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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 surveys major developments between May, 1991 and June 1, 1992 that affect business and corporate law in Virginia. Part I discusses major decisions in United States courts. Part II reviews major decisions in Virginia courts. Part III summarizes laws enacted by the Virginia General Assembly during the 1992 Session.

In Part I, five United States Supreme Court opinions of interest are summarized. The first opinion adopted a uniform statute of limitations for actions brought under section 10(b) of the Securities Exchange Act of 1934 (the 1934 Act).[1] The second opinion adopted a rule of standing for plaintiffs suing under section 16(b) of the 1934 Act. Another opinion refused to adopt a uniform rule on demand futility in federal derivative actions. The fourth is a tax case, which held that professional fees incurred in a takeover are not deductible. The fifth opinion established a standing rule for civil claims brought under RICO.[2]

Part I also discusses two opinions by the United States Court of Appeals for the Fourth Circuit. One focused on the applicability of section 10(b) of the 1934 Act to lawyers. It defined a lawyer's duty of disclosure to third parties and established when a lawyer will be liable as an aider and abettor of a securities fraud. The second decision held that a RICO claim survives the death of the injured party. Finally, one opinion of the United States District Court for the Eastern District of Virginia held that the commencement of a tender offer is determined by the actions of the bidder, not by a third party's interpretation of those actions.

Part II analyzes a Virginia Supreme Court decision examining the circumstances under which a plaintiff can sue a terminated

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1. 15 U.S.C. §§ 78a-78kk (1988 & Supp. II 1990).
2. 18 U.S.C. §§ 1961-1968 (1988 & Supp. II 1990).

corporation under Virginia law. That case also defined the minimum requirements for holding a successor corporation liable and established when a successor corporation has no duty to warn its predecessor's customers. One decision from the Virginia Court of Appeals is discussed as well. This opinion set forth a test for determining when a note will be deemed a security under the Virginia Securities Act.[3]

Part III discusses several acts of the 1992 Session of the Virginia General Assembly. This section reviews laws (i) establishing the rules for filing and maintaining a corporate derivative suit, (ii) creating professional limited liability corporations, (iii) allowing corporations, partnerships and limited liability corporations to merge, (iv) permitting corporate boards to create stock options and (v) defining the power of a corporation's shareholders when they vote unanimously.

I. Federal Court Decisions

A. *The Supreme Court*

During the October, 1990 Term, the United States Supreme Court heard arguments in an unusually high number of cases — four — involving federal securities law questions. Given the timing of publication of the *University of Richmond Law Review's Annual Survey of Virginia Law*, last year's author of this section was able to address only one of these cases. The three cases she did not address are included in this year's survey.

1. The Statute of Limitations for Fraud Actions Brought under Section 10(b) of the 1934 Act

In *Lampf v. Gilbertson*,[4] the Court adopted a uniform statute of limitations for all securities fraud actions under section 10(b) of the 1934 Act.[5] Under the Court's holding, all private actions under section 10(b), including actions under rule 10(b) of the Security and Exchange Commission (the SEC), must be filed within one year of the plaintiff's discovery of the facts constituting the alleged violation. However, under no circumstances can an action be filed more than three years after the alleged violation occurs.

3. VA. CODE ANN. §§ 13.1-501 to 527.3 (Repl. Vol. 1989 & Cum. Supp. 1992).
4. 111 S. Ct. 2773 (1991).
5. 15 U.S.C. § 78j(b) (1991).

The case arose out of the sale of several limited partnerships to the plaintiffs. The partnerships failed, and the IRS later disallowed claimed tax benefits. Several plaintiffs filed complaints in the District Court for the District of Oregon against the law firm that had helped organize the partnerships and had written income tax opinion letters on them. The plaintiffs alleged the lawyers had violated section 10(b) and rule 10(b)(5) by inducing the investors to purchase partnerships through misrepresentations in the offering materials.

Private parties have no explicit right to bring an action under section 10(b); federal courts have created this right based on the underlying purpose of the provision.[6] Consequently, no statute of limitations provision exists for private actions under section 10(b). Traditionally, when a federal cause of action had no explicit limitation, courts applied the time limitation of the forum state for the most analogous state law cause of action.[7] Adhering to that tradition, the United States District Court for the District of Oregon granted summary judgment for the law firm, holding that plaintiffs' actions were time barred under the Oregon statute of limitations for fraud. The United States Court of Appeals for the Ninth Circuit reversed the district court's decision, holding that unresolved factual issues pertaining to plaintiffs' discovery of the alleged fraud precluded entry of summary judgment. In reaching this ruling, the court of appeals applied Oregon's statute of limitations for common law fraud actions. The United States Supreme Court granted certiorari to address the conflict of authority among several of the federal courts of appeal regarding the proper statute of limitations in causes of actions based on section 10(b).[8]

In an opinion by Justice Blackmun,[9] the Court eschewed its practice of borrowing analogous state limitations periods for federal causes of action having no explicit limitations periods of their

6. *See, e.g.*, *Lampf*, 111 S. Ct. at 2779-80.

7. *See, e.g.*, Wilson v. Garcia, 471 U.S. 261, 266-77 (1985).

8. Lampf v. Gilbertson, 111 S. Ct. 242 (1990). *See, e.g.*, In re Data Access Systems Sec. Lit., 843 F.2d 1537 (3rd Cir.), *cert. denied sub nom.* Vitiello v. I. Kahlowsky & Co., 488 U.S. 849 (1988) (applying a uniform federal statute of limitations).O'Hara v. Kovens, 625 F.2d 15 (4th Cir. 1980), *cert. denied,* 449 U.S. 1124 (1981) (applying state blue sky statute of limitations).

9. The opinion was joined by Chief Justice Rehnquist and Justices White and Marshall and in part by Justice Scalia.

own.[10] In the portion of the opinion not joined by Justice Scalia, a plurality of the Court held that where a cause of action is implied from a federal statute which also contains time limitations on explicitly created causes of action, federal courts should adopt those limitations. Federal courts should turn to analogous state limitations periods only when no similar limitations exist in the federal statute.

