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THE COURTHOUSE PERSONNEL DEPARTMENT

JUNE 2007

STOCK OPTIONS MUST BE EXERCISED IN STRICT COMPLIANCE

WITH THE OPTION AGREEMENT

On October 21, 2002, Consumer Programs, Incorporated ("CPI") employed Peggy Deal ("Deal") as an Executive Vice-President under an employment agreement. The employment agreement provided that if Deal was terminated following a change in control, CPI would pay her, among other things, a lump sum equal to two times her base salary ("severance benefit"), an annual bonus, and salary for the remainder of the year.

Deal and CPI also entered into a Stock Option Agreement ("Stock Option Agreement"), which granted Deal the option to purchase 16,204 shares of CPI common stock at \$12.96 per share, or an aggregate purchase price of \$210,004. The Stock Option Agreement also provided that Deal could exercise her option to purchase within 90 days of termination "by giving written notice to [CPI] of the intention to exercise the option, accompanied by full payment of the purchase price of the shares with respect to which the option is exercised."

On May 14, 2004, CPI terminated Deal without cause following a change of control. Deal's base salary at that time was \$245,000. Upon Deal's termination, CPI refused to pay Deal's base salary for the remainder of the year, the annual bonus, or the severance benefit.

In a letter dated June 25, 2004, Deal, through counsel, sent CPI notice of her intent to exercise the option to purchase CPI common stock. Deal also demanded the remainder of her annual base salary, the severance benefit, and the annual bonus. Deal did not forward the \$210,004 payment of the shares' purchase price with her letter. Rather, the letter stated Deal "intends to exercise her options pursuant to the parties' Stock Option Agreement . . . and is prepared to tender cash in the amount of \$210,004 for her stock. Please inform me if CPI intends to perform its agreement under that contract." CPI did not respond to this letter. On August 4, 2004, Deal's counsel sent a second letter berating CPI's failure to pay Deal and stating: "Under the current circumstances, Ms. Deal will not pay CPI the purchase price for the stock. We assume that CPI would keep the money and refuse to issue Ms. Deal her stock." Again, CPI did not respond to the letter.

Deal sued CPI for breach of the employment agreement and the Stock Option Agreement. While Deal received her severance benefit in the amount of \$490,000 after a Court ordered mediation, both Deal and CPI sought summary judgment on the remainder of Deal's claims. Pursuant thereto, the lower court granted summary judgment in favor of Deal on her salary and bonus payment claim, awarding her \$106,009 and \$12,035 respectively, and in favor of CPI regarding the stock option claim. Both parties appealed.

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Your comments concerning this publication are welcome.

On appeal, Deal argued the lower court erred in holding she failed to properly exercise her stock option by failing to comply with the terms of the Stock Option Agreement, which provided, “This option shall be exercised by [Deal] . . . by giving written notice to [CPI] of the intention to exercise the option, accompanied by full payment of the purchase price of the shares.” The lower court reasoned Deal did not satisfy a condition precedent of the Stock Option Agreement because Deal failed to accompany her written notice with full payment of the purchase price.

The Appellate Court agreed. Under Missouri law, options to purchase are not favored and “are strictly construed against a person whose right it is to exercise the option. Acceptance of an option cannot be made in some manner contrary to the method provided” in the agreement. Rather, “[a]n optionee must exercise the option in strict accordance with its expressly stated terms and conditions.”

In this case, Deal did not accompany her written notice of intent to exercise the stock option with the \$210,004 purchase price. Instead, Deal merely stated she was “prepared to tender cash,” a statement which did not comply with the express terms of the Stock Option Agreement. Deal attempted to excuse her failure to strictly comply with the agreement by arguing that, at the time Deal notified CPI of her intent to exercise the stock option, CPI was holding \$490,000 of Deal’s money, thus relieving Deal of her obligation to pay CPI an additional \$210,004.

According to Deal, she effectively exercised her stock option by employing the common-law right of set-off. Deal’s correspondence to CPI before commencement of the litigation, however, did not mention that Deal wanted to set-off her obligation to submit payment of the purchase price against the severance benefit CPI was withholding. Accordingly, the Appellate Court concluded there was no effective claim of set-off.

The Appellate Court also rejected Deal’s argument that CPI’s lack of response to her correspondence was evidence of CPI’s refusal to honor the Stock Option Agreement. The Appellate Court stated that the option to purchase stock was a unilateral contract, which existed separate and apart from Deal’s Employment Agreement, and until Deal accepted the option in the prescribed manner, there was no enforceable contract. Thus, as the lower court rightly determined, “CPI was under no duty to assure [Deal] of performance or respond to her requests that it do so.”

Finally, the Appellate Court ruled CPI’s failure to pay Deal her severance benefit until the Court ordered mediation did not excuse Deal’s failure to comply with the clear requirements of the separate Stock Option Agreement. Had Deal delivered full payment of the stock purchase price and CPI nevertheless refused to issue stock in Deal’s name, Deal would be able to pursue her claim for breach of the Stock Option Agreement against CPI. In short, Deal was not without legal options to protect herself in the event CPI failed to honor the terms of the Stock Option Agreement.

The law in Illinois in this area is the same as in Missouri. Parties to an agreement must strictly comply with the terms of the agreement if they expect to reap the benefits therefrom. Please do not hesitate to call us if you have any questions about required contractual performance under employment or employment-related agreements.

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