

PACIFIC EXCHANGE, INC.  
115 Sansome Street  
San Francisco, CA 94104

In The Matter Of The Arbitration Between:

DONALD ARNDT,

Claimant,

v.

SALOMON SMITH BARNEY and  
MARCUS FAGERSTEN,

Respondents.

PCX CASE No. 02-S016

DECISION

The undersigned Arbitrators, having read and considered the Claim submitted by Claimant and the Answer of Respondents, and having considered evidence presented at the hearings on April 27, 28, and 29, 2005, hereby render the following Decision pursuant to Rule 12 of the Pacific Exchange:

REPRESENTATION OF PARTIES

Of Claimant: Donald Arndt, *in pro per*

Of Respondents: Ben Suter, Esq. and Kevin J. Woods, Esq.  
Keesal, Young & Logan

SUMMARY OF FACTS

In December 1998, Claimant Donald Arndt ("Claimant") began working as a senior product manager for Western Multiplex Corporation (WMUX), which was then a privately held company located in Sunnyvale, California. In connection with his employment, Claimant purchased 18,000 shares of WMUX stock at \$.50 per share in January 2000 (the "Founder's shares"). In January 2000, he was also granted options to purchase 50,000 shares of WMUX stock at \$.50 per share (the "option shares"). WMUX conducted an initial public offering of its stock on August 1, 2000, and thereafter WMUX was listed on the NASDAQ stock exchange.

WMUX management established the Western Multiplex Stock Option Program with the Fagersten-Varon Group at Solomon Smith Barney (SSB). On February 2, 2001, SSB exercised 18,000 of Claimant's WMUX option shares, which had an exercise cost of \$9,000. SSB sold 4,500 of these shares on February 2, 2001 and 5,500 shares on February 8, 2001. On May 22, 2001, SSB sold the remaining 8,000 WMUX options shares. SSB did not withhold amounts

for taxes or for the cost of exercising the options. The Claimant requested the proceeds from the sale of his stock immediately.

Claimant asserts that in February 2001, he instructed SSB to sell the WMUX shares that he owned, meaning the Founder's shares. By exercising the stock options and selling the option shares instead, Claimant contends that SSB failed to follow his instructions which led to negative tax consequences of \$20,060.66. Moreover, Claimant alleges that SSB's lack of response and assistance with respect to the fees and tax consequences associated with the exercise of his stock options and the sale of his option shares contributed to the termination of his employment from WMUX in January 2002.

SSB contends that it received verbal and written instructions from the Claimant on February 2, 2001 to exercise 18,000 of his WMUX options shares and then to sell 10,000 of these shares in February 2001. SSB further contends that it discussed the exercise cost and tax liability of the options exercise with the Claimant, and understood that he would deal directly with his employer on these issues.

### **ISSUES PRESENTED**

Claimant presented two issues:

1. Whether SSB failed to follow Claimant's instructions when it exercised his right to purchase 18,000 options shares in February 2001, and then sold these shares instead of Founder's shares, which resulted in negative tax consequences; and
2. Whether SSB was negligent in its dealings with Claimant with respect to the fees and tax consequences associated with the exercise of his stock options and the sale of his option shares, which was a substantial factor in the termination of his employment from WMUX.

Respondents did not assert a counterclaim.

### **RELIEF REQUESTED**

In his Statement of Claim, Claimant requested \$50,000 and a "corrected 1099 to reflect the fact that Western Multiplex has reported \$225,056.60 of income on [his 2001] W-2." At the hearing, Claimant requested \$150,000 in damages.

Respondent requested that the records of Marcus Fagersten and Deborah Tharp be expunged.

### **FINDINGS AND DECISION**

#### **A. Findings of fact:**

After considering the argument and evidence of both the Claimant and Respondent in this matter, the undersigned Arbitrators make the following findings:

1. Donald Arndt ("Claimant"), an electrical engineer, began working as a senior project manager in December 1998 for Western Multiplex Corporation (WMUX), which was then

a privately held company located in Sunnyvale, California.

