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Annual Survey of Virginia Law: Business and Corporate Law

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This article reviews recent developments in the law affecting Virginia businesses and corporations. Part II discusses judicial decisions, including: a United States Supreme Court decision concerning private rights of action under section 14(a) of the Securities Exchange Act of 1934;\(^1\) a Fourth Circuit Court of Appeals opinion denying absolute priority to the FDIC as liquidator;\(^2\) two decisions interpreting the Virginia Stock Corporation Act, one by the Fourth Circuit denying the protection of the good faith standard to directors\(^3\) and one by the United States District Court for the Western District of Virginia refusing to characterize a failed LBO/cash merger as an unlawful distribution;\(^4\) two Supreme Court of Virginia decisions regarding closely-held corporations, one returning control of a corporation from a son to his father by applying principles of gift law\(^5\) and one ordering the dissolution of a profitable corporation due to oppression of minority shareholders;\(^6\) a group of three cases in which the Fourth Circuit and two Virginia circuit courts determined whether one can recover from a successor for corporate liability;\(^7\) and several rulings that challenge convention, including a Western District decision that one of four family shareholders can bring a derivative action against the other three,\(^8\) a Western District ruling that a bank could be a seller under section 12(2) of the Securities Act of 1933,\(^9\) and a Fourth Circuit holding that a series of actions taken in pursuit of a freezeout stated a

\(^*\) Associate, Rilee, Cantor & Russell, Richmond, Virginia; B.S., 1981, University of Illinois; J.D., 1987, Northwestern University.

1. See infra notes 12-56 and accompanying text.
2. See infra notes 67-77 and accompanying text.
3. See infra notes 57-66 and accompanying text.
4. See infra notes 78-96 and accompanying text.
5. See infra notes 97-106 and accompanying text.
6. See infra notes 107-35 and accompanying text.
7. See infra notes 136-54 and accompanying text.
8. See infra notes 155-61 and accompanying text.
9. See infra notes 162-71 and accompanying text.
RICO claim.10 Part III discusses recent legislative developments affecting corporate and business law in Virginia.11

II. JUDICIAL DECISIONS

A. Section 14(a) of the Securities Exchange Act of 1934 and Private Rights of Action

In Virginia Bankshares, Inc. v. Sandberg,12 the United States Supreme Court reversed a recent holding by the Fourth Circuit Court of Appeals13 and considered two aspects of actions under section 14(a) of the Securities Exchange Act of 1934 ("Exchange Act").14 Rule 14(a)9, adopted by the Securities and Exchange Commission pursuant to section 14(a), requires that no proxy statement shall contain any statement that is "false or misleading with respect to any material fact" or omit "any material fact necessary in order to make the statements therein not false or misleading. . . ."15 In this case, the Court addressed two issues: whether imprecise statements of reason, opinion, or belief are actionable under section 14(a); and whether actions under section 14(a) may be maintained by shareholders who collectively own such a small number of shares that an action proposed in a proxy statement can be authorized without their votes.16 In a lengthy opinion written by Justice Souter, accompanied by multiple partial concurrences and dissents,17 the Court held that such statements may be actionable

10. See infra notes 172-83 and accompanying text.
11. See infra notes 184-225 and accompanying text.
13. Sandberg v. Virginia Bankshares, Inc., 891 F.2d 1112 (4th Cir. 1989), rev'd, 111 S. Ct. 2749 (1991). The Fourth Circuit held that an action for misrepresentation under § 14(a) of the Securities Exchange Act of 1934 could be maintained by a shareholder who was a member of a minority group that collectively owned insufficient shares to prevent authorization of the action proposed. Id. at 1121. Relying on Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970), the Court ruled that a finding that misrepresentations or omissions were material is sufficient to establish causation in an action under § 14(a) where it is shown that a proxy statement was an "essential link" in the accomplishment of the actions proposed in the proxy statement. Id. at 1120-21 (citing Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2nd Cir. 1974)). The Court adopted the Second Circuit's reasoning that the purpose of the Exchange Act is remedial, and that to hold otherwise "would sanction all manner of fraud and overreaching in the fortuitous circumstance that a controlling shareholder exists." Id. (quoting Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 383 (2nd Cir. 1974) (quoting Swanson v. American Consumer Industries Inc., 415 F.2d 1326, 1331 (7th Cir. 1969))).
17. Justice Scalia wrote a separate opinion concurring in part and concurring in judg-
if knowingly false; but allowing minority shareholders whose votes are not “required” for authorization of corporate action to maintain an action under section 14(a) would impermissibly extend the implied private right of action under section 14(a).¹⁸

The plaintiff, Doris Sandberg, was a minority shareholder in First American Bank of Virginia (“First American”), eighty-five percent of which was owned by Virginia Bankshares, Inc. (“VBI”). First American Bankshares, Inc. (“FABI”), which owned VBI, proposed a merger of First American and VBI. Although VBI owned a large enough percentage of First American to approve the proposed merger, under Virginia law the directors of First American were required to notify the shareholders and submit the plan for their approval.¹⁹ FABI retained an investment advisor to determine the “fair price” to be paid for the minority shares. During a presentation to FABI's executive committee, the advisor opined that a price of forty-two dollars per share was fair. The executive committee then approved the merger proposal at that price. At a later board meeting, the directors voted to approve the merger and recommend the suggested price to shareholders. No other investment advisor was consulted.²⁰

The directors solicited proxies for voting on the merger at the subsequent annual meeting. In their proxy statement, the directors recommended the merger, stating that they had approved the plan of merger because it constituted an opportunity for the minority shareholders to obtain a “high” value for their stock and that the price offered was “fair.”²¹ Most minority shareholders gave the proxies requested.²² Sandberg did not, however, and after the merger was approved, she alleged that the directors had not in fact believed the price was “high” or the merger “fair.” She argued that they had recommended the merger to retain their board positions. The trial court jury found for Sandberg and awarded damages of eighteen dollars per share.²³

¹⁸ Virginia Bankshares, 111 S. Ct at 2754.
²⁰ Virginia Bankshares, 111 S. Ct. at 2755-56.
²¹ Id.
²² Id.
²³ Id. The jury found that $60.00 per share was an adequate valuation of Sandberg’s stock. Id.
Addressing the first of the two issues, the Court agreed with the Fourth Circuit that certain statements in FABI's proxy solicitation were materially misleading under section 14(a). The Court stated that statements of reasons, opinions, or beliefs, even when couched in indefinite language, clearly may be material, and that the use of imprecise terms in a proxy solicitation does not render inapplicable the requirement that the statement in which they are contained be reasonably accurate.

The defendant directors argued that recognizing liability for a false or misleading statement of their reasons for recommending the proposed merger would "invite wasteful litigation of amorphous issues outside the readily provable realm of fact." Discussing Blue Chip Stamps v. Manor Drug Stores, the Court distinguished the reasons for the limitation of the private right of action in Blue Chip Stamps from the facts in this case. The Court pointed out that in contrast to the autonomous oral testimony on which the would-be plaintiffs in Blue Chip Stamps would have had to base their actions, the truth or falsity of directors' statements of reasons or belief is characteristically susceptible of objective third-party proof through corporate minutes and other statements of record, as well as circumstantial evidence regarding underlying facts.

The Court stated that directors' statements of reasons or belief are factual in two respects: the existence of the reason or belief stated, and the subject matter underlying the reason or belief. The Court held that only statements untrue or misleading in both respects are actionable under section 14(a), explaining that "it would be rare to find a case with evidence solely of disbelief or undisclosed motivation without further proof that the statement

24. Id. at 2757.
25. Id. at 2758-59.
26. Id. at 2757 (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)).
27. 421 U.S. 723 (1975). The Court in Blue Chip addressed whether an implied private right of action under § 10(b) of the Exchange Act should be extended to shareholders who had neither bought nor sold shares in reliance on deceptive sales practices, but claimed to have relied on them in taking no action. Because damages in such actions are based upon the number of shares involved in a shareholder's decision, the Court reasoned that recognizing liability to those who had no objectively verifiable way of demonstrating that number might increase nuisance litigation and held that only actual buyers and sellers could maintain such actions. Id.
28. Virginia Bankshares, 111 S. Ct. at 2758.
29. Id.
was defective as to its subject matter." It then stated that allowing actions based solely on false or misleading statements about the existence of a reason or belief would lead to the same difficulties of proof the Court sought to eliminate in *Blue Chip Stamps*. The Court reasoned that although such actions could be proven through objective means (and thus are apparently distinguishable from *Blue Chip Stamps*), they might result in "strike suits and attrition by discovery," and thereby would be inconsistent with the *Blue Chip Stamps* policy considerations.

