No. 83960-3

WIGGINS, J. (dissenting)—I agree with the trial court that Daniel Farmer acted fraudulently when he exercised all of the stock options, including those he agreed should be awarded to Teresa and then concealed his fraud. I agree with the trial court, the appellate court, and the majority that the remedy for Daniel's misconduct must not be punitive and that the appropriate remedy would be to make Teresa whole by placing her in as good a position as she would have been in had Daniel not exercised Teresa's options. Majority at 11, 17, 19 n.8; *In re Marriage of Farmer*, noted at 152 Wn. App. 1054, 2009 WL 3584260, at *9-10.

But I dissent because the trial court has placed Teresa in a much better position than she would have been in had Daniel not exercised her options. This is apparent for several reasons. First, without a scintilla of evidence about when Teresa would have exercised her options, the trial court simply accepted Teresa's expert's calculations, which were based on the assumption that Teresa would have exercised each option on the last possible day before each option expired. Second, the expert assumed a straight-line growth rate in the value of PACCAR stock of 20.235 percent per year, eight years into the future. Third, the trial court then accepted Teresa's expert's discount rate of 6.0 percent, which unrealistically eliminated most of the risk of holding stock options until the day before expiration.

As the majority notes, "Determining the value of stock options is a complicated endeavor." Majority at 12. The majority points out that "courts have used three main approaches to valuing stock options: present value, retained jurisdiction, and deferred distribution." Majority at 13. But as the majority notes, the present value approach is highly fact-specific, involving analysis of many variables using complex formulas. The second and third models are not valuations at all, but simply opt to "wait and see," deferring the division of the stock options until someone chooses to exercise the options.

The majority also notes that there are at least seven accepted approaches for valuing damages for the conversion of stock. Majority at 15 (citing Royce de R. Barondes, *An Alternative Paradigm for Valuing Breach of Registration Rights and Loss of Liquidity*, 39 U. Rich. L. Rev. 627 (2005)).[1] We followed one of these

[1] The seven measures of damages are:

approaches—the value of the property at the time of conversion—in *In re Marriage of Langham and Kolde,* 153 Wn.2d 553, 106 P.3d 212 (2005). The Court of Appeals followed yet another of these formulas in *Brougham v. Swarva*, 34 Wn. App. 68, 77-78, 661 P.2d 138 (1983), in which the Court of Appeals held,

> [W]here personal property which has a sharply fluctuating value is willfully converted and such conversion is fraudulently concealed by the converter, the measure of damages is the highest value of the property wrongfully and knowingly converted between the time of conversion and a reasonable time after the victim learns of such conversion. Such a rule protects the victim who has invested in property for speculative purposes when the market either rises or falls subsequent to the conversion. The innocent victim should not suffer a loss because of the wrongful taking and withholding of his property. Neither should he be granted the windfall of complete umbrella protection by being awarded the highest possible valuation of the property from the time of its taking to the entry of judgment or its return.

> (i) the value at the time of the conversion; (ii) the highest value from the time of the conversion to a reasonable period of time thereafter; (iii) the highest value from the time of the conversion to a reasonable period of time after the owner has notice of the event; (iv) the highest value from the time the owner has notice of the conversion to a reasonable period of time thereafter; (v) the higher of the value at the time of the conversion and the highest value from the time the owner has notice of the conversion to a reasonable period of time thereafter; (vi) the highest value from the time of the conversion until the time the lawsuit is filed; and (vii) the highest value from the time of the conversion until the time of trial or the time a verdict or judgment is issued.

Barondes, *supra*, at 636-39 (footnotes omitted). While the numerous approaches demonstrate that this area of law is in "severe disarray," *Id*. at 632, it is notable that none of the accepted approaches relies on speculation. Instead, each approach bases the damage award on documented values of the stock.

(Citation omitted.) Though the converted property of fluctuating value in *Brougham* was silver coins, the rule could readily be applied here, where Daniel willfully converted Teresa's share of the stock options and fraudulently concealed the conversion.[2] Teresa should not suffer a loss from Daniel's wrongful exercise of her options, but neither should she be granted the windfall of blanket protection against the market's risk. *See id.*

Alternatively, courts sometimes use a different measure of damages if it is supported by the evidence. For example, in *Greene v. Safeway Stores, Inc.*, 210 F.3d 1237 (10th Cir. 2000), an employee testified that his wrongful discharge forced him to exercise his stock options and sell the shares within a few months because he needed cash to pay taxes and living expenses after his employment was terminated.

