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Annual Survey of Virginia Law: Business and Corporate Law

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BUSINESS AND CORPORATE LAW

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This article reviews recent developments in the law affecting Virginia businesses and corporations. The most significant development was the enactment by the 1985 session of the Virginia General Assembly of a completely revised Virginia Stock Corporation Act (the "Revised Act"),[1] which generally became effective January 1, 1986.[2] This article does not review the entire Revised Act,[3] but instead focuses on the powerful anti-takeover devices contained in the Revised Act[4] and all of the amendments pertaining to the Revised Act enacted by the 1986 session of the Virginia General Assembly.[5] Additionally, this article will review judicial developments, including the establishment by the Virginia Supreme Court of an exception to the employment-at-will doctrine in favor of the free exercise of shareholder rights,[6] and the repudiation by the United States Supreme Court of the "sale of business" exception to federal securities laws.[7]

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1. VA. CODE ANN. §§ 13.1-601 to -800 (Repl. Vol. 1985) [hereinafter REVISED ACT]. At the same time, the General Assembly also enacted a completely revised Virginia Nonstock Corporation Act, VA. CODE ANN. §§ 13.1-801 to -980 (Repl. Vol. 1985) [hereinafter REVISED ACT], which parallels the Revised Act. The Revised Act replaces in its entirety the prior Virginia Stock Corporation Act and Virginia Nonstock Corporation Act, VA. CODE ANN. §§ 13.1-1 to -300 (Repl. Vol. 1978) [hereinafter OLD ACT]. In addition, the General Assembly amended various related statutory provisions, most notably those dealing with corporate registration fees and franchise taxes. VA. CODE ANN. §§ 58.1-2204, -2208 (Cum. Supp. 1985).

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

3. For a more complete review of the Revised Act, see Murphy, *The New Virginia Stock Corporation Act: A Primer*, 20 U. RICH. L. REV. 67 (1985). *See also* VA. CODE COMM'N, REPORT ON THE REVISION OF CHAPTERS 1 AND 2 OF TITLE 13.1 OF THE CODE OF VIRGINIA, H. DOC. No. 13 (1985) [hereinafter COMMISSION REPORT] (containing commentaries of the Virginia Code Commission [hereinafter CODE COMMISSION COMMENTARY] and Virginia Bar Association/Virginia State Bar Title 13.1 Joint Bar Committee [hereinafter JOINT BAR COMMITTEE COMMENTARY]).

4. *See infra* notes 8-44 and accompanying text.

5. *See infra* notes 46-65 and accompanying text.

6. *See infra* notes 66-79 and accompanying text.

7. *See infra* notes 86-104 and accompanying text.

I. Legislative Developments

A. *Anti-Takeover Provisions of the Revised Act*

The Revised Act provides management and other groups desiring to defend against a hostile takeover battle with a full arsenal of state-of-the-art weaponry. These devices include: (1) the ability to create innovative classes of stock with varying rights;[8] (2) restrictions on who may call special shareholders' meetings;[9] (3) staggered terms for directors;[10] (4) removal of directors only for cause;[11] and (5) regulations governing transactions between a corporation and a potentially dominant shareholder.[12] Several of the anti-takeover provisions merely codify, recodify or amend existing Virginia law; others adopt provisions of the Model Business Corporation Act (the "Model Act")[13] or provisions from other jurisdictions.

1. Authorized Classes of Shares

Revised Act section 13.1-638 deals with the establishment of authorized classes of shares. Subsection C offers a list of options available to the corporation in describing the designations, preferences, limitations and relative rights of a share class. Of particular interest are subsection (C)(2), which authorizes the establishment of share classes that "are redeemable or convertible as specified in the articles of incorporation . . . at the option of the corporation, the shareholder, or another person or upon the occurrence of a designated event"[14] and subsection (C)(5), which authorizes the establishment of share classes that "[e]ntitle the holders to other specified rights, including the right that no transaction of a specified nature shall be consummated while any such shares remain outstanding except upon the assent of all or a specified proportion of such shares."[15] As subsection D explicitly points out, the list con-

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8. *See infra* notes 14-18 and accompanying text.
9. *See infra* notes 19-25 and accompanying text.
10. *See infra* note 26 and accompanying text.
11. *See infra* note 27 and accompanying text.
12. *See infra* notes 28-44 and accompanying text.
13. Revised Model Business Corp. Act (1985) [hereinafter Model Act].
14. Revised Act, *supra* note 1, § 13.1-638(C)(2). Old Act, *supra* note 1, § 13.1-13(a) authorized the issuance of a share class which was redeemable at the option of the corporation only.
15. Revised Act, *supra* note 1, § 13.1-638(C)(5). This provision is taken from Old Act, *supra* note 1, § 13.1-13(f).

tained in subsection C is not exhaustive. Official Comment 4 to Model Act section 6.01, upon which section 13.1-638 is based, further explains that the section "authorizes the creation of new or innovative classes of shares without limitation or restriction. The section is basically enabling rather than restrictive."[16]

Additionally, Revised Act subsection 13.1-639(A) authorizes the articles of incorporation to allow the board of directors to determine the preferences, limitations and relative rights of a share class or series of shares without shareholder approval. This provision would permit the board of directors to create quickly a new or innovative class of shares as a defensive measure to an unwanted takeover.

Revised Act section 13.1-638 seems to permit the establishment of a "poison pill" takeover defense and of "super-shares." The use of a "poison pill" typically involves the issuance of a new class or series of stock. The holders of such stock are granted rights to require a redemption of the stock by the corporation at a premium (the "poison") upon the occurrence of certain events, such as a tender offer or acquisition of a certain percentage of the corporation's stock by a person or group, thereby adding a tremendous cost to a would-be acquirer.[17] The use of "super-shares" involves the issuance of a class of shares with each share being entitled to more than one vote. "Super-shares" are typically designed to shift voting power in a corporation from the beneficial shareholders to management.[18] When management has control over a large percentage of votes, it has the ability to act quickly to wage war against an unwanted suitor.

2. Restrictions on Special Shareholders' Meetings

Revised Act section 13.1-655, dealing with special shareholders' meetings, provides a two-tiered approach to the calling of a special

16. MODEL ACT, *supra* note 13, § 6.01 official comment 4.

17. For a general discussion of the use of the poison pill, see 2 R. WINTER, M. STUMPF & G. HAWKINS, SHARK REPELLENTS AND GOLDEN PARACHUTES: A HANDBOOK FOR THE PRACTITIONER § 11 (Supp. 1985).

