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Corporate and Business Law (Annual Survey of Virginia Law)

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CORPORATE AND BUSINESS LAW

Lyman P.Q. Johnson*

I. INTRODUCTION

This article reviews changes in Virginia corporate and business law for the period from June 2000 through May 2001. Part II examines legislative changes in corporate and other business statutes (excluding public service corporation and insurance law issues) based on Virginia General Assembly action in the 2001 session. Part III reviews judicial decisions during the year, including decisions addressing agency law, partnership law, and corporate law issues and principles. This article describes these decisions and, in several instances, it also critically analyzes the outcomes. Part IV summarizes a May 25, 2001, Order of the Virginia State Corporation Commission amending the Commission’s Securities Act Rules.

II. LEGISLATIVE DEVELOPMENTS

The 2001 General Assembly enacted several pieces of legislation that affect business law. The most important legislation provides (1) procedures whereby foreign corporations can become Virginia corporations and Virginia corporations can become incorporated under the laws of a foreign jurisdiction—so-called “domestication”—and (2) procedures for converting domestic limited liability companies to domestic corporations and domestic

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corporations to domestic limited liability companies. These pieces of legislation are summarized below.

A. Domestication of Corporations; Conversion of Domestic Corporations and Limited Liability Companies

The 2001 General Assembly adopted legislation, effective July 1, 2002, drawing on the Revised Model Business Corporation Act procedures for (1) domestication of foreign corporations in Virginia and Virginia corporations in foreign jurisdictions and (2) converting a Virginia limited liability company to a Virginia corporation and a Virginia corporation to a Virginia limited liability company. A foreign corporation may "domesticate" (i.e., essentially, reincorporate) in Virginia by complying with the laws of the state in which the foreign corporation is incorporated and filing articles of domestication with the Virginia State Corporation Commission (the "SCC"). A Virginia corporation not legally required to be a domestic corporation may domesticate in a foreign jurisdiction by obtaining board and shareholder approval of a plan of domestication and filing articles of incorporation surrender with the SCC.

A Virginia corporation may convert into a Virginia limited liability company by obtaining board and shareholder approval of a plan of entity conversion and filing articles of entity conversion with the SCC. A Virginia limited liability company may convert into a Virginia corporation by obtaining member approval of a plan of entity conversion and filing articles of entity conversion with the SCC.

The bill also sets forth the effects of domestication or conversion on the entity, including transfer of assets and liabilities.

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9. Id.
from the converting entity to the surviving entity, continuation of legal proceedings by or against the entity, reclassification of shares and interests, and deemed continuation of the entity without interruption since the date the original entity was organized.\(^2\) Fees for filing articles of domestication, entity conversion, or incorporation surrender will be the same as those for filing articles of incorporation or organization,\(^3\) except that the SCC may charge and collect fees for requested expedited handling of business entity filings, UCC filings, copies of records, and expedited provision of services or issuance of certificates.\(^4\)

B. **Limited Liability Companies**

The 2001 General Assembly enacted amendments to the limited liability company statute to permit formation of a Virginia limited liability company without any initial members and to provide procedures and conditions for the admission of members when a limited liability company has no members at the time of formation.\(^5\) New legislation also provides that statutory restrictions on distributions by limited liability companies do not apply to payments constituting reasonable compensation for present or past services or reasonable payments made in the ordinary course of business pursuant to a bona fide retirement plan or other benefits programs.\(^6\) Legislative amendments also confirm the entity status of limited liability companies under Virginia statutory law notwithstanding their status for income tax purposes.\(^7\) This latter change reflects the fact that limited liability companies may elect, for income tax purposes, not to be taxpaying entities, but rather, to allow the "flow through" of income, gains, or losses to its members. Finally, a new amendment provides procedures for admitting a member or members to a limited liability company in

\(^{14}\) *Id.* § 12.1-21.2 (Cum. Supp. 2001). This section does not become effective until July 1, 2002. *Id.*
\(^{17}\) See *id.* § 13.1-1002 (Cum. Supp. 2001) (defining "limited liability company" and "domestic limited liability company").
the situation where the last remaining member of the company has disassociated.\textsuperscript{18}

C. Registered Agents for Business Entities

The 2001 General Assembly made a small but important change to the qualifications of registered agents. Newly enacted legislation eliminates provisions that permit professional corporations, limited liability companies, and registered limited liability partnerships registered with the Virginia State Bar to serve as registered agents for domestic, foreign stock, and non-stock corporations,\textsuperscript{19} limited liability companies,\textsuperscript{20} limited partnerships,\textsuperscript{21} and registered limited liability partnerships.\textsuperscript{22} Instead of focusing on registration with the State Bar, the new amendments provide that those domestic or foreign stock or non-stock corporations, limited liability companies, or registered limited liability partnerships that are \textit{authorized to transact business in the Commonwealth} may serve as registered agents.\textsuperscript{23}

If, however, such a qualified entity is appointed as a registered agent, it cannot be its own registered agent and, moreover, it must “designate by [an] instrument in writing, acknowledged before a notary public, one or more natural persons” to receive any process, notice, or demand, and it must “continuously maintain at least one such person at that office.”\textsuperscript{24} Whenever the designated person accepts service, a photographic copy of such instrument must be attached to the return.\textsuperscript{25}

With respect to limited liability companies, new legislation provides that a trustee of a trust that is a manager or a member of the limited liability company may serve as a registered agent.\textsuperscript{26} For a registered limited liability partnership, the registered agent

\begin{itemize}
\item[23.] \textit{See supra} notes 19–22.
\item[25.] \textit{Id.}
\end{itemize}
may now be a trustee of a trust that is a general partner of the registered limited liability partnership.\textsuperscript{27}

D. \textit{Securities Act Legislation}

The 2001 General Assembly adopted legislation, effective July 1, 2002, amending the exclusion for banks and certain trust subsidiaries with language from the definition of “broker-dealer” under the Virginia Securities Act.\textsuperscript{28} Banks and trust subsidiaries will not be considered broker-dealers as a result of engaging in any one or more of certain activities specified in section 3(a)(4)(B) or in section 3(a)(5)(C) of the Securities Exchange Act of 1934.\textsuperscript{29} Moreover, transactions by a bank pursuant to an unsolicited offer or order to buy or sell securities are exempted from the securities, broker-dealer, and agent registration requirements, under Virginia Code section 13.1-514, if they are “not effected by an employee of the bank who is also an employee of a broker-dealer.”\textsuperscript{30}

E. \textit{Forfeiture of Equity in Agricultural Cooperative Associations}

New legislation authorizes the bylaws and member agreements of an agricultural cooperative association to provide that when an agricultural cooperative association holds any membership or patronage equity to the credit of a person who has not had a current address on file with the association for at least three years, the bylaws or member agreements may provide that such equity is forfeited to the association.\textsuperscript{31} The forfeiture will only occur following specified publication procedures and an opportunity for the equity to be claimed by such person or his next of kin.\textsuperscript{32} If there is no such provision in the association's bylaws or member agreements, or if there is no publication, then the Uniform Disposition of Unclaimed Property Act\textsuperscript{33} shall apply to such equity.\textsuperscript{34} Any for-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{27} Id. § 50-73.132(A)(i) (Cum. Supp. 2001).
\item \textsuperscript{29} Id. The relevant portions of the Securities Exchange Act of 1934 may be found at 15 U.S.C. §§ 78c(a)(4)(B), (a)(5)(c) (Supp. V 1999).
\item \textsuperscript{31} Id. § 13.1-322(j) (Cum. Supp. 2001).
\item \textsuperscript{32} Id.
\end{itemize}
\end{footnotesize}
feiture completed by an association prior to July 1, 2001, will be effective if such transfer was in compliance with the bylaws or member agreements of the association in effect at the time of the transfer, without regard to the publication requirements set out in the legislation; therefore, such transfer will not be subject to the Uniform Disposition of Unclaimed Property Act.