[2] The majority rejects a rule awarding damages based on the converted property's value between the time of conversion and a reasonable time after the victim learns of the conversion because the rule relies on the victim's ability to reenter the marketplace, an impossibility where the converted property, like stock options, is irreplaceable. Majority at 15. But the "reasonable period of time thereafter" rule rejected by the majority does not require the victim to reenter the market, it uses possible reentry only as a means of establishing "the outer time limit of a reasonable period during which the highest intermediate value of the lost stock could be ascertained." *Schultz v. Commodity Futures Trading Comm'n*, 716 F.2d 136, 140 (2d Cir. 1983). The Third Circuit Court of Appeals in *Scully* did not reject recovery for the conversion of stock options on the basis of the rule and explained that it allows at least "a limited recovery" of the benefit of the victim's bargain—namely, the inherent nature of a stock option that provides its holder with "a reduced risk of loss and a greater likelihood of profit." *Scully v. US WATS, Inc.*, 238 F.3d 497, 512 (3d Cir. 2001).

Greene testified that he had planned to exercise his options shortly after he retired at age 55; instead, the wrongful discharge required him to exercise them two years earlier. *Id.* at 1243. Had Greene exercised his options later, he would have reaped the benefit of increases in the market price of Safeway stock. *Id.* Greene's planned retirement date was sufficient evidence of his professed intent to exercise his options at a later date.

Similarly, in *KERS & Co. v. ATC Communications Group, Inc.*, 9 F. Supp. 2d 1267 (D. Kan. 1998), the parties entered a stock-option agreement that granted the plaintiff a 10-year right to acquire up to 225,000 shares at $1. Under the agreement, the plaintiff had "demand registration rights" that required the defendant to register the shares within 90 days of the plaintiff's request. *Id.* at 1269. The plaintiff requested registration in July 1996, but the defendant delayed registration until November 1996, more than 90 days after the request, in violation of the stock option agreement. *Id.* at 1270-71. Because of the changing market price of the shares, the plaintiff lost more than $2 million as a result of the breach and delay. *Id.* at 1271. The plaintiff presented "uncontroverted evidence" in the form of testimony from its trustees and minutes from a September board meeting (before the plaintiff became aware of the breach) "indicating that the shares would be sold as soon as possible after registration." *Id.* at 1272. This evidence was adequate to show that, had the breach not occurred, the plaintiff would have sold the shares for the higher price available in October.

By contrast, a court cannot simply assume that the victim of conversion would have exercised stock options at a specific time if no evidence supports the proposed exercise date. In *Scully v. US WATS, Inc.*, 238 F.3d 497 (3d Cir. 2001), the court held that the wrongful discharge of Scully by WATS deprived Scully of his right to exercise stock options. Scully's stock option agreement gave Scully the right to purchase 850,000 shares of restricted stock at $0.75. *Id.* at 508. Upon exercising the option, the restriction on the stock prevented Scully from transferring the stock for one year from the date of the exercise. *Id.* Scully argued that the district court should have calculated his loss as of the expiration of the restrictive period because only then would he have been able to sell his shares. *Id.* The Third Circuit Court of Appeals rejected Scully's argument, explaining that his approach was "unduly speculative." *Id.* at 512. The court held that "in the absence of a district court's express credibility finding or other convincing evidence, we cannot accept a plaintiff's after-the-fact assertion that he would have sold stock at a time that, in hindsight, would have been particularly advantageous." *Id.* at 512-13. The Third Circuit compared the facts in *Scully* to other cases where there was "adequate evidence [to confirm] a plaintiff's professed intent concerning the exercise of security interests." *Id.* at 513 n.3.

Evidence of the kind presented in *Greene* and *KERS*—testimony or pre-breach statements about the plaintiff's intent to exercise the options—is notably absent in this case. Instead, the trial court awarded damages to Teresa in the amount of $487,325, an amount based on the declaration of Teresa's expert, Ronald Nelson, who stated, "*If* Ms. Farmer had held her options until the day before expiration, and the rate of return remained consistent, Ms. Farmer would have realized $617,553 on future exercises . . . ." Clerk's Papers (CP) at 137 (emphasis added). Nelson did not base his calculation of Teresa's loss on any evidence that she would have held her options until the day before expiration. He simply speculated, as did the trial court when it relied on his declaration. The trial court could not have relied on any competent evidence of Teresa's intent to exercise her options because the record does not contain *any* evidence of that intent.[3]

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[3] A search of the record revealed only one statement regarding Teresa's intention toward the stock options. Teresa stated,

> I had already sought counsel in regards to the exercise of my share of the stock options and had planned on exercising the options in smaller stages and holding on to the shares of stock in order to pay an alternative minimum tax liability of 15% rather than the 37.5% tax that Mr. Farmer will pay since he exercised all of the options and took the money all at once . . . .

