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C. Porter Vaughan III
Hunton & Williams

David I. Meyers
Hunton & Williams

W. Lake Taylor Jr.
Hunton & Williams

ARTICLES

CORPORATE AND BUSINESS LAW

C. Porter Vaughan, III *

David I. Meyers **

W. Lake Taylor, Jr. ***

I. INTRODUCTION

This article reviews changes in Virginia corporate and business law from June 2001 through May 2002. Part II examines legislative changes in corporate and certain other business statutes based on laws passed by the Virginia General Assembly during its 2002 session. Part III reviews the major judicial decisions addressing corporate and business law issues and principles.

II. LEGISLATIVE DEVELOPMENTS

During the 2002 session, the General Assembly enacted several

* Partner, Hunton & Williams, Richmond, Virginia. B.A., 1967, Yale University; J.D., 1970, University of Virginia School of Law.

** Associate, Hunton & Williams, Richmond, Virginia. B.S., 1992, University of Virginia; J.D., 1995, University of Virginia School of Law.

***Associate, Hunton & Williams, Richmond, Virginia. B.A., 1992, University of Virginia; J.D., 1998, University of Richmond School of Law.

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pieces of legislation that will have varying degrees of impact on Virginia corporate and business law. The most significant piece of legislation establishes the Virginia Business Trust Act ("VBTA"),[1] which provides a statutory framework for the formation and operation of Virginia business trusts. Although several changes were made to statutes of governing public service corporations, public utilities, banking and finance, and taxation, these changes are not included in this review.

A. *Corporations and Other Entities*

1. Business Trusts

a. Introduction

With the adoption of the VBTA, the General Assembly established a statutory framework under Virginia law for the formation and operation of a type of entity that has been used effectively in a number of other states. A Virginia business trust is an unincorporated, perpetual, limited liability legal entity that may be formed to conduct any lawful business. The provisions of the VBTA will become effective on October 1, 2003.[2]

The VBTA provides basic mechanisms for business trust formation and internal governance. While the VBTA provides statutory certainty and protection to business trusts and their trustees, it also maximizes the flexibility of business trusts by deferring most of the details of governance to the organizing documents.[3] In fact, the VBTA expressly states that "[t]his chapter shall be construed in furtherance of the policies of giving maximum effect to the principle of freedom of contract and of enforcing governing instruments."[4] Because of the VBTA's flexibility, parties to a Virginia business trust can structure their particular transaction with the equivalent of a blank slate.

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1. VA. CODE ANN. §§ 13.1-1200 to -1284 (Cum. Supp. 2002). For an additional discussion of this Act, see John V. Cogbill, III & D. Brennen Keene, *Annual Survey of Virginia Law: Real Estate and Land Use Law*, 37 U. RICH. L. REV. 271, 313 (2002).

2. *Id.* §§ 13.1-1201 to -1209 (Cum. Supp. 2002).

3. *Id.* §§ 13.1-1200 to -1284 (Cum. Supp. 2002).

4. *Id.* § 13.1-1282(B) (Cum. Supp. 2002).

Business trusts have often been the entity of choice for mutual funds (usually Massachusetts or Delaware business trusts), real estate investment trusts (often Maryland real estate investment trusts), and mortgage and other finance entities that securitize assets (often New York common law trusts). The VBTA offers businesspersons and finance professionals an unincorporated, perpetual, limited liability Virginia entity that may offer a greater degree of flexibility than has previously been available in Virginia.

b. Formation and General Filings

The technical provisions of the VBTA conform to the Virginia Stock Corporation Act ("VSCA")[5] and the Virginia Limited Liability Company Act ("VLLCA").[6] A Virginia business trust is formed when the articles of trust are signed and filed with the Virginia State Corporation Commission ("Commission").[7] Unless the articles of trust provide otherwise, the existence of a Virginia business trust begins when the Commission issues a certificate of trust.[8] The articles of trust must set forth the name and address of the business trust and the name and address of the initial registered agent, and may set forth any other matter permitted under the VBTA.[9] An initial filing fee of $100 is payable to the Commission,[10] and an annual registration fee of $50 is due by September 1 each year thereafter.[11]

The name of a business trust must be distinguishable from the name of any other business trust or other business entity registered or reserved under Virginia law and may not contain words such as corporation, incorporated, limited liability company, or limited partnership, among others.[12] The name may contain words such as "'company,' 'association,' 'club,' 'foundation,' 'fund,' 'institute,' 'society,' 'union,' 'syndicate,' or 'trust,' or abbreviations

5. *Id.* §§ 13.1-601 to -781 (Repl. Vol. 1999 & Cum. Supp. 2002).
6. *Id.* §§ 13.1-1000 to -1073 (Repl. Vol. 1999 & Cum. Supp. 2002).
7. *Id.* § 13.1-1202 (Cum. Supp. 2002).
8. *Id.* § 13.1-1203(B) (Cum. Supp. 2002).
9. *Id.* § 13.1-1212(A) (Cum. Supp. 2002).
10. *Id.* § 13.1-1204(A)(1) (Cum. Supp. 2002).
11. *Id.* § 13.1-1252(A) (Cum. Supp. 2002).
12. *Id.* § 13.1-1214(B)–(C) (Cum. Supp. 2002).

of like import."[13] A Virginia business trust's registered agent must be: (1) a resident of Virginia who is (a) an officer or trustee of the business trust, (b) an officer, director, general partner, member or manager of an entity that is a trustee of the business trust, or (c) a member of the Virginia State Bar; or (2) a domestic or foreign entity authorized to transact business in Virginia.[14]

Except to the extent otherwise provided in the articles of trust or in the governing instrument of the business trust, "the sole trustee or a majority of the trustees may amend [or restate] the articles of trust" at any time by filing articles of amendment or articles of restatement with the Commission.[15] Articles of amendment and restatement must include "[a] statement that the amendment was adopted in accordance with the articles of trust and the governing instrument of the business trust."[16] If a change in plans or mistake results in an erroneous filing with respect to a name or address specified in the articles of trust, articles of correction may be filed at any time by a trustee or officer of the business trust correcting such name or address.[17]

Upon the winding up of the business trust, articles of cancellation must be filed with the Commission.[18] Unless otherwise provided by the articles of trust, the articles of cancellation are effective when accepted by the Commission.[19]

c. Governing Instrument

Many provisions of the VBTA regulate a business trust's governance only to the extent not addressed by the business trust's articles of trust or governing instrument.[20] A business trust's governing instrument may provide any details with respect to the business trust's governance so long as such provisions are not inconsistent with law or with the articles of trust.[21] The VBTA

13. *Id.* § 13.1-1214(A).
14. *Id.* § 13.1-1220(A)(2) (Cum. Supp. 2002).
15. *Id.* § 13.1-1216(A)–(B) (Cum. Supp. 2002).
16. *Id.* § 13.1-1216(B)(4).
17. *Id.* § 13.1-1213 (Cum. Supp. 2002).
18. *Id.* § 13.1-1238(A) (Cum. Supp. 2002).
19. *Id.* § 13.1-1238(B).
20. *See, e.g.*, *id.* § 13.1-1236 (Cum. Supp. 2002).
21. *Id.* § 13.1-1219(A)(3) (Cum. Supp. 2002).

therefore provides a great deal of flexibility with respect to a business trust's internal governance.

d. Liabilities of Beneficial Owners

The VBTA permits beneficial owners or other persons to participate in the management of the business trust without incurring personal liability for its obligations because beneficial owners of a business trust are afforded limited liability to the same extent as shareholders of a Virginia corporation.[22] In addition, the VBTA provides that, unless otherwise provided by the governing instrument, neither the possession of power to direct the trustees nor the exercise of such power shall impose on a person trustee status or any of the duties or liabilities pertaining to the business trust.[23]

A business trust's assets are immune from creditors seeking to enforce a claim against its beneficial owner.[24] Unless otherwise provided in the governing instrument, beneficial owners of a Virginia business trust have "an undivided beneficial interest in the property of the business trust" and have no interest in specific trust property.[25] Further, a creditor of a beneficial owner does not have the "right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the business trust" unless otherwise provided by the governing instrument.[26] Therefore, creditors of a beneficial owner of a Virginia business trust may not seize business trust property to satisfy claims against beneficial owners and may only reach property that the beneficial owner could reach under the governing instrument.

e. Duties and Liabilities of Trustees

The VBTA also provides a great deal of flexibility with respect to a trustee's role in the management of a business trust. Trus-

22. *Id.* § 13.1-1225 (Cum. Supp. 2002).
23. *Id.* § 13.1-1228(B) (Cum. Supp. 2002).
24. *Id.* § 13.1-1226(B)(2) (Cum. Supp. 2002).
25. *Id.* § 13.1-1226(A)–(B)(1).
26. *Id.* § 13.1-1226(B)(2).

tees are appointed in the manner provided by the business trust's governing instrument, which will prescribe the trustees' duties, rights, and powers, and may provide for one or more series of trustees with different duties and powers.[27] A trustee may be a natural person or an entity, and may also be a beneficial owner.[28] If a governing instrument does not provide otherwise, "the trustees shall choose and supervise the officers and employees of the business trust," and shall direct the management of the business trust's business and affairs.[29]

With respect to trustee liability, the VBTA provides that the standard of care of business trust trustees is the same as that required of directors of a Virginia corporation.[30] The VBTA states that, except as otherwise provided in the governing instrument, a trustee is not personally liable to third parties when acting in his capacity as trustee.[31] In addition, a trustee's liability to the business trust and its beneficial owners is limited to that of directors or officers of a Virginia corporation, and may be further limited by the articles of trust or governing instrument.[32] A business trust may purchase insurance for and indemnify a trustee, and such trustee is entitled to mandatory indemnification to the same extent as a director of a Virginia corporation.[33]

f. "Series" of a Business Trust

A Virginia business trust, like its Delaware counterpart, may create one or more series of beneficial interests whose obligations may only be enforced against the assets of such series.[34] Separate and distinct records must be maintained with respect to each series and the assets of such series must be held and accounted for separately in order to be afforded separate liability.[35]

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27. *Id.* §§ 13.1-1219(B), -1228(A) (Cum. Supp. 2002).
28. *Id.* § 13.1-1201 (Cum. Supp. 2002).
29. *Id.* § 13.1-1228(A) (Cum. Supp. 2002).
30. *Id.* § 13.1-1229(A) (Cum. Supp. 2002).
31. *Id.* § 13.1-1229(B).
32. *Id.* § 13.1-1229(C).
33. *Id.* § 13.1-1230 (Cum. Supp. 2002).
34. *Id.* § 13.1-1231(D) (Cum. Supp. 2002).
35. *Id.*

The ability to create separate series within a business trust may be particularly useful to registered investment companies, which are often structured as a primary or master trust with several series of sub-trusts. Such sub-trusts may have varying investment objectives and may reduce their expenses due to economies of scale attained by being part of a single investment company.