18. Critics have charged that these "super-shares" result in the "disenfranchisement of shareholders" and "[create] a dictatorship of the minority, approved by the majority." Hector, *The Flap Over Super-Shares*, FORTUNE, Sept. 16, 1985, at 115. In support of the use of such "super-shares," the Revised Act indicates that the existence of a share class granting multiple votes per share is permissible. REVISED ACT, *supra* note 1, § 13.1-662(A); JOINT BAR COMMITTEE COMMENTARY § 13.1-662, COMMISSION REPORT, *supra* note 3.

meeting—one dealing specifically with closely held corporations[19] and the other aimed at larger corporations.[20]

The prior Virginia Stock Corporation Act (the "Old Act") section 13.1-25 allowed the holders of at least ten percent of voting shares to call a special meeting of shareholders. Because it was thought that the ten percent figure could not be modified by the articles of incorporation or the bylaws, many large corporations were concerned that the Old Act provision permitted a would-be acquirer to call a special meeting of shareholders after acquiring a relatively small percentage of shares.[21] Revised Act section 13.1-655 combats such fears in several ways. First, subsection (A)(1) provides that a specified group of persons may call a special meeting. With respect to corporations having more than thirty-five shareholders, those persons constitute the only means by which a special meeting may be called, thereby preventing a newcomer from calling a special meeting regardless of how many shares he may have acquired.[22] Secondly, subsection (A)(2) provides that, in corporations having thirty-five or fewer shareholders, a shareholder or group of shareholders must hold at least twenty percent of all votes entitled to be cast to call a special meeting. Finally, this percentage may be increased (or decreased) by an appropriate provision in the corporation's articles of incorporation.[23]

Two additional considerations with respect to special meetings are significant. First, subsection D states that "where not inconsistent with the bylaws,"[24] a special meeting may be held at such place as provided in the notice of the meeting. This provision could cause certain hardships, such as when a would-be out-of-state acquirer schedules a special meeting far from the corporation's home base. A simple bylaw provision requiring that all meetings must be held in Virginia, for example, would alleviate the problem. Secondly, subsection E states that "[o]nly business

19. REVISED ACT, *supra* note 1, § 13.1-655(A)(2).

20. *Id.* § 13.1-655(A)(1).

21. *See* Murphy, *supra* note 3, at 85-86 n.52 and accompanying text; *see also* JOINT BAR COMMITTEE COMMENTARY § 13.1-655, COMMISSION REPORT, *supra* note 3.

22. REVISED ACT, *supra* note 1, § 13.1-655(A)(1). This provision authorizes the corporation's chairman of the board of directors, president, board of directors, or the person or persons authorized by the articles of incorporation or bylaws to call a special meeting. It applies to all corporations. It implies that a provision in the articles of incorporation could allow a certain percentage of shareholders the right to call a special meeting, regardless of the number of shareholders.

23. *Id.* § 13.1-655(B).

24. *Id.* § 13.1-655(D).

within the purpose or purposes described in the meeting notice . . . may be conducted at a special shareholders' meeting,"[25] thereby avoiding a free-for-all discussion of issues at the special meeting.

3. Staggered Terms for Directors

Revised Act section 13.1-678 authorizes a corporation's articles of incorporation to provide for the staggering of the terms of directors by dividing the directors into two or three groups, with one-half or one-third of the directors' terms expiring at any particular annual shareholders' meeting. While Old Act section 13.1-37 also authorized a staggered board, it did not provide an effective anti-takeover device since the directors could be removed at the whim of the shareholders, whether or not their terms were staggered.[26] By itself, Revised Act section 13.1-678 does not provide management with any better protection; however, when used in combination with Revised Act section 13.1-680, which authorizes the articles of incorporation to provide that directors may be removed only with cause, a staggered board could slow a would-be acquirer from taking over the board of directors.

4. Removal of Directors Only with Cause

Revised Act subsection 13.1-680(A) authorizes a corporation's articles of incorporation to provide that directors may be removed only with cause; otherwise, directors may be removed with or without cause. This concept is new to Virginia law, but it is virtually identical to Model Act section 8.08(a). Placing a removal-with-cause provision in the articles of incorporation would prevent a would-be acquirer from removing a director or directors at a special meeting held prior to the next annual meeting. Combined with a staggered board of directors, upon which directors have three-year terms, a removal-with-cause provision could postpone a board takeover for as long as two years.[27]

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25. *Id.* § 13.1-655(E).

26. *See* OLD ACT, *supra* note 1, § 13.1-42.

27. If the board of directors is divided into three groups, one-third of the directors' terms expiring at each annual meeting, a dominant shareholder could elect only one-third of the total number of directors at the next annual meeting. He would have to wait until the second annual meeting before he could elect another one-third to obtain control of the board of directors.

5. Regulation of Transactions Between a Corporation and a Potentially Dominant Shareholder

The affiliated transactions article of the Revised Act provides for the regulation of major transactions between a corporation and a potentially dominant shareholder.[28] The Joint Bar Committee Commentary to Revised Act section 13.1-725 states:

> The source of the Article is the growing concern about the unfairness to minority shareholders that can result when a dominant shareholder proposes to engage in a significant transaction with the corporation where his control may enable him to cause the corporation to enter into the transaction even though it may not be in the best interest of the other shareholders. More specifically, this Article is designed to limit the likelihood that someone can acquire a controlling block of the outstanding shares and then use this voting power to squeeze out the remaining shareholders at a price that does not reflect the fair value of their shares.[29]

Unless excepted in Revised Act section 13.1-727, Revised Act section 13.1-726 requires that an "affiliated transaction"[30] be approved by at least two-thirds of voting shares other than those owned by an "interested shareholder."[31] The exceptions include: (1) an affiliated transaction approved by a majority of disinterested directors;[32] (2) a corporation with three hundred or fewer shareholders;[33] (3) a corporation in which the interested shareholder has owned at least eighty percent of the corporation's outstanding voting shares for at least five years[34] or at least ninety percent of such shares "exclusive of shares acquired directly from the corporation

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28. *See supra* note 2. This article is not found in the Model Act. For a comprehensive list of similar legislation enacted in other states and corresponding authorities, see Murphy, *supra* note 3, at 124 n.151.

