CORPORATE AND BUSINESS LAW

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I. INTRODUCTION

Over the past two years, there have been a number of legislative changes to Virginia's business entity statutes. Part II highlights the changes to the Virginia Stock Corporation Act ("VSCA") and the Virginia Nonstock Corporation Act ("VNSCA"). Part III highlights changes to the Limited Liability Company Act ("LLCA") and other business entity statutes. Virginia courts have also addressed several significant issues over the last two years, including the assignability of limited liability company ("LLC") membership interests, standing to bring derivative claims, judicial dissolution, and significant claims against directors of Virginia corporations. Part IV reviews several of the significant cases during this period.

II. CERTAIN STATUTORY CHANGES RELATED TO CORPORATIONS AND NONSTOCK CORPORATIONS

A. *Remote Participation in Meetings*

Following the insertion of section 13.1-660.2 in the VSCA in 2010, which allowed for remote participation in any shareholder meeting,[1] in 2012 the General Assembly deleted redundant language in sections 13.1-654(C) and 13.1-655(E) that separately permitted remote participation in annual and special meetings, respectively.[2] Similar changes were made in the VNSCA with the

* Shareholder, Williams Mullen, Richmond, Virginia. J.D., 2003, University of Richmond School of Law; M.B.A., 2003, The Robins School of Business, University of Richmond; B.A., 1995, University of Virginia.

1. Act of Apr. 21, 2010, ch. 782, 2010 Va. Acts 1438, 1446 (codified at VA. CODE ANN. § 13.1-660.2 (Cum. Supp. 2010)).

2. Act of Apr. 9, 2012, ch. 706, 2012 Va. Acts 1465, 1467–68 (codified as amended at VA. CODE ANN. §§ 13.1-654(C), -655(E) (Supp. 2012)).

addition of section 13.1-844.2 and the deletion of redundant language in sections 13.1-838(C) and 13.1-839(E).[3]

B. *Less Than Unanimous Consent of Shareholders*

Certain 2012 amendments to the VSCA clarified how shareholder actions by less than unanimous written consent may be authorized in a corporation's articles of incorporation and how such actions are approved, added specific requirements for public corporations, and added a requirement that such consents be filed with the corporate secretary before shareholders holding ten percent or more of the shares sign them.[4] For a matter to be approved by less than unanimous consent, the number of shares that would be required to approve the matter if all shares were present and voting at a meeting must vote to approve the matter.[5]

For a public corporation to include in their articles of incorporation the ability to conduct a shareholder vote by less than unanimous written consent, it must get approval from a vote by class of each voting group required to amend the articles of incorporation.[6] Those classes of shareholders must approve the inclusion by the greater of (1) two-thirds of each class or (2) the vote required to adopt an amendment in the articles of incorporation.[7] The ten percent filing requirement will, for both public and private corporations, put management on notice of any matter that the shareholders seek to approve by less than unanimous written consent before the consent becomes effective.

C. *Stock Transfer Records Prima Facie Evidence*

An amendment to section 13.1-661(B) of the VSCA in 2012 added the following language: "[T]he original share transfer

3. Act of Mar. 13, 2010, ch. 171, 2010 Va. Acts 221, 226 (codified at VA. CODE ANN. § 13.1-844.2 (Cum. Supp. 2010)); Ch. 706, 2012 Va. Acts at 1474 (codified as amended at VA. CODE ANN. §§ 13.1-838(C), -839(E) (Supp. 2012)).

4. Ch. 706, 2012 Va. Acts at 1465, 1468 (codified as amended at VA. CODE ANN. § 13.1-657(B) (Supp. 2012)).

5. VA. CODE ANN. § 13.1-657(B)(4) (Cum. Supp. 2013).

6. *Id.* § 13.1-657(B)(2) (Cum. Supp. 2013).

7. *Id.*

books shall be prima facie evidence as to who are the shareholders entitled to examine such list or to vote at any meeting of shareholders."[8]

D. *Financial Statements for Appraisal Rights*

Section 13.1-732(E) was added to the VSCA to permit a corporation to deliver the financial statements required to accompany an appraisal rights notice in any manner permitted by the rules of the Securities and Exchange Commission ("SEC") if the corporation was a public corporation as of the date of the financial statements.[9] Similar language was added to section 13.1-737(C) to allow a public corporation or former public corporation to deliver financial statements required to accompany a payment of fair value in any manner permitted by SEC rules.[10]

E. *No Dissolution After Fair Value Determination*

Formerly, a corporation that had elected to buy out a shareholder in lieu of proceeding with judicial dissolution had the right to opt out of the purchase following the court's determination of fair value.[11] Because the corporation's ability to back out of the purchase was perceived as unfair, this ability to opt out was removed and section 13.1-749.1(G) was rewritten in 2012.[12]

F. *Plan of Domestication*

Amendments in 2012 to several business entity statutes clarify how to include amended and restated articles of the post-domestication entity in a plan of domestication filed with the Commonwealth of Virginia State Corporation Commission ("SCC").[13]

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8. Ch. 706, 2012 Va. Acts at 1469 (codified as amended at VA. CODE ANN. § 13.1-661(B) (Supp. 2012)).

9. *Id.* at 1470 (codified as amended at VA. CODE ANN. § 13.1-732(E) (Supp. 2012)).

10. *Id.* at 1471 (codified as amended at VA. CODE ANN. § 13.1-737(C) (Supp. 2012)).

11. VA. CODE ANN. § 13.1-749.1(G) (Repl. Vol. 2011).

12. Ch. 706, 2012 Va. Acts at 1472 (codified as amended at VA. CODE ANN. § 13.1-749.1(G) (Supp. 2012)).

13. Act of Mar. 6, 2012, ch. 130, 2012 Va. Acts 179, 180, 183, 185, 187 (codified as amended at VA. CODE ANN. §§ 13.1-722.2(C)(3), -898.2(C)(3), -1075(A)(4), -1266(A)(4) (Supp. 2012)).