III. JUDICIAL DECISIONS

A. Agency Law

1. Agent's Breach of Fiduciary Duty

In *Feddeman & Co. v. Langan Associates*, a certified public accounting firm sued certain former directors and former employees for breach of fiduciary duty. Those former directors and employees, along with a competitor accounting firm and its president, were also sued for intentional interference with contract and business expectancies and for violation of Virginia Code sections 18.2-499 and 18.2-500. The Supreme Court of Virginia reversed the trial court's grant of defendants' motion to set aside a jury verdict for plaintiff against all defendants in the amount of $3,300,000.

In the *Feddeman* case, Kent Feddeman, a ninety-five percent shareholder in and president of a public accounting company, initiated discussions with John Langan, president of Langan Associates, a rival accounting firm, concerning a possible buyout or merger of the two companies. As discussions progressed, Mr. Feddeman asked a director and employee of Feddeman & Company, Joseph Kotwicki, to handle further negotiations. After

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37. Id. at 41, 530 S.E.2d at 672.
40. Id. at 38, 530 S.E.2d at 670.
41. Id.
both Langan Associates and Feddeman & Company rebuffed an unsolicited buyout offer from the American Express Company. Kotwicki, along with another director of Feddeman and several employees of Feddeman, independently decided to act as a group to attempt a purchase of Mr. Feddeman's ninety-five percent interest in Feddeman & Company, and thereafter, to merge the company with Langan Associates.  

After the unsuccessful exchange of an offer and counteroffer between the management buyout group and Mr. Feddeman, the directors and employees decided among themselves, with John Langan's knowledge, that they would resign from Feddeman & Company on December 1, 1997, in the hope that their announced resignations would be a form of "leverage" that could strengthen their negotiating position in purchasing Mr. Feddeman's stock. Further discussions between Mr. Feddeman and the employees concerning the buyout failed.  

On December 1, 1997, the directors and several employees finalized their decision to resign. Mr. Langan agreed that Langan Associates would hire the directors and employees. On December 2, Kotwicki delivered eleven letters of resignation to Mr. Feddeman, and that evening Langan Associates held a reception for the Feddeman employees who had not yet resigned. Eventually, twenty-five of the thirty-one Feddeman & Company employees resigned and began working for Langan Associates. By December 3, all the Feddeman & Company clients had been contacted by employees of Langan Associates, and one-half of those clients eventually transferred their business to Langan Associates.  

The supreme court first took up the trial court's decision to set aside the jury verdict that three of the defendants in their capacities as directors and employees and three other individual defendants in their capacity as employees of Feddeman & Company

42. Id.  
43. Id. at 39, 530 S.E.2d at 670.  
44. Id. at 39–40, 530 S.E.2d at 670–71.  
45. Id. at 40, 530 S.E.2d at 671.  
46. Id.  
47. Id.  
48. Id.  
49. Id. at 40–41, 530 S.E.2d at 671.
had breached fiduciary duties to the corporation. The supreme court acknowledged that employees, prior to resignation, are entitled to make arrangements to resign, including plans to compete with their employer and that such conduct does not ordinarily result in liability for breach of fiduciary duty. The court noted, however, that the employee's right is not absolute and, on a case-by-case basis, "must be balanced with the importance of the integrity and fairness attaching to the relationship between employer and employee or corporation and corporate director."

After first citing factually similar authority from other jurisdictions, the court focused on those facts that they found most troubling about the director and employee conduct. The court noted that the employee and director defendants had formulated the plan to resign en masse to exert leverage on Mr. Feddeman in the buyout discussions, knowing that such a walkout would "be devastating" to the corporation for which they worked. Acting on that plan, the defendants not only prepared for their own resignations and advised others of their plans, they essentially solicited other employees to join them by supplying resignation letters for use by those employees and telling them that they could also join rival Langan Associates if they resigned. The court concluded that the totality of the defendants' actions provided credible evidence to support a jury determination that their conduct fell below the required standard of good faith and loyalty owed by both corporate directors and employees in these circumstances.

In further holding that the trial court erred in setting aside the jury verdict on the statutory conspiracy count, the court focused on several meetings between the Feddeman directors and employees and Langan Associates and its president. These meetings were held in an effort to formulate a plan to adversely affect the plaintiff and thereby impose "leverage" on Mr. Feddeman to accept a buyout offer, following which the two companies would

50. Id. at 41, 530 S.E.2d at 672.
51. Id.
52. Id. at 42, 530 S.E.2d at 672 (citations omitted).
53. See id. at 42, 530 S.E.2d at 672–73.
54. Id. at 43, 530 S.E.2d at 673.
55. Id.
56. Id. at 43–44, 530 S.E.2d at 673.
57. See id. at 45, 530 S.E.2d at 674.
merge. Participation by Langan Associates and John Langan in the conspiracy was also shown by evidence that Langan Associates' legal counsel represented the proposed buyers, advised the buyers concerning the resignation plan, and was paid for these legal services by Langan Associates. The court remanded the conspiracy count to the trial court for entry of judgment, noting that the relevant conspiracy statute provides for recovery of treble damages along with costs and attorneys' fees.

Important to this outcome was the fact that the directors and employees of Feddeman & Company behaved in a manner detrimental to their employer in an effort to extract concessions in a negotiation to buy the stock of the controlling shareholder of their employer. Notwithstanding this unusual fact, the decision merits close examination by lawyers who counsel employees contemplating a change of employment to a rival firm, particularly as to the danger of soliciting other employees while still employed or using an employer's proprietary information. Moreover, the decision shows yet another peril of a lawyer taking on multiple representation of clients with potentially conflicting interests, as did the lawyer representing both Langan Associates and the proposed buyers of Mr. Feddeman's stock.

2. Agent's Apparent Authority

In Williams Scotsman, Inc. v. Crawford, the Staunton Circuit Court addressed the liability of a principal under the theory of an agent's apparent authority. The plaintiff brought an action to recover a mobile office or the unpaid balance of the purchase price for the office from defendants Ebeneezer Crawford and Greyhound Lines, Inc. Mr. Crawford owned and operated a bus terminal in Staunton, Virginia, for a number of years, serving as a

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58. Id.
59. Id.
61. Feddeman, 260 Va. at 47, 530 S.E.2d at 675.
62. Id. at 43–44, 530 S.E.2d at 673.
63. 53 Va. Cir. 183 (Cir. Ct. 2000) (Staunton City).
64. Id. at 183.
65. Id.
ticket agent for Greyhound. After a fire caused the closure of the bus terminal, defendant Crawford entered into a contract with the plaintiff to purchase a mobile office for use as a bus terminal. Mr. Crawford, having no actual authority from Greyhound to do so, signed the purchase documentation as “Greyhound Lines, Inc., by Ebeneezer Crawford.” At no time during the negotiations did the plaintiff have any contact with Greyhound, nor did the plaintiff question Mr. Crawford as to the scope of his authority or contact Greyhound to make any inquiries about or to verify Mr. Crawford’s authority.

The court observed that the theory of apparent authority applies to cases in which the principal’s conduct indicates to a third party the existence of an agency relationship. The court held that the plaintiff’s claim failed against Greyhound on that theory because Greyhound had made no manifestations to the plaintiff about Crawford’s authority and had no contact with the plaintiff. Moreover, Greyhound had not been unjustly enriched because it did not assert ownership of the mobile office. The court went on to grant judgment in favor of the plaintiff only against Crawford individually. The court did not make explicit the theory of Crawford’s liability, although it would appear to be for misrepresentation of authority or for breach of a warranty of authority.