g. Derivative Actions

The VBTA provides that a beneficial owner of a business trust may bring a derivative action to the same extent, and in the same manner, as a shareholder of a Virginia corporation.[36] A beneficial owner who is successful in prosecuting a derivative action is entitled to reasonable attorney's fees if the court finds the proceeding "resulted in a substantial benefit to the business trust."[37] A business trust that is successful in defending a derivative proceeding is entitled to reasonable attorney's fees if the court finds the proceeding was not commenced or maintained in good faith.[38]

h. Access to Reports and Records

A business trust must "keep minutes of all meetings of its beneficial owners and trustees, [and] a record of all actions taken by the beneficial owners or trustees without a meeting."[39] A business trust must also keep appropriate accounting records,[40] a record of its beneficial owners and current trustees,[41] and copies of its articles of trust and governing instrument.[42] Further, a business trust must keep records of "[a]ll written communications to beneficial owners generally within the past three years."[43]

Subject to certain limitations, a beneficial owner is entitled to inspect and copy the above-mentioned records at the business

36. *Id.* § 13.1-1232 (Cum. Supp. 2002).
37. *Id.* § 13.1-1233(1) (Cum. Supp. 2002).
38. *Id.* § 13.1-1233(2).
39. *Id.* § 13.1-1278(A) (Cum. Supp. 2002).
40. *Id.* § 13.1-1278(B).
41. *Id.* § 13.1-1278(C).
42. *Id.* § 13.1-1278(E)(1)–(2).
43. *Id.* § 13.1-1278(E)(5).

trust's principal office.[44] The right of inspection granted by the VBTA "may not be abolished or limited by [the] business trust's articles of trust or governing instrument."[45]

i. Merger

Under the VBTA, a business trust may merge with or into another entity by executing and filing articles of merger.[46] Unless otherwise provided by the governing instrument, a merger must be approved by an "affirmative vote of the trustees and the holders of two-thirds of the outstanding beneficial interests of [the] business trust."[47] A governing instrument or an agreement of merger may provide for contractual dissenter's rights to beneficial owners of the business trust in connection with a merger or a sale of all or substantially all of the business trust's assets.[48] This suggests that absent such a provision, there will be no dissenter's rights in connection with such a transaction.

j. Conversion

A domestic entity, other than a domestic business trust, may convert into a Virginia business trust pursuant to a plan of entity conversion and by filing articles of entity conversion with the Commission.[49] If the converting entity is a corporation, an affirmative vote by more than two-thirds of all shares entitled to vote is required, unless the corporation's board of directors requires a greater vote.[50] If the converting entity is a limited liability company, an affirmative vote by all of its members is required, unless otherwise provided by the limited liability company's operating agreement or articles of organization.[51] If the converting entity is a partnership or a limited partnership, an affirmative

44. *Id.* § 13.1-1279(A) (Cum. Supp. 2002).

45. *Id.* § 13.1-1279(D).

46. *Id.* § 13.1-1260 (Cum. Supp. 2002).

47. *Id.* § 13.1-1258(A) (Cum. Supp. 2002). Under the VSCA, a merger or share exchange must be approved by *more than* two-thirds of all shares entitled to vote on the matter. *Id.* § 13.1-718(E) (Repl. Vol. 1999).

48. *Id.* § 13.1-1263(6) (Cum. Supp. 2002).

49. *Id.* §§ 13.1-1272, -1275(A) (Cum. Supp. 2002).

50. *Id.* § 13.1-1274(A)(6) (Cum. Supp. 2002).

51. *Id.* § 13.1-1274(B).

vote by all of its partners is required, unless otherwise provided by the partnership or limited partnership's partnership agreement.[52] If the converting entity is any other type of entity, a unanimous affirmative vote by the authorized persons is required, unless otherwise provided by the governing instrument of the other entity.[53]

k. Domestication

A foreign entity may become a Virginia business trust pursuant to a plan of domestication by filing articles of domestication with the Commission.[54] Although the VBTA provides that such domestication is permitted if the laws of the foreign jurisdiction in which the foreign entity is formed authorize it to domesticate in another jurisdiction, the domestication must nevertheless be approved in the manner provided by the VBTA.[55] A domesticated entity retains its assets and liabilities as if the domestication did not occur.[56]

If a Virginia business trust wishes to domesticate to a foreign jurisdiction, the plan of domestication must be approved by the sole trustee or a majority of the trustees, unless otherwise provided in the governing instrument.[57] When a Virginia business trust has approved a plan of domestication to a foreign jurisdiction, it must file articles of trust surrender with the Commission.[58]

l. Dissolution

A business trust may be dissolved upon the occurrence of any of the following events:

> 1. [a]t the time or on the happening of any events specified in writing in the articles of trust or a governing instrument; 2. [u]pon the

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52. *Id.* § 13.1-1274(C)–(D) (Cum. Supp. 2002).
53. *Id.* § 13.1-1274(E).
54. *Id.* §§ 13.1-1266, -1268(A) (Cum. Supp. 2002).
55. *Id.* § 13.1-1265 (Cum. Supp. 2002).
56. *Id.* § 13.1-1270(A)(1)–(2) (Cum. Supp. 2002).
57. *Id.* § 13.1-1267(A) (Cum. Supp. 2002).
58. *Id.* § 13.1-1269(A) (Cum. Supp. 2002).

> unanimous written consent of the beneficial owners; 3. [t]he entry of a decree of judicial dissolution . . . ; or 4. [a]utomatic cancellation of its certificate [due to nonpayment of annual registration fees].[59]

Dissolution may occur under these conditions "[u]nless otherwise provided in the articles of trust or in the governing instrument, upon the dissolution of a business trust, the trustees may wind up the business trust's affairs . . . ."[60] Distribution of the assets of a business trust occurs in the following order:

> 1. [t]o creditors . . . in satisfaction of liabilities of the business trust . . . ; 2. [u]nless otherwise provided in the articles of trust or the governing instrument, to the beneficial owners and former beneficial owners in satisfaction of liabilities for [previously declared but unpaid distributions]; and 3. [u]nless otherwise provided in the articles of trust or in the governing instrument, to the beneficial owners in the proportions in which the beneficial owners share in distributions.[61]

Once the winding up process is completed, the trustees must file articles of cancellation with the Commission.[62]

m. Foreign Business Trusts

The VBTA provides that foreign business trusts must register with the Commission before transacting business in Virginia.[63] A foreign business trust's internal affairs are governed by the laws of the jurisdiction in which the foreign business trust is organized, and its registration with the Commission may not be denied because of a difference between the laws of the foreign business trust's governing jurisdiction and the laws of Virginia.[64]

n. Existing Virginia Real Estate Investment Trusts

The VBTA repeals the Virginia Real Estate Investment Trust Act ("REIT").[65] After the effective date of the VBTA, Virginia real

59. *Id.* § 13.1-1234 (Cum. Supp. 2002).
60. *Id.* § 13.1-1236 (Cum. Supp. 2002).
61. *Id.* § 13.1-1237 (Cum. Supp. 2002).
62. *Id.* § 13.1-1238(A) (Cum. Supp. 2002).
63. *Id.* § 13.1-1242 (Cum. Supp. 2002).
64. *Id.* § 13.1-1241 (Cum. Supp. 2002).
65. *Id.* §§ 6.1-343 to -351 (Cum. Supp. 2002).

estate investment trusts formed under the REIT will be governed by the VBTA, but existing rights and proceedings will not be affected.[66]

2. Stock and Nonstock Corporations

a. Notice, Voting, and Written Consent by Electronic Transmission

i. Notice

The 2002 General Assembly passed legislation permitting stock and nonstock corporations to provide notice to their shareholders or members by means of a form of "electronic transmission"[67] consented to by the shareholder or the member to whom the notice is given.[68] A shareholder or member may revoke his or her consent by delivering written notice to the corporation and such consent is deemed revoked by the shareholder or member if (1) the corporation is unable to deliver two consecutive notices by electronic transmission; and (2) such inability becomes known to the person responsible for delivering the notice.[69] The amendment provides, however, that the inadvertent failure to treat the inability to deliver a notice as a revocation does not invalidate any meeting or other action.[70]

One of the most important aspects of this legislation is a corporation's ability to imply the consent of a shareholder or member

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66. *Id.* § 13.1-1284 (Cum. Supp. 2002); *see, e.g.*, *id.* § 55-106.4 (Cum. Supp. 2002).

67. An "electronic transmission" is "any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient thereof and that may be directly reproduced in paper form by such a recipient through an automated process." *Id.* §§ 13.1-603, -803 (Cum. Supp. 2002).

68. *Id.* §§ 13.1-610(H), -842(A)(3) (Cum. Supp. 2002). A 1999 amendment to the VSCA provided that corporations with 300 or more record shareholders could give notice of annual or special shareholders' meetings electronically to any shareholder who had authorized delivery of notice electronically. To be effective, the secretary of the corporation must have received authorization from a shareholder permitting the use of electronic notice in the form of "(i) a writing signed by the shareholder or (ii) [an electronic transmission] from the shareholder . . . [containing] information from which the secretary could determine [that the electronic transmission] was authorized by the shareholder . . . ." *Id.* § 13.1-658(G) (Repl. Vol. 1999) (repealed 2002). The 2002 amendment replaced this provision with a more comprehensive provision for all corporations.

69. *Id.* §§ 13.1-610(H), -842(A)(3).

70. *Id.*

to receiving notice by electronic transmission under certain circumstances, including (1) when the notice is directed to a facsimile number or e-mail address at which the shareholder or member has consented to receive notice; and (2) when the corporation posts the notice on an Internet Web site and sends a separate notice to the shareholder or member of the posting to the record address of the shareholder or member or an address to which the shareholder or member has consented to receiving notices.[71] For purposes of clause (2) such notice is effective upon the later of the giving of the separate notice or the posting of the notice on the Internet Web site.[72]

This new legislation, combined with the interpretations of the Securities and Exchange Commission ("SEC") regarding the use of electronic media to deliver information required under the federal securities laws,[73] will permit a Virginia public company to provide notice to its security holders of annual or special meetings and proxy solicitation materials electronically, thereby reducing the costs associated with annual or special meetings. Under the federal securities laws, public companies are generally required to deliver a proxy statement to their security holders when soliciting proxy voting authority.[74] Under the interpretations of the SEC, a public company is permitted to deliver proxy solicitation materials electronically, subject to certain requirements.[75]

The rules promulgated by the SEC also permit public companies subject to the proxy rules to deliver one proxy statement and annual report to an address shared by multiple security holders if the security holders consent to such delivery.[76] This practice is

71. *Id.* §§ 13.1-610(H), -842(F). It should be noted that the amendment does not specify how a shareholder or member is to give his or her consent or when such consent is to be given. Presumably, a shareholder or member could give his or her consent to the form of electronic transmission or facsimile number or e-mail address to which such electronic transmission may be given either by written notice or an electronic transmission to the corporation. Regardless of how such consent is given, it should be given before the notice is deemed given under given under section 13.1-610(H).

72. *Id.* §§ 13.1-610(H), -842(F).

73. Use of Electronic Media for Delivery Purposes, 60 Fed. Reg. 53,458 (Oct. 6, 1995).

74. The proxy rules apply to companies with a class of equity securities registered under section 12 of the Securities Exchange Act of 1934. 15 U.S.C. § 78a (2000). Further, proxy rules apply to investment companies registered under the Investment Company Act of 1940. *Id.* § 80a (2000).

