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I. INTRODUCTION

In its 2005 Session, the Virginia General Assembly adopted the first comprehensive revisions to the Virginia Stock Corporation Act[1] (the "Virginia Act") since 1985, when the General Assembly undertook the last major revision of the Virginia Act. In 1985, Virginia became the first state to adopt the Model Business Corporation Act (the "Model Act"), as adopted in 1984 by the Committee on Corporate Laws of the American Bar Association (the "ABA Corporate Laws Committee").[2] Twenty-five states have subsequently adopted all or significant parts of the Model Act.[3] Since 1984, the Model Act has undergone a number of significant revisions, many reflecting experience with the Model Act in the various adopting states, as well as significant technological advances affecting shareholder and director communications.

Since adopting the revisions to the Virginia Act in 1985, the General Assembly has adopted, from time to time, individual amendments to the Virginia Act, notably limitations on director and officer liability,[4] anti-takeover legislation,[5] and derivative

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1. VA. CODE ANN. §§ 13.1-601 to -781 (Repl. Vol. 1999 & Cum. Supp. 2005).
2. *See* MODEL BUS. CORP. ACT, introduction at xxviii (2002).
3. *Id.* at xxvii.
4. Act of Apr. 4, 1988, ch. 561, 1988 Va. Acts 708; Act of Mar. 23, 1987, ch. 257, 1987 Va. Acts 342; Act of Mar. 11, 1987, ch. 59, 1987 Va. Acts 82 (codified as amended at VA. CODE ANN. § 13.1-692.1 (Repl. Vol. 1999 & Cum. Supp. 2005)).
5. Act of Feb. 22, 1989, ch. 14, 1989 Va. Acts 38; Act of Mar. 31, 1988, ch. 442, 1988 Va. Acts 546 (codified as amended at VA. CODE ANN. §§ 13.1-725 to -727.1, -728.1 to -728.9 (Repl. Vol. 1999 & Cum. Supp. 2005)).

litigation procedures.[6] In addition, both courts and practitioners have amassed significant experience with the application of the provisions of the Virginia Act.

In 2004, a working group of interested practitioners and academics began meeting to discuss a comprehensive revision of the Virginia Act. The 2005 amendments to the Virginia Act adopted by the General Assembly and effective as of July 1, 2005 (the "2005 Amendments")[7] are based on the work of that group.

This article summarizes significant features of the 2005 Amendments.

II. ELECTRONIC TRANSMISSION

The explosive growth of Internet access, improvement of Internet security measures, and widespread desire for enhanced shareholder democracy have led the Securities and Exchange Commission ("SEC"),[8] various state legislatures,[9] and the ABA Corporate Laws Committee to expand the catalogue of effective means of shareholder and director notices and communications to include electronic transmission. In 2002, the General Assembly began to reflect this development with the adoption of a definition of "electronic transmission"[10] and the authorization of certain notices by electronic means.[11] The 2005 Amendments conform the Virginia Act to the Model Act and clarify the use of electronic means of communication.[12] Virginia Code section 13.1-610, as amended by the 2005 Amendments, provides that, except for notices to and from the Commonwealth of Virginia State Corporation Commission ("SCC"), notice by electronic transmission satis-

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6. Act of Mar. 15, 1993, ch. 233, 1993 Va. Acts 258; Act of Apr. 6, 1992, ch. 802, 1992 Va. Acts 1270 (codified as amended at VA. CODE ANN. §§ 13.1-672.1 to -672.5 (Repl. Vol. 1999 & Cum. Supp. 2005)).

7. Act of Mar. 26, 2005, ch. 765, 2005 Va. Acts 1219 (codified as amended in scattered sections in VA. CODE ANN. §§ 13.1-603 to -776 (Cum. Supp. 2005)).

8. *See* 17 C.F.R. § 240.14a-3 (2004) (SEC Rule 14a-3).

9. *See, e.g.*, DEL. CODE ANN. tit. 8, § 232 (2005).

10. Act of Apr. 1, 2002, ch. 285, 2002 Va. Acts 361 (codified as amended at VA. CODE ANN. § 13.1-603 (Cum. Supp. 2005)).

11. *Id.* (codified as amended at VA. CODE ANN. § 13.1-610(H) (Cum. Supp. 2005)).

12. For example, the definition of "deliver" has been expanded to include in-person delivery and electronic transmission. *See* VA. CODE ANN. § 13.1-603 (Cum. Supp. 2005). This definition in the Virginia Act mirrors the Model Act. *See* MODEL BUS. CORP. ACT § 1.40(5).

fies the requirement that all notices be in writing.[13] The 2005 Amendments also permit in-person notice, which now may occur through voice mail or other electronic means.[14] Written notice by a corporation to its shareholders through electronic transmission is now effective when transmitted to the shareholder in a manner that the shareholder has authorized.[15]

Consistent with these general provisions, the 2005 Amendments expressly provide for written shareholder and director consents by electronic transmission.[16] In language that conforms to the Model Act, the 2005 Amendments also simplify the provisions that permit appointment of a proxy through electronic transmission of the appointment.[17]

The 2005 Amendments also expand the permitted use of electronic transmissions for communications with the SCC in a manner that will assist practitioners. Virginia Code section 13.1-604(K) already provides that the SCC may accept documents for filing through electronic transmission.[18] Virginia Code section 13.1-604(D), as amended by the 2005 Amendments, now clarifies that documents filed with the SCC through electronic transmission need not be typewritten or printed, but may be in a format that can be retrieved and produced in typewritten form.[19] Furthermore, the 2005 Amendments expand the usage of articles of correction to correct any articles filed with the SCC if the electronic transmission of such articles is defective.[20] Finally, a facsimile of a certificate of any document admitted to the records of the SCC, bearing signature, including a facsimile signature, of the clerk or a staff member of the SCC, is conclusive evidence that the document has been admitted to the records of the SCC.[21]

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13. VA. CODE ANN. § 13.1-610(A) (Cum. Supp. 2005) (incorporating the exception that oral notice of board of director meetings may be given if expressly authorized by the corporation's articles of incorporation or bylaws); *cf.* MODEL BUS. CORP. ACT § 1.41(a).

14. VA. CODE ANN. § 13.1-610(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.41(b).

15. VA. CODE ANN. § 13.1-610(C)(ii) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.41(c)(ii).

16. VA. CODE ANN. § 13.1-685 (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 8.21.

17. VA. CODE ANN. § 13.1-663(B)-(D) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.22.

18. *See* VA. CODE ANN. § 13.1-604(K) (Repl. Vol. 1999).

19. *Id.* § 13.1-604(D) (Cum. Supp. 2005).

20. *Id.* § 13.4-607(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.24(a).

21. VA. CODE ANN. § 13.1-608 (Cum. Supp. 2005).

III. INCLUSION OF OBJECTIVELY ASCERTAINABLE FACTS

Practitioners have complained that under current laws and practice, the SCC would not accept the filing of articles of incorporation or a plan of merger that referred to facts or circumstances not set forth explicitly in such filed documents. By so doing, the SCC could restrict, for example, a debt security interest rate based on the federal funds rate or a merger conversion ratio dependent upon a stock index increase or decrease. Based closely on provisions of the Model Act adopted by the ABA Corporate Laws Committee in 2002, Virginia Code section 13.1-604(L), as amended by the 2005 Amendments, now permits a plan of merger or share exchange or filed document, such as articles of incorporation or articles of merger or share exchange, to include terms that are dependent upon facts "objectively ascertainable" outside the plan or filed document, so long as the plan or filed document specifies either (i) the nationally recognized news or other information media where the facts can be found or (ii) some other manner by which the facts can be ascertained objectively.[22] The plan of merger or share exchange or filed document must specify, however, the manner in which the facts to be ascertained will operate within the terms of such plan of merger or share exchange or filed document.[23]

Virginia Code section 13.1-604(L)(2), as amended by the 2005 Amendments, lists the following facts that may be ascertainable outside a plan or filed document:

> (i) statistical or market indices; (ii) market prices of any security or group of securities; (iii) interest rates; (iv) currency exchange rates or similar economic or financial data; . . . (v) action by a person or body, including the corporation; or (vi) terms of, or actions taken under, any agreement or other document, including an agreement to which the corporation is a party.[24]

Alternatively, Virginia Code section 13.1-604(L)(4), as amended by the 2005 Amendments, lists the following terms of a plan of

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22. *Id.* § 13.1-604(L)(1) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.20(k).