B. Partnership Law

1. Personal Jurisdiction Over Partners

*Design88 Ltd. v. Power Uptik Productions, LLC,* although a jurisdiction case, should be of interest to business lawyers.

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66. Id. at 184.
67. Id. at 183–84.
68. Id. at 184.
69. Id.
70. Id.
71. Id.
72. Id. at 183–86.
73. Id. at 186.
74. See id. at 185–86.
"Plaintiff Design88, designed, implemented and administered a website called the Underground Trader. The Underground Trader website caters to day stock traders, providing services to its members for a fee."76 The plaintiff and the defendants entered into a Master Partnership Agreement and often referred to themselves as partners.77 As the United States District Court for the Western District of Virginia explained:

in furtherance of the partnership, and with the knowledge of defendants, the plaintiff performed most of its duties on behalf of The Underground Trader from the plaintiff's office in Charlottesville, Virginia . . . .

Eventually, the relationship between the parties soured, and the defendants terminated their relationship. . . . The plaintiff brought a declaratory judgment action against defendants in Virginia state court, seeking, among other things, a determination that a partnership existed among the parties.78

The defendants removed the action to federal court and filed a motion to dismiss for lack of personal jurisdiction or, in the alternative, transfer.79

Senior District Judge James H. Michael, Jr., adopting the magistrate judge's Report and Recommendation, denied the defendants' motion in its entirety.80 Judge Michael recognized that federal courts "have been consistent in holding that mere access to a passive website in the forum state is insufficient to support a finding of personal jurisdiction."81 However, as a membership-based Web site for day trading, Judge Michael concluded that The Underground Trader could not be viewed as a passive Web site that simply posts information.82 Moreover, critical to the conclusion that the court had personal jurisdiction over the defendants was the plaintiff's allegation that, throughout the parties' relationship, the defendants were aware that the plaintiff was performing the predominant amount of work on the Web site from its

76. Id. at 875.
77. Id.
78. Id.
79. Id. at 874, 875.
80. Id. at 878.
81. Id. at 877.
82. Id.
Charlottesville office. Judge Michael noted, amusingly, that, there “being no District Court of Cyberspace, the defendants’ argument that laboring on the Internet defeats traditional personal jurisdiction is unpersuasive; defendants will have to settle begrudgingly for the Western District of Virginia.”

2. Partner’s Bankruptcy

In In re Shearin, the United States Court of Appeals for the Fourth Circuit examined the interplay of federal bankruptcy law and Virginia partnership law in addressing what funds could be recovered by a Chapter 7 trustee from a debtor who was a partner in a law firm. In 1996, the Shearins “filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code.” Under Virginia partnership law as it then existed, the bankruptcy of any partner caused a dissolution of the partnership. Although dissolved, Norman Shearin’s law firm did not wind up its partnership affairs at that time or any later date. Instead, the law firm partners, including Shearin, agreed to continue the business without liquidation of partnership affairs. Mr. Shearin continued as an equity partner of the reconstituted partnership.

The bankruptcy court awarded to the trustee Mr. Shearin’s share of the profits of the law firm through the day of the filing of the bankruptcy petition and in addition, awarded to the trustee the amount of his capital account as of the same date. The United States District Court for the Eastern District of North Carolina affirmed the bankruptcy court, and the Fourth Circuit affirmed the order of the district court.

The court of appeals ruled that the debtor’s pre-petition partnership interest in the law firm became property of the estate.

83. Id.
84. Id.
85. 224 F.3d 346 (4th Cir. 2000).
86. Id. at 349.
87. Id. at 347.
89. Shearin, 224 F.3d at 349.
90. Id.
91. Id. at 350 n.5.
92. Id. at 348.
93. Id. at 353.
under section 541(a) of the Bankruptcy Code. The court then turned to Virginia partnership law to determine the nature of the debtor's interest in the partnership as of the filing date. The court concluded that the debtor-partner's interest consisted both of his capital account and the annual profits attributable to his partnership interest through the date of filing the bankruptcy petition. The court rejected the debtor's argument that he had no interest in profits on the date of filing because the law firm's management committee did not determine a partner's share in net profits until later, at the fiscal year-end. The court ruled instead that on the filing date the debtor had a legally recognizable interest in profits even though they were contingent and not subject to possession until some future time.

Although, as the court noted, the outcome was "as good an approximation as could be made as to what Shearin's interest would have been,. . . ." the debtor actually may have gotten off easy. Even though the court rightly stated that then-effective Virginia law provided that the bankruptcy of a partner causes a dissolution of the partnership, the former partnership act also defined dissolution as a "change in the relation of the partners caused by any partner ceasing to be associated in the carrying on as distinguished from the winding up of the business." When a partner files bankruptcy and then continues in the same business in the form of a reconstituted partnership, it is arguable that no "dissolution," as so defined, has taken place because the partner continues, rather than ceases, to carry on the same business with the same partners. Moreover, the provision cited by the court, on which Shearin relied in contending that, as a reconstituted partnership, it held title to the dissolved partnership's assets in the form of new partnership, specifically addresses the situation where the "remaining partners agree or have agreed to continue

95. Shearin, 224 F.3d at 349.
96. Id. at 353.
97. Id. at 351 n.8.
98. Id. at 351.
99. Id. at 353.
the business.” Arguably, that section did not contemplate a partner filing bankruptcy and then continuing on in business with his former partners in a newly reconstituted, but otherwise identical, partnership. Possibly, in other words, the trustee could have pursued an even greater portion of the debtor's assets, including some portion of his still-existing, post-filing partnership interest.

This result may not obtain under the new partnership statute in Virginia, which takes more of an entity approach to partnerships. Under the default provisions of the new law, upon a partner's bankruptcy, he or she is considered to be “dissociated” from the partnership. Upon dissociation, a partner's right to participate in the management and conduct of the partnership business terminates, except to wind up. If the business of the partnership continues without winding up, the partnership shall cause the dissociated partner's interest in the partnership to be purchased for a buyout price determined pursuant to statute. This entity approach to partnership overcomes some, but not all, of the conceptually murky and metaphysical issues concerning the nature of partnership relations that arose under the older partnership statute. The new partnership statute's default provisions also may preclude the gambit seen in the Shearin case of filing for bankruptcy to cut off creditor claims and then continuing on in a “new” partnership.

C. Corporation Law

1. Director Fiduciary Duties; Director Business Judgment Statute; Shareholder Litigation

The most important corporate law decision of the past year was the ruling of the Supreme Court of Virginia in Simmons v. Miller.

109. See supra text accompanying notes 85–91.
110. 261 Va. 561, 544 S.E.2d 666 (2001). Although outside the period covered by this
The facts in Simmons were that, from its inception, "Margaret C. Miller was the sole officer, director, and shareholder of Las Palmas Tobacco Ltd., a Virginia corporation that had exclusive rights to import and distribute Professor Sila brand cigars . . .” in the eastern United States.\textsuperscript{111} In June 1996,

Miller and Calvert W. Simmons entered into a Stock Subscription Agreement giving Simmons a 30% ownership interest in Las Palmas in exchange for $100 and Simmons’ guarantee of a $100,000 letter of credit issued for the benefit of Las Palmas . . . Additionally, in a Shareholders’ Agreement, Miller and Simmons agreed that “at a future date they would fix a value for their shares and enter into a Cross-Purchase Agreement.”\textsuperscript{112}

By later discussions, Simmons and Miller were unable to agree on the valuation of Las Palmas.\textsuperscript{113} In January 1997, Miller sent a letter to Simmons that included an offer to buy his thirty-percent share of Las Palmas.\textsuperscript{114} Simmons rejected the offer because he felt his shares were worth considerably more than the price offered by Miller.\textsuperscript{115}