The defendant directors also argued that even if untrue or misleading statements of reason or belief are actionable, actions should be permitted only if sufficient factual data that would enable a reader independently to determine the truth was absent from an entire proxy statement. The Court pointed out that since materiality is an element of actions under section 14(a), the presence of sufficient truth could render immaterial a statement that in isolation might be misleading. However, it concluded that if a misleading statement is material and the inclusion of certain other facts does not "neutralize the deceptive," it remains material and therefore actionable, for "[t]he point of a proxy statement, after all, should be to inform, not to challenge the reader's critical wits." In this case, the Court concluded, "there was, in sum, no more of a compelling case for the statement's immateriality than for its accuracy."

Although the Court agreed with the Fourth Circuit that the proxy statement issued by the directors of FABI was materially misleading, it held that no damages were recoverable because section 14(a) does not provide a private right of action for shareholders who hold an insufficient number of shares to affect a decision by a majority shareholder to take a given course of action. The Court noted that the class of shareholders who brought the action in this case owned only fifteen percent of the total shares and stated that their votes were "not required by law or corporate by-

30. *Id.* at 2760.

31. *Id.* In his concurring opinion, Justice Scalia noted that "not every sentence that . . . refers to motivation for Directors' actions, leads us into this psychic thicket," and stated that the "normal" principles governing misrepresentation of facts in 14(a) cases should apply. *Id.* at 2767 (Scalia, J., concurring in part, concurring in judgment).

32. *Id.* at 2760.

33. *Id.*

34. *Id.* at 2760-61.

35. *Id.* at 2761.
law to authorize the transaction giving rise to the claim.”\textsuperscript{36} The Court distinguished \textit{Mills v. Electric Auto-Lite Co.},\textsuperscript{37} upon which the Fourth Circuit based its decision, on the ground that in \textit{Mills} the majority shareholder did not hold sufficient shares to approve the subject transaction.\textsuperscript{38} However, in its holding, the Court did not clarify the \textit{Mills} criterion or restate it so as to avoid the use of the indistinct term “essential link.” Rather, it applied the “essential link” language and found both theories advanced by the respondents inadequate to explain why the proxy statement was an essential link in the subject merger. The Court stated that to allow a private right of action on these facts would extend the scope of implied private rights of action under section 14(a) beyond the holding of \textit{Mills}.\textsuperscript{39}

The first of the two “essential link” theories was based upon FABI’s desire to avoid bad shareholder relations.\textsuperscript{40} This theory

\begin{footnotes}
\item[37] 396 U.S. 375 (1970).
\item[38] \textit{Virginia Bankshares}, 111 S. Ct. at 2762-63. In \textit{Mills}, rather than requiring proof from each individual minority shareholder that he or she had relied upon the misstatements and affected the vote, the Court held that:

\begin{quote}
[w]here there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship . . . if . . . he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an \textit{essential link} in the accomplishment of the transaction. This objective test will avoid the impracticalities of determining how many votes were affected, and by resolving doubts in favor of those the statute is designed to protect, will effectuate the congressional policy of ensuring that the shareholders are able to make an informed choice when they are consulted on corporate transactions.
\end{quote}

396 U.S. at 385 (emphasis added). In \textit{Mills}, the Court explicitly reserved without decision the question of “whether causation could be shown where the management controls a sufficient number of shares to approve the transaction without any votes from the minority.” \textit{Id.} at 385 n.7.

\item[39] \textit{Virginia Bankshares}, 111 S. Ct. at 2763. Justice Stevens disagreed, pointing out that because the merger had been found by a jury to be unfair, the interest in providing a remedy to injured minority shareholders in \textit{Sandberg} was stronger, not weaker, than in \textit{Mills}. Justice Stevens stated, “[t]hat the solicitation of proxies is not required by law . . . does not authorize corporate officers, once they have decided for whatever reason to solicit proxies, to avoid the constraints of the statute.” \textit{Id.} at 2768 (Stevens, J., concurring in part, dissenting in part).

Justice Kennedy also disagreed, reasoning that “the difficulties of proving or disproving causation are, if anything, greater where the minority lacks sufficient votes to defeat [a] proposal.” \textit{Id.} at 2771 (Kennedy, J., concurring in part, dissenting in part).

\item[40] \textit{Id.} at 2762. Evidence was adduced that the bank had wanted a “friendly transaction” with a price “so high that any reasonable shareholder will accept it,” and that management had expressed concern that there be “no loss of support for the bank out in the community.” \textit{Id.} at 2771 (Kennedy, J., concurring in part, dissenting in part) (citing Brief for Ap-
reasoned that had the proxy statement not been misleading, minority shareholders would not have voted to authorize the merger, and would likely have communicated — perhaps to the public — their reasons for not doing so. Given its concern for public relations, the bank would have either modified the terms of the merger or declined to proceed.\footnote{Id. at 2762.} The Court stated that this theory depended upon evidence the nature of which implicated the policy issues of \textit{Blue Chip Stamps}.\footnote{Id. at 2764.} According to the Court, “[r]eliable evidence [of the truth or sincerity of statements attributed to directors] would seldom exist.”\footnote{Id. at 2765.} Because “[d]irectors would understand the prudence of making [on the record] a few statements about plans to proceed even without minority endorsement,”\footnote{Id.} plaintiffs would be forced to attempt to discover contradictory oral testimony.\footnote{Id.}

The second “essential link” theory was that the proxy statement was a means by which minority shareholders had ratified the merger.\footnote{Id. at 2766; see \textit{Va. Code Ann.} § 13.1-691(A) (Repl. Vol. 1989).} Therefore, it had removed one of the avenues through which the merger might have been voidable under Virginia law, on the ground that one of the directors of VBI was also a director of FABI and thus subject to a conflict of interest.\footnote{\textit{Virginia Bankshares}, 111 S. Ct. at 2766. Justice Kennedy pointed out in his dissent that if the Virginia statute governing director conflicts of interest incorporated a standard of materiality different from that of the federal securities laws, the plaintiff could have lost her state law remedy. \textit{Id.} at 2773 (Kennedy, J., concurring in part, dissenting in part); see \textit{Va. Code Ann.} § 13.1-691(A)(2) (Repl. Vol. 1989).} The Court stated that the facts in this case did not require it to consider whether section 14(a) provides a private cause of action for lost state remedies because a material misstatement or omission in the proxy statement would itself render the vote solicited thereby insufficient to constitute ratification.\footnote{\textit{Id.} at 2771 (Kennedy, J., concurring in part, dissenting in part).} The Court also noted that no state appraisal remedy was lost through the section 14(a) violation because none otherwise existed: “Va. Code § 6.1-43 specifically excludes
bank mergers from application of § 13.1-730 [the Virginia appraisal statute].”

Both the holding in this case and the reasoning upon which it is based exemplify the trend of the Court of narrowing or denying the recognition of implied private rights of action under federal statutes. In his concurring opinion, Justice Scalia stated that no private right of action under section 14(a) should be recognized. In a previous case cited in his concurrence, Justice Scalia had made a strong argument for “get[ting] out of the business of implied private rights of action altogether.”

Sandberg reveals tension among the members of the Court on the issue of implied rights of action. For example, Justice Kennedy and the justices who joined his opinion appeared to resist the narrowing in this case with the statement that “[w]here an implied cause of action is well accepted by our own cases and has become an established part of the securities laws . . . we should enforce it as a meaningful remedy unless we are to eliminate it altogether.” Additionally, the majority opinion of Justice Souter implied a certain viability of implied rights of action in its statement that the perceived lack of congressional intent to confer a private right of action under section 14(a) is “a serious obstacle to the expansion” of such rights, but “not, however, a necessarily insurmountable barrier.” Referring to Blue Chip Stamps, Justice Souter stated:

49. Virginia Bankshares, 111 S. Ct. at 2766 n.14 (quoting Appeal to Petition for Certiorari at 31a, 32a, Virginia Bankshares, Inc. v. Sandberg, 111 S. Ct. 2799 (1991) (No. 89-1448)).
50. Justice Souter devoted a lengthy portion of the majority opinion to a general discussion of the principles governing the recognition of implied rights of action under federal statutes. See id. at 2763-64.
51. See, e.g., Thompson v. Thompson, 484 U.S. 174, 190-92 (1988) (Scalia, J., concurring in judgment) and the cases cited therein.
52. Virginia Bankshares, 111 S. Ct. at 2767 (Scalia, J., concurring).
53. Thompson, 484 U.S. at 192.
54. Virginia Bankshares, 111 S. Ct. at 2769 (Kennedy, J., concurring in part, dissenting in part).
55. Id. at 2764.
56. Id.
It appears that the Court is in the midst of changing its collective thinking with respect to private rights of action implied under federal statutes.

