UTZ & LATTAN LLC
ATTORNEYS AT LAW

JANUARY 14, 2013 VOLUME 9, NUMBER 1

UNSIGNED OPTION AGREEMENT ENFORCED

By
John L. Utz
Utz & Lattan, LLC
jutz@utzlattan.com

"A California appeals court recently enforced the terms of an unsigned stock option agreement."

A California appeals court recently enforced the terms of an unsigned stock option agreement. It did so even though the parties disputed whether they had in fact reached agreement. Although the existence of a writing may well have helped the court conclude that there was an enforceable agreement between the parties, it does not seem to have been critical to the court's analysis. For that reason, one might characterize the case as enforcing the terms of an oral option agreement, though one memorialized by an unsigned writing. The case is *Maughan v. Correia*, 210 Cal. App. 4th 507 (Cal. App. 2012).

Maughan involved a dispute between siblings as to ownership of a family-owned business. The plaintiff, Maureen, together with her former husband and her parents owned and operated a hotel in San Diego. They became delinquent on loan repayments, and as a result a bank lender foreclosed on the hotel. The bank, however, retained the family to continue to operate the hotel.

Maureen and her brother, Maurice, later approached the bank for the purpose of discussing how the family might repurchase the hotel. The bank made clear that it could not sell the hotel to the same persons who had defaulted on the prior loan. It did, though, indicate that it would be willing to sell the hotel to Maurice, because he had not been involved with the prior operation of the hotel. Alternatively, the bank would be willing to sell the hotel to a corporation. With the family's agreement, Maurice, who was an accountant, then formed an S corporation to handle the purchase of the hotel.

Maureen asserted that at the time of this repurchase, her ex-husband, her parents, and Maurice agreed the hotel would be jointly owned. Specifically, she alleged that the parties agreed Maurice would have a one-third interest in the business, Maureen and her then husband would hold a one-third interest, and Maureen's parents would own the remaining one-third interest. Maureen asserted this was to be the ownership split regardless of the amount of money each party had personally invested in the hotel. Maureen testified that although Maurice would initially be the "title" owner, stock reflecting this one-third split would issue to the rest of the family at some point in the future. In particular, Maureen thought the names of the other "owners" would later be put on the "title."

Maurice, in contrast, seemed to assert that ownership should be in proportion to each family member's "cash" contributions to the corporation. This would have given Maurice a 74 percent ownership interest, with Maureen and her husband holding only a seven percent interest. A dispute arose as a result, and Maurice made a proposal to Maureen in an effort to resolve it. Maurice proposed a means by which Maureen could acquire up to a one-third interest in the hotel by paying Maurice amounts to reduce his ownership percentage. Maurice

provided Maureen with schedules and ownership percentages in this connection, demonstrating how Maureen's purchase of a total one-third share would decrease both Maurice's cash contributions – which were sometimes referred to as "loans" – to the hotel, and Maurice's corresponding interest in the corporation. Maureen's understanding was that under this proposal she would be paying Maurice for her interest, and would be obtaining the stock from him.

The court concluded that within some months after the proposal was made the parties had entered orally into a stock option agreement. Maurice prepared a document memorializing that, under the agreement, Maureen and her then husband had 10 years to exercise their option to purchase up to a one-third interest in the company, at a specified dollar price plus two points over the prime interest rate. Maureen indicated that she and her husband understood they were relinquishing any claim they might have that the shares of the company should be differently allocated, and specifically that they were giving up any claim that they were entitled to a one-third interest under a prior agreement made at the time the hotel was repurchased from the lender.

The written document, which the parties never signed, indicated that there was an agreement between Maureen (and her husband) and the corporation, which would give Maureen the option to purchase up to one-third of the stock in the corporation. Maureen testified that her agreement was not with the corporation, but instead with Maurice, and she disagreed with various recitals set forth in the writing. These included a recital that Maurice owned 100 percent of the corporation from its inception (and up to the date of the stock option agreement). Maureen's understanding was that by paying Maurice the option price, she was effectively reimbursing him for the "loans" he made to the company, and was obtaining stock directly from him.