23. VA. CODE ANN. § 13.1-604(L)(1) (Cum. Supp. 2005). Under Virginia Code section 13.1-604(L)(3), "plan" means a "plan of merger or share exchange," and "filed document" means articles of incorporation or a document filed under Article 11 or 12 of the Virginia Act. *Id.* § 13.1-604(L)(3) (Cum. Supp. 2005).

24. *Id.* § 13.1-604(L)(2) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.20(k)(2).

merger or share exchange or filed document that may not be made dependent on facts ascertainable outside the plan or filed document: (i) the name or address of any required person in a filed document; (ii) the registered agent and office of any entity required in a filed document; (iii) the number of authorized shares and designations of each class or series of shares; (iv) the effective date of a filed document; and (v) statements required in the filed document regarding the date and manner of any required approval of the underlying transaction.[25]

These exclusions are not surprising because they each address fundamental information regarding the structure of the corporation, means of legal access to it, and the basic approvals required for effective corporate action. If the facts upon which the terms of a plan or filed document are dependent upon a fact that is not objectively ascertainable by reference to one of the listed sources or another document that is a matter of public record, then the corporation must give notice of the fact to shareholders or must file with the SCC articles of amendment specifying the fact promptly upon the fact first becoming objectively ascertainable or upon any change in the fact.[26] No further director or shareholder action is required to authorize these articles of amendment, which are deemed authorized by the original approval or adoption of the plan or filed document.[27] Practitioners should advise their corporate clients to file such articles of amendment if there is any doubt about the ability of the shareholders to ascertain the facts outside the plan or filed document.[28]

The Virginia Act, as amended by the 2005 Amendments, expressly provides that the SCC will not consider the treatment of objectively ascertainable facts outside a plan or filed document in determining whether the terms of the plan or filed document comply with Virginia law.[29] This provision, which is not included in the Model Act, is made necessary by the substantive review of filed documents undertaken by the SCC.

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25. VA. CODE ANN. § 13.1-604(L)(4) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.20(k)(4).

26. VA. CODE ANN. § 13.1-604(L)(5) (Cum. Supp. 2005).

27. *Id.*

28. *See* MODEL BUS. CORP. ACT § 1.20 cmt.

29. VA. CODE ANN. § 13.1-604(L)(6) (Cum. Supp. 2005).

The sections outlining the elements that may be included in articles of incorporation,[30] a plan of merger,[31] or a plan of share exchange[32] all expressly permit making terms of the articles or plans dependent upon facts that are objectively ascertainable outside the articles or plans in accordance with Virginia Code section 13.1-604(L), as amended by the 2005 Amendments.

IV. SHARES AND DISTRIBUTIONS

The 2005 Amendments include a number of revisions affecting the treatment of shares and dividends and other distributions, many of which are simply clarifications or changes adopted from the Model Act. Several of the revisions are quite significant, however, particularly the changes to Virginia Code section 13.1-653, as amended by the 2005 Amendments, regarding distributions.[33]

The revisions to Virginia Code section 13.1-638, as amended by the 2005 Amendments, make clear that the articles of incorporation may authorize not just one or more *classes*, but also *series*, of shares that together have unlimited voting rights and are entitled to receive the net assets of the corporation upon dissolution.[34] This clarification will be particularly helpful for those Virginia corporations with more than one series of common stock.

Furthermore, these revisions permit terms of shares of a class or series that vary among holders, so long as the variations are set forth expressly in the articles of incorporation.[35] This useful provision makes it clear that, under Virginia law, it is permissible for a corporation to issue shares of a class or series of stock that loses its voting rights if held by a person with ownership of more than a specified percentage of such stock.

30. *Id.* § 13.1-619(D) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 2.02(d).

31. VA. CODE ANN. § 13.1-716(D) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.02.

32. VA. CODE ANN. § 13.1-717(E) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.03.

33. *See* VA. CODE ANN. § 13.1-653 (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.40.

34. VA. CODE ANN. § 13.1-638(A)-(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.01(a)-(b).

35. VA. CODE ANN. § 13.1-638(E) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.01(e).

The Virginia Act has long permitted the authorization of so-called "blank check" stock or stock with the rights and limitations fixed later by the board of directors.[36] The revisions to Virginia Code section 13.1-639, as amended by the 2005 Amendments, which closely mirror the Model Act, clarify that if the articles of incorporation so authorize, the board of directors, without shareholder approval, may: (i) classify any unissued shares, regardless of whether they have never been issued or have been reacquired by the corporation, into one or more classes or series of shares or (ii) reclassify any unissued shares of any class or any series.[37]

Pursuant to revised Virginia Code section 13.1-646(A), as amended by the 2005 Amendments, authorization by a board of directors of the issuance of rights, options, or warrants also constitutes the authorization of the issuance of shares or other securities underlying the rights, options, or warrants.[38] This new language is useful for practitioners called upon to opine on the due authorization of shares issued upon exercise of a derivative security.

It has long been a trap for the unwary that shareholders of a Virginia corporation have limited preemptive rights with respect to the corporation's unissued shares *unless* those rights are denied by the corporation's articles of incorporation.[39] Pursuant to the 2005 Amendments, only shareholders of a corporation incorporated *on or before* December 31, 2005, have such preemptive rights.[40] Shareholders of a corporation incorporated *after* December 31, 2005, have no preemptive right to acquire the corporation's unissued shares unless that right is granted in the articles of incorporation.[41]

The 2005 Amendments also made two significant revisions to Virginia Code section 13.1-653, which governs distributions to shareholders. Under the Virginia Act, no distribution to share-

36. VA. CODE ANN. § 13.1-639(A) (Repl. Vol. 1999).

37. *Id.* § 13.1-639(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.02(a).

38. VA. CODE ANN. § 13.1-646(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.24(a).

39. *See* VA. CODE ANN. § 13.1-651(A) (Repl. Vol. 1999).

40. *Id.* § 13.1-651(A) (Cum. Supp. 2005).

41. *Id.* § 13.1-651(B) (Cum. Supp. 2005). Preemptive rights are a trap for the practitioner. Although certain practitioners may have preferred to eradicate all preemptive rights completely, the working group was fearful of upsetting existing arrangements and elected only to act prospectively.

holders may be made if, after giving it effect, either (i) the corporation would not be able to pay its debts as they come due in the ordinary course of business or (ii) the corporation's total assets would be less than the sum of its total liabilities, taking into account the rights of preferred shareholders.[42]

The Virginia Act, in accordance with the Model Act, has long provided that the board may base its determinations on financial statements prepared on the basis of accounting practices and principles that are reasonable under the circumstances.[43] The 2005 Amendments provide that reliance by a public corporation[44] upon the most recent financial statements prepared in accordance with generally accepted accounting principles will be deemed reasonable so long as the statements have been audited by independent certified public accountants whose certification does not include a going concern qualification.[45] This provision, which is unique to the Virginia Act but should be considered a clarification, not a change to existing law, will give public companies incorporated in Virginia helpful certainty in assessing whether a distribution is prohibited.

The 2005 Amendments also adopted a new subsection from the Model Act providing that directors need not consider indebtedness of a corporation, including indebtedness that is distributed to shareholders, as a liability for purposes of determining whether a distribution is prohibited under Virginia law, if the terms of the indebtedness provide that payments of principal and interest are made "only if and to the extent that payment of a distribution to shareholders could then be made."[46] Each payment of principal or interest on indebtedness issued as a distribution is treated as a distribution whose effect is measured as of the date of the actual payment.[47] The limitations on distributions established by this section do not apply to distributions in liquidation

42. *Id.* § 13.1-653(C) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.40(c).