B. Directors did not Meet Virginia’s Statutory “Good Faith” Standard

Addressing the important issue of state law in Sandberg v. Virginia Bankshares, Inc., 57 the Fourth Circuit panel58 left unclear the extent to which directors are protected by Virginia’s statutory good faith standard.59 Under Virginia law, a corporate director must discharge his duties “in accordance with his good faith business judgment” of the best interests of the corporation.60 A director is entitled to rely on “information, opinions, reports, or statements” presented by persons as to matters he believes, in good faith, are “within the person’s professional or expert competence.”61 The directors of First American argued in their defense that evidence of “bad faith” was lacking and that their reliance on the advisor retained by FABI and their decision not to seek a second opinion were justified under the statute. The court rejected these arguments and affirmed the jury’s finding of a lack of good faith, stating that the evidence “fully supports a view that the directors exercised no independent judgment whatsoever.”62

It appears from this decision that more than good faith may be required by a court to meet the good faith standard of section 13.1-880 of the Code of Virginia (“Code”). It is not clear from the opinion how one could demonstrate that the statute’s requirement of good faith had been met.63

In Sandberg, the Fourth Circuit also upheld the constitutional-
ity\textsuperscript{64} of Virginia’s statutory cap on the liability of directors.\textsuperscript{65} The court relied on Fourth Circuit and Supreme Court of Virginia decisions that upheld Virginia’s statutory cap on medical malpractice liability.\textsuperscript{66} Given the reversal by the United States Supreme Court of the portions of this case assigning liability to FABI and VBI, further litigation with respect to the limitation of the liability of the individual directors may ensue.

C. FDIC Priority Over Other Claims to Assets of Insolvent Institutions

In \textit{Howard v. Haddad},\textsuperscript{67} the Fourth Circuit Court of Appeals joined the Eleventh Circuit Court of Appeals in rejecting an assertion by the Federal Deposit Insurance Corporation (“FDIC”) that it should have absolute priority over claimants seeking to recover damages payable from the assets of institutions undergoing liquidation. In an action under Rule 10b-5,\textsuperscript{68} Edward G. Howard sued two directors of the ironically-named Trust Bank on grounds that they had fraudulently induced him to purchase shares of stock in the bank. The FDIC won district court motions to intervene and to dismiss the action,\textsuperscript{69} arguing that Howard’s claim was derivative because it arose out of the decrease in value of his shares that resulted from mismanagement and the FDIC, as liquidator, owned all derivative causes of action against the bank and its officers and directors. The FDIC also argued that even if Howard’s claims were not derivative, the FDIC’s duty to satisfy creditors before shareholders\textsuperscript{70} meant that it should be accorded priority over the shareholders with respect to assets of the directors of the bank.\textsuperscript{71}

\textsuperscript{64} 891 F.2d at 1125. The court reached the issue of constitutionality only with respect to the right of trial by jury. It declined to address equal protection and due process challenges not raised at the trial level.

\textsuperscript{65} Id. With respect to actions by or in the right of a corporation or by or on behalf of its shareholders § 13.1-692.1 of the Code limits damages assessable against a director and arising out of a single transaction, occurrence, or course of conduct to the lesser of (1) an amount that may be specified in the articles of incorporation or bylaws of the corporation and (2) the greater of $100,000 or the amount of cash compensation received by the director during the previous twelve months. \textit{See} \textit{VA. CODE ANN.} § 13.1-692.1 (Repl. Vol. 1989).

\textsuperscript{66} \textit{See e.g.} Boyd v. Bulala, 877 F.2d 1191 (4th Cir. 1989); Etheridge v. Medical Center Hospitals, Inc., 237 Va. 87, 376 S.E.2d 525 (1989).

\textsuperscript{67} 916 F.2d 167 (4th Cir. 1990).

\textsuperscript{68} 17 \textit{C.F.R.} § 240.10b-5 (1991).


\textsuperscript{71} \textit{Howard}, 916 F.2d at 170.
In response to the first of these arguments, the court distinguished Howard's claim from potential claims of mismanagement by other shareholders. The court observed that the reason for the decrease in value of Howard's shares was irrelevant to his claim of fraudulent inducement and found that his claim was not derivative. Although the district court had not relied upon the "absolute priority" argument in dismissing Howard's claims, the appeals court addressed it as an alternative ground upon which the dismissal could have been affirmed. Dismissing the FDIC's citation of Fourth Circuit precedent in a footnote, the court expressly adopted the analysis of the Eleventh Circuit in *FDIC v. Jenkins*:

"Of course, it would be convenient to the FDIC to have an arsenal of priorities, presumptions, and defenses to maximize recovery to the insurance fund, but . . . [w]e are not convinced Congress [so intended]. Any such priority will have to come from Congress, not this court."

The *Jenkins* court had been strongly influenced by the legislative history of the then-recently adopted Financial Institutions Reformation, Recovery and Enforcement Act of 1989 (FIRREA). An amendment conferring absolute priority on the FDIC had specifically been rejected by the FIRREA conference committee.

D. Cash Merger not Unlawful Distribution to Shareholders

*C-T of Virginia, Inc. v. Barrett* involved an action brought by the Official Committee of Unsecured Creditors ("Committee") of

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72. *Id.* at 169-170.
73. "Contrary to the FDIC's assertion, this Circuit has never adopted the absolute priority rule in a similar context." *Id.* at 170 n.4. In *FDIC v. American Bank Trust Shares, Inc.*, 412 F. Supp. 302 (D.S.C. 1976), *vacated and remanded*, 558 F.2d 711 (4th Cir. 1977), *on remand* 460 F. Supp. 549 (D.S.C. 1978), *aff'd* 629 F.2d 951 (4th Cir. 1980), the District Court of South Carolina held initially that the FDIC, as general creditor, had priority over subordinated capital noteholders of the bank. *Id.* On remand, the court only decided issues that had been presented in a counterclaim, making no further findings with respect to the priority issue. However, the court had stated in its initial ruling that the priority it conferred in the case was not absolute and was subject to a later "final determination." See *FDIC v. Jenkins*, 888 F.2d 1537, 1541-42 (11th Cir. 1989) (discussing final determination).
74. *Jenkins*, 888 F.2d 1537 (11th Cir. 1989). The panel in *Jenkins* included Judge Walter E. Hoffman, Senior United States District Judge for the Eastern District of Virginia, sitting by designation.
75. *Howard*, 916 F.2d at 170 (quoting *FDIC v. Jenkins*, 888 F.2d 1537, 1546 (11th Cir. 1989)).
77. *See Jenkins*, 888 F.2d at 1538 n.1.
the former Craddock-Terry Shoe Corporation ("C-T"). In Barrett, the United States District Court for the Western District of Virginia confirmed that although a cash merger accomplished with leveraged financing could in some circumstances be an unlawful distribution, in the absence of fraud or insolvency at the time of the transaction, directors who have properly discharged their fiduciary duties need not fear being second-guessed when the successor company files for bankruptcy protection.9

In June of 1985, the directors of C-T, having announced a proposed leveraged buyout of the company by its management at a price of fifteen dollars per share, received unsolicited offers from third parties who proposed cash mergers.8 In late 1985, an "Agreement in Principle" was signed to effect a cash merger with HH Acquisition, Inc., a result of which C-T shareholders would receive a price of twenty dollars per share.81 The merger was consummated on April 30, 1986. A petition for bankruptcy was filed on October 21, 1987. Having discharged their duties under the rule of Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.82 to obtain for shareholders the highest price for their shares,83 the former directors of the company were faced in 1989 with this action, which arose out of the bankruptcy filing.

The Committee claimed that before the "Agreement and Plan of Merger" was executed in January of 1986, the C-T directors knew or should have known that the transaction was to be financed mostly by short-term debt secured by liens on the assets of C-T; that repayment of the secured debt would require either increased sales or reduced costs; that the company was not performing as

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9. Barrett I, 124 Bankr. at 692. The court dismissed a claim by the plaintiffs that no Revlon duty had arisen and the directors of Craddock-Terry had breached a different fiduciary duty under Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Under Unocal, when a sale is "not inevitable," the duty of directors is to determine whether a proposed takeover is in the best interests of the company. The plaintiffs, as creditors of C-T, characterized themselves as members of one of the constituencies whose interests would have been allied with those of the company as a whole in a Unocal analysis. Barrett I, 124 Bankr. at 692.
well as management had predicted; and that if the merger were consummated, C-T would be “grossly undercapitalized.” The Committee sought to characterize the merger as a distribution to shareholders, relying on Virginia’s broad statutory definition of the term, and argued that, although the company did not pledge its assets directly to its shareholders, it facilitated the encumbrance of its assets by the purchasers “for the benefit of shareholders.” The directors asserted that the compensation received by shareholders came only from the parent of HH Holdings, and not from C-T. The court refused to dismiss this claim, stating that if the directors had “actively participated” in encumbering the property of the company, then the transaction could be a disguised distribution in violation of Virginia’s statutory prohibition of distributions by insolvent corporations.