75. Use of Electronic Media for Delivery Purposes, 60 Fed. Reg. at 53,458.

76. 17 C.F.R. § 240.14a-3(e) (2002) (SEC Rule 14a-3(e)). A company may receive af-

known as "householding." It remains unclear under current Virginia law whether a Virginia public company would be permitted to "household" the notice of annual or special meeting of security holders that generally accompanies the proxy solicitation materials. As the SEC has recognized, "the requirements for security holder meeting notices are governed by state law, rather than by the [SEC]'s proxy rules, and [the householding rules] are not intended to preempt state law."[77] Virginia law states that "[a] corporation shall notify shareholders of the date, time, and place of each annual and special shareholders' meeting."[78] One could argue that this provision does not require notice be sent to each shareholder at a particular address. Presumably, had the drafters intended a separate notice be sent to each shareholder, they would have so provided.[79] The conservative approach would be for a Virginia public company that chooses to, and receives consent from its security holders to, send household proxy materials to include a notice of annual or special meeting for each security holder at a particular address. Under the electronic notice legislation, however, a Virginia public company that chooses to post such notice together with its proxy solicitation materials on an Internet Web site, and provide a separate written notice of the posting, must include a separate notice of the posting for each security holder at a particular address.[80]

Under this new legislation, notice of a regular or special meeting of the board of directors of a stock or nonstock corporation may also be given by a form of electronic transmission consented to by the director.[81] A director may revoke his or her consent by delivering written notice to the corporation.[82] Such consent is deemed revoked by the director if the corporation is unable to deliver two consecutive notices by electronic transmission and this

firmative written consent from security holders with respect to householding or it may imply such consent if certain conditions are met. *Id.* § 240.14a-3(e)(1)(ii) (SEC Rule 14a-3(e)(1)(ii)).

77. Delivery of Proxy Statements and Information Statements to Households, 2000 SEC LEXIS 2325 (Oct. 27, 2000) (to be codified at 17 C.F.R. §§ 230, 240) (effective thirty days after publication in Federal Register).

78. VA. CODE ANN. § 13.1-658(A) (Cum. Supp. 2002).

79. Delaware law specifically provides that notice shall be given "to each shareholder entitled to vote at such meeting." DEL. CODE ANN. tit. 8, § 222(b) (2001).

80. VA. CODE ANN. § 13.1-842(F) (Cum. Supp. 2002).

81. *Id.* §§ 13.1-686(C), -866(C) (Cum. Supp. 2002).

82. *Id.*

inability becomes known to the person responsible for delivering the notice.[83] The inadvertent failure to treat an inability to deliver a notice as a revocation does not invalidate any meeting or other action.[84] A director's consent may be implied under certain circumstances, including (1) when the notice is directed to a facsimile number or electronic mail address at which the director has consented to receive notice; and (2) when the corporation posts the notice on an Internet Web site and sends a separate notice of the posting to the director at an address to which the director has consented to receiving notices.[85] For purposes of clause (2), such notice is effective upon the later of the giving of the separate notice or the posting of the notice on the Internet Web site.[86]

ii. Voting

The same legislation permits any vote of a corporation's shareholders or members, if authorized by the board of directors, to be taken by a ballot submitted by electronic consent by a shareholder or member or by such shareholder's or member's proxy.[87]

iii. Written Consent

The definition of "electronic transmission" includes a provision that specifically recognizes the use of an electronic transmission to satisfy the current VSCA[88] and Virginia Nonstock Corporation Act ("VNCA")[89] requirements that an action taken by written con-

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83. *Id.*

84. *Id.*

85. *Id.* Like the provisions permitting electronic transmission of notices to shareholders and members, the provisions permitting electronic transmission of notices to directors do not address how and when the directors' consent is to be given. Use of Electronic Media for Delivery Purposes, 60 Fed. Reg. 53,458 (Oct. 6, 1995).

86. VA. CODE ANN. §§ 13.1-686(C), -866(C) (Cum. Supp. 2002).

87. *Id.* §§ 13.1-664.1(E), -846(B) (Cum. Supp. 2002); *see also id.* § 13.1-647(A) (Repl. Vol. 1999).

88. *Id.* §§ 13.1-601 to -800 (Repl. Vol. 1999 & Cum. Supp. 2002). The provisions regarding action taken by written consent by shareholders and directors of stock corporations are set forth in sections 13.1-657 and 13.1-685, respectively.

89. *Id.* §§ 13.1-801 to -980 (Repl. Vol. 1999 & Cum. Supp. 2002). The provisions regarding action taken by written consent by members and directors of nonstock corporations are set forth in sections 13.1-841 and 13.1-865, respectively.

sent either by a corporation's shareholders, members, or board of directors be "signed."[90]

b. Articles of Amendment and Restatement

The 2002 General Assembly also adopted legislation amending the current provisions of the VSCA and VNCA with respect to articles of amendment and articles of restatement for stock and nonstock corporations, respectively. Under this legislation, if a corporation files articles of amendment with the Commission with respect to an amendment to the corporation's articles of incorporation that did not require shareholder or member approval, the articles of amendment must include an explanation of why such approval was not required.[91] In addition, the articles of amendment filed by a nonstock corporation must state that the amendment received the affirmative vote of at least two-thirds of the directors then in office.[92]

Articles of restatement filed by a corporation with respect to a restatement of the corporation's articles of incorporation must now include the name of the corporation immediately prior to the restatement and the date of the restatement's adoption.[93] In addition, if a corporation files articles of restatement that contain one or more amendments to the corporation's articles of incorporation that did not require shareholder or member approval, such articles of restatement must meet the amendment requirements discussed above.[94]

The amendments to the VSCA require that a foreign corporation state its name on an application for a certificate of authority and, if it is prevented from using its name under the VSCA, designate a name that satisfies the requirements of the VSCA.[95]

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90. *Id.* §§ 13.1-603, -803 (Cum. Supp. 2002).

91. *Id.* §§ 13.1-710(A)(5), -888(A)(4)(b) (Cum. Supp. 2002).

92. *Id.* § 13.1-888(A)(4)(b). The amendments to the VNCA also require an explanation of why director and member approval of amendments adopted by the incorporators was not required and that the amendment was approved by a majority of the incorporators. *Id.*

93. *Id.* §§ 13.1-711(D)(1)–(2), -889(D)(1)–(2) (Cum. Supp. 2002).

94. *Id.* §§ 13.1-711(D)(4), -889(D)(4).

95. *Id.* § 13.1-759(A)(1) (Cum. Supp. 2002); *see id.* § 13.1-762 (Repl. Vol. 1999) (stating the requirements under the VSCA with respect to the name of a foreign corporation applying for a certificate of authority to transact business in Virginia).

The new VNCA legislation also authorizes the amendment of the articles of incorporation of a nonstock corporation by a majority of the corporation's incorporators when its organization has been completed but there are no directors or members.[96]

3. Limited Liability Companies and Professional Limited Liability Companies

In 2002 the Virginia General Assembly enacted legislation amending the Virginia Limited Liability Company Act ("VLLCA").[97] These amendments provide that written consent from a member or manager of a limited liability company ("L.L.C.") sent by electronic transmission satisfies the requirement that such written consent be signed.[98] The legislation also allows voting by managers of an L.L.C. by means of a proxy that may be submitted by electronic transmission,[99] and excludes compensation distributions to managers and members from the calculation of limits on the liability of managers and members in proceedings brought by or in the right of the L.L.C.[100] The amendments further provide that a member's rights to obtain certain information regarding the L.L.C. may be restricted by the L.L.C.'s original operating agreement or an amendment to the original operating agreement adopted by all of the members in accordance with the procedures of the operating agreement.[101] Additionally, this legislation allows a member to dissociate from an L.L.C. by submitting a resignation notice only if resignation of a member is provided for in the articles of organization or operating agreement,[102] and enables a court to appoint one or more liquidating trustees to wind up an L.L.C.'s affairs in the event the L.L.C. is judicially dissolved.[103]

Under a separate piece of legislation, the 2002 General Assembly amended the VLLCA to require that a partnership or limited partnership converting to an L.L.C. include in its articles of or-

96. *Id.* § 13.1-887.1 (Cum. Supp. 2002).
97. *Id.* §§ 13.1-1000 to -1073 (Cum. Supp. 2002).
98. *Id.* §§ 13.1-1022(E), -1024(I) (Cum. Supp. 2002).
99. *Id.* § 13.1-1024(I).
100. *Id.* § 13.1-1025(A)(2) (Cum. Supp. 2002).
101. *Id.* § 13.1-1028(C) (Cum. Supp. 2002).
102. *Id.* § 13.1-1040.1(1) (Cum. Supp. 2002).
103. *Id.* § 13.1-1048(A)–(B) (Cum. Supp. 2002).

ganization the date and place of filing of the partnership's or limited partnership's organizational documents, if any.[104] The new legislation also requires that a foreign L.L.C. state its name on an application for registration to transact business in Virginia and, if it is prevented from using its name under the VLLCA, designate a name that satisfies the requirements of the VLLCA.[105] These amendments clarify that the Secretary of State or other official having custody of a foreign L.L.C.'s records must authenticate the organizational documents of the foreign L.L.C. to be included with its application for registration.[106] The General Assembly further clarified that an L.L.C. must pay all fees, fines, penalties, and interest owed to the Commission before the Commission may file or issue any L.L.C. certificate referred to in the VLLCA.[107] Finally, the legislation specifies that a professional L.L.C.'s inclusion of the initials "P.L.C.," "PLC," "P.L.L.C.," "PLLC," the phrase "professional limited liability company," or "a professional limited liability company" at the end of its name will not be considered in determining whether the proposed name of a professional L.L.C. is available on the records of the Commission.[108]

4. Limited Partnerships and Partnerships

In 2002, the Virginia General Assembly passed legislation amending certain sections of the Virginia Revised Uniform Limited Partnership Act ("VRULPA")[109] and Virginia Uniform Partnership Act ("VUPA").[110] The amendments to the VRULPA require that certificates filed under the VRULPA include the name and the capacity of the person executing the certificate.[111] The amendments also conform the registration requirements for foreign limited partnerships seeking to do business in Virginia to those of other foreign entities.[112] Under the amendments, a foreign limited partnership must include a name that satisfies the

104. *Id.* § 13.1-1010.1(A)(2) (Cum. Supp. 2002).
105. *Id.* § 13.1-1052(1) (Cum. Supp. 2002).
106. *Id.* § 13.1-1052(6).
107. *Id.* § 13.1-1065 (Cum. Supp. 2002).
108. *Id.* § 13.1-1104 (Cum. Supp. 2002).
109. *Id.* §§ 50-73.1 to -73.78 (Repl. Vol. 2002).
110. *Id.* §§ 50-73.79 to -73.149 (Repl. Vol. 2002).
111. *Id.* § 50-73.15(B) (Repl. Vol. 2002).
112. *Id.* § 50-73.54 (Repl. Vol. 2002).

requirements of the VRUPLA in its application for registration.[113] To have a name in compliance with the VRUPLA, a foreign limited partnership may add to its name the phrase "limited partnership" or "a limited partnership," the abbreviation "L.P.," or "LP," or, in the case of a limited partnership that is also registered in Virginia as a foreign limited liability partnership, "L.L.P.," or other word, abbreviation, or designation to bring its name into compliance with the requirements of the VRULPA regarding registered L.L.P.s.[114] Finally, the amendments clarify that a limited partnership must pay all fees, fines, penalties, and interest owed to the Commission before the Commission files or issues any limited partnership certificate referred to in the VRULPA.[115]

The amendments to the VUPA require that any statement filed with the Commission includes the name and the capacity of the person signing the statement.[116] Additionally, they require that a partnership statement of authority filed with the Commission include the name of the state where the partnership was formed.[117] Finally, the amendments provide that the Commission shall not file a statement with respect to any domestic or foreign registered L.L.P. until all required annual continuation reports have been filed with the Commission.[118]

5. Professional Corporations

The 2002 General Assembly passed legislation specifying that the initials "P.C.," the phrase "professional corporation," or "a professional corporation" at the end of a professional corporation's name shall not be considered in determining whether the proposed name is available on the records of the Commission.[119]

113. *Id.* § 50-73.54(1).
114. *Id.* § 50-73.56 (Repl. Vol. 2002).
115. *Id.* § 50-73.70 (Repl. Vol. 2002).
116. *Id.* § 50-73.83(C) (Repl. Vol. 2002).
117. *Id.* § 50-73.93(A)(1)(b) (Repl. Vol. 2002).
118. *Id.* § 50-73.134(G) (Repl. Vol. 2002).
119. *Id.* § 13.1-544.1 (Cum. Supp. 2002).