G. *Entity Conversion in Bankruptcy*

In 2012, the General Assembly made a number of changes to section 13.1-604.1 that permit a bankruptcy court to order an entity conversion and describe the filings required in the case of a bankruptcy court-ordered entity conversion.[14]

H. *Approval of Entity Conversion*

Amendments to the VSCA and the LLCA allow initial directors or managers named in the entity's articles—or if there are none named, organizers—to adopt a plan of entity conversion where there are not yet any equity holders.[15]

I. *Nonstock Corporations May Convert to Limited Liability Companies*

In 2012, article 17.1 was added to the VNSCA to permit a Virginia nonstock corporation to convert into an LLC.[16] The plan of entity conversion must specify the manner and basis of converting membership rights in the nonstock into membership interests in the LLC, or if there were no members, it must designate who will become members in the converted LLC.[17] The plan must be approved by two-thirds of the nonstock corporation's members or, if there are none, by two-thirds of its board of directors.[18] The effect of conversion is substantially similar to other Virginia business entities that convert to an LLC.

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14. *Id.* at 179 (codified as amended at VA. CODE ANN. § 13.1-604.1 (Supp. 2012)).
15. *Id.* at 181 (codified as amended at VA. CODE ANN. §§ 13.1-722.11(A)(5), -722.11 (B)(2) (Supp. 2012)).
16. Ch. 706, 2012 Va. Acts at 1475–76 (codified at VA. CODE ANN. §§ 13.1-944.1 to .7) (Supp. 2012)).
17. VA. CODE ANN. § 13.1-944.3 (Cum. Supp. 2013).
18. *Id.* § 13.1-944.4 (Cum. Supp. 2013).

III. CERTAIN STATUTORY CHANGES RELATED TO LIMITED LIABILITY COMPANIES, LIMITED PARTNERSHIPS, AND BUSINESS TRUSTS

A. *Members of an LLC May Rescind Dissolution*

In 2012, the General Assembly added section 13.1-1047.1 to the LLCA which permits the members of a Virginia LLC that was dissolved voluntarily or by judicial dissolution to reinstate its existence prior to the company being wound up if all members elect to waive the dissolution and continue the company's existence.[19]

B. *Execution of Documents by Foreign LLCs*

Section 13.1-1003 of the LLCA was revised in 2013 to include the following language regarding who must execute documents filed with the SCC by foreign LLCs:

> In the case of a foreign limited liability company, by a person who is authorized to sign an amendment to the articles of organization or other constituent documents delivered for filing to the Secretary of State or other official having custody of limited liability company records in the state or other jurisdiction under whose law it is formed.[20]

The new language will make it clear to the SCC and foreign filers how documents to be filed with the SCC should be executed.

C. *Perpetual Existence*

While it was generally presumed that the existence of an LLC was perpetual, the General Assembly clarified that LLCs do have perpetual existence with a change to section 13.1-1009 this year.[21]

D. *Domestication*

In 2013, the General Assembly revised the requirements for articles of domestication filed by a foreign LLC domesticating into Virginia. Namely, the foreign LLC must include a statement in

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19. Ch. 706, 2012 Va. Acts at 1477 (codified at VA. CODE ANN. § 13.1-1047.1 (Supp. 2012)).

20. Act of Feb. 20, 2013, ch. 17, 2013 Va. Acts ___, ___ (codified as amended at VA. CODE ANN. § 13.1-1003(F)(3) (Cum. Supp. 2013)).

21. *Id.* (codified as amended at VA. CODE ANN. § 13.1-1009 (Cum. Supp. 2013)).

its articles of domestication that the domestication is permitted under the laws of its state of organization and that the foreign LLC has complied with the laws of its home state in effecting the domestication into Virginia.[22] This change aligned the domestication requirements for corporations and LLCs and codified the general understanding that this transaction, much like a merger, is not permitted unless permissible under the laws of the foreign entity's state of organization.[23]

E. *Overturning* Ott v. Monroe

In its reconvened session on April 3, 2013 the General Assembly adopted amendments to section 13.1-1039(A) of the LLC Act to overturn *Ott v. Monroe* (discussed in Part IV.A below). Following the amendment to the last sentence of section 13.1-1039(A), a limited liability company's operating agreement can permit the transfer of a member's voting and management rights, but absent express language in the articles of organization or operating agreement, only the member's economic rights—the rights to distributions and allocations of profit and loss—are transferrable.[24] By modifying the third sentence of section 13.1-1039(A) to cross-reference section 13.1-1040(A), the amendments also clarify that Virginia courts should respect an alternative process for admission of a member with voting rights included in an LLC's articles of organization or operating agreement.[25]

IV. SELECTED CASES AFFECTING CORPORATE AND BUSINESS LAW

A. Ott v. Monroe

In *Ott v. Monroe*, now overturned by statute (discussed in Part III.E above), the Supreme Court of Virginia held that the daughter of a member of a Virginia LLC that inherited the member's interest by will received only the member's financial interest, not

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22. *Id.* (codified as amended at VA. CODE ANN. § 13.1-1077 (Cum. Supp. 2013)).

23. *Compare id.*, *and* VA. CODE ANN. § 13.1-722.4 (Cum. Supp. 2013) (outlining domestication requirements for corporations), *with* VA. CODE ANN. § 13.1-1070.6 (Repl. Vol. 2011) (outlining merger requirements for foreign business entities).

24. Act of Apr. 3, 2013, ch. 772, 2013 Va. Acts ___, ___ (codified as amended at VA. CODE ANN. § 13.1-1039(A) (Cum. Supp. 2013)).