After additional discovery, both parties filed for summary judgment on the question of whether a distribution had occurred. The court found the plaintiffs’ interpretation of the definition of “distribution” to be “inconsistent with Virginia’s statutory scheme.” The court noted that the statutes governing distributions are separate from those governing mergers and reasoned that the absence in the merger statutes of references to distribution considerations implied a legislative intent that the issues be considered independently. The court then returned to a consideration of the facts in this case and found that this was not a disguised merger, stating that “[a]ll available evidence suggests that the directors expected the company to continue operating after the buyout, and presumed that their replacements would make proper distributions and payments to creditors in connection with their own fiduciary duties.”

84. Id. at 692.
85. Id. at 693. Distribution means “a direct or indirect 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.” VA. CODE ANN. § 13.1-603 (Repl. Vol. 1989).
86. Barrett I, 124 Bankr. at 694 (citing Weiboldt Stores, Inc. v. Schottenstein, 94 Bankr. 488, 511 (Bankr. N.D. Ill. 1988)).
87. Id.
88. Id.
90. Barrett II, 124 Bankr. at 696. The court noted that the plaintiffs conceded at oral argument that if their characterization were to prevail, every merger would be a distribution. Id.
91. Id.
92. Id. at 697.
The court also found that even if the buyout was a distribution, the directors would not be liable because their successors, not they, had authorized the payment of cash to shareholders. To hold the directors of C-T responsible for the payments would require that the court collapse the transactions comprising the buyout, an “extreme” step not warranted by the facts. The court distinguished *Wieboldt Stores, Inc. v. Sohottenstein*, the principal authority relied upon by the plaintiffs in urging collapse. It found that in *Wieboldt* the company had been insolvent prior to the transaction in question, and the board had known of the insolvency before approving the transaction. In this case, it was not alleged that C-T was insolvent before the merger.

E. Voting and Ineffective Transfers of Stock

Lehman H. Young, Sr., incorporated his long-established printing business as Fairfax Printers, Inc., in 1970. He periodically issued directions to a trustee to transfer to his son and two daughters an equal number of shares in the company. By May of 1984, Young no longer had voting control. At that time, his son held 242 Class A (voting) shares, and each daughter held 241 shares originally issued to Young as Class A shares, but evidenced by certificates classifying them as Class B (non-voting) shares. No formal action had been taken to reclassify the daughters’ shares. Young had simply designated them Class B on the certificates issued at the time of the transfers. The certificates had been delivered to Young as “attorney” for his daughters, neither of whom was aware of the apparent transfers of stock.

In 1987, after a business dispute between father and son, Young caused a total of 254 of the shares apparently owned by his daughters to be transferred to him as Class A shares. His son successfully petitioned the Circuit Court of Fairfax County to find the transfer invalid and vacate subsequent actions taken by shareholder vote.
The Supreme Court of Virginia looked beyond the prima facie correctness of the stock transfer ledger and held that the shares had never been effectively transferred by Young to his daughters because he had retained possession of the stock certificates. The court reasoned that because Young’s daughters had given no consideration for the shares, the transfers at issue should be analyzed as purported gifts. Both the common law and the Uniform Commercial Code require that for a gift to be effective, there must be delivery and acceptance. The court found that the elements of delivery and acceptance were “entirely lacking,” and thus no effective gifts had been made because Young had retained dominion and control over the certificates evidencing ownership of the shares.

The trial court had found that delivery had been completed because Young had acknowledged receipt of the certificates on behalf of his daughters and the shareholders had annually ratified all dealings of the directors and officers of the corporation. Consequently, the trial court ruled the parties were estopped to challenge either the delivery or the apparent reclassification.

The supreme court did not reach the issue of whether shares can be converted simply by the issuance of certificates bearing a new class designation. It stated only that Young’s attempt to reclassify the shares at issue in that manner was “ineffectual.”

F. Oppression of Minority Shareholders

In Giannotti v. Hamway, the Supreme Court of Virginia affirmed a 1987 ruling of the Circuit Court of the City of Richmond that ordered the dissolution of a close corporation because its officers and directors had engaged in oppressive conduct toward minority shareholders within the meaning of former section 13.1-94 of the Code. The court also resolved any existing uncertainty re-

102. Id. at 62, 393 S.E.2d at 401.
104. Young, 240 Va. at 62-64, 393 S.E.2d at 400-01.
105. Fairfax Printers, 18 Va. Cir. at 86.
106. Young, 240 Va. at 64, 393 S.E.2d at 401.
108. Section 13.1-94 of the Code has been superseded by § 13.1-747 of the Code, which is similar in its relevant provisions.
The plaintiffs charged that the defendants paid themselves excessive direct compensation; profited from improper transactions between the corporation and entities related to or controlled by certain of the officers and directors; and failed to pay adequate dividends. Although the supreme court characterized the conduct of the defendants as "egregious, domineering, blatantly unfair, and prejudicial to the plaintiffs," it appears to have based its holding on a finding of oppression in general, rather than on specific findings as to the charges.

Libbie Rehabilitation Center, Inc. ("Libbie") was formed in 1967, and began operating its first nursing home in 1970. In 1980, when the claims in this case were first filed, it also operated two additional facilities through wholly-owned subsidiaries. The shareholders represented eight families. The three plaintiffs had initially controlled the corporation, but the expiration of a voting trust resulted in their loss of control in 1975. Upon assuming control, the five defendants reduced the size of the Board of Directors to five and elected themselves as the only directors and officers.

At trial, the defendants asserted that all dealings between them and the corporation lay within the protection of the business judgment rule. They offered evidence that they were actively involved in the management of the corporation.

111. *Giannotti*, 239 Va. at 28, 387 S.E.2d at 733.
112. The trial court pointed out that excessive "compensation" included "salaries, bonuses, fringe benefits, directors' fees, expense allowances, reimbursements, and other compensation." *Hamway v. Libbie Rehabilitation Center*, 10 Va. Cir. 245, 248 (City of Richmond Cir. Ct. 1987).
114. *Id.* at 28, 387 S.E.2d at 733.
115. See infra notes 127-31 and accompanying text.
116. While in the majority and before the date on which the voting trust was to expire, the three plaintiffs had authorized the issuance of 80,000 shares to two of their number of shares in exchange for personal guarantees of corporate debt. This issuance would have allowed plaintiffs to retain control had it not been rescinded on the ground that fiduciary duties to stockholders had been violated. *Adelman v. Conotti Corp.*, 215 Va. 782, 213 S.E.2d 774 (1975).
in the corporate business, that the market value of Libbie stock had risen substantially during the time they were in control, and that transactions with related parties were fair to Libbie and reasonably priced.\textsuperscript{118}

The supreme court defined oppressive conduct as that which "departs from the standards of fair dealing and violates the principles of fair play on which persons who entrust their funds to a corporation are entitled to rely."\textsuperscript{119} The court also noted that "the term does not mean that a corporate disaster may be imminent and does not necessarily mean fraudulent conduct."\textsuperscript{120} It further stated that corporate officers have duties of fidelity similar to those of trustees, and that a director who receives personal advantage or profit must "account therefor to the corporation," and must bear the burden of proof to show that transactions between himself and the corporation have been fair.\textsuperscript{121} The court characterized this principle as an exception to the business judgment rule.\textsuperscript{122}

In affirming the lower court's decision, the supreme court stated that the findings of the chancellor appointed by the trial court were in conflict with evidence presented by the defendants on almost every issue.\textsuperscript{123} With respect to the issue of unreasonable compensation, the chancellor accorded great weight to testimony by the administrators of the three Libbie facilities that the five defendants had participated insufficiently in the operations of the facilities to justify their compensation. The "main actor" of the five had, at most, approved administrators' decisions regarding day-to-day operation. Another director, a lawyer, was paid on an hourly basis for activities duplicating his corporate responsibilities. Finally, the director who served as the chief financial officer "demonstrated no knowledge of the Medicare and Medicaid programs, the principal sources of Libbie's income."\textsuperscript{124} The court stated that although courts "are hesitant to question" reasonableness of compensation when set by a disinterested board, in this case such dis-

