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Annual Survey of Virginia Law: Business and Corporate Law

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BUSINESS AND CORPORATE LAW

David R. Ruby*

This article reviews recent developments in the law affecting Virginia businesses and corporations. Part I covers judicial developments, including: (1) the United States Supreme Court's upholding of the validity of an Indiana anti-takeover statute,¹ similar to Virginia's affiliated transactions provisions;² (2) the Virginia Supreme Court's ruling that the providing of day care in one's home constitutes a "business pursuit" within the meaning of a standard exclusionary clause found in homeowners' insurance policies;³ and (3) in what appears to be a case of first impression before any Virginia court, a Virginia circuit court's invalidation of a stock option granted by the board of directors of a corporation to its majority stockholder (and the stockholder's wife) for past services performed.⁴ Part II covers legislative developments, including the amendments enacted by the 1987 Virginia General Assembly to the Virginia Stock Corporation Act (Revised Act),⁵ such as the limiting of corporate officers' and directors' exposure to personal liability in certain circumstances.⁶

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1. See *infra* notes 7-33 and accompanying text.

2. VA. CODE ANN. §§ 13.1-725 to -728 (Repl. Vol. 1985).

3. See *infra* notes 76-83 and accompanying text.

4. See *infra* notes 84-97 and accompanying text.

5. On January 1, 1986, a completely revised Virginia Stock Corporation Act and Virginia Nonstock Corporation Act (Revised Act), VA. CODE ANN. §§ 13.1-601 to -980 (Repl. Vol. 1985) became effective. The Revised Act replaced in its entirety the prior Virginia Stock Corporation Act and Virginia Nonstock Corporation Act (Old Act), VA. CODE ANN. §§ 13.1-1 to -300 (Repl. Vol. 1978). Many of the developments reviewed in this article involve the judicial interpretation of or legislative amendment to various corporate statutes. All references to amendments and revisions to the Revised Act are found in the appropriate 1986 or 1987 supplements of the Virginia Code. All references to provisions of the Old Act in existence at a time in question are found in the appropriate replacement volumes or supplements of the Virginia Code.

6. See *infra* notes 98-112 and accompanying text.

I. JUDICIAL DECISIONS

A. *State Anti-Takeover Statute Held Valid*

On April 21, 1987, the United States Supreme Court quelled the fears of corporations desiring to take advantage of various states' anti-takeover provisions by upholding the validity of an Indiana anti-takeover provision. In *CTS Corp. v. Dynamics Corp. of America*,⁷ the Court considered whether Indiana's Control Share Acquisitions Chapter (the Indiana Act)⁸ was preempted by the Williams Act,⁹ and whether it violated the commerce clause of the United States Constitution.¹⁰ The district court had ruled that the Indiana Act violated both,¹¹ and the Seventh Circuit affirmed the district court's rulings.¹²

The Indiana Act provides that upon the acquisition of "control shares"¹³ in certain domestic corporations,¹⁴ the acquirer will not obtain the voting rights to which it would otherwise be entitled absent a majority vote of the disinterested shareholders.¹⁵ The disinterested shareholders would make their decision at the next regularly scheduled shareholders' meeting or at a special shareholders' meeting. The acquirer could require an earlier meeting within fifty days.¹⁶ If the disinterested shareholders do not allow the acquirer to obtain the voting rights to the shares acquired, the corporation could, but is not required to, redeem the acquirer's shares at fair market value.¹⁷ According to the Court in *CTS*, "[t]he practical effect of [the statute] is to condition acquisition of control of a cor-

7. 107 S. Ct. 1637 (1987).

8. IND. CODE §§ 23-1-42-1 to 23-1-42-11 (Supp. 1986).

9. 15 U.S.C. §§ 78m(d)-(e) and 78n(d)-(f) (1982 & Supp. III 1986).

10. U.S. CONST. art. I, § 8, cl. 3.

11. *Dynamics Corp. of Am. v. CTS Corp.*, 637 F. Supp. 389 (N.D. Ill. 1986).

12. *Dynamics Corp. of Am. v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986).

13. The threshold levels are 20%, 33 ⅓% and 50%. IND. CODE § 23-1-42-1.

14. The Indiana Act applies only to a corporation incorporated in Indiana. IND. CODE § 23-1-20-5. The Indiana Act applies to an Indiana corporation which has:

(1) one hundred (100) or more shareholders; (2) its principal place of business, its principal office, or substantial assets within Indiana; and (3) either: (A) more than ten percent (10%) of its shareholders resident in Indiana; (B) more than ten percent (10%) of its shares owned by Indiana residents; or (C) ten thousand (10,000) shareholders resident in Indiana.

Id.

§ 23-1-42-4(a).

15. IND. CODE § 23-1-42-9(a) and (b).

16. *Id.* § 23-1-42-7.

17. *Id.* § 23-1-42-10(b).

poration on approval of a majority of the preexisting disinterested shareholders."¹⁸

With respect to whether the Indiana Act is preempted by the Williams Act, the Court reiterated its policy that, absent an explicit indication of intent by Congress to preempt state law, a state statute would be preempted only where compliance with both would be a physical impossibility¹⁹ or where the state law frustrated the purposes of the federal statute.²⁰ The Court found that the Williams Act was enacted in response to an increasing number of hostile takeover attempts and its purposes were to require various disclosures of an offeror and to establish procedural rules governing tender offers.²¹

In analyzing the preemption issue, the Court reviewed its plurality decision in *Edgar v. MITE Corp.*,²² which invalidated an Illinois anti-takeover provision and which served as the basis for the district and circuit courts' invalidation of the Indiana Act. The Court distinguished the Illinois statute in *MITE* from the Indiana Act by pointing out that:

the Illinois statute considered in [*MITE*] operated to favor management against offerors, to the detriment of shareholders. By contrast, the statute now before the Court protects the independent shareholder against both of the contending parties. Thus, the [Indiana] Act furthers a basic purpose of the Williams Act, "plac[ing] investors on an equal footing with the takeover bidder."²³

By providing these shareholders with additional protection, the Indiana Act did not conflict with the Williams Act. It furthered the federal act's policy of investor protection.²⁴

18. *CTS*, 107 S. Ct. at 1641.