2. In January 2000, in connection with his employment, Claimant purchased 18,000 shares of WMUX stock at \$.50 per share (the Founder's shares). At this time, he was also granted options to purchase 50,000 shares of WMUX stock at \$.50 per share (the option shares). WMUX conducted an initial public offering (IPO) of its stock on August 1, 2000, and thereafter WMUX was listed on the NASDAQ stock exchange. The stock was in a "lock up" period for 180 days after the IPO and could not be sold.
3. WMUX management established the Western Multiplex Stock Option Program with the Fagersten-Varon Group at Solomon Smith Barney (SSB), thus making SSB the designated broker for WMUX. On January 26, 2001, Marcus Fagersten and Solomon Varon gave a presentation at WMUX to employees regarding the Employee Stock Purchase Plan and Stock Option Plan. See Ex. 25. There was no mention of Founder's shares at the presentation. Claimant attended.
4. On January 30, 2001, Claimant first contacted SSB by e-mailing Mr. Varon and inquiring as to how he could open an account and "get things moving with SSB." On January 31, Claimant responded to Mr. Varon's e-mail that he wanted to open both a stock option account and an individual account.
5. On January 31, 2001, Mr. Varon e-mailed Claimant the necessary paperwork to open an individual account, introduced him to Deborah Tharp, an SSB financial consultant, and instructed him to speak with Michael Park at WMUX regarding his stock options.
6. Claimant then met with Mr. Park, the WMUX comptroller. Mr. Park was responsible for accounting and finance at WMUX, and handled the stock administration. Mr. Park testified that Claimant had completed the WMUX Exercise Stock Incentive Plan Exercise Notice form (Ex.9). He gave Claimant the SSB Exercise Notice form (Ex.8) and a form to open a SSB account (Ex. 5). After the forms were completed, and the two Exercise Notice forms had been approved and signed by Nancy Huber, the WMUX CFO, Mr. Park instructed Claimant to fax the forms to SSB. Mr. Park testified he had no discussion with Claimant about Founder's shares.
7. On February 2, 2001, SSB received the three documents from Claimant: (1) the WMUX Stock Incentive Plan Exercise Notice that instructed SSB to exercise options for 18,000 shares, with the exercise cost of \$9,000; (2) a completed and signed SSB Exercise Notice that instructed SSB to exercise the Claimant's options for 18,000 shares and to sell 10,000 of these shares; and (3) an SSB Stock Plan New Account Information and Disclosure Notice (Exhibits 9, 8, and 5, respectively).
8. On February 2, 2001, Marcus Fagersten called Claimant to confirm the instructions on his Exercise Notice. During this conversation, Claimant verbally changed his instructions and asked that SSB exercise the right to purchase 18,000 options shares, but sell only 4,500 of the 10,000 shares immediately. See Ex.8.
9. On February 2, 2001, SSB exercised Claimant's option to purchase 18,000 shares and sold 4,500 of these shares on the same day. At Claimant's request, SSB sold an additional 5,500 shares on February 8, 2001.

10. Claimant requested the proceeds from the sale of his stock immediately, receiving checks in the amounts of \$60,000 and \$66,879.84 on February 9 and 16, respectively.
11. On February 8, Claimant's 18,000 Founder's shares were credited to his main account. Ms. Tharp testified that these shares were first "viewable on the system" on February 9, 2001. According to Plaintiff's Exhibit A, the first sale of any Founder's shares took place on February 20, 2001.
12. On February 9, 2001, WMUX counsel issued an opinion letter to the transfer agent for the WMUX stock, thus finally allowing the transfer agent to process the Founder's shares. (Ex. 36).
13. On February 14, 2001, SSB received Michael Park's calculation that Claimant owed WMUX \$82,559.77 in payroll tax withholding on the exercise of his stock options, plus \$9,000 in exercise costs. (Ex.14). Claimant's stock options (Non-Qualified Stock Options or "NQSO") are taxed at the time of the exercise of the stock options. The difference between the amount paid by the employee and the amount at the time of exercise (the "spread") is taxed as ordinary income by payroll withholding. Generally, SSB remits the payroll tax to the company before proceeds are deposited into an account. SSB's failure to withhold tax on Claimant's account was an administrative error. SSB explained that this error was a result of Claimant demanding the proceeds from his stock sales immediately and Michael Park's delay in forwarding the withholding information to SSB until February 14.
14. Sean Carolan, an SSB sales assistant, testified that he called the Claimant after the sale of his option shares and before February 16, 2001. Carolan testified that he explained to the Claimant that he owed WMUX \$91,559.77 in taxes and exercise costs, and that Claimant could either return the funds to SSB which would forward the amounts to WMUX, or pay WMUX directly. Carolan testified that plaintiff stated he would contact WMUX directly.
15. Marcus Fagersten testified that Carolan reported that the Claimant did not agree to the withholding and that he indicated that he would deal with WMUX directly. Fagersten communicated this exchange to Michael Park, and then considered the issue as one strictly between employer and employee. *See generally* Ex. 33, p. CL 0108.
16. Michael Park testified that SSB advised him that Claimant had received the proceeds from the sale of his options shares, but that Claimant had declined to have any amounts withheld. In late February 2001, Park told the Claimant that he owed WMUX for the payroll withholding and the exercise costs, and that the Claimant responded that SSB had erred and that he would attempt to resolve the issue with SSB. WMUX paid Claimant's payroll taxes in the first quarter of 2001.
17. Claimant testified that he had no discussion with anyone at SSB regarding taxes and that he expected SSB either to withhold taxes or to have advised him about the taxes owed.
18. On May 22, 2001, at Claimant's request, SSB sold the remaining 8,000 WMUX options shares.