\textsuperscript{118} Giannotti, 239 Va. at 21-22, 387 S.E.2d at 729-30.
\textsuperscript{119} Id. at 23, 387 S.E.2d at 730.
\textsuperscript{120} Id.
\textsuperscript{121} Id. at 24, 387 S.E.2d at 731 (citing Adelman v. Conotti Corp., 215 Va. 782, 789, 213 S.E.2d 774, 779 (1975); Rowland v. Kable, 174 Va. 343, 366, 6 S.E.2d 633, 642 (1940); Waddy v. Grimes, 154 Va. 615, 648, 153 S.E. 807, 817 (1930)).
\textsuperscript{122} Id. at 24, 387 S.E.2d at 731.
\textsuperscript{123} Id. at 22, 387 S.E.2d at 730.
\textsuperscript{124} Id. at 26, 387 S.E.2d at 732.
interest was "impossible."\textsuperscript{125} The court noted that one of plaintiffs' experts testified that the management functions performed by all five defendants could have been performed by one individual. The court concluded that the defendants were only part-time employees of Libbie with significant outside business interests.\textsuperscript{126}

Although both courts found in favor of the plaintiffs on the issues of unreasonable compensation and failure to pay adequate dividends, neither court distinguished clearly between these issues. The plaintiffs asserted at trial that the officers' salaries, as set by themselves, were excessive and constituted a "waste of corporate resources denying to plaintiffs adequate dividends."\textsuperscript{127} The plaintiffs also asserted that "the profits of the corporation as against the salaries of the defendant officers reveal that the dividends declared during the time the defendants had controlled the corporation constitute inadequate return on their investment."\textsuperscript{128} The supreme court stated that although the business appeared to have been profitable, its before-tax profit was less than half that of comparable facilities. It further found that the trial court was justified in finding that "Libbie would have been more profitable except for the excessive compensation extracted from the corporation by defendants."\textsuperscript{129}

Notwithstanding its holding that oppression had occurred, the trial court did not find the allegedly improper related transactions voidable.\textsuperscript{130} Yet the related transactions were apparently a part of the basis on which the supreme court affirmed the trial court's holding. The supreme court referred to "the chancellor's finding that defendants breached their fiduciary duties in certain transactions," and stated that "[i]n view of the trial court's findings, . . . defendants have failed to carry their burden of proving the fairness and propriety of [certain] transactions."\textsuperscript{131}

In discussing the related transactions in this case, neither court referred to Virginia's statute regarding director conflicts of inter-

\textsuperscript{125} Id. at 24, 387 S.E.2d at 731.
\textsuperscript{126} Id. at 27, 387 S.E.2d at 732.
\textsuperscript{127} Hamway, 10 Va. Cir. at 250.
\textsuperscript{128} Id.
\textsuperscript{129} Giannotti, 239 Va. at 27, 387 S.E.2d at 733.
\textsuperscript{130} "Despite the presence of some considerations, the [c]ourt finds that the transaction involved in this case are not voidable for lack of disclosure of personal interests." 10 Va. Cir. at 255 (emphasis added).
\textsuperscript{131} Giannotti, 239 Va. at 30, 387 S.E.2d at 733.
The statute provides in essence that a "conflict of interests transaction" is not voidable if approved by a majority of directors or shareholders who have no personal interest in the transaction, or if it is fair to the corporation. The statute's unavailability in cases where contracts are unfair, yet receive the prescribed vote of approval, demonstrates its permissive rather than restrictive nature.

Giannotti illustrates the power conferred by section 13.1-747 of the Code. Oppressive conduct may be actionable even if specific elements of such conduct are not actionable under other statutes. But the exclusive remedy of dissolution may be insufficient or inappropriate to remedy oppression in some cases. Where mismanagement has significantly lessened the value of corporate assets, dissolution may place oppressed shareholders in a worse position than the continuation of business with a change in management. Further, where the business has profited and assets have grown, a more equitable remedy would substitute or include the restoration of these diverted profits. If oppressors have siphoned off corporate assets for their own benefit, they should not be allowed to retain their ill-gotten gains. And, as pointed out by Justice Gordon, dissenting in this case, "[t]o liquidate the corporation is to kill the goose that laid the golden egg."

G. Recovery from a Corporation for Liabilities of its Predecessor

Several recent cases have addressed the issue of whether liabilities of a predecessor can be recovered from a successor corporation. Although the nature of the liabilities in these cases differ, and the reasoning behind the holdings is not always clear, they share a judicial focus on the equitable aspects of their outcomes.

1. By Implication, Successor Liability for Fraud

In City of Richmond v. Madison Management Group, the Fourth Circuit affirmed a jury finding that a purchaser of business

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133. Id. The statute defines a conflict of interest transaction as "a transaction with the corporation in which a director of the corporation has a direct or indirect personal interest."
134. Id. § 13.1-691(A).
135. E.g., see supra notes 130-31 and accompanying text.
136. 239 Va. at 30, 387 S.E.2d at 734.
assets had, by implication, assumed responsibility for the liabilities of the seller. GHA Lock Joint, Incorporated ("GHA") had purchased the assets of a pipe manufacturing division of Interpace Corporation ("Interpace"). The purchase occurred two years after Interpace had agreed to supply a third party with pipe meeting the specifications of a contract with the City of Richmond. Evidence demonstrated that Interpace had been aware when it entered into the supply agreement that some of its pipe was defective. Based on this evidence, the trial court jury found that Interpace had committed fraud.

Generally, when a corporation sells or otherwise transfers assets to another, the transferee is not liable for the debts and liabilities of the transferor unless the parties have agreed to the contrary; the terms of a bona fide asset purchase agreement will govern. The terms of the asset purchase agreement between Interpace and GHA limited GHA’s responsibility for defective products of Interpace to $200,000 or less “for any single project.” However, the trial court jury found that GHA had demonstrated, by its conduct, an intent to assume “the contract” and therefore by implication assumed unlimited responsibility for all liabilities related to the contract. In affirming that verdict, the appeals court relied heavily on the willingness of GHA to repair defects in the pipe and its failure to direct the City to seek a remedy from Interpace. GHA

137. Madison Management Group, 918 F.2d at 442-43.
138. Id. at 443. Although the court did not find that GHA independently had committed fraud, evidence showed that GHA employees, who were former employees of Interpace, participated in public representations that the pipe met contract specifications after they had become aware that problems existed. Id. at 451.
139. See, e.g., 15 W. Fletcher, Cyclopedia of the Law of Private Corporations, § 7122 (rev. perm. ed. 1990). If the terms of a transaction were not legally enforceable, it would be difficult to determine the appropriate consideration.
140. The agreement provided in part:

Purchaser shall assume no liabilities of any character whatsoever . . . except . . . liabilities arising out of claims, whether before or after the Closing Date, of an alleged defect in a product or service of the Division by a purchaser thereof, an owner thereof, or any third party claiming damages or relief as a result thereof; provided, however, . . . that Purchaser does not hereby assume liability, and in no event shall Purchaser be liable or incur losses, damages, costs, and expenses (excluding attorneys’ fees and disbursements), in excess of $200,000 for any single project.

Brief for Appellants at 36 n.18, City of Richmond v. Madison Management Group, 918 F.2d 438 (4th Cir. 1990).

141. GHA had used the name “Interpace;” publicly taken credit for the work of Interpace on the project; assumed responsibility for completing the project; collected money under the project; and participated in repairs when defects in the pipe had become apparent. 918 F.2d at 450-51.
presented evidence at trial and on appeal that it had repaired the pipe only out of a desire to maintain good customer relations, and had stated in a letter to the third party who had installed the pipe that it “d[id] not feel” that it was liable for the costs of repair. However, the evidence presented by GHA failed to convince the appellate panel that the jury verdict was unsupportable.

The court also upheld the jury’s award of punitive damages against GHA as a successor to the liabilities of Interpace. The court stated that imposing punitive damages on a successor in interest of a wrongdoer serves the purpose of deterrence as well as imposing the damages on the wrongdoer itself because “[i]n Virginia, the purpose of a punitive damage award is not simply to deter the wrongdoer from future wrongdoing; it is ‘to display to others an example of the consequences they may expect if they engage in similar conduct.’”

The opinion in this case is silent as to why the City did not include Interpace, other divisions of which were still in business, as a defendant in this case, and whether there was any provision in the asset purchase agreement for indemnification of GHA by Interpace.

2. Successor Liability for Contractual Debts

In Southgate Associates v. Aker Industry, Southgate, a lessor, sought recovery for breach of a commercial lease from both Aker, its lessee, and JHA of Virginia, Inc. (“JHA”), an alleged successor to Aker. Aker did not respond or appear.

