1985

The New Virginia Stock Corporation Act: A Primer

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I. INTRODUCTION

During its 1985 session, the Virginia General Assembly enacted a new stock corporation statute for Virginia[1] ("Revised Statute").

1. Virginia Stock Corporation Act, 1985 Va. Acts 868 (codified at VA. CODE ANN. §§ 13.1-

The new statute became effective January 1, 1986.[2] The Revised Statute represents a complete revision of the Virginia corporation statute and is the result of a thorough review of prior law. This article will discuss some of the significant changes in Virginia corporate law effected by the Revised Statute and will offer some guidelines for the interpretation and application of its provisions.[3]

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601 to -800 (Repl. Vol. 1985)) [hereinafter cited as REVISED STATUTE].

A new non-stock corporation statute, VA. CODE ANN. §§ 13.1-801 to -980 (Repl. Vol. 1985), was enacted at the same time and parallels the Revised Statute. Certain amendments to the corporate fee and tax structure contained in title 58.1 of the Code were necessitated by the Revised Statute.

In 1983, the General Assembly directed the Virginia Code Commission ("Code Commission") to study chapters 1 and 2 of title 13.1 of the Code of Virginia, the then existing Stock Corporation and Non-Stock Corporation Acts, for the purpose of proposing significant revisions to those statutes. H.J. Res. 3, 1983 Va. Acts 1243. This study was prompted by revisions to the Model Act which had recently been approved or were pending and by the fact that a complete review of the Virginia statutes was thought to be due.

As a part of this study, an initial draft of the Revised Statute was prepared by Allen C. Goolsby, III, Esq. in 1983 at the Code Commission's request. In late 1983 and the first half of 1984, a joint committee of the Virginia State Bar and the Virginia Bar Association reviewed and commented on Mr. Goolsby's draft. Mr. Goolsby revised his draft to take into account some of the Joint Committee's concerns and the then still unfolding Model Act. He submitted his final draft statute to the Code Commission in June, 1984. A set of comments prepared by the Joint Committee was submitted to the Code Commission in July, 1984.

During the fall of 1984, the Code Commission reviewed, and held a series of hearings on, the draft statute. In January, 1985, the Code Commission submitted to the Governor and General Assembly its report on the review of the Stock Corporation Act, the Non-Stock Corporation Act and the fee and tax amendments. In this report, the Code Commission recommended that the revisions to these statutes as contained in the report be enacted. VA. CODE COMM'N, REPORT ON THE REVISION OF CHAPTERS 1 AND 2 OF TITLE 13.1 OF THE CODE OF VIRGINIA, H. Doc. No. 13 (1985) [hereinafter cited as CODE COMMISSION REPORT].

Appendix 1 to the Code Commission Report contains the text of the proposed revised stock corporation and non-stock corporation statutes. Appendix 3 contains the proposed amendments to title 58.1. The comments of the Joint Committee on the proposed revised stock corporation statute are contained as Appendix 4 to the Code Commission Report. The text of the Revised Statute is virtually the same as that contained in Appendix 1 to the Code Commission Report, the adoption of which the Code Commission recommended.

The Revised Statute is not merely an extensive set of amendments to the prior statute, Virginia Stock Corporation Act, VA. CODE ANN. §§ 13.1-1 to -200 (Repl. Vol. 1978) [hereinafter cited as OLD STATUTE]. Instead, the Old Statute was repealed in its entirety upon the effective date of the Revised Statute.

2. REVISED STATUTE, *supra* note 1, article 14, "Affiliated Transactions," became effective July 1, 1985. REVISED STATUTE, *supra* note 1, §§ 13.1-725 to -728.

3. This article will not discuss every change made by the Revised Statute. And because of the short period of time that has elapsed since the statute's passage, this article will not be as thorough a scholarly exegesis as has been produced with respect to some other corporation statutes. *See, e.g.*, E. FOLK, THE DELAWARE GENERAL CORPORATION LAW (1972); Folk, *Revisiting the North Carolina Corporation Law, The Robinson Treatise Reviewed and Statute Reconsidered*, 43 N.C.L. REV. 768 (1965).

The statute as set out in Appendix 1 to the CODE COMMISSION REPORT, *supra* note 1, contains a very helpful statement after each section, noting some of the differences between

The Revised Statute embodies most of the provisions of the Revised Model Business Corporation Act[4] ("Model Act"), which had been undergoing a thorough revision over the last several years. In fact, the desire to conform the Virginia statute to the most recent version of the Model Act was perhaps the most important motive prompting enactment of the Revised Statute.

Other purposes are evident in the Revised Statute. For example, certain provisions have been drafted to protect Virginia corporations from hostile takeovers. Also, while there is no separate optional chapter for closely held corporations as in some jurisdictions,[5] some provisions of the Revised Statute evidence a recognition of the special problems of small, closely held corporations.

In general, the Revised Statute adopts the Model Act's approach, except in those instances where prior Virginia law[6] was thought to be more advantageous or where difficulty with the language or effect of the Model Act's position was perceived. With several extremely important exceptions, the Revised Statute closely follows either the Model Act or prior Virginia law.

Since the Revised Statute is largely an adaptation of the Model Act, Virginia, in enacting it, has become one of the first states to adopt the most recent version of the Model Act.[7] The advantages

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the proposed provision and the then existing comparable Virginia Code provision, and the relationship between it and the comparable Model Act provision.

4. REVISED MODEL BUSINESS CORP. ACT (1985) [hereinafter cited as MODEL ACT]. The Model Act had been under revision for quite some time. Revisions to certain provisions had been approved during the last few years. *See, e.g., infra* notes 43 & 157. A draft of the revised Model Act, including those portions previously approved, was circulated for comment in 1983. *See* MODEL ACT (Exposure Draft 1983) [hereinafter cited as EXPOSURE DRAFT].

5. *See, e.g.,* CAL. CORP. CODE § 158 (West 1977); DEL. CODE ANN. tit. 8, §§ 341-56 (1974); MD. CORPS. & ASS'NS CODE ANN. §§ 4-101 to -603 (Repl. Vol. 1985).

6. Throughout this article, the term "prior Virginia law" refers to the Virginia Stock Corporation Act as it exited until January 1, 1986, OLD STATUTE, *supra* note 1, §§ 13.1-1 to -200, and the case law.

7. Virginia thus carries on a tradition of being among the first states to conform its statute to the Model Act. Virginia's Stock Corporation Act was extensively revised in 1956 to conform to the early versions of the Model Act. *See* Emerson, *Vital Weaknesses in the New Virginia Stock Corporation Act and the Model Act*, 42 VA. L. REV. 489 (1956); Gibson, *The Virginia Corporation Law of 1956*, 42 VA. L. REV. 445, 603 (1956). In the intervening 30 years, the Virginia statute has been amended piecemeal to reflect some of the revisions to the Model Act. It has been ten years since major changes have been made to the statute. In 1975 some significant amendments were introduced which updated and conformed the statute to the Model Act.

For an analysis and discussion of the older versions of the Model Act, see the authorities of following a national model are obvious. The provisions have been thoroughly considered by a number of very prominent practitioners and scholars. The Official Comments to each section of the Model Act should serve as a guide to the interpretation of the Revised Statute's provisions.[8] The evolving case law from jurisdictions having substantially the same provisions can be persuasive authority in the interpretation and application of the Revised Statute.[9]

II. Analysis of the Revised Statute

Functionally, the Revised Statute is divided into twenty articles. The corpus of statutory material contained in the thirteen articles comprising the former statute[10] ("Old Statute") has been somewhat subdivided and rearranged within these twenty articles.

A. *Article One—General Provisions*[11]

Article One includes expanded definitional sections.[12] In addition it contains provisions regarding notice and filing of documents with the State Corporation Commission ("Commission"). The requirement for local filing of certificates issued by the Commission has been retained in Revised Statute section 13.1-605.

One extremely helpful change is the provision for deferred effective dates in Revised Statute section 13.1-606(A). Normally, the effective date of a certificate issued by the Commission is the date of the certificate. Prior law and practice proved rather inflexible on

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cited in Murphy, *Redemption of Stock Under the Model Business Corporation Act and the Virginia Stock Corporation Act*, 14 U. Rich. L. Rev. 311, 311 n.1, 316 n.10, 321 n.15 (1980).

8. Since Virginia publishes little legislative history for its statutes, the Official Comments to the Model Act ought to be considered a fertile source in the interpretation and application of the Revised Statute. The Comments of the Joint Bar Committee, Code Commission Report, *supra* note 1, app. 4, are also helpful.

9. The relatively small number of reported Virginia cases in the corporate law area makes the case law of other jurisdictions having comparable provisions extremely important.

10. Article 13 of the Old Statute, dealing with Industrial Development Corporations, has been removed from the Stock Corporation Act and placed as a separate chapter within title 13.1. *See* Revised Statute, *supra* note 1, §§ 13.1-981 to -998.

11. Revised Statute, *supra* note 1, §§ 13.1-601 to -614.

12. Revised Statute, *supra* note 1, §§ 13.1-603, -610, -611, for example, define the following terms: articles of incorporation, certificate, commission, conspicuous, domestic and foreign corporation, deliver, distribution, effective date, employee, entity, principal office, proceeding, record date, share, shareholder, state, subscriber, United States, voting group, notice, and number of shareholders. Many of these terms will be discussed in connection with the substantive provisions employing them.

this point. Revised Statute section 13.1-606(A), in contrast, provides that the articles[13] based upon which the certificate is issued may state an effective date up to fifteen days after the date of issuance. This flexibility may be extremely helpful in facilitating the conclusion of many corporate transactions such as mergers.[14]

B. *Article Two—Fees*[15]

Article Two prescribes the fees to be collected by the Commission.

C. *Article Three—Formation of Corporations*[16]

Article Three provides for the formation of corporations. Revised Statute section 13.1-618 continues the limited role of incorporators. Their sole function is to sign and file the articles of incorporation with the Commission. Since "person" is defined in Revised Statute section 13.1-603 as an individual or an entity, a corporation can serve as an incorporator.

Revised Statute section 13.1-619(A) lists the information which must be set forth in the articles of incorporation. This section does not substantively differ from Old Statute section 13.1-49, except that it eliminates the required statement of purpose.[17] Revised Statute section 13.1-619(B) expands, or at least makes more explicit, the optional clauses which may be included in the articles.

Of particular advantange to the closely held corporation is the allowance of provisions "[r]egarding the management of the business and . . . affairs of the corporation" and those "[d]efining, limiting, and regulating the powers of the corporation, its directors, and shareholders."[18] This section explicitly acknowledges, to a greater degree than the Old Statute did, the possibility of molding the roles of the directors and shareholders in managing the affairs

13. "Articles" are defined in Revised Statute, *supra* note 1, § 13.1-603, to include articles of incorporation and all amendments thereto, and articles of merger.

14. It was sometimes difficult under the Old Statute to coordinate filings in the states of incorporation of the parties to a merger so as to assure effectiveness on the same day the Commission issued the certificate of merger.

15. Revised Statute, *supra* note 1, §§ 13.1-615 to -617.

16. *Id.* §§ 13.1-618 to -625.

17. *See infra* note 22 and accompanying text.

18. Revised Statute, *supra* note 1, § 13.1-619(B)(3)(b) & (c). The Official Comment to Model Act, *supra* note 4, § 2.02, on which this section is based, contains a helpful list of common types of optional provisions.

of a closely held corporation in order to give the shareholders a more active role.

Revised Statute section 13.1-619(B)(3) is introduced by the qualifying language that optional provisions included in the articles not be inconsistent with law. This section, therefore, does not expressly validate any particular management allocation provision. The legality of such provisions must be determined by other portions of the statute or by the case law.

Revised Statute section 13.1-622, which has no analog in the Old Statute, provides that persons purporting to act on behalf of a corporation knowing that there is no incorporation are jointly and severally liable for the liabilities created while so acting. They are not liable, however, to persons who also know that there is no incorporation. This provision follows from the Model Act's position that corporate existence begins upon issuance of the certificate of incorporation. If conduct is engaged in, or liability incurred, before corporate existence, those persons acting for or as a corporation must be personally responsible.[19]

Unlike the Model Act, however, the Revised Statute qualifies this liability. Under section 13.1-622, the persons acting for or as a corporation are not liable to persons who also knew there was no incorporation. This exception thus allows a limited version of "corporation by estoppel."[20] Section 13.1-622 confers, in this narrow instance, the advantage of limited liability on persons acting for or as a corporation even though they know that in fact there is no effective corporation. Therefore, it probably ought to be narrowly construed to operate only against persons having actual knowledge, not just reason to know, of the lack of corporate status.

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19. The doctrine of de facto corporations is mooted by the Model Act. Liability is limited to those persons acting as, or on behalf of, the purported corporation. Passive investors are not liable. MODEL ACT, *supra* note 4, §§ 2.03, 2.04, 2.04 official comment; *see* Timberlane Equip. Co. v. Davenport, 267 Or. 64, 514 P.2d 1109 (1973).

20. *See* Cranson v. International Business Machs., 234 Md. 477, 200 A.2d 33 (1964). The concept of "corporation by estoppel" is based on the premise that the plaintiff, often a creditor, intended to deal with the entity and not with the individuals as such. Plaintiff therefore ought to be limited to seeking recourse only from the entity with which he in fact intended to deal.

D. *Article Four—Purposes and Powers*[21]

Article Four contains those sections dealing with the corporation's purposes and powers. Revised Statute section 13.1-626 states that, unless a limited purpose is stated in the articles of incorporation or is required by law, a corporation's purpose is to engage "in any lawful business." Old Statute section 13.1-49(b) allowed a corporation to adopt this broad purpose by specific provision in the articles. The Revised Statute reverses this presumption and states that a corporation has this broad purpose unless it adopts, or is required by law to have, a narrower purpose. Thus, nothing need be stated in the articles about purpose unless a narrower one is desired.[22]

Revised Statute section 13.1-627 corresponds to Old Statute section 13.1-2.1 and lists the statutory powers conferred on corporations unless limited by the articles. This section carries forward into the Revised Statute some broader authorizations than are contained in the Model Act analog, section 3.02. For example, it sanctions payments to officers, directors and employees for previously rendered services, even though the payments are not made pursuant to a prior agreement. It also confers the power to obtain life insurance on any officer, director or employee, and on any shareholder for the purpose of acquiring his shares on death.

While this extensive list of powers is helpful, it is probably not necessary. The introductory portions of both Revised Statute section 13.1-627 and Model Act section 3.02 state that a corporation has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs, including without limitation those powers listed. Arguably, if the section ended after that grant of power, it would not be more restrictive than as drafted with the list. This list is nonetheless useful for illustrative purposes.[23]

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21. Revised Statute, *supra* note 1, §§ 13.1-626 to -629.

22. Revised Statute, *supra* note 1, § 13.1-619, makes this point clear. It lists in section 13.1-619(A) the four elements which must be included in the articles of incorporation: (1) the name; (2) the number of authorized shares; (3) the distinguishing rights of shares if more than one class is authorized; and (4) the name of the registered agent and the address of the registered office. Revised Statute, *supra* note 1, § 13.1-619(B)(3)(a), states that a corporation *may* set forth in the articles "the purpose or purposes for which the corporation is organized." The Official Comment to Model Act, *supra* note 4, § 3.01, notes that, because the allowance of the broad purpose clause is almost universal among the states, there appears to be no reason not to make it the norm.

23. Revised Statute, *supra* note 1, § 13.1-627(A)(17), like Old Statute, *supra* note 1, §

Revised Statute section 13.1-629 carries forward the thrust of Old Statute section 13.1-5 in strictly limiting the viability of the ultra vires doctrine. Section 13.1-629(A) states the general proposition that corporate action generally cannot be challenged on the ground that the corporation lacked the power to act; and section 13.1-629(B) states the three instances in which the lack of authority can be raised.

The wording of this section makes it clear that completed corporate conduct, even if unauthorized, cannot be set aside to the disadvantage of the other party to the transaction. Given the prevalence of the broad corporate purpose clause and the power to do "all things necessary or convenient" to accomplish the broad purpose, the likelihood of challenge to corporate action under this section is not great.

The section does not substantively change, however, the provisions of Old Statute section 13.1-5 in stating the three grounds on which the lack of authority can be raised. The corporation's lack of power to act may be challenged by a shareholder suing to enjoin the act. This ground, of course, would apply to corporate action not yet concluded. The corporation may sue for damages the individuals performing the unauthorized act. And finally, a proceeding seeking involuntary dissolution may be brought before the Commission.

E. *Article Five—Name; Article Six—Office and Agent*[24]

Article Five contains three sections regarding corporate names, their reservation and registration. A separate section provides, as did old Statute section 13.1-127, for the Commission's issuance of a certificate reciting the change of corporate name or succession to ownership. This certificate may be admitted to record in the recording office where corporate property is located to maintain the continuity of title records.

Article Six's provisions regarding the registered office and agent make explicit the limited role of the registered agent. Revised Statute section 13.1-634(B) provides that the sole function of the registered agent is to forward to the corporation any notice served on

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13.1-2.1(q), in an effort at "overkill," contains a final catch-all clause allowing a corporation to have and exercise all powers necessary or convenient to effect its purposes.

24. Revised Statute, *supra* note 1, §§ 13.1-630 to -633 (Article 5); *id.* §§ 13.1-634 to -637 (Article 6).

him. Revised Statute section 13.1-636 adds a procedure whereby the registered agent may resign.[25]

F. *Article Seven—Shares and Distributions*[26]

Article Seven, dealing with shares and distributions, differs substantially from the Old Statute in its treatment of these issues.

Revised Statute section 13.1-638, regarding authorized shares, covers the concepts contained in Old Statute sections 13.1-12 and -13. Revised Statute section 13.1-638(A), like Old Statute section 13.1-12, states that the corporation shall have such classes of shares and authorized number of shares as are stated in the articles of incorporation. If more than one class is authorized, the relative rights, preferences and distinguishing designations of the classes must be stated in the articles of incorporation. The statute contains no reference to par value.[27]

Section 13.1-638(B) requires every corporation to authorize one or more classes of shares possessing the two fundamental rights of plenary voting power and of receiving the net assets of the corporation on dissolution. The same class of shares need not possess both of these rights.[28] In addition, as stated in Revised Statute section 13.1-638(C), the articles of incorporation may authorize one or more classes having the typical rights and preferences of preferred shares, including special voting, liquidation, redemption or conversion features.

