



The “Peer Review Privilege” Should Not Shelter Hospital Policies and Procedures From Discovery

Roger T. Creager

In medical malpractice actions, lawyers for injured patients (or their estates) frequently seek discovery of the policies and procedures of the defendant hospital or other healthcare facility. Although most Virginia Circuit Courts that have addressed the issue have held these materials are discoverable and are not protected by the statutory “peer review” privilege created by *Virginia Code* § 801-581.17,² a minority of Circuit Courts have held that the statutory privilege does apply and have denied discovery.³ This article argues that the courts that have applied the statutory privilege to insulate hospital policies and procedures from discovery should reconsider their holdings in view of the flawed and incomplete reasoning of the case law applying the privilege and also because of more recent Virginia Supreme Court authority and legislative developments.

a. The assumption that hospital policies and procedures could never be admissible at trial is incorrect and should not influence the discoverability determination.

Most of the Circuit Court decisions holding that hospital policies and procedures are privileged under the peer-review statute have been heavily influenced by their belief that hospital policies and procedures would constitute “private rules” and would not be admissible as evidence at trial of a tort action.⁴ Importantly, however,

there is no blanket prohibition against admission of private rules as evidence. The evidentiary rule in Virginia (under the *Godsey* and *Pullen* decisions) is merely that private rules are not admissible to establish the standard of care.⁵ The Virginia Supreme Court has recognized, however, that a defendant’s safety policies may be relevant and admissible in a negligence action on the issue of defendant’s knowledge of a potential danger and as evidence of the foreseeability of the occurrence that caused injury. In *New Bay Shore v. Lewis*,⁶ the plaintiff contended that she was knocked off of a merry-go-round and injured due to movements of young boys who were moving from one horse to another during the ride. On appeal, the defendant argued that the jury verdict should be set aside because it was not foreseeable that a young boy could push an adult woman off the merry-go-round. In rejecting this argument, the Virginia Supreme Court observed:

It is not denied that defendant, for the protection of riders on its merry-go-round, adopted two safety rules, namely: (1) to require all riders on the merry-go-round to be seated, and remain seated, during a ride; and (2) “to be careful about children and boys running around.” According to plain-

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Letter From The Chair • The Butterfly Effect

by R. Lee Livingston

After a lengthy trial out of town last year my seven year-old daughter gave me one of her famous special gifts upon my return. Her homemade card in bold block letters read: "I'm so glad you won, Daddy, I prayed for you every day." As touched as I was by her thoughtfulness, her message about winning left me uneasy – feeling not entirely but something like how I feel hearing an athlete has prayed to win a game. I wondered what message I had given my daughter about the importance of winning.

Today, I anxiously await the decision of a judge in a medical malpractice case tried last week. Attending to my own thoughts about winning, I have recalled several anecdotes I will share with you. These thoughts may offer a contrasting beauty to a cold, hard weight – a weight made of pressure to win.

After my very first trial I attended an Inn of Court meeting with members from our local bar. The guest speaker was a Virginia Court of Appeals judge for whom I had interned briefly one summer when she was a trial judge. Her accommodation to me as a summer intern made me a fan of hers, particularly as she gave me what I thought then was a magnificent task – cite checking the bench book Virginia judges use.

While standing in the buffet line at the Inn of Court meeting I told her I had just finished my first trial. She snapped, "Did you win or lose?" The question caught me off guard, especially considering the judge who presided over the bench trial was standing in line behind me. He had given my client most but not all of what we asked for, so I was a bit tongue tied. Notwithstanding the presence of the finder of fact, I managed some coherent response, but I missed the point at the time. In retrospect, I realized by her inflection and her attitude that the answer to the question did not matter. Her posture was one of congratulations regardless of who won or lost.

I was in a medical malpractice trial last week as co-counsel with an outstanding trial lawyer. He has written books well-received by the plaintiff's bar and collects verdicts like I collect 1976 bicentennial quarters. The night before I was to conduct the direct-examination of our standard of care expert, and before he knew how I would perform, he offered to teach me how to use his nifty trial software program sometime – a task that could easily be left to a software representative.

On the day I was set to cross-examine the defendants' experts, my law partner sent an e-mail which among other things said simply: "Have fun!" Not "win" but "have fun." With wind in my sails, I did have fun.

Yesterday, after yet another week out of town in trial my daughter, now eight, welcomed me with a hand-crafted cut-out butterfly. With a spine made of popsicle stick, a rainbow of marker colors for wings, and a tiny smiley face, it was a beautiful butterfly. Nothing about winning or losing in this gift, only beauty.

To remember an important lesson and make it a part of living I need a short hand phrase; so, to me, "the butterfly effect" will no longer conjure up technical notions of chaos theory and of sensitive dependence on initial conditions. The comments from the judge at Inn of Court, the kindness of a lawyer who had much at risk, and encouragement from my partner, like my daughter's butterfly, were a kind of interloping beauty in a world obsessed with chalking up wins and losses.

We labor in a crucible in which winning can seem like everything. Increased competition among lawyers must be a part of this, and no doubt there are many other causes, the source of which is beyond searching out here. Moreover, the thrill of winning is hard to beat. Naturally, we want to win. A healthy fear of failure motivates the achievement of excellence. Yet, I am learning more about butterflies – to look for them, to appreciate them, and in some greater measure than I am prone to do, to share them with others.

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tiff’s testimony, defendant’s employees failed to enforce either of these rules. Hence the jury had a right to find that defendant was negligent. . . . The safety rules adopted by defendant, and its instructions to its employees, clearly indicate that defendant was aware of the potential dangers involved. Whether the negligence of defendant was the proximate cause of plaintiff’s injuries was a question for the jury to determine.⁷

Similarly, the training and instruction that a defendant has received is relevant and admissible evidence on the issue of whether his conduct constituted willful and wanton negligence that would overcome a contributory negligence defense or warrant an award of punitive damages.⁸ Hospital rules may also be relevant and admissible evidence with respect to issues such as vicarious liability and sovereign immunity.⁹ Moreover, certain aspects of the hospital policies and procedures sought in discovery may be found, when produced, not to constitute private rules within the scope of Virginia evidence law limiting the admissibility of private rules.¹⁰

Even with respect to the standard of care, hospital policies, protocols, guidelines, or procedures may be relevant and admissible evidence. In 1997, then Circuit Court Judge Donald W. Lemons (now Supreme Court Justice) cited *Godsey* and *Pullen* and held: “There is no cause of action based upon private rules; however, these rules may be evidence as to the appropriate standard of care to be provided by the defendants.”¹¹ This view of *Godsey* and *Pullen* is supported by the Virginia Supreme Court’s decision in *Bly v. Rhoades*, where the Court ruled that the issue of the correctness of the trial court’s exclusion of hospital rules was moot but also observed that the trial court’s ruling was only “arguably . . . supported by precedent [citing *Godsey*].”¹² As a result, the opinion in *Bly*, according to then Circuit Judge (now Virginia Court of Appeals Senior Judge) Rosemarie Annunziata “implies that [hospital rules] may provide some evidence of the stan-

dard of care.”¹³ As Judge Annunziata also observed, hospital rules may be outside the scope of the *Godsey* and *Pullen* private-rules doctrine since they may actually constitute relevant and potentially admissible evidence of industry-wide standards.¹⁴ Judge Annunziata stated: “The materials sought may properly be seen as reflecting widely-adopted standards established or required by third-party entities, such as the Joint Commission of Accreditation of Health Care Organizations (JCAH).”¹⁵

Although these decisions and observations do not establish that company policies, procedures, and rules are always admissible they certainly do establish that they are not always inadmissible.

It is also important to note that the Virginia Supreme Court has provided that information may be discoverable even if it appears likely to be inadmissible at trial. The *Rules of the Supreme Court of Virginia* provide in Rule 4:1(b): “Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action. . . . It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery

of admissible evidence.”¹⁶

To the extent that the Circuit Court opinions disallowing discovery of hospital policies and procedures are based upon or influenced by the assumption that the materials would not be admissible at trial, the validity of their reasoning is undermined since that assumption is not correct and is beside the point in any event.

- b. 2006 Riverside Hospital decision undercuts reasoning of Circuit Courts that have construed the statutory “peer review” privilege broadly to include hospital policies and procedures.

In late 2006, the Virginia Supreme Court held, in *Riverside Hospital, Inc. v. Johnson*,¹⁷ that the trial court did not err in admitting evidence regarding hospital ori-

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The Virginia Supreme Court has recognized, however, that a defendant’s safety policies may be relevant and admissible in a negligence action on the issue of defendant’s knowledge of a potential danger and as evidence of the foreseeability of the occurrence that caused injury.