29. JOINT BAR COMMITTEE COMMENTARY § 13.1-725, COMMISSION REPORT, *supra* note 3.

30. An "affiliated transaction" includes any of the following types of transactions between the corporation and an "interested shareholder": mergers; share exchanges; sales in excess of five percent of the fair market value of the corporation's assets or guarantees by the corporation of indebtedness of an interested shareholder in excess of five percent of the fair market value of the corporation's assets, except in the ordinary course of business; sales of voting stock in excess of five percent of the fair market value of the corporation's assets; and dissolutions. REVISED ACT, *supra* note 1, § 13.1-725.

31. An "interested shareholder" is defined as any person owning beneficially more than ten percent of the outstanding voting shares of the corporation. *Id.*

32. *Id.* § 13.1-727(1).

33. *Id.* § 13.1-727(2).

34. *Id.* § 13.1-727(3).

in a transaction not approved by a majority of the disinterested directors";[35] and (4) transactions in which the remaining shareholders are paid "fair value" for their shares.[36] Additionally, a corporation may opt out of the article's application through an appropriate provision in the articles of incorporation.[37]

The affiliated transactions article protects minority shareholders in several ways from unfair treatment in the event of a takeover. First, by requiring two-thirds approval of disinterested shareholders, the article negates the would-be acquirer's shareholder voting power. Secondly, the would-be acquirer may have a difficult time "taking control" of the board of directors and attempting to avoid the article's application on the basis of approval by a majority of disinterested directors since, by definition, any director elected by the would-be acquirer is deemed an "interested director."[38] Finally, if the would-be acquirer is not able to muster enough support to approve the desired affiliated transaction or not entitled to an exception, he may have to pay to minority shareholders the price per share as determined by the "fair value" provision of Revised Act subsection 13.1-727(6).[39] At the minimum, the minority shareholders will not have been forced out at an unfair price.

6. Miscellaneous Anti-Takeover Provisions

Means of protection offered by other provisions of the Revised Act include: (1) increasing quorum and voting requirements for specific matters;[40] (2) restricting the filling of vacancies on the board of directors;[41] (3) restricting attendance at meetings by tele-

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35. *Id.* § 13.1-727(4).

36. *Id.* § 13.1-727(6). In addition, the affiliated transactions article will not apply if the corporation is an investment company registered under the Investment Company Act of 1940. *Id.* § 13.1-727(5).

37. *Id.* § 13.1-728(A).

38. A "disinterested director" is defined, in relation to an "interested shareholder," as a person who: (1) was elected to the board before the later of January 1, 1985, and the date the interested shareholder became an interested shareholder; and (2) who was also recommended or elected by a majority of disinterested directors then on the board. *Id.* § 13.1-725. Conversely, an "interested director" would generally include any director elected to the board after the interested shareholder became an interested shareholder.

39. For a discussion regarding the application of the "fair value" provision, see Goolsby & Whitson, *Virginia's New Corporate Code*, SECURITIES & COMMODITIES REGULATION 147, 149 (June 25, 1986).

40. REVISED ACT, *supra* note 1, §§ 13.1-666 to -668.

41. *Id.* § 13.1-682.

phone and the like and use of action by written consent;[42] (4) requiring approval by disinterested directors in cases of director conflicts of interest;[43] and (5) allowing the board of directors to submit merger plans to shareholders without a recommendation or burdened with conditions.[44]

B. *Amendments Relating to the Revised Act*[45]

1. Repeal of Annual State Franchise Tax

Prior to the enactment and effective date of the Revised Act, Virginia corporations were subject to payment of an annual registration fee and franchise tax.[46] Foreign corporations were subject only to payment of the annual registration fee.[47] The determinations of the registration fee and franchise tax were based upon a formula involving the per share par value of each class of stock.[48] With the Revised Act's elimination of any significant meaning to the concept of par value, the formula was amended to take into consideration the authorized number of shares only.[49] This had the unintended effect of causing a significant increase in the amount of franchise taxes incurred by a large number of Virginia corporations, but only a minor increase in the amount of registration fees incurred by both Virginia and foreign corporations. After the effective date of the Revised Act, but before registration fee and franchise taxes were billed and due, the General Assembly enacted emergency legislation reamending the registration fee schedule and

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42. *Id.* § 13.1-657 (shareholders' action without meeting), -684 (directors' attendance by telephone and the like), -685 (directors' action without meeting).

43. *Id.* § 13.1-691.

44. *Id.* § 13.1-718.

45. VA. CODE ANN. §§ 13.1-601 to -908 (Cum. Supp. 1986) amended the Revised Act and became effective July 1, 1986. VA. CODE ANN. § 58.1-2804 (Cum. Supp. 1986) (relating to annual registration fees) became effective, and VA. CODE ANN. §§ 58.1-2808 to -2811 (Cum. Supp. 1986) (relating to annual state franchise taxes) were repealed, on February 11, 1986. These sections were made applicable to all taxes and fees assessed and due on and after January 1, 1986. 1986 Va. Acts 1-2. All references to amendments and revisions to the Revised Act are found in the 1985 or 1986 Cumulative Supplement of the Virginia Code.

46. VA. CODE ANN. §§ 58.1-2804, -2808 (Repl. Vol. 1984).

47. *Id.* § 58.1-2804.

48. The amount of the fee and tax were based upon the determination of the corporation's maximum capital stock, the sum of the products obtained by multiplying the number of authorized shares of each share class by the respective per share par value of each share class.

49. VA. CODE ANN. §§ 58.1-2804 (Cum. Supp. 1986), 58.1-2808 (Cum. Supp. 1985) (repealed by ch. 1, 1986 Va. Acts 1-2). For a discussion of the elimination of par value in the Virginia Code, see JOINT BAR COMMITTEE COMMENTARY, *supra* note 3 at § 13.1-653.

repealing the franchise tax.[50] Its intended purpose was to shift more of the fee/tax burden toward foreign corporations and away from Virginia corporations.[51]

2. Execution of Documents to be Filed with State Corporation Commission

Revised Act sections 13.1-604 and -804[52] were amended to allow the treasurer, secretary or any assistant secretary of a corporation, if authorized, to execute documents to be filed with the State Corporation Commission (SCC), in addition to the chairman, vice-chairman, president or any vice-president of the corporation.

