exercise.

**Lesson**. The lesson of this case is more for executives than for employers. And it is a simple one: recipients of stock option grants should, with the assistance of appropriate professional advisors, carefully read the terms of their grants and the terms of the underlying stock option plan document. The equally simple corollary for employers is that stock option plan documents and grants should be written carefully and precisely, because they are likely to serve as the ultimate authority concerning the terms of the options granted, particularly in cases involving Delaware corporations.

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