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entation instructions and nurse training materials. The Court ruled that the hospital staff orientation instruction and nursing curriculum “were not hospital policies or procedures of the type involved in *Godsey* and *Pullen* [the Court’s leading “private rules” decisions, cited previously in this article].”¹⁸ The Court also observed that the evidence was not offered to establish the standard of care but rather was admitted for other purposes. Finally, in another portion of its opinion addressing an additional evidentiary issue, the Court rejected a broad approach to the statutory construction of the statutory peer review privilege and instead concluded that the legislative intent was to protect “committee discussion or action by the committee reviewing the information” which is of a type “that must ‘necessarily be confidential’ in order to allow participation in the peer or quality assurance review process.”¹⁹ The Court quoted from an earlier opinion in which it had declared: “The obvious legislative intent [of the statute] is to promote open and frank discussion during the peer review process among health care providers in furtherance of the overall goal of improvement of the health care system. If peer review information were not confidential, there would be little incentive to participate in the process.”²⁰ Most importantly, in *Riverside Hospital*, the Supreme Court rejected a broad interpretation of the statute on the basis that it was contrary to the language of the statute which contained numerous limiting provisions and thereby signaled a narrower legislative intent.²¹

The approach taken by the Virginia Supreme Court in *Riverside Hospital*, both to the private rules evidentiary principle and to the statutory peer review privilege is consistent with and validates the reasoning of the many Circuit Court opinions that have allowed discovery of hospital policies and procedures. The *Riverside Hospital* decision provides ample cause for the Circuit Courts who have disallowed discovery of hospital policies and procedures to reconsider their previous rulings.

c. The General Assembly declined in its 2008

session to pass proposed legislation overruling the *Riverside Hospital* decision and refused to enact a broad approach to the peer review privilege.

Further evidence that the legislature does not intend that for peer review privilege to be applied broadly may be found in the fact that in its 2008 session the General Assembly declined to pass an amendment which would have overruled certain aspects of the *Riverside Hospital* decision and would have broadened the scope of the statutory privilege. The amendment, set forth in House Bill No. 382, would have broadened the scope of the privilege in numerous respects.²² The amendment would have protected all “restricted information” from discovery and provided, for example, that “[i]nformation created at the request of or for the express purpose of review by a committee or other entity specified in § 8.01-581.16 shall constitute restricted information without regard to the nature of the information contained therein.” House Bill 382 was eventually referred to the House Committee for Courts of Justice and never made it out of that committee. No amendment of the peer review privilege statute

was passed.

d. Special discovery protections should be narrowly construed in order to promote justice and fairness among litigants.

The discoverability of hospital rules and procedures should not be decided as though it is a bare abstract principle devoid of context. Rather, the decision of this issue obviously can have a fundamental impact on the fairness of the trial of a medical malpractice action. As Fairfax Circuit Court Judge Rosemarie P. Annunziata (now Senior Judge on the Court of Appeals) explained in her Fairfax County Circuit Court opinion ordering the discovery of hospital rules, regulations and protocols:

Logically, the hospital’s rules, regulations,

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and protocols can lead to discovery of admissible evidence on a myriad of issues. As claimant points out, the information will likely permit a more thorough and effective examination of the defendants and their expert witnesses about the medical care provided to the plaintiff, particularly in light of the applicable standard of care. Claimant's Memorandum of Points and Authorities in Support of Discovery at 4. In addition, the policies and procedures also can aid in the discovery of other reports or records generated by parties to the litigation or by other witnesses which may be admissible. The documents also can assist in understanding what the defendants knew or should have known about claimant's condition and when they knew it.²³

Knowledge of the hospital rules, regulations, and protocols can play an important role in the litigation of a medical malpractice action and can lead to relevant and admissible evidence in countless ways that cannot possibly be foreseen or even imagined by plaintiff's counsel or the trial judge at the time of the discovery dispute. It is impossible for plaintiff's counsel to fully predict and demonstrate the role that these materials would play in a case when the information and documents are completely unknown to plaintiff's counsel.

The problems created by denying discovery of this information to the plaintiff are further compounded by the obvious fact that the hospital, doctors, and nurses (and the hospital's counsel) all do have the benefit of full knowledge of and access to the hospital policies and procedures. Denying discovery of the hospital policies and procedures thus creates, by definition, a very uneven playing field. Potentially important information and documents are in the possession of one litigant and are completely denied to the other litigant. Moreover, hospitals, doctors, and nurses will presum-

ably produce and seek to take advantage of policies and procedures when they are helpful to the defense, but will oppose discovery of them when would be helpful to the patient's case.

The backdrop for determination of the discoverability of hospital policies and procedures is that the discovery procedures are designed and intended to create an even playing field, to provide equal access to relevant information, and to prevent trial by surprise. These policy considerations are obviously the fundamental reason for the adoption of the discovery provisions of the *Rules of the Supreme Court of Virginia*. Yet, these important policy considerations are disserved by denying discovery of hospital policies and procedures, and they have gone completely unmentioned in the Circuit Court opinions denying such discovery. None of those decisions has considered or discussed the unfair and unequal situation produced by denying a malpractice plaintiff's counsel any

access to information that directly controls and governs the manner in which a hospital is operated while defense counsel has full access to that same information at all times.

The policy considerations favoring full and equal access to relevant information should not, of course, override the policy considerations undergirding the peer review privilege. Those policy considerations, together with the *Riverside Hospital* opinion, however, clearly do support interpretation of the peer review privilege in a manner which takes due account of the policies served by the peer review privilege and the policies served by full and fair discovery. The policies favoring full and fair discovery deserve to be considered in the decision of discovery issues involving hospital policies and procedures, since the decision to deny one litigant access to information which is already available to the other litigant is never "cost free." Rather, the denial of discovery can have a significant adverse

The problems created by denying discovery of this information to the plaintiff are further compounded by the obvious fact that the hospital, doctors, and nurses (and the hospital's counsel) all do have the benefit of full knowledge of and access to the hospital policies and procedures. Denying discovery of the hospital policies and procedures thus creates, by definition, a very uneven playing field.

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impact on the fairness of the adversarial process and trial. "Secrecy, after all, is anathema to the search for truth" ²⁴ The fact that full impact the denial of discovery actually has on the subsequent discovery and trial will never be known is no reason to be less concerned but rather makes the decision to deny discovery all the more seriously troubling.

Because the truth-seeking process and fair adjudication of disputes are disserved by secrecy (particularly one-sided secrecy) and a denial of discovery, courts deciding discovery issues regarding hospital policies and procedures should be mindful that the party asserting a discovery protection has the burden of establishing it. ²⁵ Fairfax Circuit Court Judge Leslie M. Alden reviewed this requirement and related principles in a 1999 opinion ordering discovery of certain healthcare organization records in a defamation action:

The party asserting the protection of a privilege has the burden of establishing both the existence and applicability of the privilege. *Commonwealth v. Edwards*, 235 Va. 499, 509, 370 S.E.2d 296 (1988). Because evidentiary principles operate to exclude relevant evidence and block the fact-finding function, they should be narrowly construed. *Id.* In deciding whether the privilege asserted should be recognized, the Court must take into account the particular factual circumstances in which the issue arises and weigh the need for the truth against the importance of the relationship or policy sought to be protected. Finally, the Court must determine whether the recognition of the privilege will, in fact, protect that relationship in the factual setting of the case. *Krach-Naden v. Sauk Village*, 1999 U.S. Dist. LEXIS 11346, 1999 WL 543190 (N.D. Ill. 1999). ²⁶

As Judge Rosemarie Annunziata observed in one of the leading decisions ordering discovery of hospital rules and procedures:

The hospital first claims that the guidelines, procedures, and protocols are written "communications" within the scope of § 8.01-581.17. Although the material technically might fall within the broad language of the statute, such an interpretation would provide a limitless privilege. Any ambiguities in the statute must be strictly construed for, as the

U.S. Supreme Court has noted, "exceptions to the demand for every man's evidence are not lightly created nor expansively construed, for they are in derogation of the search for truth." *U.S. v. Nixon*, 418 U.S. 683, 709-710, 41 L. Ed. 2d 1039, 94 S. Ct. 3090 (1974). ²⁷

The time has arrived for the minority of Circuit Courts denying discovery of hospital rules, protocols, policies, and procedures to take a fresh look at their position, particularly in view of the more recent *Riverside Hospital* decision. The better-reasoned approach is to take a narrower view of the statutory "peer review" privilege and allow discovery of these materials since they are not actually part of the "peer review" deliberations and discussions and since the materials may well lead to the discovery of admissible evidence. Whether the materials will ultimately be admissible in whole or in part at trial, and for what purpose or purposes, are determinations which can and should be made after they are produced in discovery and the case is mature for trial. ☐

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² See *Hubbard v. Pascual*, 71 Va. Cir. 265 (Portsmouth Cir. Ct. 2006); *Auer v. Baker*, 63 Va. Cir. 596 (Norfolk Cir. Ct. 2004); *Saunders v. Gottfried*, 61 Va. Cir. 641 (Chesterfield Cir. Ct. 2002); *Day v. Medical Facilities of America, II, L.P.*, 59 Va. Cir. 378 (Salem Cir. Ct. 2002); *Levin v. WJLA-TV*, 51 Va. Cir. 57 (Fairfax County Cir. Ct. 1999); *Bradburn v. Rockingham Memorial Hospital*, 45 Va. Cir. 356 (Rockingham Cir. Ct. 1998); *Owens v. Children's Hospital of the King's Daughters, Inc.*, 45 Va. Cir. 97 (Norfolk Cir. Ct. 1997); *Pipkin v. Pleasant Care, Inc.*, 43 Va. Cir. 443 (Chesapeake Cir. Ct. 1997); *Messerly v. Avante Group, Inc.*, 42 Va. Cir. 26 (Rockingham Cir. Ct. 1996); *Stevens v. Hosp. Auth. For the City of Petersburg*, 42 Va. Cir. 321 (Richmond City Cir. Ct. 1997); *Stevens v. Lemmie*, 40 Va. Cir. 499 (Petersburg Cir. Ct. 1996); *Houchens v. Univ. of Va.*, 23 Va. Cir. 202 (Charlottesville Cir. Ct. 1991); *Curtis v. Fairfax Hospital Systems, Inc.*, 21 Va. Cir. 275 (Fairfax County Cir. Ct. 1990); *Sawyer v. Childress*, 12 Va. Cir. 184, 188 (Norfolk Cir. Ct. 1988); *Hedgepeth v. Jesudian*, 12 Va. Cir. 221 (Richmond City Cir. Ct. 1988); *Johnson v. Roanoke Memorial Hospitals, Inc.*, 9 Va. Cir. 196 (Roanoke City Cir. Ct. 1987).