3. Share Options

Revised Act section 13.1-646, dealing with the granting of stock options, was substantively amended to require shareholder approval if the corporation desires to issue rights, options or warrants for the purchase of corporate stock to directors, officers or employees of the corporation or a subsidiary, and not to shareholders generally. The prior section did not require shareholder approval with respect to the issuance of such rights, options or warrants to directors, nor did the prior section distinguish between issuances which involved shareholders generally and those that did not.

4. Lower Quorum Requirements

Revised Act sections 13.1-668 and -851 were amended to explicitly authorize the articles of incorporation to provide for a quorum requirement at shareholders' (or members') meetings of less than a majority, thereby eliminating a question raised by the confusing nature of the former section.[53]

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50. *Id.* §§ 58.1-2804, (Cum. Supp. 1986), -2808 (Cum. Supp. 1985) (repealed by 1986 Va. Acts 1-2). The General Assembly did not revise the basis upon which the registration fee is determined, only the fee schedule.

51. The General Assembly was persuaded to reamend the sections because the Virginia State Corporation Commission presented evidence showing that Virginia corporations bore disproportionate share of the fee/tax burden and that, if the registration fee for both Virginia and foreign corporations were increased, the franchise tax (applicable only to Virginia corporations) could be eliminated without reducing revenues.

52. REVISED ACT §§ 13.1-604 and -804 are parallel statutes, the former relating to stock and the latter to nonstock corporations. *See supra* note 1.

53. REVISED ACT §§ 13.1-668 and -851 are parallel statutes, the former relating to stock and the latter to nonstock corporations. *See supra* note 1. OLD ACT § 13.1-31 had explicitly

5. Use of Unavailable Corporate Name

Revised Act sections 13.1-630, -762, -829 and -924 were amended to eliminate the right of a corporation to obtain the use of an unavailable name by filing with the SCC a final judgment showing the corporation's right to use the name.[54]

6. Dissenters' Rights

Revised Act section 13.1-730, dealing with dissenters' rights, was amended to eliminate the applicability of dissenters' rights to situations where an agreement for the sale or exchange of property required shareholders to accept in exchange for their shares anything other than cash, certain types of stock, or a combination of both. Dissenters' rights would still apply to situations where a similar requirement was contained in an agreement involving a merger or share exchange.

7. Stock Certificates

Revised Act section 13.1-647, dealing with the form and content of stock certificates, was amended by adding a provision allowing facsimiles of required signatures to be used on stock certificates where the certificates are countersigned by a person authorized to do so by the board of directors and where the shares represented by such certificates are registered with the Securities and Exchange Commission and are listed on a national stock exchange. Under the former section, facsimiles of required signatures were permitted only if the certificates were countersigned by a transfer agent or registered by a registrar *other than the corporation or a corporation employee.*[55]

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authorized the articles of incorporation to raise or lower the majority quorum requirement. *See supra* note 1. Since that statute was repealed and replaced by § 13.1-668, a provision which explicitly authorized the articles of incorporation to raise the majority quorum requirement only, a question was raised as to whether a lower quorum requirement was valid. *See supra* note 1.

54. *See* REVISED ACT, *supra* note 1, § 13.1-630 (relating to Virginia stock corporations), -762 (relating to foreign stock corporations), -829 (relating to Virginia nonstock corporations), -924 (relating to foreign nonstock corporations). The above are parallel statutes. A corporation may still obtain the right to use an unavailable name if the entity entitled to use the desired name so consents and agrees to change its name. *Id.*

55. *Id.* § 13.1-647(D)(emphasis added).

8. Nonstock Corporations

A number of amendments were enacted which exclusively affect nonstock corporations. They include: (1) authorizing a corporation to notify its members of a members' meeting by publishing such notice in a local newspaper;[56] (2) authorizing the articles of incorporation to specify other than one-year terms of the directors constituting the initial board of directors and succeeding directors;[57] (3) eliminating the requirement that a certificate of the tax commissioner regarding the corporation's standing with the Department of Taxation be filed upon withdrawal from Virginia[58] or upon dissolution;[59] (4) providing special provision for community associations;[60] and (5) requiring approval of the SCC for mergers between corporations operating prepaid hospital, medical and surgical services plans.[61]

9. Miscellaneous Procedural Amendments

Several procedural amendments to the Revised Act were enacted. They include: (1) eliminating the requirement that annual reports state the aggregate number of authorized shares itemized by series;[62] (2) eliminating the requirements that the date of incorporation be set forth in articles of termination of corporate existence filed by the incorporators or initial directors[63] and that an annual report be submitted by a corporation seeking reinstatement if one was previously filed during the calendar year in which reinstatement is sought;[64] (3) various minor provisions relating to registered agents of a corporation, including the elimination of the requirement that a corporation notify the SCC of its registered office

56. *Id.* § 13.1-842.

57. *Id.* § 13.1-857.

58. *Id.* § 13.1-929.

59. *Id.* § 13.1-912.

60. *Id.* § 13.1-814.1. This is a new provision relating to every nonstock corporation which "owns or has under its care, custody or control real estate subject to a recorded declaration of covenants which obligates a person, by virtue of ownership of specific real estate, to be a member of the corporation." *Id.* § 13.1-814.1(A).

61. VA. CODE ANN. § 38.1-182.1 (Cum. Supp. 1986).

62. REVISED ACT, *supra* note 1, § 13.1-775.

63. *Id.* §§ 13.1-751, -913 (parallel statutes relating to stock and nonstock corporations, respectively).

64. *Id.* §§ 13.1-754, -916 (parallel statutes relating to stock and to nonstock corporations, respectively).

and agent merely upon a change in the name of the corporation;[65] and (4) various minor provisions relating to foreign corporations, including the addition of a section requiring foreign corporations authorized to transact business in Virginia, which are involved in a merger, to file with the SCC a copy of the articles of merger filed in the foreign jurisdiction.[66]

II. JUDICIAL DECISIONS

A. *Stockholder Rights*

1. Public Policy Exception to Employment-At-Will Doctrine

In *Bowman v. State Bank of Keysville*,[67] the Virginia Supreme Court recognized, for the first time, an exception to the employment-at-will doctrine.[68] The court based its decision on the legislative public policy that employee-stockholders of a corporation should have the right to exercise their stockholder rights without fear of reprisal from their employer-corporation.[69] In *Bowman*, Betty P. Bowman and Joyce T. Bridges (the "Employees") had

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65. *Id.* §§ 13.1-617, -817 (parallel statutes relating to service of process on a person as statutory agent for stock and nonstock corporations, respectively); *id.* §§ 13.1-619, -819 (parallel statutes relating to required provisions in articles of incorporation regarding registered agents of stock and nonstock corporations, respectively); *id.* §§ 13.1-635, -764, -834, -926 (parallel statutes relating to elimination of requirement that a corporation notify the SCC of its registered office and agent upon a change in the name of Virginia stock corporations, foreign stock corporations, Virginia nonstock corporations and foreign nonstock corporations, respectively); *id.* §§ 13.1-637, -766, -836, -928 (parallel statutes relating to giving notification to Virginia stock corporations, foreign stock corporations, Virginia nonstock corporations and foreign nonstock corporations, respectively, that have failed to maintain a registered agent or whose registered agent cannot be found).

