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CORPORATIONS—EMPLOYEE STOCK OPTION PLANS—NATURE OF CONSIDERATION REQUIRED FOR VALID PLAN—Restricted stock option plans, approved by a majority of the stockholders, were adopted by the defendant corporation in 1951 and 1952 pursuant to, and in compliance with, section 218 of the Revenue Act of 1950, for the purpose of “. . . providing an incentive to participating key executive employees in the form of an opportunity to acquire a greater proprietary interest in the corporation and thus stimulate their efforts in the corporate welfare. . . .” The options were effective and exercisable anytime *from the date of issuance* to the end of a five-year period, with provision for termination three months after leaving the company’s employ. The options were non-transferable and optionees stated that they exercised the options for investment only and not for distribution. In 1953 the directors passed a resolution pursuant to the amended Delaware Corporation Law that it was their opinion that the corporation had received and would receive good and sufficient consideration for the options granted under the 1951 and 1952 option plans, and employment contracts were obtained from all option holders, dating from the time of the grant of options. In a stockholder’s representative suit, *held*, the stock options were invalid for lack of consideration. At the time of granting the option, there must be conditions in the option plan, or in the circumstances, which reasonably assure the corporation that it will receive the benefit for which it bargained. Later resolutions or employment contracts cannot remedy the lack of consideration in the option grants. *Frankel v. Donovan*, (Del. Ch. 1956) 120 A. (2d) 311.

In general, majority stockholders cannot make gifts of corporate assets for other than charitable purposes over the protest of a minority stockholder.¹ There must be a consideration which meets the requirements of general contract law given in exchange for stock options.² Normally this consideration cannot be based on the past services of an employee.³ Some courts have, however, recognized exceptions to this rule when the options are granted for past services for which the option holder has not

¹ *Rogers v. Hill*, 289 U.S. 582, 53 S.Ct. 731 (1933); Del. Code Ann. (1953) tit. 8, §122 (9). See generally 88 A.L.R. 744 (1934); 39 A.L.R. (2d) 1192 (1955); BALLANTINE, CORPORATIONS 228 (1946); 6A FLETCHER, C.Y.C. CORP., perm. ed., §2939 (1950); STEVENS, CORPORATIONS §§52 to 54 (1949). Of course, even charitable gifts are subject to the limitation that they be reasonable.

² *Kerbs v. California Eastern Airways*, (Del. Ch. 1951) 83 A. (2d) 473, revd. (Del. 1952) 90 A. (2d) 652, enforced (Del. 1952) 91 A. (2d) 62; *Gottlieb v. Heyden Chemical Corp.*, (Del. Ch. 1951) 83 A. (2d) 595, revd. (Del. 1952) 90 A. (2d) 660, reargued in part (Del. 1952) 91 A. (2d) 57, enforced (Del. 1952) 92 A. (2d) 594. See also 39 VA. L. REV. 335 (1953); 5 FLETCHER, C.Y.C. CORP., perm. ed., §2142 (1952); WASHINGTON AND ROTHSCHILD, COMPENSATING THE CORPORATE EXECUTIVE 123 (1951). But see cases cited in note 6 *infra*.

³ *Blish v. Thompson Automatic Arms Corp.*, (Del. 1948) 64 A. (2d) 581; *Utica Fire Alarm Tel. Co. v. Waggoner Watchman Clock Co.*, 166 Mich. 618, 132 N.W. 502 (1911); *Holthusen v. Edward G. Budd Mfg. Co.*, (D.C. Pa. 1943) 52 F. Supp. 125, amended plan approved (D.C. Pa. 1943) 53 F. Supp. 488. See also 40 A.L.R. 1432 (1926); 5 FLETCHER, C.Y.C. CORP., perm. ed., §§2137, 2140, 2143 (1952); 32 CALIF. L. REV. 88 (1944).