19. *Id.* at 1644 (construing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963)).

20. *Id.* (citations omitted). Because the Court believed that the requirements of both statutes could be complied with simultaneously, the Indiana Act would be preempted only if it frustrated the purposes of the Williams Act. *Id.*

21. *Id.*

22. 457 U.S. 624 (1982). For a discussion of the Court's decision in *Edgar v. Mite*, see Joynes & Keeler, *Virginia's 'Affiliated Transactions' Statute: Indulging Form Over Substance in Second Generation Takeover Legislation*, 21 U. RICH. L. REV. 489 (1987). In an addendum, the authors disagree vehemently with the *CTS* Court's decision.

23. *CTS*, 107 S. Ct. at 1645-46 (quoting *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 30 (1977) (quoting S. REP. NO. 550, 90th Cong., 1st Sess. 4 (1967))).

24. *Id.* at 1646.

The Court was also satisfied that the fifty-day meeting provision did not conflict with the twenty-day provision of the Williams Act during which time a tender offer may be held open. The fifty-day provision did not impose a fifty-day delay on the purchasing of shares. It merely delayed the date upon which voting rights could be conferred on the shares purchased. The Court noted that if the offeror feared that the disinterested shareholders would vote adversely to its position, the offeror could condition its purchase on a favorable vote.²⁵ Assuming, however, that the Indiana Act did impose an additional delay, the Court did not believe that the existence of any delay would impose an impermissible conflict. In *MITE*, the Court stated that the offeror should "be free to go forward without *unreasonable* delay."²⁶ In *CTS*, the Court did not believe the fifty-day delay to be unreasonable.²⁷

Finally, the Court was concerned that if it held that the Williams Act preempted the Indiana Act on the grounds that a fifty-day delay constituted impermissible interference with the Williams Act, numerous state corporation laws might be construed as conflicting with the Williams Act. The Court concluded that "[t]he longstanding prevalence of state regulation in this area suggests that, if Congress had intended to pre-empt all state laws that delay the acquisition of voting control following a tender offer, it would have said so explicitly."²⁸

In its commerce clause²⁹ analysis, the Court reiterated the two principal criteria upon which it would find a state statute violative of the commerce clause: (1) the statute discriminates against interstate commerce; or (2) the statute adversely affects interstate commerce by subjecting activities to inconsistent regulations.³⁰ The Court found that the Indiana Act met neither criterion. The Court based its findings on the simple fact that the Indiana Act regulated the voting rights of Indiana corporations only. It emphasized that "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."³¹

25. *Id.* at 1646-47.

26. *MITE*, 457 U.S. at 639, quoted in *CTS*, 107 S. Ct. at 1647.

27. *CTS*, 107 S. Ct. at 1647.

28. *Id.* at 1648.

29. U.S. CONST. art. I, § 8, cl. 3.

30. *CTS*, 107 S. Ct. at 1648-49.

31. *Id.* at 1649.

The Court's decision in *CTS* should provide a Virginia corporation desiring to defend against a hostile takeover with some assurance that the anti-takeover provisions of the Revised Act pass constitutional muster. Had the Court invalidated the Indiana Act, the validity of Virginia's affiliated transactions provision³² may have been called into question. While the Virginia provision differs from the Indiana Act in several respects, its primary objective is virtually identical to that of the Indiana Act.³³

B. *Personal Liability of Individuals for Corporate Obligations*

1. Officer of Foreign Corporation not Liable for Pre-Qualification Contract

In *Holliday v. Scanseas*,³⁴ the Virginia Supreme Court addressed, but did not decide, the issue of whether an officer of a foreign corporation was personally liable on a contract entered into by the corporation in Virginia before it acquired a certificate of qualification. In *Holliday*, Scanseas, Inc. (Scanseas) entered into a loan commitment agreement with FSI Financial Services Corp. (FSI), a Delaware corporation with offices in Virginia, engaged in investment banking and loan financing. FSI agreed to finance for Scanseas a fish-processing operation off the coast of Alaska, subject to Scanseas's performance of various conditions. Scanseas paid FSI a non-refundable application fee and a commitment fee. After FSI failed to fund the loan, Scanseas sued FSI, its parent corporation, a third corporation and three of FSI's corporate officers.

32. VA. CODE ANN. §§ 13.1-725 to -728 (Repl. Vol. 1985).

33. Joint Bar Committee Commentary to § 13.1-725 states:

The source of the [affiliated transactions] 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 his voting power to squeeze out the remaining shareholders at a price that does not reflect the fair value of the shares.

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) (containing commentaries of the Virginia Code Commission and Virginia Bar Association/Virginia State Bar Title 13.1 Joint Bar Committee [hereinafter JOINT BAR COMMITTEE COMMENTARY]).

34. 232 Va. 316, 350 S.E.2d 607 (1986).

Scansea claimed damages for breach of contract and common law fraud and that it was entitled to the refund of the application and commitment fees "[d]ue to the Principal Defendants' breach."³⁵ The trial court ruled against Scansea on the breach of contract and fraud claims.³⁶ As to the refund claim, the court ruled in favor of Scansea on the basis that the fees constituted the payment of points, and since the loan was never funded, the fees should be refunded.³⁷ The three corporate officers were held jointly and severally liable for the application and commitment fees, and one of the officers, Carolyn B. Holliday (Holliday), appealed the judgment against her.³⁸

Holliday was employed by FSI as an office secretary. She also served as corporate secretary, a title she stated that she had accepted "as a matter of convenience."³⁹ With respect to the financing transaction, Holliday attended the "dry settlement," attested to the signature of FSI's president and affixed the corporate seal to various documents.⁴⁰

In defending the trial court's judgment on appeal, Scansea argued that since FSI had failed to acquire a certificate of authority to do business in Virginia as required by Virginia law,⁴¹ Holliday, as a corporate officer, was personally liable for any corporate obligation in Virginia.⁴² Holliday argued that she was merely a

35. *Id.* at 317, 350 S.E.2d at 608.