In February 1997, Las Palmas ceased doing business because the Professor Sila cigar company refused to ship any more cigars.\textsuperscript{116} Also in February 1997, Miller’s lawyer filed articles of organization for a new company, Las Palmas Tobacco International, L.L.C. (“International”).\textsuperscript{117} An unsigned Limited Liability Company Operating Agreement listed Miller and Professor Sila as equal owners in the new L.L.C.\textsuperscript{118} Professor Sila became Interna-
tional's sole supplier of cigars, and International sold cigars to some of the customers who had previously purchased from Las Palmas.\textsuperscript{119}

Simmons sued Miller, Miller's lawyer, Maria Kear, and other defendants, one of whom made a successful motion to strike all counts against him.\textsuperscript{120} Other than Miller, Kear, and the third defendant, all other defendants failed to respond and default judgments were entered against the non-answering defendants.\textsuperscript{121} Simmons asserted individual claims against Miller and Kear and also derivative claims, on behalf of Las Palmas, against them.\textsuperscript{122} Several claims were stricken by the trial court at the conclusion of plaintiff's case in chief.\textsuperscript{123} The jury returned a verdict against Miller on eleven counts and a verdict against Kear on three counts.\textsuperscript{124} After post-trial motions, the trial court struck all counts against Kear and all individual counts against Miller, including a claim for breach of fiduciary duty, granting judgment to Simmons only on his derivative claims on behalf of Las Palmas.\textsuperscript{125}

On appeal, Simmons argued that the trial court erred in granting Miller's motion to strike the jury's verdict on his individual claim for breach of fiduciary duty.\textsuperscript{126} The jury had returned verdicts in favor of Simmons, individually, in the amount of $10,000 and, derivatively, in the amount of $10,000 for breach of fiduciary duties.\textsuperscript{127} The Supreme Court of Virginia upheld the trial court, although not on the simple ground that sustaining both verdicts would constitute a penalty or double recovery, but on broader, potentially overbroad, grounds.\textsuperscript{128}

The court stated that it declined adoption of "a closely held corporation exception to the rule requiring that suits for breach of fiduciary duty against officers and directors must be brought derivatively on behalf of the corporation and not as individual

\begin{enumerate}
\item \textsuperscript{119} Id. at 570, 544 S.E.2d at 672.
\item \textsuperscript{120} Id.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} Id. at 570–71, 544 S.E.2d at 672–73.
\item \textsuperscript{123} Id. at 571, 544 S.E.2d at 673.
\item \textsuperscript{124} Id.
\item \textsuperscript{125} Id.
\item \textsuperscript{126} Id.
\item \textsuperscript{127} Id. at 573, 544 S.E.2d at 674.
\item \textsuperscript{128} Id. at 573–77, 544 S.E.2d at 673–76.
\end{enumerate}
shareholder claims." It is not clear whether the court means that all suits for breach of fiduciary duty against officers and directors must be brought derivatively on behalf of the corporation and that it simply will not recognize individual shareholder claims for fiduciary duty breaches. Alternatively, the court might simply be saying that, on the facts of this case, the wrongdoing was a wrong to the corporation, and therefore, is derivative in nature and that, unlike several other states and the American Law Institute, Virginia will not allow shareholders of close corporations to bring derivative claims as direct shareholder actions. If the court means to adopt the first position, it is a radical and unprecedented departure from established corporate law principles universally recognized. This is because some wrongs by fiduciaries are wrongs to the corporation as a business entity while other fiduciary misdeeds are wrongs to shareholders in their shareholder capacity. Several well-known examples of the latter can be cited, including many in Delaware.

The court, therefore, misstates Delaware law when it states that Delaware "has yet to embrace the concept of a direct shareholder action in a closely held corporation." What the court should have said is that Delaware refuses, in the close corporation context, to allow what are admittedly derivative claims to be brought in the form of direct shareholder claims. When a fiduciary duty claim is personal to the shareholder as a shareholder, however, Delaware has long allowed the shareholder to sue directly as an individual. Moreover, the Seventh Circuit Court of Appeals decision relied on by the Supreme Court of Virginia to summarize Delaware law miscites the underlying Delaware

129. Id. at 576, 544 S.E.2d at 675.
130. See id. ("Suits for breach of fiduciary duty... must be brought derivatively on behalf of the corporation and not as individual shareholder claims."). This would mean, too, that a prior demand on the board of directors would be required in all fiduciary duty litigation. See Va. CODE ANN. § 13.1-672.1(B)(1) (Repl. Vol. 1999).
131. See 2 AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 7.01(d), at 17 (1994).
133. See, e.g., Grimes v. Donald, 673 A.2d 1207 (Del. 1996); Van Gorkom, 488 A.2d 858 (Del. 1985). See generally Moran v. Household Infl, Inc., 490 A.2d 1059, 1070 (Del. Ch. 1985) (discussing the requirements necessary to maintain a shareholder suit in either a derivative or an individual capacity under Delaware law).
134. Simmons, 261 Va. at 575, 544 S.E.2d at 675.
135. Id. (citing Bagdon v. Bridgestone/Firestone, Inc., 916 F.2d 379 (7th Cir. 1990)).
The referenced Delaware Chancery Court decision, rather than requiring the minority shareholder to bring an action derivatively, as the Seventh Circuit states, in fact allowed the shareholder to bring a direct shareholder action. Furthermore, as the Seventh Circuit opinion itself recognizes, Delaware recognizes a “special injury” exception that permits a shareholder to bring a personal action to redress a wrong to the corporate entity if the wrong inflicts a distinct and disproportionate injury on the investor.

In the Simmons case, the initial issue should have been the usual one of whether the action could fairly be characterized as personal or derivative in nature. Only if the claim undeniably was derivative in nature would the issue of allowing a shareholder to proceed directly on a derivative claim then arise. There is, in Simmons, a strong argument that the wrongdoing could be characterized as both personal and derivative, and if anything, more of a direct wrong to the minority shareholder than to the corporation. The most mischievous reading of Simmons would be to interpret it as saying that all fiduciary duty cases must be brought derivatively. That is not the law elsewhere and would be bad policy. The case is best read in the narrowest way possible, as simply precluding a plaintiff from obtaining a double recovery on a breach of fiduciary duty claim and as holding that the traditional distinction between direct and derivative actions will be insisted upon in Virginia.

On another point, the Simmons court in dictum reiterated what this author considers to be a faulty reading of Virginia Code section 13.1-690, stating that that statute “makes no distinction between duties of care and loyalty.” The court introduces that statement by asserting that Virginia Code section 13.1-690 applies to the “discharge [of] duties as a director,” erroneously

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137. See id. at 420.
138. Bagdon, 916 F.2d at 383 (citing Elster v. Am. Airlines, Inc., 100 A.2d 219, 222 (Del. Ch. 1953)).
139. See Simmons, 261 Va. at 574–75, 544 S.E.2d at 674–75 (2001).
141. Simmons, 261 Va. at 577, 544 S.E.2d at 676; see also Lyman Johnson, Misunderstanding Director Duties: The Strange Case of Virginia, 56 Wash. & Lee L. Rev. 1127, 1146–58 (1999).
suggesting that the word "duties" in the quoted statutory language refers to fiduciary duties when, in fact, that word refers to the word "duties" in the statutory fount of director power.\textsuperscript{143} Nevertheless, the court went on to clearly and properly interpret Virginia Code section 13.1-690 as applying only where directors exercise business judgment.\textsuperscript{144} Consequently, when Miller organized International, a competitor to Las Palmas, she was not exercising business judgment on behalf of Las Palmas and, accordingly, was not entitled to the protection of Virginia Code section 13.1-690. Instead, her conduct was evaluated under the common law duty of loyalty.\textsuperscript{145}

This last point is a very important ruling for Virginia corporate law. It clearly reveals that there is more to a director's fiduciary duty than the requirements of Virginia Code section 13.1-690.\textsuperscript{146} Moreover, this applies in the duty of care context as well as in the \textit{Simmons} duty of loyalty context. That is, inasmuch as \textit{Simmons} has authoritatively interpreted Virginia Code section 13.1-690 as applying only where directors exercise business judgment, where directors are charged with wrongdoing that can be characterized as a violation of care, rather than (as in \textit{Simmons}) a violation of loyalty, their conduct will be evaluated under the more demanding common law duty of care—not Virginia Code section 13.1-690—if they did not exercise business judgment.\textsuperscript{147}

The remainder of the \textit{Simmons} opinion addressed the statutory conspiracy claim, the conversion claim, and the legal malpractice claim.\textsuperscript{148} The supreme court upheld the trial court's decision to strike the malpractice claim.\textsuperscript{149} Nonetheless, that claim should cause business lawyers to proceed very carefully with multiple representation in the close business context. A lawyer representing the business entity and/or one or more of the principals should be crystal clear as to whom exactly they are representing.