The traditional terms "common," "preferred" and "special" classes of shares are intentionally omitted from the Revised Statute. Neither the precise definition of these categories nor their legal significance has been clear for many years.[29] Although section 13.1-638(A) requires a specific descriptive designation for each class, it assigns no legal consequence to the descriptive designation. Accordingly, articulation of the relative rights of the classes of shares in the articles is extremely important.

25. A comparable provision was deleted from the Old Statute in 1981.

26. Revised Statute, *supra* note 1, §§ 13.1-638 to -653.

27. *See generally infra* notes 41-47 and accompanying text. Under the Old Statute, charter, entrance and annual registration fees and franchise taxes for stock corporations were based on the amount of authorized capital stock. Elimination of the concept of par value necessitated a change in the basis used to compute these fees and taxes. They will be based on the number of authorized shares. *See* Va. Code Ann. tit. 58.1 (Repl. Vol. 1982).

28. *See* Model Act, *supra* note 4, § 6.01 official comment.

29. *See id.* § 6.01(B) official comment; Murphy, *supra* note 7, at 331-39.

Revised Statute section 13.1-638(C)(2) adds flexibility with respect to the redemption or conversion of shares. It specifically allows the terms or formula by which the redemption price or conversion ratio is determined to be stated in the articles of incorporation, or to be determined by extrinsic data or events identified in the articles.[30] Moreover, the shares can be made redeemable at the option of the holder, the corporation or some other person. Old Statute section 13.1-13(a) authorized provisions providing for redemption at the option of the corporation. The Revised Statute balances this right by providing for redemption at the option of the corporation or shareholder.

Revised Statute section 13.1-638(B) clearly states that every corporation must have at least one class of shares possessing plenary voting rights and one class having the right to receive the net assets of the corporation upon dissolution. If more than one class of shares is authorized, the precise rights of all classes must be stated in the articles so that it is clear which class has these fundamental rights.

It is somewhat unclear whether a statement of the voting and net asset distribution rights must be articulated in the articles if only one class is authorized. Revised Statute section 13.1-638(A) supports the argument that they need not be. It states that if more than one class is authorized, the articles must state the distinguishing characteristics and rights of each class. But Revised Statute section 13.1-638(B) requires that the articles authorize one or more classes possessing plenary voting and net asset distribution rights.

The Official Comment to Model Act section 6.01 states that if only one class is authorized, no statement of the rights need be made. If two or more classes are authorized, one of which possesses these fundamental rights, that class need only be described as "common shares" or shares having general distribution and voting rights.[31] This instruction does assign legal consequences to the term "common shares," even though the thrust of the Model Act generally is to focus on the statement of rights in the articles.

Revised Statute section 13.1-639 carries forward the notion of

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30. *See* Murphy, *supra* note 7, at 324-29.

31. Model Act, *supra* note 4, § 6.01 official comment. Since Revised Statute, *supra* note 1, § 13.1-638(A) & (B), substantially tracks the language of Model Act, *supra* note 4, § 6.01, this explanation should resolve any doubt on this point.

"blank stock." It allows the board of directors, if so authorized by the articles, to define the rights of any class of shares by filing an amendment to the articles before any shares of the class are issued.

Revised Statute section 13.1-640 is new to Virginia law. This section first authorizes the corporation to issue up to the number of shares of each class stated in the articles of incorporation. These issued shares are outstanding until they are reacquired, redeemed, converted or cancelled pursuant to Revised Statute section 13.1-653. Revised Statute section 13.1-640(C) allows, if the articles so provide, all shares to be redeemed, whether they are called preferred or common, so long as one share remains outstanding which possesses plenary voting and net asset distribution rights.

This provision resolves the uncertainty in prior law regarding whether common shares can be redeemed. By one school of thought they could, if a class of non-redeemable common shares remained outstanding. This, in turn, led to the question of whether the redeemable shares were in fact common, preferred or a special class.[32] Revised Statute section 13.1-640 eliminates the issue by allowing all shares to be redeemed so long as one share possessing plenary rights remains outstanding.

Revised Statute section 13.1-641, dealing with fractional shares, changes prior Virginia law. It provides the board of directors with a range of options in dealing with fractional interests. The board may issue fractional shares or pay in money the value of the fractional interest. It may also arrange for the disposition of the fractional shares, or it may issue scrip.

Old Statute section 13.1-21 did not authorize the issuance of fractional shares, except in open-end investment trusts; it allowed only the issuance of scrip or payment of the value of the fractional share. Revised Statute section 13.1-641 is introduced by the language "[a] corporation *may*, if authorized by its board of directors. . . ." (emphasis added). Consequently, the board is able to exercise its discretion and determine in any instance how to deal with fractional interests.

Revised Statute section 13.1-643, regarding the issuance of shares, is one of the first sections, in order of occurrence, to give effect to the Model Act's revised financial provisions;[33] and it sig-

32. *See* Murphy, *supra* note 7, at 331-39.
33. *See infra* notes 40-48 and accompanying text.

nificantly changes prior Virginia law contained in Old Statute sections 13.1-17 and -18. The concepts of par value, stated capital, earned and capital surplus, and treasury stock have been eliminated from the Model Act. The Revised Statute follows this change. Accordingly, the allocation of the consideration received for shares to stated capital and capital surplus, as provided in Old Statute section 13.1-18, and the determination of the consideration which must be paid for newly issued or treasury shares, as stated in Old Statute sections 13.1-17 and -18, are unnecessary. In their place, Revised Statute section 13.1-643(B) first states that any issuance of shares must be authorized by the board, then lists the types of consideration which may be accepted in exchange for shares. This list includes any tangible or intangible property or benefit to the corporation, including cash, property, promissory notes, or past or future services.

This list of valid types of consideration does not depart from prior Virginia law.[34] However, Revised Statute section 13.1-643(C) does change prior Virginia law. By its terms, the good faith determination of the board that the consideration received or to be received by the corporation is adequate is conclusive. Upon receipt of this consideration, the shares are deemed to be fully paid and non-assessable. The board is not required by this section to determine the adequacy of the value of the consideration for all purposes. The "adequacy" determination required by this section establishes only whether the shares are validly issued and fully paid. Old Statute section 13.1-17 required that the directors place a dollar value on the consideration, and this valuation was deemed conclusive in the absence of fraud.[35] Moreover, the "absence of fraud" standard used in the Old Statute has been replaced in this section by a "good faith standard."

Shares issued in exchange for promissory notes or contracts for future services are deemed to be fully paid, assuming the board's determination of the adequacy of consideration, when it accepts the promissory note or the contract for services. Revised Statute section 13.1-643(D) contains some protective measures (including

34. The prohibition on acceptance of promissory notes or future services was eliminated from OLD STATUTE, *supra* note 1, § 13.1-17, in 1975.

35. MODEL ACT, *supra* note 4, § 6.21 official comment, notes that the directors need not, but may, place specific dollar value on noncash consideration. The comment recognizes that some value must be placed on consideration for accounting purposes, but that the determination of such values is not necessarily the responsibility of the board.

escrow of the shares, transfer restriction and credit of distributions) which a corporation may employ to insure that the services are performed or the note paid. These measures do not affect the fully paid and non-assessable status of the shares; they only provide security for performance or payment.

Finally, Revised Statute section 13.1-643 does not allow the shareholders to restrict the board's authority to issue shares, as did Old Statute section 13.1-17. Section 13.1-643 authorizes the board to issue the shares, and it sets forth the procedures under which the shares may be issued. It does allow the shareholders to reserve for themselves this same prerogative by a provision in the articles of incorporation. It appears, however, that the substantive provisions of the section cannot be modified. If no provision is contained in the articles, the board will perform this function on the terms stated in section 13.1-643. With a provision in the articles, the shareholders will perform this function, but under the same terms and procedures stated in the section.

Revised Statute section 13.1-644 provides that the sole liability of the shareholder is to pay the consideration for which the shares were authorized to be issued to him. Revised Statute section 13.1-644(B) fixes this amount as the consideration which the board or the shareholders determine in good faith to be adequate.[36]

Revised Statute section 13.1-649 codifies principles that perhaps existed, albeit inchoate, in prior Virginia law.[37] It explicitly authorizes share transfer restrictions, be they in the articles of incorporation, bylaws, a shareholders' agreement, or an agreement between the corporation and shareholders.

Revised Statute section 13.1-649(B) makes such restrictions enforceable against a holder or any transferee if the restriction is noted on the share certificate or contained in the information statement required with respect to uncertificated shares. It is not otherwise enforceable against a person without knowledge of the restriction.

36. A transferee in good faith, and without knowledge that the consideration has not been paid, would not be liable to the corporation or creditors for any unpaid portion of the consideration; but the original holder would remain liable.

37. *See* OLD STATUTE, *supra* note 1, § 13.1-24. Reasonable restrictions on the transfer of stock were permissible under prior law because the corporation's charter was viewed as a contract between the corporation and its shareholders, as well as between the shareholders themselves. However, such restrictions were strictly construed by the courts. *See* Monacan Hills v. Page, 203 Va. 110, 122 S.E.2d 654 (1961).

Revised Statute section 13.1-649(C) sanctions restrictions intended to serve any reasonable purpose, including preservation of securities act exemptions or closely held corporation status. Section 13.1-649(D) lists typical transfer and registration restrictions, including the right of first refusal or option, approval before transfer, and prohibition of transfer to designated classes of persons, if the class is not unreasonable.

Revised Statute section 13.1-651 maintains the traditional Virginia approach to preemptive rights.[38] They exist unless limited or denied in the articles of incorporation. Although Revised Statute section 13.1-651 confers the right generally, it continues the common practice of denying the right with respect to shares offered for other than money or to officers or employees pursuant to plans approved by the shareholders. Moreover, the right does not extend to shares having distribution preferences, shares without general voting power, or to shares having preferential rights to distributions unless they are convertible into shares without that right. In all of these instances, the preemptive right would exist only if specifically provided in the articles of incorporation.

Revised Statute section 13.1-653(G) clarifies the corporation's right to issue the shares not acquired by the present shareholders pursuant to their preemptive right. The corporation may offer these shares to others for a period of one year at a price not lower than that offered to the existing shareholders. If the shares are offered after one year or at a lower price, the preemptive right is again triggered.

The statutory qualifications on the preemptive right make it a less attractive right than may initially appear. The right is particularly important in the closely held corporation context, when relative voting position is critical. Yet the statutory exemptions present the corporation or majority shareholder with various ways of avoiding the right. Shares issued for property or services, for example, do not trigger the right. Consequently, holders of preemptive rights cannot take too much comfort in them.[39]

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38. This section is more complete than OLD STATUTE, *supra* note 1, § 13.1-23, but does not substantively differ from it; and it follows MODEL ACT, *supra* note 4, § 6.30, except in the "opt out" variant. MODEL ACT, *supra* note 4, § 6.30, provides, like the law of many states, that preemptive rights do not exist unless provided for in the articles. A statement in the articles to the effect that the corporation elects to have preemptive rights is sufficient to confer statutory preemptive rights.

39. Any abusive avoidance of the preemptive right by a corporation or its majority share-

Revised Statute section 13.1-652 authorizes a corporation to reacquire shares of its stock and states the consequence of the reacquisition on the corporation's capital structure. The shares on reacquisition are returned to the status of authorized but unissued shares. They can be freely reissued unless the articles of incorporation prohibit reissue. If reissue is prohibited, the authorized number of shares in the class is reduced on reacquisition by the number of reacquired shares through an amendment to the articles of incorporation. In this event, the corporation is obligated to adopt, by action of the board without shareholder approval, an amendment to the articles and to file it with the Commission.

Elimination of the concepts of par value, stated capital, earned and capital surplus, and treasury shares from the Revised Statute greatly simplifies the procedures for and accounting consequences of share reacquisitions.[40] Elimination of these accounting concepts also has the salutary effect of eliminating the distinction between a reacquisition and a redemption. Consequently, the separate provisions regarding a redemption set forth in Old Statute section 13.1-62 have not been retained.[41]

Since a reacquisition of shares fits within the definition of a distribution,[42] Revised Statute section 13.1-652 merely states the consequence of the reacquisition to the corporation's authorized capital. The question of whether a corporation may reacquire shares and the impact of the reacquisition on the financial position of the corporation are governed by Revised Statute section 13.1-653, which authorizes distributions to shareholders.

Section 13.1-653 is probably the capstone of the financial provisions in the Revised Statute. This section is an enactment of Model Act section 6.40 without change. It thereby gives full effect to the Model Act's aim of revising the accounting and financial provisions to better reflect today's financial realities.[43] Elimination

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holder would raise issues of fiduciary duty, however.

40. The procedures for cancellation of shares and reduction in capital as contained in OLD STATUTE, *supra* note 1, §§ 13.1-63, -64, are no longer necessary and have not been carried over into the Revised Statute.

41. *See generally* Murphy, *supra* note 7.

42. REVISED STATUTE, *supra* note 1, § 13.1-603.

43. *See Changes in the Model Business Corporation Act-Amendments to Financial Provisions, A Report of the Committee on Corporate Laws*, 34 BUS. LAW. 1867 (1979) [hereinafter cited as *Changes*]. The revised financial provisions of the Model Act are essentially contained in this report. They were adopted by the Committee on Corporate Laws in 1980. *Changes in the Model Business Corporation Act-Amendments to Financial Provisions: A*

of the concepts of par value, stated capital, earned and capital surplus, and treasury shares from the definitional and operational sections of the Revised Statute surely provides flexibility in accounting for both the consideration received for shares and their reacquisition. However, it is in the context of a distribution to shareholders that the full significance of these changes is apparent.[44]

A distribution is defined in Revised Statute section 13.1-603 as a "transfer of money or other property, except its own shares, or incurrence of indebtedness by a corporation to or for the benefit of its shareholders in respect of any of its shares." A distribution thus includes transactions commonly thought of as dividends, share purchases, redemptions and liquidation distributions; and the currency for these distributions is money, property or debt.

Revised Statute section 13.1-653(A) authorizes the board to make any distribution to shareholders, subject only to any restriction in the articles of incorporation and Revised Statute section 13.1-653(C). Thus, the requirements of the Old Statute—that dividends be paid or that shares be repurchased only out of earned or capital surplus, and that stated capital not be paid out to the shareholders until liquidation—have been abandoned.[45] Under Revised Statute section 13.1-653, a corporation is free to pay out virtually its entire net worth to its shareholders, subject to Revised Statute section 13.1-653(C).

Section 13.1-653(C) sets forth two constraints on distributions, the "equity" and "balance sheet" solvency limitations. No distribution can be made under this section if, after giving effect to it, the corporation would not be able to pay its debts as they become due in the usual course of business (equity solvency), or if its total assets would be less than its liabilities and the amount of any liquidation preference of shares senior to the class receiving the distribution (balance sheet solvency).

Report of the Committee on Corporate Laws, 35 Bus. Law. 1365 (1980). The commentary contained in *Changes* has been somewhat reworked in the Official Comment to Model Act, *supra* note 4, § 6.40.

44. *See generally* B. Manning, A Concise Textbook on Legal Capital (2d ed. 1981); Murphy, *Equity Insolvency and the New Model Business Corporation Act*, 15 U. Rich. L. Rev. 839 (1981); Note, *The 1980 Amendments to the Financial Provisions of the Model Business Corporation Act: A Positive Alternative to the New York Statutory Approach*, 47 Alb. L. Rev. 1019 (1983).

45. *See generally* B. Manning, *supra* note 44, at 165-80; Murphy, *supra* note 44.

Although section 13.1-653(C) frees corporate managers from the artificial constraints of earned and capital surplus, it does require of them some sophisticated judgments about the corporation's future. Revised Statute section 13.1-653(D) allows these solvency determinations to be based on financial statements prepared on the basis of accounting practices which are reasonable under the circumstances, or on fair valuation or any other reasonable method.

Once the accounting method is chosen, the balance sheet solvency test is fairly easy to apply. However, the equity solvency test requires careful analysis of the corporation's liquidity and the future course of its business. Unfortunately, the analysis and judgments it demands are not within the everyday experience of many directors, especially those of small closely held corporations.[46]

Revised Statute section 13.1-653(E) states that the tests are to be applied generally on the earlier of the dates the money is paid or the indebtedness incurred. If the distribution is made by promissory note or installment payment, the operative date is the date on which the obligation is incurred, not the date on which it is paid.[47]

The Official Comment to Model Act section 6.40 notes that the two solvency judgments are used to determine both the validity of the distribution and the liability of the directors for improper distributions. It acknowledges that comparable solvency standards are used in the bankruptcy and fraudulent conveyance settings for other purposes. The comment, however, states that, in view of the

46. Fortunately, the Official Comment to MODEL ACT, *supra* note 4, § 6.40, contains helpful guidance with respect to the framework within which these judgments must be made and offers a methodology to be employed. The comment indicates that application of the equity solvency test requires a cash flow analysis, based on a business forecast and budget, for a time period sufficient to assess whether known liabilities reasonably can be expected to be met as they mature. The equity solvency test is not new; it has been a separate test under the Old Statute and almost every other state's corporation law for decades. However, it now assumes a greater importance. *See* Murphy, *supra* note 44. Although that article discusses the financial provisions and comments as contained in *Changes, supra* note 43, the text of the relevant provisions is virtually unchanged and the Official Comments are not substantively different from the commentary in *Changes*.

47. An argument can be made that the test should be applied on the date of payment since until that time no money actually leaves the corporation. *See* Williams v. Nevelow, 513 S.W.2d 535 (Tex. 1974). However, payment of the indebtedness often would be made as a routine corporate matter with no review by the board. Moreover, incurrence of the debt is sufficient for balance sheet solvency purposes since the amount of the debt is a liability. Likewise for equity solvency purposes, the obligation to make the payment in the future is a factor to be considered in the cash flow analysis required to determine if the distribution can be made.

differing purposes of these laws, it is unnecessary that these tests as applied under the Model Act be interpreted identically to the solvency tests employed in those settings. Accordingly the body of case and statutory law from those fields should not be controlling for corporate law purposes.[48]

G. *Article Eight—Shareholders*[49]

Article Eight of the Revised Statute contains the provisions relating to shareholder action at meetings or otherwise.