43. VA. CODE ANN. § 13.1-653(D) (Repl. Vol. 1999); MODEL BUS. CORP. ACT § 6.40(d).

44. A "public corporation" is defined as a corporation with shares listed on a national securities exchange or regularly traded in a market maintained by members of a national securities association. *See* VA. CODE ANN. § 13.1-603 (Cum. Supp. 2005).

45. *Id.* § 13.1-653(D) (Cum. Supp. 2005).

46. *Id.* § 13.1-653(G) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.40(g).

47. VA. CODE ANN. § 13.1-653(G) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.40(g).

of the corporation, which are provided for in Article 16, Dissolution, of the Virginia Act, as amended by the 2005 Amendments.[48]

V. SHAREHOLDERS' MEETING MATTERS

The 2005 Amendments contain several provisions that simplify or clarify the conduct of shareholders' meetings and the implementation of the shareholder franchise. In a small but important revision to the procedure for setting a record date, the Virginia Act, as amended by the 2005 Amendments, now makes clear that in the absence of a relevant bylaw, the board of directors may fix as a record date *either* the date on which the board acts or a future date.[49] The new language gives the board of a company more flexibility to set as a record date the date of the board action, whereas the original statutory language arguably only permitted the fixing of a *future* date as a record date.[50] This change may not be relevant for a publicly held company because a company whose securities are listed on a securities exchange or traded on the NASDAQ Stock Market, Inc. generally will be required to give to that exchange a minimum of ten days' notice of the record date.[51]

In a change based on the Model Act, the definition of "record date" now specifies that the determination of shareholders and their holdings is made as of the close of business at the principal office of the corporation on the record date unless another time is set when the record date is originally fixed.[52] This revision reflects usual best practice but eliminates possible ambiguity when no time is included in the board resolution fixing a record date.

In a new section adopted from the Model Act, the Virginia Act, as amended by the 2005 Amendments, now outlines simple rules for the conduct of a shareholders' meeting. First, a chairman appointed in accordance with the articles of incorporation or the by-

48. VA. CODE ANN. § 13.1-653(H) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 6.40(h).

49. VA. CODE ANN. § 13.1-660(A) (Cum. Supp. 2005).

50. *Compare id.* § 13.1-660(A) (Cum. Supp. 2005), *with id.* § 13.1-660(A) (Repl. Vol. 1999).

51. *See* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 401.02, *available at* http://www.nyse.com/lcm/subsection_4_401_00.shtml?printable=yes (last visited Oct. 1, 2005).

52. VA. CODE ANN. § 13.1-603 (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 1.40(19).

laws or, in the absence of a relevant provision, by the board of directors, presides at each shareholders' meeting.[53] Second, the chairman determines the order of business at the meeting and establishes rules for the conduct of the meeting, unless the articles of incorporation or the bylaws require otherwise.[54] Third, the chairman announces the opening and closing of the polls with respect to each matter being voted upon.[55] The codification of these procedural rules will assist a corporation dealing with contentious shareholders' meetings by establishing clear authority in the chairman to determine both the agenda of the meeting and the basic rules of order.

The statutory provisions that define the voting entitlement of shares are complicated but critical to the fair management of the shareholder franchise. The 2005 Amendments contain several revisions to these provisions of the Virginia Act. The Virginia Act prior to the 2005 Amendments provided that "redeemable shares" were not entitled to vote and would not be deemed outstanding after notice of redemption was mailed and provision was made for payment of the redemption price.[56] The Virginia Act, as amended by the 2005 Amendments, now clarifies that "[s]hares that have been called for redemption are not entitled to vote."[57] Further, the 2005 Amendments provide additional flexibility to corporations with respect to amounts deposited to pay redemption prices, permitting amounts not claimed after a period of not less than two years, as specified by the corporation, to be repaid to the corporation.[58] The statute previously called for an absolute five-year holding period.[59]

Reflecting a number of changes throughout the Virginia Act, as amended by the 2005 Amendments to accommodate limited liability companies, the Virginia Act now states explicitly that shares of a Virginia corporation held of record by a "limited liability

53. VA. CODE ANN. § 13.1-660.1(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.08(a).

54. VA. CODE ANN. § 13.1-660.1(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.08(b).

55. VA. CODE ANN. § 13.1-660.1(C) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.08(d). In the absence of an announcement, the polls are deemed to open when the meeting begins and to close when the meeting is adjourned. *See* VA. CODE ANN. § 13.1-660.1(C) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.08(d).

56. *See* VA. CODE ANN. § 13.1-662(C) (Repl. Vol. 1999).

57. *Id.* § 13.1-662(C) (Cum. Supp. 2005).

58. *See id.*

59. *See id.* (Repl. Vol. 1999).

company may be voted as the articles of organization or an operating agreement may prescribe, or in the absence of any such provision, as the managers, or if there are no managers, [as] the members . . . determine."[60]

The Virginia Act, as amended by the 2005 Amendments, also makes clear that shareholders who have made a written demand for a special meeting of shareholders, as permitted by the statute under certain circumstances, may revoke that demand in a writing, including an electronic transmission, that the corporation receives prior to its receipt of a sufficient number of demands to require the holding of the special meeting.[61] This section, which is based on a Model Act provision, enables the corporation that negotiates with a shareholder or group of shareholders to withdraw a demand for a special meeting to achieve certainty about the withdrawal.

The 2005 Amendments contain a similar provision that establishes certainty with respect to written shareholder consents. The Virginia Act has long permitted shareholder action without a meeting through unanimous written consent[62] or, if authorized in the articles of incorporation of a corporation other than a public corporation, by written consent of shareholders with that number of votes required to approve the action at a meeting at which all the shareholders entitled to vote are present and voting.[63] The Virginia Act, as amended by the 2005 Amendments, now provides that such written consents are only effective if shareholders with a sufficient number of shares to take the corporate action have delivered an executed written consent to the corporation within 120 days after the earliest execution date of a consent delivered to the corporation with respect to such action.[64]

VI. DIRECTOR MATTERS

Since its initial adoption in 1985, the Virginia Act has established, through its statutory articulation of directors' duties, its

60. *Id.* § 13.1-662(G) (Cum. Supp. 2005).
61. *Id.* § 13.1-655(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 7.02(a)(2).
62. VA. CODE ANN. § 13.1-657(A)(1) (Repl. Vol. 1999).
63. *Id.* § 13.1-657(A)(2) (Repl. Vol. 1999).
64. *Id.* § 13.1-657(B) (Cum. Supp. 2005).

expansive indemnification authorization, and its clear derivative litigation procedures, a uniquely positive environment for corporate directors. The 2005 Amendments continue this tradition of providing directors clear guidance with respect to their statutory obligations and procedural tools to meet those obligations.

Many of the statutory protections afforded to shareholders of Virginia corporations rest on decision making by directors whose judgment is unaffected by personal interests, but the Virginia Act has not used consistent language in referring to these independent or disinterested directors. Before the 2005 Amendments, a conflict of interests transaction was not voidable solely because of a director's interest if approved by a committee of directors with no direct or indirect personal interest in the transaction and to whom the material facts of the transaction and the director's interest were disclosed.[65] This section included a brief definition of "indirect personal interest" that was applied nowhere else in the Virginia Act.[66] A court was required to dismiss a derivative proceeding in the right of a corporation if a committee of independent directors, properly appointed, reviewed and evaluated the allegations made in the complaint and determined in good faith that maintaining the proceeding was not in the best interests of the corporation.[67] A committee of directors, made up of members that are "not at the time parties to the proceeding," was authorized to make the determination that the corporation might indemnify an officer or director made a party to the proceeding.[68]

The 2005 Amendments now include a detailed definition of "disinterested director"[69] and revisions to each of these statutory sections of the Virginia Act that incorporate the new, consistent terminology.[70] The new definition of "disinterested director" does not change existing law, but provides greater specificity and certainty for directors and those advising them, as well as consistency among the various sections calling for disinterested director action.