\textsuperscript{144} Simmons, 261 Va. at 577, 544 S.E.2d at 676; see also Johnson, supra note 141, at 1132-41.
\textsuperscript{145} See Simmons, 261 Va. at 577, 544 S.E.2d at 676.
\textsuperscript{146} See generally Johnson, supra note 141.
\textsuperscript{147} Id.
\textsuperscript{148} Simmons, 261 Va. at 577–82, 544 S.E.2d at 676–79.
\textsuperscript{149} Id. at 580, 544 S.E.2d at 677–78.
In a recent opinion, Judge James Jones, United States District Judge for the Western District of Virginia, Abingdon Division, ruled that a close corporation's guarantee of a shareholder's note is a voidable transaction under Virginia Code section 13.1-691. Briefly, one fifty percent shareholder contracted to buy the stock of the other fifty percent shareholder of Dunford Roofing, Inc., a Virginia corporation, for $500,000, payable in monthly installments over thirteen years at seven percent interest. The corporation itself agreed to guarantee the full amount of the purchasing shareholder's promissory note.

Judge Jones found that, because the selling shareholder also was a director of the company, the guarantee was a conflict of interest transaction falling within Virginia Code section 13.1-691. Such a transaction is voidable unless the transaction was approved by directors or shareholders who had no personal interest in the transaction or unless the transaction was "fair to the corporation." Since there was no approval of the guarantee by disinterested directors or shareholders, Judge Jones inquired into whether the transaction was "fair" to the company. Observing that fairness included a "fair price" as well as a "fair dealing" component, Judge Jones found that the guarantee was not fair to the corporation. Although such a guarantee could, on the right facts, be beneficial to the corporation because it might promote continuity of management, the purchase price and resulting corporate indebtedness clearly exceeded the fair value of the stock and, moreover, impaired the company's ability to continue in its line of business. Accordingly, Judge Jones rescinded the corporation's guarantee but left intact the purchasing shareholder's

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152. Id. at *4–5.
153. Id. at *5.
154. Id. at *8–9.
156. Id. at *8.
157. Id. at *8 (citing Johnson, supra note 141, at 1152).
158. Id. at *9.
159. Id.
personal obligation to buy and pay for the selling shareholder's stock. 160

The United States Court of Appeals for the Fourth Circuit ruled that the broad protection accorded directors under Virginia Code section 13.1-690 applies to shelter corporate directors in a securities fraud matter. 161 Plaintiff Richmond Dellastatious sued, among other defendants, two outside directors for damages in connection with his purchase of $261,000 worth of securities from SurroundVision Advanced Imaging, L.L.C. 162 The plaintiff's theory against the two outside directors was that they were control persons having liability under section 20 of the Securities Exchange Act of 1934 163 and under Virginia Code section 13.1-522(C) 164 of the Virginia Securities Act. 165 Defendants raised the federal statutory defense that they had acted in good faith, and the state statutory defense that they "did not know, and in the exercise of reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist." 166 On that basis, the defendants moved for, and the district court granted, summary judgment. 167

The Fourth Circuit assumed that the defendants were required to show that they had acted reasonably in order to satisfy Virginia law. 168 The court stated that one way to determine whether the outside directors had acted with "reasonable care" under Virginia Code section 13.1-522(C) was to consider whether they had complied with the duties set forth in Virginia's corporate statute at Virginia Code section 13.1-690. 169 This is a dubious assertion built upon faulty reasoning.

First, the court observes that although the few cases interpreting Virginia Code section 13.1-690 have concerned protections af-

160. Id.
162. Id. at 193.
167. Id.
168. Id. at 195.
169. Id.
forded directors under the business judgment rule, the statutory text is in no way limited to that. The text, however, is limited to the discharge of those responsibilities assigned to directors under the enabling framework and policy of state corporate law, not those assigned by the more regulatory framework and policy of state securities law. Second, the court states that, in light of the expansive safe harbor provisions found in Virginia Code section 13.1-690(C), it is unlikely that section 13.1-522(C) would hold directors to a higher standard of care than that set forth under section 13.1-690. However, as the Fourth Circuit's own opinion in WLR Foods, Inc. v. Tyson Foods, Inc. makes clear, and as the Supreme Court of Virginia opinion in Willard v. Moneta Building Supply, Inc. also explicitly states, Virginia Code section 13.1-690 deliberately did not adopt the "reasonableness" language found in the comparable section of the Revised Model Business Corporation Act statute addressing a director's standard of conduct. Consequently, inasmuch as the Virginia Securities Act does adopt a "reasonable care" standard, it is more sensible to conclude that a higher standard was intended for control persons under the Virginia Securities Act than was intended for directors under the Virginia corporate statute.

Finally, the policy underpinnings of the two statutes differ. Deference to a board of directors' decision under Virginia Code section 13.1-690 is designed to encourage and facilitate directors in making business judgments that advance corporate and shareholder interests, without fearing liability under a "reasonableness" standard in the event those decisions, in hindsight, are unsuccessful. The policy aim, in short, is to have a low liability standard in the hope of advancing shareholder welfare by encouraging directors to act without fear of legal liability. By way of

170. Id. at 196.
171. Id. at 195.
172. 65 F.3d 1172 (4th Cir. 1995).
175. See WLR Foods, 65 F.3d at 1185; Willard, 258 Va. at 151, 515 S.E.2d at 284. In adopting Code § 13.1-690, the General Assembly rejected § 8.30 of the Revised Model Business Corporation Act (RMBCA). . . . [Requiring directors] to discharge the duties of the office in good faith, with the care that an ordinary prudent person . . . would exercise . . . [believing it] to be in the best interests of the corporation. Willard, 258 Va. at 151, 515 S.E.2d at 284 (internal citations omitted).
contrast, the policy aim of securities law is investor protection and deterrence, specifically, to encourage those in control of the corporation, through risk of legal sanction, to ensure that they are using “reasonable care” in overseeing the corporation's capital-raising activities.