B. *Commercial Law*

In 2002, the Virginia General Assembly enacted several pieces of legislation amending Article 9. These amendments permit a financing statement filing office to provide certain information regarding financing statement filings by providing the requesting person with a list of private record research service providers.[120] The new legislation also requires that an amendment or correction to a previously filed financing statement include the name and address of the debtor,[121] and eliminate the specific reference to filing fees for public finance and manufactured housing transactions.[122]

C. *Electronic Commerce*

In 2002, the Virginia General Assembly enacted legislation amending the Uniform Computer Information Transactions Act ("UCITA").[123] UCITA was initially adopted by the 2000 General Assembly to regulate the transferability of a contractual interest in a computer program.[124] Under UCITA, a provision prohibiting the transfer of a contractual interest in a computer program is enforceable, and a transfer made in violation of such a provision is a breach of contract.[125] Moreover, such transfer does not create contractual rights in the transferee against the transferor.[126] Prior to the new legislation, UCITA provided an exception for transfers made in connection with a merger, acquisition, or sale of a subsidiary or affiliate when the transfer was made for specified reasons.[127] The new legislation amended UCITA by removing this exception.[128]

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120. *Id.* § 8.9A-523(d) (Cum. Supp. 2002).
121. *Id.* § 8.9A-516(b)(3)(B)(ii) (Cum. Supp. 2002).
122. *Id.* § 8.9A-525(a)–(b) (Cum. Supp. 2002).
123. *Id.* §§ 59.1-501.1 to -509.2 (Repl. Vol. 2001 & Cum. Supp. 2002).
124. *Id.* § 59.1-501.3 cmt. 2 (Repl. Vol. 2001).
125. *Id.* § 59.1-505.3(2) (Cum. Supp. 2002).
126. *Id.*
127. *Id.* § 59.1-505.3(2)(D).
128. *Id.*

III. JUDICIAL DECISIONS

A. *Federal Securities Laws Decisions*

For the first time since Congress passed the Private Securities Litigation Reform Act of 1995 ("PSLRA"),[129] the United States District Court for the Eastern District of Virginia examined the pleading standard for "scienter"[130] in a lawsuit involving alleged breaches of federal securities law.[131] In *Arnlund v. Deloitte & Touche, LLP*,[132] seven shareholders of Heilig Meyers Co., Inc. ("Heilig"), a Virginia corporation, asserted claims for securities

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129. 15 U.S.C. §§ 78a–78mm (2000).

130. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the United States Supreme Court held that a private plaintiff who seeks damages under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder ("section 10(b)" & "Rule 10b–5") must allege that defendant acted with "scienter," defined as the "intent to deceive, manipulate, or defraud." 424 U.S. at 193 n.12. An allegation of negligence, therefore, was deemed to be insufficient to state a claim for securities fraud. *Id.* The Supreme Court, however, did not decide whether pleading recklessness under section 10(b) and Rule 10b-5 was sufficient to satisfy the scienter requirement. *Id.* At the same time, the Supreme Court observed that recklessness "is considered to be a form of intentional conduct" in some areas of the law. *Id.* Since *Hochfelder*, the appellate courts "that have addressed this issue have accepted that some form of recklessness is sufficient to satisfy the element of scienter in private securities fraud cases." Arnlund v. Deloitte & Touche, LLP, 199 F. Supp. 2d 461, 470 (E.D. Va. 2002). Subsequently, there arose different standards, however, by which to measure the adequacy of allegations of scienter in securities fraud cases among the different circuits. *Id.* The Second Circuit required the most stringent standard, and the Ninth Circuit provided for a more lenient standard. *Id.*

131. *See Arnlund*, 199 F. Supp. 2d at 465. In 1995, Congress passed the PSLRA as a means to prevent strike suits and other abuses that had arisen in securities fraud litigation. *See Id.* at 471, 475 (citing *In re* Advanta, 180 F.3d 525, 531 (3d. Cir. 1999). *Advanta* explained that:

> The purpose of the Act was to restrict abuses in securities class-action litigation, including: (1) the practice of filing lawsuits against issuers of securities in response to any significant change in stock price, regardless of defendants' culpability; (2) the targeting of "deep pocket" defendants; (3) the abuse of the discovery process to coerce settlement; and (4) manipulation of clients by class action attorneys.

In re Advanta, 180 F.3d at 531. The PSLRA requires a plaintiff to plead scienter

> [i]n any private action arising under this chapter in which the plaintiff may recover money damages on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

15 U.S.C. § 78u-4(b)(2) (2000). The PSLRA provides that if a plaintiff does not meet this requirement, a court may, on any defendant's motion, dismiss the complaint. *Id.* § 78u-4(b)(3).

132. 199 F. Supp. 2d 461 (E.D. Va. 2002).

fraud and common law fraud arising out of misrepresentations and omissions alleged to have been made by Heilig's outside auditor, Deloitte & Touche, LLP ("Deloitte").[133] These alleged misrepresentations were made in connection with Heilig's Annual Report issued on May 30, 2000, which included, among other things, audited financial statements.[134] Deloitte argued that the lawsuit should be dismissed because the plaintiffs had failed to state a claim under section 10(b) of the Securities Exchange Act of 1934, as amended ("1934 Act") and Rule 10b-5, promulgated thereunder, and because the complaint failed to meet "the heightened standard for pleading scienter that is created by [the] PSLRA."[135]

In examining whether scienter had been adequately pleaded by the plaintiffs under the PSLRA, the court found "that it [was] sufficient to plead scienter by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior."[136] The court also noted that it would determine the adequacy of the scienter allegations by measuring them by the facts collectively alleged in the complaint.[137] The court held that in this instance, the totality of the facts alleged raised a strong inference of the requisite state of mind based on conscious behavior.[138] The court, therefore, denied Deloitte's motion to dismiss.[139]

Deloitte performed an audit of the financial statements of Heilig for the fiscal year ending on February 29, 2000, that was subsequently incorporated into Heilig's annual report on Form 10-K (the "Annual Report") issued on May 30, 2000.[140] On March 22, 2000 Deloitte presented its unqualified audit report to Heilig's Board of Directors ("Heilig Board").[141] On May 29, 2000 the Heilig Board approved the Annual Report and sent it to the SEC on May 30, 2000.[142]

The Annual Report included Deloitte's audit opinion representing "that (1) Deloitte had audited the [company's financial state-

133. *Id.* at 466.
134. *Id.*
135. *Id.* at 470.
136. *Id.* at 475.
137. *Id.*
138. *Id.* at 485.
139. *Id.* at 492.
140. *Id.* at 466.
141. *Id.*
142. *Id.*

ments]; (2) [Heilig's] financial statements 'present fairly, in all material respects, the financial position' of [Heilig] as of February 29, 2000; and (3) the audit was in conformity with [generally accepted] accounting principles."[143] Deloitte's opinion also stated that Heilig "was solvent; that it had almost $535 million in shareholder equity; and a book value of $8.81 per share" as of February 29, 2000, and May 30, 2000.[144] Plaintiffs also argued

> that Deloitte knew that its unqualified opinion was to be used in [Heilig's] Annual Report and that, as of May 30, 2000, when the Annual Report was issued, Deloitte knew that [Heilig] was not solvent; that the shareholder equity was not $535 million; that the book value was not $8.81 per share; and that the audited financial statements did not in most material respects fairly present [Heilig's] financial position either as of February 29, 2000, or as of May 30, 2000.[145]

Further, the plaintiffs charged that based on the financial information that it was given and the prior discussions between Deloitte and Heilig's management, "Deloitte knew, or should have known" before the Annual Report was released, that the accuracy of Heilig's financial statements was problematic "and that there was material uncertainty about the ability of [Heilig] to continue as a going concern."[146] The plaintiffs also argued that Deloitte knew, by May 30, that its audit opinion and Heilig's Annual Report inaccurately portrayed Heilig's liquidity situation.[147] The plaintiffs claimed Deloitte was informed of these misrepresentations by Heilig's chief financial officer at a Heilig board meeting held on May 17, 2000.[148] In addition, the plaintiffs averred that Deloitte was aware, before the Annual Report was issued, that the company was positioning itself to seek protection under the bankruptcy laws and that an investment banker was retained to inquire into potential purchasers for Heilig.[149] The plaintiffs further alleged that Deloitte knew of several other misrepresentations of material fact in the Annual Report.[150]

143. *Id.*
144. *Id.*
145. *Id.* (quoting the Amended Complaint, ¶¶ 127, 141).
146. *Id.* (quoting the Amended Complaint, ¶ 27).
147. *Id.*
148. *Id.*
149. *Id.* at 466–67.
150. *Id.* at 467.

On November 27, Heilig filed its quarterly report with the SEC.[151] The quarterly report revealed that by August 31, 2000, Heilig was in dire straits and that "the equity interests of the Company's shareholders may have no value."[152] The plaintiffs' lawsuit followed.[153]

As an initial matter, the court examined whether the plaintiffs had standing to bring the lawsuit.[154] The court noted that

> private claims under [s]ection 10(b) of the 1934 Act and Rule [10b-5] may be brought only by persons who *sold* or *purchased* stock *after the date of an alleged misrepresentation*, and that claims by persons alleging that they were fraudulently induced not to sell their shares are legally insufficient in most instances.[155]

Based on this standard, five plaintiffs who had purchased shares of Heilig stock prior to the dissemination of the Annual Report were dismissed totally from the case.[156]

The court also examined Deloitte's motion to dismiss for failure to state a claim.[157] The court first noted that to satisfy the pleading requirements applicable to section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder, "a plaintiff must allege that: (1) a defendant made a false statement or omitted to make a statement of material fact"; (2) the false statement or omission was made with scienter; (3) the plaintiff justifiably relied on the false statement or omission; and (4) the false statement or omission "proximately caused the plaintiff's damages."[158]

In order to determine whether this requirement was met, the court first examined the requirements of the PSLRA.[159] The court found that while the PSLRA requires a higher pleading standard,

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151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.* at 469.

155. *Id.* (emphasis added) (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975); Gurley v. Documation, Inc., 674 F.2d 253, 255–56 (4th Cir. 1982); Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952)).

156. *Id.*

157. *Id.* at 468.