Applying this rule to the facts of the case, Justice Blackmun found that all but one of the limitations periods for express causes of action contained in the 1934 Act and created contemporaneously with section 10(b) were a variation of a "one-year period after discovery combined with a three-year period of repose."[11] He concluded that the one- and three-year limitations periods should apply to actions under section 10(b). Justice Blackmun explicitly rejected the SEC's argument[12] that the court should apply the most liberal specific statute of limitations in the 1934 Act, which was the five-year period provided in section 20A. This section applies to insider trading and securities fraud enforcement provisions enacted by the 1988 amendments.[13] The plurality opinion also rejected the argument that principles of equitable tolling should apply to the newly adopted limitations period.

While concurring in the result, Justice Scalia disagreed with Justice Blackmun's reasoning.[14] He asserted that state limitations periods should apply when a federal statute does not specify a limitation. His exception to this principle would apply where the cause of action is implied from the statute, as it was in this case.

Justices Stevens, O'Connor, Kennedy and Souter dissented. Justice Stevens, joined by Justice Souter, argued that the Court had embarked on a lawmaking task that should be carried out by Congress. In his opinion, the Court's new rule rejecting the practice of looking to analogous state statutes of limitation was not justified by the Court's prior cases.[15] Justice O'Connor, joined by Justice Kennedy, argued that the new rule should not apply retroactively

10. *See, e.g.*, Agency Holding Corp. v. Malley-Duff & Assoc., Inc., 483 U.S. 143, 147 (1987).

11. *Lampf*, 111 S. Ct. at 2780.

12. The SEC filed an amicus curiae brief in this case.

13. 15 U.S.C. § 78t-1 (1991).

14. *Lampf*, 111 S. Ct. at 2783.

15. *Id.* at 2783-85.

to the plaintiffs.[16] Justice Kennedy, joined by Justice O'Connor, stated he would apply the one-year from discovery rule, but the three-year repose period was contrary to section 10(b)'s basic function of protecting investors from fraudulent practices in the securities market.[17]

The *Lampf* decision is important because it clearly defines when causes of action brought under section 10(b) will be time barred. No longer will the answer depend on the particular state or federal judicial circuit in which a plaintiff brings an action. The decision, however, has prompted Congress to enact legislation exempting from this rule all lawsuits filed before the date of the opinion.[18] As this article goes to press, several district courts have struck down this new law as unconstitutional because it violates the doctrine of separation of powers.[19]

2. Standing to Sue for Short-Swing Profits under Section 16(b) of the 1934 Act

During the October, 1990 Term, a unanimous Supreme Court held in *Gollust v. Mendell*[20] that a shareholder bringing an action under section 16(b) of the 1934 Act in order to force a party to disgorge short-swing profits does not lose standing to prosecute the suit, if the company's stock is exchanged for stock of a new corporate parent after commencement of the suit. In *Mendell*, Keith Gollust, a shareholder in Viacom International, Inc. (International), filed a complaint alleging that the defendants, acting as a single group owning more than ten percent of the common stock, owed the corporation eleven million dollars in short-swing profits earned in trades made between July and October of 1988. Several months after Gollust filed suit, a shell corporation, Viacom, Inc. (Viacom), was formed to acquire International. Viacom, in exchange for its stock and cash, acquired all of the International stock. International was Viacom's only asset.

Granting the defendants' motion for summary judgment, the United States District Court for the Southern District of New

16. *Id.* at 2785-88.
17. *Id.* at 2788-90.
18. Pub. L. No. 102-242, § 476, 105 Stat. 2236 (1991) (to be codified as Securities and Exchange Act of 1934, 15 U.S.C. §§ 27A, 78aa-1).
19. *See, e.g.*, In re Buchard Sec. Lit., No. C87-2987 (C.D. Cal. March 27, 1992).
20. 111 S. Ct. 2173 (1991).

York ruled that section 16(b) actions can be maintained only by the issuer of the securities traded or by its shareholders.[21] As a shareholder in Viacom, Mendell could no longer maintain the suit.

The United States Court of Appeals for the Second Circuit reversed the lower court's decision.[22] It held that the statute required that a suit to be initiated by an owner of the harmed corporation's stock, but contained no language requiring the plaintiff to maintain ownership throughout the suit. The court also stated that under the facts of this case, implying such a requirement would not be consistent with the statute's remedial purpose.[23] The United States Supreme Court granted certiorari to resolve the conflict between the Second Circuit and other federal courts of appeal.[24]

Justice Souter, writing for the Court, affirmed the Second Circuit's decision. Following the lower court's reasoning, Justice Souter noted that the statutory language requires a plaintiff bringing an action under section 16(b) to "own a security of the issuer at the time the . . . action is instituted."[25] Although the statute clearly does not include parents or subsidiaries as "issuers," Justice Souter found nothing in the statute or legislative history indicating Congress wished to require a plaintiff to maintain continuous ownership during the lawsuit.

In dicta, Justice Souter noted that while there is no continuous ownership requirement, Congress clearly intended that anyone maintaining a section 16(b) action have a continuous financial interest in the action's outcome.[26] He also noted that a continuous financial interest is probably needed to confer standing on a plaintiff under Article III of the Constitution.[27] In this case, standing existed because Gollust had an ongoing interest in the parent corporation that owned the allegedly harmed securities.

As Justice Souter's dicta illustrates, the Court's holding in *Mendell* is somewhat limited. Only in rare factual situations would

21. Mendell v. Gollust, Fed. Sec. L. Rep. (CCH) ¶ 94,086 (S.D.N.Y. 1988).

22. Mendell v. Gollust, 909 F.2d 724 (2d Cir. 1990).

23. *Id.* at 730.

24. *See* Portnoy v. Kawecki Berylco Indus., Inc., 607 F.2d 765, 767 (7th Cir. 1979); Rothenberg v. United Brands Co., Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. 1977), *aff'd mem.* 573 F.2d 1295 (2d Cir. 1977).

25. *Gollust*, 111 S. Ct. at 2179.

26. *Id.* at 2080-81.

27. *Id.* at 2080.

a plaintiff who had been a security holder of the issuer somehow become divested of that interest while still maintaining a financial interest in the outcome of the litigation.

3. Demand Excused in Federal Derivative Suits

While the Supreme Court seemed to be further federalizing securities litigation issues in *Lampf v. Gilbertson*, in *Kamen v. Kemper Financial Services, Inc.*, it declined to federalize one aspect of federal securities laws controlled by state law.[28] Writing for a unanimous Court, Justice Marshall rejected a uniform federal rule that shareholders must make a demand on a corporation's board before filing a derivative suit based on federal securities law.