CP at 584. This does not support an assumption that Teresa would have held the options until the date before each expired, because, as shown by the calculations of Teresa's expert, the exercise of the option triggers a tax on the difference between the

The trial court's assumption that Teresa would have held her options until the date before expiration is similar to the "after-the-fact assertion" the *Scully* court found inadequate to support an award based on a date that "in hindsight, would have been particularly advantageous" to the plaintiff. *Scully*, 238 F.3d at 513. In this case, an award based on the options' expiration dates is improperly based on speculation and conjecture.

Several facts demonstrate the excessiveness of the trial court's judgment. First, it is undisputed that Daniel netted a total of $444,664 upon his exercise of all the options, half of which belonged to Teresa and half to Daniel, but the trial court's judgment against Daniel was $487,325, over twice the amount received by Daniel for Teresa's half of the options. Second, if the trial court had used the formula followed by the appellate court in *Brougham*, Teresa would have received half as much as the trial court awarded. In *Brougham*, the court measured damages as "the highest value of the property wrongfully and knowingly converted between the time of conversion and a reasonable time after the victim learns of such conversion." 34 Wn. App. at 77. Applying this formula in this case results

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market price and the exercise price, whether or not the holder of the options sells or holds the stock. Nor did the trial court refer to this statement to support the award of damages. In contrast, there is evidence to support an assumption that Teresa might have sold the options sooner because she needed the income. Teresa stated it took time to "adjust to [her] current income level" because the dissolution forced her "to make huge adjustments and changes in lifestyle and spending habits." CP at 591.

in damages of $237,450.[4] Third, whether or not Teresa's expert's projection of a 20 percent annual increase in value was reasonable when he made the projection in March 2007, it was apparent by April 2008 when the trial court entered judgment that the stock market as a whole had suffered a steep decline. The high for PACCAR stock in March 2007 was $78 per share, and in March 2008, the high, adjusted for a three-for-two stock split, was $72.88 per share.[5] *See* PACCAR Inc. Historical Prices, Yahoo! Finance, http://finance.yahoo.com/q/hp?s=PCAR&a=07&b=14&c=2005&d=07&e=14&f=2008&g=m (last visited August 31, 2011). Instead of a 20 percent increase, the stock suffered an 8 percent decline during the period March 2007 to March 2008.

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[4] Nelson calculated that Daniel exercised 7,447 (total options less 125 not exercised) of Teresa's options at a total exercise cost of $124,413 (sum of adjusted exercise price multiplied by options exercised for each grant). *See* CP at 141. The record reveals that from the date of exercise, August 14, 2006, to November 27, 2006 (which was just over one month after Teresa learned that Daniel had exercised the options), the highest value of the PACCAR stock was $66.88 during the week of November 13. CP at 598. To exercise the options at this price, Teresa would have to pay the exercise price plus taxes on the difference between the market price and the exercise price. The damages would equal $498,055 ($66.88 multiplied by 7447 shares), minus the exercise price of $124,413, minus the taxes that would have been due on the exercise of the options. Nelson calculated that the taxes would equal 36.45 percent of the difference between the selling price of the stock and the exercise price, which results in a tax bill of $136,193. When the taxes are deducted, Teresa should have received at most $237,450, or roughly half of the damages awarded by the trial court.

[5] The March 2008 high was $48.44. Multiplying by 3/2, or 1.5, the split-adjusted high was $72.88.

As the Court of Appeals concluded, the damage award was not deliberately punitive.[6] *Marriage of Farmer*, 2009 WL 3584260, at *10. But the effect is certainly punitive; the trial court awarded damages to Teresa that exceed the total proceeds received by Daniel from the exercise of all the options, both his and hers. Accordingly, because I would hold that the trial court abused its discretion by awarding damages based on speculation unsupported by the record, I dissent. I would remand the case to the trial court to allow Teresa the opportunity to present evidence of her intent to exercise the options. If she cannot present credible evidence that she intended to hold the options, the trial court should calculate her damages based on the highest value of her stock options between the date she discovered Daniel's wrongful conversion and a reasonable period of time thereafter. This could be the date used as an example above—approximately one month after Daniel admitted selling Teresa's options—or some other period of time determined by the trial court to be reasonable.

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[6] "Since its earliest decisions, this court has consistently disapproved punitive damages as contrary to public policy. Punitive damages not only impose on the defendant a penalty generally reserved for criminal sanctions, but also award the plaintiff with a windfall beyond full compensation." *Dailey v. N. Coast Life Ins. Co.*, 129 Wn.2d 572, 574, 919 P.2d 589 (1996) (citation omitted). An award intended to punish Daniel for the wrongful conversion would be improper.

I dissent.

AUTHOR:
Justice Charles K. Wiggins

WE CONCUR:
Chief Justice Barbara A. Madsen

Justice James M. Johnson