158. *Id.* at 469 (citing *In re* Microstrategy, Inc., 115 F. Supp. 2d 620, 628 (E.D. Va. 2000)). The language derives from *Phillips v. LCI Int'l, Inc.*, 190 F.3d 609, 613 (4th Cir. 1999). *Accord* Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 208 (4th Cir. 1994); Malone v. Microdyne Corp., 26 F.3d 471, 476 (4th Cir. 1994).

159. *Arnlund*, 199 F. Supp. 2d at 470.

it never defined that standard.[160] The court reasoned, however, that "the PSLRA did not change the nature and degree of scienter that a plaintiff must prove to prevail in a securities fraud case, but instead only changed what a plaintiff must plead in the complaint in order to survive a motion to dismiss."[161] The court then looked to the Fourth Circuit for guidance. The court noted that in *Phillips v. LCI International, Inc.*,[162] the Fourth Circuit held that a plaintiff may establish scienter by proving that the defendant acted recklessly, as this demonstrates the requisite intent.[163] The *Arnlund* court noted, however, that the Fourth Circuit had "not yet determined which pleading standard best effectuates Congress's intent."[164]

After conducting an exhaustive review of a number of circuit court decisions to identify what is required to plead scienter adequately under the PSLRA,[165] the court determined that a plaintiff may "plead scienter by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior . . . ."[166] Further, a court should measure the adequacy of the scienter allegations "by the facts collectively alleged in the complaint."[167] In this instance, the court held that

> a plaintiff can satisfy the heightened burden of pleading scienter under the PSLRA by identifying specific facts and circumstances available to the auditor that are unusual, suspicious or that, for other reasons, would put the auditor on notice of matters that ought to be looked into or reported on because, if true, they could alter an auditor's opinion or foreclose it entirely, and by alleging that these facts

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160. *Id.* at 471; *see also Phillips*, 190 F.3d at 620–21 (examining the circuit court interpretation of PSLRA). There remains widespread disagreement among courts as to what constitutes the proper pleading of "scienter" under the PSLRA. *Id.*

161. *Arnlund*, 199 F. Supp. 2d at 471; *see, e.g.*, *In re* Glenayre Techs. Inc. Sec. Litig., 982 F. Supp. 294, 298 (S.D.N.Y. 1997).

162. 190 F.3d 609 (4th Cir. 1999).

163. *Id.* at 620; *see also In re* Comshare, 183 F.3d 542, 548–49 (6th Cir. 1999).

164. *Arnlund*, 199 F. Supp. 2d at 474 (citing *Phillips*, 190 F.3d at 621).

165. *Id.* at 473–74. Compare the Second Circuit's standard requiring a plaintiff to allege facts showing either (1) a defendant's "motive and opportunity" to commit fraud; or (2) strong circumstantial evidence of conscious or reckless behavior, Shields v. Citytrust Bancorp., Inc., 25 F.3d 1124, 1128 (2d Cir. 1994), with the Ninth Circuit's standard that does not require a plaintiff to allege any specific facts to survive a motion to dismiss and merely requires a plaintiff to make general allegations of scienter, *In re* GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1545 (9th Cir. 1994).

166. *Arnlund*, 199 F. Supp. 2d at 475 (citing *In re* Microstrategy, 115 F. Supp. 2d 620, 628–30, 633 (E.D. Va. 2000)).

167. *Id.*

> were ignored, either deliberately, recklessly or by failing to follow generally accepted accounting and auditing principles.[168]

The court stated that "'[i]f the totality of the circumstances alleged raises a "strong inference" of the requisite state of mind, it is immaterial whether plaintiffs satisfy their burden by "pleading motive and opportunity, conscious misbehavior, recklessness, or by impressing upon the Court a novel legal theory."'"[169] Further, the court found that if one alleges reckless rather than willful conduct, the conduct must meet the *Phillips* standard.[170]

Applying the court's legal analysis to the facts in *Arnlund*, the court held that "the totality of the factors alleged raise[d] a strong inference of the requisite state of mind based on conscious behavior under any of the standards of recklessness promulgated by the various circuit courts."[171] Specifically, the court agreed with the plaintiffs that "Deloitte's involvement and participation was integral to the creation of all [Heilig's] SEC filings."[172] The court also recognized the plaintiffs' contention that Deloitte worked closely with management and key executives of Heilig for many years and had unrestricted access to Heilig's employees, management, books, and records.[173] The court further noted that Deloitte's unfettered access to Heilig was not offered solely by the Plaintiffs "as the requisite strong inference of scienter," but was used "as part of the context to support the particulars of scienter set forth in the other allegations" of the case.[174] Based on these facts, the court inferred that Deloitte was positioned to understand the significance of both events that had transpired, or that were occurring in, the fiscal year being audited.[175] The court found that, "from the kind of tasks Deloitte is said to have engaged in, the concert of activity with executive management . . . and the responsibility of an auditor, it [was] inferable that Deloitte either

168. *Id.* (citing *In re* SmarTalk, 124 F. Supp. 2d 505, 513–14 (S.D. Ohio 2000)).

169. *Id.* at 476 (quoting *Microstrategy*, 115 F. Supp. 2d at 631).

170. *Id.* at 475. In *Phillips*, the Fourth Circuit defined "recklessness" under section 10(b) as "an act so highly unreasonable and such an extreme departure from the standard of ordinary care as to present a danger of misleading the plaintiff to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it." *Phillips v. LCI Int'l. Inc.*, 190 F.3d 609, 621 (4th Cir. 1999).

171. *Arnlund*, 199 F. Supp. 2d at 485.

172. *Id.* at 477.

173. *Id.*

174. *Id.*

175. *Id.* at 477–78.

knew of the deterioration of [Heilig's] finances . . . or with great recklessness ignored it."[176] The court went on to point out that "those inferences [were] underscored by the specifically alleged access to, and discussions with, [Heilig's] management and its Board of Directors about facts that were highly pertinent to [its] financial affairs and its viability as a going concern as of May 30."[177]

The court found that such allegations were vital to establishing scienter because Deloitte played an important role in assisting Heilig prepare for bankruptcy and was aware of Heilig's liquidity and credit concerns, in addition to having access to and being intimately familiar with the finances of Heilig.[178] Based on this analysis, the court found that the plaintiffs adequately alleged both the actual knowledge and recklessness necessary to proceed under the PSLRA as analyzed by the Fourth Circuit in *Phillips* and therefore denied Deloitte's motion to dismiss.[179]

B. *Supreme Court of Virginia Decisions*

1. *Flippo v. CSC Associates*[180]

In *Flippo*, the Supreme Court of Virginia upheld a trial court's judgment holding one L.L.C. member liable for a breach of fiduciary duty to the L.L.C., barring two members of the L.L.C. from serving as managers of the company, awarding compensatory and punitive damages, and imposing sanctions under Virginia Code section 8.01-271.1.[181]

The case concerned the ownership of timberlands by descendents of T. Frank Flippo.[182] On Mr. Flippo's death, the timberlands were devised to his three children, Arthur P. Flippo, F. Carter Flippo and Lucy Flippo Wisely.[183] Carter Flippo man-

176. *Id.* at 478.
177. *Id.*
178. *Id.* at 478–79.
179. *Id.* at 485.
180. 262 Va. 48, 547 S.E.2d 216 (2001).
181. *Id.* at 53, 547 S.E.2d at 219.
182. *Id.*
183. *Id.*

aged the timberlands in his capacity as executor of the estate.[184] Lucy Flippo Wisely, however, transferred her interest to her three children, who maintained their interests in the name of CSC Associates, a general partnership.[185] In 1988, Carter Flippo and Arthur Flippo ("Flippos"), and CSC Associates established the Flippo Land & Timber Company Partnership ("Flippo Partnership"), which served as owner and operator of the business.[186]

The Flippos and CSC Associates later held discussions concerning amendments to the partnership agreement that would address issues of partner withdrawal or death that were not covered in the existing agreement.[187] Subsequently, they drafted—but never executed[188]—a restated partnership agreement with specific provisions dealing with the purchase of a member's shares by the remaining members upon such member's death or withdrawal from the partnership.[189]

In 1995, the Flippos allowed CSC Associates to hold its interest in Flippo partnership as CSC Associates III, L.L.C. ("CSC"), a limited liability company.[190] Additionally, the Flippos and CSC converted the Flippo Land & Timber Company Partnership into a limited liability company, Flippo Land & Timber Co., L.L.C. ("FLTC").[191] Carter Flippo was the manager of FLTC, and CSC and the Flippos were its members.[192]

In 1997, the Flippos looked for a mechanism by which they could retain their interests in FLTC for the purpose of estate planning.[193] CSC rejected the Flippos' requests to hold their FLTC interests through personal L.L.C.s.[194] Carter Flippo then conferred with a firm that was both his personal counsel and FLTC's outside counsel regarding other mechanisms to achieve their estate planning goals.[195] The legal counsel advised Carter Flippo to

184. *Id.* at 53, 547 S.E.2d at 219–20.
185. *Id.* at 53, 547 S.E.2d at 220.
186. *Id.*
187. *Id.*
188. *Id.* at 53–54, 547 S.E.2d at 220.
189. *Id.* at 54, 547 S.E.2d at 220.
190. *Id.*
191. *Id.*
192. *Id.*
193. *Id.*
194. *Id.*
195. *Id.*

form a joint venture between FLTC and a newly formed company, Flippo Lumber Corporation.[196] Carter Flippo, as manager of FLTC, could transfer its assets to Flippo Lumber Corporation, resulting in the dissolution of FLTC pursuant to the terms of FLTC's operating agreement.[197] The legal counsel also advised the Flippos that L.L.C.s could hold their interests in the joint venture without CSC's approval under FLTC's operating agreement.[198]

In October 1998, Carter Flippo wrote a letter informing CSC that, as FLTC's manager, he accepted Flippo Lumber Corporation's proposal for FLTC to enter a joint venture and convey all of FLTC's property to the new venture, Timber Enterprises, L.L.C.[199] Further, the letter informed CSC that FLTC had "dissolved" pursuant to the terms of the operating agreement "because FLTC had contributed all of its non-cash assets to Timber Enterprises."[200] CSC was given the option to join Timber Enterprises if CSC agreed to the terms of the new venture's operating agreement.[201]

CSC then filed a bill of complaint against Carter Flippo, Arthur Flippo, FLTC, Flippo Lumber Corporation, and Timber Enterprises, individually and derivatively on behalf of FLTC, which sought to: (1) recover FLTC's assets; (2) remove Carter Flippo as manager of FLTC; (3) prevent future efforts to dissolve FLTC or dispose of its assets; and (4) recover compensatory and punitive damages resulting from a breach of fiduciary duties by the Flippos.[202]

The Flippos separately filed an amended bill of complaint which sought the dissolution of FLTC and the distribution of the assets in kind on three alternative bases:[203] (1) judicial dissolution pursuant to Virginia Code section 13.1-1047, under the theory that "it was not reasonably practicable to carry on the business of FLTC"; (2) reform of Article 13 of FLTC's operating agreement based on mutual mistake; and (3) rescission of [FLTC's] operating

196. *Id.*
197. *Id.*
198. *Id.*
199. *Id.*
200. *Id.*
201. *Id.*
202. *Id.* at 54–55, 547 S.E.2d at 220.
203. *Id.* at 55, 547 S.E.2d at 220.