JHA asserted that it could not be found liable because the evidence failed to establish a transfer of assets from Aker to JHA. Yet Southgate presented evidence that Aker office equipment had been transferred to JHA and subsequently surrendered to Aker creditors; former Aker clients did business with JHA; blinds purchased by Aker were installed by JHA; and “proceeds” received by JHA were forwarded to an Aker creditor. Remarkably, the court found that a transfer of assets from Aker to JHA was “conspicuously absent,” and stated that JHA and Aker Industries were separate en-

142. Id. at 451.
143. Id. at 456 (emphasis in original) (citing F.B.C. Stores, Inc. v. Duncan, 214 Va. 246, 251, 198 S.E.2d 595, 599 (1973)).
144. 20 Va. Cir. 168 (County of Chesterfield Cir. Ct. 1990).
145. The opinion does not state from what source the proceeds had been derived.
ties and the claim against JHA failed for want of privity. In an 
item-by-item response to Southgate’s evidence, the court detailed 
the reasons why the obvious connection between the two entities 
was not legally sufficient to constitute a transfer of assets.

Both parties in this case, as well as both parties in *Madison 
Construction Co.* to support their contrary arguments. South-
gate cited *Crawford* for the proposition that certain exceptions to 
the general rule of nonliability of successor entities exist, one being 
a set of circumstances in which a purchasing corporation is a 
“mere continuation” of a selling corporation. Having found that 
in this case there was no transfer of assets, the court apparently 
reasoned that JHA therefore was not a “successor entity.” It did 
not address whether any of the exceptions to the general rule were 
applicable.

Another exception to the general rule of nonliability is a 
purchase transaction found to be “fraudulent in fact.” Fraud in 
the transaction is to be distinguished from fraud as the source of 
the liability in question, as occurred in *Madison Management 
Group*. The *Madison Management Group* opinion contains no 
mention of any allegation that the sale of Interpace assets to GHA 
was itself an attempt by the two entities to defraud the City. But 
the court’s final words in *Southgate* are consistent with the result 
in *Madison Management Group*: “The harshness of the nonliabil-
ity rule occurs when the successor corporation derives a benefit 
from the predecessor corporation without accepting associated lia-

146. 20 Va. Cir. at 169-70.
147. Investment monies were loaned to Mr. Aker by a personal friend for JHA. Aker Indus-
tries’ office equipment initially taken by JHA without consideration was returned 
for the benefit of Aker Industries’ creditors. No evidence was presented of a transfer 
of accounts receivable. JHA secured former Aker Industries’ clients. However, [the 
name of] these parties were readily available from [a local business publication]. 
JHA’s installation of the remaining Aker Industries’ blinds fails to constitute a trans-
fer sufficient to impose liability.

*Southgate Associates*, 20 Va. Cir. at 170.
148. 918 F.2d 438 (4th Cir. 1990); see also supra notes 137-43 and accompanying text.
150. *Southgate Associates*, 20 Va. Cir. at 169. The other exceptions recited in *Southgate* 
are circumstances warranting a finding “that there was consolidation of the two corpora-
148 S.E. 828 (1929))).
(E.D. Va. 1987)).
bilities and obligations. No showing of such a benefit has been established by plaintiff.\footnote{Id. at 170.}

3. Successor Liability for Negligence

In *Hancock v. Shoenle and Philips Police Equipment Co.*,\footnote{Law No. 12887, letter op. (City of Alexandria Cir. Ct. 1989).} the Circuit Court of Alexandria ruled on an action by the administrator of an estate against two defendants — an individual who, she claimed, had negligently sold a firearm to the decedent whose estate she administered, and the corporation into which the “individual company” was subsequently “merged.”\footnote{The three paragraph letter opinion does not make clear the exact nature of the operation by which the individual became part of the corporation.} In sustaining the demurrer of the corporate defendant, the court recognized that liability “is carried over” in a stock merger of two corporations where the surviving corporation “is entitled to” all of the assets and liabilities of the former entities. However, it could not find authority passing individual liability to a corporation when the corporation “acquires” a sole proprietorship.

The court’s reference in *Hancock* to the transfer of all assets and liabilities implies a focus similar to that in *Madison Management Group* and *Southgate*. The reason why the corporation had not assumed the liabilities of a sole proprietorship with which it had purportedly “merged” is not clear.

H. *Derivative Action by a Class of One*

In a recent memorandum opinion, the United States District Court for the Western District of Virginia distinguished family relationships from “situational similarities” to enable a twenty-two percent shareholder in a family corporation to maintain a derivative action against her brother. In *Jordon v. Bowman Apple Products Co.*\footnote{728 F. Supp. 409, mem., No. 89-00210C (W.D. Va. 1990).} Patricia Jordon, one of four shareholders and a sister of the company president, alleged that her brother had misapplied corporate assets and improperly participated in related partnerships. The other two shareholders were Peggy Zirkle, Jordon’s sister, and their mother. Zirkle and her mother had surrendered voting control of their stock to the brother through a voting trust
Jordon brought a derivative action against all three of the other shareholders, seeking to recover for the corporation her brother’s allegedly ill-gotten gains.\textsuperscript{157}

The defendants moved to dismiss in part on the ground that Jordan did not “fairly and adequately represent the interests of the shareholders or members similarly situated.”\textsuperscript{158} Zirkle, who owned a percentage of the corporation equal to that of Jordon, shared the additional situational similarities of nonmanagement status and being a member of the family. Thus, the defendants argued that because Zirkle was named a defendant and joined the motion to dismiss, Jordon failed to represent the interests of the entire class of those similarly situated.

In the absence of Virginia precedent, the court considered two contrary cases from other jurisdictions,\textsuperscript{159} concluding that a single shareholder could occupy a unique position and thereby constitute a legitimate class of one.\textsuperscript{160} In refusing to dismiss this derivative action, the court noted that rule 23.1 of the Federal Rules of Civil Procedure grants the court broad discretion in determining what constitutes “similarity of situation,” and stated that the existence of a voting arrangement that alters the power structure of a corporation from that implied by ownership percentages alone is “clearly important” in this type of case.\textsuperscript{161}

\begin{itemize}
  \item \textsuperscript{156} Jordon, 728 F.Supp. at 413.
  \item \textsuperscript{157} The derivative action was one of several counts in Jordan’s complaint.
  \item \textsuperscript{158} See FED. R. CIV. P. 23.1.
  \item \textsuperscript{160} In Kuzmickey, each of six shareholders who were not defendants submitted affidavits stating that the single plaintiff did not represent their interests and that the action at issue was not in the best interests of the corporation. Kuzmickey v. Dunmore Corp., 420 F. Supp. 226, 230 (E.D. Pa. 1976). Somewhat confusingly, the court stated that under rule 23.1 of the Federal Rules of Civil Procedure a single plaintiff’s derivative action could not be maintained unless she represented the interests of shareholders other than herself. Id. at 231. The Halsted Video court correctly characterized the Kuzmickey holding as a conclusion that the plaintiff did not fairly and adequately represent the interests of similarly situated shareholders. Halsted Video, Inc. v. Guttill, 115 F.R.D. 177, 180 (N.D. Ill. 1987). The Halsted court distinguished the single plaintiff in Halsted as one who was not similarly situated with any of the corporation’s other shareholders, and held that as such, a single shareholder could maintain a derivative action under rule 23.1. Id.
  \item \textsuperscript{161} Id.
\end{itemize}
I. Bank as a Seller Under Section 12(2) of the Securities Act

In a memorandum opinion filed March 7, 1991, the United States District Court for the Western District of Virginia, Judge Kiser presiding, denied summary judgment to the defendant, Central Fidelity Bank ("CFB"). It reasoned that there were disputed material issues of fact as to whether CFB could be subject to liability as a seller of securities under section 12(2) of the Securities Act of 1933 ("Securities Act"). Recent United States Supreme Court precedent holds that an entity can be a "seller" if it solicits the purchase of a security and receives consideration for its services.

As a service to Gunnoe Sausage Co., Inc. ("Gunnoe"), CFB's Investment Division invested excess funds from Gunnoe's checking account in commercial paper. Gunnoe and CFB disagreed as to whether Gunnoe was routinely consulted before each purchase was made. However, CFB argued in its motion for summary judgment that even if it had selected each investment, it could not be held liable for related investment losses because it had merely acted in accord with standard banking industry practice and was not a "seller" under the Securities Act.