Revised Statute section 13.1-654, regarding annual meetings, is comparable to Old Statute section 13.1-25, except that it codifies the common law rule that failure to hold an annual meeting does not affect the validity of any corporate action.

Revised Statute section 13.1-655 deals with special shareholder meetings. This section changes prior Virginia law and is an attempt to protect Virginia corporations from unwanted takeovers. Revised Statute section 13.1-655(A)(1) is based on the Delaware statute,[50] not the Model Act. It states that a special meeting shall be held at the call of the board, its chairman, the president of the corporation or the persons authorized by the articles of incorporation. Therefore, shareholders cannot demand a special meeting unless they are authorized to do so in the articles. Thus, without an article provision the holders of even a majority of the shares could not demand a meeting for the purpose of removing a director or considering a merger proposal.

Old Statute section 13.1-25 allowed the holders of ten percent of the shares to demand a meeting.[51] It was generally thought that this ten percent provision could not be varied in the articles of incorporation or bylaws.[52] This provision, allowing a demand by a

48. Since there is relatively little corporate distribution solvency case law, the inclination would be to look to the bankruptcy and fraudulent conveyance solvency case law, which is highly developed on these points. The comment may caution against this inclination.

49. REVISED STATUTE, *supra* note 1, §§ 13.1-654 to -672.

50. DEL. CODE ANN. tit. 8, § 211 (Repl. Vol. 1983).

51. MODEL ACT, *supra* note 4, § 7.02, provides that a special meeting may be called at the demand of the listed persons or the holders of 10% of the shares entitled to vote on the issue—a provision very similar to OLD STATUTE, *supra* note 1, § 13.1-25.

52. OLD STATUTE, *supra* note 1, § 13.1-25, stated that special meetings may be called "by the chairman . . ., president, the board of directors, the holders of not less than one tenth of all shares entitled to vote at the meeting, or such other officers or persons as may be authorized in the articles of incorporation or the bylaws." The statute specifically provided the percentage of shareholders which could call a special meeting. It did not allow this provision

fairly low percentage of the shares, may have made Virginia corporations particularly vulnerable to takeover. Since the ten percent shareholder demand provision was widely thought to be mandatory, there was no need, or value, in having a provision in the articles of incorporation on this point. The Revised Statute thus substantively changes Virginia law on this point. Without a provision in the articles, the shareholders in many Virginia corporations have no right to demand a shareholders' meeting.

Revised Statute section 13.1-655(A)(2) states a separate, additional rule for small corporations. By its terms, in addition to the listed persons, twenty percent of the shares entitled to vote on the issue to be considered may demand[53] a shareholders' meeting of corporations having thirty-five or fewer shareholders of record. Revised Statute section 13.1-655(B) allows an increase or decrease in the percentage of shares which may demand a meeting. By analogy, Revised Statute section 13.1-655(A)(1) would presumably sanction any percentage for shareholder demand in the over-thirty-five-shareholder corporation, if specifically stated in the articles of incorporation.

Revised Statute section 13.1-655(E) makes explicit that only the matters stated in the notice may be considered at a special meeting.

Revised Statute section 13.1-656 is a remedial section, allowing a court to order the holding of an annual or special meeting if it is not held on proper demand. The court is authorized to fix the time for the meeting and to determine the shares entitled to notice and voting rights. Model Act section 7.03, on which section 13.1-656 is based, also allows the court to establish special quorum requirements for a court-ordered meeting. Such a provision avoids the situation in which a majority shareholder stays away from a meeting for the purpose of frustrating the quorum, with the consequence that the meeting cannot be held. Revised Statute section 13.1-656 does not include this provision. Under section 13.1-656, a court

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to be modified by the articles or bylaws. It was only if the last words of the section ("or persons as may be authorized") were interpreted to apply to a different percentage of shareholders that the one-tenth provision could have been modified. *See* OLD STATUTE, *supra* note 1, § 13.1-25.

53. The shareholders make this demand by delivering written dated demands to the secretary of the corporation, stating the purpose for which a meeting is demanded. The date the first shareholder signs the demand is the date of record for determining which shareholders are entitled to make the demand.

may order the meeting and require that notice be given; but the section does not upset any strategy among the shareholders to frustrate the quorum.[54] The usual quorum and voting rules apply.

Revised Statute section 13.1-657 fills gaps in the Old Statute regarding action without a meeting. Any shareholder action can be taken without a meeting by the unanimous written consent of the shareholders entitled to vote on the matter. To be valid, the consent must state the date on which each shareholder signed. The corporate action evidenced by the consent is deemed to be taken by the shareholders and is effective according to its terms when all the written consents are in the possession of the corporation. A shareholder may withdraw his consent by written notice of withdrawal to the corporation before all consents have been received by it.[55]

Revised Statute section 13.1-658 extends from fifty to sixty days the maximum time period in advance of an annual or special meeting by which notice must be given.[56] Unless otherwise fixed, the record date, for purposes of determining the shareholders entitled to notice and to vote, is the close of business on the day before the effective date of notice.

Revised Statute section 13.1-659 states, more precisely than Old Statute section 13.1-27, the procedure for waiver of notice. Waiver is either by written waiver delivered to the secretary of the corporation or by attendance at the meeting. Under Revised Statute section 13.1-659(B), attendance at the meeting constitutes a waiver of any objection to lack of, or defective, notice unless at the beginning of the meeting the shareholder objects to the holding of the meeting. It also constitutes a waiver of the propriety of a discussion of a particular matter unless the shareholder objects to the matter

54. For cases illustrating the ability of a majority shareholder to defeat a quorum and thus prevent a meeting from being held, see Hall v. Hall, 506 S.W.2d 42 (Mo. App. 1974); Gearing v. Kelly, 11 N.Y.2d 201, 182 N.E.2d 391, 227 N.Y.S.2d 897 (1962).

55. Revised Statute, *supra* note 1, § 13.1-657, requires that notice of certain proposed corporate action, such as amendments to the articles, mergers, share exchanges, sales of corporate assets other than in the ordinary course of business, and dissolutions, be given to nonvoting shares. If any of these actions are to be taken by unanimous written consent, notice must be given to the nonvoting shares at least 10 days before the action is taken; and the written consents must state that such notice was given.

56. Under Revised Statute, *supra* note 1, § 13.1-658, notice must be given not less than 10 nor more than 60 days before the meeting. However, if the meeting is to consider significant corporate transactions, including amendments to the articles of incorporation, mergers, share exchanges, sales of assets, or dissolutions, notice must be given not less than 25 nor more than 60 days before the meeting.

when it is presented.

Certain fundamental corporate transactions, such as amendments to the articles of incorporation, mergers, share exchanges, sales of assets other than in the ordinary course of business and dissolution, require that notice be given to both the voting and nonvoting shares.[57] Although Revised Statute section 13.1-659 does not explicitly so state, it appears that for a waiver of notice be effective for those transactions, it must be obtained from all the shareholders, voting and nonvoting.

Revised Statute section 13.1-660, regarding the record date, is not significantly different from Old Statute section 13.1-29, except that the provision for closing the transfer books in lieu of fixing a record date has not been carried forward. Consequently, a record date must be fixed. If a record date is not provided for in the bylaws, it may be fixed by the board. It may not, however, be more than seventy days before the date of the meeting or action requiring the determination of shareholders.

Revised Statute section 13.1-661, regarding the shareholder list for the meeting, is largely a restatement of Old Statute section 13.1-30. It makes clear, however, a point on which the Old Statute was silent. Failure to make the list available (as required by section 13.1-661) does not invalidate action taken at the meeting before a demand for the list is made. But action taken after such a demand is invalid and without effect.[58]

Revised Statute section 13.1-662, regarding the voting entitlement of shares, is comparable to Old Statute section 13.1-32 in articulating who has the right to vote the shares held by interests such as corporations, fiduciaries, partnerships, executors and joint tenants. It embraces the general principle that each voting share is entitled to one vote. It does not, however, answer the question of whether different voting rights within the same class of shares can be authorized.[59]

Revised Statute section 13.1-663 is more comprehensive in its ar-

57. REVISED STATUTE, *supra* note 1, § 13.1-658(A).

58. OLD STATUTE, *supra* note 1, § 13.1-30, validated action taken before the demand, but is silent as to action taken after the demand. Obviously, such action should be invalid; otherwise the provision would have been ineffective.

59. EXPOSURE DRAFT, *supra* note 4, § 7.21 official comment, indicates that such a distinction is appropriate, citing the Delaware Supreme Court opinion in Providence & Worchester Co. v. Baker, 378 A.2d 121 (Del. 1977). The Official Comment to MODEL ACT, *supra* note 4, § 7.21, omits any discussion of this point.

ticulation of the right to vote by proxy than was its predecessor, Old Statute section 13.1-32. The appointment of the proxy is effective upon receipt by the corporate secretary and is valid for eleven months, unless a longer term is specified. The death or incapacity of the shareholder does not affect the right of the proxy holder to vote, or of the corporation to accept the votes, until notice of the death or incapacity is received by the secretary of the corporation.

This is a modification of the common law rule that death or incapacity terminates the proxy holder's auhority.[60] This modification addresses the needs of the large corporation with numerous shareholders. The corporation need not inquire into the validity of the proxy and is entitled to presume the viability of the proxy unless it has notice of the death or incapacity.

The rules for irrevocable proxies are clearly set forth in section 13.1-633. Proxies can be made irrevocable if explicitly so stated in the proxy and if it is coupled with an interest in the shares. The statute gives some examples of such an interest, including security interests and the purchase of the shares. Both of these are property interests. Certain contract interests are also sufficient to support irrevocable proxies, such as when a shareholder is obligated by the terms of his employment to give an irrevocable proxy or when the shares are subject to a voting agreement. A transferee of shares burdened by an irrevocable proxy takes the shares free of the proxy if he had no knowledge of its irrevocability and if this feature is not noted on the share certificate.

Revised Statute section 13.1-664 allows, but does not require, a corporation to establish a procedure by which the beneficial owner of shares held of record by nominees is recognized by the corporation as the shareholder. This section responds to the desire of a corporation to communicate readily with the owners of shares held by brokers in street name. Beneficial holders of shares are included within the Revised Statute section 13.1-603 definition of "shareholder" if they are recognized as shareholders under this section. As such, they ought to receive directly from the corporation notices of meetings, distributions and communications regarding takeover attempts.

Revised Statute section 13.1-665(B) sets forth the circumstances under which the corporation, acting in good faith, can accept the

60. *See* H. Henn & J. Alexander, Laws of Corporations § 196 (3d ed. 1983).

written vote, consent, waiver or proxy purportedly on behalf of, but not precisely in the name of, the shareholder. These situations include action on behalf of a shareholder which is an entity and on behalf of a fiduciary, trustee or receiver, or agent. The corporation, if acting in good faith, is entitled to accept written action by these persons.

Revised Statute section 13.1-665(D), however, allows the corporation to reject any such vote, consent, waiver or proxy if, acting in good faith, it has reasonable doubt about the validity of the signature or the authority of the agent. Under Revised Statute section 13.1-665(E), the agent of the corporation who either accepts or rejects the vote, consent, waiver or proxy is not liable to the shareholder for the consequences of the failure to accept or reject them if he acts in good faith and in accordance with this section.

In all instances, the agent may demand reasonable proof of the validity of the signature or authority. The burden of proving the invalidity of a vote, consent, waiver or proxy is not placed on the challenger, as under prior Virginia law. Instead, the corporation's agent, acting in good faith, may demand satisfactory proof of authority or validity if he has reasonable basis for doubt; otherwise, he must accept the vote, consent, waiver or proxy.

Revised Statute section 13.1-666 changes prior Virginia law with respect to quorums. Revised Statute section 13.1-666(A) states that, unless the articles of incorporation or the statute otherwise provide, a majority of the votes entitled to be cast on the matter at the meeting constitutes a quorum. The statute does not authorize bylaw provisions fixing quorums; nor does it indicate what type of quorum provisions are authorized in the articles, that is, whether more-than-majority or less-than-majority provisions are valid. However, Revised Statute section 13.1-668 states that the articles may provide for greater quorum or voting requirements than are stated in the statute. Old Statute section 13.1-31 authorized article provisions raising the quorum or reducing it to no less than one-third. Since this statute was repealed and replaced by a provision which explicitly authorizes only provisions increasing the percentage, it appears that less-than-majority quorum provisions are no longer valid.[61]

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61. Revised Statute, *supra* note 1, §§ 13.1-666 and -668, are substantially based on Model Act, *supra* note 4, §§ 7.25 and 7.27, respectively. This same ambiguity exists in the Model Act. The Official Comment to Model Act § 7.25 notes that earlier versions of the

Revised Statute section 13.1-666(B) provides that once a share is present for any purpose, including, apparently, presence for the limited purpose of objecting to the propriety of the meeting, it is present for quorum purposes. And further, once present a share is deemed present for the remainder of the meeting. This reverses the holding in *Levisa Oil Corp. v. Quigley*,[62] in which the Virginia Supreme Court held that the withdrawal of the majority shareholder from the meeting frustrated the quorum. Shares present for quorum purposes are also present for any adjourned session of the meeting unless a new record date is set for the adjourned session.

This section also changes the number of votes necessary to approve a matter. Revised Statute section 13.1-666(C) provides that, absent a special provision in the articles or statute, a measure is passed if the number of votes cast in favor of it exceeds the number cast against it.[63] Under this procedure, abstentions are of no effect. Passage merely requires more affirmative than negative votes. Old Statute section 13.1-31 provided that passage required a majority of the votes present, not of the votes cast. Hence, abstention worked against passage.

The Revised Statute introduces the notion of "voting groups" as a convenient term to describe classes or groups of shares having the same voting rights. As provided in Revised Statute section 13.1-638, the exact voting rights of the various groups of shares must be expressed in the articles of incorporation. A voting group is defined as a class or series of shares which, as provided in the articles or statute, is "entitled to vote and be counted together and

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Model Act allowed less-than-majority quorum provisions so long as the quorum was at least one-third. The Comment states that this one-third restriction was eliminated because it was unreasonably confining in certain situations. Thus the intent of Model Act § 7.25 is to allow any supermajority or less-than-majority provision. However, the statutory language does not so state, and this intent is undercut by Model Act § 7.27 which, like Revised Statute § 13.1-668(a), authorizes the articles to require greater quorum or voting provisions than those in the statute. It does not authorize less-than-majority quorum provisions.

62. 217 Va. 898, 234 S.E.2d 257 (1977). The bylaw provision in *Levisa Oil Corp.* stated that a quorum for the transaction of business at any shareholder meeting shall consist of a majority of the shares. The court focused on the "for transaction of business" language and held that the quorum must be present when business is transacted. *Id.* at 901, 234 S.E.2d at 259-60. REVISED STATUTE, *supra* note 1, § 13.1-666(B), clearly would change the holding of that case. It states that once a share is present for any purpose, it is deemed present for the remainder of that meeting and any adjournment thereof.

63. Very different rules govern shareholder approval of amendments to the articles, mergers or share exchanges, sales of assets, dissolutions, and voting at directors' meetings. See, e.g., *infra* pp. 99-102, 117-19, 121-23, 130 for discussion of these provisions.

collectively on a matter at a meeting of shareholders."[64] Shares traditionally thought of as preferred with separate class voting rights or, in the closely held corporation context, a class of common shares having the right to elect a certain number of directors, constitutes a separate voting group under this definition.

Revised Statute sections 13.1-666 and -667 apply the quorum and voting rules separately to voting groups. Thus, if the matter to be considered at the meeting requires the approval of more than one voting group voting separately, the requisite quorum and voting rules must be met separately for each voting group.

The statutory definition of a voting group and precise voting rights of the shares of a class as set forth in the articles are extremely important in this context. If the articles confer on a class general voting rights along with the "common" shares, this class does not constitute a separate voting group since the definition of a voting group requires that the shares be entitled to vote and be counted together and collectively. If the articles or the statute do not state that the shares are to be voted separately, there is only one voting group, consisting of the "common" shareholders and this other class.[65] In this example there would be one application of the quorum and voting rules to the entire group.

Revised Statute section 13.1-669 governs the election of directors. It authorizes cumulative voting for directors if the articles provide for it. To ensure that all shareholders realize that the election of directors will be by cumulative voting, section 13.1-669(D) requires that either the notice of meeting or the proxy statement disclose that the election of directors will be by cumulative voting, or that a shareholder notify the corporation of his intent to vote cumulatively.

In the absence of any provision in the articles regarding cumulative voting or other voting matters, the election of directors takes place as provided in Revised Statute section 13.1-669(A). That section states that directors are elected by a plurality of the votes cast. Again, it is a plurality of the votes cast, not of those present at the meeting.

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64. REVISED STATUTE, *supra* note 1, § 13.1-603 (Repl. Vol. 1985).

65. *See* MODEL ACT, *supra* note 4, § 7.26 official comment. The general rule is that all shares have the same rights, except to the extent that the articles create distinctions among different classes. *See* Buxbaum, *Preferred Stock-Law and Draftsmanship*, 42 CALIF. L. REV. 243 (1954).

As explained in the Official Comment to Model Act section 7.28, a plurality means that the individuals with the highest number of votes cast are elected, even though they may have received less than a majority of all votes cast. In the typical majority-minority faction setting, the majority shareholder would elect all of the directors. In this setting, the plurality rule would not yield a different result than the usual majority vote rule. However, if several shareholder factions each put up a slate, the slate garnering the most votes would win, even though it received less than a majority of the votes cast.[66] Under the usual majority vote rule, no slate would be elected until it received a majority of the votes.

Revised Statute section 13.1-671 authorizes voting agreements and explicitly exempts them from the voting trust rules. The substance of this section is not new to Virginia law since Old Statute section 13.1-34 also validated such agreements. However, unlike its predecessor, section 13.1-671 requires a written agreement. Moreover, section 13.1-663 deems each party to such an agreement to have a sufficient interest in the shares of the other parties to support irrevocable proxies in the shares of the other parties.[67] The section states that voting agreements are specifically enforceable. This provision is intended to encourage courts to enforce the terms of the agreement since money damages for violation of the agreement are often not an adequate remedy.[68]

Revised Statute section 13.1-672 codifies a set of procedural

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66. REVISED STATUTE, *supra* note 1, § 13.1-662(B), provides that each share is entitled to one vote for as many persons as there are directors to be elected. The election could be among slates proposed to fill all seats or among individuals proposed to fill a seat. If the election is among individuals nominated to fill a seat, each share will have one vote. If the election is among competing slates, the statute would appear to again give each share one vote which would be cast in favor of one of the slates.

