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Shareholders' Preemptive Rights in West Virginia

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SHAREHOLDERS' PREEMPTIVE RIGHTS
IN WEST VIRGINIA

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I. INTRODUCTION

The percentage of shares, as opposed to the number of shares, owned by a corporation’s shareholder defines that shareholder’s interest in the corporation. Because a shareholder’s interest in the corporation is diluted when additional shares are sold to other investors, the judiciary created the doctrine of preemptive rights to ensure evenhanded treatment of all shareholders when a corporation issues new shares.\footnote{1} Essentially, the doctrine of preemptive rights grants each shareholder the right to purchase, in a new issuance of stock by a corporation, a number of new shares proportionate to the percentage of original stock held by the shareholder.\footnote{2} Therefore, the foundation of the preemptive

\footnotesize

2. Specifically, preemptive rights have been defined as “the right of a shareholder, no matter at what price the corporation proposes to create the new shares, that a proportion thereof be first offered to him.” Alexander Hamilton Frey, Shareholders’ Pre-emptive Rights, 38 YALE L.J. 563, 564 (1929).
right is the preservation of the original stockholder's proportionate voting strength and control.3

Preemptive rights have been accepted, in principle at least, by every jurisdiction in the United States, including West Virginia.4 West Virginia recognizes preemptive rights both at common law and by statute, although the state's treatment of preemptive rights is not as comprehensive as those of other jurisdictions.5 West Virginia's statutory treatment of preemptive rights began with a codification of the common law into a code section defining, generally, the shares to which preemptive rights apply.6 However, the West Virginia Legislature repealed this code section in 1992 for no apparent reason. Since that time, the treatment of preemptive rights in West Virginia has culminated into confusion as to the extent and the applicability of the doctrine. Two remaining code sections, which do not identify the shares to which the right applies, grant preemptive rights by implication, unless the right is limited in the articles of incorporation.7 Because the remaining statutes do not specify the parameters and applicability of preemptive rights, the boundaries are defined by the common law, which provides little more than a recognition that preemptive rights exist in West Virginia.8 This lack of specificity opens the door for corporate executives to manipulate the scope of preemptive rights in West Virginia, providing an invitation for opportunistic behavior.

Presently, the doctrine of preemptive rights has the potential to create serious problems for West Virginia corporations and shareholders because the state's existing preemptive rights statutes: (1) do not define

3. FLETCHER CYC. CORP. § 5135 (1986).
4. See discussion infra Part III.A.
5. See discussion infra Part III.A.
7. Section 31-1-27(b)(4) states that: (b) . . . the articles of incorporation shall set forth: (4) Any provision limiting or denying to shareholders the preemptive right to acquire additional unissued or treasury shares of the corporation. W. VA. CODE § 31-1-27(b)(4) (1988).
8. Section 31-1-108(i) permits shareholders of the outstanding shares of a class of stock the right to vote as a class upon a number of matters, including the right to vote as a class on a proposed amendment if that amendment would limit or deny the existing preemptive rights of the shares of such class. W. VA. CODE § 31-1-108(i) (1988).

See discussion infra Part IV.A.
the scope of preemptive rights or the exceptions to such rights; (2) do not provide for the waiver of preemptive rights; (3) do not provide for situations where a corporation has more than one class of shares; and (4) do not meet the needs of corporations with complex capital structures.

The purpose of this Note is threefold. First, it provides a background of the treatment of preemptive rights throughout the United States, both at the common law and through various legislation, including modern legislation found in the Model Business Corporation Act (MBCA) and the Revised Model Business Corporation Act (RMBCA). Second, it presents the current status of preemptive rights in West Virginia and the continuing problems associated with West Virginia’s preemptive rights statutes. Finally, this Note proposes new legislation for West Virginia, drafted according to the provisions of the RMBCA. The adoption of this new legislation would resolve the lack of specificity of current preemptive rights in West Virginia and provide West Virginia corporations with clear and efficient guidance via a preemptive rights statute tailored to meet the needs of both public and closely-held corporations.

II. PREEMPTIVE RIGHTS AT COMMON LAW

The doctrine of preemptive rights began as a judicial development from the ruling in a nineteenth century Massachusetts case.\(^9\) It was created to ensure evenhanded treatment of all shareholders by the corporation when issuing shares.\(^10\) Preemptive rights avoided the unfair treatment of shareholders when a corporation issued new voting shares to one group of shareholders without an equal opportunity of participation by opposing groups or when shares were offered at less than their


\(^10\) For an excellent analysis of the two early leading cases on preemptive rights, Gray v. Portland Bank, 3 Mass. 364 (1807) (preemptive rights at common law), and Stokes v. Continental Trust Co., 78 N.E. 1090 (N.Y. 1906) (preemptive rights in the absence of statute, holding that a shareholder has an inherent right to a proportionate part of new shares issued for money and that, while he can waive the right, he cannot be deprived of it without his consent), see Henry S. Drinker, Jr., The Preemptive Right of Shareholders to Subscribe to New Shares, 43 HARV. L. REV. 586 (1930).
fair value to a favored group without being offered to others. Under the doctrine of preemptive rights, each shareholder had a preemptive right to subscribe for a proportional number of additional shares issued by the corporation. The doctrine facilitated the two principles: (1) existing shareholders should be given an opportunity to keep their proportionate control of the corporation; and (2) the equities of the stockholders in the surplus of the corporation should be preserved. However, the preemptive right is not an absolute rule of law and is subject to judicially created exceptions and limitations.