36. *Id.*

37. *Id.* at 317-18, 350 S.E.2d at 608.

38. *Id.* at 318, 350 S.E.2d at 608.

39. *Id.*

40. *Id.*

41. Section 13.1-102 of the Old Act provided: "No foreign corporation shall transact business in this State until it shall have procured a certificate of authority to do so from the [Virginia State Corporation] Commission." VA. CODE ANN. § 13.1-102 (Repl. Vol. 1978). Section 13.1-757(A) of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-757(A) (Repl. Vol. 1985).

42. Section 13.1-119 of the Old Act provided:

If a foreign corporation transacts business in this State without a certificate of authority, its directors, officers and agents doing such business shall be jointly and severally liable for any contracts made or to be performed in this State . . . between the time when it began to transact business in this State and the date when it obtains a certificate of authority.

Id. § 13.1-119 (Cum. Supp. 1982).

Personal liability for contracts is no longer imposed. Section 13.1-758(D) of the Revised Act imposes a penalty on each officer, director and employee who transacts business on behalf of a foreign corporation without a certificate of authority and who knows that a certificate of authority is required. Each such officer, director and employee is subject to a penalty of not less than \$100 and not more than \$5,000. *Id.* § 13.1-758(D) (Repl. Vol. 1985).

“subordinate officer” performing only clerical duties and that the personal liability provisions of Virginia law applied only to “those officers who would be ‘responsible,’ or who could control the corporation’s business.”⁴³

At first blush, the court seemed to reject Holliday’s interpretation of the statute in favor of Scansea’s more literal reading. The court ultimately reversed the trial court’s judgment, however, on technical grounds.⁴⁴ The court reasoned that since Scansea had premised its refund claim on a breach of contract and the trial court had ruled that FSI had not breached the contract, Scansea’s claim “fail[ed] for want of proof of its predicate”⁴⁵

Because the court decided the case on technical grounds, it did not need to decide the issue of Holliday’s liability under corporate law. The court did not indicate whether it would have ruled in favor of Scansea had it pleaded its case properly. The court stated only that “[u]nder the statute, when a foreign corporation transacts business in Virginia in violation of her laws, corporate officers ‘doing such business’ are personally liable”⁴⁶

2. Officers Liable for Purported Corporate Debt Incurred After Corporate Dissolution and Prior to Corporate Reinstatement

In *McLean Bank v. Nelson*,⁴⁷ the Virginia Supreme Court decided whether, under Virginia corporate law, persons who act on behalf of a dissolved corporation can be held personally liable for their acts and, if so, whether such personal liability is relieved by a subsequent reinstatement of the corporation. In *McLean*, Isle of Eden, Inc. (Isle) was automatically dissolved for failure to file annual reports with the Virginia State Corporation Commission (SCC).⁴⁸ During the period of dissolution, the president and secretary of Isle executed a promissory note in their respective representative capacities, which note was later indorsed and transferred

43. *Holliday*, 232 Va. at 318, 350 S.E.2d at 609.

44. *Id.* at 318-19, 350 S.E.2d at 609.

45. *Id.* at 319, 350 S.E.2d at 609.

46. *Id.* at 318, 350 S.E.2d at 609 (emphasis added).

47. 232 Va. 420, 350 S.E.2d 651 (1986).

48. *Id.* at 422, 350 S.E.2d at 654. Section 13.1-91 of the Old Act provided that if a corporation failed to file annual reports for two successive years, the corporation would be automatically dissolved as of June 1 after the due date of the second annual return. VA. CODE ANN. § 13.1-91 (Repl. Vol. 1978). Section 13.1-752 of the Revised Act is virtually identical to the predecessor statute. VA. CODE ANN. § 13.1-752 (Repl. Vol. 1985). Isle was dissolved on June 1, 1973. *McLean*, 232 Va. at 422, 350 S.E.2d at 654.

by the holder to McLean Bank (Bank). Before the transfer, Isle was reinstated as a corporation.⁴⁹ Upon Isle's default, the Bank sued various stockholders, officers and directors of Isle. The trial court sustained the defendants' demurrers and the Bank appealed.⁵⁰

With respect to whether persons acting on behalf of a dissolved corporation can be held personally liable for their acts, the court construed three corporate statutes and a criminal statute to reach its decision. The three corporate statutes provided as follows: (1) corporate existence commences upon the issuance of the certificate of incorporation,⁵¹ (2) a corporation is automatically dissolved upon its failure to file two successive annual reports and upon dissolution, the properties and affairs of the corporation pass automatically to its directors;⁵² and (3) upon being reinstated, a corporation will be deemed to have existed continuously "except that reinstatement shall have no effect on any question of personal liability of the directors, officers, or agents in respect of the period between dissolution and reinstatement."⁵³ The criminal statute provided that it was a misdemeanor for individuals to transact business as a corporation without authorization from the SCC.⁵⁴

The appellees argued on appeal that (1) the imposition of personal liability required an express statutory mandate;⁵⁵ (2) the statutory provision regarding continued existence shielded them from liability;⁵⁶ (3) in states where personal liability has been im-

49. *McLean*, 232 Va. at 422-23, 350 S.E.2d at 654. Section 13.1-92 of the Old Act provided that if a corporation was dissolved for failure to file annual reports and applied for reinstatement within five years after being dissolved, it would be reinstated upon payment of a \$100 reinstatement fee, together with all past due registration fees, penalties, franchise taxes and interest. VA. CODE ANN. § 13.1-92 (Repl. Vol. 1978). Section 13.1-754 of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-754 (Repl. Vol. 1985).

50. *McLean*, 232 Va. at 423-24, 350 S.E.2d at 654-55.

51. VA. CODE ANN. § 13.1-52 (Repl. Vol. 1978). Section 13.1-621 of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-621 (Repl. Vol. 1985).