25. *See id.*; VA. CODE ANN. § 13.1-1040(A) (Repl. Vol. 2011 & Cum. Supp. 2013).

his management rights, because the LLC's operating agreement and articles did not displace the statutory default of automatic dissociation of a member on death and could not alter the non-transferability of his management rights.[26]

Admiral Dewey Monroe and his wife, Lou Ann, were eighty percent and twenty percent members, respectively, in L&J Holdings, LLC, a Virginia LLC.[27] Paragraph two of the L&J Holdings, LLC Operating Agreement stated: "[e]xcept as provided herein, no Member shall transfer his membership or ownership, or any portion or interest thereof, to any non-Member person, without the written consent of all other Members, except by death, intestacy, devise, or otherwise by operation of law."[28]

Paragraph 10(C) of the operating agreement stated: "any Member . . . may transfer all or any portion of the Member's Interest at any time to . . . [o]ther Members [or] [t]he spouse, children, or other descendants of any Member."[29] Dewey died in 2004.[30] His daughter, Janet, inherited his interest by will and shortly after his death called a meeting where she attempted to elect herself as managing member.[31] Lou Ann responded that Janet was only an assignee and had inherited only Dewey's right to share in profits and losses and receive distributions.[32] Janet sought a declaratory judgment that she was a member, not just an assignee, and Lou Ann demurred.[33] The Circuit Court of Stafford County found that Janet was in fact an assignee holding only Dewey's right to receive distributions and allocations of profits and losses.[34] Janet appealed.[35]

The Supreme Court of Virginia's analysis in this case is important to read carefully. The court traced the origins of the LLCA as a hybrid between partnership and corporate law with the distinct management and economic components of an LLC

26. 282 Va. 403, 406–07, 409, 411, 719 S.E.2d 309, 310, 312–13 (2011).
27. *Id.* at 406, 719 S.E.2d at 310.
28. *Id.* (alteration in original).
29. *Id.* (alterations in original).
30. *Id.*
31. *Id.*
32. *See id.*
33. *See id.* at 406–07, 719 S.E.2d at 310.
34. *Id.* at 405, 407, 719 S.E.2d at 309–10.
35. *Id.*

membership interest.[36] Then the court looked at the limited language in the L&J Holdings, LLC operating agreement and the default and mandatory provisions of the LLCA.[37]

Importantly, the court held that the operating agreement failed to override the automatic dissociation of a member under section 1040.1(7) of the LLCA, so upon Dewey's death he was dissociated as a member, leaving only his financial interest to transfer, as permitted by section 13.1-1039 of the LLCA.[38] While the court's holding does not rest on this analysis, it continued on to say:

> Even if Paragraph 2 had superseded dissociation under Code § 13.1-1040.1, it is not possible for a member unilaterally to alienate his personal control interest in a limited liability company. Code § 13.1-1039(A). The words "[u]nless otherwise provided in the articles of organization or an operating agreement" in Code § 13.1-1039 make it possible for a limited liability company to restrict the assignment of members' financial interests because they modify the remainder of the sentence, which continues "a membership in a limited liability company is assignable in whole or in part." The words "[u]nless otherwise provided in the articles of organization or an operating agreement" do not make it possible for a limited liability company to allow a member to assign his control interest because they do not modify the separate sentence, which states that "[a]n assignment does not entitle the assignee to participate in the management and affairs of the limited liability company or to become or to exercise any rights of a member." Additionally, Code § 13.1-1023(A) provides that an operating agreement may not contain provisions inconsistent with the laws of the Commonwealth. Thus it was not within Dewey's power under the Agreement unilaterally to convey to Janet his control interest and make her a member of the Company upon his death because the Agreement could not confer that power on him.[39]

Because this quoted passage is so strongly worded, it could be interpreted to prevent any alienation of the management interest, no matter what the operating agreement says. This would be a troubling outcome and is likely why the General Assembly modified section 13.1-1039(A) of the Virginia Limited Liability Company Act this year to overturn *Ott v. Monroe*. However, the L&J Holdings, LLC operating agreement could have been drafted to rely on section 13.1-1040(A) to override the majority vote requirement for an assignee to become a member, which should

36. *Id.* at 408–09, 719 S.E.2d at 311–12.
37. *Id.* at 406, 408–09, 719 S.E.2d at 310–12.
38. *Id.* at 410, 719 S.E.2d at 312.
39. *Id.* at 410–11, 719 S.E.2d at 312–13.

have resulted in a different outcome in *Ott v. Monroe*, even without this year's amendments. For example, if the L&J Holdings, LLC operating agreement had provided that an assignee, like Janet, taking from Dewey upon his death would be admitted as a member with full voting rights if the assignee executed an instrument agreeing to be bound by the operating agreement, then it seems likely that the court in *Ott v. Monroe* would have held that the financial component had transferred to Janet and that the alternative process for obtaining her admission as a full member with voting rights was enforceable.[40] Fortunately, the amendments to the LLCA this year eliminate any ambiguity on this point and make it clear that an operating agreement can permit a member to transfer his management rights.[41] In addition, if the operating agreement provides an alternative process for admission as a member with voting and management rights, following this year's amendments that process should be respected.[42]

B. Cattano v. Bragg

In *Cattano v. Bragg*, the Supreme Court of Virginia held that a former shareholder of a two shareholder corporation could assert a derivative action despite the fact that she was seeking the dissolution of the corporation, the other shareholder did not support her claim, and she had asserted direct breach of contract claims against the corporation.[43]

John Cattano and Caroline Bragg were the only two shareholders in Cattano Law Firm, P.C.[44] In 2008, after discovering checks written to Cattano's wife and children out of the firm's operating account, Bragg requested the right to review all of the corporate records.[45] Cattano responded by terminating Bragg's employment.[46] Bragg originally filed suit in the Albemarle Circuit Court seeking judicial dissolution, an accounting of assets, and division

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40. *See* VA. CODE ANN. §§ 13.1-1040(A)–(B) (Repl. Vol. 2011 & Cum. Supp. 2013).
41. Ch. 772, 2013 Va. Acts ___, ___ (codified as amended at VA. CODE ANN. § 13.1-1039(A) (Cum. Supp. 2013)).
42. *Id.*
43. 283 Va. 638, 643, 647, 649, 727 S.E.2d 625, 626–27, 629–30 (2012).
44. *Id.* at 643, 727 S.E.2d at 626.
45. *Id.*
46. *Id.*

of assets.[47] She later amended her complaint to add a writ of mandamus of inspection and copying, several derivative claims, and a breach of contract claim.[48] Cattano demurred to the derivative claims, arguing that Bragg did not fairly represent the interests of the corporation.[49] The court appointed a receiver who determined that there did not appear to be widespread criminal conduct or elaborate fraud, but that there were unusual disbursements to Cattano and his wife from his client trust accounts.[50] The trial was bifurcated with the jury determining all matters but attorneys' fees and awarding judicial dissolution and $234,412.18 on the derivative claims.[51] The trial court awarded attorneys' fees on both the writ of mandamus and the derivative action.[52] Cattano appealed with five questions for the Supreme Court of Virginia:

> (1) whether the circuit court erred in failing to strike Bragg's derivative claim for failure to fairly and adequately represent the interests of the corporation; (2) whether the circuit court erred in failing to instruct the jury on the issue of fair and adequate representation; (3) whether the circuit court erred in assigning attorneys' fees on the writ of mandamus count; (4) whether the circuit court erred in concluding that the proceeding substantially benefitted the corporation; and (5) whether the circuit court abused its discretion in its award of attorneys' fees.[53]

On appeal, Cattano argued that one shareholder cannot represent the interests of the corporation—that under the factors adopted in *Jennings v. Kay Jennings Family Limited Partnership*,[54] Bragg could not fairly and adequately represent the corporation because of the economic antagonism and apparent animos-

47. *Id.* at 642–43, 727 S.E.2d at 625–27.
48. *Id.* at 643, 727 S.E.2d at 627.
49. *Id.*
50. *Id.* at 643–44, 727 S.E.2d at 627.
51. *Id.* at 644, 727 S.E.2d at 627.
52. *Id.* at 644–45, 727 S.E.2d at 627–28.
53. *Id.* at 645, 727 S.E.2d at 628.
54. 275 Va. 594, 601–02, 659 S.E.2d 283, 288 (2008) ("[T]he following factors [are] relevant to determining whether the plaintiff meets the representational requirements: (1) economic antagonisms between the representative and members of the class; (2) the remedy sought by the plaintiff in the derivative action; (3) indications that the named plaintiff is not the driving force behind the litigation; (4) plaintiff's unfamiliarity with the litigation; (5) other litigation pending between the plaintiff and defendants; (6) the relative magnitude of plaintiff's personal interests as compared to his interests in the derivative action itself; (7) plaintiff's vindictiveness toward the defendants; and (8) the degree of support plaintiff is receiving from the shareholders he purports to represent.").

ity between the two shareholders and because Cattano did not support the derivative suit.[55] The court applied the *Jennings* factors but ultimately held that the "totality of the circumstances" combined to show that Bragg did fairly and adequately represent the interests of the corporation, because there were no external parties motivating Bragg, her individual breach of contract claim did not present an inappropriate conflict of interest, and her derivative claims did in fact benefit the corporation's interest in having misappropriated funds returned.[56]

On the jury instructions regarding fair and adequate representation, the court held that since there were no facts in dispute regarding Bragg's standing, there was no need for a jury finding of fact on the matter and the court properly determined Bragg's standing as a legal matter.[57] On attorneys' fees for the writ of mandamus, the court held that the fact that Bragg was a director entitled her to receive the requested documents without pleading with any particularity her reasons for access and thus the court did not err in awarding her attorneys' fees.[58]

As to substantial benefit to the corporation, the court quoted section 13.1-672.5(1) of the VSCA: "On termination of a derivative proceeding, the court shall . . . [o]rder the corporation to pay the plaintiff's reasonable expenses (including counsel fees) incurred in the proceeding if it finds that the proceeding has resulted in a substantial benefit to the corporation."[59] Because no Virginia court had addressed what constituted a "substantial benefit," the court cited the United States Supreme Court:

> [A] substantial benefit must be something more than technical in its consequence and be one that accomplishes a result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation or affect the enjoyment or protection of an essential right to the stockholder's interest.[60]

Because Bragg collected $234,000 on behalf of the corporation, the court held that she had in fact bestowed a substantial benefit

55. *Cattano*, 283 Va. at 646–47, 727 S.E.2d at 628–29.
56. *Id*. at 648, 727 S.E.2d at 629.
57. *Id*. at 649–50, 727 S.E.2d at 630.
58. *Id*. at 651, 727 S.E.2d at 631.
59. *Id*.
60. *Id*. at 652, 727 S.E.2d at 631 (alteration in original) (quoting Mills v. Electric Auto-Lite Co., 396 U.S. 375, 396 (1970)).

and was entitled to her attorneys' fees.[61] Finally, the court held that the award of attorneys' fees in the case was not an abuse of discretion.[62]

Justice McLanahan dissented.[63] While Justice McLanahan agreed that a shareholder in a two shareholder corporation should be permitted to bring a derivative action notwithstanding animosity between the two shareholders, he argued that in this case, Bragg's breach of contract claim was actually inimical to the corporation's interest and thus precluded her from representing the corporation's interests as a derivative plaintiff.[64] Justice McLanahan also argued that Bragg should not receive attorneys' fees for her claims related to access to records because her access was provided by the receiver under the judicial dissolution statute and the right to attorneys' fees only arises under an award pursuant to VSCA provisions permitting shareholders or directors to obtain access to corporate records.[65]

C. Russell Realty Associates, et al. v. C. Edward Russell, Jr., Individually and as Co-Trustee

Virginia courts have been busy addressing the issue of judicial dissolution in 2012 and 2013.[66] In the most recent opinion from the Supreme Court of Virginia on the matter, the court analyzed the "economic purpose" test of the Virginia Uniform Partnership Act's judicial dissolution provision and held that the economic purpose of Russell Realty Associates was likely to be unreasonably frustrated.[67]

C. Edward Russell, Jr. ("Eddie") and Parthenia Russell Randolph ("Nina") were the children of Charles E. Russell, Sr. ("Charles Sr."), who created a partnership between them that held certain real property investments.[68] Charles Sr. also created three irrevocable trusts, one for the benefit of Nina and one each

61. *Id.* at 652, 727 S.E.2d at 631–32.
62. *Id.*, 727 S.E.2d at 632.
63. *Id.* at 653, 727 S.E.2d at 632 (McLanahan, J., dissenting).
64. *Id.* at 653 & note, 727 S.E.2d at 632 & note (McLanahan, J., dissenting).
65. *Id.* at 656, 727 S.E.2d at 634 (McLanahan, J., dissenting).
66. See *infra* Part IV.D for discussion of another dissolution case.
67. Russell Realty Assocs. v. Russell, 283 Va. 797, 799–800, 724 S.E.2d 690, 690 (2012).
68. *Id.* at 800, 724 S.E.2d at 690–91.