The judiciary developed the preemptive right during a time when small, closely-held corporations had just begun the process of development and when there existed only one class of stock. Preferred stock was not commonly resorted to until after 1850. The growing complexity of corporate structures made the doctrine of preemptive rights increasingly less attractive than when it was first introduced. In fact, as capital structures became more complex, preemptive rights in certain situations created serious problems.

First, in situations where corporations had several classes of shares outstanding, corporations had difficulty in identifying a method for

12. Yoakam v. Providence Biltmore Hotel Co., 34 F.2d 533, 538-39 (D.R.I. 1929) ("[T]he so-called right of pre-emption is not, except within narrow and defined limits, an absolute rule of law. It had its origin in the days of simple corporate structures; that is, during the period when it was usual for a corporation to have but one class of stock . . . . The right has never been consistently extended to nonvoting stocks, or to non-participating preferred stocks having but a special and limited voting right.").
13. See, e.g., Dunlay v. Avenue M Garage & Repair Co., 170 N.E. 917 (N.Y. 1930) (holding that preemptive rights extend only to an issue of newly authorized shares, not to a new issue of previously authorized shares, unless the issue is for expansion of the business); Hammer v. Werner, 265 N.Y.S. 172 (App. Div. 1933); Borg v. International Silver Co., 11 F.2d 147 (2d Cir. 1925) (holding that the preemptive right does not extend to the reissue or resale of treasury shares because treasury shares are not reissued in large amounts); Yoakam v. Providence Biltmore Hotel Co., 34 F.2d 533 (D.R.I. 1929) (preemptive rights are applicable only to fully voting participating stock); Zweifach v. Scranton Lace Co., 156 F. Supp. 384 (D. Md. 1957) (preemptive rights do not extend to the issue of shares where the new stock is to be issued for property).
15. Id.
allocating additional shares that would preserve the shareholders' relative rights as to voting power and financial interest. Modern corporate stock structures contained a multiplicity of classes of stock with varying voting and participating rights. The common law preemptive rights doctrine was too uncertain when applied to a complex stock structure. Second, preemptive rights complicated corporations' access to the national markets because publicly held corporations were required to make a prior offering to existing shareholders before going to the national market for equity capital. Thus, the application of the common law doctrine hampered legitimate corporate financing. This prompted many states to adopt preemptive rights statutes that reflected that a preemptive right was not a vested property right and could be limited, or eliminated entirely, if statutory authority permitted. Such comprehensive legislation not only proved conducive to public corporations, but allowed the preservation, extension and strengthening of preemptive rights in closely-held corporations. Unlike most other jurisdictions, West Virginia has not adopted this type of comprehensive legislation. Therefore, the extent and applicability of preemptive rights in West Virginia are still defined by the parameters of the common law.

III. STATUTORY PREEMPTIVE RIGHTS IN OTHER JURISDICTIONS

A. Legislative Responses to Common Law Preemptive Rights

In order to determine the best option for the treatment of preemptive rights in West Virginia, it is helpful to review how other jurisdictions have responded to common law preemptive rights through various legislation. Modern corporate statutes deal with preemptive rights in one of the following three ways: (1) some statutes specifically deny the existence of preemptive rights unless the articles of incorporation provide such a right (the "opt in" statutes); (2) some statutes specifically provide that preemptive rights shall exist if not denied by the articles

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16. FLETCHER CYC. CORP. § 5135 (1986).
18. Id.
19. FLETCHER CYC. CORP. § 5135 (1986).
of incorporation (the "opt out" statutes); and (3) some statutes "assume" that a preemptive right exists if such right is not specifically denied by the articles of incorporation ("opt out by implication" statutes).

Twenty-six jurisdictions have "opt in" statutes that deny preemptive rights to shareholders except to the extent, if any, that these rights are provided in the articles of incorporation. Delaware's preemptive rights statute provides an example of a comprehensive "opt in" statute. Under Delaware's preemptive rights provision, no preemptive right exists unless the corporation specifically grants such preemptive right in the articles of incorporation. The preemptive right specifically applies to "any or all additional issues of stock" of "any or all classes or


22. Specifically, Delaware's statute provides, in pertinent part, that: (b) [i]n addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:

(3) Such provisions as may be desired granting to the holders of the stock of the corporation, or the holders of any class or series of a class thereof, the preemptive right to subscribe to any or all additional issues of stock of the corporation of any or all classes or series thereof, or to any securities of the corporation convertible into such stock. No stockholder shall have any preemptive right to subscribe to an additional issue of stock or to any security convertible into such stock unless, and except to the extent that, such right is expressly granted to him in the certificate of incorporation. All such rights in existence on July 3, 1967, shall remain in existence unaffected by this paragraph unless and until changed or terminated by appropriate action which expressly provides for the change or termination ....

series thereof" or to "any securities of the corporation convertible into such stock." In addition, the statute provides a grandfather clause that makes the statute inapplicable to preemptive rights which existed before the effective date of Delaware's "opt in" statute. Under this statute, preemptive rights may be altered by a charter amendment, including the adoption of a stock option plan requiring issuance of newly authorized shares without recognizing preemptive rights.