66. *Id.* §§ 13.1-758, -920 (parallel statutes relating to certificate of compliance issued by the SCC to a complainant suing foreign stock or nonstock corporations, respectively, which have failed to "qualify" in Virginia); *id.* §§ 13.1-760, -922 (parallel statutes eliminating need for foreign stock or nonstock corporations, respectively, to file an amended certificate of authority if they change their period of duration or state or country of incorporation); *id.* §§ 13.1-762, -924 (parallel statutes eliminating requirement of foreign stock or nonstock corporations, respectively, to deliver to the SCC a certified copy of a board of directors' resolution adopting an assumed name if its name is unavailable in Virginia); *id.* §§ 13.1-766, -928 (parallel statutes requiring designated person accepting service of process on behalf of registered agent of foreign stock and nonstock corporations, respectively, to attach a copy of such designation to the return); *id.* §§ 13.1-766.1, -928.1 (parallel statutes requiring foreign stock and nonstock corporations, respectively, involved in a merger with another foreign corporation, to file a copy of the articles of merger with the SCC).

67. 229 Va. 534, 331 S.E.2d 797 (1985).

68. For a comprehensive list of authorities on the employment-at-will doctrine, see *id.* at 539, 331 S.E.2d at 800-01.

69. *Id.* at 540, 331 S.E.2d at 801.

been employed with the State Bank of Keysville (the "Bank") for eight years and eighteen years, respectively, and they had owned five and six shares, respectively, of the Bank's common stock. During the months preceding the terminations of the employees, the Bank was engaged in merger negotiations with another bank, a transaction to which the Employees were in opposition. Prior to the special meeting of stockholders called to vote upon the merger, one of the Employees "was told [by the president of the Bank] that if her shares were not voted in favor of the merger and the merger was not consummated her employment with the Bank would be terminated"[70] and even "if the merger was approved, but her shares were not voted in favor of the merger, her vote against the merger would have 'a definite adverse effect on her job.' "[71] The same information was later communicated to the other Employee.

The other employees did in fact vote in favor of the merger, but several days after the special meeting, they informed the Bank's president that "their proxies were invalid, illegally obtained, improper and null and void."[72] Because the Employees' votes were necessary to approve the merger, the Bank decided to abort the merger plans. A week after that decision was made, the Employees were fired.[73]

Each of the Employees individually sued the Bank and various individuals associated with the Bank for wrongful retaliatory discharge from her employment. In each case, the trial court sustained the Bank's demurrer based upon the employment-at-will doctrine. The Virginia Supreme Court granted each of the Employees an appeal from the trial court's orders.

The employment-at-will doctrine states that, where the period of employment is not determinable from the contract (i.e., the period is of indefinite duration), a contract of employment is terminable at will by either party upon reasonable notice.[74] The Bank argued that the employment-at-will doctrine gave it the right to fire the Employees for any or no reason. In addition, the Bank pointed to several statutory exceptions to the doctrine and argued that any

70. *Id.* at 537, 331 S.E.2d at 799.
71. *Id.*
72. *Id.*
73. *Id.* at 538, 331 S.E.2d at 799.
74. *Id.* at 535, 331 S.E.2d at 798, (citing Stonega Coal & Coke Co. v. Louisville & N.R.R., 106 Va. 223, 226, 55 S.E. 551, 552 (1906)).

additional exceptions should be established by the General Assembly, and not by the court.[75]

Old Act section 13.1-32 provides stockholders with the right to vote at a stockholders' meeting.[76] The Employees claimed that their dismissals "were premised solely upon the proper exercise of their protected rights as shareholders"[77] and that the Bank should not be allowed to discharge them in retaliation for the exercise of their statutory rights. The court agreed, but made it clear that Virginia still adhered to the common law doctrine and the court was not altering the traditional rule.[78]

The court cited a number of cases from other jurisdictions in which exceptions to the doctrine were based upon "established public policy."[79] It is interesting to note that in each of those cases, as well as in *Bowman*, the public policy asserted involved a legislative policy. In *Bowman*, the court stated:

> This statutory provision [section 13.1-32] contemplates that the right to vote shall be exercised free of duress and intimidation imposed on individual stockholders by corporate management. In order for the goal of the statute to be realized and the public policy fulfilled, the shareholder must be able to exercise this right without fear of reprisal from corporate management which happens also to be the employer. Because the right conferred by statute is in furtherance of established public policy, the employer may not lawfully use the threat of discharge of an at-will employee as a device to control the otherwise unfettered discretion of a shareholder to vote freely his or her stock in the corporation.[80]

While the court did not explicitly define the parameters of the public policy exception it announced in *Bowman*, it would appear that, in light of its strong defense of the employment-at-will doctrine and the specific cases it cited in support of the exception, the

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75. *Bowman*, 229 Va. at 538, 331 S.E.2d at 800; *see* VA. CODE ANN. § 40.1-28.7 (relating to handicapped employees), *repealed by* 1985 Va. Acts 539 (current version at VA. CODE ANN. § 51.01-46 (Repl. Vol. 1986)); *id.* § 40.1-51.2:1 (Repl. Vol. 1986) (relating to employees who file safety or health complaints); *id.* § 65.1-40.1 (Cum. Supp. 1986) (relating to employees who exercise rights under the Workers' Compensation Act).

76. The statute provides that "[e]ach outstanding share . . . shall be entitled to one vote on each matter submitted to a vote at a meeting of stockholders." OLD ACT, *supra* note 1, § 13.1-32.