Jill Kamen filed a derivative action in federal district court against the fund's investment advisor. Kamen did not make a demand on the fund's board because she believed it would have been futile. Upon the defendant's motion, the district court dismissed the action on the grounds that Kamen had failed to plead facts sufficient to excuse her failure to make a demand upon the board. The Court of Appeals for the Seventh Circuit affirmed the dismissal of Kamen's claim,[29] because under federal common law, a plaintiff must always make a demand before filing a derivative suit alleging violation of a federal law.

The Supreme Court granted certiorari[30] and reversed.[31] Writing for the Court, Justice Marshall restated the principle that federal courts should look to state law as the rule of decision, unless such an application would frustrate the specific objectives of the federal statute at issue.[32] Justice Marshall elaborated on this general rule, stating the presumption of applying state procedural law is particularly strong where the parties have entered into legal relationships expecting their rights to be governed by state law.[33] He concluded that corporate law was one such area because corporations are created and exist under state law.

28. 111 S. Ct. 1711 (1991).
29. Kamen v. Kemper Fin. Servs., Inc., 908 F.2d 1338 (7th Cir. 1990).
30. 111 S. Ct. 554 (1990).
31. *Kamen*, 111 S. Ct. at 1711.
32. *Id.* at 1717 (citations omitted) (noting that the issue of the demand required by the Investment Company Act was a federal question).
33. *Id.*

Applying these principles to the facts of *Kamen*, Justice Marshall found that the demand requirement relates to the issue of corporate governance since the requirement potentially limits directors' power to control corporate litigation.[34] Under many states' laws, demand is considered futile when a majority of directors have approved the alleged improper act. The court concluded, therefore, that a federal rule of universal demand would bolster the power of directors at shareholders' expense.[35] Finally, Justice Marshall noted that the futility exception was not inconsistent with the basic policies of the Investment Company Act.[36]

4. Professional Fees Incurred in a Friendly Acquisition Are Not Deductible

In the October, 1991, Term, the Supreme Court decided a tax case that could affect corporate acquisitions. In *Indopco, Inc. v. Commissioner of Internal Revenue*,[37] a unanimous Court held that expenses for professional charges incurred during a corporation's friendly acquisition by another corporation are not deductible as ordinary and necessary business expenses under section 162(a) of the Internal Revenue Code.[38]

5. Standing to Sue Under Civil RICO

In another case from the 1991 Term, *Holmes v. Securities Investor Protection Corp.*,[39] the Supreme Court held that for a plaintiff to bring suit under the civil provisions of RICO, he must show a direct relationship between the predicate offense and the alleged injury. The Court granted certiorari to resolve a split among the federal circuit courts of appeals regarding whether the rule of *Blue Chip Stamps v. Manor Drug Stores*,[40] which established that only a purchaser or seller of the affected securities can sue under sec-

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34. *Id.* at 1719.

35. *Id.* at 1720.

36. *Id.* at 1722.

37. 112 S. Ct. 1039 (1992).

38. 26 U.S.C. § 162(a) (1988). Specifically, the Court held that simply because expenditures did not "create or enhance . . . a separate and distinct additional asset" does not mean that they are not capital in nature and deductible under § 162. 112 S. Ct. at 1046.

39. 112 S. Ct. 1311 (1992).

40. 421 U.S. 723 (1975) (holding that plaintiff must have purchased or sold securities at issue to bring a private action under § 10(b)).

tion 10(b) of the 1934 Act, applies to a RICO claim predicated on violations of section 10(b).[41]

In July, 1981, the Securities Investor Protection Corporation (SIPC) sought decrees in federal district courts to protect the customers of two broker-dealers. The district courts issued the decrees and appointed trustees to liquidate each broker-dealer.[42] In 1983, SIPC and the two trustees filed suit against seventy-five defendants in the District Court for the Middle District of California. The plaintiffs alleged the defendants had conspired to manipulate the stock of six companies and had caused two broker-dealers to collapse, thereby harming the broker-dealers' customers.[43] The customers had not, however, purchased any of the manipulated stock. Plaintiffs also sought treble damages under RICO arguing the defendants' acts were part of a pattern of racketeering activity.[44]

After five years of litigation, the district court granted summary judgment for one defendant, Robert Holmes. The court held that plaintiffs did not have standing as purchasers or sellers to bring the securities fraud claim on which the RICO claim was predicated, and that plaintiffs failed to establish that Holmes' actions had proximately caused the customers' injuries.[45]

On appeal, the Ninth Circuit reversed and remanded, holding that a RICO claim based on securities fraud was not subject to the standing requirements applicable to section 10(b) claims.[46] The Supreme Court granted certiorari on this issue.[47]

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41. The Fourth and Eighth Circuits have held that only a purchaser or seller of securities can bring a RICO action predicated on violations of § 10(b). International Data Bank, Ltd. v. Zepkin, 812 F.2d 149 (4th Cir. 1987); Brannan v. Eisenstein, 804 F.2d 1041 (8th Cir. 1986). The Ninth and Eleventh Circuits have held that the § 10(b) standing requirement is not applicable to a RICO claim predicated on violations of § 10(b). Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461 (9th Cir. 1990); Warner v. Alexander Grant & Co., 828 F.2d 1528 (11th Cir. 1987).

42. *Holmes*, 112 S. Ct. at 1314. The SIPC is a private non-profit corporation formed by the Securities Investor Protection Act, 15 U.S.C. §§ 78aaa-78111 (1988 & Supp. II 1990). One of the SIPC's primary functions is to protect customers of member broker-dealers. Most broker-dealers registered under § 15(b) of the 1934 Act are required to be members of SIPC. *See id.*

43. *Holmes*, 112, S. Ct. at 1315.

