

Business Law Monthly Practice Tip
July 2008

The Virginia Supreme Court rejects the “Sale of Business” doctrine and holds that the Virginia Securities Act applies to the sale of a closely held corporation

Andrews v. Browne, No. 071079, June 6, 2008.

Facts of the case:

- o Following the sale of 100% of the stock of a closely held corporation, the purchaser filed a complaint against the sellers of the stock alleging actual fraud, common civil law conspiracy and, under §13.1-522 of the Code of Virginia, making untrue statements of material fact and omitting material facts in furtherance of the sale of a security. The purchaser’s claims are based on its allegation that the sellers deliberately understated the expenses and overstated the income of the corporation.
- o The trial court granted the sellers’ motion for summary judgment on the §13.1-522 claim by adopting the “sale of business” doctrine. The trial court agreed with the sellers’ argument that the Virginia Securities Act “is not intended to protect active purchasers of a business.”
- o Justice Donald W. Lemons, writing for a unanimous court, rejected the sale of business doctrine and found that the Virginia Securities Act, Code of Virginia §13.1-501 *et seq.*, applies to the sale of 100% of the stock of a closely held corporation.

Sale of business doctrine:

- o In some states (e.g. New Mexico, Illinois and Louisiana), the sale of 100% of the stock of a corporation in which control passes to the purchaser does not constitute a sale of “securities,” and therefore state securities regulations do not apply.

A broad definition of “securities”:

- o The Virginia Supreme Court rejected the sale of business doctrine, stating that, “When the instrument purchased bears the label ‘stock’ and possesses the characteristics of traditional stock, the purchaser is justified in assuming that the Virginia Securities Act applies.”
- o In rejecting the sale of business doctrine, the court reasoned that many practical difficulties, such as determining whether control has passed to the purchaser, would arise from its application.
- o The court adopted the federal definition of “security,” which includes “any... stock.” It held that the sale of a closely held corporation constitutes the sale of “securities,” triggering the requirements of the Virginia Securities Act.

- o Relying on *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975), the Court set out five characteristics typically associated with stock, which indicate when a “stock” is a “security” under Virginia law. These characteristics are:
 - the right to receive dividends contingent upon an apportionment of profits;
 - negotiability;
 - ability to be pledged or hypothecated;
 - conferring of voting rights in proportion to the number of shares owned; and
 - ability to appreciate in value.

- o Relying on these factors, the court found that the sale of the business at issue was a sale of securities governed by the Virginia Securities Act.

Decreased burden for purchaser claims:

- o Disgruntled purchasers of a closely held business will find it much easier to bring a claim because of the *Andrews v. Browne* decision.

- o The burden of proof for a claim under the Virginia Securities Act is a preponderance of the evidence, rather than the clear and convincing standard for an actual fraud claim.

- o Under the Virginia Securities Act, plaintiffs must only prove a material misrepresentation in connection with the sale of the stock, rather than establish all the elements of an actual fraud claim.

- o When selling an entire corporation, sellers must be certain that they disclose all material information to the purchaser.

- o A seller may want to consider structuring the sale as an asset sale, rather than a stock sale, to avoid liability under the Virginia Securities Act.

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