67. This provision in REVISED STATUTE, *supra* note 1, § 13.1-663, means only that there is a sufficient interest to support irrevocability. It does not mean that a proxy given by one party to a voting agreement to another party is automatically irrevocable. REVISED STATUTE, *supra* note 1, § 13.1-663(D), states that a proxy is revocable unless it explicitly states that it is irrevocable and is supported by an interest in the shares. The provision in REVISED STATUTE, *supra* note 1, § 13.1-663(D)(5), regarding parties to a voting agreement, merely supplies the latter element, the sufficient interest in the shares.

68. MODEL ACT, *supra* note 4, § 7.31 official comment. This provision is intended to encourage courts not to follow the approach in Ringling Bros.-Barnum & Bailey Combined Shows v. Ringling, 53 A.2d 441 (Del. 1947). There the court held that the appropriate remedy was to void the votes of the breaching party that were cast in violation of the agreement. Since the *Ringling* case dealt with cumulative voting for directors, the court's upholding of the election, while refusing to count these votes, frustrated the purpose of the agreement to the detriment of both the willing and recalcitrant parties.

rules for derivative suits for the first time[69] in Virginia. The Revised Statute substantially follows the Model Act's approach in this matter, thus bringing to Virginia law some of the refinements to these procedures which have taken place in recent years.[70]

Section 13.1-672 establishes two prerequisites to maintaining a derivative suit. First, the plaintiff must either have been a shareholder at the time the challenged transaction occurred or have acquired the shares by operation of law from such a shareholder.[71] This provision is a statement of the usual "contemporaneous ownership" rule.[72] Section 13.1-672 does not require ownership throughout the pendency of the suit.[73] Second, the complaint must allege with particularity why demand on the board was excused or that demand to obtain action by the board was made and refused or ignored.[74] Revised Statute section 13.1-672(B) allows the court

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69. Although some of the new provisions may be consistent with prior case law, the Old Statute contained no provision specifically dealing with this crucial means of enforcing shareholder rights. For an excellent compendium of resource material regarding derivative suits, see A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, (Discussion Draft No. 1, 1985) [hereinafter cited as DISCUSSION DRAFT].

70. The Model Act's provisions governing derivative suits reflect a reappraisal of these procedures in view of the extensive litigation in this area and major developments in corporate governance generally. MODEL ACT, *supra* note 4, § 7.40 official comment. The Revised Statute thus engrafts onto Virginia law a "state of the art" set of derivative suit procedures.

71. For purposes of this section, a beneficial owner of shares is deemed a shareholder, but the holder of an option or convertible debenture is not.

72. Some statutes apply the rule at the time of discovery of the wrongful nature of the transaction. *See, e.g.*, CAL. CORP. CODE § 12490(b)(1) (West Supp. 1985); PA. STAT. ANN. tit. 15, § 1516 (Purdon 1967); DISCUSSION DRAFT, *supra* note 69, § 7.02(a)(1). *See generally* Harbrecht, *The Contemporaneous Ownership Rule in Shareholders' Derivative Suits*, 25 UCLA L. REV. 1041 (1978).

73. Some cases have held that a shareholder whose shares are canceled as a result of a merger may not maintain a derivative suit to challenge the transaction, even though he met the contemporaneous ownership rule. *See, e.g.*, Lewis v. Anderson, 477 A.2d 1040 (Del. 1984); Yanow v. Teal Indus., Inc., 178 Conn. 263, 422 A.2d 311 (1979); Note, *Survival of Rights of Action After Corporate Merger*, 78 MICH. L. REV. 250 (1979). DISCUSSION DRAFT, *supra* note 69, § 7.02(a)(2), requires, as one of its criteria, continued ownership unless the shareholder ceased to be a shareholder through corporate action in which he did not acquiesce. The Revised Statute meets this concern by not requiring continuous ownership.

74. This requirement follows the general approach of FED. R. CIV. P. 23.1. One of the exasperating questions in derivative suit litigation is when demand would be futile. The comment and reporter's note to DISCUSSION DRAFT, *supra* note 69, § 7.03, contain an extremely helpful exposition of the law on this point. Aronson v. Lewis, 473 A.2d 805, 814 (Del. 1984), holds that demand is excused when there is reasonable doubt that the business judgment rule would validate the transaction. Lewis v. Curtis, 671 F.2d 779 (3d Cir.), *cert. denied*, 103 S. Ct. 176 (1982), would excuse demand when the complaint permits the inference that the directors lack the requisite disinterest to determine fairly whether the corporate claim should be pursued. *See generally* Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS.

to stay the proceeding if the corporation commences an investigation of the charges made in the demand.

Section 13.1-672 does not import into Virginia law the security for expenses prerequisite to the derivative suit which had in the past been common elsewhere.[75] This requirement was thought to discriminate against small shareholders.

Once commenced, a derivative suit cannot be discontinued or settled without the court's approval. If the court determines that discontinuance or settlement will substantially affect the shareholders, the court shall direct that notice be sent to the shareholders.[76]

The statute, like Model Act section 7.40 on which it is based, takes no position on the troublesome question of what weight should be accorded the judgment of the board, or a special litigation committee of the board, that the suit ought to be dismissed as contrary to the best interest of the corporation.[77] By one approach, the court is free to inquire into the good faith and independence of the decision maker; but assuming these, it will accept the recommendation and dismiss the suit.[78] By another approach, the business judgment rule is operative. The court would be free to determine, in addition to good faith and independence, whether there is a rational basis for the decision that the suits ought to be dis-

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LAW. 1503 (1984); Payson, *Dismissal of Derivative Actions: The Debate*, 6 DEL. J. CORP. L. 522 (1981).

In Mount v. Radford Trust Co., 93 Va. 427, 25 S.E. 244 (1896), the court noted that before a shareholder may maintain a derivative suit, he must demonstrate that demand was made and refused, or he must allege that the defendants constitute a majority of the board "or that they or a majority of them are under the control of the defendant wrongdoers, so that the court may infer that they would refuse to bring such suit." *Id.* at 430, 25 S.E. at 245.

REVISED STATUTE, *supra* note 1, § 13.1-672, does not require a demand on the shareholders. FED. R. CIV. P. 23.1 requires such a demand "if necessary." The Model Act does not contain this requirement, and it appears to have been rejected in other recent statutes and cases. *See* DISCUSSION DRAFT, *supra* note 69, § 7.03 reporter's note 7.

75. *See, e.g.*, CAL. CORP. CODE § 800(c)-(f) (West 1977 & Cum. Supp. 1985); N.Y. BUS. CORP. LAW § 627 (McKinney Cum. Supp. 1984).

76. The statute does not state which party shall bear the cost of this notice, but leaves the matter to the court's discretion. MODEL ACT, *supra* note 4, § 7.40 official comment § 1(j), notes that the Model Act, on which the Revised Statute is based, is unlike some state statutes that impose the cost of notice on a particular party.

77. *See generally* Brown, *Shareholder Derivative Litigation and the Special Litigation Committee*, 43 U. PITT. L. REV. 601 (1982); Dent, *The Power of Directors to Terminate Shareholder Litigation: The Death of the Derivative Suit?*, 75 NW. U.L. REV. 96 (1980).

78. *See* Roberts v. Alabama Power Co., 404 So. 2d 629 (Ala. 1981); Auerbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979).

missed.[79] Finally, in several recent cases, courts have declined to recognize the decisions of special litigation committees and have determined for themselves whether dismissal is in the best interest of the parties.[80] In one case involving a Virginia corporation, *Abella v. Universal Leaf Tobacco Co.*,[81] the court determined that, in addition to reviewing the board's or committee's conclusion, it must make its own business judgment of whether maintenance of the suit was in the corporation's interest.

Revised Statute section 13.1-672(D), which has no Model Act analog, seems to encourage an active involvement by the court in this determination along the lines of the *Abella* case. Section 13.1-672(D) authorizes the court to appoint a committee of disinterested directors or other persons to determine whether it is in the corporation's best interest to pursue a particular right or remedy. This committee is to report its findings to the court, which shall consider the report and any other relevant evidence and make the final determination as to whether the proceeding ought to be discontinued.[82] Presumably the conclusion of the board or a special litigation committee could, but need not necessarily, be considered by the court as part of the other relevant evidence.

H. *Article Nine—Directors and Officers*[83]

Article Nine deals with the election and responsibility of directors and officers.

Revised Statute section 13.1-673 states the currently accepted charge to the directors that "[a]ll corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors."[84] This formulation recognizes that the board does not always manage, but that it does retain ultimate responsibility for management by the officers and employees. It also recognizes the differing

79. *See* Zapata Corp. v. Maldonado, 430 A.2d 779, 789 (Del. 1981); Block & Prussin, *supra* note 74; Comment, Zapata Corp. v. Maldonado: *Restricting the Power of Special Litigation Committees to Terminate Derivative Suits*, 68 VA. L. REV. 1197 (1982).

80. *See, e.g.*, Miller v. Register & Tribune Syndicate, Inc., 336 N.W.2d 709 (Iowa 1983); Alford v. Shaw, 72 N.C. App. 537, 324 S.E.2d 878 (1985).

81. 546 F. Supp. 795 (E.D. Va. 1982).

82. *Cf. Miller*, 336 N.W.2d 709 (adopting a comparable procedure).

83. REVISED STATUTE, *supra* note 1, §§ 13.1-673 to -695.

84. *Id.* § 13.1-673(B).

roles of the board in large and small corporations.[85]

Revised Statute section 3.1-673(A) states that all corporations shall have a board of directors. It does not authorize, as does Model Act section 8.01(c), closely held corporations to dispense with the board and describe in the articles of incorporation who will perform the functions of the board.[86] The Revised Statute requires a board for all corporations, but it allows provisions in the articles limiting the role of the directors.

Revised Statute section 13.1-675 clarifies prior law regarding the fixing and changing of the number of directors. The number of directors is to be fixed by the bylaws or, if there is no provision in the bylaws, by the articles. Because Revised Statute subsections 13.1-675(A) and (B) specifically deal with amendment to bylaw provisions regarding the size of the board, they ought to prevail over Revised Statute section 13.1-714, which deals with amendments to the bylaws generally.

Pursuant to Revised Statute section 13.1-675(B), the shareholders may adopt a bylaw fixing the number of directors and stating that the bylaw cannot be amended by the board of directors. If there is no such prohibition, the board may amend the bylaw to increase or decrease the number of directors, but by no more than thirty percent.

Revised Statute section 13.1-675(E) provides that no one can be elected a director without his prior consent. Although a person elected without prior consent could attempt to resign, probably the better argument is that he was never validly elected to the board.

Revised Statute section 13.1-676 recognizes that the articles of incorporation may provide for the election of a certain number of directors by specified classes of shares. Any class having this right is a separate voting group for purposes of the election and removal of directors.

Revised Statute section 13.1-677, regarding the terms of office of directors, is consistent with prior Virginia law, except that the term of a director elected by the board to fill a vacancy now runs only until the next election of directors by the shareholders. Previously such a director would serve the remainder of his predeces-

85. MODEL ACT, *supra* note 4, § 8.01 official comment, at 193.

86. The Model Act's approach is found in the corporation codes of states having optional closely held corporation chapters. *See, e.g.*, DEL. CODE ANN. tit. 8, § 351 (Repl. Vol. 1983).

sor's term.

Revised Statute section 13.1-679 explicitly provides for resignation by a director. Resignation is effective upon delivery of a written notice of resignation to the corporation unless the notice specifies a later effective date.

Revised Statute section 13.1-680 provides for the removal of directors. This section allows removal of directors by the shareholders with or without cause unless the articles of incorporation specifically state that directors may be removed only for cause. This latter point seems to be a change from the Old Statute. Old Statute section 13.1-42 provided that a director could be removed with or without cause; it did not sanction a provision in the articles providing for removal only for cause.

The Revised Statute thus clearly makes available a defensive anti-takeover amendment. The articles could be amended to provide that directors can be removed only for cause. Such an amendment would mean that an acquiring party could not take immediate control of the board by removing the incumbents and replacing them with individuals of his choice. This amendment would be a deterrent only until the next annual meeting unless coupled with an articles provision for staggered terms for directors, as allowed by Revised Statute section 13.1-678.

Removal can take place only at a meeting called for that purpose, and notice of the meeting must state that removal is the purpose, or one of the purposes, of the meeting.[87] Removal can take place at either the annual or a special meeting. Notice of purpose generally need not be given for the annual meeting;[88] however, if one of the purposes is to vote on removal of a director, notice of this purpose must be given.

The list in Revised Statute section 13.1-654 of who may demand a special meeting is critical in this instance. For the over-thirty-five-shareholder corporation, only the board, its chairman or the president can demand a special meeting unless the articles list additional persons.[89] For the thirty-five-or-fewer-shareholder corporation, those same persons or the holders of twenty percent of the

87. Revised Statute, *supra* note 1, § 13.1-680(D).

88. *Id.* § 13.1-658(B) states that, unless the articles otherwise provide, notice of purpose for the annual meeting need not be given. Section 13.1-658(C) requires that the notice of a special meeting state the purpose of the meeting.

89. *Id.* § 13.1-655(A)(1).

shares entitled to vote may demand a meeting.[90] Hence in the over-thirty-five-shareholder corporation having no special article provision, it is unlikely that removal could take place at a special meeting since the persons authorized to call the meeting may be sympathetic to the individual whose removal is sought. However, removal could take place at the annual meeting. Since the shareholders have the right to remove directors, they could demand that this be included on the agenda for and notice of the meeting. Of course, removal at the annual meeting would only be an issue if the terms of the board are staggered.

If a director is elected by a separate voting group, only that voting group may participate in the vote to remove him.[91] At the meeting called for removal, unless the corporation employs cumulative voting or unless the articles require a greater percentage, the director is removed only if the votes in favor of removal are a majority of the votes entitled to vote on the motion.[92] This is a different voting rule than applies elsewhere in the statute, and it is analogous to the rule governing shareholder approval of significant corporate transactions.[93] Generally, matters are approved at the shareholders' meetings by a majority of the votes cast; election of directors is by a plurality of votes cast. Yet, removal requires a larger number of votes: a majority of the votes entitled to be cast.

Revised Statute section 13.1-682 provides for the filling of vacancies on the board, including vacancies arising from an increase in the size of the board. Both the shareholders and the remaining directors, even if they are less than a quorum, may fill vacancies.The statute thus provides the maximum opportunity to maintain full board membership at little harm to any group. If the shareholders disapprove of the person selected by the board, they can remove him, assuming they can demand that a meeting be called to consider removal.

Revised Statute section 13.1-684 provides that the board may permit any member to participate in the meeting by any means of communication allowing all members participating to simultaneously hear each other. A member participating in the meeting pur-

90. *Id.* § 13.1-655(A)(2).

91. *Id.* § 13.1-680(B).

92. *Id.* § 13.1-680(C).

93. See, e.g., *infra* pp. 117-19, 121-23, 130 for discussion of shareholder voting on amendments to the articles of incorporation, plans of merger or share exchange, sales of all or substantially all the assets other than in the ordinary course of business, and dissolutions.

suant to this section is deemed to be present at the meeting, whether or not physically present.

The difference between this section and Old Statute section 13.1-41 is that the Old Statute seemed to allow such participation at the option of the director. Revised Statute section 13.1-684, on the other hand, provides that "the board . . . may permit" a member to participate by conference call. It thus appears that the board, presumably by a majority, has the right to decide if a member can participate by conference call. The possibility exists that a majority of the board could determine that a director not physically present at the meeting site may not so participate. The Official Comment to Model Act section 8.20 states that the directors' judgment on this matter is discretionary. It is possible then for one faction to eliminate opposition by deciding that only those physically present may participate in the meeting.

Revised Statute section 13.1-685 allows the board of directors to act by unanimous written consent. Action of the board taken in this manner is deemed to be the action of the board as of the date the last director signs the consent, unless the consents specify a different date. Although action by written consent requires unanimity, the consent forms could provide, for example, that the consents constitute action of the board as of the date on which a majority of the board has signed.

The Official Comment to Model Act section 8.21, on which this section is based, describes the usefulness of written consents. It notes that for publicly held corporations consents are especially useful when matters require prompt action and are non-controversial. From this statement, an inference ought not be drawn that good corporate practice requires that significant corporate matters not be acted on by unanimous consent, but only at a meeting. The theory of the unanimous consent is that if all the directors are of a like mind, a meeting is not necessary.[94]

Revised Statute section 13.1-687 governs waiver of notice of a meeting. It allows a director to waive notice either before or after the meeting. Waiver is effected either in writing or by the director's attendance at, or participation in, the meeting. The director does not waive notice by attendance or participation if, at the be-

94. There may be little consequence to the comment's distinction between controversial and non-controversial matters, however. In reality, if the matter is controversial it is likely that a meeting will be necessary because unanimous consent will not be obtainable.

ginning of the meeting or upon his arrival, he objects to holding the meeting or transacting business at it and does not thereafter vote for or assent to action taken at the meeting.[95]

It seems clear from this language that, in order to preserve this objection, the director need not leave the meeting after stating his objection. It is less clear whether the objection is preserved if the director participates in discussion. The question involves the meaning of "participation." Are voting for or assenting to[96] action the only things destroying the objection? Or is stating a position on the issue before the meeting deemed participation? By common understanding, the latter is deemed participation.

The Official Comment to the Model Act states that notice of a meeting is a technical requirement and waivers should be permitted freely.[97] This statement supports the argument that participation short of voting or assenting would constitute a waiver. The Official Comment states that one who attends did in fact have notice and generally should not be able to raise a technical objection to lack of proper notice. It concedes, however, that in some situations lack of notice can result in actual prejudice, as for instance if certain key directors are not present. In these situations, the objecting director must follow the procedures set forth in the statute.[98] The Model Act seems to add a gloss of "actual prejudice" to the statutory language. A director not receiving the requisite notice ought to be free, for whatever tactical reason, to object and ought not be required to demonstrate "actual prejudice."