for the benefit of Nina's children, Robert and Isham.[69] Eddie and Nina were co-trustees of the trusts for Nina, Robert, and Isham.[70] In 1985, Charles Sr. withdrew from the partnership, leaving Eddie holding a 50% interest, Nina's trust holding a 25% interest, and each of Robert and Isham's trusts holding a 12.5% interest.[71]

The partnership agreement vested management control in Eddie.[72] However, following the death of Charles Sr. there were a number of disputes between Eddie and Nina over the management of the partnership, sale of its properties, conversion of the partnership into a limited liability company, and whether to admit Nina's son Robert as a partner and provide Robert some management control.[73] These disputes led to continual hardships for the partnership: the partnership was unable to pursue an offer to sell property to Sam's Club because of Nina's objections; Nina insisted on editing the minutes of partnership meetings; Nina recorded partnership meetings and meetings with potential buyers of partnership property; the partnership engaged a mediator starting in 1989; and the partners were involved in various legal disputes with each other, forcing the partnership and partners to retain legal counsel with the associated expenses.[74] Eventually, Eddie brought an action to dissolve the partnership in the City of Chesapeake.[75] Nina filed an intervener complaint against Eddie individually and as co-trustee, seeking an equitable accounting of certain legal fees and personal fees billed to the partnership or the trusts, alleging that Eddie had breached his fiduciary duties to the partnership and the trusts, requesting aid, guidance, and declaratory relief regarding her son's rights to distributions from the trusts, and calling for Eddie's removal as co-trustee of the trusts.[76] The court denied all of Nina's claims and found that the partnership should be dissolved because the differences between Eddie and Nina were frustrating the economic

69. *Id.*, 724 S.E.2d at 690.
70. *Id.*, 724 S.E.2d at 690–91.
71. *Id.*, 724 S.E.2d at 691.
72. *Id.*
73. *Id.* at 801, 724 S.E.2d at 691.
74. *Id.* at 801–03, 724 S.E.2d at 691–92.
75. *Id.* at 803, 724 S.E.2d at 692.
76. *Id.*

purposes of the partnership and making the management of its affairs not reasonably practical.[77] Nina appealed.[78]

The sole issue before the court on appeal was "whether the trial court erred in holding that Eddie 'met the strict standards for judicial dissolution of a partnership under [Virginia] Code § 50-73.117(5).'"[79] Applying the reasoning from *Dunbar Group, LLC v. Tignor*, the court held that both Virginia's LLCA and Uniform Partnership Act impose "a strict standard for judicial dissolution of a limited liability company, deferring to the contractual agreement of the parties and allowing judicial dissolution only under the specific circumstances identified in the statute."[80] The court then analyzed whether or not the economic purpose of the partnership had been frustrated. The court held that it was not necessary to find that a partnership was unprofitable for its economic purpose to be frustrated.[81] The court observed that although Eddie had management control under the partnership agreement, he was not able to exercise it effectively because of the disputes between the trustees.[82] Because the partnership was unable to pursue offers to sell its properties efficiently, the various disputes between the parties over the partnership's management and processes, and the need to engage a mediator and counsel to facilitate discussions between the parties and the associated expenses, the court held that the business purpose of the partnership was likely to be frustrated and thus, it was unnecessary to address whether the business operations test was satisfied.[83]

D. Curtis Dixon Colgate v. The Disthene Group, Inc.

On August 30, 2012, Judge Jane Marum Roush, a Fairfax County judge appointed to hear the case in Buckingham County Circuit Court, ordered the judicial dissolution of The Disthene Group, Inc. ("Disthene").[84] Disthene was a holding company that

77. *Id.*, 724 S.E.2d at 692–93.

78. *Id.* at 803–04, 724 S.E.2d at 693.

79. *Id.* at 804, 724 S.E.2d at 693.

80. *Id.* at 804–05, 724 S.E.2d at 693 (citing Dunbar Group, LLC v. Tignor, 267 Va. 361, 367, 593 S.E.2d 216, 219 (2004).

81. *Id.* at 806, 724 S.E.2d at 694.

82. *See id.* at 807, 724 S.E.2d at 694–95.

83. *Id.*

84. Colgate v. Disthene Grp., Inc., 85 Va. Cir. 286, 286, 317 (2012) (Buckingham County).

owned the Kyanite Mining Corporation, one of the largest Kyanite mining concerns in the world, Blue Rock Resources LLC, which owned certain land and timber, and the Cavalier Hotel Corporation, which owned the historic Cavalier Hotel and one of the largest parcels along the oceanfront in Virginia Beach.[85] It was estimated that Disthene may have been worth $200,000,000.[86] The plaintiffs, Curtis Dixon Colgate ("Curtis"), Sharon Marie Newcomb ("Sharon"), Marion J. Colgate, Sr. ("Boyd"), and Peaceful Valley Limited Partnership ("Peaceful Valley") filed a complaint seeking the judicial dissolution of Disthene, which was owned primarily by the descendants of Gene Dixon, Sr. and certain past and present employees of Disthene and/or their heirs or estates.[87] The plaintiffs alleged that the controlling shareholders, Gene Dixon, Jr. ("Gene") and his son Guy Dixon ("Guy"), "engaged in a pattern of oppressive and fraudulent conduct designed to disadvantage the minority shareholders and consolidate all of Disthene's outstanding shares on Gene's side of the family."[88] Disthene was capitalized with Class A voting stock, all of which was owned by Gene and Guy, and Class B non-voting stock, which was owned by the other shareholders.[89] Both classes of stock were entitled to the same per share distribution rights.[90] Sharon and Curtis were the children of Gene's sister, Jeanne Dixon Colgate, who died in 1988.[91] Boyd was Jeanne's husband at the time of her death.[92] Previously, Sharon and Curtis brought suit against Gene alleging improprieties in Gene's handling of his mother's marital trust, of which Sharon and Curtis were contingent beneficiaries (the "Trust Litigation").[93] The Trust Litigation was settled, but in that case, "the plaintiffs alleged that Gene had engaged in self-dealing, with the goal of looting the marital trust of all the shares of stock that would otherwise go to Sharon and

85. *Id*. at 287–89.