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65. *Id.* § 13.1-691(A), (C) (Repl. Vol. 1999).
66. *See id.* § 13.1-691(B) (Repl. Vol. 1999).
67. *Id.* § 13.1-672.4(A)-(B) (Repl. Vol. 1999).
68. *Id.* § 13.1-701(B) (Repl. Vol. 1999).
69. *Id.* § 13.1-603 (Cum. Supp. 2005).
70. *Id.* §§ 13.1-672.4, -691, -699, -701 (Cum. Supp. 2005).

The Virginia Act, as amended by the 2005 Amendments, now defines "disinterested director" as a director who, at the time of the relevant board action, does not have *either* a financial interest in the matter being acted on, or a familial, financial, professional, employment, or other relationship with a person who has a financial interest in the matter being acted upon, if either of those interests could reasonably be expected to have an adverse effect on the objectivity of the director participating in the action.[71]

Furthermore, a director acting in an indemnification matter is only disinterested if he or she is *not* a party to the proceeding.[72] The new definition of "disinterested director" also lists the following specific circumstances that do not by themselves prevent a director from qualifying as disinterested: (i) nomination or election of the director by a person acting alone or in concert with others, who is interested in the matter being acted on; (ii) service on the board of another corporation, of which an interested person is also a member; or (iii) with respect to a decision regarding the pursuit of a derivative proceeding, status as a named defendant, as a director against whom a demand is made, or as a director who approved the action that is the subject of the derivative litigation.[73]

The Virginia Act, as amended by the 2005 Amendments, now creates a safe harbor pursuant to which a director may pursue a business opportunity without becoming subject to equitable relief or a damages award based on a claim that the opportunity first should have been offered to the corporation.[74] To take advantage of this safe harbor, the director must notify the corporation of the opportunity before assuming any legal obligations with respect to the opportunity.[75] Additionally, the board or a committee of the board must disclaim the corporation's interest in the opportunity using the same process they would to consider a conflict of interests transaction[76] or the shareholders must disclaim the corpora-

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71. *Id.* § 13.1-603 (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 8.50(3).

72. VA. CODE. ANN. § 13.1-603 (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 8.50 (3).

73. VA. CODE. ANN. § 13.1-603 (Cum. Supp. 2005).

74. *Id.* § 13.1-691.1(A) (Cum. Supp. 2005).

75. *Id.*

76. *Id.* § 13.1-691.1(A)(1) (Cum. Supp. 2005).

tion's interest in the opportunity using the same process they would use to consider a conflict of interests transaction.[77]

In a lawsuit against a director who pursues a business opportunity without taking advantage of the safe harbor, the failure to use the safe harbor does not create an inference that the business opportunity should have been presented to the corporation first, nor does it shift from the plaintiff the burden of proving that the director breached his or her statutory duty to the corporation when he or she pursued the opportunity.[78]

The 2005 Amendments contain several revisions to the provisions on liability for unlawful distributions, some of which are clarifications but one of which is a procedural addition. The first revision clarifies that a director who approved an unlawful distribution is personally liable to the corporation and its creditors for any unlawful amounts if the party asserting the liability demonstrates that in approving the distribution, the director acted in violation of his or her statutory duty to exercise his or her good faith business judgment of the best interests of the corporation.[79] The second revision clarifies that a director held liable for an unlawful distribution is entitled to contribution from other directors who could be held liable for the unlawful distribution under this statute and recoupment from the shareholders who received the unlawful distribution.[80] The final revision, which is procedural, provides that a claim for contribution or recoupment is barred unless the claim is commenced within one year after the director's liability for the unlawful distribution is finally adjudicated.[81]

In addition, the 2005 Amendments include several clarifications, which provide straightforward answers to procedural questions that have been raised periodically about Virginia corporations. The Virginia Act, as amended by the 2005 Amendments, now provides expressly that directors may not vote by proxy unless, for non-public corporations, otherwise provided for in a shareholders' agreement.[82] The express prohibition on proxy voting by directors reflects the long-standing view of Virginia practi-

77. *Id.* § 13.1-691.1(A)(2) (Cum. Supp. 2005).
78. *Id.* § 13.1-691.1(B) (Cum. Supp. 2005).
79. *Id.* § 13.1-692(A) (Cum. Supp. 2005).
80. *Id.* § 13.1-692(B) (Cum. Supp. 2005).
81. *Id.* § 13.1-692(D) (Cum. Supp. 2005).
82. *Id.* § 13.1-688(E) (Cum. Supp. 2005).

tioners and is consistent with the duty imposed by the Virginia Act on directors to act in accordance with their good faith business judgment of the best interests of the corporation.[83]

The Sarbanes-Oxley Act of 2002 and related SEC and securities exchange regulations have created significant new responsibilities and qualifications for committees of the board of directors of public corporations.[84] The authorization of the creation of such committees now includes a very useful provision that permits the board to appoint alternate committee members to serve in the event a committee member is absent or disqualified from service.[85] Further, unless the articles of incorporation, the bylaws, or the resolutions creating the committee prohibit such action, a committee member or members not absent from a meeting or disqualified from voting may vote unanimously to appoint a director to act in place of an absent or disqualified committee member.[86]

In a new provision, based on a Model Act provision, the Virginia Act, as amended by the 2005 Amendments, now provides expressly that a director of a corporation is entitled to inspect the books and records of the corporation at any reasonable time to the extent such inspection is reasonably related to the performance of the director's duties, including duties as a committee member.[87] The director, however, is not entitled to inspect the books and records for any purpose or in any manner that would violate the director's duties to the corporation.[88] If the corporation refuses to give the director inspection rights, the circuit court of the city or county in Virginia in which the corporation's principal office is located, or in which the corporation's registered office is located if the principal office is outside of Virginia, may order the corporation to permit inspection and copying upon the director's application, unless the corporation establishes that the director is not entitled to inspection rights.[89]

83. *Id.* § 13.1-690(A) (Repl. Vol. 1999 & Cum. Supp. 2005).

84. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116. Stat. 745 (codified in scattered sections of 11 U.S.C., 15 U.S.C., 18 U.S.C., and 28 U.S.C.).

85. VA. CODE ANN. § 13.1-689(F) (Cum. Supp. 2005).

86. *Id.*

87. *Id.* § 13.1-773.1(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 16.05(a).

88. VA. CODE ANN. § 13.1-773.1(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 16.05(a).

89. VA. CODE ANN. § 13.1-773.1(B) (Cum. Supp. 2005).

Furthermore, the court is required to address the director's application on an expedited basis.[90] In its order requiring inspection rights, the court may include requirements designed to protect the corporation from undue expense or burden; prohibit the director from using information gained in the inspection in a manner that would violate the director's duty to the corporation; or require the corporation to reimburse the director for the director's reasonable costs, including reasonable counsel fees, incurred in connection with the director's application, if the director establishes that the corporation's refusal of inspection rights was not reasonably based on a doubt that the director was entitled to such rights.[91]

Before adoption of this provision, a director of a Virginia corporation probably would have been able to argue successfully that the performance of his or her statutory duties required that he or she have the right to inspect the corporation's books and records. The new provision makes enforcement of this right much simpler.

VII. INDEMNIFICATION AND LIMITS ON LIABILITY

The provisions of the Virginia Act that address indemnification of and limits on director and officer liability are critical to the ability of Virginia corporations to attract and retain qualified persons to serve in those capacities. The 2005 Amendments contain several significant amendments to those provisions. Directors or officers who become parties to litigation usually look to the corporation they serve to advance their counsel fees and litigation expenses. The Virginia Act originally permitted a corporation to advance such expenses if the person seeking the advance furnishes the corporation a written statement of his or her good faith belief that he or she has met the applicable standard of conduct for indemnification; the person seeking the advance furnishes the corporation a written undertaking to repay any funds advanced if it is ultimately determined that the person did not meet the relevant standard of conduct; and the board, a board committee, or a properly appointed counsel determined that the facts then known would not preclude indemnification.[92]

90. *Id.*
91. *Id.* § 13.1-773.1(C) (Cum. Supp. 2005).
92. *Id.* § 13.1-699(A) (Repl. Vol. 1999).