77. *Bowman*, 229 Va. at 539, 331 S.E.2d at 800.

78. *Id.* at 539, 331 S.E.2d at 800-01.

79. *Id.* at 539-40, 331 S.E.2d at 801.

80. *Id.* at 540, 331 S.E.2d at 801.

court would limit the exception to those situations where the doctrine conflicted with a legislative public policy.

2. Defamation of a Corporation Not a Stockholder Cause of Action

In *Landmark Communications, Inc. v. Macione*,[81] the Virginia Supreme Court addressed the issue of whether defamatory statements made about a corporation would allow an individual stockholder of that corporation to claim damages as a result of the defamatory statements. In *Landmark*, Jack F. Macione and his wife owned all of the stock in a corporation which had contracted with a racquetball club to act as its advertising agent. In furtherance of the contract, Macione placed advertisements in newspapers published by Landmark Communications, Inc. (Landmark). For a number of reasons, Macione and Landmark maintained a tenuous relationship. One Saturday evening, Macione called the Landmark employee assigned to the racquetball club account to complain about Landmark's failure to publish a certain advertisement in one of its newspapers that afternoon. The employee claimed that Macione was abusive and that he had been drinking. He conveyed this information to another Lankmark employee who reconveyed the story to the general manager and secretary of the racquetball club. When the advertising contract with Macione's corporation expired, the racquetball club decided not to renew the contract. Macione sued Landmark, claiming that Landmark had defamed him and had caused damage "to his business or professional reputation."[82] The jury awarded Macione compensatory damages and the trial court entered judgment in favor of Macione.

On appeal, the Virginia Supreme Court reversed the trial court because Macione never presented any evidence showing that the defamatory remarks damaged him personally, as opposed to damaging the corporation in which Macione and his wife were sole stockholders.[83] The only evidence of damages presented was the non-renewal of the racquetball club contract with the corporation. The court pointed to and reaffirmed its holding in *Keepe v. Shell Oil Co.*,[84] that a stockholder of a corporation does not have stand-

81. 230 Va. 137, 334 S.E.2d 587 (1985).
82. *Id.* at 139, 334 S.E.2d at 588.
83. *Id.* at 140-41, 334 S.E.2d at 588-89.
84. 220 Va. 587, 260 S.E.2d 722 (1979).

ing to sue in an individual capacity for an injury to the corporation resulting in the depreciation of the value of the stockholder's stock, nor does a corporate employee have standing to sue for lost income resulting from damages incurred by the corporation at the hands of a third party.[85] It is unclear whether this case would have been decided differently had the corporation brought suit instead of Macione, because the court did not address Landmark's affirmative defense of qualified privilege.[86]

B. *Repudiation of Sale of Business Doctrine*

On May 28, 1985, the United States Supreme Court handed down companion decisions, which read together severely restrict, if not eliminate, the "sale of business" doctrine as an exception to the applicability of the federal Securities Act of 1933[87] and the Securities Exchange Act of 1934[88] (collectively the "Acts") in certain transactions. Simply, the "sale of business" doctrine provides that the Acts do not apply to the sale of the stock of a closely held corporation where the purchaser will have managerial control, because the transaction consists of the sale to an investor of a business and not a security, and it is the investor, not the entrepreneur, whose interests the Acts are intended to protect.[89]

In *Landreth Timber Co. v. Landreth*,[90] the Court was presented with the issue of whether the sale of all of the stock of a closely held corporation is a securities transaction subject to the antifraud provisions of the Acts. In *Gould v. Ruefenacht*,[91] the Court was presented with the very same issue, except that the transaction involved the sale of fifty percent of the stock of a closely held corporation. *Landreth* came to the Court on appeal from the Ninth Circuit,[92] which court had affirmed the district court's ruling of summary judgment against the plaintiff based upon the "sale of

85. *Landmark*, 230 Va. at 140, 334 S.E.2d at 588.

86. *Id.* The court found the standing issue dispositive of the case.

87. 15 U.S.C. § 78a-bbbb (1982 & Supp. III 1985).

88. *Id.* § 78a-kk.

89. For comprehensive lists of authorities on the sale of business exception, see Ruefenacht v. O'Halloran, 737 F.2d 320, 321 n.2 (3d Cir. 1984), *aff'd sub nom.* Gould v. Ruefenacht, 105 S. Ct. 2308 (1985), and Landreth Timber Co. v. Landreth, 731 F.2d 1348, 1351 n.2 (9th Cir. 1984), *rev'd*, 105 S. Ct. 2297 (1985).

90. 105 S. Ct. 2297 (1985).

91. 105 S. Ct. 2308 (1985).

92. Landreth Timber Co. v. Landreth, 731 F.2d 1348 (9th Cir. 1984). The district court case is unreported.

business" doctrine. *Gould* came to the Court on appeal from the Third Circuit,[93] which court had reversed the district court's ruling of summary judgment against the plaintiff based upon "the plain language of the Acts' definitions of 'security.' "[94]

In *Landreth*, Ivan K. Landreth and his sons (collectively, the "Sellers"), owners of 100% of the stock of a Washington corporation engaged in the lumber business, sold all of their stock in the corporation to a Massachusetts tax attorney who assigned the stock to a shell corporation which merged with Landreth Timber Company (collectively, the "Purchaser"). Prior to the consummation of the transaction, the Purchaser received and reviewed a great deal of data including representations regarding rebuilding plans (necessitated as a result of damage caused by fire), predicted productivity, contracts, and expected profits. In addition, the Purchaser conducted an audit and an inspection of the mill. By agreement, Mr. Landreth was to remain as a consultant for some time to assist in daily operations. In the Court's words, "the mill did not live up to the [Purchaser's] expectations."[95] The Purchaser eventually sold the business at a loss, went into receivership and filed suit for rescission of the stock sale and damages based upon violations of the Acts.[96]

In *Gould*, Max A. Ruefenacht (the "Purchaser") purchased fifty percent of the stock of a corporation, conducting business as an importer of wine and spirits, from the corporation's president, who immediately prior to the sale had owned 100% of the corporation's stock. As part of the consideration paid, the Purchaser agreed to participate in the management of the corporation, subject always to the president's veto and the constraints of remaining a full-time employee of another corporation. The Purchaser claimed that, in purchasing the stock, he relied upon documentation and oral representations made by the president, a certified public accountant, and W. George Gould, the corporation's corporate counsel (collectively, the "Sellers"). After some time, the Purchaser "began to doubt the accuracy of some of the representations that had been

93. Ruefenacht v. O'Halloran, 737 F.2d 320 (3d Cir. 1984). The district court case is unreported.

94. *Gould*, 105 S. Ct. at 2310.

