

Assent Is Prerequisite for Binding Stock-Transfer Restrictions

By Francis G. X. Pileggi

In 2013, the board of Phixios Holdings approved a stockholder agreement to protect itself from harm caused by stockholders' actions, yet the company failed to state those restrictions on the stock certificate. That omission was the catalyst for a recent ruling by the Delaware Court of Chancery clarifying nuances of restrictions on stockholder transfers.

The case, *Henry v. Phixios Holdings, Inc.*, arose when Jon Henry demanded information from Phixios while investigating alleged mismanagement at the company. Phixios refused to fulfill Henry's request because it claimed Henry violated shareholder restrictions in the stockholder agreement.

In March 2015, Henry accepted an employment offer from Phixios that included 50,000 shares of stock. Those shares were issued with certificates that did not contain the company's transfer restrictions adopted in 2013. Later in 2015, Phixios' chief operating officer sent an e-mail to various stockholders with a copy of the 2013 stockholder agreement to confirm that they had received it. Henry testified at trial that he did not look at the e-mailed copy of the agreement.

Henry's employment was terminated in May 2016 amid deteriorating business conditions and after the company accused him

of providing sensitive information to a competitor.

In July 2016, the company held a special meeting of stockholders to revoke Henry's stock pursuant to the terms of the stockholder agreement, which allowed mandatory redemption if a stockholder violated certain standards of conduct. Phixios argued in court that the stockholder agreement and the bylaws imposed transfer restrictions before Henry was issued stock, and although the restrictions were not noted on the stock certificate, Henry was aware of them before and after the shares were issued.

In her ruling, Delaware Court of Chancery Vice Chancellor Tamika Montgomery-Reeves explained that in order for a stockholder to be bound by stock transfer restrictions "not 'noted conspicuously on the certificate or certificates representing the security,' he must have actual knowledge of the restrictions before he acquires the stock. If the stockholder does not have actual knowledge of the stock transfer restrictions...he can become bound by the stock transfer restrictions after the acquisition of the stock only if he affirmatively assents to the restrictions."

Henry alleged that the requirements of Section 202(a) of the Delaware General Corporation Law were not satisfied even if the

stockholder agreement's restrictions were in place before his stock was issued. Section 202(a) provides that a written restriction on the transfer of a security may be enforceable against a particular stockholder if: "(1) It is noted conspicuously on the certificate representing the security in the case of certificated shares; and (2) The person against whom enforcement is sought had actual knowledge of the restriction."

In addition, Section 202(b) provides that a stock transfer restriction may be binding on existing securities: "(1) By inclusion in the certificate of incorporation; (2) By inclusion in the bylaws of the corporation; or (3) By agreement among stockholders or among stockholders and the corporation."

Importantly, Section 202(b) specifies that a "restriction cannot be retroactively imposed on a current stockholder without his express consent."

The court concluded that Henry never expressly assented to the stockholder restrictions, despite various e-mails on the topic. Therefore, the court held that the stock revocation was invalid and the stock transfer restrictions unenforceable. As a result, Henry remains a stockholder. The court stated that the company must, therefore, meet Henry's request to inspect Phixios' books.



Francis G. X. Pileggi is the member-in-charge of the Wilmington, Del., office of Eckert Seamans Cherin & Mellott LLC. He summarizes key corporate and commercial decisions of the Delaware courts at delawarelitigation.com.