³ See *Colston v. Johnston Mem. Hosp.*, 49 Va. Cir. 540 (Chesterfield Cir. Ct. 1998); *Mangano v. Kavanaugh*, 30 Va. Cir. 66 (Loudoun Cir. Ct. 1993); *Riordan v. Fairfax Hospital System, Inc.*, 28 Va. Cir. 560 (Fairfax Cir. Ct. 1988); *Leslie v. Alexander*, 14 Va. Cir. 127 (Alexandria Cir. Ct. 1988); *Francis v. McEntee*, 10 Va. Cir. 126

(Henrico Cir. Ct. 1987).

⁴ See, e.g., *Riordan v. Fairfax Hosp. Systems, Inc.*, 28 Va. Cir. 560 (Fairfax County Cir. Ct. 1988); *Leslie v. Alexander*, 14 Va. Cir. 127 (Alexandria Cir. Ct. 1988); *Francis v. McEntee*, 10 Va. Cir. 126 (Henrico County Cir. Ct. 1987).

⁵ See *Virginia Ry. & Power Co. v. Godsey*, 117 Va. 167, 83 S.E. 1072 (1915); *Pullen v. Nickens*, 226 Va. 342, 310 S.E.2d 452 (1983).

⁶ 193 Va. 400, 69 S.E.2d 320 (1952) (relied upon in *Curtis v. Fairfax Hospital Systems, Inc.*, 21 Va. Cir. 275 (Fairfax County Cir. Ct. 1990)).

⁷ 193 Va. 400, 408-409, 69 S.E.2d 320, 325-326 (1952).

⁸ See *Alfonso v. Robinson*, 257 Va. 540, 546, 514 S.E.2d 615, 619 (1999) (“A critical characteristic distinguishing the present case from those two cases [two previous cases in which there was insufficient evidence of willful and wanton conduct] is that Alfonso was a professional driver who had received specialized safety training warning against the very omissions he made prior to the accident. As stated above, Alfonso admitted at trial that he was instructed that the deployment of safety flares and reflective triangles was the first act that should be taken after securing a disabled truck. He knew that the purpose of such safety devices was to warn motorists that they were approaching a stopped vehicle. Despite this training and knowledge, Alfonso consciously elected to leave the disabled truck in a travel lane of an interstate highway without placing any warning devices behind it.”).

⁹ See *Houchens v. Rector and Visitors of the Univ. of Va.*, *supra*.

¹⁰ See, e.g., *Riverside Hospital, Inc. v. Johnson*, 272 Va. 518, 636 S.E.2d 416 (2006).

¹¹ *Stevens v. Hospital Auth. of Petersburg*, 42 Va. Cir. 321, 329 (Richmond City Cir. Ct. 1997) (emphasis added).

¹² *Bly v. Rhoads*, 216 Va. 645, 653, 222 S.E.2d 783, 789 (1976).

¹³ *Curtis*, *supra*, 21 Va. Cir. at 278-279. A law review article has suggested the same approach: “Patient care standards . . . do not ultimately define the defendant’s duty. . . . The standards, along with learned treatises and [testimony of] expert witnesses, simply represent some concrete evidence of that duty and assist the trier of fact in determining the relevant standard of care. . . . Invariably, a defendant hospital’s employees admit under oath that knowledge of relevant standards and substantial compliance with them is a basic part of their orientations training and a required part of their job description.” Schockemoehl, “Admissibility of Written Standards as Evidence of the Standard of Care in Medical and Hospital Negligence Actions in Virginia,” 18 *U. Rich. L. Rev.* 725, 742-743 (1984).

¹⁴ See, e.g., *Tazewell Oil Co. v. United Va. Bank*, 243 Va. 94, 110, 413 S.E.2d 611, 620 (1992) (expert witness was properly prohibited from testifying because he was not shown to be familiar with acceptable commercial standards within the banking industry).

¹⁵ *Curtis*, *supra*, 21 Va. Cir. at 279.

¹⁶ *Va. Sup. Ct. Rules*, Rule 4:1(b).

¹⁷ 272 Va. 518, 636 S.E.2d 416 (2006).

¹⁸ 272 Va. at 529, 636 S.E.2d at 422.

¹⁹ 272 Va. at 533, 636 S.E.2d at 424.

²⁰ *HCA Health Services of Virginia, Inc. v. Levin*, 260 Va. 215, 221, 530 S.E.2d 417, 420 (2000).

²¹ The Virginia Supreme Court explained:

A literal application of the phrase “all communications, both oral and written, . . . provided to such committees” would impress the privilege on every document and every statement made available to a committee or entity identified in the statute. Such an application would allow a health care facility to immunize from disclosure every statement or document maintained by the facility simply by insuring that such statement or document was provided or available to a peer or quality review committee. Considering this phrase in the context of the entire section, however, shows that the General Assembly did not intend such a broad application of the privilege. For example, the privilege attaching to oral communications regarding a specific medical incident involving patient care is limited. *Code* § 8.01-581.17(B). Similarly, the section is not to “be construed” as applying the privilege to the facility’s medical records of a specific patient kept in the ordinary course of operating such facility, or to evidence of a patient’s treatment or hospitalization kept in the ordinary course of the patient’s hospitalization. *Code* § 8.01-581.17(C). These limitations on the application of the privilege are consistent with preserving the confidentiality of the quality review process while allowing disclosure of relevant information regarding specific patient care and treatment.

272 Va. at 532-533, 636 S.E.2d 424. Interpreting the statutory privilege to encompass and protect hospital policies and procedures involves an overly broad interpretation which would protect any and all documents that pass through or are disseminated by a peer review committee regardless of whether they actually contain confidential peer review deliberations and information.

²² See House Bill No. 382 (offered January 9, 2008).

²³ *Curtis v. Fairfax Hospital Systems, Inc.*, 21 Va. Cir. 275, 280 (Fairfax Cir. Ct. 1990).

²⁴ *Johnson*, *supra*, 9 Va. Cir. 202.

²⁵ *Robertson v. Commonwealth*, 181 Va. 520, 540, 25 S.E.2d 352, 360 (1943) (“Since exemption from production is the exception and not the rule, the burden is on the party claiming the privilege to show that he is entitled to it. His mere assertion that the matter is confidential and privileged will not suffice. Unless the document discloses such privilege on its face, he must show by the circumstances that it is privileged.”).

²⁶ *Levin v. WJLA-TV*, 51 Va. Cir. 57 (Fairfax Cir. Ct. 1999).

²⁷ *Curtis v. Fairfax Hospital Systems, Inc.*, 21 Va. Cir. 275, 277 (Fairfax County Cir. Ct. 1999). ☒

We've Got to Go Where? The Trials and Tribulations of Litigating Venue Disputes in Virginia State Courts

Josh Long

For many reasons, sound and otherwise, venue disputes often arise between litigants. Everyone wants a home court advantage and no one wants to go on the road. When it comes to venue for litigation, we all subscribe to the scheduling philosophy of Virginia Tech football and Duke basketball. The problem is we can't all play all of our out-of-conference games at home.

While perhaps based on exaggerated or imagined regional differences, the fact remains that many Northern Virginians would prefer not to litigate in Southside, many Southwest Virginians would prefer not to litigate in Tidewater, and vice versa. Comfort and familiarity is not readily relinquished. Moreover, when large distances are involved, the time and expense differential between litigating in one's home forum and having to travel to the opposite end of the Commonwealth can be substantial, if not prohibitive.

Despite the importance of these issues and the frequency with which they arise, there is a notable lack of guidance from the General Assembly and Virginia state courts for resolving venue disputes. When these uncertainties are combined with the natural propensities of so many in our profession, venue disputes often become a sideshow and assume a life of their own.

WHERE IS VENUE PROPER?