52. *Id.* § 13.1-91 (Repl. Vol. 1978). Section 13.1-752 of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-752 (Repl. Vol. 1985).

53. *Id.* § 13.1-92 (Repl. Vol. 1978). Section 13.1-754 of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-754 (Repl. Vol. 1985).

54. *Id.* § 13.1-296 (Repl. Vol. 1978). Section 13.1-812 of the Revised Act is virtually identical to the predecessor statute. *Id.* § 13.1-812 (Repl. Vol. 1985).

55. *McLean*, 232 Va. at 425, 350 S.E.2d at 655. For the appellees' example of such an express statutory mandate, see *supra* note 42. The appellees argued that, based on the Old Act explicitly imposing personal liability, "had the General Assembly intended to impose personal liability upon individuals who act on behalf of a dissolved corporation it would have said so." 232 Va. at 425, 350 S.E.2d at 655.

56. 232 Va. at 426, 350 S.E.2d at 655. See *supra* note 53 and accompanying text. The

posed on individuals for actions taken while the corporation was out of existence there was a statute imposing such liability;⁵⁷ (4) the criminal statute either preempted a private cause of action or required proof of intent in a private cause of action;⁵⁸ and (5) it would be too harsh to impose personal liability automatically without regard to the reason for the corporate dissolution.⁵⁹ The court rejected each of the appellees' arguments, noting that the arguments had some surface appeal but overlooked "important considerations of the nature of corporations and of statutory interpretation."⁶⁰

The court explained that no express statutory provision is required to impose personal liability. On the contrary, it is corporate existence which provides limited liability.⁶¹ Absent corporate existence, personal liability is automatic.⁶² The court reasoned that if corporate existence commences upon the issuance of a certificate of incorporation, "[s]urely, corporate existence must end upon dissolution."⁶³ Further, the court charged that by contending that the statute did not impose liability, but simply left liability unaffected,

appellees argued that since the corporation had been reinstated before the date of the transfer of the note to the Bank, the note became a corporate and not a personal obligation. 232 Va. at 426, 350 S.E.2d at 655.

57. 232 Va. at 426, 350 S.E.2d at 656. The appellees did not present any of the statutes they claimed existed; instead, they merely pointed to the fact that no parallel provision existed in Virginia with respect to domestic corporations. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. The appellees had argued that § 13.1-119 of the Old Act indicated that an express statutory provision was necessary to impose personal liability. 232 Va. at 425, 350 S.E.2d at 655. *See also supra* note 55 and accompanying text. The court found the appellees' argument and statutory example unpersuasive. Section 13.1-119 imposed personal liability for acts performed on behalf of an existing, yet undomesticated, corporation. The court stated that:

the appellees' argument on this point overlooks a critical distinction between a dissolved domestic corporation and a foreign corporation. A dissolved domestic corporation is no corporation at all. A foreign corporation is still a corporation even though it might not be domesticated. If an entity is no corporation at all, the individuals who conduct its affairs must be personally liable for their acts and, as noted above, no need exists to recite the obvious in a statute. On the other hand, if liability were not expressly imposed upon those acting on behalf of a foreign corporation, those individuals might escape liability by reliance on the corporate form. Thus, in the case of a dissolved domestic corporation, the legislature had no need expressly to impose individual liability on those who conduct its affairs. However, in the case of an undomesticated foreign corporation, that precise need does exist.

232 Va. at 426-27, 350 S.E.2d at 656.

62. *Id.*

63. *Id.*

the appellees failed to account for the statutory provision mandating continued personal liability after reinstatement.⁶⁴ The court stated that the appellees' contention:

beg[ged] the central question of what personal liability is being left unaffected. The only personal liability that could be left unaffected is personal liability that came into being during the period of dissolution. The only personal liability to which the statute could refer is personal liability for doing business as if the entity were a de jure corporation. In our opinion, the language in former Code § 13.1-92 is an acknowledgement that personal liability attaches, by operation of general principles of law, to individuals who act on behalf of a dissolved corporation. Otherwise the language is superfluous and meaningless . . . Here, the proper way to read former Code § 13.1-92 is that it did not relieve directors, officers, or agents of personal liability that otherwise arose during the period of dissolution.⁶⁵

The court also rejected the appellees' claim that reinstatement of corporate status before the note was transferred to the Bank relieved the individuals of personal liability because the note had become a corporate note.⁶⁶ The court reiterated the statute's explicit statement that personal liability was not extinguished, regardless of whether the note became a corporate obligation. For that reason, the court did not decide whether the reinstatement before the transfer converted the note into a corporate obligation.⁶⁷

The court rejected the appellees' argument that the criminal statute preempted or hindered a private cause of action. The court believed it to be:

incongruous to suggest that conducting the affairs of a dissolved corporation can lead to criminal punishment but not personal liability. This is especially true because, without the imposition of personal liability, it would often be the case that nobody would be liable for a debt.⁶⁸

64. See *supra* note 53 and accompanying text.

65. 232 Va. at 427, 350 S.E.2d at 656. The court's analysis is consistent with JOINT BAR COMMITTEE COMMENTARY, *supra* note 33, to § 13.1-754, which states that the retention of the continuing personal liability provision "should spare Virginia the statutory uncertainty that has prompted considerable litigation on the interim liability issue in other jurisdictions."

66. *Id.* at 427, 350 S.E.2d at 657.

67. *Id.* at 427-28, 350 S.E.2d at 657.

68. *Id.* at 428, 350 S.E.2d at 657.