44. *Id.*

45. *Id.*

46. Securities Investor Protection Corp. v. Vigman, 908 F.2d 1461 (9th Cir. 1990).

47. Holmes v. Securities Investor Protection Corp., 111 S. Ct. 1618 (1990).

In an opinion written by Justice Souter,[48] the Court held that under RICO a plaintiff must show the defendant's alleged violation proximately caused the harm entitling that plaintiff to relief. The Justice began by observing that the relevant parts of RICO are based on the same language found in section 7 of the Sherman Act[49] and section 4 of the Clayton Act.[50] Years ago, courts determined that plaintiffs bringing an action under either of those statutes must show the defendant's violation proximately caused the plaintiff's injury. Justice Souter reasoned, therefore, that Congress must have intended to incorporate this proximate cause requirement into RICO.[51]

The plaintiffs argued they were entitled to recover from Holmes because they were subrogated to the rights of the broker-dealers' customers and because SIPC had an independent right to sue Holmes for funds advanced to SIPC trustees.[52] Addressing the first theory, the court found that no proximate cause existed between the violation alleged, stock manipulation, and the harm suffered by the customers of the bankrupt broker-dealers. Justice Souter stated the causal chain was indirect and purely contingent on the harm suffered by the broker-dealers.[53] The plaintiffs' second theory was also rejected since the Court found no statutory authorization for SIPC to maintain a suit to recover damages from Holmes.[54] Consequently, the Court reversed the judgment of the court of appeals and remanded the case for further proceedings.[55]

Justice O'Connor, joined by Justices White and Stevens, wrote a separate concurring opinion. Although Justice O'Connor agreed proximate cause must be proven to establish RICO violations, she emphasized that the Court should have addressed the issue on which it granted certiorari. She also explained that, in her opinion, a plaintiff need not be a purchaser or seller of securities to assert RICO claims based on securities fraud.[56] Justice Scalia also wrote a separate concurring opinion in which he argued that the Court

48. Chief Justice Rehnquist and Justices Blackmun, Kennedy, and Thomas joined Justice Souter in the majority opinion.

49. 15 U.S.C. §§ 1-7 (1988 & Supp. II 1990).

50. 15 U.S.C. §§ 12-27 (1988 & Supp. II 1990); *Holmes*, 112 S. Ct. at 1317.

51. *Holmes*, 112 S. Ct. at 1317-18.

52. *Id.* at 1319.

53. *Id.*

54. *Id.* at 1321.

55. *Id.* at 1322.

56. *Id.* at 1322-27.

should address the issue on which certiorari was granted. He stated he would have resolved that issue the same way Justice O'Connor did, but for different reasons.[57]

As Justice Souter pointed out in the majority opinion, the proximate cause requirement will resolve many cases in which the question of the applicability of section 10(b)'s seller/purchaser requirement to RICO claims would arise. However, a split still exists among the circuit courts on this issue. Should the question present itself in a case where the plaintiff could satisfy the proximate cause requirement, it could easily reach the Supreme Court. Furthermore, each of the four Justices who has stated a view has indicated an intent to vote contrary to the Fourth Circuit's current position.

B. *The United States Court of Appeals for the Fourth Circuit*

1. Disclosure of a Lawyer's Duties Under Section 10(b) of the 1934 Act

In *Shatz v. Rosenberg*,[58] the United States Court of Appeals for the Fourth Circuit held that a law firm cannot be held liable under section 10(b) for failing to disclose information about a client to a third party, in the absence of a fiduciary or other confidential relationship with that third party. The litigation stemmed from the sale by Ivan and Joanne Shatz of their controlling interest in two corporations in exchange for a promissory note issued by MER Enterprises (MER) and personally guaranteed by Mark Rosenberg.[59] Before closing the sale, Rosenberg showed Mr. and Mrs. Shatz false financial statements and his attorneys delivered an updated letter from him stating that his net worth exceeded seven million dollars. In reality, Rosenberg was on the verge of bankruptcy.

Several months later, when they had still not received payment on the promissory note, and after making a $150,000 bridge loan to another company owned by Rosenberg, the Shatzes sued Rosenberg, MER, and its counsel, the law firm of Weinberg & Green. The plaintiff alleged the defendants had violated federal securities laws and had committed common law fraud.[60] The United States District Court for the District of Maryland dismissed all of the

57. *Id.* at 1327.
58. 943 F.2d 485 (4th Cir. 1991).
59. *Id.* at 487-88.
60. *Id.* at 488.

claims under Federal Rule of Civil Procedure 12(b)(6).[61] Mr. and Mrs. Shatz appealed only the claims filed against the law firm.

On appeal, Mr. and Mrs. Shatz argued that the law firm violated section 10(b) by failing to disclose Rosenberg's misrepresentations in the financial statements and by knowingly misrepresenting his financial condition.[62] Acknowledging that one must have a duty to disclose under section 10(b) to be held liable for failing to disclose, the Shatzes maintained that a law firm has such a duty. According to their theory, this duty exists when a firm deliberately disseminates false information it knows to be false with the intention or knowledge that the information will be relied upon by a third party in connection with a sale of securities. The Shatzes also asserted that a law firm has a duty to disclose under state rules of professional conduct and as a general matter of public policy.[63]

Addressing the first theory, the Fourth Circuit held that unless a lawyer makes active misrepresentations in the solicitation of a sale of securities, he has no duty to disclose information to a third party, absent a relationship of confidence and trust with that party.[64] The court also rejected the Shatzes's second theory, reasoning that while the attorneys had an *ethical* duty to disclose under the Maryland Rules of Professional Conduct, such a duty did not create a *legal* duty, in the absence of an attorney-client relationship.[65] Finally, the court rejected the public policy theory of liability on the grounds that imposing a duty to disclose under these facts would actually harm the public.[66] The court believed the plaintiff's proposed disclosure rule would encourage both clients and their attorneys to avoid learning all of the facts in a particular controversy. Holding attorneys liable is more likely to make them unknowing accomplices to securities law violations than to make them society's watchdogs. Under the rule adopted by the court, however, "the client is more likely to disclose damaging or problematic information [to counsel], and the lawyer will more likely be able to counsel his client against misconduct."[67]

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61. FED R. CIV. P. 12(b)(6); 943 F.2d at 488-89.
62. 943 F.2d at 490.
63. *Id.*
64. *Id.* at 490-92.
65. *Id.* at 492.
66. *Id.* at 493-94.
67. *Id.* at 493. *See also* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1124 (5th Cir. 1988), *vacated on other grounds*, 492 U.S. 914 (1989); DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir.), *cert. denied*, 111 S. Ct. 347 (1990).