In Virginia, every action shall be commenced and

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tried in a forum convenient to the parties and witnesses, where justice can be administered without prejudice or delay.¹

Except for habeas corpus proceedings, certain tax proceedings and juvenile and domestic relations proceedings concerning children, the venue for any action is proper only if laid in accordance with the provisions of Virginia Code §§ 8.01-261 and 8.01-262.²

Section 8.01-261 establishes preferred places of venue for certain specified actions.³ For all other actions, which include most civil disputes, Section 8.01-262 establishes that "one or more of the following counties or cities shall be permissible forums:" (1) where the defendant resides or has his or her principal place of employment (or where a corporate defendant's chief officer resides); (2) where the defendant has a registered office or has appointed an agent to receive process (or in the event a defendant has withdrawn from Virginia where venue was proper at the time of withdrawal); (3) where the defendant regularly conducts substantial business activity; (4) where the cause of action, or any part thereof, arose; (5) in actions to recover or partition personal property, where the property is physically located, where the evidence of such property is located or if neither applies where the plaintiff resides; (6) in actions against a fiduciary as defined in § 8.01-2 appointed under court authority, where such fiduciary qualified; (7) in actions for improper message transmission or misdelivery where the transmission or misdelivery occurred; (8) in actions arising based on delivery of goods, wherein the goods were received; (9) in no other forum is available under (1) through (8) above, where the defendant has property or debts owing to him subject to seizure by any civil process; or (10) where any of the plaintiffs reside if (a) all of the defendants are unknown or are nonresidents of Virginia or if (b) there is no other preferred or permissible venue.⁴

Of these ten categories of permissible venue, categories (1), (2), (3), (4) and (8) appear to be the most frequently utilized. Plaintiffs with little interest litigating a dispute in their adversary's home forum frequently elect to file an action in their own home forum (or some other forum perceived to be favorable to them or at least neutral) claiming that (3) the defendant regularly conducts substantial business activity there; and/or (4) the cause of action, or any part thereof, arose there. The issue then becomes whether either of these bases for venue can be demonstrated.

DOES DEFENDANT DO ENOUGH BUSINESS THERE?

Until 2004, Section 8.01-262(3) created permissible venue “wherein the defendant regularly conducts affairs or business activity.” In 2004, the General Assembly modified this statutory language, requiring that a defendant “regularly conducts *substantial* business activity” in order to establish proper venue.⁵ Regular business activity is more than casual or occasional visits over time.⁶ In this context, regular means “[s]teady or uniform in course, practice, or occurrence; not subject to unexplained or irrational variation.”⁷

While the amended statute is more stringent in terms of the nature and extent of business activity required, there is nothing to suggest that such activity necessarily must occur at a greater frequency. Consistent with the pre-amendment case law, there still does not appear to be any requirement that business activity occur at specific, periodic intervals such as weekly or monthly.⁸

Venue likely is permissible so long as the defendant consistently conducts its business or its affairs or responds to business opportunities in the forum.⁹ Regularly promoting oneself and advertising to potential customers in the forum may establish permissible venue under Section § 8.01-262(3).¹⁰

DID PART OF THE CAUSE OF ACTION ARISE THERE?

Section 8.01-262(4) creates permissible venue wherein “the cause of action, *or any part thereof*, arose.” Consistent with this statutory language, Virginia courts have long recognized that there may be multiple forums in which a cause of action or a part thereof arises.¹¹

In contract cases, a cause of action arises where the contract is made or where any breach takes place.¹² Formation and breach may occur in different places.¹³ A contract is formed at the location of the final act that makes the contract binding, which typically is the final signing required to execute the contract.¹⁴ A breach of contract occurs where the defendant failed to perform his or her obligations.¹⁵

Depending on the type of contract alleged and the nature of the alleged breach, determining the location of the breach may be complicated or relatively straight forward. For example, in an action for breach of a payment guarantee contract, Virginia courts have recognized that the nonpayment occurs where the payee resides because, unless the parties agreed otherwise, that

is where the receipt of payment would logically have been expected.¹⁶ While plaintiffs tend to believe otherwise, not every contractual dispute is a mere collection action. For example, in a sale of goods setting, the breach may occur where the transaction was intended to be consummated or where the products at issue were delivered.¹⁷

WHEN CAN A DEFENDANT OBJECT OR MOVE TO TRANSFER?

Under Virginia Code § 8.01-264, absent an extension to file responsive pleadings, a defendant has twenty one (21) days from service of the summons and complaint in which to file an objection to venue or move to transfer venue. If there is another forum within Virginia where venue is proper, the remedy for improper venue is transfer not dismissal. Objecting to venue is a privilege, which may be waived and must be timely claimed otherwise it will be lost.¹⁸

A defendant also may move for change of venue under Section 8.01-265, which provides that the Court wherein an action is commenced may, upon motion and for good cause shown, transfer the action to any fair and convenient forum having jurisdiction within Virginia. Good cause includes, but is not limited to, the agreement of the parties or the avoidance of substantial inconvenience to the parties or the witnesses, or complying with the law of any other state or the United States.

Because there is uncertainty concerning whether a venue objection or motion to transfer venue qualifies as a responsive pleading, defendants typically elect to file their venue objections and motions in conjunction with an answer, demurrer or motion for bill of particulars to avoid the possibility of a default.¹⁹

WHAT STANDARD NEEDS TO BE MET TO OBTAIN A TRANSFER?

Venue statutes generally afford a plaintiff a choice of appropriate forums. The choice insures that the plaintiff will be able to prosecute his cause, and usually allows him to choose a place which he considers most suitable.²⁰ A presumption of correctness attaches to the plaintiff's choice of forum.²¹ To secure a change in venue, defendant has the burden of showing that there is good cause to transfer the case to another forum.²²

Virginia Code § 8.01-265 does not authorize trial

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courts to transfer actions from the plaintiff's chosen forum to another forum merely because the other forum might be more convenient. Rather, the party seeking transfer must prove that the transfer is necessary for "the avoidance of substantial inconvenience to the parties or the witnesses." Section 8.01-265 does not provide for the transfer of a case from one forum to another based upon the standard that one forum is 'fair and substantially more convenient' than another forum. Rather, good cause is defined in the statute as the avoidance of substantial inconvenience to the parties or the witnesses.²³

The seminal Virginia case on venue transfer is *Norfolk and Western Ry. Co. v. Williams*, 239 Va. 390, 389 S.E.2d 714 (1990). In *Williams*, the Supreme Court of Virginia noted that the factors to be considered in motions to transfer include "the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling, and the cost of obtaining attendance of willing witnesses; possibility of a view of premises, if a view would be appropriate to the action; and all other practical problems that make trial of a case easy, expeditious and inexpensive." *Id.* at 395 (adopting federal factors from *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947)).

Applying these factors, the *Williams* court upheld the transfer of an action from Portsmouth to Roanoke because all but one of the liability and damages witnesses lived or worked in Roanoke (which is 284 miles from Portsmouth), the injury occurred in Roanoke, and the only reason venue was permissible in Portsmouth was the happenstance that "N&W's railroad tracks run through Portsmouth, requiring N&W to engage in business in that city, thereby making Portsmouth a proper choice of venue." The Court observed: "By holding a trial in Portsmouth, the witnesses faced the inconvenience of being away from families, homes, and jobs while traveling to Portsmouth to testify, regardless of who made the arrangements and paid for the travel expenses. Not one potential witness was from Portsmouth and would be spared this imposition." *Id.*

In *Virginia Elec. and Power Co. v. Dungee*, 520 S.E.2d 164, 170 (Va. 1999), the Supreme Court of Virginia restated the *Williams* factors to consider in reviewing a request for transfer of venue to include the following: (1) cost of witness attendance (and avoiding substantial inconvenience to the parties and witnesses); (2) accessibility of sources of proof; (3) availability of compulsory process of witnesses; (4) the potential need for a view of the premises; and (5) the absence of other practical problems making trial of a case easy, expeditious and inexpensive.

Applying these factors, the *Dungee* court held that the trial court correctly refused to transfer to the City of Richmond an action that was filed in Charles City County because, while the injury occurred in Richmond and the case had no nexus with Charles City County, Charles City County was sufficiently close to the City of Richmond that there was no "substantial inconvenience" to the parties and witnesses in retaining the action in Charles City County, and thus no good cause to transfer. *Id.*

Read together, the *Williams* and *Dungee* decisions suggest that relatively minor differences between the forums cannot estab-

lish the substantial inconvenience necessary to justify a transfer of venue for good cause. *Id.* The holdings of several Virginia Circuit Courts are consistent with this interpretation. See *Wray v. Floyd & Beasley Transfer Co.*, 29 Va. Cir. 126 (City of Richmond Cir. Ct. 1992) (rejecting defendant's motion to transfer case to South Hill where plaintiff fell and sustained his injuries because, although South Hill may have a stronger nexus, traveling the distance of 80 miles to Richmond does not represent a substantial inconvenience); See *Gentry v. Toyota Motor Sales*, 29 Va. Cir. 140 (City of Richmond Cir. Ct. 1992) (transferring action to Danville because virtually all of the witnesses (including the plaintiffs) in a products liability action were located in or near Danville and conducting a trial 140 miles away in Richmond would be substantially inconvenient). To hold otherwise would frustrate the General

Section 8.01-265 does not provide for the transfer of a case from one forum to another based upon the standard that one forum is 'fair and substantially more convenient' than another forum. Rather, good cause is defined in the statute as the avoidance of substantial inconvenience to the parties or the witnesses.