The court felt that if the appellees' arguments were followed to their logical conclusion, the corporation could not be held liable because it would not exist; the individuals acting on behalf of the nonexistent corporation could not be held liable because of the absence of an express statutory provision and, absent proof beyond a reasonable doubt of criminal intent, they could not be held criminally liable for their actions. The court concluded that the above scenario "is not the state of the law in the Commonwealth."⁶⁹

Based on the similarity between Old Act section 13.1-119 and Revised Act section 13.1-754, *McLean* appears to be good law in Virginia, yet Revised Act section 13.1-622 seems to confuse the matter by limiting personal liability with respect to pre-incorporation transactions.⁷⁰

3. Officer Not Liable for Addendum Executed in Corporate Name

In *Muhleman Investments, Inc. v. Bruce*,⁷¹ Muhleman Investments, Inc. (Muhleman) sought to hold William G. Bruce (Bruce) personally liable for the obligations of William G. Bruce, Inc. (corporation) under a real estate lease between Muhleman as landlord and the corporation as tenant. In an attempt to bind Bruce under the lease, Muhleman offered him an addendum which stated that "the undersigned . . . bind themselves . . . jointly and severally with the tenant . . ."⁷² Below the signature line was typed "William G. Bruce, Inc." and the addendum was executed by Bruce as "William G. Bruce, Inc."⁷³

Judge Hughes of the Circuit Court of the City of Richmond held that Bruce was not personally liable because no contract existed between Bruce and Muhleman. While it was clear that Muhleman intended that Bruce sign the addendum in his individual capacity, Bruce did not do so. Thus, Bruce's acceptance did not comply with the terms of Muhleman's offer.⁷⁴ The court found the addendum to

69. *Id.*

70. The statute provides, with respect to preincorporation transactions, as follows: "All persons purporting to act as or on behalf of a corporation, knowing there was no incorporation under this chapter, are jointly and severally liable for all liabilities created while so acting except for any liability to any person who also knew that there was no incorporation." VA. CODE ANN. § 13.1-622 (Repl. Vol. 1985).

71. No. LJ-1823-1, letter op. (Richmond Cir. July 10, 1986).

72. *Id.* at 1.

73. *Id.*

74. *Id.* at 2.

be "indefinite and inexact on the issue of Bruce's individual personal liability such that the intent of the parties cannot be sufficiently determined to allow the contract to be carried into effect."⁷⁵

C. *Providing Day Care in Home Is a Business Pursuit*

In *Virginia Mutual Insurance Co. v. Hagy*,⁷⁶ the Virginia Supreme Court ruled that Nancy Hagy (Hagy), who provided day care services in her home for compensation, was engaged in a "business pursuit" within the meaning of an exclusionary clause in her homeowner's insurance policy. This case arose out of a wrongful death action instituted by a mother whose child had suffered fatal injuries while under Hagy's care. At the time of the accident, Hagy was insured under a homeowner's insurance policy issued by Virginia Mutual Insurance Company (Virginia Mutual). Virginia Mutual filed a declaratory judgment action in circuit court against the mother and Hagy, requesting that the court declare, as a matter of law, that Hagy was not covered for the child's injuries because they arose "out of business pursuits of [the] insured."⁷⁷ Instead, the court submitted the question to the jury and the jury found against Virginia Mutual. Virginia Mutual appealed.⁷⁸

The court defined the term "business pursuit" as follows:

To constitute a business pursuit, there must be two elements: first, continuity, and, secondly, the profit motive; as to the first, there must be a customary engagement or a stated occupation; and, as to the latter, there must be shown to be such activity as a means of livelihood, gainful employment, means of earning a living, procuring subsistence or profit, commercial transactions or engagements.⁷⁹

The evidence at trial showed that Hagy had engaged in a day care operation for more than a year. She had placed advertisements in the newspaper and on radio. She had applied for and received formal certification as a "Day Care Provider," entitling her to fees for caring for children whose mothers were eligible for pub-

75. *Id.*

76. 232 Va. 472, 352 S.E.2d 316 (1987).

77. *Id.* at 473-74, 352 S.E.2d at 317.

78. *Id.* at 475, 352 S.E.2d at 318.

79. *Id.* (quoting *Fadden v. Cambridge Mut. Ins.*, 51 Misc. 2d 858, 862, 274 N.Y.S.2d 235, 241 (1966) (citations omitted), *aff'd*, 27 A.D.2d 287, 280 N.Y.S.2d 209 (1967)).

lic assistance. She was employed to care for as many as five children per day.⁸⁰ On her 1979 income tax return, Hagy listed her occupation as "Waitress and babysitter" and reported a net profit of \$500.00 in "Day Care."⁸¹

The court rejected Hagy's argument that the jury was the appropriate body to determine whether or not Hagy was engaged in a "business pursuit," ruling that the issue presented at trial was "one 'upon which reasonable persons should not differ' and that 'the trial court should not have submitted the question to the jury.'"⁸² The court found that Hagy's day care operation constituted a business pursuit which continued through the child's death, notwithstanding the abandonment of her advertising campaign, her search for other full-time employment, and the cessation of commitments to all of the children for whom she had been caring except to the one remaining child. In the court's words, "[b]usiness ventures do not lose their identity as such merely because profits decline."⁸³

Although the court's decision is correct, this case highlights a serious problem faced by parents and in-home day care providers. As recently as three years ago, insurance agents and underwriters disagreed about whether the standard business exclusionary clause in homeowner's policies applied to in-home day care providers. The more cautious agents and underwriters advised that it did and, consequently, wrote separate policies or attached specific riders to ensure coverage. One can only assume that, at the same time, many in-home day care providers, believing themselves to be insured, were not. Those who obtained insurance coverage before the current liability insurance crisis and who have remained covered may continue to receive coverage if they can afford the premiums. Because so few companies will write new policies for in-home day care providers today, many may not be able to obtain coverage at any cost.

80. *Id.* at 474, 352 S.E.2d at 317.

81. *Id.* at 474, 352 S.E.2d at 317-18.

82. *Id.* at 475-76, 352 S.E.2d at 318 (quoting and applying *Allstate Ins. Co. v. Patterson*, 231 Va. 358, 363, 344 S.E.2d 890, 893 (1986)).

83. 232 Va. at 476, 352 S.E.2d at 319.