Eighteen jurisdictions have "opt out" statutes expressly granting shareholders preemptive rights, subject to limitation or denial in the articles of incorporation. New York's preemptive rights statute provides an example of a comprehensive "opt out" statute. Under the New York statute, preemptive rights are expressly granted by statute unless a corporation denies preemptive rights in its articles of incorporation. New York's statute is comprehensive in that it specifically

23. Id.

24. Id. Delaware's preemptive rights statute was revised in 1967. The previous statute provided for stockholders preemptive rights unless "limited or denied" in the certificate of incorporation. The 1967 revision reversed this presumption so that, absent a charter provision, "no stockholder of a Delaware corporation shall have any preemptive right to subscribe to additional issues of stock." The purpose of the revision was to achieve simplicity. "[B]ecause the boundaries of common law preemptive rights are vague, it seemed desirable to spell out whether, and to what extent, the stockholder should enjoy preemptive rights." ERNEST L. FOLK, III, DELAWARE GENERAL CORPORATION LAW 11 (Little Brown ed., 1972).


27. New York's lengthy statute provides, in pertinent part:

(b) Except as otherwise provided in the certificate of incorporation, and except as provided in this section, the holders of equity shares of any class, in case of the proposed issuance by the corporation of, or the proposed granting by the corporation of rights or options to purchase, its equity shares of any class or any shares
defines preemptive rights as applied to unlimited dividend rights, equity
shares, voting rights, and voting shares.\textsuperscript{28} New York's statute also
provides that preemptive rights will be granted "during a reasonable time
and on reasonable conditions" as determined by the board of directors.\textsuperscript{29}
For even greater specificity, the statute carves out certain shares that are
not subject to preemptive rights, including shares issued by the board to
effect a merger or consolidation; shares issued for consideration other
than cash; shares issued to satisfy conversion rights, option rights, or
treasury shares; shares issued within two years from the date of filing the
articles of incorporation; etc.\textsuperscript{30}

Seven jurisdictions have "opt out by implication" statutes that recognize
preemptive rights by implication, usually by simply providing
that the articles of incorporation may limit or deny preemptive rights.\textsuperscript{31}
Maryland provides an example of a comprehensive "opt out by

or other securities convertible into or carrying rights or options to purchase its
equity shares of any class, shall, if the issuance of the equity shares proposed to
be issued or issuable upon exercise of such rights or options or upon conversion of
such other securities would adversely affect the unlimited dividend rights of such
holders, have the right during a reasonable time and on reasonable conditions, both
to be fixed by the board, to purchase such shares or other securities in such propor-
tions as shall be determined as provided in this section.
(c) . . . the holders of voting shares of any class, . . . shall, if the issuance of
the voting shares proposed to be issued or issuable upon exercise of such rights or
options . . . have the right during a reasonable time and on reasonable conditions,
both to be fixed by the board, to purchase such shares or other securities in such propor-
tions as shall be determined as provided in this section.
(d) The preemptive right provided for in paragraphs (b) and (c) shall entitle share-
holders having such rights to purchase the shares or other securities to be offered
or optioned for sale as nearly as practicable in such proportions as would, if such
preemptive right were exercised, preserve the relative unlimited dividend rights and
voting rights of such holders and at a price or prices not less favorable than the
price or prices at which such shares or other securities are proposed to be offered
for sale to others . . . .

\textbf{N.Y. BUS. CORP. LAW} § 622(b)-(d) (McKinney 1986).

\textsuperscript{28} Id.
\textsuperscript{29} Id.
\textsuperscript{30} Id.

\textsuperscript{31} REV. MODEL BUSINESS CORP. ACT § 6.30 (1993) (citing ALA. CODE § 10-2A-44
(1989); D.C. CODE ANN. § 29-347 (1991); HAW. REV. STAT. § 415-26 (1985); MD. CODE
ANN., CORPS. & ASS'NS § 2-205 (1993); MO. ANN. STAT. § 351.305 (Vernon 1991); P.R.
LAWS ANN. tit. 14, § 110 (1989); W. VA. CODE § 31-1-90 (repealed 1992)).
SHAREHOLDERS' PREEMPTIVE RIGHTS

implication" statute. Maryland's statute, unlike New York's "opt out" statute, does not expressly recognize a preemptive right granted by the legislature, but implies the existence of a preemptive right. The statute also outlines circumstances in which preemptive rights do not accrue, specifically providing a laundry list of shares and securities that do not carry preemptive rights unless otherwise provided in the corporation's charter. In addition, the statute gives deference to the board of directors to determine the fair value of the shares.

Although West Virginia's preemptive rights statute falls into this third category, West Virginia's current preemptive rights legislative provisions, unlike Maryland's comprehensive one, do not define to what extent and to which shares preemptive rights apply.