86. Bill McKelway, *Jurists Reject Appeal of Firm's Dissolution: Va. High Court Refuses Kyanite Company's Bid to Overturn Liquidation*, RICH. TIMES-DISPATCH, Feb. 17, 2013, at B1.

87. *Disthene*, 85 Va. Cir. at 287.

88. *Id*. at 289.

89. *Id*. at 287.

90. *Id*.

91. *Id*. at 288.

92. *Id*.

93. *Id*.

Curtis on Maillie's [Gene's mother's] death."[94] In seeking dissolution of Disthene, the plaintiffs alleged:

> Gene's stated goals are to maintain voting control of Disthene in himself and Guy, to consolidate ownership of all of the Class B shares in the smallest number of people (preferably on his side of the family), and to keep the per share value of the stock as low as possible;
>
> Many of Gene's actions are driven by his desire to keep the share value as low as possible in order to minimize the estate taxes that will be due upon Gene's death and the deaths of other shareholders on his side of the family;
>
> After Sharon and Curtis instituted the Trust Litigation, Gene retaliated by drastically cutting the dividends paid to shareholders in order to squeeze them out or deprive them of the funds needed to prosecute the Trust Litigation;
>
> At the same time that the dividends were sharply reduced, Gene authorized exorbitant salaries and bonuses to himself and Guy;
>
> In the past, Gene has suppressed or eliminated dividends in order to squeeze out minority shareholders;
>
> Disthene has intentionally misrepresented the value of its stock when redeeming its shares from minority shareholders;
>
> At the behest of Gene, Disthene undertook a program to purchase and/or pay the substantial premiums on life insurance policies on the lives of Gene, Barbara [Gene's wife], Guy, and Mallie [Gene's mother], all for the benefit of Gene's children and grandchildren;
>
> Gene and his family have used the company's assets for their own use without compensating Disthene;
>
> Disthene intentionally fails to operate Blue Rock and the Cavalier Hotel as profitable businesses;
>
> Blue Rock and the Cavalier Hotel serve to siphon corporate funds to Dixon family members who are compensated for their services as officers, directors, and managers despite minimal qualifications for their positions;
>
> Gene and Guy have resisted providing any meaningful corporate records to Sharon and Curtis.[95]

The court found that in deciding to cut dividends in 2006, Gene was acting in bad faith, out of his personal motive to retaliate against Sharon and Curtis for having brought the Trust Litigation.[96] The court found that Disthene's past misrepresentations regarding its valuation when redeeming minority shareholders' shares amounted to oppression.[97] When Jeanne died, rather than

94. *Id.*
95. *Id.* at 289–90.
96. *Id.* at 298.
97. *Id.* at 302.

using the proceeds of Disthene's life insurance policy on her life to buy enough shares to provide Jeanne's estate with the liquidity to pay estate taxes, Gene insisted that Jeanne's estate sell all of her shares at a below fair market price in order to receive any of the insurance proceeds.[98] The court viewed this effort to use the estate's liquidity needs to force sale of the stock at a below market price as an attempt to squeeze out Jeanne's family.[99] The court found that Gene and Guy's compensation, which increased significantly after the Trust Litigation at the same time that Disthene cut dividends to shareholders, was excessive and oppressive to the minority shareholders.[100] The court also found evidence of oppressive conduct in the fact that every member of Gene's immediate family derived income from employment as an officer, director, or employee of Disthene, yet Gene refused to employ Curtis or Sharon, even at a low level.[101] The court found that the use of company assets to pay personal expenses of Gene and his family was a misapplication and waste of corporate assets.[102] In addition, Gene caused Disthene to pay over $6,590,000 in premiums for life insurance policies owned by trusts for the benefit of Gene's children and grandchildren, which the court found to be a misapplication and waste of corporate assets.[103] However, the court found that the operation of The Cavalier Hotel and Blue Rock in an unprofitable manner[104] and the denial of information did not constitute a basis for judicial dissolution.[105] On balance, the court concluded that dissolution was the appropriate remedy and appointed a receiver to wind up the company.[106]

Originally, in early February of this year, a panel of the Supreme Court of Virginia declined to hear Disthene's appeal of the dissolution order.[107] However, following a rehearing, on April 25, 2013, the Supreme Court of Virginia granted the appeal.[108] Once

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98. *Id*. at 303.
99. *Id*.
100. *Id*. at 304–07.
101. *Id*. at 307–08.
102. *Id*. at 310.
103. *Id*. at 312–13.
104. *Id*. at 315.
105. *Id*. at 316.
106. *Id*. at 317.
107. *See* McKelway, *supra* note 86, at B1.
108. Disthene Grp., Inc. v. Colgate, 2013 Va. LEXIS 60, *appeal docketed*, No. 122073 (Va. Apr. 25, 2013).

the appeal was granted, Disthene's dissolution order was suspended and the company was operated by the receiver pending the outcome of the appeal.[109] Before the appeal could be heard and decided, the parties reached a settlement, which the trial court approved.[110] Since the Supreme Court of Virginia did not have the opportunity to rule on this high stakes case, it remains to be seen what precedential value it may have; however, at a minimum, the Disthene case highlights the risk of taking a large judicial dissolution claim to trial.