The 2005 Amendments eliminate the third requirement of a preliminary determination of the facts of litigation before an advance.[93] This change will relieve corporations of the burden of attempting to make this determination at a premature stage of the litigation. With complex, extended litigation, this requirement could be especially burdensome because the determination would have to be made for each advance.

The 2005 Amendments also include two small, but significant revisions to Virginia Code section 13.1-704, which governs the application of the provisions on indemnification. The substantive and procedural limitations in the Virginia Act on the authorization for indemnification reflect the underlying conflict of interest when a director or officer seeks indemnity as a party to a proceeding, including a proceeding brought by the corporation itself. The 2005 Amendments revised Virginia Code section 13.1-704 to reflect the reduced concern raised when the director or officer is a witness in, and not a party to, litigation, or when an employee or agent of the corporation who is not a director or officer is involved. These changes should assist corporations in responding to the complexities of modern litigation. Accordingly, Virginia Code section 13.1-704, as amended by the 2005 Amendments, now provides that the Virginia Act provisions on indemnification do not limit, substantively or procedurally, the corporation's ability to pay or reimburse a director's or officer's expenses incurred in connection with a proceeding in which he or she is a witness but not a party[94] and do not limit the corporation's ability to indemnify, advance expenses to, or provide insurance for an employee or agent who is not a director or officer.[95]

Previously, under the Virginia Act, the indemnification of employees and agents was subject to the same substantive limitations as the indemnification of directors and officers—the requirement that the employee or agent had met the requisite standard of conduct.[96]

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93. *See id.* (Cum. Supp. 2005).
94. *Id.* § 13.1-704(D) (Cum. Supp. 2005).
95. *Id.* § 13.1-704(E) (Cum. Supp. 2005).
96. *See id.* § 13.1-702 (Repl. Vol. 1999).

VIII. AMENDMENTS TO ARTICLES AND BYLAWS

The 2005 Amendments contain several significant revisions to the manner in which a corporation may effect amendments to its articles of incorporation and bylaws. First, if a corporation has only one class of shares outstanding, the board of directors acting alone may now adopt an amendment to increase the number of authorized shares of the class as necessary to accommodate the issuance of shares as a share dividend.[97] The Virginia Act already permitted the board of directors to adopt an amendment to change each issued and unissued authorized share of the sole outstanding class of shares into a greater number of whole shares.[98] With the revision to Virginia Code section 13.1-706, as amended by the 2005 Amendments, the board acting alone can effect a stock split either through an amendment changing each issued and unissued authorized share into a greater number of shares or through a stock dividend.[99]

The rules in the Virginia Act governing voting rights by separate voting groups are complex. One of the 2005 Amendments simplifies those rules in two respects. Under prior law, the outstanding shares of a class were entitled to vote as a separate group on an amendment to articles of incorporation that created a new class of shares, or changed a class of shares with subordinate or inferior rights into a class of shares, with rights to distributions or upon dissolution that are prior, superior, or substantially equal to the shares of the class.[100] The 2005 Amendments provide for a vote of a class of shares as a separate voting group *only* on an amendment that creates a class of shares, or changes a class with inferior rights into a class of shares, with rights to distribution or upon dissolution that are prior or superior to the shares of the class.[101] Similarly, a class of shares is now entitled to vote as a separate voting group on an amendment to the articles of incorporation that increases the rights, preferences, or number of authorized shares of any class that, after giving effect to the amendment, has rights with respect to distributions or dissolu-

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97. *Id.* § 13.1-706(3)(b) (Cum. Supp. 2005).
98. *Id.* § 13.1-706(3) (Repl. Vol. 1999).
99. *See id.* (Cum. Supp. 2005).
100. *Id.* § 13.1-708(A) (Repl. Vol. 1999).
101. *Id.* § 13.1-708(A)(6) (Cum. Supp. 2005).

tion that are prior or superior to the shares of the class.[102] More importantly, the 2005 Amendments now permit a corporation in its articles of incorporation to take away, in whole or in part, the separate voting group rights created by the Virginia Act.[103]

The Virginia Act, as amended by the 2005 Amendments, also now expressly provides that shareholders, in adopting a bylaw that increases voting or quorum requirements for directors, may expressly permit subsequent amendment to the bylaw by directors.[104] In the absence of express authorization, only shareholders may amend such a bylaw.[105] The Virginia Act previously did not permit shareholders to authorize such a director-adopted amendment regarding quorum and voting requirements.[106]

IX. MERGERS AND SHARE EXCHANGES

The changes by the 2005 Amendments to Article 12, Mergers and Share Exchanges, of the Virginia Act, appear to be voluminous; in fact, although some of the changes are significant, many merely provide greater clarity or conformity to the Model Act.[107] Article 12 of the Virginia Act, as amended by the 2005 Amendments, now begins with a series of definitions that serve as a foundation for the most significant changes to the Article, namely the provisions that permit mergers and share exchanges involving a domestic corporation and a domestic or foreign corporation *or* any "eligible entity."[108] This definition affords businesses and not-for-profit entities great flexibility and permits mergers and share exchanges involving a corporation and a limited liability company, a partnership, or other form of unincorporated entity. An eligible entity is defined as "a domestic or foreign unincorporated entity or a domestic or foreign nonstock corporation."[109] The

102. *Id.*

103. *See id.* § 13.1-708(A) (Cum. Supp. 2005).

104. *Id.* § 13.1-715(A) (Cum. Supp. 2005).

105. *Id.* § 13.1-715(A)(1) (Cum. Supp. 2005).

106. *See id.* § 13.1-715(A) (Repl. Vol. 1999).

107. For example, the 2005 Amendments move the provisions regarding amendments to a plan of merger or share exchange after shareholder approval from the sections on shareholders approval to the sections on plan requirements. *See* Act of Mar. 26, 2005, ch. 765, 2005 Va. Acts 1219 (codified as amended at VA. CODE ANN. §§ 13.1-716(E), -717(F) (Cum. Supp. 2005)).

108. *See* VA. CODE ANN. § 13.1-715.1 (Cum. Supp. 2005).

109. *Id.* § 13.1-603 (Cum. Supp. 2005). Unincorporated entities are restricted to partnerships, limited liability companies, limited partnerships, and business trusts. *Id.*

merger provisions now specifically permit a merger between a domestic corporation and one or more domestic or foreign corporations or eligible entities, or a merger of two or more foreign corporations or domestic or foreign eligible entities into a new domestic corporation.[110] A foreign corporation or a foreign eligible entity may be a party to a merger under these provisions only if the merger is permitted by the laws of the jurisdiction in which the foreign corporation or eligible entity is domiciled.[111]

The 2005 Amendments also expand the required features of a plan of merger to accommodate mergers involving eligible entities. These changes do not alter the fundamental merger process but contemplate the conversion of shares into so-called "eligible interests," such as a limited liability company or partnership interests and vice versa.[112]

In a series of parallel changes, the Virginia Act, as amended by the 2005 Amendments, now makes clear that pursuant to a plan of share exchange:

> [a] domestic corporation may acquire all of the shares of one or more classes or series of shares of another domestic or foreign corporation, or all of the eligible interests [such as limited liability company or partnership interests] of one or more classes or series of eligible interests of a domestic or foreign eligible entity, as well as rights to acquire any such shares or eligible interests, in exchange for shares or other securities, eligible interests, . . . cash, other property or any combination [thereof]; or[113]
>
> [another domestic or foreign corporation or eligible entity may acquire a]ll of the shares of one or more classes or series of shares of a domestic corporation . . . in exchange for shares or other securities, eligible interests, . . . cash, other property or any combination [thereof].[114]

A foreign corporation or a foreign eligible entity may be a party to a share exchange under these provisions only if the share exchange is permitted by the laws of the jurisdiction in which the foreign corporation or eligible entity is domiciled.[115] If the statute governing the internal affairs of a domestic eligible entity—now

110. *Id.* § 13.1-716(A) (Cum. Supp. 2005).
111. *Id.* § 13.1-716(B) (Cum. Supp. 2005).
112. *Id.* § 13.1-716(C), (E) (Cum. Supp. 2005).
113. *Id.* § 13.1-717(A)(1) (Cum. Supp. 2005).
114. *Id.* § 13.1-717(A)(2) (Cum. Supp. 2005).
115. *Id.* § 13.1-717(B) (Cum. Supp. 2005).