According to Gunnoe, CFB had suggested that Gunnoe authorize the investment of its excess funds, which it did, expressing a preference for conservative investments. In selecting the paper to be purchased, CFB relied on Standard and Poor's Commercial Paper Rating Guide. CFB argued that it was justified in relying on ratings agencies for its information because it was not a full service broker-dealer. Gunnoe maintained that such reliance was unjustified because the Standard and Poor's Guide provided stale and insufficient information and other evidence demonstrated that the issuer of the paper was in significantly worse financial condition than its Standard and Poor's rating indicated. Therefore, according to Gunnoe, CFB was guilty of material misrepresentation or omissions of fact in connection with the offer or sale of securities.

In addressing the issue whether CFB could be a seller or offeror, Judge Kiser noted that the "substantial factor" test previously re-

164. See infra note 167 and accompanying text.
lied upon in the Fourth Circuit had been expressly rejected by the United States Supreme Court in *Pinter v. Dahl.* Judge Kiser stated that under *Pinter*, even one who has not held title to a security can be a "seller" if he solicited the purchase of the security and received consideration for his services. In applying this rule to the facts, Judge Kiser found disputed issues of material fact as to whether CFB solicited Gunnoe's purchase of commercial paper in this case. Therefore, he refused to grant the bank's motion for summary judgment.

Judge Kiser also refused to grant summary judgment on a parallel count under Virginia's Blue Sky Law. He stated that the appropriate inquiry in this context was "very similar" to that under the Securities Act: "whether CFB received compensation for advice regarding the actual purchase of securities." The case has since been settled.

J. Minority Shareholder Allegation of Fraudulent Freezeout Activities Stated RICO Claim

On remand from the United States Supreme Court for reconsideration in light of a recent decision in *Walk v. Baltimore and...*
Ohio Railroad the Fourth Circuit reversed in part its previous affirmation of the granting of a motion to dismiss. The plaintiffs in Walk alleged a ten-year fraudulent freezeout scheme, involving CSX Corporation and several of its subsidiaries, to deprive minority shareholders of the Baltimore and Ohio (“B&O”) Railroad of their just profits. The Fourth Circuit had earlier affirmed a Maryland District Court’s rule 12(b)(6) dismissal of the plaintiffs’ RICO claims for failure sufficiently to allege the requisite “pattern of racketeering activity.”

The RICO statute defines a “pattern of racketeering activity” as “at least two” acts within ten years. Interpreting the statute, the Supreme Court has stated that two acts may not be sufficient to form a “pattern,” and that “continuity” and “relationship” are the distinctive characteristics of a RICO “pattern.” Lower courts have struggled to apply these concepts; their analyses have focused on differing aspects of the subject activities. The Fourth Circuit has stated that although separate acts can be part of a single “scheme” and yet form the requisite “pattern,” a “single, limited scheme” should not be transformed into a RICO violation simply because, for example, several acts of mail or wire fraud were involved. The court had reasoned that given the frequency of mail and wire communication, such an interpretation would cause nearly every fraudulent act to meet the requirements of the RICO statute.

In its initial decision, the court found, after a lengthy and thoughtful analysis, that the activities of B&O were “limited in scope to the accomplishment of a single discrete objective,” that of forcing out the minority shareholders in a single corporate structure. It held that this could not constitute a pattern of continuing

173. 890 F.2d 688 (4th Cir. 1989).
175. The plaintiffs held minority interests in B&O Railroad, a Maryland railroad corporation approximately 98.5% of which was owned by the Chesapeake & Ohio Railroad, a Virginia corporation wholly owned by CSX. Other subsidiaries of CSX were also involved. Walk, 847 F.2d at 1101.
179. The court in this case characterized the terms “continuity” and “relationship” in this context as “inherently contradictory.” Walk, 847 F.2d at 1103; see id. at 1103-05.
180. Id. at 1104.
criminal activity of RICO nature.\textsuperscript{181} On remand, the court took note of the Supreme Court's discussion in \textit{H.J., Inc.} of the continuity requirement, in which the Court emphasized that although the activity in question might have ended with the accomplishment of a single objective, requisite continuity could be found in the fact that the activity had extended "over a substantial period of time."\textsuperscript{182} The court concluded that its earlier analysis had probably given "too little weight to the sheer duration of the predicate acts alleged, and too much to their closed-ended character."\textsuperscript{183}

### III. Legislative Developments

In contrast to the legislative focus on public companies of recent years, some of the most significant legislation of 1990 and 1991 occurred in the realm of the small, privately-held concern.

#### A. Virginia Limited Liability Company Act

With the Virginia Limited Liability Company Act\textsuperscript{184} ("Act"), the Virginia General Assembly has authorized a new hybrid form of entity for small businesses.\textsuperscript{185} The Act is discussed fully in another article in this survey.\textsuperscript{186}

\begin{itemize}
\item \textsuperscript{181} \textit{Id.} at 1105. The court noted that "virtually every" action taken by those in control of a corporation could otherwise be challenged under RICO, which would not only have a chilling effect on legitimate transactions, but also was not likely to be a use of the RICO statute intended by Congress. The court cautioned, however, that it did not intend to rule out the application of the RICO statute to all schemes occurring in the corporate context. \textit{Id.}
\item \textsuperscript{182} 890 F.2d at 689-90 (quoting \textit{H.J., Inc. v. Northwestern Bell Telephone Co.}, 492 U.S. 229, 242 (1989)).
\item \textsuperscript{183} \textit{Id.} at 689.
\item \textsuperscript{185} The first limited liability company law was passed in Wyoming in 1977, but could not confer on members the full benefits of its hybrid nature until the Internal Revenue Service ruled in 1988 that it would be granted partnership treatment for federal income tax purposes. \textit{See Rev. Rul. 88-76, 1988-2 C.B. 360.} Virginia is one of five other states that have now enacted similar statutes; legislation has been introduced in eight additional states. \textit{Partnership, Corporation Aren't Only Ways to Start Out}, Wall St. J., May 14, 1991, at 2, col. 3.
\end{itemize}
B. New Kinds of Agreements of Shareholders or Members Authorized for Both Stock and Nonstock Corporations

Section 13.1-671.1 of the Code,187 adopted by the 1990 General Assembly, authorizes provisions in agreements among shareholders of small stock corporations188 that may conflict with certain requirements of the Stock Corporation Act.189 Such provisions may eliminate or restrict the powers of a board of directors; transfer to one or more shareholders or other persons all or part of the power to manage the corporation; govern the exercise or allocation of voting powers; govern the authorization or making of distributions; require the dissolution of the corporation at the request of one or more shareholders or upon the occurrence of a specific event; and otherwise govern the management of the corporation or the relationships among or between directors, shareholders, and the corporation in any way not contrary to public policy.190

This recent law offers those who represent small corporations enhanced flexibility in structuring small corporations to meet the needs of individual clients. It also allows the elimination of some of the routine “housekeeping” activities otherwise required. For example, shareholders may provide that annual meetings of a corporation will not be held and its directors and officers will remain in office until successors are elected; or that shareholders will direct the operations of the corporation in lieu of directors. The law provides that persons assuming the discretion and powers of directors shall bear the liability otherwise imposed by law on directors.191 The law also specifically states that the existence of an agreement authorized under section 13.1-871.1 of the Code shall not be a ground for imposing on any shareholder personal liability for corporate acts or debts, “even if the agreement or its performance treats the corporation as if it were a partnership . . . .”192

Shareholder agreements must be approved by all shareholders and be either set forth in a corporation’s articles of incorporation or bylaws or contained in a written agreement executed by all

188. Agreements authorized by § 13.1-671.1 of the Code would become ineffective if a corporation had more than 35 shareholders of record. Id. § 13.1-671.1(D).
191. Id. § 13.1-671.1(E).
192. Id. § 13.1-671.1(F).
The drafting and implementation of these agreements may suggest more considerations than are initially apparent. For example, the payment of dividends or distributions in a manner other than in proportion to the percentage of shares held may have undesirable tax consequences; or the elimination of some routine activities of corporate governance could result in a failure to comply with certain requirements that always remain applicable.

A bill enacted by the 1991 General Assembly permits similar agreements among the members or directors of nonstock corporations.

C. Shareholder Voting Procedures Enacted

Section 13.1-663 of the Code was amended in 1991 to afford greater flexibility in the appointment of proxies. Formerly, the law required that a proxy be appointed by means of a writing executed by the shareholder or his authorized agent. The amendment provides that in addition, appointments shall be valid when effected by some form of electronic transmission containing information from which inspectors or other persons can determine that an appointment was authorized by the shareholder. The amendment also provides that reproductions of proxy authorizations may be used instead of originals for all purposes, provided they are complete reproductions of an entire transmission.