33. Maryland's statute provides, in pertinent part, that:
(a) Unless the charter provides otherwise, a stockholder does not have any preemptive rights with respect to:
   (1) Stock issued to obtain any of the capital required to initiate the corporate enterprise;
   (2) Stock issued for at least its fair value in exchange for consideration other than money;
   (3) Stock remaining unsubscribed for after being offered to stockholders;
   (4) Treasury stock sold for at least its fair value;
   (5) Stock issued or issuable under articles of merger;
   (6) Stock which is not presently entitled to be voted in the election of directors issued for at least its fair value;
   (7) Stock, including treasury stock, issued to an officer or other employee of the corporation or its subsidiary on terms and conditions approved by the stockholders by the affirmative vote of two thirds of all the votes entitled to be cast on the matter; and
   (8) Any other issuance of shares if the applicability of preemptive rights is impracticable.
(b) Fair value. — In the absence of actual fraud or gross disparity in the determination, the fair value of stock determined by the board of directors and recorded in the resolution authorizing the issuance is conclusive.
(c) Securities to which preemptive rights do not accrue. — Unless the charter provides otherwise, holders of the following securities do not have any preemptive rights:
   (1) Bonds, notes, debentures, or other obligations convertible into stock; and
   (2) Stock not presently entitled to be voted in the election of directors.

34. Id.
35. See discussion infra Part IV.C.
Thirty-eight jurisdictions, including the above statutes of Maryland and New York, enumerate the specific instances in which preemptive rights do not apply. The most common exclusions are: (1) shares issued to officers or employees under terms and conditions approved by the shareholders; (2) shares issued for consideration other than cash; (3) shares issued to satisfy conversion or option rights; (4) shares issued to effect a merger or consolidation; (5) treasury shares; (6) shares of a different class; (7) shares originally authorized, within a specified period of time; and (8) shares that are preferred or limited as to dividends or assets.

B. Model Statutes

Both the Revised Model Business Corporation Act (RMBCA) and the Model Business Corporation Act (MBCA) are “opt in” statutes, denying the preemptive right to shareholders unless the right is specifically provided for in the articles of incorporation. However, the RMBCA preemptive rights provision is more comprehensive than that of the MBCA. Therefore, the RMBCA is examined in greater detail below.


Under the RMBCA,⁴⁰ if the "opt in" option is exercised, the

tive statutes for preemptive rights. Section 26 states that:

The shareholders of a corporation shall have no preemptive right to acquire unissued
or treasury shares of the corporation, or securities of the corporation convertible into
or carrying a right to subscribe to or acquire shares, except to the extent, if any, that
such right is provided in the articles of incorporation.

Id. Section 26A states that:
Except to the extent limited or denied by this section or by the articles of incorpo-
ration, shareholders shall have a preemptive right to acquire unissued or treasury
shares or securities convertible into such shares or carrying a right to subscribe to
or acquire shares.

Unless otherwise provided in the articles of incorporation,
(a) No preemptive right shall exist
   (1) to acquire any shares issued to directors, officers or employees pursuant
to approval by the affirmative vote of the holders of a majority of the shares
entitled to vote thereon or when authorized by and consistent with a plan
theretofore approved by such a vote of shareholders; or
   (2) to acquire any shares sold otherwise than for cash.
(b) Holders of shares of any class that is preferred or limited as to dividends or
assets shall not be entitled to any preemptive right.
(c) Holders of shares of common stock shall not be entitled to any preemptive
right to shares of any class that is preferred or limited as to dividends or assets
or to any obligations, unless convertible into shares of common stock or carrying
a right to subscribe to or acquire shares of common stock.
(d) Holders of common stock without voting power shall have no preemptive right
to shares of common stock with voting power.
(e) The preemptive right shall be only an opportunity to acquire shares or other
securities under such terms and conditions as the board of directors may fix for
the purpose of providing a fair and reasonable opportunity for the exercise of
such right.

Id.

40. The RMBCA provides:
(a) The shareholders of a corporation do not have a preemptive right to acquire the
corporation's unissued shares except to the extent the articles of incorporation so
provide.
(b) A statement included in the articles of incorporation that "the corporation elects
to have preemptive rights" (or words of similar import) means that the following
principles apply except to the extent the articles of incorporation expressly provide
otherwise:
   (1) The shareholders of the corporation have a preemptive right, granted on
uniform terms and conditions prescribed by the board of directors to provide a
fair and reasonable opportunity to exercise the right, to acquire proportional
amounts of the corporation's unissued shares upon the decision of the board of
directors to issue them.
   (2) A shareholder may waive his preemptive right. A waiver evidenced by a
writing is irrevocable even though it is not supported by consideration.
articles of incorporation need only to state that the corporation elects to have preemptive rights.\(^4\) The RMBCA then defines preemptive rights and enumerates a list of exceptions to preemptive rights.\(^5\) The articles of incorporation may define preemptive rights, varying the standard statutory definition to meet the corporation's specific needs. If affirmative reference to these rights does not appear in the articles of incorporation, no preemptive rights exist.