Notwithstanding these objections, the *Dellastatious* court stated that the two outside directors complied with Virginia’s standards for directorial duties “and they likewise acted with reasonable care under § 13.1-522(C).” 176 Thus, although the court initially stated that it was looking to Virginia Code section 13.1-690 as one way to determine whether the outside directors had acted with “reasonable care” under Virginia Code section 13.1-522(C), the court appears to have backstopped that ruling by separately finding that the directors had acted reasonably, as required under Virginia’s securities laws. 177 Having found that the outside directors satisfied the standard of Virginia’s good faith and reasonable care defense, the court found that they also qualified for the defense under federal law and, therefore, affirmed a grant of summary judgment in their favor. 178

2. Piercing the Corporate Veil; Reverse Piercing

A Fairfax Circuit Court case addressed the doctrine of piercing the corporate veil and held that the veil should not be pierced. 179 The plaintiff, Fidelity National Title Insurance Company of New York, having obtained judgments against certain individual defendants and a Virginia corporation (“Madison–VA”), sought to collect on that judgment from the assets of a related Maryland corporation (“Madison–MD”). 180 The plaintiff argued that Madison–MD was the alter ego of Madison–VA and, therefore, the corporate veil of Madison–MD should be pierced, allowing the plaintiff to collect from the assets of Madison–MD. 181

The court first reviewed applicable Virginia law, noting that

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176. *Dellastatious*, 242 F.3d at 196.
177. *Id.* at 197.
178. *Id.*
180. *Id.* at 118.
181. See id.
piercing is "an extraordinary exception to be permitted only when it becomes necessary to promote justice."\textsuperscript{182} The court noted, too, that proof of domination or control of a company is not sufficient to pierce the veil.\textsuperscript{183} Rather, the plaintiff must also establish that the corporation was a device or sham used to disguise wrongs, obscure fraud, or conceal crime.\textsuperscript{184} The court concluded that the evidence presented did not satisfy that standard because confusion as to the identity of two corporations is not enough to pierce the corporate veil.\textsuperscript{185} Moreover, any confusion in the case before him was to no one's detriment because the plaintiff was not an innocent, gullible member of the public but instead had sophisticated counsel who prepared separate contracts in its dealings with the two corporations.\textsuperscript{186}

In \textit{C.F. Trust, Inc. v. First Flight Limited Partnership},\textsuperscript{187} the United States District Court for the Eastern District of Virginia, in denying cross-motions for summary judgment, concluded that Virginia would recognize a cause of action for "reverse piercing" of the corporate veil.\textsuperscript{188} In a traditional veil-piercing action, a court disregards the existence of the corporate entity so that a claimant can reach the assets of a corporate insider, typically a natural person.\textsuperscript{189} In a reverse piercing action, however, the plaintiff seeks to reach the assets of a corporation (or limited partnership or other business entity) to satisfy claims held against a corporate insider.\textsuperscript{190}

Plaintiff C.F. Trust held judgments against defendants Barrie Peterson, individually, Barrie Peterson as a trustee, and Nancy Peterson, in the amount of $6.1 million.\textsuperscript{191} Plaintiff Atlantic Funding Corporation held a judgment against Barrie Peterson individually and as trustee in the amount of $1.2 million.\textsuperscript{192} The

\textsuperscript{182} Id. (citing Cheatle v. Rudd's Swimming Pool Supply Co., 234 Va. 207, 212, 360 S.E.2d 828, 831 (1987)).
\textsuperscript{183} Id. at 119.
\textsuperscript{184} Id.
\textsuperscript{185} Id. at 120.
\textsuperscript{186} Id. at 119.
\textsuperscript{187} 111 F. Supp. 2d 734 (E.D. Va. 2000).
\textsuperscript{188} Id. at 740.
\textsuperscript{189} Id.
\textsuperscript{190} Id.
\textsuperscript{191} Id. at 737.
\textsuperscript{192} Id.
plaintiffs brought suit against three Virginia corporations wholly owned and controlled by Barrie Peterson and against a limited partnership in which Barrie Peterson was a forty-nine percent limited partner.  

The plaintiff alleged that, during and after the time the initial judgment had been entered, the defendants engaged in numerous transactions among themselves for the purpose of avoiding Barrie Peterson's obligations to the plaintiffs. The plaintiffs contended that Mr. Peterson had used these various business entities as his alter ego, and thus, sought access to their assets. Being a diversity case, the court had to apply state law and, inasmuch as the Supreme Court of Virginia has not yet addressed the reverse piercing doctrine, was required to determine whether the supreme court would recognize that theory of recovery.

The district court first looked at decisional authority, including a 1998 decision by the Court of Appeals of Virginia recognizing the reverse piercing cause of action, and found that reverse piercing actions are gradually gaining acceptance throughout the country. The court next looked at policy considerations and observed that the rationale for traditional piercing operates with equal force in support of reverse piercing. In both instances, when the corporate or other organizational form is abused, courts may, in appropriate circumstances, disregard the entity fiction whether the fiction is used to shield the owner's assets from claims against the corporation or to shield the entity's assets from claims against the owner.

The court, having concluded Virginia would recognize the reverse piercing doctrine, went on to articulate the standard for such a piercing. The court cited Supreme Court of Virginia authority that there is "no single rule or criterion... to determine whether piercing the corporate veil is justified." The determina-

193. Id. at 738.
194. Id. at 739.
195. Id.
196. See id. at 740–41.
198. C.F. Trust, 111 F. Supp. 2d at 740.
199. Id. at 741.
200. See id.
201. Id. (quoting O'Hazza v. Executive Credit Corp., 246 Va. 111, 115, 431 S.E.2d 318,
tion is a "fact-specific inquiry into the circumstances surrounding the corporation, the related parties, and the acts in question." It is not enough, under Virginia law, for the plaintiff to establish that an individual had control over the corporation or that the corporate entity was the alter ego of the individuals. In addition, the plaintiff must establish that the corporation (or other business entity) was used "to evade a personal obligation, to perpetrate fraud or a crime, to commit an injustice, or to gain an unfair advantage." The court went on to rule that only an organization such as a corporation or partnership could be the alter ego of another individual and that one individual cannot be the alter ego of another individual.

3. Preemptive Rights

An Alexandria Circuit Court decision addressed the issue of whether an option holder has preemptive rights to acquire a pro rata amount of shares to be newly issued by a corporation. Under Virginia Code section 13.1-651(A), shareholders of a corporation have preemptive rights to purchase new issuances of stock unless that right is negated in the articles of incorporation. Looking to the definition of "shareholder" found in Virginia Code section 13.1-603, the court concluded that an option holder is not a "shareholder" and, therefore, does not have preemptive rights.

4. Oppression of Minority Shareholder; Custodian Pendente Lite

In Berman v. Physical Medicine Associates, the United States Court of Appeals for the Fourth Circuit, applying Virginia law,
addressed the interplay of fiduciary duties and explicit contractual protections in the close corporation setting. The plaintiff, Dr. William S. Berman, was a stockholder, director, and employee of defendant Physical Medicine Associates, Ltd., a Virginia medical corporation having six physician-stockholders, five physician-directors, and six physicians as employees. After the director of a nursing home client of the corporation observed the plaintiff yelling at nursing home personnel, the director stated that she did not want Berman to return to the nursing home, and if he did come back, the firm’s doctors would be asked to stop seeing patients at the home. On learning of the complaint and that his colleagues might insist that he make amends, the plaintiff submitted a letter of resignation effective nine months later. The purpose of giving nine months notice was that such notice was necessary to entitle a physician-employee to severance benefits pursuant to an employment agreement each physician had with the corporation. After receiving the letter of resignation, and after a stockholder meeting attended by all stockholders except Berman and where Berman’s conduct at the nursing home was discussed, the six other directors met and voted unanimously to dismiss Berman as an employee pursuant to his employment agreement, which permitted discharge “for reasonable cause.”