Assembly’s statutory provisions expressly establishing numerous alternative permissible venues and affording plaintiffs multiple choices.

In the event that the Court sustains a venue objection and transfer the action pursuant to 8.01-264 or determines that a motion to transfer venue was frivolous, the Court award costs in an amount necessary to compensate the prevailing party for the inconvenience, expense, and delay to which he or she has been subjected.²⁴

WHAT HAPPENS WHEN THE PARTIES FILE RELATED ACTIONS IN SEPARATE PERMISSIBLE FORUMS AND PURSUE COMPETING VENUE TRANSFER MOTIONS?

There does not appear to be any established mechanism or procedure, let alone any precedent, in the Virginia state system for resolving venue disputes where actions with a common nexus have been filed in separate permissible forums and competing motions to transfer venue are being pursued.

Conversely, in the federal system, courts follow the “first to file” rule. This rule provides that, other factors with respect to change of venue being equal, the case ought to be tried in the district court in which it was first filed.²⁵ While federal courts look with disfavor upon races to the courthouse, procedural fencing and forum shopping,²⁶ the fact that the first suit is a mirror image of the second or merely seeks declaratory relief will not necessarily change the general rule that the first-filed case should go forward.²⁷

Federal courts likewise provides guidance on another issue on which the Virginia state courts are silent: the sequence in which competing venue transfer motions should be heard. In the federal system, the court in which the proceeding was filed first is the appropriate forum to decide the venue and transfer issues.²⁸ This approach avoids the possibility of

inconsistent rulings on discretionary matters as well as the duplication of judicial effort.²⁹ As Virginia federal courts have recognized, sound judicial discretion dictates that the second court decline its consideration of the action before it until the prior action before the first court is terminated.³⁰

Despite the fact that competing venue scenarios are fairly routine (occurring, for example, when a plaintiff files in its home forum a breach of contract action for non-payment on delivered goods and defendant responds not by asserting a counterclaim but by filing in its home forum a breach of warranty action for losses resulting from defects in those same goods and both parties move to transfer venue to their home forum), there do not appear to be any specific rules in Virginia for addressing them. Although it is conceivable that both venue transfer motions could be denied and the related actions be allowed to proceed in separate forums, many judges and litigants would consider this to be an undesirable and inefficient result.

Given the absence of any standards for evaluating competing venue transfer motions, Virginia courts tend to fallback on the *Williams* factors to determine which is the superior forum for the adjudication of the dispute.

In conducting this comparative analysis, these courts typically will focus on which forum: (1) minimizes cost of witness attendance and inconvenience to witnesses; (2) offers greater accessibility of sources of proof; and (5) avoids practical problems and makes trial of the case easy, expeditious and inexpensive. When choosing between competing forums (3) the availability of compulsory process of witnesses is typically insignificant because Virginia residents can be compelled to testify anywhere in the Commonwealth.³¹ Likewise, (4) the opportunity for a view of the premises is often irrelevant because a premises view is unnecessary in most types of actions. In many instances, the court’s comparative analysis will turn on each forum’s

In the event that the Court sustains a venue objection and transfer the action pursuant to 8.01-264 or determines that a motion to transfer venue was frivolous, the Court award costs in an amount necessary to compensate the prevailing party for the inconvenience, expense, and delay to which he or she has been subjected.

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connection to the dispute and the location of the witnesses and documents.

From a practical perspective, given that the moving party has the burden of showing that there is good cause to transfer the case to another forum, a litigant may gain some advantage by having the adversary's venue transfer motion heard first in its chosen forum. On the other hand, this approach could backfire if the adversary successfully obtains the transfer of the litigant's action to the adversary's chosen forum, which in all likelihood also would cause the litigant's venue transfer motion to be denied. Rather than overanalyze this sequence issue, the parties may be better served by focusing their time and energy on application of the *Williams* factors. ☒

¹ Virginia Code § 8.01-257; see *City of Danville v. Virginia State Water Control Bd.*, 18 Va. App. 594, 597, 446 S.E.2d 466, 468 (Va. App. 1994).

² Virginia Code §§ 8.01-259 and 8.01-260.

³ These include: (1) actions involving state administrative regulations; (2) actions against officers of the Commonwealth in an official capacity, (3) actions to recover or partition land; to subject land to a debt; to sell, lease, or encumber the land of persons under disabilities, to sell wastelands, to establish boundaries, for unlawful entry or detainer, for ejectment; or to remove clouds on title; (5) certain actions for writs of mandamus, prohibition, or certiorari; (6) actions on bonds required for public contract; (7) actions to impeach or establish a will; (10) actions on any contract between a transportation district and a component government; (11) attachments; (12) any action for the collection of state, county, or municipal taxes or the correction of an erroneous assessment of state taxes and tax refunds; (14) proceedings by writ of quo warranto; (15) proceedings to award an injunction; (17) disbarment or suspension proceedings against any attorney-at-law; (18) actions under the Virginia Tort Claims Act; (19) suits for annulment, affirmance, or divorce; and (20) distress actions.

⁴ Another pertinent venue statute, Va. Code § 8.01-262.1, provides that where a Virginia company enters into a construction related contract, any cause of action arising under such contract may be brought where the construction project is located or in any other forum in which venue is proper under Virginia Code §§ 8.01-261 and 8.01-262.

⁵ *Barnett v. Kite*, 271 Va. 65, 69, 624 S.E.2d 52, 54 (Va. 2006).

⁶ *Meyer v. Brown*, 256 Va. 53, 57, 500 S.E.2d 807, 810 (Va. 1998).

⁷ *Id.*

⁸ *Peaks v. Environmental Laboratories, Inc.*, 34 Va. Cir. 484, 1994 WL 1031356, at *1 (City of Richmond Cir. Ct. 1994).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Big Seam Coal Corp. v. Atlantic Coast Line R. Co.*, 196 Va. 590, 593, 85 S.E.2d 239, 241 (1955); see also *S. Galeski Optical Co. v. Blum*, 1984 WL 276349, at *1 (City of Richmond Cir. Ct. 1984) (holding that venue was permissible in Richmond where Galeski allegedly failed to perform services and manufacture optical goods for respondents, even though respondents alleged that Galeski's default was based on its failure to make timely delivery in Roanoke); *Carter Machinery Co., Inc. v. The Prism Group, Inc.*, 23 Cir. CL0298 (2002) (in claims arising from a breach of contract, the long-standing rule in the Commonwealth has been that the cause of action consists of two parts: first, the contract which imposes the obligation; and second, any breach or failure to perform the specified obligation in accordance with the contract's terms).

¹² *Rector v. Approved Financial Corp.*, 48 Va. Cir. 329, 1999 WL 262437, at *2 (Cir. Ct. of Va. 1999).

¹³ *Big Seam Coal Corp.*, 196 Va. at 593, 85 S.E.2d at 241.

¹⁴ *Black v. Powers*, 48 Va. App. 113, 129-30, 628 S.E.2d 546, 554 (Va. App. 2006); see *Southeastern Textile Machinery, Inc. v. H. Warshaw & Sons, Inc.*, 2006 WL 213723, at *4 (W.D. Va. 2006) ("Virginia law has long held that the place of contracting is the place where the last act occurred that made the contract binding").

¹⁵ *Wasson v. Engineering and Economics Research, Inc.*, 20 Va. Cir. 133, 1990 WL 751104, at *1 (Westmoreland County Cir. Ct. 1990).

¹⁶ *Noland Co. v. Aden*, 1 Va. Cir. 201, 1980 WL 143175, at *2 (City of Roanoke Cir. Ct. 1980).

¹⁷ Under this scenario, venue also may be proper in this same forum under Virginia Code § 8.01-262(8), which provides that "in actions arising based on delivery of goods" venue is permissible "wherein the goods were received." This venue provision may apply to both breach of contract and products liability actions.

¹⁸ *Morgan v. Pennsylvania R. Co.*, 148 Va. 272, 278, 138 S.E. 566 (1926).

¹⁹ Rule 3:8(a) provides an exhaustive list of responsive pleadings: in addition to an "answer," "[a] demurrer, plea, motion to dismiss, and motion for a bill of particulars shall each be deemed a pleading in response for the count or counts addressed therein." Venue objections and motions to transfer venue are not listed as responsive pleadings in Rule 3:8, presumably because they do not address or respond to the allegations of the Complaint. Nevertheless, the Supreme Court of Virginia has sent mixed messages as to whether a venue objection or motion is a responsive pleading. Compare *Harrison Motor Co. v. Newsome*, 253 Va. 129, 132, 480 S.E.2d 741 (1997) ("The defendants filed numerous responsive pleadings including substantially similar pleadings styled 'Objection to Venue and Motion to Transfer'") with *Turner v. Thiel*, 262 Va. 597, 599, 553 S.E.2d 765 (2001) ("defendants filed responsive pleadings and a motion to transfer venue . . ."). See also *American Express Centurion Bank v. Global Express, Inc.*, 58 Va. Cir. 494, n. 1, 2002 WL 31431872, at *1, n. 1 (Fairfax County Cir. Ct. 2002)

(“motion to transfer venue may be a responsive pleading”).