Under the RMBCA, whether or not preemptive rights are elected by reference in the articles, the directors' fiduciary duties extend to the issuance of shares.\(^6\) For example, the issuance of shares at favorable prices to directors (but excluding other shareholders) or the issuance of shares on a nonproportional basis for the purpose of affecting control

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(3) There is no preemptive right with respect to:
   (i) shares issued as compensation to directors, officers, agents, or employees of the corporation, its subsidiaries or affiliates;
   (ii) shares issued to satisfy conversion or option rights created to provide compensation to directors, officers, agents, or employees of the corporation, its subsidiaries or affiliates;
   (iii) shares authorized in articles of incorporation that are issued within six months from the effective date of incorporation;
   (iv) shares sold otherwise than for money.
(4) Holders of shares of any class without general voting rights but with preferential rights to distributions or assets have no preemptive rights with respect to shares of any class.
(5) Holders of shares of any class with general voting rights but without preferential rights to distributions or assets have no preemptive rights with respect to shares of any class with preferential rights to distributions or assets unless the shares with preferential rights are convertible into or carry a right to subscribe for or acquire shares without preferential rights.
(6) Shares subject to preemptive rights that are not acquired by shareholders may be issued to any person for a period of one year after being offered to shareholders at a consideration set by the board of directors that is not lower than the consideration set for the exercise of preemptive rights. An offer at a lower consideration or after the expiration of one year is subject to the shareholders' preemptive rights.
(c) For purposes of this section, "shares" includes a security convertible into or carrying a right to subscribe for or acquire shares.

41. REV. MODEL BUSINESS CORP. ACT § 6.30(b) (1993).
42. REV. MODEL BUSINESS CORP. ACT § 6.30(3)-(5) (1993).
rather than raising capital would violate the directors fiduciary duty.\textsuperscript{44} Therefore, such opportunistic behavior would be discouraged in any jurisdiction that has adopted the RMBCA preemptive rights provision because shareholders would always have the remedy of suing the director for breach of fiduciary duty.

Thus, the RMBCA resolves the ambiguities present in jurisdictions, like West Virginia, where the scope of the preemptive right is defined only by the common law. The RMBCA defines the general scope of preemptive rights while giving appropriate recognition to the discretion of the board of directors in establishing the terms and conditions for exercising the rights, creates rules with respect to waiver of these rights, and lists the principal exceptions to the rights. The RMBCA also provides rules for problems created when preemptive rights are recognized in corporations with more than a single class of shares, defines the status of preemptive rights after a shareholder has elected not to exercise the preemptive right, and contains a special definition of "shares" to ensure that the preemptive right of shareholders, if granted, apply to all securities that are convertible into or carry a right to acquire voting shares.\textsuperscript{45}

Thus, [the RMBCA] combines the value judgment preferring an "opt in" approach with the advantages of defining the scope of preemptive rights in the statute for the benefit of corporations and their attorneys who desire preemptive rights but may not be aware of limitations that experience has indicated may be desirable to the recognition of preemptive rights.\textsuperscript{46}

In sum, the treatment of preemptive rights throughout most U.S. jurisdictions has grown from a recognition of preemptive rights in the common law to comprehensive legislation that addresses a multitude of potential problems with specific provisions. No matter whether preemptive rights statutes contain "opt in," "opt out," or "opt out by implication" provisions, well drafted preemptive rights statutes specifically define to what extent and to which shares preemptive rights apply. If preemptive rights statutes, like the ones in West Virginia, do not specify such

\begin{itemize}
  \item \textsuperscript{44} Rev. Model Business Corp. Act § 6.30, off. cmt. (1993).
  \item \textsuperscript{45} Id.
  \item \textsuperscript{46} Id.
\end{itemize}
parameters, the parameters of the shareholders' preemptive rights remain defined by the common law, and the common law offers little guidance. This is especially true in a jurisdiction such as West Virginia, where the common law doctrine is little more than an obscure recognition that preemptive rights exist.\textsuperscript{47}

IV. PREEMPTIVE RIGHTS IN WEST VIRGINIA

A. Common Law Preemptive Rights in West Virginia

The Supreme Court of Appeals of West Virginia first recognized shareholders' preemptive rights in 1918 in \textit{Thurmond v. Paragon Colliery}.\textsuperscript{48} In \textit{Thurmond}, J.S. Thurmond and others, the minority stockholders in the Paragon Colliery Company, appealed from a decree dissolving in part and modifying an injunction which prohibited, among other things, the majority of directors of the company from selling 350 shares of unissued capital stock.\textsuperscript{49} The minority shareholders insisted that the company was prospering and, therefore, it was unnecessary to sell its unissued stock to raise money to pay off an indebtedness.\textsuperscript{50}

The court noted that the board of directors did not, alone, make the decision to sell the unissued stock.\textsuperscript{51} Instead, the board first submitted the question to the stockholders who authorized the sale by majority vote and were given the right to purchase their pro rata shares at the price fixed.\textsuperscript{52} The \textit{Thurmond} court recognized a shareholders' common law preemptive right by stating that:

When the capital stock of a corporation is increased by the issue of new stock, each holder of the original stock has a right to offer to subscribe for and to demand from the corporation such a proportion of the new stock as the number of shares already owned by him bears to the whole number of

\textsuperscript{47} See discussion infra Part IV.A.
\textsuperscript{48} 95 S.E. 816 (W. Va. 1918).
\textsuperscript{49} Id.
\textsuperscript{50} Id. at 819.
\textsuperscript{51} Id.
\textsuperscript{52} Id.
shares before the increase. This pre-emptive right of the stockholder in respect to new stock is well recognized.\textsuperscript{53}

The court also recognized that preemptive rights only apply to capital stock that is issued after the corporation has commenced business, not to treasury stock of a corporation which has previously been issued.\textsuperscript{54}

Hence, shareholders' common law preemptive rights have been recognized in West Virginia as early as 1918, and continue to exist to date.\textsuperscript{55} The existence of the common law preemptive right in West Virginia will continue until the courts overturn the precedents or an affirmative act of the legislature abolishes the shareholders' preemptive rights to additional issues of corporate stock.