Revised Statute section 13.1-688 establishes the quorum and voting rules for directors' meetings. A majority of the number of directors, as fixed in the articles or bylaws, is necessary to establish a quorum. The articles or bylaws may reduce this percentage, for quorum purposes, to as low as one-third. Different rules apply to shareholders' meetings.[99]

Revised Statute section 13.1-688(C) states the voting rules for

95. Revised Statute, *supra* note 1, § 13.1-687(B).

96. *Id.* § 13.1-688(D) states that a director present at a meeting is deemed to have assented to the action unless he objects, votes against it, or abstains.

97. Model Act, *supra* note 4, § 8.23 official comment.

98. *Id.*

99. In contrast, Revised Statute, *supra* note 1, § 13.1-668(A), authorizes supermajority quorum provisions for shareholders' meetings only if they are contained in the articles. A bylaw provision is not valid. It also allows a greater-than-majority, but not a less-than-majority, quorum provision.

directors' meetings, which differ in two significant aspects from those governing shareholders' meetings. First, consistent with *Levisa Oil Corp. v. Quigley*,[100] the quorum must be present whenever a vote is taken.[101] The presence of a quorum at the outset of the meeting is not sufficient. Second, approval requires a majority, or such higher percentage as the articles or bylaws[102] require, of the votes present, not of the votes cast, as is the case at shareholders' meetings.

Under a provision in Revised Statute section 13.1-688(E), approval by the board is unnecessary for certain major corporate transactions if they have been unanimously approved by the shareholders.

In a separate subsection, Revised Statute section 13.1-688(D) states the circumstances in which a director is deemed to have assented to board action. A director present at a meeting is deemed to have assented to action at a meeting unless he: (1) objects to the holding of the meeting or to the transacting of certain business; (2) votes against it; or (3) abstains from voting on the matter. As stated in the voting provision of Revised Statute section 13.1-688(C), abstaining works against passage since passage requires a majority of the votes present. It is therefore appropriate that voting against or abstaining be treated the same for "assenting" purposes.

In contrast, Old Statute section 13.1-44 provided that a director was deemed to have assented unless his dissent was entered in the record of the meeting or a written dissent was filed before or within three days after adjournment of the meeting. Abstention without filing a written dissent was deemed assent.[103] Under the Revised Statute, assent seems to be devoid of any separate meaning and is the same as voting in favor of board action. If a director is present at a meeting and does not object to the meeting or trans-

100. 217 Va. 898, 234 S.E.2d 257 (1977).

101. REVISED STATUTE, *supra* note 1, § 13.1-688(C).

102. OLD STATUTE, *supra* note 1, § 13.1-39, authorized only articles of incorporation provisions increasing the required percentage for board action.

103. Under the Old Statute, abstaining worked against passage. However, abstaining without filing a dissent constituted assent for which a director would be deemed accountable.

MODEL ACT, *supra* note 4, § 8.24(d), is similar to OLD STATUTE, *supra* note 1, § 13.1-44. A director present at a meeting is deemed to have assented unless he: (1) objects to the meeting or the transaction of specific business at it; (2) dissents or abstains, and this fact is entered in the minutes; or (3) delivers a written dissent before or after adjournment.

acting of specific business, or votes against it or abstains, what else can he have done but voted in favor?

The Revised Statute thus seems to afford the directors greater protection from liability than the Old Statute did, even though the liability sections are comparable. For example, both Revised Statute section 13.1-692 and Old Statute section 13.1-44 impose liability on directors voting in favor of, or assenting to, an illegal distribution. Under the Old Statute, a director who simply abstained would be liable; he would not be liable under the Revised Statute.

Moreover, under the Old Statute, the identity of those not liable could readily be determined. The procedure set out in Old Statute section 13.1-44 required a notice of dissent to be recorded in the minutes or filed separately. In either event, the identity of the dissenting director would be disclosed. The Revised Statute is less specific on this point. Since it does not require written dissents, in some circumstances it may be difficult, after the fact, to determine who is liable.[104]

Revised Statute section 13.1-689 allows the board to create various committees, unless otherwise provided in the articles or bylaws. Such committees are created by the approval of the greater of a majority of the directors then in office or of the number of directors required by the articles or bylaws to take action under Revised Statute section 13.1-688.[105] The board may create the

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104. For example, assume seven directors are present at a meeting and a measure is passed, four votes in favor and two opposed. If the minutes simply reflect the vote, four to two, there is no way to know which three directors are not liable. The Old Statute placed the onus on the director wishing to avoid liability. The Revised Statute imposes no such burden. This is especially a problem since the burden of proof in suits alleging breach of the standard of care is on the plaintiff, not on the director.

105. Section 13.1-688 allows supermajority provisions. REVISED STATUTE, *supra* note 1, § 13.1-689, is taken from MODEL ACT, *supra* note 4, § 8.25(b). The Official Comment to § 8.25(b) explains that it is intended as a supermajority provision and underscores the importance of the decision to create committees and empower them to act on behalf of the board. The comment states that the committees are created by "the affirmative vote of a majority of the board of directors then in office, or, if greater, by the number of directors required to take action by the articles of incorporation or bylaws." This is apparently a reference to a supermajority provision in the articles or the bylaws.

As drafted, however, REVISED STATUTE, *supra* note 1, § 13.1-689(B), is unclear. The articles may state what percentage of the board is required for quorum or voting purposes. Use of the word "number" of directors rather than "percentage" is confusing. There is no way to know how many votes are required for a majority, or a supermajority, unless the number present at the meeting is also known. One interpretation of the provision is that the approval of the committee requires the vote of the greater of: (1) a majority of the directors in office; or (2) a supermajority, if the articles or bylaws have a supermajority provision. While this interpretation clarifies the provision, it makes it unnecessary because it merely restates committees; but their role and responsibilities, subject to the constraints of this section, are defined by the articles or bylaws.

These committees are committees of the board. As such, they discharge the responsibilities of the board as stated in Revised Statute section 13.1-673. The conduct of a director serving on a committee is governed by the same standards that apply to board members generally. In no event, however, may a committee approve or recommend to the shareholders for their approval certain significant corporate actions including filling vacancies on the board, adopting amendments to the articles or bylaws, authorizing certain distributions or issuance of shares, or approving mergers.[106]

Revised Statute section 13.1-690 states the general standard of conduct to which directors will be held in the discharge of their responsibilities. Since the Old Statute contains no comparable provision, this section imports new statutory material into Virginia law.

The issue of the appropriate standard of conduct for directors has been the subject of intense interest in recent years and has evoked a plethora of scholarly writing.[107] The Model Act has been concerned with the topic for quite some time, and the American Law Institute's Principles of Corporate Governance Project has recently dealt with the issue.[108]

Given this national concern and the fact that the Revised Statute has generally closely followed the Model Act, it is extremely

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the usual rule. A provision in the articles establishing a supermajority would prevail over the statutory majority voting rule.

106. REVISED STATUTE, *supra* note 1, § 13.1-689(D).

107. *See, e.g.*, Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1979); Arsht & Hinsey, *Codified Standard—Same Harbor But Charted Channel: A Response*, 35 BUS. LAW. 947 (1980); Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099 (1977); Hinsey, *Business Judgment and the American Law Institute's Corporate Governance Project: the Rule, the Doctrine, and the Reality*, 52 GEO. WASH. L. REV. 609 (1984); Kennedy, *The Standard of Responsibility for Directors*, 52 GEO. WASH. L. REV. 624 (1984); Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477 (1984); Manning, *The Business Judgment Rule in Overview*, 45 OHIO ST. L.J. 615 (1984); Small, *The Evolving Role of the Director in Corporate Governance*, 30 HASTINGS L.J. 1353 (1979); Veasey & Manning, *Codified Standard-Safe Harbor or Uncharted Reef? An Analysis of the Model Act Standard of Care Compared with Delaware Law*, 35 BUS. LAW. 919 (1980).

108. A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Tent. Draft No. 3, 1984 & Tent. Draft No. 4, 1985) [hereinafter cited, respectively, as TENT. DRAFT NO. 3 and TENT. DRAFT NO. 4].

significant that the Revised Statute departs radically from the Model Act on this fundamental point. Moreover, the Revised Statute is significantly different from prior Virginia law.[109]

As stated in Revised Statute section 13.1-690(A), "[a] director shall discharge his duties as a director, including his duties as a member of a committee, in accordance with his good faith business judgment of the best interests of the corporation."

In contrast Model Act section 8.30(a) provides that:

> [a] director shall discharge his duties as a director, including his duties as a member of a committee:
>
> (1) in good faith
>
> (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
>
> (3) in a manner he reasonably believes to be in the best interest of the corporation.

Generally speaking, the Model Act adopts a tort-like reasonable man standard comprising numerous elements. The director must act: (1) in good faith, (2) with the care of an ordinarily prudent person (3) in a like position (4) under similar circumstances.[110] Application of this standard requires the trier of fact first to construct a factual background including the time and information constraints, the makeup of the board, and its role in corporate decision making (the "in like position" and "in similar circumstances" elements). Next, what the ordinarily prudent person, as measured against that factual background, would do with respect to the issue in question must be determined. Finally, the trier of fact must decide if the conduct or action of the directors in question was consistent with the reasonable man standard.

Because of the numerous variables and the real, but difficult to quantify or articulate, pressures that existed at the time the judgment in question was made, the Model Act standard is difficult to construct and apply. These difficulties may result in its not being

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109. *See infra* notes 112 & 118 and accompanying text.

110. For a discussion of the components of the Model Act standard, see A.B.A. Committee on Corporate Laws, Section of Corporation, Banking & Business Law, *Corporate Director's Guidebook*, 33 Bus. Law. 1591, 1600-04 (1978) in addition to the Model Act, *supra* note 4, § 8.30 official comment.

rigorously used by the courts. Consequently, there is uncertainty as to its meaning and viability. It may be hard for directors subject to the standard to take it seriously if they cannot understand it or do not believe it will be employed. If rigorously applied, it could be criticized for holding directors to an unrealistically high standard.[111]

Prior Virginia case law was more compatible with the general approach of the Model Act. Directors were required to exercise "the same degree of care . . . that men prompted by self-interest generally exercise in their own affairs."[112] While these cases did not require the construction of the elaborate framework called for by the Model Act, they did require the trier of fact to measure the conduct in question against an external standard of care.

In contrast, the standard articulated in Revised Statute section 13.1-690(A) comprises only two elements. The director must discharge his responsibilities in accordance with (1) his good faith (2) business judgment of the best interests of the corporation. This standard has the appeal of apparent simplicity.

It may be a unique statute nationally. This fact, coupled with the lack of legislative history, may mean that it will be difficult for courts to define its elements and parameters. Some preliminary observations may be useful in this regard.[113]

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111. *See* CODE COMMISSION REPORT, *supra* note 1, app. 4 at 248.

TENT. DRAFT No. 4, *supra* note 108, sets forth a standard of care very similar to the Model Act, but it protects business decisions separately under the less rigorous business judgment rule, if they are made on an informed basis. This model establishes the reasonable man standard for conduct generally. Actual business decisions are not reviewed against that standard, but rather against the more lenient business judgment rule.

For a discussion of the earlier, but not substantively different, A.L.I. version of the standard of care contained in TENT. DRAFT No. 3, *supra* note 108, see generally Frankel, *Corporate Directors' Duty of Care: The American Law Institute's Project on Corporate Governance*, 52 GEO. WASH. L. REV. 705 (1984); Hinsey, *supra* note 107, at 609; Kennedy, *supra* note 107, at 624; Phillips, *Principles of Corporate Governance: A Critique of Part IV*, 52 GEO. WASH. L. REV. 653 (1984).

112. Anderson v. Bundy, 161 Va. 1, 17, 171 S.E. 501, 506 (1933) (quoting Hun v. Cary, 82 N.Y. 65, 71 (1880)). The same test was applied in O'Connor v. First Nat'l Investors Corp., 163 Va. 908, 920, 177 S.E. 852, 857 (1935). These cases involved failed banks and financial institutions. The directors were found liable for not acting as prudent bank or financial institution directors. *See also* Marshall v. Farmers' & Mechanics' Sav.'s Bank, 85 Va. 676, 8 S.E. 586 (1889). In Abella v. Universal Leaf Tobacco Co., 546 F. Supp. 795 (E.D. Va. 1982), the court examined the conduct and the conclusion of a special litigation committee and found that the committee had acted reasonably and that there was a reasonable basis for its conclusion.

113. *See also* CODE COMMISSION REPORT, *supra* note 1, app. 4, at 248-50.

The statute presents two separate, but related, issues. The first raises the question whether the statute articulates a standard to which directors will be held in the performance of their duties. The second involves the substantive content of that standard.

It is important to recognize that the statute does purport to state a standard of conduct to which directors will be held in discharging their duties. The statute is not merely a codification of the business judgment rule.[114] The business judgment rule protects directors from liability for decisions made;[115] it does not, however, directly establish a standard by which directors are to guide their future conduct.[116] In the section heading, "[g]eneral standards of conduct for directors," and in the introductory phrase, "a director shall discharge his duties," Revised Statute Section 13.1-690(A) clearly states a standard against which the conduct of the directors is to be measured.[117]

As a standard, the section applies to directors in discharging their duties generally and in making specific decisions or taking actions. It thus applies to passive misconduct and inattention to duties, as well as to actual misconduct.[118]

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114. The business judgment rule is most often applied as a presumption in favor of directors, rather than as an affirmative standard of conduct. *See* Arsht, *supra* note 107, at 130-31. In showing that a defendant director made a decision, plaintiff establishes the fact from which the presumption is drawn. The presumption raises the business judgment rule as a defense, and the burden shifts to plaintiff to negate it. The court does not attempt to decide whether it agrees with the directors; it determines only whether there is a rational basis for the decision. *Id.* at 126.

115. Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Casey v. Woodruff, __ Misc. 2d __, 49 N.Y.S.2d 625 (Sup. Ct. 1944); Arsht, *supra* note 107; Block & Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva* Zapata?, 37 Bus. Law. 27 (1981).

116. Indirectly, it certainly does provide a standard. If the directors understand that a court will uphold those decisions supported by a rational basis, they will realize the need to act rationally in the future. Recently, in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), the Delaware Supreme Court held that the action of directors in approving a merger was not entitled to protection under the business judgment rule since it was not an informed decision. In order for the decision to be an informed one, the directors would have had to inform themselves, before acting, of all information reasonably available. *Id.* at 872; *see* Tent. Draft No. 4, *supra* note 108, § 4.01(c)(2).

117. Use of the phrase "business judgment" in the statutory language ought not tempt courts to conclude that § 13.1-690(A) is merely a codification of the business judgment rule, rather than of a standard of conduct. This introductory language is the same as that in the Model Act. The Official Comment to Model Act, *supra* note 4, § 8.30, explains that this section provides the standard which directors must meet in discharging their responsibilities.

118. *See* Francis v. United Jersey Bank, 87 N.J. 15, 432 A.2d 814 (1981) (applying the Model Act standard to passive conduct).

The Virginia Supreme Court opinions in O'Connor v. First Nat'l Investors Corp., 163 Va.

The next question presented is: precisely what is the substantive content of this standard applicable to both actual and passive misconduct? The section may present some difficulty regarding this question. In an effort to avoid the complication and artificiality of the Model Act, the section sets forth a very straightforward standard. The section is intended to afford directors very broad latitude in the discharge of their duties.[119]

There is a risk, however, that in so doing, the standard has been substantially diluted. In an effort to avoid measuring the conduct or decision in question against any outside or objective standard, the drafters did not include the words "reasonable" or "rational basis" in the statute. The trier of fact need only find good faith and determine whether the conduct in question was a product of the director's own business judgment of what is in the best interest of the corporation. The director's conduct or decision is not to be analyzed in the context of whether a reasonable man would have acted similarly.

As so applied, the standard may be reduced to a purely subjective inquiry into the director's conduct. If the trier of fact does not measure the conduct in question against some external standard, it must determine, in hindsight, whether the conduct comported with what the trier of fact believes was the director's good faith business judgment of the best interest of the corporation. This application may encourage directors to take risks necessary to develop the corporation's business without undue concern for liability and may be a true advantage of the statute.

The statute, however, may also protect the utterly inept, but well-meaning, good faith director.[120] In support of the statute, it could be argued that, since the shareholders ultimately own the enterprise and elect the directors, there is no need to impose a high statutory standard of care on the directors. If some directors are well-intentioned but marginal, it is the shareholders' responsibility. They could elect better individuals or replace the inept.

908, 177 S.E. 852 (1935), and Anderson v. Bundy, 161 Va. 1, 171 S.E. 501 (1933), held the directors liable for inattention to their duties. Applying REVISED STATUTE, *supra* note 1, § 13.1-690, to inattention or passive misconduct would therefore be consistent with prior case law.

119. *See* Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, 39 BUS. LAW. 1477 (1984).

120. TENT. DRAFT No. 4, *supra* note 108, § 4.01 comment f, describes a good faith standard as one providing too much protection for the directors and officers. It would insulate the decision makers from liability for the consequences of objectively irrational conduct.

This argument ignores several realities. First, it is the majority, or plurality, of the shareholders which elects the directors. Those elected are charged with acting in the best interest of the entity and of all the shareholders, not only of those who elected them. Second, in the large, publicly held corporation, the board, or perhaps more frequently the dominant executive officers, nominate the directors. And their choices are typically ratified overwhelmingly by the shareholders through the proxy process.

In considering whether the statute does protect the inept but well-meaning director, one might consider that rational conduct is an element assumed within the standard. The statute requires a director to act in what he believes to be the best interests of the corporation. The corporation exists as an entity to serve some purpose or achieve some objective or advantage for the shareholders. It is difficult to demonstrate that irrational acts are in the best interest of the entity or are of any advantage to the entity in achieving its purpose. One might thus conclude that only a director's rational acts are protected.[121]

The remaining sections of Revised Statute section 13.1-690 follow the Model Act fairly closely. In performing his functions, a director is entitled by section 13.1-690(B) to rely on information, opinions or reports, including financial information and data prepared by officers, employees, board committees or outside experts, so long as the director in good faith believes the individuals to be competent. This reliance provision is qualified by the clause "[u]nless [the director] has knowledge or information concerning the matter . . . that makes reliance unwarranted."[122]

If the action taken by the director would in fact violate the standard of care, but the director acted in reliance on others and had no reason to doubt the competence of the individual relied upon, he will not be liable. However, one possessing knowledge or information[123] suggesting that the conclusion or opinion of the expert is

121. Admittedly, this argument ignores the fact that the statute inquires only into the director's own assessment of what is in the corporation's best interest. A director who honestly believes that an utterly stupid, irrational act is in the corporation's best interest would be protected under a literal reading of the statute. The difficulty a trier of fact would have in exonerating such conduct may provide the impetus to adopt an interpretation of the statute allowing inquiry at least into the rationality of the belief, either on the ground suggested or as bearing on the director's good faith.