New section 13.1-664.1 of the Code requires that large public corporations appoint inspectors to act at shareholder meetings and make written reports of their determinations and actions. Although inspectors have long been customary, Virginia law did not
previously require that they be appointed. The new law also requires that the times for opening and closing the polls for each matter voted be announced at the meeting, and that no ballot submitted after the closing of the polls be accepted unless a circuit court orders otherwise.202 Finally, the new law sets forth requirements for the scope of any inspector’s examination of proxies and the reconciliation of proxies and ballots submitted by or on behalf of brokers and other nominees when such proxies or ballots may represent more votes than the holder of a proxy is authorized by the record holder to cast or more votes than the shareholder holds of record.201

D. Service of Process Provisions Consolidated

Multiple sections of the Code were amended in 1991 to set forth unambiguously the law on substituted service of process on the Clerk of the Commission as statutory registered agent.202 Until this legislation was passed, provisions governing the substitute service of process were scattered throughout the Code. The new law emphasizes the importance of actual notice to defendants. It requires that the clerk keep a record of the mailing of actual notice and that a certificate of compliance be filed in the relevant proceeding evidencing compliance.203

E. Various Stock Corporation Amendments Passed

The 1990 legislature amended section 13.1-646 of the Code to provide that “the terms and conditions of rights, options, and warrants . . . may include . . . restrictions or conditions that preclude or limit the exercise, transfer, or receipt thereof by designated persons or classes of persons or that invalidate or void such rights, options, or warrants held by designated persons or classes of persons.”204 This amendment, which was effective immediately upon its passage, was passed in response to a 1989 challenge to a shareholders’ rights plan205 based on Virginia’s statutory prohibition.

201. Id. § 13.1-664.1(D).
204. Id. § 13.1-646(B).
against discrimination among shares of the same class.\textsuperscript{206}

Section 13.1-718 of the Code has been amended to provide that a plan of merger or share exchange may be abandoned without action by shareholders at any time prior to the effective date of a certificate of merger or share exchange, rather than the date of issuance.\textsuperscript{207}

Section 13.1-675 of the Code has been amended to provide that where the terms of directors are staggered, the bylaws require a fixed number of directors and the board can amend the bylaws, the number of directors may be increased or decreased by thirty percent or less of the number of directors of all classes immediately following the most recent election of directors by shareholders.\textsuperscript{208} This is a technical clarification that eliminates an uncertainty regarding the permissible size of an increase or decrease in the case of so-called staggered boards.

In 1990, section 13.1-695 of the Code, which governs the resignation and removal of officers of a corporation, was amended to state that the election or appointment of an officer does not in itself create any contract rights in the officer or the corporation. This section was amended again in 1991 to provide that an officer's removal does not affect any existing contract rights of either the officer or the corporation.\textsuperscript{209}

Sections 6.1-194.40 and 13.1-716 of the Code have been amended to clarify existing provisions and to permit a national bank to merge into or consolidate with a state association or federal savings institution whose main office is located in Virginia.\textsuperscript{210}

A 1990 amendment to section 13.1-719 of the Code made the short form merger statute available regardless of the direction in which the merger is accomplished.\textsuperscript{211} Prior to adoption of this


\textsuperscript{207} Id. § 13.1-718. Yet “written notice of abandonment must be filed with the Commission prior to the effective date of the certificate of merger or stock exchange.” Id.

\textsuperscript{208} Id. § 13.1-675(B).

\textsuperscript{209} Id. § 13.1-695(B).

\textsuperscript{210} Id. § 13.1-716(B).

\textsuperscript{211} Id. § 13.1-719(A).
amendment, the short form merger statute only permitted a merger of a subsidiary into its parent. This amendment provides additional flexibility in circumstances where there is a need to preserve the corporate identity of a subsidiary for example, when a subsidiary has already fulfilled certain regulatory requirements or obtained certain licenses.

Section 13.1-706 of the Code was amended in 1990 to provide that a board of directors may amend the corporation's articles of incorporation without shareholder action to eliminate or change the par value of the shares of any class or series.212 This allows the stated capital of a corporation to remain unchanged when a stock split is effected.

Certain additional minor technical corrections were made that are not included in this discussion.

F. Nonstock Corporations May Mortgage Assets Without Approval of Members

Section 13.1-900 of the Code has been amended to allow a nonstock corporation to mortgage all or substantially all of its property other than in the usual and regular course of business without first obtaining the approval of its voting members.213 However, approval must still be obtained in connection with sales, leases, exchanges, or other disposals under the same circumstances.

G. Certain Amendments Made that Affect all Corporations

A number of bills passed by the 1991 legislature relate to certain ministerial aspects of corporate governance. Section 13.1-615 of the Code was amended to provide that any foreign corporation amending its articles of incorporation before January 1 of a given year to reduce the number of authorized shares shall have its annual registration fee reassessed if the authenticated copy of the amendment is filed after January 1 but within thirty days.214

Sections 13.1-753 and 13.1-915 of the Code have been amended to allow for the involuntary termination of a corporation that fails to file any document required by the Commission.215 This amend-
ment will eliminate the confusion caused by duplicate names in certain situations. For example, corporations that were terminated and later reinstated often fail to file articles of amendment to change their names when the names have been taken by others during the period of termination. This amendment will enable the Commission simply to terminate the existence of a corporation that has failed to file the required articles of amendment.

Sections 13.1-775.1 and 13.1-936.1 of the Code have been amended to provide for the payment of registration fees in each year after the calendar year in which a corporation was incorporated or authorized to transact business in Virginia.\(^{216}\) Previously, registration fees were only payable by corporations authorized as of January 1. Thus, corporations incorporating as of January 1 paid a registration fee in their initial year that was avoided by those incorporating effective January 2.

A number of sections have been amended to permit the filing of corporate documents not previously “required or permitted” to be filed under either of sections 13.1-604 and 13.1-804 of the Code.\(^{217}\) These amendments now permit a person who has resigned as a director of a corporation or whose name is incorrectly on file with the Commission as a director to file a statement to that effect with the Commission, and also permit a corporation to file an amended annual report reflecting the resignation of a director and identifying his successor.\(^{218}\)

Sections 13.1-752, -768, -914, and -930 have been amended to provide for the automatic termination of a domestic corporation’s existence\(^{219}\) and the automatic revocation of the certificate of authority of a foreign corporation\(^{220}\) for failure to file an annual report or pay annual registration fees by September 1 of each year. Under present law, the existence of a corporation is terminated automatically, and the certificate of authority of a foreign corporation is revoked, on June 1 of the second consecutive year after failure to file an annual report. Beginning next year, if a corporation fails to file its annual report by April 1, it will receive notice of impending termination or revocation in July and will be automati-


\(^{217}\) The sections of the Code amended are §§ 13.1-679(D), -680(E), -682(D), -695(D), -859(D), -860(F), -862(D), and -874(D).

\(^{218}\) Id. § 13.1-679(D).

\(^{219}\) Id. §§ 13.1-752(A), -752(B)(2), -914(A), -914(B)(2).

\(^{220}\) Id. §§ 13.1-768(A), -768(B)(2), -930(A), -930(B)(2).
cally terminated, or its certificate revoked, as of September 1 if its annual report has not been received by the Commission by the close of business on August 31.221

H. Provisions Affecting Limited Partnerships are Adopted

Limited partnerships no longer must file documents with both the Commission and with local circuit courts.222 This change parallels the elimination in 1988 of local filing requirements for corporate documents.

Section 50-37.3 of the Code has been amended to provide that a limited partnership that has changed its name or succeeds to the ownership of or any interest in real estate may obtain a certificate issued by the Commission that can be filed in a local recording office in order to maintain the continuity of title records.223

Also, section 59.1-70 of the Code has been amended to require that a foreign limited partnership conducting business under an assumed or fictitious name in Virginia file a copy of its locally filed assumed name certificate with the Commission.224 Only domestic limited partnerships and domestic and foreign corporations had previously been required to do so. Finally, section 50-74 of the Code has been amended to provide that a certificate of limited partnership may be signed by an attorney-in-fact.225

IV. Conclusion

Recent developments in the law affecting Virginia businesses have been diverse. Several of the judicial decisions reviewed in this article recognized new interpretations or applications of well-established statutory and common law. Decisions interpreting the revisions to the Virginia Stock Corporation Act made in 1985 and refined since then continue to be significant. Legislative developments continue to provide additional alternatives to Virginia businesses.

221. Id. §§ 13.1-752(A), -752(B)(2), -768(A), -768(B)(2), -914(A), -914(B)(2), -930(A), -930(B)(2).
222. See VA. CODE ANN. §§ 50-73.5, -73.17, -73.20, and 73.67.
223. Id. § 50.1-37.3(A).
224. Id. § 59.1-70(A).
225. Id. § 50-74(a).