D. *Stock Options Issued to Director-Employee For Past Services Held Invalid*

In *Baggarly v. Cooper*,⁸⁴ Judge Whiting of the Circuit Court of Warren County⁸⁵ invalidated stock options granted to a majority stockholder-director-employee and his wife (the Coopers) as a result of an action instituted by George Baggarly, a minority stockholder. The options permitted the Coopers to purchase shares of corporate stock at a bargain price, the bargain price being justified as a bonus for extraordinary services performed by the Coopers during the previous year.⁸⁶ In what appears to be a case of first impression in Virginia,⁸⁷ the court reached the correct decision, yet its analysis is confusing. More importantly, the court failed to interpret correctly what should have been the dispositive statutory provision.

The bonus stock options (options) were granted in 1986.⁸⁸ At that time, Revised Act section 13.1-646 explicitly authorized the board of directors to issue stock options "upon such terms and conditions and for such consideration"⁸⁹ as it may approve, provided that options issued to an officer or employee (or director) are authorized by the shareholders, unless there is a provision in the articles of incorporation that shareholder approval is not required.

It is clear that the court was aware of Revised Act section 13.1-646; it is less clear whether it understood the meaning of the statute. In a footnote, the court stated that "[section] 13.1-646 requires a provision in the charter to grant stock options by directors

84. No. 4862, letter op. (Warren County Cir. Sept. 12, 1986).

85. Judge Whiting is currently an associate justice of the Virginia Supreme Court, having replaced retired Justice Cochran.

86. No. 4862, letter op. at 1.

87. *Id.* at 2.

88. It is unclear, however, whether the options were granted before or after March 7, 1986. Section 13.1-646 of the Revised Act was amended effective March 7, 1986 to add directors to the category of persons to whom options may be granted only with shareholder approval or pursuant to a provision in the articles of incorporation stating that shareholder approval is not required. If the options are granted to shareholders generally, no special approval is necessary. VA. CODE ANN. § 13.1-646 (Cum. Supp. 1987). Previously, the category consisted of officers and directors only. VA. CODE ANN. § 13.1-646 (Repl. Vol. 1985). It is also unclear whether the options were granted to the Coopers as stockholders, directors or officers. If the options were granted before March 7, 1986 and they were granted to the Coopers as directors, some of the court's analysis would make sense since the shareholder approval process of § 13.1-646 would not apply. Regardless, the court's analysis is muddled.

89. VA. CODE ANN. § 13.1-646 (Cum. Supp. 1987).

to officers and employees of the corporation.”⁹⁰ The Court was technically correct. Directors, *by themselves, without shareholder approval*, can grant stock options to officers or employees (or directors) *only* by virtue of an express authorization in the charter. But the court did not stop there. Later in the opinion, the court misstated that “[p]erhaps Virginia would approve a bonus plan for directors adopted by a majority of the *stockholders*.”⁹¹

The court has missed the point. First, as previously explained, a grant of stock options to officers and employees (and directors) does not require an enabling charter provision, but merely shareholder approval. The statute serves as the dispositive enabling provision. More importantly, the statute is clear in authorizing the shareholders to approve a bonus plan for employees and officers (and directors). Because the statute required shareholder approval, and such approval was never obtained, the options were correctly invalidated.

In addition to the court’s failure to understand the dispositive nature of Revised Act section 13.1-646, the court’s analysis is disturbing in two further respects. First, the analysis dwells on the fact that the options were granted as bonuses for past performance of services. It seems rather obvious that most, if not all, bonuses are granted for past performance. A huge number of businesses in Virginia pay their officers and employees bonuses for past performance. Bonus has been defined as “[a]n addition to salary or wages normally paid for extraordinary work.”⁹² While conceding that the Coopers “did render quite valuable and extraordinary services to the corporation,”⁹³ the court took offense at the payment of the bonus. Perhaps the court’s attack on the bonus stems not from a dislike of bonuses per se, but rather from the fact that the bonus was not approved by the shareholders.⁹⁴ If that is the case, it supplies further evidence of the court’s misunderstanding of Revised Act section 13.1-646.

Finally, the court seemed to pay lip service only to its statement that “Courts should not substitute their judgement for that of the directors and accord every action of the directors a presumption of

90. No. 4862, letter op. at 2 (footnote at 5).

91. *Id.* at 4.

92. BLACK’S LAW DICTIONARY 165 (5th ed. 1979).

93. No. 4862, letter op. at 5.

94. *See id.* at 1 (issuance of option by the vote of the directors).

good faith and proper exercise of discretion"⁹⁵ Without offering any evidence of bad faith or minority oppression, the court would impose a number of restrictions on a corporation desiring to adopt a bonus plan for directors for past services, including "a consistent pattern of prior bonuses for such past services . . . and [bonuses which are] shown to be of direct benefit in the future to the stockholders generally."⁹⁶ Such restrictions would appear to be contrary to an avowed purpose of Revised Act section 13.1-646.⁹⁷

II. LEGISLATIVE DEVELOPMENTS

A. *Limitations On Liability of Corporate Officers and Directors*

The 1987 Virginia General Assembly heard the cries of corporations having difficulty recruiting outside directors and from the directors themselves about the increased risk of directors' liability from shareholder suits. The General Assembly enacted section 13.1-692.1(A) which provides, with respect to stock corporations, that the liability of an officer or director for damages assessed in a proceeding brought by a shareholder in the right of a corporation or by or on behalf of shareholders shall not exceed the lesser of: (1) an amount specified in the articles of incorporation or in the by-laws, if such bylaw provision is approved by the shareholders; or (2) the greater of (a) \$100,000 or (b) the amount of cash compensation received by the officer or director from the corporation during the twelve-month period immediately preceding the act or omission for which the liability was imposed.⁹⁸ Section 13.1-629.1(B) provides that the limitation on liability provided in section 13.1-629.1(A) shall not apply to liability imposed as a result of willful misconduct or a knowing violation of the criminal law or of any state or federal securities law.⁹⁹

95. *Id.* at 2.

96. *Id.* at 4-5.