defined by the 2005 Amendments as the "organic law" of an entity[116]—does not establish procedures for approving a share exchange, the Virginia Act, as amended by the 2005 Amendments, now expressly permits a plan of share exchange to be approved and the share exchange effectuated in accordance with the procedures for mergers.[117] As with mergers, the 2005 Amendments expand the required features of a plan of share exchange to accommodate share exchanges involving eligible entities.[118]

The Virginia Act, as amended by the 2005 Amendments, has also expanded the notice requirements with respect to obtaining necessary shareholder approvals for a plan of merger or share exchange. The Virginia Act previously required that the corporation seeking approval at a shareholders' meeting notify each shareholder, whether or not the shareholder is eligible to vote, of the meeting, state that a purpose for the meeting is to consider the plan of merger or share exchange, and provide a copy or summary of the plan.[119] The 2005 Amendments preserve these requirements and add the following additional ones:

> [i]f the corporation is to be merged into an existing domestic or foreign corporation or eligible entity and its shareholders are to receive capital stock or other interests in the surviving corporation or eligible entity, the notice shall also include or be accompanied by a copy or summary of the articles of incorporation or organic document of that corporation or eligible entity;[120] [or]
>
> [i]f the corporation is to be merged into a domestic or foreign corporation or eligible entity that is to be created pursuant to the merger and its shareholders are to receive capital stock or other interests in the surviving corporation or eligible entity, the notice shall include or be accompanied by a copy or a summary of the articles of incorporation or organic document of the new domestic or foreign corporation or eligible entity.[121]

The 2005 Amendments also significantly restate the requirements for a parent-subsidiary merger, but, as is the case else-

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116. *See id.* § 13.1-603 (Cum. Supp. 2005).

117. *Id.* § 13.1-717(C) (Cum. Supp. 2005).

118. *See id.* § 13.1-717(D) (Cum. Supp. 2005).

119. *Id.* § 13.1-718(D) (Repl. Vol. 1999); MODEL BUS. CORP. ACT § 11.04(d).

120. VA. CODE ANN. § 13.1-718(C) (Cum. Supp. 2005). An "organic document" is a document that is "filed of public record to create an unincorporated entity." *Id.* § 13.1-603 (Cum. Supp. 2005).

121. *Id.* § 13.1-718(C) (Cum. Supp. 2005).

where in Article 12 of the Virginia Act, the changes are more formal than substantive. In a slight adjustment to the language of the prior law, the special rules for a parent-subsidiary merger now apply to a transaction between a domestic parent corporation and a subsidiary of which the parent owns shares that possess at least ninety percent of the voting power[122] of each class and series of outstanding shares of the subsidiary that have voting power.[123] A domestic parent corporation may merge such a subsidiary into itself, it may merge itself into the subsidiary, or it may merge the subsidiary into a sibling corporation, all without the approval of the board of directors or the shareholders of the subsidiary unless the articles of incorporation or the laws of the domicile of a foreign subsidiary provide otherwise.[124] The authorization of sibling mergers is new to the Virginia Act, as amended by the 2005 Amendments, and should provide some valuable flexibility to practitioners. The elimination of the need for approval of the plan of merger by the board of directors of the subsidiary is also new. This change should be very helpful to boards of controlled corporations by removing from them the burden of either assisting in effecting a merger desired by the controlling parent corporation or attempting to prevent its effectuation.

If no approval of the subsidiary's shareholders is required, the parent corporation must notify each of the subsidiary's shareholders of the effectiveness of the merger within ten days after the merger becomes effective.[125] Except for these particular requirements, parent-subsidiary mergers are governed by those provisions of the Virginia Act, as amended by the 2005 Amendments, which apply to mergers generally.[126]

The 2005 Amendments expand the requirements for filing articles of merger or articles of share exchange as necessary to accommodate mergers and share exchanges involving eligible entities, as well as corporations.[127] The 2005 Amendments also state

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122. *See id.* § 13.1-603 (Cum. Supp. 2005) (defining voting power as "the current power to vote in the election of directors").

123. *Id.* § 13.1-719(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.05(a).

124. VA. CODE ANN. § 13.1-719(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.05(a).

125. VA. CODE ANN. § 13.1-719(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT. § 11.05(b).

126. VA. CODE ANN. § 13.1-719(C) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.05(c).

127. *See* VA. CODE ANN. § 13.1-720(A) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT §

explicitly what has been a longstanding filing practice: the surviving entity in a merger or the acquiring corporation in a share exchange must file the appropriate articles with the SCC.[128]

The 2005 Amendments contain a more detailed listing of the effects of a merger or share exchange than the Virginia Act previously included. The new listing, which closely follows the Model Act, probably does not significantly change existing law, but it does provide the following useful clarifications: when a merger becomes effective, the survivor of the merger continues or commences its existence;[129] the separate existence of each corporation or eligible entity that is merged into the survivor ceases;[130] property owned by each corporation or eligible entity that merges into the survivor vests in the survivor without reversion or impairment (*except that* contract rights of the nonsurviving entities do not vest in the survivor to the extent that assignment of those rights would violate a contractual prohibition or assignment by operation of law);[131] liabilities of each corporation or eligible entity that merges into the survivor vests in the survivor;[132] the name of the survivor may, but need not, be substituted for the name of any nonsurviving entity in a pending proceeding;[133] the articles of incorporation or organic document of any pre-existing survivor are amended as provided by the plan of merger;[134] the articles of incorporation or organic document of any newly created survivor becomes effective;[135] and all share or interest conversions to be effected under the plan of merger are effected and former holders of such shares or interests are entitled to any such rights afforded them by the plan of merger, or the Virginia Act or applicable organic law.[136] Similarly, when a share exchange becomes effective, the shares of each corporation that are to be exchanged are entitled only to the rights afforded to them by the plan of

11.06(a).

128. VA. CODE ANN. § 13.1-720(B) (Cum. Supp. 2005); *cf.* MODEL BUS. CORP. ACT § 11.06(b).

129. VA. CODE ANN. § 13.1-721(A)(1) (Cum. Supp. 2005).

130. *Id.* § 13.1-721(A)(2) (Cum. Supp. 2005).

131. *Id.* § 13.1-721(A)(3) (Cum. Supp. 2005).

132. *Id.* § 13.1-721(A)(4) (Cum. Supp. 2005).

133. *Id.* § 13.1-721(A)(5) (Cum. Supp. 2005).

134. *Id.* § 13.1-721(A)(6) (Cum. Supp. 2005).

135. *Id.* § 13.1-721(A)(7) (Cum. Supp. 2005).

136. *Id.* § 13.1-721(A)(8) (Cum. Supp. 2005).

share exchange or the Virginia Act, as amended by the 2005 Amendments.[137]

Upon effectiveness of a merger, under the Virginia Act, as amended by the 2005 Amendments, a foreign corporation or foreign eligible entity that is a survivor of that merger is deemed to appoint the clerk of the SCC as its agent for service of process in connection with any appraisal rights proceeding and agree that it will pay any amounts to which shareholders are entitled in any appraisal rights proceeding.[138]

X. DISPOSITION OF ASSETS

Determining whether shareholder approval is required when a Virginia corporation sells a significant portion of its assets has traditionally been a perplexing question for practitioners. There had been no well-defined line under Virginia law between transactions that required shareholder approval and those that did not. The 2005 Amendments, following closely the Model Act, provide significantly more detail, and therefore certainty, than prior versions of the Virginia Act. The shareholder approval requirements for asset sales were intended to give shareholders a voice in corporate actions—such as mergers, share exchanges, and amendments to articles of incorporation—that change the fundamental nature of the corporate enterprise. The 2005 Amendments reflect that underlying principle by adopting from the Model Act the concept of "significant continuing business activity" as the decisive analytical tool for determining when shareholder approval is required.[139]

The Virginia Act, as amended by the 2005 Amendments, begins by providing expressly that, unless the articles of incorporation provide otherwise, *no* shareholder approval is necessary for the following four categories of dispositions, of which only the fourth is new:

1) sale, lease, exchange, or other disposition of any or all of the corporation's assets in the usual and regular course of business;[140]

137. *Id.* § 13.1-721(B) (Cum. Supp. 2005).
138. *Id.* § 13.1-721(C) (Cum. Supp. 2005).
139. *See* MODEL BUS. CORP. ACT § 12.02(a).
140. VA. CODE ANN. § 13.1-723(1) (Cum. Supp. 2005).