²⁰ *Norfolk and Western Rwy. Co. v. Williams*, 239 Va. 390, 392, 389 S.E.2d 714 (1990).

²¹ *Id.*; *Grubbs v. Southern Ry.*, 19 Va. Cir. 367, 369, 1990 WL 751159, at *2 (City of Richmond Cir. Ct. 1990) (“As the legislature has given plaintiffs a wide variety of choices of venue, presumably it has determined that selecting a ‘happy hunting ground’ is the prevailing policy of this state”).

²² *Virginia Power v. Dungee*, 258 Va. 235, 245, 520 S.E.2d 164 (1999)

²³ *City of Danville v. State Water Control Bd.*, 18 Va. App. 594, 598, 446 S.E.2d 466 (1994).

²⁴ Va. Code. § 8.01-266.

²⁵ *Ellicott Mach. Corp. v. Modern Welding Co., Inc.*, 502 F.2d 178, 180 n.2 (4th Cir. 1974) (citing *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508 (1947)).

²⁶ *Learning Network, Inc. v. Discovery Commc'ns, Inc.*, 11 Fed. Appx. 297, 301, 2001 WL 627618 (4th Cir. 2001)

²⁷ *Genentech v. Eli Lilly & Co.*, 998 F.2d 931, 937 (Fed.Cir. 1993), abrogated on other grounds, *Wilton v. Seven Falls Co.*, 515 U.S. 277, 288-89 (1995); *SAS Institute, Inc. v. Practicingsmarter, Inc.*, 353 F. Supp. 2d 614, 617 (M.D.N.C. 2005). See *Schnadig Corp. v. Collezione Europa U.S.A.*, 2001 WL 766898, at *1 (N.D.Ill. July 5, 2001) (noting that when two parallel actions are filed, “the general rule is that the forum of the first-filed suit is favored, regardless of whether it is the declaratory judgment action”). See also *Sumitomo Elec. Indus., Ltd. v. Corning, Inc.*, 169 F. Supp. 2d 440, 443-48 (M.D.N.C. 2001) (embracing first-filed declaratory judgment action wherein jurisdictional prerequisites were met).

²⁸ *Affinity Memory & Micro, Inc. v. K & Q Enterprises, Inc.*, 20 F. Supp.2d 948, 954 (E.D.Va. 1998).

²⁹ *Id.* at 954 n.11

³⁰ *Id.*; see *J. W. Rayder v. Abtna Govt. Servs. Corp.* Va. Code. § 8.01-409. ☒

Unhappy People – When Your Client Wants to Dissolve a Closely Held Business

Kathleen L. Wright

Whatever the underlying cause, a dispute between people involved in a family or closely held business enterprise can quickly become as bitter as any divorce.¹ Don't be too quick to rush off to the courthouse, though — courts still generally disfavor judicial dissolution.²

When one of the unhappy parties appears in your office seeking advice, make sure you start off on the proper footing by gathering some basic information. Careful consideration of the situation may reveal alternatives to litigation that provide a win-win solution for the parties (or less of a lose-lose).

Develop a strategy to reach the desired goal. The first step in this process is to identify the goal. Does your client want to close the business and retire or move into a new field? Would he rather remove a problem owner or manager and continue the business? Is the problem with current operations or is the problem one that your client foresees developing in the future and hopes to avoid? Does he want to change the business' direction, add to or subtract from the business' current activities, or stay the course?

You may be able to identify more than one goal, or a hierarchy of goals starting with the most desirable objective and then secondary or "back-up" goals. Your client may not have a clear idea of the desired result, and may be eager to leap into battle. Taking the time

to clarify and define "success" for this particular unhappy person will save a lot of time and wasted effort.

The next step in the process is identifying the problem. What is blocking the intended result? "A problem stated is well on its way to solution."³ Try to identify the key elements of the disagreement from both sides.

In order to develop a strategy to meet the determined goal, you will need to collect information:

What type of business entity is involved? Is it a corporation or some type of limited liability company (LLC)? If there is more than one business, how are they related? For example, a closely held corporation may be owned by one individual, a trust, and a limited liability company.

How is the business managed? As soon as possible, you will need to collect (and read) copies of any document that affects the management or operation of the business. The obvious place to start is with the business' articles of incorporation, operating agreement and/or bylaws; however you will also need to ask about shareholder agreements, stock purchase agreements, employment contracts, intellectual property agreements or other contracts involving the directors, officers, members, or key employees.⁴ If the business was purchased recently, in whole or in part, an asset purchase agreement may include agreements as to shares, membership, or property that may affect an attempted dissolution. A limited liability company may be member-managed or manager-managed, and the management and voting structure will be important.

In many small businesses, members, officers, directors and shareholders do not follow the requirements of the operating agreement.⁵ However, in an adversarial climate, those requirements must be followed. Particularly in areas that touch on due process concerns, such as adequate notice of meetings or votes, the letter of any agreement should be strictly followed.

Who is your client? As with all cases dealing with entities, make sure you know who your client is and whether he, she or it meets the requirements for filing a judicial dissolution action. Corporate dissolution actions may be filed by shareholders, certain creditors, the corporation (voluntarily) or the board of directors

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under specific circumstances.⁶ If your client inherited shares in a business or received shares by gift or purchase, make sure any stock transfer requirements were fulfilled. A member of an LLC may request judicial dissolution of the LLC.⁷

Identifying your client includes clarifying responsibility for your fees and any costs. The person seeking to hire you must have the authority to hire counsel on his own behalf or on behalf of any entity or group involved. The title of “President” of a corporation has no inherent power; the president may only exercise authority granted by the board of directors or bylaws.⁸ Individual corporate directors are not agents of the corporation; boards of directors must act collectively as a board to bind the corporation.⁹ An LLC must operate in accordance with its operating agreements. This is particularly important if you may be defending against a dissolution suit. For example, when one of two 50% shareholders files for dissolution, may the other owner hire counsel to defend the company? That will depend on the other roles the shareholder fills, the standard operating procedures in the business, and the controlling agreements.¹⁰ If you do not have a clear mandate from the business entity to represent its interests, be prepared to justify your appearance in the case.

Next, who are the people involved, and what positions do they hold? Frequently in small businesses, people wear more than one hat. The same three or four individuals may be acting as shareholders, directors, officers, and employees of the corporation.¹¹ A limited liability company may include a member-manager with more power and authority than other members.

Corporate officers and directors owe fiduciary duties to the corporations they serve, as do LLC managers.¹² Employees generally owe a fiduciary duty of honesty and loyalty to their employers. Does the director/shareholder filing a dissolution action violate her fiduciary duty to the company? What about an employee/shareholder? There may not be clear answers to these questions,¹³ but you and your client must be aware of these duties and responsibilities from both an offensive and defensive point of view.

Look for alternatives to filing suit. The risks and costs of litigation are well known to lawyers. In some cases, a small business may not have enough assets to support

the cost of a dissolution suit or adequate funds to pay a receiver. Even if your client prevails in obtaining a judicial dissolution, he may be left with nothing but the emotional satisfaction of being able to move away from the conflict and dissension of dealing with the other parties. In some situations there may be a less costly and more satisfying solution.

Change in position: Can your client force the removal of a director, officer or employee who is causing conflict? Can your client resign from a position she is holding; sell her stock or remove herself from the situation in a satisfying way?

Buy out: Can one or more of the parties buy out the conflicting parties’ interest?

Removal of a minority interest: A “squeeze out” or “freeze out” refers to the use of strategic position, legal device or power of control of the shares or management of a business to eliminate a member or owner.¹⁴ This type of maneuver can be performed well or poorly. For example, in *Willard v. Moneta Building Supply, Inc.*,¹⁵ a corporation with only a husband and wife as directors marshalled the sale of all of the company’s assets to a new corporation owned by their son, against the wishes of a minority shareholder. Although this transaction involved a possible conflict of interest for the parent/directors, the Virginia Supreme Court held that the transaction was fair to the corporation,¹⁶ that the directors had met the statutory standard for discharge of their duties,¹⁷ and had not acted oppressively with regard to the sale of assets.¹⁸ This conclusion was based on the observance of notice procedures and other corporate formalities and the fact that an independent business valuation supported the fairness of the purchase price.

Removal of a member of the LLC: Virginia Code § 13.1-1040.1 lists several grounds for dissociation of a member of an LLC, as long as the statutory grounds are not in conflict with the articles of organization or operating agreement of the LLC. These grounds include a judicial determination of dissociation.¹⁹

Compromise: Does your client have anything that the other party may want? Is there room for compromise or an entirely new avenue of approach that has not occurred to the parties?