The Shatzes's second argument was that the law firm violated section 10(b) by making affirmative misrepresentations when it delivered the letter misrepresenting Rosenberg's financial status and when it drafted closing documents attesting that Rosenberg's financial statements were true and correct.[68] The Fourth Circuit found that the law firm did not make any affirmative misrepresentation merely because it forwarded the letter from Rosenberg. The court also noted that the provisions in closing documents had been decided earlier by the parties and the attorneys had simply had recorded the terms of the deal. Under these facts, the firm's transmission of Rosenberg's misrepresentations did not transform them into its own.[69]

The essence of the Fourth Circuit's holding in *Shatz* is that a lawyer has no duty to disclose a client's misdoings to unrelated third parties in the absence of an independent duty to that party. As many lawyers are aware, this issue has attracted much attention recently, particularly with regard to attorneys who represent failed savings and loan institutions. It is an issue where the boundaries of liability may be shifting. The court's reasoning in this case may provide guidance for attorneys in areas of the law where a lawyer's duty to disclose is less clear.

2. Aider and Abettor Liability under Section 10(b) of the 1934 Act

In *Shatz v. Rosenberg*, the plaintiffs also argued that the law firm was liable under section 10(b) and section 12(d) of the 1934 Act for aiding and abetting Rosenberg's violations.[70] The Fourth Circuit rejected this argument because Mr. and Mrs. Shatz had failed to allege in their complaint the scienter requirement for aider and abettor liability. Under section 10(b), absent a duty owed by the aider and abettor to the injured party, the aider and abettor must possess a "high[ly] conscious intent" and a "conscious and specific motivation" to aid the fraud to be liable.[71] In their pleadings, the Shatzes had merely asserted that the attorneys knowingly and/or recklessly had provided substantial assistance to

68. 943 F.2d at 494.
69. *Id.* at 495.
70. 943 F.2d 485 (4th Cir. 1991).
71. *Id.* at 496.

Rosenberg's fraud. Consequently, they did not properly plead their aider and abettor claim.[72]

Alternatively, the Fourth Circuit held the Shatzes failed to properly plead an aider and abettor claim because the complaint contained no allegations that the attorneys had substantially assisted Rosenberg in perpetrating the fraud.[73] The Shatzes argued the attorneys assisted Rosenberg by failing to disclose his real financial condition and by participating in negotiations and in the closing. In what appears to be the first time a federal court of appeals has decided the issue, the Fourth Circuit held that absent a duty to disclose, an allegation that the defendants knew of a wrongdoing, but failed to act, does not state an aiding and abetting claim.[74]

The court went on to explain that while aider and abettor liability may be predicated on an attorney's active participation in a transaction (i.e., soliciting sales or negotiating terms), where a lawyer merely acts as a scrivener liability cannot be imposed without alleging a conscious intent to violate the securities laws.[75] Otherwise the court would be essentially creating a per se rule, holding attorneys liable in every securities fraud case because the attorneys almost always draft closing documents. Since the Shatzes had alleged the attorneys had not intended to violate the 1934 Act, the court affirmed the dismissal of the aider and abettor claims under this theory also.[76]

3. Civil RICO Claims Survive the Plaintiff's Death

The Fourth Circuit, in a case of first impression for the federal courts of appeal, held that a civil RICO claim survives the death of the plaintiff. In *Faircloth v. Finesod*,[77] the controversy arose out of the sale of art reproductions[78] based on phony appraisals of each reproduction's worth and an attorney's fraudulent opinion letter stating that the reproduction was a viable tax shelter. Phyllis Faircloth, the administrator of the estate of a purchaser of one of the reproductions, brought suit against the seller, the appraisers, and

72. *Id.* at 496-97.
73. *Id.* at 497.
74. *Id.* at 496-97.
75. *Id.* at 497.
76. The court also dismissed plaintiff's state law claims. *Id.* at 497-98.
77. 938 F.2d 513 (4th Cir. 1991).
78. The reproductions were art masters from which prints and posters could be made. *Id.* at 514.

others alleging fraud, securities law violations and unfair trade practices. She also sought treble damages under RICO. After four years of litigation, a jury awarded Faircloth damages, which, after trebling, totaled over four million dollars. One defendant appealed, arguing that the district court erred in holding that civil RICO claims survive the plaintiff.[79] The Fourth Circuit reversed the district court on one issue, but upheld the award of damages under RICO. Reasoning that Congress had declared civil RICO to be a remedial statute which should be liberally construed, the Fourth Circuit announced that civil RICO claims survive the death of the injured party.[80]

D. *United States District Court for the Eastern District of Virginia*

1. Commencement of a Tender Offer

In *Kahn v. Virginia Retirement System*,[81] the District Court for the Eastern District of Virginia held that a press release describing a corporate restructuring, of which one part would be a tender offer, did not *commence* a tender offer under section 14(d)(7) of the Williams Act.[82] The basis of the decision was that the press release was not issued by the bidder and did not identify the bidder.[83]

The plaintiffs brought suit against the various parties involved in the sale of RF&P Corporation's (RF&P) assets. The complaint alleged the defendants had violated section 14(d)(7) of the Williams Act and SEC Rules 14d-10 and 10b-13 by purchasing stock from two stockholders at a price per share in excess of that specified in the tender offer.[84] Both purchases occurred after RF&P had publicly announced it would restructure itself in three steps, one of which was a tender offer. Significantly, this announcement did not identify the party that would be making the tender offer.