95. *Landreth*, 105 S. Ct. at 2300-01.

96. *Id.* at 2301.

made to him" and filed suit alleging various violations of the Acts.[97]

The analyses employed by the Court in *Landreth* and *Gould* are identical, and the Court's message is simple: if (i) the instruments being sold are labeled "stock," and (ii) the instruments possess some of the significant characteristics traditionally associated with stock, a purchaser should be able to rely on the protection of the Acts.[98] The Court clearly rejected arguments that courts should "look beyond the label 'stock' and the characteristics of the instruments involved to determine whether application of the Acts is mandated by the economic substance of the transaction"[99] and that "the Acts were intended to cover only 'passive investors,' and not privately negotiated transactions involving the transfer of control to 'entrepreneurs.' "[100] Instead, the Court opted for a clear-cut rule, reasoning that making case-by-case determinations would require difficult line-drawing and arbitrary distinctions.[101]

Justice Stevens, on the other hand, sided with the Sellers in favor of applying the "sale of business" doctrine.[102] He did not believe that "Congress [intended] the antifraud provisions of the federal securities law to apply to every transaction in a security described in § 2(1) of the 1933 Act"[103] but rather only to those transactions involving "(i) the sale of a security that is traded in a public market; or (ii) an investor who is not in a position to negotiate appropriate contractual warranties and to insist on access to inside information before consummating the transaction."[104] Justice Stevens did acknowledge the initial uncertainty that would ensue in applying the above standard but dismissed the Court's "bright-line" rule as "not strong enough to 'justify expanding liability to reach substantive evils far outside the scope of the legislature's concern.' "[105]

The *Landreth* and *Gould* rulings raise several new concerns for the seller of a closely held business (and his agents), requiring greater strategy development both prior to placing the business on

97. *Gould*, 105 S. Ct. at 2308-10.
98. *See id.* at 2308; *Landreth*, 105 S. Ct. at 2297.
99. *Landreth*, 105 S. Ct. at 2303.
100. *Id.* at 2305.
101. *Id.* at 2307-08.
102. *Id.* at 2312 (Stevens, J., dissenting).
103. *Id.*
104. *Id.*
105. *Id.*

the chopping block and also during sale negotiations. First, the seller may no longer determine whether or not to sell his business as a stock or asset deal solely on the basis of tax and business considerations. He must now review federal and state securities laws, which may conflict with the economic substance of the transaction. Secondly, the seller may no longer merely comply with the contractual representations and warranties to which he is bound. He may now be required to go further to ensure that he has fully disclosed all material facts, lest he subject himself to possible civil and criminal penalties. Thirdly, the manner in which the business is advertised for sale may affect whether the transaction must be registered or is exempted from registration. The more extensive the advertising, the greater is the likelihood that an exemption will not be available. If a seller believes that extensive advertising is necessary, he may be faced with the tremendous expense of registering. The consequence of limited advertising may limit the seller's ability to reach an adequate number of potential purchasers. Finally, the seller's business broker must now consider his situation, as he may now be deemed a broker-dealer or underwriter of securities, necessitating a battery of examinations and qualifications and subjecting himself to increased liability exposure.

C. *Contracts*

1. Tortious Interference with Contractual Rights

In *Chaves v. Johnson*,[106] a case of first impression before the court, the Virginia Supreme Court recognized the right of an aggrieved party to seek damages for tortious interference with contractual rights. In *Chaves*, Juan O. Chaves, a licensed architect practicing in the Fredericksburg area, had been awarded a contract with the City of Fredericksburg to perform architectural services in connection with the development of plans to meet future building needs of the City's government and subsequent construction. An initial project included the renovation of an existing post office as a new City Hall. Cost estimates for the project submitted by Chaves were nearly triple what the City Council had intended to spend on the project, and he was asked to study present alternatives.[107]

H. C. Johnson, Jr., also a practicing architect in the area, had

106. 230 Va. 112, 335 S.E.2d 97 (1985).
107. *Id.* at 114, 335 S.E.2d at 98-99.

submitted a competing bid for the architectural contract, and was annoyed that his bid had not been accepted. Knowing of the City Council's cost concerns, he wrote a letter to the City Council regarding the City Hall project. The letter stated that Chaves lacked experience and that his fees were excessive. Three weeks after the letter was delivered, upon the recommendation of the City Council's Public Works Committee, the City Council terminated Chaves' contract. The contract was later awarded to Johnson.[108]

Chaves sued Johnson for tortious interference with his contractual rights and for defamation. The jury awarded Chaves damages on both counts, but the trial court set aside both verdicts. With respect to the defamation issue, the Virginia Supreme Court affirmed the trial court's ruling that Johnson's charges of inexperience and excessive fees were mere statements of opinion, therefore not actionable as defamation.[109]

With respect to the issue of tortious interference with contractual rights, the court outlined the elements required to show a *prima facie* case as follows:

> (1) the existence of a valid contractual relationship or business expectancy; (2) knowledge of the relationship or expectancy on the part of the interferor [sic]; (3) intentional interference inducing or causing a breach or termination of the relationship or expectancy; and (4) resultant damage to the party whose relationship or expectancy has been disrupted.[110]

The court, satisfied that the jury was presented with sufficient evidence to satisfy proximate cause and intent requirements, rejected the trial court's ruling that malice is a required element.[111]

In addition, the court discussed an affirmative defense of justification or privilege based upon "legitimate business competition, financial interest, responsibility for the welfare of another, directing business policy, and the giving of requested advice."[112] Johnson argued on appeal that his letter to the City Council was justified because of financial self-interest, freedom of speech and the right of a

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108. *Id.* at 114-17, 335 S.E.2d at 99-101.
109. *Id.* at 118-19, 335 S.E.2d at 101-02.
110. *Id.* at 120, 335 S.E.2d at 102.
111. *Id.* at 122-23, 335 S.E.2d at 104.
112. *Id.* at 121, 335 S.E.2d at 103 (citing Calborn v. Knudtzon, 65 Wash. 2d 157, 163, 396 P.2d 148, 152 (1964)).

taxpayer to complain about public expenditures. The court rejected in turn each of Johnson's arguments, finding in favor of Chaves.[113]

2. Validity of Multi-Year Employment Contracts with Local Governments

In *Fairfax-Falls Church Community Services Board v. Herren*,[114] the Virginia Supreme Court addressed, but did not decide, the issue of whether multi-year employment contracts between individual employees and a local government agency run afoul of the debt clause or constitute continuing-services contracts, a recognized exception to the application of the debt clause.[115] Additionally, the court addressed the issue of damages for breach of continuing-services contracts.

