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BEAN KINNEY & KORMAN PC
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Business Law Newsletter

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The Business Judgment Rule in Difficult Times

By James V. Irving

The "Business Judgment Rule" is intended to insulate corporate directors from liability for informed, good faith decisions made in the regular course of business and with the honest belief that the decision was in the best interest of the company. Recently, with companies large and small collapsing under the weight of bad management judgments, plaintiffs have begun to ask courts to take a hard look at many corporate decisions and their results.

In February, Delaware Chancery Court affirmed Citigroup's board of directors' business judgment in handling the risks associated with Citigroup's financial exposure to the subprime mortgage market failure. The Delaware court rejected the opportunity to "second guess" the board and instead deferred to their good faith judgment. The case is *In re Citigroup Inc. Shareholder Derivative Litigation*.

Citing a series of negative benchmarks, the Plaintiffs alleged that the directors ignored red flags that should have put them on notice of the severity of the business risks of investing in subprime assets. In consciously ignoring these obvious and growing risks, the plaintiffs argued, the directors breached their fiduciary duty to the shareholders, for which the directors should be held personally liable for the losses occasioned by this oversight. Failure to exercise oversight can constitute a breach of the fiduciary duty of loyalty under Delaware law, which would not be protected under Citigroup's charter provision exculpating directors from personal liability for violations of this duty.

The Delaware Court rejected this claim, ruling that oversight liability requires a showing that the directors (i) knew they were not discharging their fiduciary obligations; or (ii) demonstrated a conscious disregard for such responsibilities, such as by failing to act in the face of a known duty to act. Moreover, the Court found that "bad faith" is a necessary precondition to director oversight liability.

Consistent with its judgment in the landmark case of *In re Caremark Int'l Inc. Derivative Litigation* (1966), the Delaware Court noted that, at most, the warning signs were *ex post facto* proof of bad business decisions. The Court went on to hold that to impose liability on directors for failure to monitor business risks would require courts to conduct hindsight evaluations of business decisions, precisely the sort of process the Business Judgment Rule is designed to protect against.

In today's business climate, directors face increased and increasing scrutiny of their business decisions. While the Business Judgment Rule is not a safe harbor for a careless or self-interested director, it does provide insulation when well-intended decisions achieve negative results.

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Virginia's Data Theft Notification Statute

By Michael R. Abejuela

With the New Year comes New Year's resolutions. Often times, the beginning of the calendar year marks a time for businesses to review their current policies and procedures and assess areas where they can implement positive changes or improvements. Similarly, this is a time for businesses to review changes in the law to ensure compliance and adherence to applicable legal requirements.

In 2008, Virginia joined the growing number of states that have enacted a data theft notification statute. The protection of individuals' personal information has been in recent headlines following breaches of security measures protecting such information. Virginia's statute went into effect on July 1, 2008 and seeks to mitigate the negative effects to residents of the Commonwealth of Virginia when their information may have been accessed or acquired without proper authorization through the breach of the security of a system. The statute specifically addresses the "unauthorized access and acquisition of unencrypted and un-redacted computerized data that compromises the security or confidentiality of personal information maintained by an individual or entity as part of a database of personal information regarding multiple individuals and that causes, or the individual or entity reasonably believes has caused, or will cause, identity theft or other fraud to any resident of the Commonwealth."

This new statute has application to any business that maintains a database of personal information that includes any residents of Virginia. In this day and age, encryption and redaction of personal information has become a common practice among businesses. However, given this new statute, it would be advisable for businesses to review and assess how they manage information and ensure they are taking appropriate measures.

In the unfortunate event of a breach of the security of a system where un-redacted or unencrypted personal information was, or is reasonably believed to have been, accessed without proper authorization, this new statute provides very specific requirements for the notice that must be sent to affected individuals. In some instances, notice must be sent to more than 1,000 persons at one time, the Office of the Attorney General and all consumer reporting agencies that compile and maintain files on consumers on a nationwide basis.

The potential penalty for violation of this statute is quite severe. The Office of the Attorney General is authorized to bring an action against an individual or an entity that violates this statute and may impose a civil penalty of up to $150,000 per breach of the security of a system or series of breaches of a similar nature that are discovered in a single investigation. Furthermore, the statute does not limit the ability of an individual to recover direct economic damages resulting from a violation of the statute.