On the defendants' motion, the district court dismissed the action under Rule 12(b)(6) of the Federal Rules of Civil Procedure for failing to state a claim upon which relief could be granted. The

79. *Id.* at 515-16.
80. *Id.* at 518.
81. 783 F. Supp. 266 (E.D. Va. 1992).
82. 15 U.S.C. § 78n(d)(7) (1981).
83. *Kahn*, 783 F. Supp. at 271.
84. Both purchases occurred after the announcement of restructuring, which the plaintiffs argued commenced the tender offer for purposes of § 14(d)(7). 783 F. Supp. at 270.

court held that, as a matter of law, both purchases at issue were not made during a tender offer.[85] Addressing the allegation that RF&P's press release commenced the tender offer, the court stated it had not because the release did not state it was a tender offer and did not identify the bidder. It was deemed irrelevant that the press had surmised the identity of bidder, as long as the bidder did not positively affirm the information in the newspapers. To determine whether a tender offer has commenced, "[t]he Court looks solely to the official actions of the tender offer bidder."[86]

II. Virginia Courts

A. *The Virginia Supreme Court*

In *Harris v. T.I., Inc.*,[87] the Virginia Supreme Court made several rulings of first impression which are important to corporate acquisitions. The case arose from a garbage truck backing over and killing a blind woman. The truck was not equipped with a device to sound an alarm when the truck was placed in reverse. Truxmore Industries manufactured the vehicle and sold it to the owner in 1981. In 1985, Truxmore Industries sold all of its assets to a corporation, Truxmore, which held itself out to be the ongoing concern of Truxmore Industries. As part of the sale agreement, Truxmore Industries, the seller, changed its name to T.I., Inc. (T.I.). One year later, T.I. filed Articles of Dissolution and Articles of Termination with the Virginia State Corporation Commission.[88]

Richard Harris, the executor of the decedent's estate, brought a products liability action against the dissolved T.I. and its successor, Truxmore. The trial court sustained both T.I.'s and Truxmore's demurrers and dismissed the action. The Virginia Supreme Court granted Harris's petition for appeal.[89]

1. Claims Against the Terminated Corporation

Before the Virginia Supreme Court, Harris first challenged the trial court's ruling that he had no right of action against T.I. because the claim arose after the date of T.I.'s termination. Harris

85. *Id.* at 274.
86. *Id.* at 271.
87. 243 Va. 63, 413 S.E.2d 605 (1992).
88. *Id.* at 65-67, 413 S.E.2d at 606-07.
89. *Id.* at 65, 413 S.E.2d at 606.

argued that under section 13.1-755 of the Virginia Code (the Code), T.I. remained liable for any defective product sold before the termination date.[90] Section 13.1-755 provides in part: "[t]he termination of corporate existence shall not take away or impair any remedy available to or against the corporation . . . for any right or claim existing or any liability incurred, prior to such termination."[91] Harris asserted that "liability" includes future and contingent liability and, therefore, a product's liability is incurred at the time of sale.[92]

The court rejected Harris's interpretation of "liability" under section 13.1-755. The court noted that section 13.1-755 altered the common law rule that a terminated corporation could not be sued. Therefore, as with any statute changing the common law, section 13.1-755 must be strictly construed. Applying that rule of construction, the court held that "liability" means only an actual liability existing at the time of termination. The court concluded that there were no claims existing against or liabilities incurred by T.I. when it terminated. Therefore, Harris could not bring any claim against T.I.[93]

2. Liability as a Successor Corporation

Harris also argued that the trial court erred in sustaining Truxmore's demurrer because the defendant was liable as the successor of Truxmore Industries. Under Virginia law, a purchasing corporation will be liable for the obligations of its predecessor only if: (i) the purchaser expressly or implicitly agreed to assume such liabilities; (ii) the transaction was a consolidation or de facto merger of the two corporations; (iii) the transaction was fraudulent; or (iv) the purchaser was merely a continuation of the seller corporation.[94] The court found that Truxmore had not assumed the product liabilities of its predecessor. The Virginia Supreme Court also decided Harris had not alleged the existence of fraud or a de facto merger.[95]

90. *Id.* at 67-68, 413 S.E.2d at 607-08.
91. *Id.* at 67, 413 S.E.2d at 607 (quoting VA. CODE ANN. § 13.1-755 (Repl. Vol. 1989)).
92. *Id.* at 68, 413 S.E.2d at 608.
93. *Id.*
94. *Id.* at 70, 413 S.E.2d at 609.
95. *Id.* at 69-70, 413 S.E.2d at 608-09.

Arguing that Truxmore was a mere continuation of Truxmore Industries, Harris asserted that Truxmore continued the same operations at the same location with the same personnel as Truxmore Industries. The successor also had actively tried to keep the same customers. The court, however, held that these factors were not sufficient. Instead, the court indicated that to state a claim under the mere continuation exception to the rule against successor corporate liability, a plaintiff must at least allege a "common identity" of officers, directors, and shareholders between the two companies or allege that the transaction was not made at arms length.[96]

3. No Duty of Successor Corporation to Warn Predecessor's Customers in Absence of Service Arrangement

Harris's final argument against the trial court sustaining Truxmore's demurrer was that, as a matter of law, Truxmore had an independent duty to warn the truck owner of the dangers of not having a back-up sounding device.[97] In support of this position, Harris demonstrated that at the time of the accident industry standards mandated such devices in all new trucks. Harris also alleged that Truxmore representatives contacted the owner to inform him that business would continue as usual and before the accident, attempted to sell him a new truck. In addition, the owner bought replacement parts for the truck involved in the accident from Truxmore's Richmond plant, the only source of such parts.[98]

The Virginia Supreme Court again upheld the trial court. Assuming, without deciding, that successor corporations could have a duty to warn customers who had purchased products from the predecessor, the court analyzed the law in those jurisdictions recognizing such a duty. The court stated that these jurisdictions have "looked to whether there was a direct and continuing relationship between the successor and the predecessor's customers."[99] Most of these jurisdictions have required, at a minimum, that the successor owe a current service obligation to the customer or that the successor have serviced the product. In this case, the facts alleged showed nothing more than "casual contact" between the truck

96. *Id.* at 70-71, 413 S.E.2d at 609.
97. *Id.* at 71, 413 S.E.2d at 610.
98. *Id.* at 71, 413 S.E.2d at 610.
99. *Id.* at 72, 413 S.E.2d at 610.

owner and Truxmore. Therefore, the court concluded, even if a successor corporation has a duty to warn its predecessor's customers of product defects, no such duty existed in this case.[100]

B. *The Virginia Court of Appeals*

1. Definition of a Security Under the Virginia Securities Act

In *Ascher v. Commonwealth*,[101] the Virginia Court of Appeals adopted a broad definition of a security under the Virginia securities act.[102] Drawing an analogy to the federal securities acts, the court of appeals essentially adopted the federal definition of a security spelled out by the United States Supreme Court in *Reves v. Ernst & Young*.[103]

Ascher began when the Commonwealth of Virginia sought to indict Rochelle Ascher "on eleven counts of securities fraud in violation of the Virginia Securities Act" and one count of "conspiracy to commit securities fraud" for her involvement in soliciting loans for Lyndon H. LaRouche, Jr.'s political organization, the National Caucus of Labor Committees (NCLC).[104] The loans were evidenced by promissory notes. A jury convicted Ascher on eight counts of securities fraud and one conspiracy count. The Virginia Court of Appeals granted her an appeal on six assignments of error.[105]

In one assignment of error, Ascher argued that the jury had not been adequately instructed on the definition of a security, and therefore lacked the standard needed to determine whether the promissory notes at issue were securities under the Virginia Securities Act. The Court of Appeals rejected her argument, finding the instruction to be a "correct statement of the law" and concluding

100. *Id.*

101. 12 Va. App. 1105, 408 S.E.2d 906 (1991).