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Consider the tax consequences of any possible plan of action. A misstep with regard to tax consequences can be costly. If you do not have expertise in this area, a consultation with a tax professional may be well worth the money.

The last resort. If no better alternative is available, a suit for dissolution may be necessary. Before filing, make sure there are sufficient facts to meet the legal standard for dissolution. This may require calling meetings, forcing votes, or other actions to demonstrate the existence of a deadlock, oppressive behavior, or the failure of business operations. Consider having a court reporter attend a board meeting to document a deadlock. A request for dissolution is an equitable claim; the court is not required to decree dissolution. In equity, particularly, it is important to be the party on the side of fairness and right.

Virginia statutes regarding corporate dissolution vary slightly from the statutes dealing with LLCs. As an example, the Virginia Limited Liability Company Act²⁰ allows a court to decree the dissolution of a limited liability company when "it is not reasonably practicable to carry on the business in conformity with the articles of organization and any operating agreement."²¹ The Virginia Stock Corporation Act,²² and the Virginia Nonstock Corporation Act,²³ each provide more specific sections describing who may apply for judicial dissolution in various situations.²⁴ A circuit court may decree dissolution of a corporation when the directors are deadlocked to the extent that irreparable injury is threatened or "the business...of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock."²⁵ Other grounds for judicial dissolution of a corporation include illegal, fraudulent, or "oppressive" conduct by the directors or those controlling the corporation; shareholder deadlock; waste or misapplication of corporate assets; or a creditor's inability to satisfy a judgment against an insolvent corporation.²⁶

If you are dealing with a corporation, you must be aware that filing a request for judicial dissolution may leave your client vulnerable. Virginia law gives the corporation or other shareholders, in response to a judicial dissolution suit, 90 days to elect to purchase the shares

from a petitioning shareholder.²⁷ Once an election to purchase is made, the plaintiff may not non-suit or settle the action without the court's permission.²⁸ The plaintiff may not dispose of his shares without the court's permission.²⁹ There is no equivalent law relating to membership in an LLC.

When drafting a complaint, make sure to tell your client's story in a way that will allow a court to grant dissolution. Tell the story of the notices that were sent, the sources that were consulted, the opposing party's lack of cooperation or refusal to bargain. Explain the management system designed by the company and how your client has worked within the system without success. Tell the court about the opportunities that will be lost if the stalemate continues, and the years of preparation and work that will go to waste. Do not miss an opportunity during the litigation to show the court why your client is entitled to the remedy he seeks.

While business litigation rarely leaves the participants unscathed, a well-planned course of action may allow your client to reach his goals with only minimum unhappiness. And that should make him happy. ☒

¹ "When love ends, we cry out against destiny. When friendship ends, we cry out against our friend." Attributed to Mason Cooley. The Columbia World of Quotations. (Robert Andrews et al. eds., Columbia University Press 1996), <http://www.bartleby.com/66/55/14355.html>. (July 2001).

² See, e.g., Dunbar Group, LLC v. Tignor, 267 Va. 361, 367 (2004) ("The statutory standard set by the General Assembly for dissolution of a limited liability company is a strict one, reflecting legislative deference to the parties' contractual agreement to form and operate a limited liability company.")

³ Attributed to John Dewey. The Columbia World of Quotations. (Robert Andrews et al. eds., Columbia University Press 1996), <http://www.bartleby.com/66/85/16185.html>. (July 2001).

⁴ If the business operates in a highly regulated field, a strategy may be impacted by federal or state statutes or regulations.

⁵ Actions taken without following corporate or operating agreement formalities may still be binding on the company. See, Gowin v. Granite Depot, LLC, 272 Va. 246 (2006) (stating that the "corporate formalities" rule may be applied to LLC's.)

⁶ Va. Code § 13.1-747.

⁷ Va. Code § 13.1-1047.

⁸ Va. Code § 13.1-694; see, Clement v. Adams Bros.-Paynes Co., 113 Va. 547 (1912). The holding in Clement regarding a president's authority to sign affidavits without special authority has been affected by Va. Code § 49-7. In re Al-Wyn Food Distributors, Inc., 8 B.R. 42, 43 (Bankr. D. Fla. 1980) (the president of a corporation has no general power to file a bankruptcy petition, nor is such a power implied.) But see 2A William Meade Fletcher, Fletcher Cyclopedia of the Law of Private Corporations, §§ 618-619 (perm. ed., rev. vol. 2001) ("There is a body of respectable authority to the effect that a president of a corporation as such may employ and authorize counsel to initiate a suit in behalf of the corporation, especially where he or she is also general manager of the corporation, or where the attorney is hired to defend the corporation, or where the president who hired the attorney owns practically all of the corporate stock.")

⁹ Va. Code § 13.1-673. See, Monacan Hills, Inc. v. Page, 203 Va. 110 (1961).

¹⁰ See, e.g., In re Adorn Glass & Venetian Blind Corp., 2005 U.S. Dist. LEXIS 35291, 19-21 (D.N.Y. 2005) (referring to a stock purchase agreement to hold that a 60% owner's vote prevailed in a disagreement with the 40% owner) ("While inartfully drafted—perhaps not surprising for a two-person business—its intent appears unambiguous: for actions requiring approval by both parties, Brustowsky's decision prevails in the event of a disagreement. ... In Zion, the shareholders of a close corporation incorporated under Delaware law agreed that the corporation would not engage in certain business activities without the consent of a minority shareholder. As the New York Court of Appeals noted, Delaware law generally provides that the board of directors shall manage a corporation. ... However, further provisions permit written shareholder agreements that "restrict or interfere with the discretion or powers of the board of directors." [cite omitted] Such agreements should be reflected in the company's certificate of incorporation, but where that is not the case, a court will still enforce an agreement as between the consenting shareholders." Referring to Zion v. Kurtz, 50 N.Y.2d 92, 405 N.E.2d 681, 428 N.Y.S.2d 199 (N.Y. 1980) (applying Delaware law)). See, Conlee Constr. Co. v. Cay Constr. Co., 221 So. 2d 792 (Fl. Ct. App. 1969) (holding that a president may sue or defend a suit in a deadlock situation "where the need for action to preserve vital corporate interests was urgent." Id. at 795.)

¹¹ See, Curley v. Dahlgren Chrysler-Plymouth, Dodge, Inc., 245 Va. 429, 434 (1993) (holding that shareholders who ran the dealership on a daily basis, made acquisition and sales, and encumbered the corporation with debt assumed the roles of directors and officers even though they never formally elected directors or appointed officers).

¹² Gianotti v. Hamway, 239 Va. 14, 24 (1990) (corporate officers have the same duty to the corporation that a trustee owes a trust beneficiary); Flippo v. CSC Associates III, L.L.C., 262 Va. 48, 56-57 (2001) (even legal acts may breach a manager's fiduciary duties). See, Lyman Johnson, Misunderstanding Director Duties: The Strange Case of Virginia, 56 Wash & Lee L. Rev. 1127 (Fall 1999), for a discussion of the scope of director duties

under both common law and statute in Virginia.

¹³ See, e.g., Mary Siegel, Fiduciary Duty Myths in Close Corporation Law, 29 Del. J. Corp. L. 377, 378 (2004) ("It is ... odd how relatively little attention has been paid to the fundamental controversy over who is a fiduciary in a close corporation and the extent of that duty."). For a reference on officer and director duties, see, e.g., Edward Brodsky & M. Patricia Adamski, Law of Corporate Officers and Directors (2001) ("The precise standard of loyalty required may vary from situation to situation, and since the 'occasions for the determination of honesty, good faith and loyal conduct are many and varied, ... no hard and fast rule can be formulated.'" Id. at § 3.01, quoting Guth v. Loft, Inc., 23 Del Ch. 255, 5 A2d 503, 510 (1939)). Also, 13 William Meade Fletcher, Fletcher Cyclopedia of the Law of Private Corporations, § 5972.1 (perm. ed., rev. vol. 2004) (stating that a shareholder is not disqualified from filing a derivative suit as a shareholder simply because he or she is also a director).

¹⁴ F. Hodge O'Neal & Robert B. Thompson, Oppression of Minority Shareholders and LLC Members, § 1.1 (rev. 2d ed. 2004).

¹⁵ 258 Va. 140 (1999).

¹⁶ Id. at 156.

¹⁷ Id. at 153.

¹⁸ Id. at 158. Compare to Flippo v. CSC Associates III, LLC, 262 Va. 48 (2001) (upholding an award of damages and imposition of sanctions against an LLC manager who transferred the LLC's assets to a joint venture without prior notice to other members). See, Gregory J. Haley, It's the Sneaking Around that Gets You in Trouble: The key to unlocking fiduciary duty litigation claims, 53 VA. LAWYER 39 (No. 4 Dec. 2004).

¹⁹ Va. Code § 13.1-1040.1(5).

²⁰ Va. Code § 13.1-1000 *et seq.*

²¹ Va. Code § 13.1-1047.

²² Va. Code § 13.1-601 *et seq.*

²³ Va. Code § 13.1-801 *et seq.*

²⁴ See Va. Code §§13.1-747 (for stock corporations), and 13.1-909 (nonstock corporations)

²⁵ Va. Code § 13.1-747(A)(1)(a).