agreement based on CSC's alleged fraud in the inducement."[204] The Flippos also submitted "contingent resignations" that would operate should the trial court determine that Article 13 of FLTC's operating agreement allowed a member to resign under that Article and receive an in kind distribution of the member's share of the assets.[205] CSC then filed a motion for sanctions on the grounds that the Flippos' allegations of mutual mistake were not well grounded in fact or warranted by existing law or a good faith argument for the extension, modification or reversal of the existing law.[206]

At trial, the court held that Carter Flippo, assisted by Arthur Flippo in forming Timber Enterprises and in transferring FLTC's assets to that company, breached his fiduciary duties to FLTC and violated its operating agreement.[207] The court awarded attorneys' fees to CSC for prosecuting the action on behalf of FLTC, and also awarded compensatory and punitive damages of $12,860.64 and $350,000.00, respectively, against Carter Flippo.[208] The court also made CSC manager of FLTC and prohibited such service by the Flippos.[209] Further, the court denied the Flippos' request for dissolution of FLTC and for reformation or rescission of FLTC's operating agreement,[210] and therefore also rejected the Flippos' contingent resignations.[211] Finally, the court granted CSC's motion for sanctions, awarding additional attorneys' fees to CSC.[212]

On appeal, the Supreme Court of Virginia first examined the Flippos' claim that Carter Flippo should be protected from liability for breach of fiduciary duty to the limited liability company under Virginia Code section 13.1-1024.1(B).[213] This section provides that a manager may rely on "information, opinions, reports or statements" if they are prepared or presented by certain experts, including legal counsel and public accountants, unless such

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204. *Id.*; *see also* VA. CODE ANN. § 13.1-1047 (Repl. Vol. 1999).
205. *Flippo*, 262 Va. at 55, 547 S.E.2d at 220–21.
206. *Id.* at 55, 547 S.E.2d at 221.
207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.*
211. *Id.*
212. *Id.*
213. *See id.* at 56–58, 547 S.E.2d at 221–22.

reliance is unwarranted.[214] In order to be afforded the protection of Virginia Code section 13.1-1024.1(B), however, a manager must have "received and acted upon . . . [the] advice sought in good faith for the benefit of the company."[215] The court explained that "[a] manager, like a corporate director, is required to discharge his duties in accordance with his 'good faith business judgment of the best interests of the limited liability company.'"[216] Both Virginia Code section 13.1-690(B) and section 13.1-1024.1(B) provide protection to managers and corporate directors from liability "in the exercise of their good faith business judgment."[217] The court found that a corporate director is entitled to liability protection under Virginia Code section 13.1-690(B) only when the acts related to the exercise of business judgment on behalf of the corporation of which he or she was the director,[218] and concluded that the same analysis must also apply to section 13.1-1024.1(B).[219] Because the legal advice sought by Carter Flippo was not related to the business interest of FLTC, such advice was not afforded the protections of section 13.1-1024.1(B).[220] It made no difference that the advice upon which the Carter Flippo acted involved acts that could legally be taken by him as manager of FLTC.[221] As the court stated:

> Even if legal, the action was neither sought nor taken with the intent of benefiting FLTC and in fact, had an adverse impact on the company. Following such advice cannot be the basis for a defense under subsection(B) of Code § 13.1-1024.1 to a violation of subsection (A) of that section.[222]

Turning its attention to punitive damages, the court held that the trial court's award of $350,000 against Carter Flippo was not

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214. VA. CODE ANN. § 13.1-1024.1(B) (Repl. Vol. 1999 & Cum. Supp. 2002).

215. *Flippo*, 262 Va. at 57, 547 S.E.2d at 222.

216. *Id.* at 56, 547 S.E.2d at 221 (quoting VA. CODE ANN. § 13.1-1024.1(A) (Repl. Vol. 1999 & Cum. Supp. 2002)); *see also* VA. CODE ANN. § 13.1-690(A) (Repl. Vol. 1999 & Cum. Supp. 2002) (requiring directors to act with good faith business judgment).

217. *Flippo*, 262 Va. at 57, 547 S.E.2d at 221; *see also* VA. CODE ANN. § 13.1-690(B) (Repl. Vol. 1999 & Cum. Supp. 2002) (outlining the circumstances in which a director is entitled to rely on outside information); *id.* § 13.1-1024.1(B) (Repl. Vol. 1999 & Cum. Supp. 2002) (prescribing the same standards for managers).

218. *Flippo*, 262 Va. at 57, 547 S.E.2d at 222 (citing Simmons v. Miller, 261 Va. 561, 544 S.E.2d 666 (2001)).

219. *Id.*

220. *See id.*

221. *See id.*

222. *Id.*

in error because the Flippos had "acted in conscious disregard of the interests of FLTC and CSC."[223] As the court stated:

> [T]he trial court found that the Flippos "weren't going [to the counsel involved] asking for advice as to what is in the best interest of [FLTC], they were asking what was the best way to break [FLTC] after the younger members of the organization, CSC, had not done what they wanted them to do." This action, as characterized by the trial court, was "secretive, concealed, dishonest" and "an attempt to steal property worth millions of dollars." Punitive damages were assessed "because of that clearly dishonest conduct."[224]

In addition the court found that it made no difference that the "scheme" was devised by their counsel nor that their counsel had a conflict of interest by representing both FLTC and the Flippos because it did not alter the reasoning for the "scheme;" namely "the Flippos' desire to implement their estate planning goals regardless of the interests of FLTC and CSC and any duties they owed to those entities."[225]

Next, the court examined the trial court's ruling that removed Carter Flippo as manager of FLTC, disqualified Arthur Flippo from being manager of FLTC, and installed CSC as manager of FLTC.[226] The court held that because the trial court found that "the Flippos had breached their fiduciary duties to FLTC and violated [FLTC's] operating agreement in doing so," Virginia Code section 13.1-1023(C)(1) authorized it to "enforce an operating agreement by relief 'that the court in its discretion determines to be fair and appropriate.'"[227] The court continued by noting that whether the enforcement of FLTC's operating agreement by the trial court was "fair and appropriate" was an appealable issue, but the initial decision was fully within the purview of the trial court to consider.[228]

One final area that should be highlighted is the court's discussion of sanctions pursuant to Virginia Code section 8.01-271.1.[229]

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223. *Id.* at 60, 547 S.E.2d at 223.

224. *Id.* at 59, 547 S.E.2d at 223.

225. *Id.* at 60, 547 S.E.2d at 223.

226. *Id.* at 60, 547 S.E.2d at 224.

227. *See id.* at 61, 547 S.E.2d at 224 (quoting VA. CODE ANN. § 13.1-1023(C)(1) (Repl. Vol. 1999)).

228. *Id.* at 61–62, 547 S.E.2d at 224.

229. *See id.* at 65–67, 547 S.E.2d at 227–28; VA. CODE ANN. § 8.01-271.1 (Repl. Vol. 2000 & Cum. Supp. 2002).

The trial court granted CSC's motion for sanctions based on the allegations of mutual mistake and fraud in the Flippos' amended bill of complaint.[230] The Flippos objected to the sanctions, arguing that the trial court's finding did not support the sanctions and that "the Flippos' theories of recovery were well grounded in fact and in law."[231] In applying an abuse of discretion standard, the court

> use[d] an objective standard of reasonableness in determining whether a litigant and his attorney, after reasonable inquiry, could have formed a reasonable belief that the pleading was well grounded in fact, warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and not interposed for an improper purpose.[232]

The Flippos based their fraud allegation on a letter from CSC to both legal counsel and the Flippos, in which CSC's proposed changes to the draft of FLTC's operating agreement were characterized as "housekeeping" items.[233] The Flippos contended that the proposed changes were, in actuality, material.[234] In particular, the letter stated "[w]e 'have had our attorney review the document and some "oversights" and housekeeping items have been added (as shown). I would hope these are just housekeeping items and have no material affect [sic] on the agreement. Please let me know if any of these are not acceptable.'"[235]

In upholding the trial court's award of sanctions, the court noted that the clear language of the letter stated an opinion of the writer, and "[f]raud cannot be predicated upon the mere expression of an opinion."[236] The court also found that there was no intent to mislead—a prerequisite to a finding of fraud—because the letter invited the Flippos "to consider the impact of the suggested changes."[237] The court, referring to the record of the trial court, stated that "'[e]verything done by CSC . . . was above board, high-

230. *Flippo*, 262 Va. at 65, 547 S.E.2d at 227.

231. *Id.*

232. *Id.* at 65–66, 547 S.E.2d at 227 (citing VA. CODE ANN. § 8.01-271.1 (Repl. Vol. 2000 & Cum. Supp. 2002)).

233. *Id.* at 66, 547 S.E.2d at 227.

234. *Id.*

235. *Id.*

236. *Id.* (citing Tate v. Colony House Builders, Inc., 257 Va. 78, 82, 508 S.E.2d 597, 599 (1999)).

237. *Id.* at 66–67, 547 S.E.2d at 227.

lighted in red, done in writing. And to try to say that . . . [CSC] could mislead a sophisticated law firm or sophisticated attorneys who specialize in this type of work, and that [it] succeeded in doing that, is ridiculous.'"[238]

Flippo highlights why it is critically important for a manager of a Virginia L.L.C. to act in the best interests of the company if the manager wishes to avail himself or herself of the protections afforded under Virginia Code section 13.1-1024.1(B). Merely relying on the advice of outside counsel will not shield a manager from liability if the manager cannot prove that the advice sought was for the company's benefit.

2. *Willard v. Moneta* [239]

In *Willard*, the Supreme Court of Virginia examined whether a dissenter's loss of the right to demand payment for shares of stock constituted an injury to property, which would make it subject to the applicable five-year statute of limitations, or a personal injury, which was subject to a two-year statute of limitations.[240] In holding that the loss of dissenters' rights was an injury to property subject to the applicable five-year statute of limitations,[241] the court was able to take a second bite of the *Moneta* apple.[242]

Willard previously filed a derivative suit on behalf of Moneta Building Supply, Inc. ("Moneta") and its shareholders against Moneta and its directors and officers, on the grounds that a sale of Moneta's assets to another company involved a conflict of interest in violation of Virginia Code section 13.1-691.[243] In dismissing this claim, the court held that a director discharges his/her fiduciary duties by acting "in accordance with his/her good faith business judgment of what is in the best interests of the corporation."[244] If a director acts in accordance with this standard, the

238. *Id.* at 67, 547 S.E.2d at 227.

239. 262 Va. 473, 551 S.E.2d 596 (2001) [hereinafter *Willard II*].

240. *Id.* at 476, 551 S.E.2d at 596. *Compare* VA. CODE ANN. § 8.01-243(B) (Repl. Vol. 2000 & Cum. Supp. 2002), *with id.* § 8.01-248 (Repl. Vol. 2000 & Cum. Supp. 2002).

241. *Willard II*, 262 Va. at 483, 551 S.E.2d at 600.

242. *See* Willard v. Moneta Bldg. Supply, Inc., 258 Va. 140, 515 S.E.2d 277 (1999) [hereinafter *Willard I*].

243. *Id.* at 148, 515 S.E.2d at 282; *see also* VA. CODE ANN. § 13.1-691 (Repl. Vol. 1999 & Cum. Supp. 2002) (prescribing general standards of conduct for directors).

