

Client Alert

February 2015

Supreme Court of Virginia Rejects Step-Transaction Argument in Interpreting Corporate Appraisal Statutes

Last month in *Fisher v. Tails, Inc.*, the Supreme Court of Virginia affirmed a circuit court's order, finding that minority shareholders were not entitled to appraisal rights in connection with a corporate transaction.¹ The Supreme Court strictly construed the Virginia Stock Corporation Act and concluded that a reincorporation and subsequent sale of the corporation's assets did not trigger appraisal rights, even though appraisal rights would have been available if the transaction had been structured differently. In doing so, the Supreme Court rejected application of the "step transaction" and "substance over form" doctrines. The decision is noteworthy because it confirms that Virginia courts will generally enforce statutes as written, thus providing certainty to Virginia business entities and practitioners in structuring transactions.

Background

The litigation involved the sale of a privately held Virginia corporation named Tails, Inc., which operated a regional real estate agency franchise. The sale was structured as a series of related transactions. First, Tails, Inc., became a Delaware corporation pursuant to a domestication.² Under then-existing Virginia law, domestications did not trigger appraisal rights. Second, after the domestication, Tails, Inc., merged into a new Delaware limited liability company that was owned by a newly formed Delaware holding company. Finally, the assets were sold to a third party. Under Delaware law, shareholders are not entitled to appraisal rights in connection with the sale of substantially all of a corporation's assets. Had the sale been structured as a sale of all the Virginia corporation's assets or a cash-out merger, however, the shareholders would have been entitled to appraisal rights under the Virginia Stock Corporation Act.³

Several minority shareholders, who collectively owned 21% of the corporation's shares, filed a complaint seeking appraisal rights. They argued that the series of related transactions resulted in the sale of Tails's assets, thus entitling them to appraisal rights under Virginia law. They also cited to Delaware law in arguing that, under the "step transaction" or "form over substance" doctrines, the court should honor their appraisal rights under Virginia law. The Circuit Court of Henrico County dismissed the complaint, and the shareholders appealed.

Supreme Court of Virginia's Decision

The Supreme Court of Virginia affirmed the trial court's dismissal. It explained that the Virginia Stock Corporation Act expressly states which corporate actions trigger appraisal rights, and domestications is not one of them.⁴ Applying the statutory canon of *expressio unius est exclusio alterius* (i.e., "the express

¹ *Fisher v. Tails, Inc.*, Record No. 140444, 2015 Va. LEXIS 9 (Jan. 8, 2015).

² Va. Code Ann. § 13.1-722.2. Technically, Delaware treats domestications as "conversions."

³ See *id.* §§ 13.1-730A.1 and A.3.

⁴ See *id.* § 13.1-730A.1-5.

mention of one thing excludes all others”), the Supreme Court concluded that the General Assembly intentionally omitted domestications. In so doing, the Supreme Court acknowledged that the Model Business Corporation Act does grant appraisal rights in domestications.⁵

The Supreme Court then refused to apply the “step transaction” or “substance over form” doctrines. The Supreme Court assumed *arguendo* that Virginia law recognizes those doctrines, but it held that “the circuit court did not err ... because the purpose of the substance over form and the step transaction doctrines is to prevent transactional formalities from blinding the court to what truly occurred.” It also explained that Delaware courts have applied the “doctrine of independent legal significance” when “a transaction effected pursuant to a statute will be subject to the requirements and consequences of that statute alone.” In that situation, the Supreme Court said, “[i]t is not within a court’s purview to second guess the legislature’s decision.”

The Supreme Court concluded that “[d]omestication of the corporation is not properly considered a step in the step transaction or substance over form analysis because domestication concerns the law that is applicable to the transaction rather than an equitable characterization of the transaction that took place.” It further stated that “domestication is regulated by statute.”

Conclusion

The Supreme Court’s decision is significant because it provides certainty in structuring corporate transactions under the Virginia Stock Corporation Act. The decision applied a straightforward analysis, interpreted the plain terms of the Virginia Stock Corporation Act, and refused to imply rights or other terms that were not expressly provided in the statute. This is consistent with how most Virginia courts enforce contracts and statutes as written, thus making Virginia a favorable environment for doing business.

The Supreme Court did not expressly reject the “step transaction” or “substance over form” doctrines. Rather, the Supreme Court assumed, without deciding, that they were recognized under Virginia law. But this decision suggests that those doctrines have very limited applicability in Virginia. Moreover, the Supreme Court recognized the countervailing doctrine of independent legal significance, which allows a business entity to accomplish a transaction under one statute even if it would be precluded or result in a different outcome if effected under another statute.

This decision does not foreclose all remedies of minority shareholders. In particular, it does not necessarily insulate a board of directors from a breach of fiduciary duty claim if the transaction was structured for an improper purpose. It should also be noted that there is legislation pending in the General Assembly to provide shareholders with appraisal rights in a domestication unless they receive shares with terms as favorable in all material respects and representing at least the same percentage interest in the total voting rights of the outstanding shares of the corporation as held immediately before the domestication.⁶

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⁵ See *Fisher*, 2015 Va. LEXIS 9, at *7 (citing Allen C. Goolsby & Steven M. Haas, GOOLSBY & HAAS ON VIRGINIA CORPORATIONS § 15.1 (5th ed. 2014)).

⁶ See House Bill No. 1878.