E. Matson v. Alpert (In re LandAmerica Financial Group, Inc.)

Prior to 2008, LandAmerica Financial Group, Inc., a Virginia corporation ("LFG") was the third largest title insurer in the United States.[111] LFG owned LandAmerica 1031 Exchange Services, Inc. ("LES"), a Maryland corporation which served as a qualified intermediary for like-kind exchanges consummated under section 1031 of the Internal Revenue Code.[112] LES invested 1031 exchange funds it received from customers in a number of short term investments, including "money market mutual funds, short term bonds, certificates of deposit, floating rate notes, and auction rate securities ('ARS')."[113] "Investors who purchase ARS are typically seeking a cash-like investment that pays a higher yield than money market mutual funds or certificates of deposit."[114] In early February of 2008, the market for ARS failed and "remained frozen."[115] This caused a significant liquidity problem for LES, which in turn caused a liquidity problem for LFG.[116] While the ARS market remained frozen, the balance of exchange funds held by LES continued to decline, from $1.1 billion in August 2007 to less than $400 million in September 2008 as the

109. Bill McKelway, *Kyanite Case Going to Va. High Court*, RICH. TIMES-DISPATCH, Apr. 27, 2013, at B1.

110. Bill McKelway, *Kyanite Mining Case Finally Comes to a Close*, RICH. TIMES-DISPATCH, June 11, 2013, at B1.

111. Matson v. Alpert (*In re* LandAmerica Fin. Grp., Inc.) 470 B.R. 759, 772 (Bankr. E.D. Va. 2012).

112. *Id.*

113. *Id.* at 774.

114. FIN. INDUS. REGULATORY AUTH., AUCTION RATE SECURITIES: WHAT HAPPENS WHEN AUCTIONS FAIL 1 (2011), www.finra.org/web/groups/investors/@inv/@protect/@ia/documents/investors/p125856.pdf.

115. *LandAmerica*, 470 B.R. at 775.

116. *Id.* at 775–76.

broader financial crisis impacted the market for real estate transactions.[117] This shrinking exchange fund left seventy percent of LES's exchange funds tied up in the frozen ARS market.[118]

On November 26, 2008, LFG and LES filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code.[119] As a result of those proceedings, a liquidating trustee was appointed to administer the LFG liquidating trust.[120] By virtue of LFG's bankruptcy plan, any claims against the directors and officers of LFG were assigned to the liquidating trustee,[121] who asserted, among other claims,[122] that the directors and officers of LFG had breached their fiduciary duties to LFG.[123] The LFG directors and officers filed a motion to dismiss these claims under Federal Rule of Civil Procedure 12(b)(6), alleging that, as permitted by section 13.1-692.1 of the VSCA, LFG had eliminated the liability of its officers and directors except in the case of willful misconduct or a knowing violation of criminal law or of any federal or state securities laws.[124]

The trustee made the following relevant allegations:

> [The LFG officers and directors allowed] LES to continue its usual business practice of comingling new Exchange Funds with existing Exchange Funds and permitt[ed] LES to use new Exchange Funds to satisfy old Exchange liabilities despite (i) LES's steadily declining revenues since August 2007, (ii) the ARS freeze in February 2008, and (iii) the fact that nearly half of LES's commingled exchange portfolio was frozen constitut[ing] a conscious failure to respond to a critical risk facing LFG. . . . [Certain] defendants . . . knowingly violated corporate guidelines when they transferred a total of $65 million from LFG to LES without the requisite review and approval of the LFG Board of Directors.[125]

117. *Id*. at 775.

118. *Id*.

119. *Id*. at 776.

120. *Id*. at 772–73.

121. *Id*. at 778–79.

122. The parties litigated multiple issues related to bankruptcy, standing and Maryland laws that are beyond the scope of this article. *See id*. at 772, 777, 779–80, 805–06. This article focuses on the Virginia fiduciary duty claims against the LFG officers and directors and the 12(b)(6) motion to dismiss on the grounds of LFG's exculpation provisions in its articles of incorporation.

123. *Id*. at 777.

124. *Id*. at 771–72, 784–85; *see* VA. CODE ANN. § 13.1-692.1 (Repl. Vol. 2011 & Cum. Supp. 2013).

125. *LandAmerica*, 470 B.R. at 787.

The bankruptcy court, applying Virginia law, determined that these allegations, assuming they were true for purposes of a 12(b)(6) motion, could rise to the level of willful misconduct and thus, could not be dismissed.[126] The court cited the following passage from section 10.1 of *Goolsby on Virginia Corporations*: "In the case of willful misconduct the perpetrator not only must have intentionally acted or failed to act, but also must have done so knowing that what he or she was doing was wrong."[127] While the court carefully cited several reasons why the board arguably should have taken action, the only apparent evidence of conduct that the defendants clearly should have known was wrong was the transfers by the officer defendants of funds from LFG to LES in violation of certain LFG policies.[128] One would think that failure to act in the face of a crisis, in and of itself, would not be sufficient to show that the defendants knew inaction was wrong. If inaction was a reasonable course of action,[129] regardless of the decision process that led to inaction or if the defendants (in particular the director defendants) were not aware of the severity of the liquidity crisis caused by the ARS freeze, could the defendants have known inaction was wrong? It is also interesting that defendants who were officers and directors of LFG were held to have engaged in willful misconduct for failing to act to address problems in a subsidiary, albeit only for purposes of surviving a 12(b)(6) motion to dismiss.

As to Virginia's statutory business judgment rule, which the court acknowledged is subjective and protects both action and decisions not to act, the trustee alleged that the board of LFG failed to make any decision or take any action regarding the frozen ARS market for more than five months after the ARS freeze began.[130] The trustee also alleged in the alternative that "even if this failure to take affirmative action was the result of a conscious business decision, the [board failed] to gain an understanding of the

126. *Id.*

127. *Id.* (quoting ALLEN C. GOOLSBY, GOOLSBY ON VIRGINIA CORPORATIONS § 10.1 (4th ed. 2011)).

128. *See id.* at 802–03.

129. While the court did not address options to find liquidity for the ARS, according to The Financial Industry Regulatory Authority ("FINRA"), the options for generating liquidity for the frozen ARS were quite bleak, and holding until the market cleared was one of the options suggested by FINRA. *See* AUCTION RATE SECURITIES, *supra* note 114, at 1–2.

130. *LandAmerica*, 470 B.R. at 790–91.