19. In June 2001, Claimant completed the necessary Form 144 paperwork for the proposed sale of his Founder's shares. On June 29, 2001, SSB sold 8,000 of Claimant's Founder's shares. SSB sold Claimant's remaining 10,000 Founder's shares on three days in December 2001. The sale of the Founder's stock was subject to the long term capital gain tax, rather than ordinary income tax.
20. In July 2001, Claimant received notice that his employer had continuing issues with his job performance. See Exhibit 31, p.27. Claimant received a Written Warning for Unacceptable Performance, dated September 26, 2001, which he read and to which he added comments on September 27, 2001. *Id.*
21. In November 2001, Michael Park, Nancy Huber, SSB representatives, counsel to WMUX and others discussed the facts and circumstances of the debt owed to WMUX by Claimant and the possible remedies the company could pursue to collect. Fagersten testified that it was not until November 2001 that he learned Claimant was asserting that SSB had sold the wrong stock in February 2001.
22. WMUX terminated Claimant's employment on January 22, 2002.
23. Plaintiff sold a total of 36,000 WMUX shares during 2001, for which he received a total of \$247,423.24. The negative tax consequences of exercising Claimant's options and selling the option shares before the sale of the Founder's shares was \$20,060.66.

**B. Decision:**

After considering the argument and evidence of both the Claimant and Respondent in this matter, the undersigned Arbitrators make the final determination and decision of the issues presented, as set forth below:

1. SSB followed Claimant's express instructions when, in February 2001, SSB exercised Claimant's right to purchase 18,000 option shares and sold these shares instead of Founder's shares.

Claimant testified that he did not understand the difference between Founder's shares and options shares, and that he asked SSB to sell the shares that he had already paid for. When Claimant spoke to SSB representatives, however, they had paperwork before them with Claimant's express instructions to exercise his option to purchase 18,000 shares and then to sell these shares. See Exhibits 8 and 9. Moreover, Claimant verbally confirmed and modified these instructions in a conversation with Marcus Fagersten on February 2, 2001. SSB was not even aware that Claimant owned 18,000 shares of Founder's stock until February 9, 2001, when such stock was "viewable on the system." Claimant's complaint with the paperwork and instructions directing SSB to exercise his option rights and sell option shares, instead of Founder's shares, does not rest with SSB or its employees.

2. Claimant failed to prove that SSB was negligent in its dealings with Claimant with respect to the fees and tax consequences associated with the sale of his WMUX shares.

Claimant's assertion that he assumed SSB was withholding taxes for him was not reasonable in light of 1) the multiple witnesses that testified that they had discussed with Claimant the tax consequences of the sale of the stock; and 2) the account statements that Claimant regularly received from SSB. See Exhibit 29.

3. Claimant failed to prove that the conduct of SSB was a substantial factor in the termination of his employment. There was simply no evidence offered at the arbitration proceeding linking SSB's conduct with the termination of Claimant's employment in January 2002.
4. The records of Marcus Fagersten and Deborah Tharp should be expunged.

C. Award:

For the reasons set forth above, Claimant is awarded no damages or other relief. The Panel requests that the records of Marcus Fagersten and Deborah Tharp be expunged. SSB shall pay the forum costs, as set forth below.

D. Other determinations (please check "yes" or "no" for each item)


1. Respondent shall reimburse Claimant's non-refundable filing fee: ☐ YES ☒ NO
2. Respondent shall reimburse Claimant's hearing session deposit: ☒ YES ☐ NO
3. Parties shall bear their own costs of arbitration: ☒ YES ☐ NO
4. Should this matter be referred to any regulatory organization (SRO or SEC) for disciplinary investigation of rule violations or violation federal securities laws? ☐ YES ☒ NO

E. Forum Fees:

Two pre-hearing conferences and five hearing sessions were held in this matter, for a total cost of \$3300. Based on testimony given by both parties in this case, the panel is of the opinion that SSB through its Fagersten-Varon Group was not providing sufficient service to their new clients. A more comprehensive relationship may have prevented some of the problems that occurred.

The Panel finds that the \$3300 fees shall be assigned wholly to SSB, and that SSB reimburse Claimant for his \$500 hearing session deposit.

Dated: 5/13/05

  
Gail Killefer, Chair

Dated: \_\_\_\_\_

\_\_\_\_\_  
Roger Schuster, Public Arbitrator

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\_\_\_\_\_  
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Dated: \_\_\_\_\_

Dated: 5/12/2005

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Rodger S. Mueller  
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