²⁶ Va. Code § 13.1-747.

²⁷ See, Va. Code § 13.1-749.1.

²⁸ Id.

²⁹ Id.



A Primer on Admiralty for the Virginia Litigator

Carl D. Gray

Most lawyers practicing in Virginia go their entire careers without ever encountering a case involving admiralty jurisdiction or the application of federal maritime law. But admiralty cases still frequently appear on the dockets of federal courts in Virginia. Also, because of the “saving to suitors” clause in 28 U.S.C. § 1333, admiralty cases may be filed in state courts. This article will provide an overview of admiralty jurisdiction and the application of federal maritime law in cases filed in Virginia state courts. It is designed to provide the Virginia practitioner with the basic knowledge required to spot admiralty jurisdiction and understand when maritime law may govern a case.

What is Admiralty Jurisdiction and Maritime Law

While the terms “admiralty” and “maritime” are frequently used interchangeably, this article draws a distinction between admiralty jurisdiction and maritime law. Admiralty jurisdiction is the jurisdiction of federal district courts to hear admiralty cases under 28 U.S.C. § 1333. Maritime law is the substantive law applicable to admiralty cases. It is a body of federal common law and federal statutes used for deciding cases within admiralty jurisdiction. It is often referred to as general maritime law or federal maritime law.

Why it Matters in State Court

Whenever a state court may provide a remedy to a claimant in an admiralty case, that case may be brought

in state court.¹ State courts may award money damages to admiralty claimants. Thus, many personal injury and contract claims that would otherwise qualify for federal admiralty jurisdiction may be brought in state as opposed to federal court.

Just because an admiralty case is brought in state court does not mean that maritime law yields to state law. As clearly explained by the U.S. Supreme Court, “[w]ith admiralty jurisdiction comes the application of substantive admiralty law.”² Substantive maritime law, therefore, governs whenever the facts qualify the case for federal admiralty jurisdiction, regardless of whether the case is brought in state or federal court. This rule is based on two principles — preemption of state law by federal law and the need for uniformity in admiralty cases.

Most state court practitioners have difficulty recognizing when a case comes within admiralty jurisdiction and requires application of maritime law. As a result, state law is sometimes used to resolve cases that would otherwise be resolved using maritime law. In addition, sometimes a party in a case may be caught off guard because it fails to recognize in advance that maritime law rather than state law governs the case. It is therefore helpful to understand the basic rules used to determine admiralty jurisdiction in tort and contract cases that may be filed in state courts.

Tort Cases

The test for admiralty jurisdiction over a tort or products liability case consists of two prongs — loca-

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tion and nexus. First, the location of the alleged negligence must be on navigable water. Second, “the wrong must bear a significant relationship [i.e. a nexus] to traditional maritime activity.”³

The first prong of the test requiring negligence on navigable water cannot be read too literally because federal courts have held that the negligence may occur in, on, or even above navigable water. A scuba diver injured below water would satisfy the location test just like a worker injured in a boat or movable platform above the water. In addition, federal courts have established that a person injured while working on a ship in a floating drydock satisfies the location test.⁴

The second prong of the test requires that the wrong bear a significant relationship — or nexus — to traditional maritime activity. This is a we-know-it-when-we-see-it test that is the subject of most of the litigation concerning admiralty jurisdiction. Because even the U.S. Supreme Court has not coherently explained when something bears a significant relationship to traditional maritime activity, it is easier to point out what has and has not been determined to satisfy the test than to explain how to apply the test. Ship repair activity satisfies the nexus prong.⁵ So does maintaining a vessel’s equipment.⁶ It makes no difference whether or not the activity is frequently performed on land. For instance, causing an accident by welding on a ship satisfies the nexus prong even though welding is an activity frequently performed on land.⁷ Other activities that have been held to satisfy the nexus test include recreational boating;⁸ drowning while swimming, when it involves negligent operation of a boat;⁹ and water skiing.¹⁰

A federal statute extends admiralty jurisdiction to “all cases of damage or injury, to person or property, caused by a vessel on navigable water, notwithstanding that such damage or injury be done or consummated on land.”¹¹ This statute sweeps into admiralty jurisdiction

cases involving damage on land caused by a vessel on navigable water. Examples include property damage in downtown Chicago caused by pile-driving in a river nearby¹² and injury caused by slipping on cocoa beans spilling from a pallet that had recently been discharged from a ship.¹³ In addition, the Supreme Court of Virginia has held that admiralty jurisdiction applies in a case involving exposure to asbestos on a submarine even though the injury and damages are not apparent until years later on land.¹⁴

Contract Cases

Admiralty jurisdiction exists to govern disputes over maritime contracts that are not inherently local. Federal maritime law controls the interpretation of these contracts. The difficulty resides in determining whether a contract is a maritime contract. Even the U.S. Supreme Court admits that its “cases do not draw clean lines between maritime and nonmaritime contracts.”¹⁵

To determine whether a contract is a maritime contract, courts will look at the nature and character of the contract to determine whether it references maritime service or maritime transactions. Basically, a contract is a maritime contract if its “principal objective” is maritime commerce.¹⁶ For instance, a bill of lading calling for the transportation of goods by sea is a maritime contract.¹⁷ In addition, contracts governing inland legs of international shipments may be maritime contracts.¹⁸ Likewise, insurance contracts that cover maritime interests — such as cargo insurance and ship protection and indemnity insurance — are considered maritime contracts, and ship repair contracts are considered maritime contracts.¹⁹ On the other hand, contracts that do not relate to actual maritime commerce are not considered maritime contracts. These include contracts to build a new ship²⁰ and contracts related to the sale of ships.²¹

A Primer on Admiralty *cont'd from page 19*

Helpful Hints

There are a few common fact patterns that fit within admiralty jurisdiction. The five most common are listed below:

1. Tortious acts on navigable water causing injury or death on water or ashore.
2. Tortious acts on navigable water causing property damage on water or ashore.
3. Contracts related to shipment of goods over water.
4. Contracts related to the repair of ships.
5. Insurance contracts insuring vessels or cargo involved in maritime commerce.

The presence of any one of these fact patterns should raise a red-flag and warrant further investigation and research to determine whether your case is indeed an admiralty case, necessitating the application of federal maritime law. Recognizing these fact patterns may be the difference between surprising an opponent or being surprised by an opponent with regard to the application of federal maritime law to a case. ☒

¹ See *Lewis v. Lewis & Clark Marine, Inc.*, 531 U.S. 438, 443-45 (2001).

² *East River S.S. Corp. v. Transamerica Delaval Inc.*, 476 U.S. 858, 864 (1986).

³ *Matthews v. Commonwealth*, 253 Va. 180, 182, 482 S.E.2d 810, 811-12 (1997).

⁴ *Sea Vessel Inc. v. Reyes*, 23 F.3d 345, 348-49 (11th Cir. 1994) (providing an overview of the U.S. Supreme Court cases on this point).

⁵ *Mizenko v. Electric Motor & Contracting Co., Inc.*, 244 Va. 152, 157, 419 S.E.2d 637, 640 (1992).

⁶ *Matthews*, 253 Va. at 183, 482 S.E.2d at 812.

⁷ *Mizenko*, 244 Va. at 161, 419 S.E.2d at 643.

⁸ *Foremost Ins. Co. v. Richardson*, 457 U.S. 668, 674 (1982).

⁹ *Matthews v. Howell*, 2000 AMC 2067, 2082 (Md. App. 2000).

¹⁰ *O'Quinn v. CIGNA Prop. & Cas.*, 2002 AMC 2459, 2460 (Fl.

Cir. Ct. 2002).

¹¹ 46 U.S.C. § 30101 (1996) (formerly 46 U.S.C. app. § 740).

¹² *Jerome B. Grubart, Inc. v. Great Lakes Dredge & Dock Co.*, 513 U.S. 527, 532 (1995).

¹³ *Gutierrez v. Waterman Steamship Corp.*, 373 U.S. 206, 209-10 (1963).

¹⁴ *Garlock Sealing Technologies, LLC v. Little*, 270 Va. 381, 386-87, 620 S.E.2d 773, 776-77 (2005).

¹⁵ *Norfolk Southern Ry Co. v. Kirby*, 543 U.S. 14, 23 (2004).

¹⁶ *Id.* at 25.

¹⁷ *Id.* at 24; see *M. Rothschild & Co., Inc. v. P.T. Trikorra Lloyd*, 237 Va. 358, 361-62, 377 S.E.2d 408, 410 (1989) (applying federal maritime law to dispute over crude rubber shipment allegedly damaged while at sea).

¹⁸ *Norfolk Southern Ry Co.*, 543 U.S. at 24-26.

¹⁹ *Norfolk Shipbuilding and Drydock Corp. v. M/V Norma T.*, 1977 AMC 103 (E.D. Va. 1976).

²⁰ *Thames Towboat Co. v. The Francis McDonald*, 254 U.S. 242, 243 (1920).

²¹ *Magallanes Investment, Inc. v. Circuit Systems Inc.* ☒

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