122. REVISED STATUTE, *supra* note 1, § 13.1-690(B).

123. Inclusion of this "or information" language means that if a director has available information about the matter which would cause reliance to be unwarranted, the defense is

unfounded may not avail himself of the reliance defense.

Revised Statute section 13.1-690(C) states that a director is not liable for action taken as a director, or for failure to act, if he performed his duties in conformance with this section. This provision establishes the pervasiveness of the standard: the standard is coextensive with the directors' duties as defined in the statute, other law or the articles. Once the director proves that he has met the standard, he is exonerated. The business judgment rule is not to be applied separately as grounds on which to review the conduct.

This provision probably is not intended to insulate directors from liability based on theories or causes of action other than the standard of care. For example, if a director voted in favor of a measure which substantially and inordinately benefited him personally, compliance with the standard of care probably would not preclude a suit based on breach of fiduciary duty.[124]

Revised Statute section 13.1-691 deals with director conflicts. Although it does not change the thrust of prior Virginia law, it does amplify prior law by some extremely helpful definitional and procedural provisions. Moreover, it narrows the ambit of the conflict of interest rules. Old Statute section 13.1-39.1 applied to both directors and officers; Revised Statute section 13.1-691 applies only to directors. Under the Revised Statute, a transaction in which a director has a direct or indirect personal interest is not voidable merely because of such interest if any one of the following circumstances exists: (1) the material facts surrounding the transaction are disclosed, and the transaction is approved or ratified by either the board or the shareholders; or (2) the transaction is fair to the corporation.

Revised Statute section 13.1-691(B) defines an indirect interest to include material financial interests in an entity which is a party to the transaction, or service on the board as an officer or trustee of the entity which is a party to the transaction, if the transaction has been, or ought to have been, approved by the board of the entity.

Revised Statute sections 13.1-691(C) and (D) set forth special voting procedures for board or shareholder approval of conflict of

unavailable even though the director had no actual knowledge. The director is required to act on the information he possesses.

124. It probably should not, if for no other reason than that the burdens of proof are completely different in these two causes of action.

interest transactions. These procedures essentially require approval by a majority of those having no direct or indirect interest in the transaction.

Old Statute section 13.1-39.1 provided that approval by the board or shareholders required passage by the requisite majority without counting the votes of the interested director. Revised Statute subsections 13.1-691(C) and (D) are in one sense more liberal and in another more rigorous than the Old Statute. They require approval only by a majority of the disinterested votes, even if this number is less than a majority of all the votes. However, the approval must be by a majority of all the disinterested votes, not merely by the majority at a meeting at which a quorum is present.

Several additional points regarding section 13.1-691 should be noted. First, this section merely provides that transactions meeting one of the validation tests are not voidable. The section does not mean that such transactions cannot be challenged on other grounds, including breach of fiduciary duty by the director involved or breach of the standard of care by the directors in approving it.

Second, an uncertainty existing under prior versions of this type of provision has not been clarified by this section, nor by Model Act section 8.31 on which it is based. For example, if a transaction is approved by the directors in compliance with this section, may it nonetheless be voidable if it is manifestly unfair to the corporation? If the section is read literally, the answer is no. If any one of the three alternative means of validation is met, the transaction is not voidable. Fairness to the corporation is a separate test of validation; it is not an element in the alternatives providing for approval by either the directors or shareholders.

Some courts have read the fairness element into those alternatives.[125] As drafted, section 13.1-691 renders an unfair transaction approved by the board binding on the corporation. However, the corporation in turn may have recourse against the director benefiting from the transaction on breach of fiduciary duty grounds and perhaps against the entire board on standard of care or corporate waste grounds.

Finally, this section states nothing about the burden of proof.

125. *See, e.g.*, Remillard Brick Co. v. Remillard-Dandini Co., 109 Cal. App. 2d 405, ___, 241 P.2d 66, 74-75 (1952).

Old Statute section 13.1-39.1, like prior versions of the Model Act,[126] stated those instances where the common law rule that conflict of interest transactions were automatically void, or voidable at the option of the corporation, would not apply. The presumption was in favor of voidability, especially where the issue involved the fairness of the transaction. The burden of proving that the contract was binding on the corporation fell on the party seeking to uphold it, the interested director.

The approach of the Old Statute was consistent with the corporate law principle that the corporate fiduciary bears the burden of proving compliance with his duties. While section 13.1-691 is silent on the burden of proof issue, there is no reason to believe that a change in the common law burden of proof rule is intended.[127]

Revised Statute section 13.1-692 imposes personal liability on directors voting for or assenting to distributions made in violation of the statute unless the director complies with the standard of care set forth in Revised Statute section 13.1-690. Given the latitude of the standard of care, and the discretion provided the directors by Revised Statute section 13.1-653(D) to use financial statements prepared on various bases in determining allowable distributions, the liability imposed by this section may be minimal. The reliance defense is especially important in this setting, given the sophisticated judgments required by the equity solvency test.[128] In the absence of knowledge or information, the directors may rely on the judgment of others as to the impact of the distribution on the corporation's solvency.

Revised Statute section 13.1-692 is consistent with Old Statute section 13.1-44 in limiting liability to the illegal amount of the distribution only; and the liability is to the corporation and its creditors. A director found liable is entitled to contribution from all other directors voting for or assenting to the distribution without complying with the standard of care and from all shareholders re-

126. *See generally* Larson, *Corporate Conflicts of Interest under the Virginia Stock Corporation Act*, 9 U. RICH. L. REV. 463 (1975) (discussing OLD STATUTE, *supra* note 1, § 13.1-39.1); Pinto & Bulbulia, *Statutory Responses to Interested Director Transactions: A Watering Down of Fiduciary Standards?*, 53 NOTRE DAME LAW. 201 (1977).

127. This statute, which is silent on the point, replaces one explicitly providing for a burden of proof. One could argue, then, that there must have been a legislative intent to change the burden. However, REVISED STATUTE, *supra* note 1, § 13.1-691, is largely an enactment of MODEL ACT, *supra* note 4, § 8.31; and there is no evidence that the Model Act intended to change the common law on this point.

128. *See supra* note 46 and accompanying text.

ceiving the distribution.

Model Act section 8.33(b)(2) limits the contribution right against the shareholders to those knowing that the distribution is made in violation of the statute. Revised Statute section 13.1-692, like Old Statute section 13.1-44, makes no such distinction. Accordingly, all shareholders receiving the distribution are liable in proportion to the amount they received.[129]

Revised Statute section 13.1-692(C) provides a two-year statute of limitations on suits against directors. The outside time limit on the shareholders' obligation would be somewhat longer than two years. Section 13.1-692(C) does not allow the corporation to pursue the shareholders. The corporation or its creditors may sue the directors to recover the illegal portion of the distribution. The directors, if found liable, may seek contribution from all shareholders receiving the distribution.

Revised Statute section 13.1-693 requires that every corporation have at least a president and a secretary, together with such other officers as are described in the bylaws. The same person may simultaneously hold more than one office, including those of president and secretary.

The section sets forth a statutory responsibility for only one office, that of secretary. He shall have responsibility for preparing and maintaining custody of the minutes of directors' and shareholders' meetings and for authenticating corporate records. Under Revised Statute section 13.1-694, other officers shall perform the duties set forth in the bylaws, or prescribed by the directors consistent with the bylaws or by other officers authorized to do so by the board.

Revised Statute section 13.1-695 provides for the resignation and removal of officers. An officer may resign at any time. He may also be removed at any time, with or without cause, by the board or by the officer who appointed him. This section does not incorporate the provision of Model Act section 8.44 which states that removal does not affect the officers' contract rights. Resolution of removed officers' contract rights is thus left to contract law.

The Revised Statute does not adopt Model Act section 8.42, the

129. The theory is that all shareholders received something to which they were not entitled. There is, however, the potential for harm to unknowing shareholders who may have spent the distribution long before they were called upon for contribution.

standard of conduct for officers. It contains no provision on this point. Consequently the common law will continue to apply.

I. *Article Ten—Indemnification*[130]

Article Ten contains the indemnification provisions. Because of the complexity and integration of these provisions, it is not practical to consider each one separately. It is more feasible to discuss the right of indemnification generally.

Revised Statute section 13.1-696 contains some helpful definitions to be used in Article Ten. Section 13.1-697 authorizes the corporation to indemnify an individual serving as a director if certain conditions are met. Section 13.1-698 states instances in which the corporation must indemnify.

Revised Statute section 13.1-697 provides that an individual, serving as a director, who is a party to a proceeding[131] may be indemnified if he acted in good faith and: (1) if acting in his official capacity, he believed that his conduct was in the best interest of the corporation; (2) if not acting in his official capacity, he believed that his conduct was at least not opposed to the corporation's best interest; or (3) if in a criminal proceeding, he had at least a reasonable belief that his conduct was not unlawful. A separate standard is applied to individuals sued as a result of their conduct with respect to an employee benefit plan.

This section prohibits indemnification by the corporation in connection with proceedings brought by, or in the right of, the corporation, where the individual has been found liable to the corporation. Indemnification is also prohibited in suits where the individual was found to have improperly received a personal benefit. Old Statute section 13.1-3.1, in contrast, narrowly authorized corporate indemnification for expenses in instances where the director was found liable for negligence or misconduct in performance of his duties if a court found that, liability notwithstanding, such person was fairly and reasonably entitled to indemnification. Indemnification in these circumstances may be sought under the court-ordered indemnification provisions of Revised Statute section 13.1-700.

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130. Revised Statute, *supra* note 1, §§ 13.1-696 to -704.

131. A proceeding is broadly defined, *id.* § 13.1-696, to include threatened, pending or completed civil, criminal, administrative or investigative action whether formal or informal.

Article Ten provides two types of indemnification, mandatory and discretionary. Revised Statute section 13.1-698 confers a mandatory right of indemnification in limited circumstances. Under section 13.1-698, the corporation must indemnify against expenses a director who "entirely prevails" in the proceeding. This section does allow, however, a provision in the articles of incorporation modifying or eliminating the right to indemnification.

The "entirely prevails" language is intended to limit the statutory indemnification right to instances where the proceeding was concluded without a finding of liability. It thereby avoids the argument that a person who successfully defends some counts, but not others, is entitled to at least partial indemnification.[132]

Discretionary indemnification is more common than the mandatory right. In order to obtain discretionary indemnification pursuant to Revised Statute section 13.1-697, two separate judgments must be made. First, a determination must be made that the individual is entitled to be indemnified. This determination is made pursuant to either the general determination procedures in section 13.1-701 or to the separate court-ordered indemnification procedures of section 13.1-700.

The individual seeking indemnification must demonstrate in this phase that indemnification is permissible because the criteria of Revised Statute section 13.1-697 have been met.[133] The determination is made in one of several ways: (1) by a majority vote of a quorum consisting of directors not parties to the proceeding; (2) if a quorum cannot be obtained, by a majority vote of a special committee consisting of directors not at the time parties to the proceeding; (3) by legal counsel; or (4) by a vote of the shareholders (not counting the shares owned by or voted under control of directors who are at the time parties to the proceeding).[134]

After the determination that indemnification is permissible, the authorization of the amount of indemnification must be made, generally by the same body that made the determination.[135] In making this authorization, it is appropriate for that body to consider, in addition to the reasonableness of the request, the ability of the

132. Model Act, *supra* note 4, § 8.52 official comment; *see* Merritt-Chapman & Scott Corp. v. Wolfson, 321 A.2d 138 (Del. Super. Ct. 1974).
133. Revised Statute, *supra* note 1, § 13.1-701(A) & (B).
134. *Id.* § 13.1-701(B).
135. *Id.* § 13.1-701(C).

corporation to pay the amount requested and whether the corporation's financial resources ought to be devoted to this or some other purpose.[136]

Unless limited by the articles, the individual has the right, under Revised Statute section 13.1-700, to apply to the court conducting the proceeding, or to another court having jurisdiction, for indemnification. This right to apply for a judicial determination of indemnification exists in two instances. First, it is a means of enforcing the mandatory right of indemnification conferred by Revised Statute section 13.1-698. Second, it is the only means by which an individual found liable to the corporation in a derivative suit may apply for indemnification. Section 13.1-700 allows a court to determine whether, despite liability, indemnification against expenses would be reasonable under the circumstances.

Revised Statute section 13.1-699 authorizes a corporation to pay or reimburse reasonable expenses before final disposition of the proceeding. In order to be eligible for such an advance, the individual must state in writing his good faith belief that he meets the criteria for indemnification set forth in Revised Statute section 13.1-697. He must also undertake to repay the advance if it is later determined that indemnification is not appropriate.[137]

Officers, employees and agents are entitled by Revised Statute section 13.1-702 to the same rights of indemnification as directors.

Revised Statute section 13.1-703 authorizes a corporation to maintain insurance against liability on behalf of its directors, officers, employees and agents. This right is not substantively limited by the statutory indemnification provisions. A corporation may thus provide insurance coverage broader than the indemnification right.

Revised Statute section 13.1-704(A) states that, unless the articles or bylaws explicitly so provide, any article or bylaw provision regarding indemnification does not supplant the statutory right. Moreover, section 13.1-704(B) allows a corporation to confer indemnification rights in addition to, or broader than, those contained in Article Ten by a provision in the articles, in any bylaw made by the shareholders, or in a resolution of the shareholders.

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136. MODEL ACT, *supra* note 4, § 8.55 official comment.

137. This undertaking need not be secured, and the corporation need not determine the individual's financial ability to repay before advancing expenses.

No indemnification may be provided, however, which would relieve individuals from liability for gross negligence or willful misconduct.

J. *Article Eleven—Amendment of Articles of Incorporation and Bylaws*[138]

Article Eleven collects in one place the provisions regarding amendment of the articles of incorporation and bylaws.

Revised Statute 13.1-705(A) states the general proposition that a corporation may amend its articles to add or omit any provision that could originally be contained in, or omitted from, the articles. Section 13.1-705(B) reinforces this right by stating that shareholders have no vested property rights as a consequence of any provision in the articles. Of course, amendments to the articles may alter shareholder expectations; but shares are held subject to this possibility, and any change to the articles must receive the consent of a substantial portion of the shares.

Revised Statute section 13.1-706 lists certain routine amendments which may be effected by the board without shareholder approval. These amendments include deletion of the names and addresses of the initial directors and registered agent and accomplishment of a stock-split if only one class of shares is outstanding.

The usual procedure for approval of amendments is contained in Revised Statute section 13.1-707. The board may propose amendments to the articles for submission to the shareholders.[139] Under section 13.1-707(B), the submission of an amendment to the shareholders should generally be accompanied by a recommendation of the board that it be approved by the shareholders. However, the board may submit the proposed amendment without recommenda-

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138. Revised Statute, *supra* note 1, §§ 13.1-705 to -715.

139. The statute does not specifically state that the board shall first approve the amendment and then propose it to the shareholders. The sections governing other significant corporate events, such as mergers, share exchanges, asset sales and dissolution, explicitly require board approval. Approval is certainly implicit in the notion that the board proposes the amendment, however. Model Act, *supra* note 4, § 10.03 official comment, clearly states that the procedure for adoption of amendments is that they be approved by the shareholders after approval by the board. It is probably inappropriate for the shareholders to demand a special meeting to vote on a proposed amendment which has not been previously approved by the board since they do not have the right to initiate an amendment. However, it probably would be appropriate for the shareholders to demand a meeting for the purpose of requesting that the board consider and approve the proposed amendment and then submit it to the shareholders.

tion if it determines that, because of confiets of interest or other circumstances, a recommendation is not appropriate.

Under Revised Statute section 13.1-707(C), the board is allowed to condition its submission of an amendment on any basis. This is an extremely important provision. Through it, the board, in its discretion, can alter the usual voting rights of the shareholders as stated in the articles. For example, if an amendment would benefit a certain group of shares not constituting a separate voting group, the board could condition its submission of the amendment on approval by a certain percentage of the votes of all other shares.

All shareholders, whether or not entitled to vote, are to be given notice of the meeting at which a proposed amendment is to be considered. The notice shall state that one purpose of the meeting is to consider the amendment[140] and shall be accompanied by the text of the amendment.

At the meeting, the amendment must be approved by more than two thirds of the votes of each voting group entitled to vote on it. This provision is consistent with Old Statute section 13.1-56. Although the normal quorum rule of a majority of the shares entitled to vote applies, approval requires a much higher number (more than two thirds of the shares entitled to vote, not of the votes present).[141] The articles can require a greater or lesser percentage, but in no event less than a simple majority of the votes cast. The directors, pursuant to Revised Statute section 13.1-707(C), could require a greater percentage for approval than stated in the articles or statute by so conditioning their submission.

Revised Statute section 13.1-708 provides for approval of the proposed amendment by the separate voting groups in certain circumstances. Like Old Statute section 13.1-57, it provides that the proposed amendment be approved by the requisite percentage of shares in each voting group, voting separately. This is true even

140. This notice of purpose is necessary even if the meeting is the annual meeting which generally does not require notice of purpose. REVISED STATUTE, *supra* note 1, § 13.1-658(B).

141. MODEL ACT, *supra* note 4, § 10.03, likewise requires approval of a majority of the shares entitled to vote. The very high vote requirement in the Revised Statute may be a mixed blessing in the takeover context. It means that any amendment, including any antitakeover defensive amendment, requires this very high vote. On the other hand, this same rule applies to mergers, share exchanges, and sales of assets. Consequently, acquisition proposals unacceptable to relatively fewer shareholders, somewhat less than one-third of the shares, cannot be effected. Some of these transactions would also require approval under Article 14, Affiliated Transactions. *See* REVISED STATUTE, *supra* note 1, §§ 13.1-725 to -728.

though the shares are not generally voting shares if the amendment affects those shares in any one of nine ways, including changing the designations or rights of the shares,[142] limiting or denying preemptive rights, and canceling or limiting rights to accrued distributions.