already been compensated⁴ or are granted for services rendered under a formal or informal agreement that additional compensation might be paid subsequently,⁵ or if the options have not risen in value above the option price at any time between the grant of the option and the commencement of the action.⁶ Generally the consideration for option rights is based on future services, and the most common benefits to the company found to be sufficient are employment contract rights, and the assumption or continuation of corporate duties by the benefited employees.⁷ The Delaware courts have taken the strict view of requiring that there be conditions in the plan, or in the circumstances, which reasonably assure that the corporation will receive the benefits for which it bargained, i.e., that the consideration is not illusory. In the principal case the court rigidly adheres to this requirement. While admitting that "It may seem captious to decline to find consideration in the undisputed fact that the option holders have not only remained with the corporation but have to some extent changed position by exercising options,"⁸ the court holds that the time for ascertaining whether the option plans are supported by sufficient consideration is not when the options are exercised but when they are granted.⁹ Therefore, in order for the consideration to be sufficient the Delaware decisions require (a) a benefit to the corporation (b) bargained and exchanged for the option (c) with reasonable assurance in the option plan, or in the circumstances, that the corporation will receive the benefit for which it bargained. These requirements can easily be met, and future representative suits

⁴ *Blish v. Thompson Automatic Arms Corp.*, note 3 supra; *Hurt v. Cotton States Fertilizer Co.*, (5th Cir. 1947) 159 F. (2d) 52, cert. den. 331 U.S. 823 (1947). See also 5 FLETCHER, CYC. CORP., perm. ed., §§2113 to 2118 (1952).

⁵ *National Loan & Investment Co. v. Rockland Co.*, (8th Cir. 1899) 94 F. 335; *Richardson v. Blue Grass Mining Co.*, (D.C. Ky. 1939) 29 F. Supp. 658, affd. (6th Cir. 1942) 127 F. (2d) 291, cert. den. 317 U.S. 639 (1942).

⁶ *Abrams v. Allen*, 36 N.Y.S. (2d) 170 (1942), 36 N.Y.S. (2d) 174 (1942), affd. per curiam 266 App. Div. 835, 42 N.Y.S. (2d) 641 (1943); *Leech v. Fuller*, 173 Misc. 543, 19 N.Y.S. (2d) 98 (1939), affd. 259 App. Div. 816, 20 N.Y.S. (2d) 398 (1940). The New York courts hold these options are not assets since they are worthless. This view overlooks the speculative value of the option which allows the option holder to take advantage of any increase in the value of the stock without investment or risk of loss. See 49 COL. L. REV. 232 at 234 (1949).

⁷ *Holthusen v. Edward G. Budd Mfg. Co.*, note 3 supra; *Kerbs v. California Eastern Airways*, note 2 supra; *Gottlieb v. Heyden Chemical Corp.*, note 2 supra; *McQuillen v. National Cash Register Co.*, (D.C. Md. 1939) 27 F. Supp. 639, affd. (4th Cir. 1940) 112 F. (2d) 877, cert. den. 311 U.S. 695 (1940); *Sandler v. Schenley Industries*, 32 Del. Ch. 46, 79 A. (2d) 606 (1951); *Diamond v. Davis*, 38 N.Y.S. (2d) 103 (1942), affd. 265 App. Div. 919, 39 N.Y.S. (2d) 412 (1942), affd. per curiam, 292 N.Y. 554, 54 N.E. (2d) 683 (1944); *Clamitz v. Thatcher Mfg. Co.*, (2d Cir. 1947) 158 F. (2d) 687, cert. den. 331 U.S. 825 (1947).

⁸ Principal case at 315.

⁹ *Elster v. American Airlines*, (Del. Ch. 1953) 100 A. (2d) 219. See also 1 CONTRACTS RESTATEMENT §75, comment c (1932). Del. Code Ann. (1953; Supp. 1954) tit. 8, §157 provides in part: "In the absence of actual fraud in the transaction, the judgment of the directors as to the consideration for the issuance of such rights or options and the sufficiency thereof shall be conclusive." The court considered the issue in the principal case not to be the "... corporate judgment as to consideration or its sufficiency but the very existence of consideration as of the time the options were granted," and thus not within the statute. Principal case at 316.

avoided, by tying stock options to employment contracts for a specific period. Greater insurance that the corporation will receive the benefit for which it bargains is obtained when the options are exercisable only after a specified period of employment,¹⁰ preferably in installments, with the consideration to the corporation for each installment reasonably commensurate with the benefits granted.¹¹

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¹⁰ See *Eliasberg v. Standard Oil Co.*, (N.J. Ch. 1952) 92 A. (2d) 862.

¹¹ On adequacy see generally 32 CALIF. L. REV. 88 (1944); Carson, "Current Phases of Derivative Actions Against Directors," 40 MICH. L. REV. 1125, 1150 (1942); WASHINGTON, CORPORATE EXECUTIVES COMPENSATION 293 (1942); 5 FLETCHER, CYC. CORP., perm. ed., §2143 (1952).