As one can see, it is advisable for a business to understand the method in which it manages and maintains personal information of individuals, monitors the security of its computer systems, and ensures it implements appropriate policies and procedures to comply with Virginia's new data theft notification statute. With appropriate management and planning, businesses can readily comply with this new law and at the same time increase the security of the personal information in its possession.

Don't Write that Personal Check!

By Charles B. Thomas

Owners of small businesses should be aware that the limited liability afforded to them by operating their business as a corporation or limited liability company can be lost if they undertake to satisfy a debt belonging to their corporation or LLC with personal funds. A former client of this firm made that mistake and the owner now is subject to personal liability for an obligation which was solely that of his company. A Westchester County, New York Supreme Court recently imposed personal liability on the owner of a wine distribution company for an amount in excess of $110,000.00.

The obligation at issue arose when a New York wine supplier ("Supplier") sold nine hundred cases of wine to a Florida-based wine distributor ("Distributor"). There was no argument that the Distributor received the wine, resold at least part of it, and never paid for any of it. The dispute arose during the effort to collect the debt when the Supplier alleged that the owner of the Distributor had rendered himself personally liable for the entire business debt.

The delivery of the nine hundred cases of wine was accompanied by an invoice identifying the Distributor as the responsible party, and a purchase order which was signed by an employee of the Distributor. After the wine was delivered, the Distributor issued a check in the amount of the invoice but advised the New York-based Supplier not to deposit it. There followed substantial correspondence and communication between the principals of the two companies. During the course of this negotiation, the principal of the Distributor issued and then withdrew a personal check for the full amount of the invoice. He later directed his company to supply a separate company check which was returned twice for insufficient funds. A lawsuit followed.

The Supplier sued not only the Distributor but also its principal on the theory that he had undertaken personal responsibility for his company's debt through the issuance of his personal check. The fact that the personal check was withdrawn was irrelevant under this theory. Under Florida law, the Distributor's principal would have been shielded from his company's debts under the Uniform Limited Liability Company Act. This Act holds that members or managers of a limited liability company are not personally responsible for the debts, obligations or liabilities of that company solely by reason of being a member or manager. Thus, the principal would not have been personally liable to the Supplier under the purchase order or invoice. However, the Court held that the mere issuance of a personal check constituted a separate contract under which he assumed personal responsibility as to the debt of his company.

The lesson of this tale is that a principal of a business entity should never make a personal commitment to satisfy the obligations of a corporation or LLC unless it is the principal's intention to make his or her personal assets available to satisfy the company's business obligation.

Zoning and Land Use

Arlington County Fee Increase

Arlington County is planning to raise the land use, zoning and building permit fees effective July 1, 2009. Increases will range from 3.3% to 10% based on when the fees were last increased. This is basically an attempt by Arlington County to keep up with the costs of inflation. All zoning fees, building permit application fees, certificate of occupancy fees, sign permit fees (the whole gamut of fees charged by Arlington County in the construction and development area) will be raised. The largest increases will come in certificate of occupancy fees and plat review application fees. A schedule of fees will be available on the Arlington County website at least 30 days prior to implementation on July 1, 2009.

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James V. Irving is a shareholder with the firm. He has been a practicing attorney for more than twenty years, primarily in the areas of Corporate and Business Law, Commercial and General Litigation and Appellate Practice.

He has successfully served businesses in business counseling and formation; document drafting, including contracts; employment agreements, trade secrets, non-competition and non-disclosure agreements; purchase and sale agreements and related transactions; litigation; and appellate practice. He has handled appeals fully briefed and argued in the Supreme Count of Virginia; jury and bench trials in Virginia State and Federal Courts; and before Maryland Circuit Courts and administrative bodies.

Mr. Irving has conducted seminars on Mechanic's Liens, Starting a New Business, Employment Law and Covenants Not to Compete. He serves as a member of the Green Energy Committee for the Greater Washington Board of Trade.

Mr. Irving holds an undergraduate degree from the University of Virginia, Charlottesville, Virginia and a law degree from Marshall-Wythe School of Law, College of William and Mary. He may be reached at jirving@beankinney.com.