97. VA. CODE ANN. § 13.1-646 (Cum. Supp. 1987) is based in part on REVISED MODEL BUSINESS CORP. ACT § 6.24 (1985) [hereinafter MODEL ACT]. While MODEL ACT § 6.24 does not require shareholder approval, the provision is instructive. Official Comment to MODEL ACT § 6.24 states:

The creation of incentive compensation plans for directors, officers, agents, and employees is basically a matter of business judgment and the good faith determination by the board of directors should therefore be conclusive. This is as true for incentive rights as for those that involve the payment of cash. In appropriate cases incentive plans may involve the granting of options at prices below the current market prices of the shares.

98. VA. CODE ANN. § 13.1-692.1(A) (Cum. Supp. 1987).

99. *Id.* § 13.1-692.1(B).

The General Assembly also enacted section 13.1-870.1(A) which provides similar limitations on liability for the officers and directors of nonstock corporations, with two major exceptions.¹⁰⁰ Section 13.1-879.1(B) provides that liability imposed upon a compensated officer or director of a nonstock corporation which is exempt from taxation under section 501(c) of the Internal Revenue Code¹⁰¹ shall be limited to the amount of compensation received from such corporation during the twelve-month period immediately preceding the act or omission for which the liability was imposed. An uncompensated officer or director of such a corporation shall not be liable for any damages.¹⁰² Section 13.1-870.1(C) states that the limitation on liability provided in sections 13.1-870.1(A) and (B) shall not apply to liability imposed as a result of willful misconduct or a knowing violation of the criminal law.

B. *Officers' and Directors' Immunity from Civil Liability*

The General Assembly provided further relief for officers and directors of a nonstock corporation which is exempt from taxation under section 501(c) of the Internal Revenue Code.¹⁰³ New section 8.01-220.1:1(A) provides that an uncompensated director or officer of such a corporation shall be immune from civil liability for acts taken in his or her respective representative capacity.¹⁰⁴ Section 8.01-220.1:1(B) provides that liability imposed upon a compensated officer or director of such a corporation shall be limited to the amount of compensation received from such corporation during the twelve-month period immediately preceding the act or omission for which liability was imposed.¹⁰⁵ Section 8.01-220.1:1(C) provides that the limitation on or exemption from liability provided in sections 8.01-220.1:1(A) and (B) shall not apply to liability imposed as a result of willful misconduct or a knowing violation of the criminal law, or liability derived from the operation of a motor vehicle.¹⁰⁶

100. *Id.* § 13.1-870.1(A).

101. I.R.C. § 501(c) (West Supp. 1986).

102. VA. CODE ANN. § 13.1-870.1(B).

103. I.R.C. § 501(c) (West Supp. 1986).

104. VA. CODE ANN. § 8.01-220.1:1(A) (Cum. Supp. 1987).

105. *Id.* § 8.01-220.1:1(B).

106. *Id.* § 8.01-220.1:1(C).

C. Court Orders for Advances, Reimbursement or Indemnification

The General Assembly repealed Revised Act sections 13.1-700 and -879, dealing with court-ordered indemnification for directors, and replaced the repealed sections with sections 13.1-700.1 and 13.1-879.1.¹⁰⁷ Section 13.1-700.1 expands the scope of a court's authority to provide relief to a director for liability and/or expenses incurred or to be incurred in connection with a proceeding in which the director has been made a party. The new statute provides for advances and reimbursement for expenses and indemnification as follows: (1) a director's ability to apply to a court for advances or reimbursement of expenses or indemnification does not appear to be limitable by the corporation's articles of incorporation;¹⁰⁸ (2) a director may apply for advances in addition to reimbursement for expenses and indemnification;¹⁰⁹ (3) if the court determines that the director is entitled to advances, reimbursement or indemnification, they shall be ordered paid, together with reasonable expenses incurred by the director in obtaining the court order;¹¹⁰ (4) if indemnification is ordered with respect to a proceeding by or in the right of the corporation, the director shall be entitled to reasonable expenses incurred by him in obtaining the court order;¹¹¹ and (5) the director's application for advances, reimbursement or indemnification shall not be prejudiced by: (a) the corporation's failure to make a determination regarding the director's entitlement before the commencement of an action in which the application is made; or (b) the corporation's determination that

107. VA. CODE ANN. §§ 13.1-700.1, -879.1 (Cum. Supp. 1987) (parallel statutes relating to stock and nonstock corporations, respectively).

108. *Id.* § 13.1-700.1(A). Repealed § 13.1-700 permitted a corporation's articles of incorporation to limit a director's ability to apply for court-ordered indemnification. *Id.* § 13.1-700 (Repl. Vol. 1985). A similar limiting provision is absent from the new statute.

109. *Id.* § 13.1-700.1(A) (Cum. Supp. 1987). Repealed § 13.1-700 did not permit a director to apply for advances. *Id.* § 13.1-700 (Repl. Vol. 1985).

110. *Id.* § 13.1-700.1(B) (Cum. Supp. 1987). Under repealed § 13.1-700, a director could obtain court-ordered indemnification only if he entirely prevailed in the defense of the proceeding in which he had been a party, and only at the discretion of the court. *Id.* § 13.1-700 (Repl. Vol. 1985). New § 13.1-700.1(B) does not impose this requirement. The court is left to its own devices in determining whether the director is entitled to advances, reimbursement or indemnification.

111. *Id.* § 13.1-700.1(C) (Cum. Supp. 1987). Repealed § 13.1-700 did not provide for the payment of the director's expenses in obtaining the court-ordered indemnification. *Id.* § 13.1-700 (Repl. Vol. 1985).

the director is not entitled to advances, reimbursements or indemnification.¹¹²

D. Sale of Assets Other than in the Regular Course of Business

Revised Act section 13.1-724(D)¹¹³ was amended to allow a corporation desiring to sell all, or substantially all, of its property to send to shareholders a summary of the sale agreement rather than the entire agreement. Any shareholder requesting the entire agreement will be entitled to a copy. The repealed section had required the entire agreement to be sent to every shareholder.