\textbf{B. Early Corporate Statutes and the Adoption of the MBCA}

Prior to 1974, West Virginia's preemptive rights statute granted preemptive rights by implication to any or all additional issues of stock of any or all classes, unless limited or denied in the agreement of incorporation.\textsuperscript{56} Thus, preemptive rights were applicable only to additional stock issues.

On March 9, 1974, the West Virginia Legislature passed the first comprehensive corporation act to be adopted in West Virginia since 1931.\textsuperscript{57} The Corporation Law Study Committee (CLS Committee) had been created by the legislature in 1972 to draft the act.\textsuperscript{58} After studying West Virginia law, Delaware corporation law, the American Bar

\begin{itemize}
\item \textsuperscript{53} 95 S.E. at 819 (citations omitted).
\item \textsuperscript{54} Id. (citing Gray v. Portland Bank, 3 Mass. 364 (1807); Way v. American Grease Co., 47 A. 44 (N.J. 1900); Crosby v. Stratton, 68 P. 130 (Colo. App. Div. 1902)).
\item \textsuperscript{55} See also Hall v. McLuckey, 60 S.E.2d 280 (W. Va. 1950) (citing Thurmond v. Paragon Oil & Gas Co., 95 S.E. 816 (W. Va. 1918) ("[i]n this state we are committed to the principle that the preemptive right of stockholders to purchase the capital stock of a corporation is applicable to stock originally authorized and unissued")).
\item \textsuperscript{56} W. Va. CODE § 31-1-6(i) (repealed 1974).
\item \textsuperscript{57} The pending 1974 act, as adopted, contained flaws, and some members of the West Virginia Legislature desired the act to be reviewed by a committee of the West Virginia State Bar. Thus, the effective date of the 1974 act was purposely delayed until July 1, 1975.
\end{itemize}
Association Model Business Corporation Act and Model Non-Profit Corporation Act, the CLS Committee chose the A.B.A. Model Acts as the basis for the new West Virginia Corporation Act. However, the CLS Committee did not follow the A.B.A. Model Act when it drafted its preemptive rights statute.

The preemptive rights statute adopted in the 1974 West Virginia Corporation Act authorized the denial of the preemptive right only to unissued and treasury shares "theretofore and thereafter" authorized. This statute remained in place from 1974 until the entire statute was repealed, for no apparent reason, by the legislature in 1992.

C. West Virginia Code § 31-1-90 Repealed

West Virginia Code § 31-1-90 was the only section of the West Virginia Code that was specifically dedicated to the topic of shareholders' preemptive rights. Both before and after its preemptive rights statute was repealed, West Virginia's scope and extent of preemptive rights were defined only by the parameters of the common law. Section 31-1-90 stated:

The articles of incorporation may contain such provisions as may be desired limiting or denying to the shareholders of a corporation the preemptive right

59. Id.
60. The text of the MBCA § 26, unlike West Virginia's statute which grants preemptive rights by implication, denies preemptive rights except to the extent provided in the articles of incorporation. Its alternative provision, § 26A, provides for automatic preemptive rights except in specific instances, where in the ordinary case, its elimination is believed to be for the best interest of the corporation and its shareholders. MODEL BUSINESS CORP. ACT §§ 26, 26A (1971).
62. See infra note 70 and accompanying text.
63. Preemptive rights are also referenced in two other sections of the West Virginia Code. W. VA. CODE § 31-1-27(b)(4) (1988) states that: (b) . . . the articles of incorporation shall set forth: (4) Any provision limiting or denying to shareholders the preemptive right to acquire additional unissued or treasury shares of the corporation.

W. VA. CODE § 31-1-108(l) (1988) also references preemptive rights in passing, and allows shareholders of the outstanding shares of a class of stock the right to vote as a class upon a proposed amendment if the amendment would limit or deny the existing preemptive rights of the shares of such class.
64. See discussion supra Part IV.A.
SHAREHOLDERS' PREEMPTIVE RIGHTS

...to acquire unissued or treasury shares theretofore or thereafter authorized of any or all classes or securities convertible into such shares or carrying a right to subscribe to or acquire such shares. 65

This provision can be characterized as an adoption of preemptive rights by "implication." 66 It did not specifically state that the West Virginia Legislature had adopted preemptive rights; rather, it implied that preemptive rights already exist by stating that such provisions limiting or denying preemptive rights could be contained in the articles of incorporation. 67

The West Virginia Legislature repealed W. Va. Code § 31-1-90 in 1992. The senate bill that repealed the code section was sponsored by West Virginia State Senator Wooton. 68 The bill stated that this was "an act to repeal section ninety, article one, chapter thirty-one of the code of West Virginia, one thousand nine hundred thirty-one, as amended . . . removing the provision concerning shareholders' preemptive rights in conflict with other provisions . . . ." 69 However, the bill did not specify the conflicting provisions.