2) mortgage, pledge, or dedication to repayment, with or without recourse, or encumbrance of any or all of the corporation's assets, whether or not in the usual and regular course of business;[141]

3) transfer of any or all of the corporation's assets to one or more wholly owned entities, regardless of the corporate form of such entities;[142] or

4) distribution of assets pro rata to the holders of one or more classes or series of the corporation's shares.[143]

Any sale, lease, exchange, or other disposition of the corporation's assets, other than one described above, "requires approval of the corporation's shareholders if the disposition would leave the corporation without a significant continuing business activity."[144]

Unless the articles of incorporation or a shareholder-approved bylaw require otherwise, the corporation will be deemed conclusively to have retained a "significant continuing business activity" if the corporation retains a business activity that represented at least twenty percent of the corporation's total assets at the end of the most recently completed fiscal year *and* twenty percent of either: (i) income from continuing operations before taxes *or* (ii) revenue from continuing operations for that fiscal year, in each case of the corporation and any of its subsidiaries that are consolidated for federal income tax purposes.[145]

For purposes of these determinations, the assets of a consolidated subsidiary are deemed assets of the parent corporation.[146] The 2005 Amendments include several clarifying revisions to the process for obtaining shareholder approval for an asset disposition, but no substantive changes.[147]

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141. *Id.* § 13.1-723(2) (Cum. Supp. 2005).

142. *Id.* § 13.1-723(3) (Cum. Supp. 2005). Under prior versions of the Virginia Act, public corporations could not take advantage of this provision. *See id.* (Repl. Vol. 1999). The 2005 Amendments remove that restriction.

143. *Id.* § 13.1-723(4) (Cum. Supp. 2005).

144. *Id.* § 13.1-724(A) (Cum. Supp. 2005).

145. *Id.*

146. *Id.* § 13.1-724(H) (Cum. Supp. 2005).

147. *See id.* § 13.1-724(B)-(F) (Cum. Supp. 2005).

XI. APPRAISAL RIGHTS

Article 15, Appraisal Rights, of the Virginia Act, as amended by the 2005 Amendments, has undergone a thorough revision, including a change to its title, which formerly was "Dissenters' Rights," and now closely conforms to the Model Act. Several of the changes are significant, but many of them are merely technical changes. All of the revisions are designed to guarantee that appraisal rights are available to those shareholders, and only those shareholders, who need such rights—namely those shareholders whose investments have been rendered illiquid in a transaction with which they do not agree.[148]

A shareholder is entitled to appraisal rights in the event of the following corporate actions:

1) consummation of a merger to which the corporation is a party if shareholder approval is required by Virginia Code section 13.1-718, the shareholder is entitled to vote on the merger, and the shareholder's shares do *not* remain outstanding after the consummation of the merger, or if the corporation is a party in a parent-subsidiary merger under Virginia Code section 13.1-719;[149]

2) consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares are being acquired if shareholder approval is required, the shareholder is entitled to vote, and the shareholder's shares are exchanged;[150]

3) consummation of a disposition of assets if the shareholder is entitled to vote;[151]

4) a reverse stock-split that reduces the shareholder's holdings to a fraction of a share that the corporation has the right or obligation to repurchase;[152] or

5) any other articles of amendment, merger, share exchange, or asset disposition, if appraisal rights are granted in connec-

148. *See id.* §§ 13.1-729 to -741 (Cum. Supp. 2005).
149. *Id.* § 13.1-730(A)(1) (Cum. Supp. 2005).
150. *Id.* § 13.1-730(A)(2) (Cum. Supp. 2005).
151. *Id.* § 13.1-730(A)(3) (Cum. Supp. 2005).
152. *Id.* § 13.1-730(A)(4) (Cum. Supp. 2005).

tion with such action by the articles of incorporation, bylaws, or board resolution.[153]

In accordance with the basic goal of appraisal rights to protect shareholders from illiquidity, the Virginia Act, albeit with the revised language set forth in the 2005 Amendments, preserves the so-called "Wall Street exception" from appraisal rights: shareholders facing a corporate action that would entitle them to appraisal rights nevertheless are *not* entitled to such rights if they hold shares of a class or series listed on the New York Stock Exchange or the American Stock Exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc.[154] Shareholders are also not entitled to appraisal rights with respect to a class or series of shares with at least 2000 holders and a market value of at least $20 million, exclusive of the value of such securities held by corporate insiders.[155]

The corporation must also determine whether appraisal rights are available as of the record date to determine the shareholders entitled to vote or the shareholders' meeting with respect to the corporate action giving rise to the appraisal rights, or the day before the effective date of the corporate action if there is no shareholders' meeting.[156]

The Wall Street exception is not applicable, and shareholders *are* entitled to appraisal rights, if they otherwise qualify and are required by the corporate action to accept for their shares anything other than cash, shares, or other securities that do fit the Wall Street exception.[157] The Wall Street exception also is not applicable when the corporate action involves certain transactions involving current or former officers and significant shareholders of the corporation.[158] This provision is new to the Virginia Act, as amended by the 2005 Amendments, and provides an innovative new protection for shareholders of Virginia public corporations against self-dealing by officers and major shareholders.

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153. *Id.* § 13.1-730(A)(5) (Cum. Supp. 2005).

154. *Id.* § 13.1-730(B)(1)(a) (Cum. Supp. 2005).

155. *Id.* § 13.1-730(B)(1)(b) (Cum. Supp. 2005). The statute defines such insiders as the corporation's subsidiaries, senior executive officers, directors, and beneficial holders of more than ten percent of such shares. *Id.*

156. *Id.* § 13.1-730(B)(2) (Cum. Supp. 2005).

157. *Id.* § 13.1-730(B)(3) (Cum. Supp. 2005).

158. *Id.* § 13.1-730(B)(4) (Cum. Supp. 2005).

The 2005 Amendments also provide that the articles of incorporation, as originally filed, or pursuant to a subsequent amendment, may limit or eliminate the rights of any class or series of preferred stock to appraisal rights, but any amendment adopted after issuance of shares of such class or series may not eliminate the appraisal rights of such shares—or other shares of that class issued upon exercise of any conversion or exchange right existing before the effectiveness of the amendment—with respect to corporate actions affording appraisal rights until one year following the effectiveness of the amendment.[159]

Appraisal rights entitle the qualified shareholder who satisfies the procedural requirements to receive a determination and payment of fair value for his or her shares.[160] The 2005 Amendments define "fair value" as the value of the shares determined immediately upon the effectiveness of the corporate action, using customary and current valuation concepts generally employed for similar enterprises in the context of the action, and "[w]ithout discounting for lack of marketability or minority status except, if appropriate," for certain articles of amendment.[161]

The procedures for obtaining appraisal rights have been substantially restated in the 2005 Amendments, with the result that they are clearer and more straightforward for both shareholders and corporations.