In this case, Patience S. Herren and Allen G. Schor (collectively, the "Employees") had been hired in different capacities and at different times by the Fairfax-Falls Church Community Services Board (the "Board"), an agency established by three northern Virginia localities to operate mental health facilities serving the residents of those localities. Their three-year employment contracts could be terminated only for cause. Prior to the expiration of the terms of the contracts, the Employees were informed that their contracts were to be terminated, presumably as a result of funding cut-backs. They were given the option of becoming regular civil service employees with Fairfax County if they waived all rights under their contracts.[116]

The Employees filed identical suits against the Board for anticipatory breach of contract and, at the same time, applied for transfers to Fairfax County. They were informed that they could not maintain their suits and transfer; consequently, their employment with the Board was terminated. The trial court ruled in favor of

113. *Id.* at 121-22, 335 S.E.2d at 103-04.

114. 230 Va. 390, 337 S.E.2d 741 (1985).

115. VA. CONST. art. VII, § 10(b) states: "No debt shall be contracted by or on behalf of any county or district thereof or by or on behalf of any regional government or district thereof except by authority conferred by the General Assembly by general law." Debts may be contracted if approved by a majority of voters in the jurisdiction. *Id.* The continuing services exception to the debt clause states that "[c]ontracts obligating a local government to pay for continuing services only *after* the services are rendered do not constitute a commitment for debt within the meaning of the Constitution." *Herren*, 230 Va. at 393, 337 S.E.2d at 743.

116. *Herren*, 230 Va. at 391-92, 337 S.E.2d at 741-42.

the Employees, and the Board appealed.[117]

The Board argued that the employment contracts constituted debts of Fairfax County not authorized by voter referendum, therefore, void on constitutional grounds. The Employees contended that, even if the contracts were debts, they constituted continuing-services contracts and were, therefore, valid.[118]

The court rejected the Employees' contentions, reversing the trial court's rulings on alternative theories—either the contracts were void on constitutional grounds or the contracts were valid continuing-services contracts which, by their nature, prevented the Employees from claiming damages as a result of the Board's anticipatory breach of the contracts.[119] In reaching its decision, the court discussed the applicability of debt clause analysis to the facts of the case and the differences between valid and invalid contracts vis-a-vis the debt clause. It explained that "[t]he distinction [between valid and invalid contracts] depends upon whether the local government is unconditionally liable for the whole debt, even though payment is postponed [in which case the contract is invalid], or whether its obligation to pay only arises after it has received, within each year, the service contracted for that year [in which case the contract is valid]."[120] The court refused, though, to decide whether the contracts at issue met the continuing-services exception. Instead, it jumped to a discussion of damages, placing the Employees in an inescapable "Catch-22" situation. In the words of the court:

> [The Employees] are confronted with a dilemma: the contracts on which they rely are either within the debt clause and are therefore void, or they are contracts for continuing services outside the debt clause, for the breach of which they have incurred no damages and for the anticipatory repudiation of which they have no remedy. In either event, the result must be the same.[121]

This case is disturbing in several respects. First, the court purposely failed to recognize the inequities involved in the Board's fir-

117. *Id.* at 392-93, 337 S.E.2d at 742.
118. *Id.* at 393, 337 S.E.2d at 742-43.
119. *Id.* at 395, 337 S.E.2d 744.
120. *Id.* at 393-94, 337 S.E.2d at 743 (citing Board of Supervisors v. Massey, 210 Va. 680, 684, 173 S.E.2d 869, 872 (1970)).
121. *Id.* at 395, 337 S.E.2d at 744.

ing of the Employees in contravention of written employment contracts which, presumably, were prepared by the Board. One must wonder whether the court would have decided the case in the same manner had the Employees breached their contracts with impunity, only later to claim that the contracts had been invalid from the start. Secondly, in failing to decide the issue presented of whether multi-year employment contracts between individual employees and local governments are constitutionally permitted, the court may have hindered both local governments and employees from entering into certain types of employment relationships without fear of whether their rights in such relationships are enforceable. Finally, circumstances similar to those presented in this case are bound to be litigated again at the trial court level, resulting in inconsistent decisions. The court will no doubt be required to deal with the very same issue again in the near future.

3. Discontinuance of Product Line Not a Termination of Dealer's Franchise

Hechler Chevrolet, Inc. v. General Motors Corp.[122] involved a dispute between Hechler Chevrolet, Inc. (Hechler), a dealer in Chevrolet cars and trucks, and General Motors Corporation (GM), regarding GM's decision to discontinue the manufacture and marketing of Chevrolet heavy trucks. Hechler claimed that GM's actions amounted to a termination of or refusal to renew Hechler's franchise to sell such trucks in violation of the Virginia Motor Vehicle Dealer Licensing Act (the "Dealer's Act").[123] On appeal, the Virginia Supreme Court analyzed the Dealer's Act from two perspectives. In each case the court was satisfied that the Act was inapplicable to product line discontinuance situations. First, the court looked to the legislature's intent in enacting the Act, finding that the legislature intended to regulate excessive competition. The court felt that if the legislature had desired to cover the situation presented in this case "it knew how to do so."[124] Secondly, the court reviewed applicable cases interpreting the Automobile Dealer's Day in Court Act,[125] a federal statute similar to the

122. 230 Va. 396, 337 S.E.2d 744 (1985).

123. VA. CODE ANN. §§ 46.1-515 to -550.5 (Repl. Vol. 1980 & Cum. Supp. 1985).

124. *Hechler Chevrolet*, 230 Va. at 401, 337 S.E.2d at 747.

125. 15 U.S.C. §§ 1221-25 (1982).

Dealer's Act, all of which hold that a product line discontinuance does not constitute a franchise termination.[126]

126. *Hechler Chevrolet*, 230 Va. at 401, 337 S.E.2d at 747.