Research of the issue indicates that the code section was repealed because it conflicted with W. Va. Code § 31-1-84, which made it optional for provisions limiting or denying preemptive rights to be included in the articles of incorporation, and W. Va. Code § 31-1-27(b)(4), which made it mandatory for stock rights and options to be set forth in the articles of incorporation.70 The conflict supposedly existed because § 31-1-90 stated that "the articles of incorporation may contain such provisions . . . limiting or denying . . . preemptive rights," while...

66. See discussion supra Part IIIA.
69. Id. (emphasis added).
70. I telephoned Senator Wooton's office for information behind the repeal of the preemptive rights statute. The Senator's secretary directed my question to a member of the Senate Judiciary Committee who researched the file that was dedicated to S.B. 431. The Committee member's notes on the subject revealed that a business firm in downtown Charleston (name of the firm unknown) requested that W. VA. CODE § 31-1-90 be repealed because it was in conflict with W. VA. CODE § 31-1-84 and W. VA. CODE § 31-1-27(b)(4). Telephone interview with Ms. Jennifer Walker, Senate Judiciary Committee (Nov. 15, 1994).
the other two sections required that such provisions “shall” be set forth in the articles of incorporation.71

However, pari materia is a settled rule of statutory construction in West Virginia and means that “statutes which relate to the same subject matter should be read and applied together so that the legislature’s intention can be gathered from the whole of the enactments.”72 When reading the preemptive rights provisions in pari materia, it becomes evident that these statutes did not conflict with each other: The provisions state that a corporation may, if it wishes, limit or deny preemptive rights.73 However, if the corporation chooses to do so, it shall deny the preemptive rights in the articles of incorporation.74 In addition, the reference in § 31-1-84 that makes that section “subject to the provisions of § 31-1-90” shows that the legislature intended for these code sections to be consistent with each other.75 To repeal § 31-1-90 because it conflicted with a statutory provision which, itself, is “subject to the provisions of § 31-1-90” is illogical.

71. W. VA. CODE § 31-1-84 states the following:
Subject to the provisions of section ninety [§ 31-1-90] of this article and further subject to any provisions in respect thereof set forth in its articles of incorporation, a corporation may create and issue, whether or not in connection with the issuance and sale of any of its shares or other securities, rights or options entitling the holders thereof to purchase from the corporation shares of any class or classes. Such rights or options shall be evidenced in such manner as the board of directors shall approve and, subject to the provisions of the articles of incorporation, shall set forth the terms upon which, the time or times within which and the price or prices at which such shares may be purchased from the corporation upon the exercise of any such right or option. If such rights or options are to be issued to directors, officers or employees as such of the corporation or of any subsidiary thereof, and not to the shareholders generally, their issuance shall be approved by the affirmative vote of the holders of a majority of the shares entitled to vote such a vote of shareholders. In the absence of fraud in the transaction, the judgment of the board of directors as to the adequacy of the consideration received for such rights or options shall be conclusive. The price or prices to be received for any shares having a par value, other than treasury shares to be issued upon the exercise of such rights or options, shall not be less than the par value thereof.


Even if the members of the West Virginia Legislature believed that these provisions were in conflict, the legislature overreacted by repealing the entire section dedicated to preemptive rights, as opposed to changing the word “may” in § 31-1-90 to the word “shall.” It seems odd that the statute remained in place from 1974 to 1992 with no changes. Then, after eighteen years, based upon a single request, the statute was totally repealed. The perils of this type of ad hoc legislating are evidenced by the fact that a single request easily resulted in the disappearance of the only statute that defined to which shares preemptive rights apply — a statute drafted by the CLS Committee and enacted in the West Virginia Corporation Act of 1974.

Currently, because § 31-1-90 was repealed, the only reference to preemptive rights that remain in the West Virginia Code are contained in W. Va. Code § 31-1-27(b)(4) (requiring the articles of incorporation to set forth any limitation or denial of preemptive rights) and § 31-1-108(i) (entitling shareholders to vote on amendments limiting or denying preemptive rights). West Virginia has regressed back to a statutory protection of preemptive rights that is less definitive than that which existed prior to the adoption of the 1974 Act. Prior to 1974, West Virginia’s preemptive rights statute at least defined that preemptive rights applied to “additional issues of stock” of “any or all classes.” The remaining code provisions in effect today do not even provide that amount of guidance.

One could hypothesize that the legislature thought that it abolished, or meant to abolish, preemptive rights altogether in West Virginia when it repealed the preemptive rights statute. If this were the impetus behind the statute’s repeal, however, the legislature failed to accomplish its goal. Even if all references to preemptive rights in the West Virginia Code were repealed, a common law preemptive right would still exist in West Virginia absent any code provision expressly denying such preemptive right. Moreover, although they do not define parameters of the preemptive rights, the remaining two code sections that reference preemptive rights effectively adopt the right by implication. As they

76. See discussion supra Part IV.A.
77. See discussion supra Part III.A.
currently stand, these remaining code sections have the potential to create serious problems for West Virginia corporations and shareholders because these code sections: (1) do not define the scope of preemptive rights or the exceptions to such rights; (2) do not provide for the waiver of preemptive rights; (3) do not clearly state how preemptive rights are to be treated when a corporation has more than one class of shares; and (4) do not meet the needs of corporations with complex capital structures. This lack of specificity opens the door for corporate executives to manipulate the scope of preemptive rights in West Virginia, providing an invitation for opportunistic behavior.