After approval by the shareholders, the corporation files articles of amendment with the Commission, pursuant to Revised Statute section 13.1-710. The corporation must include, among other things, the text of the amendment and indicate the number of votes, by voting group, cast in favor of and against its adoption, or state that the number of votes in favor was sufficient to constitute approval. Thereafter, the Commission will issue the certificate of amendment.

Revised Statute section 13.1-711 allows the board, with or without shareholder approval, to restate the articles of incorporation. This process allows the corporation to integrate its articles, including in their proper place all amendments previously approved and eliminating the provisions replaced by those amendments.

Revised Statute section 13.1-714 establishes a more orderly procedure for amending the bylaws than that which existed under Old Statute section 13.1-24. The substance of the old section is not changed, however.[143]

Section 13.1-714 acknowledges the general proposition that the board and the shareholders have concurrent power to amend the bylaws. The power of the board in this regard may be limited in two ways. First, the articles of incorporation may reserve the power exclusively to the shareholders. If this reservation is not contained in the initial articles, it could be added only by an amendment to the articles, which, of course, would require board approval. The second way of limiting the board's prerogative may be more effective. The shareholders, when amending or adopting a particular bylaw, may expressly provide that it not be amended or repealed by the board. If neither of these two strictures is imposed, the board may amend or repeal a bylaw adopted by the shareholders,

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142. OLD STATUTE, *supra* note 1, § 13.1-57(d), required that such a change be adverse before separate class voting was triggered.

143. *See* Levisa Oil Corp. v. Quigley, 217 Va. 898, 234 S.E.2d 257 (1977) (holding that OLD STATUTE, *supra* note 1, § 13.1-24, prohibits directors from overriding bylaw provisions setting quorum for shareholders' meeting); Scott County Tobacco Warehouses v. Harris, 214 Va. 508, 201 S.E.2d 780 (1974) (under OLD STATUTE, *supra* note 1, § 13.1-24, power to amend bylaws granted to directors unless reserved to shareholders).

and vice versa.

Bylaws establishing supermajorities for quorum or voting purposes at board meetings are dealt with separately in Revised Statute section 13.1-715. If such a provision is originally contained in a bylaw adopted by the shareholders, only the shareholders can change it, even though the explicit statement of shareholder exclusivity required by Revised Statute section 13.1-714 is not made. If the provision is initially adopted by the board, either the board or the shareholders may change it.

K. *Article Twelve—Merger and Share Exchange*[144]

Article Twelve, dealing with mergers and share exchanges, does not differ significantly from the Old Statute.

Revised Statute sections 13.1-716 and -717 authorize mergers and share exchanges and set forth the procedures for accomplishing them substantially on the same terms as did Old Statute sections 13.1-68 and -69.1.

Revised Statute section 13.1-716(B)(3) requires that the plan of merger state the manner of converting shares of the constituent corporation into either shares or securities of the surviving or other corporation, or into cash or property. Thus, cash mergers, having the effect of eliminating some shareholders from the enterprise, continue to be permitted. This section does not address the question whether such mergers are fair to the "frozen out" shareholders; it merely allows the transaction if it can be effected consistent with other obligations to those shareholders.

The Revised Statute does not expressly allow different treatment of shares of the same class. The Official Comment to Model Act section 11.01 states that it is permissible under this provision to distinguish among shareholders even of a single class or voting group. Under this interpretation, the plan of merger could provide that some shareholders accept cash while others are given securities or other property.

Section 13.1-716 does not provide for consolidation. The notion of a consolidation seems redundant and therefore is not carried over into the Revised Statute. Typically, it is advantageous for one of the merger partners to survive. If survival of one constituent is

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144. REVISED STATUTE, *supra* note 1, §§ 13.1-716 to -722.

not desired, as perhaps in the case of the combination of two independent corporations of relatively the same size, the functional equivalent of a consolidation could be achieved by having the constituents form a new corporation and then merging each constitutent into it.

Revised Statute section 13.1-717, dealing with share exchanges, is very similar to Old Statute section 13.1-69.1 which was adopted in 1975. In an exchange, shares of one corporation are directly exchanged for shares or securities of the other corporation or for cash. The transaction is subject to the same safeguards as a statutory merger, such as shareholder approval and dissenters' rights. It is a procedure whereby one entity may become the subsidiary of another without the awkward process of a reverse triangular merger.[145]

Revised Statute section 13.1-718 sets out the procedures whereby the shareholders may adopt a plan of merger or share exchange. It is the same procedure as governs shareholder approval of amendments to the articles of incorporation. After approval by the board, the plan of merger or share exchange is submitted to the shareholders entitled to vote on it. The plan must be approved by the affirmative vote of more than two thirds of the shares entitled to vote on it. The articles may increase this percentage or reduce it to not less than a majority of votes cast.

The plan of merger or exchange must be approved by separate voting groups, even if the shares are not otherwise voting shares, if the plan contains provisions which, if contained in a proposed articles amendment, would trigger separate voting. Again, the board generally should submit the proposal to the shareholders along with its recommendation except in conflict of interest situations or

145. In a reverse triangular merger, the acquiring corporation forms a wholly owned subsidiary, providing it with cash or securities. The subsidiary is merged into the acquired corporation, and the plan of merger provides that the shareholders of the acquired corporation (nominally the surviving entity) receive cash or the securities of the parent in exchange for their stock. Through this procedure, the acquired corporation does not cease to exist, but becomes a subsidiary of the acquiror.

The language of some merger statutes may not allow this procedure since the shareholders of the surviving corporation lose their status as such. OLD STATUTE, *supra* note 1, § 13.1-68(c), allowed, and REVISED STATUTE, *supra* note 1, § 13.1-716, allows reverse triangular mergers. OLD STATUTE, *supra* note 1, § 13.1-68(c), provided that the manner or basis of converting the shares of *each merging corporation* into shares of the survivor or shares or securities of *any other corporation* be stated in the plan of merger. The italicized language allowed the reverse triangular merger. It is carried over into the Revised Statute.

other special circumstances. The board may condition its submission on any basis.[146]

There are some significant differences between this section and Old Statute section 13.1-68. Revised Statute section 13.1-718(G)(3) provides that a plan of merger need not be approved by the shareholders of the surviving corporation if certain criteria are met. First, the articles of the surviving corporation may not differ from its articles before the merger. Second, the shareholders in the surviving corporation must hold the same number of identical shares as they held before the merger. Finally, the shares issued or issuable as a result of the merger must not increase the number of voting or participating shares by more than twenty percent.

Although this provision enables a corporation to avoid calling a shareholders' meeting to approve a fairly insignificant merger, it may be of limited importance. A surviving entity wishing to avoid a shareholders' meeting can, as it could previously, simply form a wholly owned subsidiary and merge the other entity into it. While this procedure requires the acquiring party to hold a shareholder meeting, the meeting is of the sole shareholder of the wholly owned subsidiary.

Under Revised Statute section 13.1-718(I), the board of each corporation may approve amendments to the plan of merger or share exchange without resubmission to the shareholders. These amendments may not change the amount or type of consideration the shareholders will receive in exchange for their shares, or change any term of the plan which would adversely affect any shares of the corporation.

The short-form merger provision has been carried over in Revised Statute section 13.1-719, but this section is more flexible than Old Statute section 13.1-76. A domestic or foreign corporation owning at least ninety percent of the outstanding shares of each class of a subsidiary's shares may merge the subsidiary into the parent without approval of the shareholders of either corporation.[147]

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146. If corporation A owns 60% of corporation B's shares and desires to merge B into itself, the board of B could condition its submission of the merger on approval by a majority of the 40% minority interest. Under the Revised Statute, only more than two thirds of all the voting shares, including A's 60%, would be required. The separate voting rules of Article 14, Affiliated Transactions, might also apply to this example. *See* REVISED STATUTE, *supra* note 1, § 13.1-726.

147. REVISED STATUTE, *supra* note 1, § 13.1-719, does not allow merger of the subsidiary

Under the Revised Statute, a Virginia domestic subsidiary could be merged into a foreign parent if the law of the parent's state of incorporation allows the short-form merger. Old Statute section 13.1-76 only allowed Virginia domestic parent corporations to be parties to short-form mergers.

Under the short-form merger statute, the board of the parent must approve the plan of merger and send a copy of it to each shareholder of the subsidiary unless the shareholder waives this right in writing. After adoption of the plan, the merger is effected like any other.

L. *Article Thirteen—Sale of Assets*[148]

Article Thirteen, dealing with the sale of assets, is not significantly different from prior Virginia law. Revised Statute section 13.1-723 authorizes sales, leases and exchanges of all or substantially all of a corporation's assets in the regular course of business to be concluded on the terms and conditions established by the board. It also, and separately, authorizes the mortgage or encumbrance of all or substantially all the assets for whatever purpose, again on the terms and conditions acceptable to the board. Old Statute section 13.1-73 allowed mortgages and encumbrances only for the purpose of borrowing money.

The Official Comment to Model Act section 12.01, on which this section is based, notes that the words "substantially all" are to mean "nearly all." This seems to be a quantitative test. "All or substantially all" is determined by the percentage of assets sold, and it must be a very high percentage. However, the Official Comment adds a qualitative aspect. It notes that the sale of all assets, other than cash or near-cash, is a sale of all or substantially all the assets.

Revised Statute section 13.1-724 governs sales of all or substantially all assets other than in the ordinary course of business. The procedure for approving such sales is virtually the same as that for approving amendments to the articles of incorporation, or plans of merger or share exchanges. This section applies to the transfer of assets regardless of the character of the transferee. The section must be complied with even if the corporation seeks to transfer all

into another wholly owned subsidiary, but only into the parent.

148. REVISED STATUTE, *supra* note 1, §§ 13.1-723 to -724.

or substantially all its assets not in the ordinary course of business to a wholly owned subsidiary.[149] If the transfer fits within the definition of a distribution, it is governed not by this section, but by Revised Statute section 13.1-653.

M. *Article Fourteen—Affiliated Transactions*[150]

Article Fourteen is a discrete set of provisions dealing with transactions between the corporation and a potentially dominant shareholder. This article became effective in June, 1985, and has no analog in the Model Act.

Article Fourteen was prompted by two motives, one a bit more altruistic than the other. First, there was a growing concern about the unfairness to minority shareholders resulting from corporate transactions with a controlling shareholder. By reason of his share ownership and resulting control of the board, a majority shareholder could fix the terms of the transaction and assure its approval to the possible detriment of the minority.The second motive was the desire to protect Virginia corporations from certain takeover tactics.[151]

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149. MODEL ACT, *supra* note 4, § 12.01, considers transfers to a wholly owned subsidiary like a transfer in the ordinary course of business and therefore does not require shareholder approval. This approach has some logical appeal since the assets are not transferred out of the enterprise which the shareholders ultimately control.

The Revised Statute requires shareholder approval for this transaction. Even though the wholly owned subsidiary (transferee) is controlled by the parent and indirectly by the shareholders, the assets are owned after the transfer by a different entity with its own legal responsibilities. The assets may be subject to different encumbrances; the financial position and makeup of the transferor's business, which determine the legalilty of a distribution by the parent to its shareholders, would likewise be different.

150. REVISED STATUTE, *supra* note 1, §§ 13.1-725 to -728.

151. Article 14 is Virginia's response to these concerns. Other states recently have adopted legislation to deal with the same concerns. *See, e.g.*, MD. CORPS. & ASS'NS CODE ANN. §§ 3-202, -601 to -603 (Repl. Vol. 1985); OHIO REV. CODE ANN. §§ 1701.01, 1701.831 (Baldwin Supp. 1984); PA. STAT. ANN. tit. 15, §§ 408, 409.1, 910 (Purdon 1983). Some of this legislation is in response to Edger v. Mite Corp., 457 U.S. 624 (1982), in which the Illinois anti-takeover statute was held unconstitutional as an undue burden on interstate commerce. *See* Kreider, *Fortress Without Foundation? Ohio Takeover Act II*, 52 U. CIN. L. REV. 108 (1983); Scriggins & Clarke, *Takeovers and the 1983 Maryland Fair Price Legislation*, 43 MD. L. REV. 266 (1984); Steinberg, *State Law Developments: The Pennsylvania Anti-Takeover Legislation*, 12 SEC. REG. L.J. 184 (1984). *See generally* Carney, *Shareholder Coordination Costs, Shark Repellents, and Takeout Mergers: The Case Against Fiduciary Duties*, 1983 AM. B. FOUND. RESEARCH J. 341; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981); Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249 (1983).

This article comprises several integrated provisions, including a very refined set of definitions. These definitions render a detailed explanation of the article difficult. Consequently, the following discussion is general.

Under Revised Statute section 13.1-725, the holder, directly or beneficially, of more than ten percent of the outstanding voting shares of a corporation is deemed to be an "interested shareholder." An interested shareholder can be an individual, corporation or other holder. The term does not include the corporation itself, any of its subsidiaries, or any of the corporation's various employee stock ownership or benefit plans.

Certain significant corporate transactions between the corporation and the interested shareholder are "affiliated transactions." These corporate transactions include mergers, share exchanges, sales not in the ordinary course of business of assets having a fair market value of more than five percent of the corporation's assets, guarantees of indebtedness of the interested shareholder if in an amount more than five percent of the corporation's assets, sales of any voting shares having an aggregate fair market value in excess of five percent of the fair market value of all outstanding voting shares, and dissolution.

The article sets forth two correlative provisions. The first states a general rule governing the approval of affiliated transactions, and the second, a series of exemptions from that stringent rule.

Revised Statute section 13.1-726 establishes the general rule that affiliated transactions must be approved by the affirmative vote of two thirds of the voting shares other than the shares owned by the interested shareholder. This voting rule is in addition to, not in lieu of, the other voting provisions in the statute or articles. This separate voting rule tends to protect minority shareholders since a very sizable percentage of the minority must approve the transaction before it can be concluded.[152]

The voting rule also discourages hostile takeovers. Of course, the article does not apply to the tender offer itself; but it would apply to the second phase of the acquisition, such as a merger. Regardless of the percentage of voting shares owned by the acquiror, the

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152. If this article applied to the merger example in footnote 146, the transaction would require approval of more than two thirds of the shares entitled to vote, pursuant to REVISED STATUTE, *supra* note 1, § 13.1-718, and two thirds of the disinterested 40%, pursuant to REVISED STATUTE, *supra* note 1, § 13.1-726.

second phase would require the approval of a substantial majority of those shares other than the acquiror's. An acquiror may be discouraged from making the initial tender offer if he realizes that he may not be able to acquire one hundred percent of the entity.

Revised Statute section 13.1-727 contains a series of exemptions from the separate voting rule. As a result, the voting rule does not apply if: (1) the corporation has three hundred or fewer shareholders;[153] (2) the transaction has been approved by a majority of the disinterested directors;[154] or (3) the interested shareholder owns ninety percent of the voting stock or has owned at least eighty percent for five years.

A separate, and extremely technical, exemption is the "fair price" provision of Revised Statute section 13.1-727(6). In general, this provision exempts from the separate voting rule affiliated transactions in which the shareholders receive "fair value" for their shares. Fair value is determined by a series of calculations which are drafted to ensure that all shareholders receive the higher of the following for their shares: (1) the same dollar value as the interested shareholder paid for other shares of the same class during a two-year period; or (2) the fair value of the shares on the date the proposed transaction is announced to the public.[155]

Article Fourteen will apply unless a contrary amendment to the articles is adopted. Any such amendment must be approved by two thirds of the voting shares other than those owned by any interested shareholder.

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153. The provision exempts affiliated transactions from the special voting rule of REVISED STATUTE, *supra* note 1, § 13.1-726, if there were not more than 300 shareholders at any time during the three years before the announcement. Therefore, if the corporation had partially "gone private" within that time, with the result that there were fewer than 300 shareholders, this exemption would not be available.

154. Consequently, a "friendly" acquisition through tender offer and merger, or merger alone, approved by the requisite percentage of disinterested directors, escapes the special voting rule of REVISED STATUTE, *supra* note 1, § 13.1-726.

155. This "fair price" amendment is designed to protect Virginia corporations from front-loaded, two-tier takeovers. In such takeovers, the acquiror typically makes a cash tender offer for a stated number of the target's shares (sufficient to give the acquiror control, perhaps 51%) and states its intent to follow up the tender offer with a merger in which the remaining shares may receive substantially less consideration than the first group. This approach is intended to have a stampede effect, assuring the acquiror of obtaining 51%. It enables the acquiror to conclude the acquisition at a lesser overall cost than if all shares received the same consideration as that provided the first 51%. *See* Scriggins & Clarke, *supra* note 151, at 266-67. This fair price amendment is similar to the Maryland statute. *See supra* note 151.

It is important to note that Article Fourteen applies to all Virginia corporations, not only to large, publicly held corporations. The exemption for three-hundred-or-fewer-shareholder corporations only exempts them from the separate voting procedure of Revised Statute section 13.1-726. The article therefore serves as a guide, even for the small corporation, to what affiliated transactions are and how the corporation and shareholders can deal with them.[156]

N. *Article Fifteen—Dissenters' Rights*[157]

Article Fifteen contains the appraisal procedures. In the past, the issue of appraisal rights has evoked two principal criticisms. First, from the perspective of a dissenting shareholder, the proceeding was thought to be highly technical, expensive and risky. Second, corporate management argued that the procedure was fraught with the potential for nuisance suits.[158] The Model Act identifies two competing interests which its dissenters' rights provisions attempt to accommodate.[159] Management must have the right to enter new lines of business and to readjust the rights of some or all of the shares in order to accomplish legitimate corporate goals. On the other hand, shareholders opposing management and shareholder majority decisions ought to have some means of withdrawing from the enterprise with the fair value of their shares. This latter point is especially critical in the closely held corporation setting, where there is no ready market for the shares.[160]

The Revised Statute and the Model Act attempt to address these concerns by redesigning the concept of dissenters' rights. The provisions in Article Fifteen establish a procedure for judicial appraisal of value. This procedure is the final, but hopefully unneces-

156. For example, the board can condition its submission of merger or sale of asset proposals on affirmative approval on the terms required by REVISED STATUTE, *supra* note 1, § 13.1-726.

157. REVISED STATUTE, *supra* note 1, §§ 13.1-729 to -741.

158. *See generally* MODEL ACT, *supra* note 4, ch. 13 introductory comment; Committee on Corporation Laws, Section of Corporation, Banking and Business Law, American Bar Association, *Changes in the Model Business Corporation Act Affecting Dissenters' Rights*, 32 BUS. LAW. 1855 (1977); Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80 and 81)*, 33 BUS. LAW. 2587 (1978).