XII. DISSOLUTION

Prior to the 2005 Amendments, the Virginia Act did not provide a vehicle for a dissolving corporation to deal with claims that did not qualify as "known claims" against the corporation. The 2005 Amendments now include a provision that allows a dissolving corporation to publish a notice of dissolution and request for presentment of claims in a newspaper of general circulation in the city or county where the principal office is located, or if none in the Commonwealth, where its registered office is or was last located.[162] Thereafter, any such claim is barred unless the claim-

159. *Id.* § 13.1-730(C) (Cum. Supp. 2005).
160. *Id.* § 13.1-730(A) (Cum. Supp. 2005).
161. *Id.* § 13.1-729 (Cum. Supp. 2005).
162. *Id.* § 13.1-746.1 (Cum. Supp. 2005).

ant commences a proceeding within the earlier of the applicable statute of limitations or three years after the publication date.[163] The types of claims subject to this section include: (i) known claims for which the claimant did not receive the known claims notice under Virginia Code section 13.1-746, as amended by the 2005 Amendments; (ii) contingent claims; (iii) claims that are based on events occurring after the effective date of the dissolution; and (iv) claims that became mature more than sixty days after delivery of the known claims notice under Virginia Code section 13.1-746, as amended by the 2005 Amendments.[164]

The 2005 Amendments also establish a procedure for the dissolving corporation that has published such a newspaper notice to apply to the circuit court where the "principal office [is located], or, if none in the Commonwealth, its registered office, is or was last located for a determination of the amount and form of security to be provided for payment of claims that are contingent or have not been made known" to the corporation or that are based on post-dissolution events but are reasonably estimated to arise after the effective date of dissolution.[165] Within ten days thereafter, the corporation must give notice of the proceeding to any holder of a contingent claim shown on the corporation's records, and the court may appoint a guardian ad litem for unknown claimants.[166]

The corporation, by making provision for the security ordered by the court, satisfies its obligation for any claims covered by the order—other than any claim that could be resolved as a known claim under Virginia Code section 13.1-746, as amended by the 2005 Amendments—and the affected claimants have no recourse against any shareholder with respect to assets received in liquidation.[167]

In addition, the 2005 Amendments include protection for the directors of a dissolving corporation that has disposed of claims in the manner provided for in the dissolution article. Virginia Code section 13.1-746.3, as amended by the 2005 Amendments, obligates directors of the dissolving corporation to apply the corpora-

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163. *Id.* § 13.1-746.1(C) (Cum. Supp. 2005).
164. *See id.*
165. *Id.* § 13.1-746.2(A) (Cum. Supp. 2005).
166. *Id.* § 13.1-746.2(B)-(C) (Cum. Supp. 2005).
167. *Id.* § 13.1-746.2(D) (Cum. Supp. 2005).

tion's assets to discharge or "make reasonable provision" for the payment of claims and then to distribute any remaining assets to shareholders.[168] It then provides that directors will not be liable for breach of such section with respect to claims disposed of under the claims resolution sections of the dissolution article.[169]

The second major change provided for in the 2005 Amendments to the articles of dissolution is the creation of an alternative to court-ordered dissolution when the shareholders have reached an impasse.[170] In situations where the board of directors or the shareholders are deadlocked or those in control have acted in an illegal, oppressive, or fraudulent manner, court-ordered dissolution has been used to divide up businesses and shut down operations.[171] Forced dissolution, however, is a severe remedy that may cause hardship to employees and other interested persons besides the disputing shareholders.

An alternative, in the form of a buy-out at fair value, as determined by the court, of the shares of the shareholder who petitioned for court-ordered dissolution, was first adopted as a part of the Model Act in the late 1980s.[172] Shortly thereafter, consideration was given to adding the alternative to the Virginia Act, but no action was taken. After further reflection, as a part of the 2005 Amendments, Virginia became the twelfth jurisdiction to adopt the buy-out alternative.[173]

The buy-out alternative has been structured with the intent of providing a less Draconian remedy to a conflict among shareholders, without providing to any one shareholder a tactical advantage. Its existence needs to be considered carefully by any shareholder who is considering filing a petition seeking court-ordered dissolution. By filing the petition, the shareholder exposes himself or herself to the possibility that the sale of his or her shares may be on terms that may not be to his or her liking. As a result,

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168. *Id.* § 13.1-746.3(A) (Cum. Supp. 2005).

169. *Id.* § 13.1-746.3(B) (Cum. Supp. 2005).

170. *See id.* § 13.1-749.1 (Cum. Supp. 2005).

171. *See, e.g.*, Schultz v. Schultz, 250 Va. 121, 122–24, 458 S.E.2d 458, 459–60 (1995) (discussing both the dissolution court's prior holding that the corporation's board of directors was deadlocked and the dissolution court's subsequent order to dissolve the corporation).

172. *See* MODEL BUS. CORP. ACT § 14.34.

173. *See* Act of Mar. 26, 2005, ch. 765, 2005 Va. Acts 1219 (codified as amended at VA. CODE ANN. § 13.1-749.1 (Cum. Supp. 2005)).

shareholders may be less inclined to petition for court-ordered dissolution as a means of exerting pressure on the other shareholders. By giving the corporation first priority in exercising the buy-out alternative, the statute minimizes the likelihood that one or more remaining shareholders will use that option to the detriment of other remaining shareholders.

That result also is achieved by allowing all remaining shareholders to participate on a pro rata basis in any buy-out of the petitioning shareholder.[174] Once an election is made to acquire the petitioner's shares, it is irrevocable unless the court determines that it is equitable to set aside or modify the election.[175] The statute also leaves the question of fair price to the court without establishing any parameters, thereby allowing the court to take all relevant facts into consideration.[176] A closely held corporation concerned about the buy-out alternative can opt out of the statute in its articles of incorporation.[177]

Any election to exercise the buy-out alternative must be filed with the court within ninety days after the filing of the petition for dissolution, subject to the court's discretion to extend the filing deadline.[178] If the first election is filed by a shareholder, within ten days thereafter, the corporation must give all shareholders other than the petitioner notice of their right to join.[179] Shareholders must opt in within thirty days of the effective date of notice to them.[180] Shareholders who elect to participate become parties to the proceeding and participate in the purchase in proportion to their ownership of shares as of the date the first election was filed.[181]

The parties have sixty days from the filing of the first petition to agree on the terms of purchase of the petitioner's shares.[182] Thereafter, on application of any party, the court will stay the dissolution proceedings and determine fair value.[183] The court can

174. VA. CODE ANN. § 13.1-749.1(B) (Cum. Supp. 2005).
175. *Id.* § 13.1-749.1(A) (Cum. Supp. 2005).
176. *See id.* § 13.1-749.1(D) (Cum. Supp. 2005).
177. *Id.* § 13.1-749.1(A) (Cum. Supp. 2005).
178. *Id.* § 13.1-749.1(B) (Cum. Supp. 2005).
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.* § 13.1-749.1(C) (Cum. Supp. 2005).
183. *Id.* § 13.1-749.1(D) (Cum. Supp. 2005).

appoint an appraiser to appraise fair value of the petitioner's shares and may assess the costs as the equities may appear.[184]

Once fair value has been determined, the court will enter an order directing the purchase.[185] The court has discretion to provide for payment in installments, to provide security to assure payment, and if the shares are to be purchased by shareholders, to provide the allocation of shares among them, taking into account differing interests of holders of different classes of shares.[186] The statute directs the court to attempt to preserve the existing distribution of voting rights among holders of different classes of shares insofar as practicable.[187] The statute also allows an award of attorneys' fees, as well as expert fees, to the petitioning shareholder if the court determines that such petitioning shareholder had probable grounds for relief under the dissolution statute because of misconduct by the directors or those in control of the corporation.[188]

Any purchase of shares ordered by the court must be made within ten days of the entry of the order unless prior to that time the corporation files with the court notice of its intent to dissolve, in which event the articles of dissolution must be filed within fifty days thereafter.[189] With the filing of the articles, the purchase order has no further force and effect except that the court retains the right to order reimbursement of the petitioner's attorney and expert fees if the court believes the petitioner had probable grounds for relief because of misconduct.[190]

It will take a number of years to gain meaningful experience with the buy-out alternative. It may prove more difficult in situations where there are multiple classes of shares outstanding. But the additional flexibility that the statute provides in addressing situations where the owners of the enterprise are in conflict seems apparent. Surely a dissolution order should be used as a last resort when a practitioner is addressing a conflict among owners of an enterprise that is actively engaged in business and is not threatened with insolvency.

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184. *Id.*
185. *Id.* § 13.1-749.1(E) (Cum. Supp. 2005).
186. *Id.*
187. *Id.*
188. *Id.*
189. *Id.* § 13.1-749.1(G) (Cum. Supp. 2005).
190. *Id.*