Because the parameters are not defined by statute, it is necessary to look to the common law which has not defined the right with precision. As previously noted, problems with the sparse common law boundaries have been recognized and remedied in other jurisdictions through the adoption of comprehensive preemptive rights statutes that provide protection for both public and closely-held corporations. In order to remedy the problem in West Virginia, the West Virginia Legislature needs to amend the existing statutory provisions into comprehensive, definitive legislation.

V. PROPOSED LEGISLATION FOR WEST VIRGINIA

Having reviewed both common law preemptive rights and preemptive rights granted or limited by various legislatures, it is evident that even before W. Va. Code § 31-1-90 was repealed, West Virginia’s treatment of preemptive rights fell short in comparison to the treatment of preemptive rights in other jurisdictions. Without any defined boundaries, the references to preemptive rights found in the West Virginia Code are not sufficient to protect shareholders or provide guidance to West Virginia corporations.

In drafting new legislation, the West Virginia Legislature has several options available to meet the needs of West Virginia corporations. If the legislature chooses to adopt a comprehensive preemptive rights provision

78. See discussion supra Part III.A.
79. See discussion supra Part III.A.
and retain West Virginia's "opt out by implication" status, it can do so by adopting a statute similar to that of Maryland. Although this is clearly the minority position, such a statute could be drafted to define the scope of preemptive rights and circumstances in which preemptive rights do not accrue.

Alternatively, the West Virginia Legislature could draft a comprehensive "opt out" statute, like that of New York, expressly granting shareholders preemptive rights, subject to the limitation or denial in the articles of incorporation. Such a statute could also be drafted specifically to define the scope of preemptive rights and circumstances in which preemptive rights do not accrue.

However, the modern trend, and the statute more adaptable to the needs of both public and closely-held corporations, is the "opt in" statute. A statute drafted according to the provisions of the RMBCA would provide protection to shareholders in West Virginia's public and closely-held corporations. The "opt in" provision would require an affirmative reference in the articles of incorporation stating merely that the corporation elects to have preemptive rights. Once preemptive rights are affirmatively adopted in the articles of incorporation, a multitude of default protections for the corporation and its shareholders would apply, including explicit boundaries, an extension of directors' fiduciary duties, rules solving most of the problems involving preemptive rights, discretion of the board of directors in establishing the terms and conditions for exercising the rights, rules with respect to waiver of these rights, provisions dealing with corporations with more than a single class of shares, and explicit exceptions to the rights. The individual corporations would also be allowed to create their own definition of preemptive rights, varying the standard statutory definition to meet the corporations' specific needs.

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81. Only seven jurisdictions, including West Virginia, have such provisions. See discussion supra Part III.A.
82. N.Y. BUS. CORP. LAW § 622 (McKinney 1986). See discussion supra Part III.A.
83. REV. MODEL BUSINESS CORP. ACT § 6.30 (1993). See discussion supra Part III.B.
84. REV. MODEL BUSINESS CORP. ACT § 6.30(b) (1993).
86. Id.
This type of statute would be helpful to all West Virginia businesses and is the best solution to the problems of preemptive rights in West Virginia. In small or closely-held corporations, the preemptive right provides an important protection for the relative position of the several stockholders and should be defined with care in the applicable statute in order to prevent corporate officials from changing the rules to take advantage of opportunistic situations. As corporations become larger and their capitalization becomes increasingly complicated, the importance of the right decreases and the difficulties in enforcing the right increases. "In short, it is easier for the draftsman to write the rules of a particular situation in advance than it is for a court to define them later, perhaps in wholly unanticipated circumstances." This is especially true in a state such as West Virginia, where there is very little case law involving preemptive rights. Therefore, an "opt in" provision, similar to the provisions in Delaware or the RMBCA, would provide protection for both closely-held corporations (defining preemptive rights "with care" in the default statute or as desired in the articles of incorporation while still preserving fiduciary responsibility) and public corporations (conducive to complex capital structures while retaining fiduciary responsibility) in West Virginia.

VI. CONCLUSION

West Virginia’s treatment of statutory preemptive rights began with an implied recognition of preemptive rights and, with the repeal of the only West Virginia code section that was specifically dedicated to shareholders’ preemptive rights, the status of preemptive rights in West Virginia has culminated into confusion as to the extent and the applicability of the doctrine. No matter whether the preemptive right statute contains “opt in,” “opt out,” or “opt out by implication” provisions, a well drafted preemptive rights statute must specifically define to what extent and to which shares preemptive rights apply. The RMBCA is the best solution because it supplies a comprehensive preemptive rights statute adaptable to both public and closely-held

88. See discussion supra Part IV.A.
corporations. The adoption of a similar statute by the West Virginia Legislature would provide protection for West Virginia shareholders and guidance to West Virginia corporations.

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