LES liquidity problem prior [to] making any such decision."[131] For the foregoing reasons, the court held that these allegations, assuming they were true for purposes of a 12(b)(6) motion, could preclude the application of Virginia's statutory business judgment rule.[132]

The court also held that because the trustee alleged that the directors failed to employ a decision-making process sufficient to properly inform themselves and to make a defensible business decision, the trustee's allegation of a breach of fiduciary duty by the directors was sufficient to withstand a 12(b)(6) motion.[133] The court relied on duties implicit in the LFG bylaws, in the commonly held meanings of officer titles, and, for the General Counsel, in the Sarbanes-Oxley Act to find that the trustee had sufficiently pleaded breaches of fiduciary duties by the officers to survive a 12(b)(6) motion.[134]

While the *LandAmerica* case was a bankruptcy proceeding and thus not necessarily of precedential value for Virginia state courts, it demonstrates that, notwithstanding Virginia's management-friendly standards for exculpation and management-friendly business judgment rule, the actions and inactions of directors and officers may be second guessed when a corporation encounters hard economic times, especially in bankruptcy proceedings. The exceptional situation in *LandAmerica*—the procedural posture of a 12(b)(6) motion where the plaintiff's pleadings are taken as true, the extraordinary facts pleaded by the plaintiff trustee, the extraordinary nature of the economics crisis in 2008, and the unprecedented freeze in the ARS market[135]—may make this case somewhat of an outlier. It is at least arguable, however, that the economic crises that began in 2008 and the unprecedented ARS freeze should have weighed in favor of applying the business judgment rule or a favorable interpretation of willful misconduct, even if the business judgment rule did not apply. Perhaps, if the case had moved forward, the officers and directors may have prevailed on some of the factual issues; however, as is often the case in high stakes cases like this, the parties settled

131. *Id.* at 791.
132. *Id.* at 792.
133. *Id.* at 798.
134. *Id.* at 799–801.
135. Braintree Labs., Inc. v. Citigroup Global Mkts., 622 F.3d 36, 39 (1st Cir. 2010) (discussing the unprecedented nature of the ARS freeze).

shortly after the defendants failed to obtain a dismissal.[136] The *LandAmerica* case is a strong warning to the directors and officers of Virginia corporations that begin facing a financial crisis. If a crisis arises, the officers and directors need to: (1) have systems in place that allow the officers and board to identify an emerging crisis,[137] (2) actually recognize the crisis early, (3) begin building a robust record of the process that the officers, board, and board committees engaged in to address the pending crisis, and (4) make sure the minutes of board and committee meetings reflect not just decisions to act, but also decisions not to act, the reasons why actions were taken or not taken, and the reports and advice from officers and third party experts relied on when deciding to act or not to act.

V. CONCLUSION

Over the past two years, the General Assembly made a number of changes to Virginia's business entity statutes. The amendments: (1) eliminate redundant provisions on remote participation in meetings of directors and shareholders of Virginia corporations; (2) require that any shareholder action authorized by less than unanimous written consent must be filed with the Secretary before shareholders holding ten percent or more sign the action; (3) require an amendment of a public corporation's articles of incorporation authorizing votes by less than unanimous written consent to be approved by each class authorized to vote by the greater of two-thirds of each class or the vote required in its articles of incorporation for an amendment to the corporation's articles of incorporation; (4) clarify that a corporation's stock records are prima face evidence of share ownership; (5) allow a public corporation to deliver the financial statements required under the appraisal rights statute in any manner permitted by the rules of the SEC; (6) eliminate a corporation's right to opt out of buying

136. Gregory J. Gilligan, *Deal Lets Investors Get All Funds Back from Unit*, RICH. TIMES-DISPATCH, July 25, 2012, at D1.

137. Although the court in the *LandAmerica* case was clear that this was not a *Caremark* case (i.e., a case where the management was liable because it breached its duty to put adequate supervisory systems in place), it is not a substantial leap to conclude that if a robust set of systems like those required to avoid *Caremark* liability had provided the LandAmerica board an early warning of this crisis and its potential magnitude, the board may have taken action earlier, which in turn could have made a 12(b)(6) motion more likely to prevail. *See LandAmerica*, 470 B.R. at 798 & n.31 (discussing *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996)).

the stock of a shareholder seeking judicial dissolution after the court determines fair value; (7) clarify how to file the Virginia articles of organization or incorporation of an entity that domesticates into Virginia; (8) allow organizers to file articles of entity conversion for Virginia limited liability companies and corporations if no managers or directors have been elected; (9) make filing a plan of entity conversion in connection with a corporation's bankruptcy proceeding more straight forward; (10) permit Virginia nonstock corporations to convert to limited liability companies; (11) allow limited liability companies to rescind dissolution after voluntarily filing articles of dissolution or after a judicial dissolution if all of the members vote to waive the dissolution; (12) incorporate signature standards for foreign limited liability company filing documents with the SCC; (13) clarify that limited liability companies continue perpetually unless dissolved and that a foreign limited liability company cannot domesticate into Virginia unless it has complied with the law of its home state in effecting the domestication; and (14) enable a member of a limited liability company to transfer his membership interest, along with management and voting rights, if expressly permitted in the limited liability company's operating agreement.

On the judicial front, cases established that: (1) a shareholder in a two-shareholder corporation has standing to bring a derivative claim even though she may be seeking the dissolution of the corporation, the other shareholder does not support her claim, and she has asserted breach of contract claims against the corporation; and (2) under the "economic purpose" test permitting judicial dissolution of a partnership or LLC, the party seeking dissolution does not have to show that the entity is unprofitable, only that its primary economic purposes are likely to be frustrated. In addition, the judicial dissolution of The Disthene Group, Inc. was significant because it was probably the largest company ever to be the subject of a judicial dissolution in Virginia, and the opinion included an extensive factual record and analysis that may carry some persuasive authority in other Virginia courts. Finally, in one of the more consequential cases involving liability of directors and officers of a Virginia corporation, the Bankruptcy Court of the Eastern District of Virginia, Richmond Division, refused to grant a motion to dismiss brought by the officers and directors of The LandAmerica Group, Inc. The court's lengthy opinion highlights the risk that officers and directors of Virginia corporations face if the corporation seeks bankruptcy protection and there is no clear record they can put before the court showing actions taken to address the circumstances that led to the corporation's bankruptcy, actions that the board affirmatively decided not to take, and the rationale for such actions or inactions.