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Delaware Court of Chancery Rescinds Stock Cancellation and Stock Repurchase Agreements for Board of Directors' Failure to Adhere to Corporate Formalities

WRITTEN BY

Taylor B. Bartholomew | Christopher B. Chuff | Matthew M. Greenberg

In *Foley v. Session Corp.*, the Delaware Court of Chancery rescinded a stock cancellation agreement (SCA) and stock repurchase agreement (SPA) entered into following a dispute among several founders, holding that enforcement of the agreements amounted to conversion. This decision confirms that board approvals must strictly follow corporate formalities as outlined in an entity's governing documents and in accordance with Delaware General Corporation Law (DGCL).

Background

In 2017, four friends formed Session Corp. (the company), a cannabis accessories company. Camden Foley, Samual Bertain, Esther Lenoir Ramirez, and Vinh Pho (collectively, the founders) each owned 25% of the company's shares. The company's certificate of incorporation named Ramirez the CEO as a matter of formality; however, the founders made decisions collectively. In May 2018, Ramirez, acting by written consent as the sole director, appointed herself president and CEO. The written consent granted Ramirez the power to appoint and remove subordinate officers and employees of the company. Foley, Bertain, and Pho each held officer roles within the company. In September 2018, Bertain, Pho, and Foley formally joined the company's board of directors. As the company grew, Ramirez proposed an equity restructuring to reflect her role as the company's CEO and only full-time employee. Pho supported the restructuring, but Foley and Bertain opposed it.

On December 31, 2021, the founders formalized a mediation agreement regarding the equity dispute, which allocated 26.5% of shares to Ramirez, 24.5% to Pho, and 19.5% each to Foley and Bertain, with a 10% employee option pool. In 2022, following the mediation agreement, the founders each signed the SCA and SPA, under which the founders' shares became unvested and a sixty-month vesting schedule was established. The SPA afforded the company the ability to repurchase unvested shares for nominal consideration valued at 1/1000 of a cent if any founder's employment terminated. Ramirez acted by written consent as the purported sole member of the board to authorize the SCA and SPA, without the authorization of the remaining founders and members of the board.

In October 2022, following consecutive quarters of the company's poor economic performance, Ramirez terminated Foley and Bertain. The company exercised its right under the SPA to repurchase Foley and Bertain's unvested shares. Foley and Bertain each received a total of $19.50 for their shares. Foley and Bertain subsequently sued Ramirez, Pho, and the company for the conversion of their shares, among other claims.

Analysis

The court held that the company's board failed to properly authorize the company's participation in the SCA, SPA, or the company's exercise of its rights under the SCA. According to the court, Delaware courts and the DGCL demand strict adherence to proper corporate formalities, particularly in transactions involving stock. Under the DGCL, any valid board action that can be taken at a meeting of the board of directors may be taken without a meeting if consented to in writing by all members of the board. A non-unanimous director consent is invalid as a matter of law.

Since each founder held a director position when Ramirez purported to act by written consent, Ramirez's attempt was invalid.

Takeaways

This case demonstrates that corporate formalities must be strictly followed when entering any agreement or transaction, including with respect to unanimous board approval and the approval of stock redemptions and repurchases. Failure to adhere to these corporate formalities may render the underlying action invalid.

Nick Fore also contributed to this article. He is not licensed to practice law in any jurisdiction; bar admission pending.

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