After being discharged, Berman filed an action claiming that the corporation, its directors, and its stockholders had breached his employment agreement, his severance benefit agreement, and a stockholder agreement. The stockholder agreement claim was settled by payment of $50,000, in accordance with its terms. Berman also alleged that the directors of the medical corporation had breached their fiduciary duties of loyalty and due care owed to him. The contractual claims for breach of the employment agreement and severance benefit agreement resulted in a jury verdict for Berman of over $4,900. The trial court granted de-
fendant’s motion for judgment as a matter of law on the fiduciary duty claims, concluding that while the directors owed a fiduciary duty to the stockholders as a class, they owed no such duty to Berman as an individual stockholder. 221 Berman appealed that ruling, contending that the directors did owe him a fiduciary duty as an individual stockholder, and that because the corporation had essentially operated as a partnership, its stockholders owed each other the fiduciary duties owed by partners to one another. 222

The Fourth Circuit Court of Appeals stated that “[t]he question whether the fiduciary duty of a director of a close corporation runs to stockholders individually, as well as to stockholders as a class, does not appear to have been decided in Virginia.” 223 The court did not believe it was necessary to resolve that question, however, because it decided the case on different grounds. 224 First, Berman’s only claim directly implicating his status as a stockholder was a violation of a stockholder agreement, which was settled by payment in full of $50,000 as provided in the stockholder agreement. 225 His other claims implicated his status not as a stockholder but as an employee. 226 His interests as an employee arose only from breach of the contractual duties owed by the corporation, not from breach of any fiduciary duties owed by the directors. 227 Those contractual claims were submitted to the jury, which found for Berman. 228

Second, distinguishing a case heavily relied upon by Berman, 229 the court ruled that shareholders in close corporations in Virginia do not have partner-like fiduciary duties in the usual case. 230 Rather, having chosen the corporate form of business and having operated fully in accordance with proper corporate procedures,

221. Id.
222. Id.
223. Id. at 433; see also supra notes 129–38 and accompanying text (discussing fiduciary duty in the context of a closely held corporation).
224. Berman, 225 F.3d at 433.
225. Id.
226. Id.
227. Id.
228. Id.
230. Berman, 225 F.3d at 434.
partner-like fiduciary duties would not be imputed upon defendants in this case.\(^{231}\)

The *Berman* case warrants comment for three reasons. First, it shows the importance of addressing close corporation affairs by express contract, including the use of stockholder agreements and employment agreements. Doing so may lead courts, for the most part, to look to those express contractual understandings to adjudicate the rights and responsibilities of the participants. In certain instances, however, non-contractual fiduciary duties may still govern on matters not specifically and pointedly addressed in those contracts.

Second, as to the question passed over by the court of appeals—whether the fiduciary duty of a director of a close corporation runs to stockholders individually—a word of caution is in order. Generally, of course, director fiduciary duties run to stockholders as a class. Frequently, however, directors or shareholders who control corporate affairs in a close corporation act to oppress or unfairly disadvantage one or more minority shareholders in the corporation.\(^{232}\) On proper facts, such oppression or unfair conduct might be regarded as a breach of fiduciary duty running to those minority shareholders, especially when they lack contractual protections, and such minority shareholders should be held to have an individual claim against the directors or other persons in control. An example would be where a minority shareholder, not having any express contractual protections, is terminated from long-held employment solely because the other persons in control want to completely block that shareholder’s access to any corporate funds as a prelude to making an unreasonably low offer to purchase his stock.

Third, the purported distinction between the supposedly robust fiduciary duties owed by Virginia partners and, depending on future developments on the second issue above, the potentially non-existent fiduciary duties owed by shareholders to one another in close Virginia corporations is formalistic, not well-grounded, and is likely to be revisited in future decisions.

\(^{231}\) See *id.*

\(^{232}\) *Cf.* VA. CODE ANN. § 13.1-747(A) (Repl. Vol. 1999 & Cum. Supp. 2001) (providing courts with the power to dissolve a corporation if “[t]he directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent”).
A recent decision of the Loudoun Circuit Court,233 wherein the court appointed a custodian pendente lite pursuant to Virginia Code section 13.1-747(E), demonstrates an individual shareholder’s claim for oppression and corporate waste.234 The plaintiff owned a share certificate duly issued by the corporation indicating that he was the owner of forty shares of common stock.235 The shares were issued pursuant to a land transfer agreement between the plaintiff and the corporation, which provided that plaintiff would transfer ownership of fifty-five acres of real estate in exchange for the forty shares of stock.236 Although as of the date of the hearing the plaintiff had not executed a deed conveying the property to the corporation, the property was shown on the corporation’s financial statements as an asset of the corporation.237 The board of directors of the corporation met and acted to cancel plaintiff’s shares.238 The court noted that summary cancellation of the shares, if later proven to be unjustified, would constitute oppressive conduct or fraud, and accordingly, warranted the appointment of a temporary custodian for corporate affairs.239

The facts of this case provide an example of one shareholder alleging that directors acted oppressively toward him individually. Directors have a fiduciary duty to shareholders that includes a duty not to unfairly or oppressively treat one or more of the shareholders of the corporation.

5. Dissolution; Director Liability

A Richmond Circuit Court decision addressed the issue of director liability for mishandling corporate assets upon dissolution.240 The plaintiff, a creditor of a dissolved corporation, sought to hold the former directors individually liable for the corporate...
debt on the grounds that they had not only failed to properly dis-
solve the corporation, but that they had also taken possession of
the corporate assets and converted them to their own use. The
circuit court, citing a Fourth Circuit Court of Appeals decision in-
volving Virginia law, held that directors in such circumstances
were personally liable to creditors, but only up to the value of the
corporation’s assets at the time of dissolution, taking into account
debts owed to other creditors. In the case at bar, the plaintiff
failed to carry its burden of proof on the value of the corporation’s
assets, and hence, judgment was entered in favor of the individ-
ual defendants.

6. Distributions to Shareholders

In Federal Trade Commission ex rel. Earley v. Med Resorts In-
ternational, Inc., the United States District Court for the
Northern District of Illinois addressed the propriety of a distribu-
tion to shareholders under Virginia Code section 13.1-653. In
that case, the Federal Trade Commission and the Commonwealth
of Virginia sued several corporations for violations of the Federal
Trade Commission Act and the Virginia Consumer Protection
Act, alleging fraudulent and deceptive practices in the sale of
vacation services. The plaintiff sought, and was granted, in-
terim injunctive relief, a temporary freeze of corporate assets, and
the appointment of a temporary receiver.

Two of the corporate defendants had made elections under fed-
eral income tax law whereby income and losses of the corporation
“flow through” to the shareholder so that the shareholder reports
the income or loss, as the case may be, on his or her personal in-

241. Id. at 286.
242. See Flip Mortgage Corp. v. McElhone, 841 F.2d 531 (4th Cir. 1988).
243. Crews & Hancock, 52 Va. Cir. at 237.
244. Id. at 237–38.
246. See id. at *16–21. The Virginia shareholder distribution statute is found at VA.
250. Id.
come tax return. The sole shareholder of these two income tax "S corporations," one of which was a Virginia corporation, moved the district court to allow the corporations to make substantial distributions to him as shareholder. He argued that he needed the funds to pay the tax liability he would personally incur from the five million dollars the two companies expected to earn for fiscal year 2000.

The court denied the shareholders' motion on two grounds, noting first that the parties had stipulated that there was good cause to believe the plaintiffs would ultimately succeed in establishing that the defendants had engaged in acts that violated the Federal Trade Commission Act and other federal and state laws. Thus, in order to preserve corporate assets for the benefit of those consumers who might demonstrate harm caused by such violations, the court refused to lift the asset freeze, notwithstanding the fact that this meant the shareholder would have substantial corporate income passed through to him without any corresponding corporate distribution to pay the tax liability.

