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STOCK OPTIONS: PROJECT DELAY RESULTS IN VESTING, TO COMPANY'S CHAGRIN

By
John L. Utz
Utz, Miller & Eickman, LLC
jutz@utzmiller.com

It's hard to predict the future. Which makes it especially hard to describe the future in a legal document. One company's inability to anticipate the degree to which a project might be scaled back has apparently allowed an executive to vest in more options than the company intended. This was the result in *Lewitton v. ITA Software, Inc.*, 585 F.3d 377 (7th Cir. 2009).

In *Lewitton*, the federal appeals court for the Seventh Circuit rejected the company's argument that a former executive was not entitled to exercise some of his options due to the company failing to meet certain revenue targets. The employer was an airline information technology and services provider, offering to online travel agents a product used for airfare shopping and pricing. Although this product allowed travel agents to shop for tickets, it did not allow them to book reservations or purchase tickets. The employer embarked on a project to add that capability. Early in 2005, the employer indicated that it expected to roll out this additional capability between April and June of the same.

Not long after, in April 2005, the executive entered into an employment agreement with the company agreeing that he would serve as a vice president. Among his duties was to supervise the development and marketing of the new booking and purchasing capability. The executive's employment contract granted the executive stock options to purchase up to 200,000 shares of the employer's stock. Those options were to vest in equal monthly installments of 5,556 shares, except that the first 12 months of options would vest on the executive's one-year employment anniversary.

Important to the parties' dispute, there was an additional provision under which some of the options would be forfeited if the company failed to achieve certain revenue goals. Under that provision, the executive could forfeit up to 150,000 of his options if those goals were not met. The measurement period for the company's revenue performance was to run from June 1, 2006, through May 31, 2007. But, in a refinement that led to the dispute, the contract said if the development schedule for the project the executive was supervising was "materially deferred" from the schedule "presently contemplated," the 12-month measurement period would be deferred by an equal number of months. So, for example, if the development schedule for the new product were delayed by two months, the measurement period would be delayed two months, to run from August 1, 2006, through July 31, 2007.

The executive terminated employment on May 21, 2007, just before the end of the initial 12-month measurement period applicable if there were no

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material delay in the development schedule. Three months later, the executive attempted to exercise 138,900 options. This was 5,556 options for each month of the executive's 25 months with the company. The company permitted the executive to exercise only 34,722 options, taking the position that the remaining 104,178 options were forfeited pursuant to the forfeiture clause based on company revenue.

As it turned out, the rollout of the new product was substantially delayed, and had not occurred even by the date of the court's opinion in October 2009. The company, though, asserted that the new product was not delayed, but was instead terminated, and therefore there should be no delay in the 12-month measurement period for hitting the revenue targets required to avoid the forfeiture of options. The company's CEO said the company, in consultation with its board, had concluded that it should "reduce the resources" devoted to the project, and that there were "no full-time resources devoted" to the project. The company described the development of its new capability as having been "significantly scaled back," but admitted work was still being done on the project to protect the company's investment in the program to date.

Because the rollout had not yet occurred, the court concluded that the 12-month revenue measurement period never began and, therefore, the forfeiture provision did not apply. Presumably, this was because the length of the delay was not yet known, but was instead ongoing.

This, of course, is an ironic result, given that tying the measurement period for the company's revenues to the development of the new product suggested that the new product was critical to evaluating the executive's contribution to the company. It is interesting that the court concluded that the measurement period never began. The employment agreement did not seem to delay the measurement period until the new product was rolled out, but instead provided for a delay corresponding to any delay in the "development schedule" for the product. The court may have concluded that these amounted to the same thing, particularly given that the company's original stated expectation was that the product would be rolled out within a few months after the executive entered into the agreement, well before the original 12-month measurement period was even set to begin.

The court found that the employment agreement's reference to the development schedule being "materially deferred" was unambiguous. The court therefore would not consider evidence of any negotiations that preceded the contract, which might have permitted the company to show that it did not intend for the executive to vest in all of his options where the product development was curtailed or delayed so substantially. The court disallowed this extrinsic evidence of the parties' intentions both because the court found the employment agreement's language to be unambiguous and because the contract included an "integration clause," which stated that the written agreement "supersedes all prior agreements, understandings or negotiations." According to the court, this integration clause demonstrated that the parties formally decided "to protect themselves against misinterpretations which might arise from extrinsic evidence," and that they agreed that the "negotiations leading to the written contract *are not* the agreement." (Citing, and quoting from, an Illinois Supreme Court decision.)

Lesson. In essence, the company was unable to tie the vesting of options to the company's revenue performance, as it had intended, because it failed to address in the agreement the possibility that the new product would be significantly scaled back, rather than merely delayed. Drafters of documents might do well, then, to try to anticipate worst case scenarios, and explain to their clients why anticipating those possibilities is not a case of drafting "overkill."

Utz, Miller & Eickman, LLC
7285 West 132nd St.
Suite 320
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Matthew J. Eickman
meickman@utzmiller.com
Phone: 913.685.0749
Fax: 913.685.1281

Eric N. Miller
emiller@utzmiller.com
Phone: 913.685.8150
Fax: 913.685.1281

John L. Utz
jutz@utzmiller.com
Phone: 913.685.7978
Fax: 913.685.1281

www.utzmiller.com