Above the signature lines (which, again, were blank because the agreement was never signed), was the following statement: "By signing below I certify that, to the best of my knowledge and belief, . . . the information set forth in this statement is true, complete and correct." According to Maureen, she and her husband orally agreed to the stock option agreement, but did not sign it because the agreement was one between family members, she and Maurice had been "very close," and Maurice did not ask her to sign it. Maurice, in contrast, testified that there was no agreement because Maureen told him she would never have the money to purchase the additional shares. For this reason, Maurice testified, he believed the stock option agreement was "a dead issue." Maureen responded that her inability to pay for the entire one-third interest at the time of the agreement was why the agreement gave her 10 years to exercise.

In a portion of the opinion not certified for publication (meaning, generally, that it must not be cited or relied on by a court or party in another lawsuit), the court enforced the option agreement. The court referred to it as an "oral stock option agreement," suggesting that the existence of the written memorialization of the agreement was not a prerequisite to the court's finding that the agreement was enforceable. In the unpublished portion of the opinion, the court addressed Maurice's two principal arguments. The first was that the document memorializing the agreement specified that acceptance must be indicated by a signature, but the parties never signed the agreement. Maurice's second principal argument was that the parties' conduct after the agreement was supposedly entered into was inconsistent with the existence of an agreement. The trial court found otherwise on both points, and the appellate court found that the evidence was sufficient to support the trial court's conclusions.

Notably, as to Maurice's point about the document not having been signed, the court said it is true that an offeror may require that an agreement be signed in order for it to be binding. But "if the respective parties orally agreed

Utz & Lattan, LLC

Overland Park Office:
7285 West 132nd St.
Suite 320
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Skokie Office:
10024 Skokie Blvd.
Suite 213
Skokie, IL 60077-9944

Phone: 224.233.1342
Fax: 913-685-1281

Huntsville Office:
P.O. Box 1547
Huntsville, AR 72740

Phone: 479-738-1083
Fax: 913-685-1281

Katherine Utz Hunter
kutz@utzlattan.com
Phone: 224.233.1342

Lisa H. Lattan
lisalattan@utzlattan.com
Phone: 913.685.8150

Dale K Ramsey
dramsey@utzlattan.com
Phone: 479-738-1083

John L. Utz
jutz@utzlattan.com
Phone: 913.685.7978

www.utzlattan.com

upon all of the terms and conditions of a proposed written agreement with the mutual intention that the oral agreement should thereupon become binding, the mere fact that a formal written agreement to the same effect has not yet been signed does not alter the binding validity of the oral agreement." The court continued by saying "whether it was the parties' mutual intention that their oral agreement to the terms contained in a proposed written agreement should be binding immediately is to be determined from the surrounding facts and circumstances of a particular case and is a question of fact for the trial court." (Citing and quoting *Banner Entertainment, Inc. v. Superior Court*, 62 Cal. App. 4th 348 (Cal. App. 1998).)

Lesson. *Maughan* may suggest that omnibus or other option plans should include provisions making clear that no option is granted unless the parties have signed a written option agreement, presumably either in a form attached to the plan or approved by the compensation committee or other committee with primary responsibility for the plan. The case may also suggest that the option agreement itself should recite that it is ineffective unless signed by both parties. Although neither of these steps would prohibit a plaintiff from arguing that the parties entered into an oral option agreement, this practice would seem to undercut any argument that an agreement had been reached based on an unsigned agreement in the form typically used by the corporation. One concern with expressly conditioning an option on the parties signing an agreement relates to the establishment of the grant date. A signature requirement might be considered to delay the date of grant to the date the last of the parties signs, which would raise option exercise price issues where the option is not intended to be in the money upon grant.

Utz & Lattan, LLC

Overland Park Office:
7285 West 132nd St.
Suite 320
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Skokie Office:
10024 Skokie Blvd.
Suite 213
Skokie, IL 60077-9944

Phone: 224.233.1342
Fax: 913-685-1281

Huntsville Office:
P.O. Box 1547
Huntsville, AR 72740

Phone: 479-738-1083
Fax: 913-685-1281

Katherine Utz Hunter
kutz@utzlattan.com
Phone: 224.233.1342

Lisa H. Lattan
lisalattan@utzlattan.com
Phone: 913.685.8150

Dale K Ramsey
dramsey@utzlattan.com
Phone: 479-738-1083

John L. Utz
jutz@utzlattan.com
Phone: 913.685.7978

www.utzlattan.com

Note: This article has been published in the *NASPP Advisor*, a publication of the National Association of Stock Plan Professionals (NASPP).