244. *Willard I*, 258 Va. at 151, 515 S.E.2d at 284.

court reasoned, Virginia Code section 13.1-690(C) "provides a 'safe harbor' that shields a director from liability for any action taken as a director, and for failure to take action."[245] Because the court found that the directors acted in accordance with Virginia Code section 13.1-690(A), such directors were entitled to the safe harbor protection of subpart (C) of the section.[246] The court, therefore, dismissed the case.[247]

On November 15, 1996, A.S. Cappellari ("A.S.") and Rose Mary Cappellari ("Rose Mary"), the officers, directors, and shareholders of Moneta, entered into a contract on behalf of Moneta to sell substantially all of its assets to Capps Home and Building Center, Inc. ("Capps").[248] Capps was controlled by David Cappellari ("David"), a shareholder of Moneta and the son of A.S. and Rose Mary.[249]

Ronald L. Willard ("Willard"), a shareholder of Moneta, brought suit in order to void the sale of Moneta's assets to Capps, alleging that the transaction involved a conflict of interest in violation of Virginia Code section 13.1-691.[250] When that lawsuit failed, Willard then filed the case at issue against Moneta seeking monetary damages for the alleged injury to Willard's property.[251] Willard's basis for this allegation was that, as a shareholder of Moneta, he was entitled to dissenters' rights with respect to the proposed transaction as set forth in Virginia Code section 13.1-730.[252] Willard claimed, however, that the notice of the special meeting of the shareholders on the proposed sale of substantially all of Moneta's assets to Capps did not contain any notice of such dissenters' rights.[253]

The special meeting of Moneta's shareholders to vote on the proposed sale took place on December 20, 1996. Although Willard voted against the sale and made a competing offer at a higher

245. *Id.* at 151, 515 S.E.2d at 284 (citing Commonwealth Transp. Comm'r v. Matyiko, 353 Va. 1, 6, 481 S.E.2d 468, 470 (1997)).
246. *Id.* at 153, 515 S.E.2d at 286–87.
247. *See id.*
248. *Willard II*, 262 Va. 473, 476, 551 S.E.2d 596, 597 (2001).
249. *Id.*
250. *Id.*
251. *Id.*
252. *See id.* at 478, 551 S.E.2d at 597–98; *see also* VA. CODE ANN. § 13.1-730 (Repl. Vol. 1999 & Cum. Supp. 2002) (outlining the shareholder's right to dissent).
253. *Willard II*, 262 Va. at 478, 551 S.E.2d at 597.

price than Capps's, the votes of A.S. and Rose Mary were sufficient to approve the sale to Capps.[254] In January 1997 the transaction closed, and Moneta ceased conducting business.[255]

The trial court issued its opinion in April 2000 and sustained Moneta's plea of the running of the statute of limitations, dismissing Willard's motion for judgment.[256] Specifically, the trial court held that "Willard's motion for judgment was not an action for injury to property that entitled him to the benefit of the five-year limitation period set forth in [Virginia] Code § 8.01-243(B)."[257] Instead, the court held that Willard's motion for judgment was barred by the two-year limitation in Virginia Code section 8.01-248 because the deprivation of his dissenters' right was a personal injury.[258]

The issue for the Supreme Court of Virginia, therefore, was whether the motion for judgment filed by Willard was an "action for injury to property" under Code § 8.01-243(B), thereby governed by the five-year statute of limitation period. Otherwise, the catch-all provisions of Code §8.01-248 would apply and Willard's action would be time-barred by the two-year limitation.[259]

The court held that "dissenters' rights are property interests and that allegations of loss of dissenters' rights constitute an allegation of 'injury to property' within the meaning of Code § 8.01-243(B)."[260] As the court stated:

> Ownership of stock provides the shareholder with a bundle of rights, some of which are provided by contract while others are provided by the Code. Some rights may be unique to certain classes of stock, while other rights exist in all stock, independent of class. We have previously stated, for example, that the right to vote shares of stock at a corporate meeting is an incident of ownership; it is a part of the stockholder's property interest. Carnegie Trust Co. v. Security Life Ins. Co., 111 Va. 1, 27, 68 S.E. 412, 421 (1910). In *Fein v. Lanston Monotype Mach. Co.*, 196 Va. 753, 767, 85 S.E.2d 353, 361 (1955), we held that "[t]he right to vote for directors is a right to protect prop-

254. *Id.* at 477, 551 S.E.2d at 597.
255. *Id.*
256. *Id.*
257. *Id.*
258. *Id*; *see also* VA. CODE ANN. § 8.01-248 (Repl. Vol. 2000 & Cum. Supp. 2002).
259. *Willard II*, 262 Va. at 478, 551 S.E.2d at 598.
260. *Id.* at 481, 551 S.E.2d at 599; *see also* VA. CODE ANN. § 8.01-243 (Repl. Vol. 2000 & Cum. Supp. 2002).

erty from loss, and to make its possession beneficial. To deprive a stockholder of his right to vote is to deprive him of an essential attribute of his property."[261]

Similarly, the court ruled that Virginia Code section 13.1-730(A)(3) "gives a shareholder a right incident to ownership of stock," which is further described as "the right to dissent from certain corporate actions."[262] The court stated that "the presence of dissenters' rights triggers a series of rights and obligations under the Code that ultimately provides the shareholder the opportunity to demand the fair value of his shares."[263] The court reasoned, therefore, that a share of stock with such rights may be more valuable than one without such rights.[264] As a result, the loss of such rights injures the stock, regardless of how it occurs.[265]

Accordingly, the court ruled that Moneta's alleged failure to provide proper notice of dissenters' rights could be properly characterized as "conduct directed at Willard's property."[266] The court reasoned that a director's loss of the right to vote constitutes an injury to property, and therefore the same analysis should apply to a dissenting shareholder's loss of the right to demand fair value.[267] Because the applicable statute of limitations is determined by the type of injury alleged, the court stated that Willard's loss of dissenters' rights was the alleged injury, not Moneta's failure to give Willard notice.[268] The court concluded, therefore, that "[w]hether the alleged failure to give Willard notice of dissenters' rights in accordance with Code § 13.1-732 caused injury or loss is a different question" for another day.[269]

3. *Commonwealth of Virginia v. JOCO Foundation*[270]

In *Commonwealth of Virginia v. JOCO Foundation,* the Supreme Court of Virginia examined whether a circuit court's sub-

261. *Willard II*, 262 Va. at 481, 551 S.E.2d at 599–600.
262. *Id.*
263. *Id.*
264. *Id.*
265. *Id.*
266. *Id.*
267. *Id.* at 481–82, 551 S.E.2d at 600.
268. *Id.* at 482, 551 S.E.2d at 600.
269. *See id.*
270. 263 Va. 151, 558 S.E.2d 280 (2002).

ject matter jurisdiction extends to suits instituted by the Attorney General of Virginia against Virginia corporations that are duly established by the State Corporation Commission (the "Commission") under the VNCA.[271] At issue was whether the Commission was the proper forum for the suit, or whether the Attorney General could proceed in the circuit court "under some 'inherent power' of the circuit court or under the common law" in order to obtain the relief sought.[272] In a four to three split decision, the court rejected the Attorney General's suit, holding that the circuit court lacked subject matter jurisdiction over the issues raised in the suit.[273]

JOCO Foundation ("JOCO") was a Virginia non-stock corporation formed to benefit community organizations and created under the will of Reid Jones, Jr., a philanthropist from Moneta, Virginia.[274] The suit alleged that the defendants, who were the directors of JOCO, had breached their fiduciary duties owed to the corporation to the detriment of the intended beneficiaries of JOCO.[275] The Attorney General sought, *inter alia*, removal of the defendants as directors of JOCO, and appointment of a receiver to preserve the assets of the corporation.[276] The trial court ruled in a May 2001 order

> "that it lack[ed] subject matter jurisdiction over the Commonwealth's claims seeking appointment of a receiver and a preliminary injunction" against corporate directors "because the Commonwealth's exclusive remedy to address alleged breaches of fiduciary duties owed by these . . . directors" is set forth in Title 13.1 of the Code of Virginia, "which gives exclusive jurisdiction to the State Corporation Commission."[277]

On appeal to the Supreme Court of Virginia, the Attorney General argued that the circuit court has the authority to consider claims brought by the Commonwealth against directors of a charitable foundation organized as a nonstock corporation that allege that the directors have breached fiduciary duties, engaged

271. *Id.* at 154–55, 558 S.E.2d at 280.
272. *Id.* at 155, 558 S.E.2d at 281.
273. *Id.* at 165, 558 S.E.2d at 287.
274. *Id.* at 155, 558 S.E.2d at 281.
275. *Id.* at 156, 558 S.E.2d at 281.
276. *Id.* at 157, 558 S.E.2d at 282.
277. *Id.* at 158, 558 S.E.2d at 283.

in acts of self dealing, and wasted foundation assets.[278] While acknowledging that "generally only members or shareholders of a corporation have standing to challenge internal management decisions of a corporation," the Attorney General argued that the rule does not apply "'where the Corporation is also a charitable foundation.'"[279] The Attorney General's argument was that "'[i]nasmuch as JOCO is a charitable foundation, it is essentially a trust as well as a non-stock corporation,'" and that the Attorney General had the common law authority to act on behalf of the public in such a case."[280] Based on this theory, the Attorney General argued that the court had the power to remove the directors and require an accounting "to ensure the funds are being distributed in a way that satisfies the charitable purposes set forth in JOCO's original articles of incorporation."[281] The Attorney General also contended that the circuit court "'has inherent ancillary authority' to award injunctive relief and appoint a receiver."[282]

The court disagreed, holding that the trial court was correct in ruling that it lacked subject matter jurisdiction over the issues raised in the suit.[283] There is no authority, reasoned the court, for the Attorney General's argument "that a Virginia nonstock corporation devoted to charitable purposes 'essentially' is a charitable trust."[284] As the court stated:

> The Act, in Code § 13.1-860, sets forth detailed procedures for removal of directors, and the General Assembly has not authorized the Attorney General to participate in that exercise by prosecuting a suit in an appropriate circuit court. Code § 13.1-861 permits any member or director, not the Attorney General, to contest an election of directors in an appropriate circuit court. Code § 13.1-874 provides for removal of officers of nonstock corporations, without any mention of the participation of the Attorney General. Code §§ 13.1-884 through -893 control the amendment of articles of incorporation, including addition or deletion of provisions, under the supervision of the Commission, without any participation in such reformation in a circuit court at the relation of the Attorney General.[285]

278. *Id.* at 159, 558 S.E.2d at 283.
279. *Id.* (quoting the Attorney General's brief).
280. *Id.* (quoting the Attorney General's brief).
281. *Id.* at 159–60, 558 S.E.2d at 283–84.
282. *Id.* at 160, 558 S.E.2d at 284 (quoting the Attorney General's brief).
283. *Id.*
284. *Id.* at 161, 558 S.E.2d at 284.
285. *Id.* at 161–62, 558 S.E.2d at 285.

