

“You Think He’s Gone? He’s Never Gone!”

Delaware Law Update

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In the movie “What About Bob?,” Dr. Leo Marvin’s Lake Winnepesaukee family vacation is interrupted by the unexpected arrival of a patient, Bob Wiley. After Dr. Martin forces Bob to leave, his family protests. Dr. Marvin shouts, “You think he’s gone? He’s never gone!” And to prove his point, Dr. Marvin opens the front door to reveal a smiling Bob standing on the porch.

In a recent decision^[1] the Delaware Court of Chancery dealt with a corporation’s attempt to keep itself free of unwanted “Bobs.” The initial directors of Phixios Holdings, Inc. (“Phixios” or “the company”) adopted stock transfer restrictions that permitted the revocation of stock in certain circumstances. Afterwards, the company hired the plaintiff and issued him stock. Eventually, the company soured on the plaintiff and purported to revoke his stock under the previously adopted restrictions. The plaintiff, however, refused to go away and argued that the revocation was invalid under 8 *Del. C.* § 202.

The Court of Chancery agreed with the plaintiff and held that under Section 202, “an existing restriction on the transfer of a security is binding on subsequent purchasers” only if one of three conditions is satisfied: (1) the restriction “is noted conspicuously on the certificate representing the security,” (2) “the stockholder has actual knowledge of the restriction at the time he acquires the stock,” or (3) “the stockholder consents to be bound by the restriction either through a vote or through a subsequent agreement with the stockholders or with the company.” Because none of these conditions existed with respect to the plaintiff, the company’s purported revocation was invalid and the plaintiff remained a stockholder.

Like Phixios, many companies desire control over who participates in the business. As a general matter, stock is freely transferable and the corporate form offers less control than alternative business entities offer, such as limited liability companies and partnerships. However, Delaware corporations may impose stock transfer restrictions under Section 202. To do so, they must satisfy Section 202, and, with respect to subsequent purchasers, the conditions set forth in *Phixios* (and any other applicable requirements of the Delaware General Corporation Law). Otherwise, like Phixios and Dr. Marvin, corporations can expect to be stuck with their own Bob Wileys.

[1] *Henry v. Phixios Holdings, Inc.*, WL 2017 WL 2928034 (Del. Ch. July 10, 2017).