102. VA. CODE ANN. §§ 13.1-501 to -527.3 (Repl. Vol. 1989 & Cum. Supp. 1992).

103. 494 U.S. 56 (1990).

104. *Ascher*, 12 Va. App. at 1107-08, 408 S.E.2d at 908-09. Ascher had been in charge of NCLC's phone solicitation team operating out of Baltimore, Maryland. The NCLC fund raisers called people on the telephone and asked them to make donations. When the fund raisers could not solicit a contribution from an individual, they would ask the person for a loan, promising a higher interest rate than those offered by banks. If the person agreed to make a loan, NCLC would immediately send a courier over to the person to receive the check and give the lender a promissory note. By 1984, Ascher was aware that NCLC was only selectively paying back the loans, but she continued to solicit loans through 1986, while still representing to lenders that the organization always paid back its loans. *Id* at 1108-11, 408 S.E.2d at 909-11.

105. *Id.* at 1108, 1112, 408 S.E.2d at 909, 911.

that the "instruction was adequate because, on the[] facts [of the case], there [was] no context in which the jury could have found the notes at issue not to have been securities."[106]

In reaching this latter conclusion, the court adopted the test used by the United States Supreme Court in *Reves*[107] for determining when a note is a security under the federal securities acts. Under the test adopted by the Virginia Court of Appeals, a promissory note is presumed to be a security and " 'th[is] presumption may be rebutted *only* by a showing that the note at issue bears a *strong* resemblance . . . to one of the enumerated categories of instrument' which the [United States Supreme] Court declared were notes that did not have the character of a security."[108] If the note at issue does not resemble one of the instruments not considered a security, then "the court must consider and decide whether the note may fall within a broader definition of a promissory note that is not a security."[109] Under this broader definition, a court must consider four factors. The first factor is the motivation of the parties to the transaction: if the note originator's motivation is to raise operational capital and the buyer's motivation is profit, the instrument probably is a security.[110] The second factor to be considered is the extent of the note's planned distribution: if notes are offered to a "broad segment of the public," then they are more likely to be securities. The third factor to be considered is the public's perception of the note: if the public perceives it as an investment, the note is a security.[111] The fourth and final factor is the presence of a " 'regulatory scheme' applicable to the transaction or instrument which would 'significantly' reduce the risk to the buyer or to the public . . . if the securities act did not control."[112] In the absence of an alternative regulatory scheme, a court will be more inclined to find that a note is a security.

106. *Id.* at 1121, 408 S.E.2d at 915-17.

107. *Reves*, 494 U.S. at 64-67.

108. *Ascher*, 12 Va. App. at 1122, 408 S.E.2d at 917 (quoting *Reves*, 494 U.S. at 67). The Ascher court listed examples of notes "which are generally non-securities," including consumer financing notes and "note[s] secured by [a] mortgage on a home." *Id.* at 1123, 403 S.E.2d at 917 (quoting *Reves*, 494 U.S. at 65).

109. *Id.* at 1123, 403 S.E.2d at 918.

110. *Id.* (citing *Reves*, 494 U.S. at 66).

111. *Id.* at 1124, 408 S.E.2d at 918 (citing *Reves*, 494 U.S. at 68-69).

112. *Id.*

Applying these elements to the facts of the case,[113] the court found that each one favored defining the notes as securities. Consequently, it held there was no evidence upon which a juror could have found Ascher was able to rebut the presumption that the notes were securities.[114] The court also rejected Ascher's other five points of error and affirmed her convictions.

III. LEGISLATIVE DEVELOPMENTS

A. *Shareholder Derivative Actions*

The Virginia General Assembly has enacted a new law that amends the definition of a shareholder derivative suit in section 13.1-603 of the Code and eliminates the old provisions of section 13.1-672, substituting new provisions.[115] These new provisions, codified as sections 13.1-672.1 through 13.1-672.5, establish the ground rules for filing and maintaining derivative lawsuits and are far more specific than those they replaced. Clearly, these new rules are less favorable to plaintiffs than their predecessors.

The new provisions require that any plaintiff filing a derivative suit first must have made a written demand upon the board of directors to take "suitable" action. There are no exceptions to this demand requirement.[116] After submitting this demand, the shareholder-plaintiff must then wait for ninety days to pass before filing the action unless the demand is rejected in the interim or "irreparable injury to the corporation would result by waiting until the end of the ninety-day period."[117] If a corporation has begun evaluating allegations in a shareholder's demand, the new law also allows a court to stay a derivative suit for a period deemed appropriate by that court.[118]

The new law retains the same requirements regarding court approval of derivative suit settlements.[119] It does, however, add a new paragraph providing that if a derivative action against a foreign

113. Ascher did not argue that the notes were similar to one of the enumerated nonsecurities. *Id.*

114. *Id.* at 1126, 408 S.E.2d at 918-19.

115. *See* Act of Apr. 6, 1992, ch. 802, 1992 Va. Acts 1270 (codified at VA. CODE ANN. §§ 13.1-603, 13.1-672.1 to -672.5 (Cum. Supp. 1992).

116. VA. CODE ANN. § 13.1-672.1(B)(1) (Cum. Supp. 1992). Some other jurisdictions, however, excuse demand if such demand would be futile.

117. *Id.* § 13.1-672.1(B)(2).

118. *Id.* § 13.1-672.1(C).