Although the court recognized that a circuit court under Virginia law has "'full power to liquidate the assets and business of the corporation at any time after the termination of corporate existence ... upon the application of any person, for good cause, with regard to any assets or business that may remain,'"[286] the court found that only the Commission may involuntarily terminate the corporate existence of a Virginia nonstock corporation.[287] The court stated that the General Assembly has provided that "'[n]o court within or without Virginia ... shall have jurisdiction to review, reverse, correct or annul any action of the Commission, within the scope of its authority ... or to enjoin, restrain or interfere with the Commission in the performance of its official duties.'"[288] Further, it held that "[i]f circuit courts, at the request of the Attorney General, are to have subject matter jurisdiction over claims like those made in the suit, the General Assembly has the power to so provide."[289] The court proceeded to find that JOCO had been duly established by the Commission and was a lawful and viable entity "with full power to operate within the authority granted by the Commission."[290] Therefore, under Virginia law, the circuit court had no authority to terminate its existence involuntarily.[291]

In a strongly worded dissent, Justice Lemons, joined by Justice Koontz and Justice Kinser, argued that the circuit court should have jurisdiction over the suit.[292] Justice Lemons stated that the flaw in the majority opinion was that it held "that the circuit court would have jurisdiction over this action brought by the Attorney General if the entity involved were a trust rather than a corporation."[293] Justice Lemons contended that the critical factor is the nature of the claim not the form of the entity involved in the claim.[294] According to his dissent, "[t]he public interest in the

286. *Id.* at 162, 558 S.E.2d at 285 (quoting VA. CODE ANN. § 13.1-909(B) (Repl. Vol. 1999)).

287. *JOCO Found.*, 263 Va. at 162, 558 S.E.2d at 285; *see also* VA. CODE ANN. § 13.1-915 (Repl. Vol. 1999) (providing for involuntary termination of corporate existence).

288. *JOCO Found.*, 263 Va. at 164, 558 S.E.2d at 286 (quoting VA. CODE ANN. § 13.1-813 (Repl. Vol. 1999)).

289. *JOCO Found.*, 263 Va. at 164, 558 S.E.2d at 286.

290. *Id.* at 160, 558 S.E.2d at 284.

291. *See id.* at 162, 165, 558 S.E.2d at 285, 287.

292. *Id.* at 165, 558 S.E.2d at 287 (Lemons, J., dissenting).

293. *Id.* (Lemons, J., dissenting).

294. *Id.* (Lemons, J., dissenting).

proper disposition of charitable assets is the same irrespective of the form of the entity entrusted with the assets."[295] Justice Lemons argued that, at the very least, the Commission's jurisdiction is not exclusive, even if it did have jurisdiction over some of the claims in this action.[296]

C. *Virginia Circuit Court Decision*—Beck v. Virginia Sash & Door, Inc.[297]

In *Beck*, the Richmond Circuit Court examined the issue of successor liability among corporations.[298] The two plaintiffs, John Beck and Thomas Sizer, owned two Virginia companies, Virginia Sash and Door, Inc. and Architectural Windows of Virginia, Inc..[299] In 1994, Kelmor, Inc., a Virginia corporation controlled by two shareholders, Dan Kelley and Emmett Morgan, purchased the assets of the companies.[300] Subsequently, Kelmor renamed itself Virginia Sash and Door, Inc. ("Virginia Sash"), and operated under the name Architectural Windows of Virginia.[301] As part of the sale, Kelmor agreed to make monthly payments to the two plaintiffs from 1996 until 2000 in return for non-compete and consulting agreements.[302]

In 1999, Virginia Sash experienced problems making its payments to the plaintiffs as well as a debt owed to its bank, Wachovia Bank ("Wachovia").[303] Wachovia, after informing Virginia Sash that it wished to terminate its lending relationship with the company, agreed to a "friendly foreclosure" with Virginia Sash.[304] Under the agreement, Virginia Sash and/or Kelley and Morgan intended to use a new corporation, funded with equity of $200,000 and a bank line of credit, to purchase Virginia Sash's assets.[305]

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295. *Id.* (Lemons, J., dissenting).
296. *Id.* (Lemons, J., dissenting).
297. 58 Va. Cir. 65 (Richmond City 2001).
298. *Id.* at 67.
299. *Id.* at 65
300. *Id.*
301. *Id.*
302. *Id.* at 65.
303. *Id.*
304. *Id.*
305. *Id.*

The result would be to pay off Wachovia and eliminate the debt owed to the plaintiffs.[306]

In September 2000, Wachovia conducted the foreclosure sale and the new company formed by Kelley and Morgan, Architectural Windows of Virginia Acquisition Corporation ("Architectural Windows"),[307] submitted the only bid, which Wachovia accepted.[308] In addition, Architectural Windows also entered into a purchase agreement with Virginia Sash through which it purchased the assets not subject to the foreclosure sale.[309] The plaintiffs brought suit against Architectural Windows alleging that it was liable for the debt owed to them from Virginia Sash under the theory of successor liability.[310]

Under Virginia law, a company that purchases another company's assets is generally not liable for the obligations of that company, subject to four exceptions: (1) the buyer expressly or impliedly agreed to take on such liabilities; (2) the circumstances surrounding the transaction justify a finding that it was in fact a de facto merger; (3) the buyer is a mere continuation of the seller; or (4) the exchange is fraudulent in fact.[311] In this instance, the plaintiffs alleged that Architectural Windows was a mere continuation of Virginia Sash and therefore successor liability should apply.[312] The factors that the court examined to find successor liability on the basis of mere continuation were: (1) inadequate consideration; (2) substantial commonality of ownership, directorship and administration; (3) continuity of control; and (4) continuity of business.[313] In this case, the court found all of these factors present, noting that substantially all of the owners, officers, directors and shareholders of Virginia Sash were also owners, officers, directors, and shareholders of Architectural Windows and that the sale of the assets to Architectural Windows was for less

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306. *Id.*

307. *Id.*

308. *Id.*

309. *Id.* at 66–67.

310. *Id.* at 67.

311. *Id.* at 67–68 (citing Kaiser Found. Health Plan of the Mid-Atlantic States v. Clary & Moore, 123 F.3d 201 (4th Cir. 1997)).

312. *Id.* at 68; *see also* Harris v. T.I., Inc., 243 Va. 63, 413 S.E.2d 605 (1992).

313. *Beck*, 58 Va. Cir. at 68; *see also Kaiser*, 123 F.3d at 208.

than adequate consideration.[314] In addition, the court found clear continuity of business and control.[315]

The court recognized, however, that in Virginia the finding of "mere continuation" by a court is not sufficient to hold in favor of the plaintiffs under the theory of successor liability because Virginia recognizes an exception to the "mere continuation" doctrine where the purchase of all of the assets of a corporation is a bona fide arm's-length transaction.[316] Here, Architectural Windows argued that such an exception should be found because the foreclosure sale by Wachovia sanitized the transaction.[317] In rejecting this argument, the court held that although Wachovia initiated the foreclosure, (1) Architectural Windows proposed the structure of the deal; (2) Architectural Windows was the only bid; and (3) the bid amount was almost the exact amount owed to Wachovia.[318] Based on these facts, the court held that this was not an arm's-length transaction; therefore, successor liability would be imposed.[319] *Virginia Sash* highlights the continued importance that courts place on structuring arm's-length transactions to avoid potential liability, particularly where there are continuing officers, directors, and shareholders.

IV. DEVELOPMENTS IN CORPORATE GOVERNANCE; INDEMNIFICATION AND EXCULPATION OF DIRECTORS AND OFFICERS

Although a comprehensive analysis is outside the scope of this article, certain recent developments in federal legislation and securities regulations merit mention. These developments, even absent any parallel Virginia legislative changes, may raise important issues under Virginia corporate law. One issue that is already attracting attention is the extent to which director and officer indemnification and exculpation provisions found in the VSCA[320] and the articles of incorporation or bylaws of many Vir-

314. *Id.* at 69.
315. *Id.*
316. *Id.* at 69–70.
317. *Id.* at 69.
318. *Id.* at 70.
319. *Id.*
320. VA. CODE ANN. § 13.1-697 to -704 (Repl. Vol. 1999).

ginia corporations will be applicable to actions taken by corporate officials as required by such legislation and regulations.

The Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act")[321] and regulations adopted by the SEC implementing portions of that statute[322] mandate a number of actions by certain publicly-held corporations or their specified officers and prohibit a variety of other conduct.[323] One variety of actions that has attracted a great deal of attention is the requirement that the principal executive and financial officers of corporations subject to the Sarbanes-Oxley Act personally make certifications as to the accuracy and fair presentation of financial statements and other financial information contained in certain periodic reports filed with the SEC.[324]

Immediately upon the announcement of the new requirement, the financial press and legal commentators highlighted the potential exposure of the signing officers to both civil liability and criminal penalties arising from the required certifications.[325]

Without analyzing the accuracy of the SEC's statements that the new certification regulations do not increase the likelihood or expand the scope of potential personal liability,[326] this prospect quickly captured the attention of executives across the country. One of the earliest questions asked of counsel after the new regulations were proposed was: "Will the company's indemnification provisions cover inadvertent incorrect certifications?"[327]

For Virginia corporations that have taken advantage of the liberal standard for indemnification set forth in Virginia Code sec-

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321. Pub. L. No. 107-204, 116 Stat. 745 (2002).

322. *See, e.g.*, Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 67 Fed. Reg. 51,900 (Aug. 9, 2002); Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. 57,276 (Sept. 9, 2002) (to be codified at 17 C.F.R. pts. 228, 229, 232, 240, 249, 270, 274).

323. *See supra* notes 321, 322.

324. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,277.

325. *See, e.g.*, Paul Beckett, *Executives Face Harsh Sanctions in Corporate-Governance Law*, WALL ST. J., July 31, 2002, at C7; Bob Keefe, *Will 'I Certify' Help Restore Credibility?* ATLANTA J. AND CONST., Aug. 11, 2002, at E1; Gary Strauss, *With Days to Go, Many Execs Haven't Backed Results*, USA TODAY, Aug. 12, 2002, at B2.

326. Certification of Disclosure in Companies' Quarterly and Annual Reports, 67 Fed. Reg. at 57,285.

327. This article does not address the availability of indemnification and exculpation provisions to officers and directors for conduct required by the new regulations.

tion 13.1-704(B), the answer should be in the affirmative, because an innocently made certification that turns out to be wrong would not involve "willful misconduct or a knowing violation of the criminal law."[328] The same analysis and result should apply under exculpation provisions based on section 13.1-692.1.[329]

V. CONCLUSION

While there were a number of significant judicial decisions affecting Virginia corporate and business law this past year, the pieces of legislation enacted by the General Assembly were more substantial. The most significant legislation was the Virginia Business Trust Act, which provides a statutory framework for the formation and operation of Virginia business trusts. This structure will permit the Commonwealth of Virginia to compete more effectively with those states that currently permit such flexible entities. Also important in the continuing modernization of Virginia law is the fact that the General Assembly enacted several important pieces of legislation that recognize the increased use of electronic media such as e-mail and the Internet. Finally, of importance in the judicial arena was the Virginia courts' recognition of fiduciary duties in the L.L.C. context.

328. VA. CODE ANN. § 13.1-704(B) (Repl. Vol. 1999). Moreover, for inadvertent incorrect certifications, there should be no underlying liability for the certifying officer under section 906 of the Sarbanes-Oxley Act because that section is limited to knowingly false certifications. However, the officer's right to the advance of defense costs, under typical corporate indemnification provisions, will be important to enable the officer to defend against claims of a violation.

329. VA. CODE ANN. § 13.1-692.1 (Repl. Vol. 1999 & Cum. Supp. 2002).