E. Staggered Terms of Directors of Nonstock Corporations

Revised Act section 13.1-858(A)¹¹⁴ was amended to authorize a nonstock corporation's articles of incorporation to provide for the staggering of the terms of directors by dividing the directors into four groups. One-fourth of the directors' terms would expire at any particular annual meeting of members or of directors, in the event the corporation does not have members. Before amendment, the section authorized the staggering of terms by dividing the directors into two or three groups.

F. Removal of Directors of Nonstock Corporations Without Members

Revised Act section 13.1-860 was amended by the addition of subsection (C1),¹¹⁵ which provides that a nonstock corporation without members may remove a director in accordance with the procedures set forth in the corporation's articles of incorporation or bylaws. If no procedures are set forth, a director may be removed by the same number of votes as would be required for his election.

G. Annual Reports and Registration Fees

The General Assembly enacted amendments to various statutes changing the due date of annual reports and registration fees from March 1 of each year to April 1 of each year.¹¹⁶ The date by which

112. *Id.* § 13.1-700.1(D) (Cum. Supp. 1987).

113. VA. CODE ANN. § 13.1-724(D) (Cum. Supp. 1987).

114. VA. CODE ANN. § 13.1-858(A) (Cum. Supp. 1987).

115. VA. CODE ANN. § 13.1-860(C1) (Cum. Supp. 1987).

116. VA. CODE ANN. §§ 13.1-752, -768 (Cum. Supp. 1987) (parallel statutes relating to do-

the State Corporation Commission (SCC) is to forward to each corporation the amount of the annual registration fee due was changed from February 15 of each year to March 15 of each year.¹¹⁷

H. *Fees for Uncertified Copies of Documents*

Virginia Code section 12.1-21 was amended by the addition of subsection (D),¹¹⁸ which explicitly authorizes the SCC to charge for uncertified copies of records.

I. *Merger of Domestic Professional Corporation with Foreign Professional Corporation*

Virginia Code section 13.1-545.1¹¹⁹ was amended to reconcile two conflicting statutes regarding the merger of a domestic and foreign professional corporation engaged in the practice of law. Section 13.1-549.3¹²⁰ provides that a professional corporation engaged in the practice of law may issue shares of its capital stock to attorneys licensed to practice law in Virginia or any other state, subject to the restriction that only those attorneys licensed to practice law in Virginia may do so. Before amendment, section 13.1-545.1¹²¹ had required that if the surviving or new professional corporation existing after a merger of a domestic and foreign professional corporation were to be organized and operated as a Virginia professional corporation, only those professionals licensed to practice in Virginia were eligible to be shareholders. The amendment provides that section 13.1-545.1¹²² is subject to the provisions of section 13.1-549.3.¹²³

J. *Amendments Relating to Foreign Corporations*

Several amendments to the Revised Act were enacted relating to foreign corporations. First, Revised Act sections 13.1-760(A) and

mestic and foreign stock corporations, respectively); *id.* §§ 13.1-914, -930 (parallel statutes relating to domestic and foreign nonstock corporations, respectively); *id.* § 13.1-936 (relating to filing of annual reports).

117. *Id.* § 58.1-2805 (applicable to all fees assessed and due on and after January 1, 1987).

118. VA. CODE ANN. § 12.1-21(D) (Cum. Supp. 1987).

119. VA. CODE ANN. § 13.1-545.1 (Cum. Supp. 1987).

120. *Id.* § 13.1-549.3 (Repl. Vol. 1985).

121. *Id.* § 13.1-545.1.

122. *Id.* § 13.1-545.1 (Cum. Supp. 1987).

123. *Id.* § 13.1-549.3 (Repl. Vol. 1985).

13.1-922(A)¹²⁴ now provide that a change by a foreign corporation of its state or country of incorporation requires the corporation to obtain an amended certificate of authority from the SCC.

Secondly, Revised Act sections 13.1-769.1 and 13.1-931.1¹²⁵ were added to provide a procedure by which a foreign corporation whose certificate of authority had been revoked or surrendered could apply to the SCC for reentry. Revised Act section 13.1-769.1 provides that a foreign corporation may seek reentry within five years of the surrender or revocation of the certificate, "unless the certificate . . . was revoked by the [SCC] upon a finding that the corporation has continued to exceed or abuse the authority conferred upon it by law."¹²⁶ The procedure is a simple one. The corporation need only to submit an application for reentry and an annual report and to pay a \$100.00 reentry fee,¹²⁷ together with all registration fees, penalties and interest due before the certificate was surrendered or revoked and which would have become due if the certificate had not been surrendered or revoked by the date of the application for reentry. If the corporation has amended its articles of incorporation since the surrender or revocation of the certificate, it must also file any such amendments with the application for reentry.

K. *Notification and Recordation of Documents in Localities*

The General Assembly enacted amendments to various statutes to include Chesterfield County in the list of localities exempt from the requirement that an additional filing be made, together with an additional fee paid, whenever a document is filed or certain notice is given to the SCC.¹²⁸

124. VA. CODE ANN. §§ 13.1-760(A), -922(A) (Cum. Supp. 1987) (parallel statutes relating to foreign stock and nonstock corporations, respectively).

125. *Id.* §§ 13.1-769.1 and -931.1 (parallel statutes relating to foreign stock and nonstock corporations, respectively).

126. *Id.* § 13.1-769.1. It is unclear whether a foreign corporation will be denied reentry.

127. The reentry fee for foreign nonstock corporations is \$10.00. *Id.* § 13.1-93.1.

128. VA. CODE ANN. §§ 13.1-605, -805 (parallel statutes relating to the issuance of a certificate by the SCC for stock and nonstock corporations, respectively); *id.* §§ 13.1-616, -816 (parallel statutes relating to fees for filing documents or issuing certificates for stock and nonstock corporations, respectively); *id.* §§ 13.1-635, -834 (parallel statutes relating to change of registered office or registered agent for stock and nonstock corporations, respectively); *id.* §§ 13.1-756, -918 (parallel statutes relating to terminations of corporate existence and reinstatements and records thereof for stock and nonstock corporations, respectively).