119. *Id.* § 13.1-672.2.

corporation is brought in Virginia, the issues of standing and grounds for dismissal shall be governed by the laws of that corporation's state of incorporation.[120]

In addition, the statute establishes the grounds upon which a derivative action may be dismissed by a court.[121] Under these new provisions, a court must dismiss a derivative action if one of the approved groups (discussed below) has (i) conducted an adequately informed review and evaluation of the allegations; (ii) determined in good faith from this review and evaluation that maintenance of the action is not in the corporation's best interest; and (iii) has submitted a short statement of the reasons for its determination and such determination is not unreasonable.[122]

Unless a court appoints an independent panel upon the motion of the corporation's board, the review of allegations and determination shall be made by a majority of the independent directors or by a majority of a committee consisting of at least two independent directors appointed by a majority of the independent directors.[123] The new provisions also give some standard for determining if a director is independent.[124] Section 13.1-672.4(C) provides that:

> None of the following shall by itself cause a director to be considered not independent for purposes of this section:
>
> 1. The nomination or election of the director by persons who are defendants in the derivative proceeding or against whom action is demanded;
>
> 2. The naming of a director as a defendant in a derivative proceeding or as a person against whom action is demanded; or
>
> 3. The approval by the director of the act being challenged in the derivative proceeding or demand if the act resulted in no personal benefit to the director.

If a shareholder brings a derivative suit after a shareholder's demands have been rejected, the statute requires the plaintiff to al-

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120. *Id.* § 13.1-672.3.
121. *Id.* § 13.1-672.4.
122. *Id.* § 13.1-672.4(A).
123. *Id.* § 13.1-672.4(B).
124. *Id.* § 13.1-672.4(C).

lege with particularity that the conditions for dismissal[125] have not been met.[126] A plaintiff is then "entitled to discovery with respect to the issues presented by the motion only if and to the extent that the complaint alleges such facts with particularity."[127] The statute now clearly places the burden of proving that the grounds for dismissal have not been met on the plaintiff, although the corporation will have to prove issues of director independence "if the complaint alleges with particularity facts raising a substantial question as to such independence."[128]

Finally, the new provisions require that at the termination of a derivative action, a court must award costs to the plaintiff if it finds the action has benefitted the corporation.[129] Even more noteworthy, the statute provides that a court shall direct the plaintiff to pay the defendant's expenses and legal fees if it finds the action was "commenced or maintained without reasonable cause."[130] A court may also, at any time during a derivative suit, "require the plaintiff to furnish security for the payment of expenses for which that plaintiff may become liable."[131]

B. *Limited Liability Companies*

The Virginia General Assembly also added Chapter 13 to the Code, the Professional Limited Liability Company Act,[132] which allows professional or business entities which were formed to provide professional services to organize as a limited liability company for the purpose of rendering the same type of professional services.[133] The act provides background rules of organization and management. Under its terms, professional limited liability companies are also subject to Chapter 12, the Virginia Limited Liability Company Act,[134] but Chapter 13 controls in the event the two chapters conflict.[135]

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125. *See supra* notes 121-22 and accompanying text.
126. VA. CODE ANN. § 13.1-672.4(D) (Cum. Supp. 1992).
127. *Id.*
128. *Id.* § 13.1-672.4(E).
129. *Id.* § 13.1-672.5(A)(1).
130. *Id.* § 13.1-672.5(A)(2).
131. *Id.* § 13.1-672.5(B).
132. Act of Mar. 30, 1992, ch. 574, 1992 Va. Acts 738 (codified at VA. CODE ANN. §§ 13.1-1100 to -1123 (Cum. Supp. 1992)).
133. VA. CODE ANN. § 13.1-1101 (Cum. Supp. 1992).
134. *Id.* §§ 13.1-1000 to -1073.
135. *Id.* § 13.1-1122.

Another act amended portions of the Virginia Limited Liability Company Act, the Virginia Stock Corporation Act,[136] and the Virginia Revised Uniform Limited Partnership Act[137] to allow corporations, limited partnerships and limited liability companies to merge.[138] The one major limitation to these mergers is that whenever a limited partnership merges with a corporation, domestic or foreign, or a limited liability company, domestic or foreign, the limited partnership cannot be the surviving entity.[139] The new legislation also establishes procedures for carrying out these mergers and essentially tracks the merger provisions for corporations presently contained in the Virginia Stock Corporation Act.

C. *Corporate Board's Power to Create Stock Options*

The General Assembly also amended the Virginia Stock Corporation Act as it applies to the power of a corporation's board of directors to create options or warrants to purchase shares of the corporation without shareholder approval.[140] Under section 13.1-646 of the Code as amended, the board of directors has the power, subject to the shareholder preemption provisions of section 13.1-651, to create "rights, options or warrants for the purchase of shares of the corporation," unless such power is specifically reserved to the shareholders in the articles of incorporation.[141] The board is also empowered with the ability to decide the terms of, compensation for, or restrictions on, these plans.[142] In addition, any actions taken by the board in regard to such plans are to be judged by the business-judgment rule described in section 13.1-690.[143]

D. *Shareholder Power*

Another amendment, affecting both the Stock Corporation Act and the Nonstock Corporation Act, provides that actions taken by

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136. *Id.* §§ 13.1-603 to -780 (Repl. Vol. 1989 & Cum. Supp. 1992).
137. *Id.* §§ 50-73.1 to -73.77.
138. Act of Mar. 30, 1992, ch. 575, 1992 Va. Acts 754 (codified primarily at VA. CODE ANN. §§ 13.1-1070 to -1073, 50-73.48:1 to -73.48:4, 50-73.57:2 (Cum. Supp. 1992)).
139. *See* VA. CODE ANN. § 50-73.48:1(A)(6)(Cum. Supp. 1992).
140. Act of Mar. 26, 1992, ch. 472, 1992 Va. Acts 605 (codified at VA. CODE ANN. § 13.1-646 (Cum. Supp. 1992)).
141. VA. CODE ANN. § 50-73.48:1(A)(6) (Cum. Supp. 1992).
142. *Id.* § 13.1-646(B).
143. *Id.*

the unanimous consent of shareholders (or members of non-stock corporations) do not need further approval by the corporation's directors.[144] Although this power of shareholders voting as a group is an inherent right of the owners of such corporation, the General Assembly has chosen to make this power absolutely clear by enacting the provision into the Code.

144. *Id.* §§ 13.1-688, -868.