Second, the court noted that under Virginia Code section 13.1-653, a board of directors of a Virginia corporation is prohibited from distributing money to its shareholders if, after distribution has been given effect, "the corporation would not be able to pay its debts as they become due" or "the corporation's total assets would be less than the sum of its total liabilities." Noting that "[t]he effect of a distribution is measured as of the date the distribution is authorized if the payment occurs within 120 days after the date of authorization," the court refused to modify the asset freeze. Substantial claims by a secured creditor and by the defrauded consumers as probable unsecured creditors were of sufficient size and probability of success that the corporate defendants could not, in the court's view, be considered solvent in either the equity or balance sheet sense. Accordingly, the motion to allow

251. Id. at *4–5.
254. Id. at *5 n.4.
255. Id. at *15.
256. Id. at *16.
257. Id. (quoting VA. CODE ANN. § 13.1-653(c)(1)–(2) (Repl. Vol. 1999)).
258. Id. at *16 n.10.
259. Id. at *18–19.
a distribution to the shareholder was denied on the ground that it would violate Virginia's corporate statute.\textsuperscript{260}

7. Dissenter's Rights; Fair Value of Shares

In \textit{U.S. Inspect, Inc. v. McGreevy},\textsuperscript{261} Judge Stanley Klein of the Fairfax Circuit Court addressed an important corporate law issue—the proper methodology for valuing shares where dissenters' rights are exercised.\textsuperscript{262} In a merger of a Virginia corporation into its wholly owned subsidiary, a Delaware corporation, a shareholder of the plaintiff, Noris McGreevy, properly exercised her dissenter's rights under Virginia Code section 13.1-729.\textsuperscript{263} The corporation and Mrs. McGreevy failed to agree as to the proper valuation of her stock.\textsuperscript{264} A statutory proceeding to determine the fair value of her shares ensued.\textsuperscript{265}

Judge Klein first reviewed Virginia common law and changes in the statutory law regarding the rights of dissenting shareholders.\textsuperscript{266} After doing so, he concluded that a court in Virginia should value a dissenting shareholder's stock based upon his or her proportionate interest in the merging company as a going concern, prior to consummation of the merger.\textsuperscript{267} He then determined the full panoply of elements of value to be considered in gauging such interest in the company as a going concern, and within that analytical framework, the court focused on an income approach to valuation.\textsuperscript{268} The two competing expert witnesses agreed that an asset approach would seriously undervalue the corporation, and the court itself found that a market approach evaluation was in-

\textsuperscript{260} \textit{Id. at *19.}
\textsuperscript{261} No. 160966, 2000 WL 33232337 (Va. Cir. Ct. Nov. 27, 2000) (Fairfax County).
\textsuperscript{262} \textit{See id. at *2.}
\textsuperscript{263} \textit{Id. at *1.} The Dissenter's Rights article of the Virginia Stock Corporation Act is found at VA. CODE ANN. §§ 13.1-729 to -741 (Repl. Vol. 1999).
\textsuperscript{264} \textit{McGreevy, 2000 WL 33232337, at *1.}
\textsuperscript{265} \textit{Id.}
\textsuperscript{266} \textit{See id. at *1-5.}
\textsuperscript{267} \textit{See id. at *5.}
\textsuperscript{268} \textit{See id.} (discussing the various methodologies available to value a closely held corporation under the "income" approach).
appropriate given the lack of comparable companies needed for a market approach analysis.269

After conducting a fairly sophisticated discounted future cash flow analysis, the court took up the question—which it considered to be a matter of first impression in the Commonwealth—of whether to impose a minority discount, a marketability discount, or a control premium to the value of the stock so arrived at.270 After reviewing authority from other jurisdictions, the court concluded that, in Virginia, no minority discount should be applied in a proceeding under Virginia Code section 13.1-740,271 and furthermore, that absent “extraordinary circumstances,” none of which existed in the case at bar, a marketability discount also was inappropriate.272 Finally, Judge Klein refused to include any control premium on the facts before him.273 Having determined the value of the corporation as a going concern under the approach described, Judge Klein then valued Mrs. McGreevy’s proportionate share thereof, to which he added an interest factor.274

IV. STATE CORPORATION COMMISSION SECURITIES ACT RULES

By order dated May 25, 2001 (“Order”), the SCC adopted an order amending the SCC’s Securities Act Rules.275 The amendments became effective July 1, 2001.276 This section briefly summarizes those amendments.

The Order amends Securities Act Rule 21 VAC 5-20-10 by providing that an application for registration as a broker-dealer by a NASD member is to comply with all requirements of the NASAA/NASD Central Registration Depository system.277 Application for registration as any other broker-dealer must be

269. See id. at *6
270. Id. at *10.
273. Id. at *12–13.
274. Id. at *17.
276. Id.
cation for registration as any other broker-dealer must be filed with the SCC in compliance with forms prescribed by the SCC.\textsuperscript{276} The amendment to Rule 21 VAC 5-20-10 details what information the application must include.\textsuperscript{279}

The Order adopts Regulation 21 VAC 5-20-85 regulating the registration of Canadian broker-dealers engaging in limited transactions in securities.\textsuperscript{280} Securities Act Regulation 21 VAC 5-20-155 provides for agent registration of a Canadian broker-dealer engaged in limited securities transactions.\textsuperscript{281}

The Order amends Securities Act Regulation 21 VAC 5-20-240 to add a new subparagraph "F" governing access to broker-dealer records.\textsuperscript{282} The Order repeals Regulation 21 VAC 5-30-30 dealing with refunds of fees paid by unit investment trusts.\textsuperscript{283} It also repeals Regulation 21 VAC 5-30-60 dealing with requirements for renewal applications filed pursuant to Virginia Code section 13.1-512.\textsuperscript{284}

The Order amends Regulation 21 VAC 5-30-80 by updating the NASAA statements of policy that will apply to the registration of securities in Virginia.\textsuperscript{285} The Order amends Regulation 21 VAC 5-30-10 by providing that registration as an investment advisor shall be filed in compliance with all requirements of the Investment Advisor Registration Depository (IARD) system.\textsuperscript{286} The Order makes certain other technical changes with respect to the reg-

\textsuperscript{278} Id.

\textsuperscript{279} See id.

\textsuperscript{280} Limited Canadian Broker-Dealer Registration Regulation, 17 Va. Regs. Reg. 2925 (June 18, 2001) (to be codified at 21 VA. ADMIN. CODE § 5-20-85).

\textsuperscript{281} Limited Canadian Broker-Dealer Agent Registration Regulation, 17 Va. Regs. Reg. 2926 (June 18, 2001) (to be codified at 21 VA. ADMIN. CODE § 5-20-155).


istration of investment advisors and "federal covered advisors."\textsuperscript{287} One of the more important changes is that the Order amends Regulation 21 VAC 5-80-160 by adding a new section K governing access by the SCC to the investment advisor's records.\textsuperscript{288}

Another important clarifying change, welcomed by accountants, is the amendment of Regulation 21 VAC 5-80-210 by adding a new section C excluding from the term "investment advisor":

any certified public accountant who holds a valid CPA certificate as defined by § 54.1-2000 of Title 54.1 of the Code of Virginia and who during the ordinary course of business does the following:

1. Issues publications, writings, reports, or testimony in a court of law or in an arbitration as to the value of privately held securities in a transaction involving the purchase, sale or valuation of a business;

2. Issues publications, writings, reports or testimony in a court of law or in an arbitration as to the advisability of investing in, purchasing, or selling privately held securities in a transaction involving the purchase, sale or valuation of a business; or

3. Advises clients about the disposition or value of assets, of which ownership is evidenced by privately held securities and such assets are the subject of (i) bankruptcy, (ii) estate or gift planning or settlement, (iii) divorce, (iv) sale of a business, whether whole or in part, (v) employee stock option plan, or (vi) an insurance settlement.\textsuperscript{289}

There are other technical changes to the Securities Act Rules made by the Order that also should be examined by lawyers practicing in this area.

V. CONCLUSION

The General Assembly and the SCC made several business law changes over the past year, but most of the action was in the judicial arena. Courts over the past year issued many significant rul-


ings in business law. Especially important—in Virginia as else-
where—are those decisions addressing the fiduciary duties of
those who manage or control business organizations. These deci-
sions settle some issues and yet raise others. In all events, they
warrant attention from both litigators and business lawyers.