159. MODEL ACT, *supra* note 4, ch. 13 introductory comment, at 316-17.

160. A dissenting shareholder in a closely held corporation cannot exercise the "Wall Street exception" and simply sell his shares for what the market perceives to be their fair value.

sary, method of determining fair value. The article is structured so as to encourage a mutually acceptable determination of fair value without judicial intervention. It is believed that this new procedure will be more expeditious and less expensive than the prior system of appraisal. The procedure is still, however, very precise with numerous specific requirements and timing provisions. Failure to meet the deadlines, or to follow the procedure exactly, terminates the shareholder's ability to receive payment for his shares pursuant to this article.

Revised Statute section 13.1-730(A) states that a shareholder has a right to dissent and obtain payment of fair value for his shares in four corporate transactions: (1) consummation of a plan of merger requiring shareholder approval if the shareholder is entitled to vote on the merger or is a shareholder of the constituent corporation to a short-form merger; (2) consummation of a plan of share exchange if the shareholder is a shareholder in the acquired corporation and is entitled to vote on the plan; (3) sale of substantially all the assets of the corporation other than in the ordinary course of business if the shareholder is entitled to vote on the proposed sale, unless the sale is pursuant to court order or is for cash followed within a year by a distribution of the cash to the shareholders; and (4) any other transaction for which the articles, bylaws or a resolution of the board provide dissenters' rights.

A beneficial owner of shares can exercise the dissenters' rights conferred by this article if he submits to the corporation the record owner's written consent to the dissent.

A "Wall Street exception" is contained in Revised Statute section 13.1-730(C). Unless the articles otherwise provide, there are no dissenters' rights in favor of the holders of any class of shares listed on a national securities exchange or held by at least two thousand record holders. However, the holders of such shares are afforded dissenters' rights if the transaction is an affiliated transaction or when, upon consummation of the transaction, these shareholders would receive something other than cash or shares of a corporation which are also listed on a national exchange or held of record by at least two thousand shareholders.

Revised Statute section 13.1-730(B)(a) provides that a shareholder entitled to dissent under this article may not challenge the corporate action giving rise to the right unless the action is unlawful or fraudulent. This section is intended to make the dissenters' right exclusive. It will succeed on this point only if the terms "unlawful" and "fraudulent" are narrowly construed.[161]

The appraisal procedure contains six separate steps. First, as provided in Revised Statute section 13.1-732, if the transaction giving rise to the dissenters' right is to be voted on at a shareholders' meeting, notice of the meeting shall contain a statement to the effect that the shareholders may be entitled to assert dissenters' rights and shall be accompanied by a copy of Article Fifteen. If the transaction is concluded without shareholder action, the dissenters' notice described in Revised Statute section 13.1-734 must be sent within ten days of the effective date of the transaction.

If the transaction in question requires shareholder approval, a shareholder planning to exercise his right to dissent must deliver written notice of his intention to the corporation *before* the vote is taken. The shareholder must not then vote the shares in favor of the transaction.

Next, during the ten days following the effective date of the transaction, the corporation, pursuant to Revised Statute section 13.1-734, must send notice to all shareholders who have asserted dissenters' rights. The notice must state, among other things, when and where the shareholder must send his demand for payment and tender his shares. This dissenters' notice must also set a date, between thirty and sixty days after delivery of the notice, as the date by which the shareholder must submit a payment demand.

Within thirty days after receipt of the payment demand submitted by the shareholder in reply to the dissenters' notice, the corporation shall pay the dissenter the amount it estimates to be the fair value of the shares, plus accrued interest. This payment is to be accompanied by financial statements and an explanation of how the corporation determined the fair value.

If a shareholder is dissatisfied with the corporation's payment offer, he may notify the corporation within thirty days of his estimate of the fair value and demand payment of his estimate.

If the parties do not agree on the fair value, the corporation shall institute a court proceeding to determine the fair value. The court will award the dissenter judgment in the amount it has determined to be fair value. Court costs for this proceeding, including the com-

161. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964).

pensation of any appraisers appointed by the court, shall be borne by the corporation, except to the extent the court finds that the dissenter did not act in good faith. The court may also award counsel fees to the dissenter if it finds that the corporation did not comply with the procedures or may award counsel fees against either party if it finds that the party did not act in good faith.

O. *Article Sixteen—Dissolution*[162]

Article Sixteen changes the terminology used in conjunction with, and some of the procedures for, dissolving a corporation. These changes were made to conform to the Model Act scheme; however, there are not many substantive changes from the Old Statute.[163]

Revised Statute section 13.1-742 addresses dissolution by voluntary action of the directors and shareholders. This section is drafted consistent with those provisions governing board and shareholder approval of amendments to the articles, mergers or share exchanges, and sales of assets other than in the ordinary course of business. The Official Comment to Model Act section 14.02 notes that only shares having general voting rights have the right to vote on a dissolution.[164]

After the dissolution is authorized, the corporation files, pursuant to Revised Statute section 13.1-743, articles of dissolution with the Commission. The Commission in turn issues a certificate placing the corporation "in dissolution."

In essence, these procedures differ from the Old Statute only in terminology. Under Old Statute section 13.1-82, after approval of dissolution by the shareholders, the corporation submitted to the Commission a statement of intent to dissolve. Once the Commission filed this statement, the same status was achieved as now occurs under the Revised Statute when the Commission issues the certificate of dissolution. However, a certificate issued under the Revised Statute does not terminate corporate existence as did the certificate of dissolution issued under the Old Statute.

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162. REVISED STATUTE, *supra* note 1, §§ 13.1-742 to -756.

163. *See generally* Gusky, *Dissolution, Forfeiture, and Liquidation of Virginia Corporations*, 12 U. RICH. L. REV. 333 (1978).

164. Other shares do not vote on a dissolution, on the theory that the rights of other shares are fixed in the articles. Dissolution does not change these fixed rights, but merely triggers some of them, such as a liquidation preference.

Revised Statute section 13.1-745 states the consequence of being "in dissolution." A corporation in dissolution exists for the limited purpose of winding-up and liquidating its business and affairs. The corporation may not carry on any business other than that appropriate to this limited purpose. It may collect its assets, discharge and provide for its liabilities, and distribute remaining assets to its shareholders.

Revised Statute section 13.1-747 addresses the grounds for judicial dissolution at the request of a shareholder or creditor. Any shareholder may institute a proceeding requesting dissolution on the same grounds as previously stated in Old Statute section 13.1-94. The provision relating to dissolution for fraudulent or oppressive conduct remains substantively the same as in the Old Statute.[165]

The "dissolution for deadlock" provision has been broadened, however. Revised Statute section 13.1-747(A)(1) provides that a shareholder can request dissolution if there is a management deadlock and "irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally."[166] In addition, a shareholder deadlock, resulting in the inability to elect directors at two successive annual meetings, is grounds for the proceeding without any showing of additional harm.[167]

In a judicial dissolution proceeding, the court may appoint receivers or custodians pursuant to Revised Statute section 13.1-748. This section, unlike Old Statute section 13.1-94, allows the court to appoint custodians without an explicit finding that to do so is in the best interest of both the shareholders and creditors. The Re-

165. This provision is remedial in nature and is liberally construed to allow shareholders relief in addition to that provided by corporate bylaws. *See* Baylor v. Beverly Book Co., 216 Va. 22, 216 S.E.2d 18 (1975); White v. Perkins, 213 Va. 129, 189 S.E.2d 315 (1972).

166. REVISED STATUTE, *supra* note 1, § 13.1-747(A)(1)(a). This provision is more flexible than its antecedent, OLD STATUTE, *supra* note 1, § 13.1-94(a)(1), which allowed dissolution only when "irreparable injury to the corporation [was] being suffered or [was] threatened by [the deadlock in management]."

167. OLD STATUTE, *supra* note 1, § 13.1-94(a)(3), had a comparable provision, but it required a showing of harm. As provided in REVISED STATUTE, *supra* note 1, § 13.1-677(A), the terms of directors expire at the next annual shareholders' meeting, unless the terms are staggered. REVISED STATUTE, *supra* note 1, § 13.1-677(E), however, states that incumbent directors continue to serve (unless they resign) until their successors are elected. Therefore, the "deadlock in the election of directors" provision of REVISED STATUTE, *supra* note 1, § 13.1-747, does not mean that the corporation has been without directors for two years.

vised Statute broadens the custodian's power by allowing him to exercise all corporate powers, either through or in place of the board or officers, in order that he may manage the business in the best interest of the shareholders and creditors.

After a hearing, if the court finds one of the grounds for judicial dissolution, it may enter a decree directing that the corporation be dissolved. The decree is transmitted to the Commission, which then enters an order of involuntary dissolution. Thereafter the court directs the winding-up and the distribution of assets. The court will advise the Commission when the corporation has been liquidated, at which point the Commission will issue an order terminating existence.[168]

After a corporation has paid, or made provision for, its debts and has distributed its remaining assets to its shareholders, it must file articles of termination of corporate existence with the Commission. Thereafter, the Commission issues a certificate of termination of corporate existence at which time corporate existence ceases.[169]

Revised Statute section 13.1-755 carries over substantively the same provision as Old Statute section 13.1-101 regarding survival of remedies after termination of corporate existence. This section provides for the survival of rights or claims existing, and liabilities incurred, before termination. Rights or claims coming into existence after termination are not covered by this statute.

P. *Article Seventeen—Foreign Corporations*[170]

The major change made within Article Seventeen is the elimination of the joint and several liability of directors, officers and agents on certain contracts and for torts of corporations doing business in Virginia without registration. The elimination of this harsh penalty is reasonable, considering the difficulty in defining what activities constitute "transacting business" so as to require registration.

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168. Revised Statute, *supra* note 1, § 13.1-749.

169. *Id.* § 13.1-750.

170. *Id.* §§ 13.1-757 to -769.

Q. *Article Eighteen—Records and Reports*[171]

Revised Statute section 13.1-770, which lists the categories of records a corporation must maintain, is more explicit than the comparable provision in Old Statute section 13.1-47. As stated in Revised Statute section 13.1-770 (A) through (D), a corporation must maintain a permanent record of all action by the shareholders and directors, including action by board committees and action by written consent. A list of the names and addresses of the shareholders, alphabetized by class of shares, and "appropriate" accounting records are also required. Revised Statute section 13.1-770(E) requires the corporation to keep separate copies of certain materials, even though they may also fit within the records-retention provisions of subsections (A) through (D). These materials include the articles, bylaws and amendments currently in effect; certain board resolutions creating classes or series of shares, or fixing their relative rights; minutes of shareholders' meetings and record of all shareholder action without a meeting for the most recent three years; all communications to shareholders during the most recent three years, including financial statements; and the corporation's most recent report to the Commission.

Revised Statute section 13.1-771 confers upon the shareholders two separate inspection rights, each keyed to the category of records set forth in Revised Statute section 13.1-770. Shareholders have a virtually automatic right under Revised Statute section 13.1-771(A) to inspect the materials listed in section 13.1-770(E) upon five days prior written notice. No showing of proper purpose is required. Because these records are either public documents or relate to the shareholder's status, the statute confers a very broad right to inspect these documents. The right to inspect includes the right to copy, and the corporation is authorized to charge the reasonable cost of reproducing the records.

Under Revised Statute section 13.1-771(B), a shareholder may inspect the other records referred to in Revised Statute section 13.1-770(A) through (D), including the accounting records, shareholder lists and records of board action—likewise on five days written request. There are, however, several preconditions to the exercise of this right. The individual must have been a shareholder of record for at least six months or own five percent of all outstanding

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171. *Id.* §§ 13.1-770 to -775.

shares; he must make his demand in good faith and for a proper purpose, describing with reasonable particularity both his purpose and the records he desires to inspect; and the records sought must be directly related to the stated purpose.

The inspection rights conferred by Revised Statute section 13.1-771 are limited to the documents specified in subsections (A) and (B). These two subsections do not exhaust the shareholder's inspection rights, however. Revised Statute section 13.1-771(E) states that subsections (A) and (B) do not affect a shareholder's right, as a litigant against the corporation, to exercise the same inspection rights as other litigants. Section 13.1-771(E) also acknowledges the power of a court, independent of section 13.1-771, to compel the production of corporate documents. This latter provision preserves the shareholder's common law inspection rights.

Revised Statute section 13.1-773 grants shareholders the right to institute a court action to enforce either of the inspection rights conferred by section 13.1-771(A) and (B). The court may assess costs and counsel fees against the corporation if the shareholder proves that the corporation refused inspection without a reasonable basis for doubting the shareholder's right to inspect the demanded records. The shareholder bears the burden of proof; and the award of costs and fees against the corporation is a matter of court discretion. For both of these reasons, the judicial enforcement provision favors the corporation. Model Act section 16.04 is more advantageous to the shareholder. The Model Act requires the corporation to pay the shareholder's costs, including counsel fees, unless the corporation can prove that its refusal of inspection was in good faith based on a reasonable doubt.

Revised Statute section 13.1-774 requires a corporation to furnish to any shareholder, upon demanding it, a set of its financial statements for the most recent fiscal year, including a balance sheet, income statement, and statement of changes in shareholder equity. If the financial statements are reported on by a public accounting, his report must accompany them. Otherwise, the president or officer responsible for the accounting records must provide an explanation of the basis of accounting used in preparing the statements and a description of any respects in which the statements are not prepared on a basis consistent with the prior year's.

This right to financial statements generally follows the approach of Old Statute section 13.1-47. The Revised Statute differs from

Model Act section 16.20, which requires the corporation to furnish all shareholders the financial statements, and thus represents a compromise. Management is concerned about both the effort required to prepare and disseminate this information to shareholders who may not be interested in it and about the liability attendant to dissemination of this information if it is in any respect inaccurate. Section 13.1-774 purports to alleviate these concerns by requiring that the information be sent only to those shareholders requesting it.

The management explanation of the accounting basis is a more serious concern. The statute does not give any guidance as to the specificity required in this explanation. Presumably, a particularized description is not required. The Official Comment to Model Act section 16.20 acknowledges that the person furnishing this statement often will not be a trained accountant and that he should not be held to the standard of a professional. It notes, however, that the description of accounting bases should follow the guidelines of the accounting profession for reporting on a format which departs from generally accepted accounting principles.[172]

While section 13.1-774 may impose some burden, particularly on small corporations, all shareholders ought to be able to obtain financial information, and an understanding of the bases on which it was prepared, without exercising their formal inspection rights. Moreover, the distribution provisions of Revised Statute sections 13.1-653 and -692 require that much of this same information be prepared to determine the legality of a distribution.

R. *Article Nineteen—Proceeding for Determination of Shareholders*[173]

Article Nineteen sets forth a procedure by which a corporation can determine the identity of its shareholders. When the board believes the corporate records no longer accurately reflect the ownership of the corporation's shares, the board may commence a suit in equity requesting the court to determine the identity of its proper shareholders. After a hearing, the court shall determine the iden-

172. For example, if the entity uses the cash basis of accounting, the description of the statement of receipts and disbursements might state that it was prepared on the cash basis and that it presents the cash receipts and disbursements of the entity during the period, but that it does not purport to present the results of operation on the accrual basis.

173. Revised Statute, *supra* note 1, §§ 13.1-776 to -777.

tity of the corporation's shareholders; this determination is final.

S. *Article Twenty—Transition Proceedings*[174]

Finally, Article Twenty contains the transition provisions. Revised Statute section 13.1-778 states that the Revised Statute applies on its effective date to all corporations and that the articles of all corporations, organized before or after its effective date, are subject to it. However, section 13.1-779 states that rights or liabilities acquired or incurred before the effective date are not affected by the Revised Statute.

The articles and bylaws of all Virginia corporations were structured in reliance on prior Virginia law. Care has been taken throughout the Revised Statute not to unduly upset these expectations. Few provisions have been changed in a way that rights conferred by the Old Statute (which therefore needed no articulation in the articles) now exist only if specifically provided in the articles. Otherwise, amendments to the articles would be required to restore these rights. For example, the preemptive rights provisions of Revised Statute section 13.1-650 were retained in the "opt out" version for precisely this reason. Under Old Statute section 13.1-23, if a corporation desired preemptive rights, it did not need a provision for them in the articles because it could instead rely on the statutory right. If the Revised Statute had followed the Model Act, preemptive rights would exist only if stated in the articles.[175] An amendment to the articles would be required to restore these rights, and such an amendment might be difficult to accomplish.

One instance in which this general approach was not followed involves the shareholders' right to demand a special meeting. Under the Old Statute, the holders of ten percent of the shares could demand a meeting. Under the Revised Statute, shareholders in corporations with over thirty-five shareholders have lost this right unless they are able to cause an amendment to be adopted restoring it.[176]

In some instances, enabling provisions authorized by the Old Statute have been preempted by the Revised Statute. For example, the Old Statute allowed provisions in the articles which lowered

174. *Id.* §§ 13.1-778 to -800.

175. *See supra* note 38 and accompanying text.

176. *See supra* notes 50-52 and accompanying text.

the quorum provision for shareholder meetings to one-third. The Revised Statute seems to sanction provisions raising, but not lowering, this percentage.[177] A provision lowering the quorum could remain in the articles, but it would not be effective. The Revised Statute has preempted it.[178] The reverse has also occurred. The Revised Statute allows a provision in the articles that directors can be removed only for cause;[179] the Old Statute did not explicitly allow such a provision.[180]

The greatest areas of change effected by the Revised Statute are in its treatment of the consequences of certain conduct, such as the change in assenting to board action, and, more importantly, its totally different or new treatment of certain subjects. The financial, standard of care, derivative suit and affiliated transactions provisions are all substantive departures from, or additions to, prior Virginia corporate law.

III. CONCLUSION

It will be extremely interesting to observe the application of the Revised Statute in practice and its judicial amplification. The first step in its application requires careful consideration by corporate managers, shareholders, counsel and others of the statute's implications for the structure of existing corporations and for the planning of corporate action.

177. *See* REVISED STATUTE, *supra* note 1, § 13.1-668(A).
178. *See supra* text accompanying note 61.
179. REVISED STATUTE, *supra* note 1, § 13.1-680(A).
180. *See supra* pg. 98.