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September 2003
Volume 3, Issue 5

BUSINESS LAW NEWSLETTER

PIERCING THE CORPORATE VEIL

By James V. Irving, Esq.

In June 2003, the case of C.F. Trust, Inc. v. First Flight Limited Partnership presented the Supreme Court of Virginia with an unusual opportunity to set out the standards for reverse piercing of the corporate veil. The questions were posed to the Supreme Court by the Fourth Circuit Court of Appeals, seeking state law guidance on whether the legal theory is recognized in the Commonwealth, and, if so, a statement of the standards governing its application. In answering those questions, the Supreme Court provided a thorough answer to questions of importance to Virginia business people.

Piercing the corporate veil refers to the rare circumstance in which the corporate shield is ignored, allowing a business creditor to pursue collection against the individual assets of a corporate insider or shareholder. Reverse piercing refers to the even more unusual case when the assets of a business are made available to satisfy the debts of the individual.

C.F. Trust held two notes in the aggregate amount of more than $6 million dollars. These notes were endorsed by Barrie Peterson both individually and, as trustee, and also by his wife. After the Petersons' default, a Virginia Circuit Court entered a judgment in favor of the Plaintiff against the Petersons. In an effort to collect on this judgment, C.F. Trust asked the U.S. District Court for garnishment orders against the Petersons' businesses, based upon a theory that these business entities were nothing more than alter-egos of the Petersons.

The trail court found that the Petersons financed their lavish lifestyle through their business entities. Mr. Peterson contended that he took no salary and that the numerous payments made on his behalf were repayments of prior "loans" that he had made to the corporations before the date of judgment. The trail court found by clear and convincing evidence that this pattern evidenced an intention to improperly conceal Peterson's assets and ruled that the grounds to establish reverse veil piercing had been conclusively established.

After pointing out that corporate immunity is an essential provision of both statutory and common law, the Virginia Supreme Court noted that the decision to ignore the corporate shield should only be undertaken in "extraordinary" circumstances. The Court held that reverse veil piercing is recognized in Virginia, and that the standards parallel the test for direct piercing of the corporate veil. In either case, the proponent must show, by clear and convincing evidence, the use of the separate entity "to evade a personal obligation, to perpetrate fraud or a crime, to commit an injustice, or to gain an unfair advantage." The court must also consider how reverse veil piercing would impact innocent secured and unsecured creditors and whether or not the creditor has exhausted its other remedies.

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Virginia is a pro-business jurisdiction and creative financial planning remains not only legal, but prudent. However, the Supreme Court has laid out clear ground rules to prevent fraud and protect the interests of creditors. Both debtors ands creditors should be aware of conduct that crosses the line.

CONFIDENTIALITY OF NEWS SOURCES

By James V. Irving, Esq.

A Judge sitting in the Circuit Court for the City of Roanoke has recently ruled that a news gathering organization's promise to maintain the confidentiality of a source is not an enforceable contract. The case is Krisha v. Times World Corporation.

In 2000, the *Roanoke Times* ran a series of articles on domestic violence. During their investigation, they identified a recent victim of domestic violence and asked to have a reporter and photographer sit in on her interview with local police. When the victim expressed concern about the use of the photographs, she was apparently told that they would be "cropped or reduced." Understanding this to be a commitment to render the photos unrecognizable, she allowed the reporter and photographer to attend her police interview. Two months later, the women's clearly recognizable photograph appeared in the paper promoting the series on domestic violence. The victim sued the *Times'* parent organization for constructive fraud and breach of contract.

In August 2001, Judge Richard Pattisall threw out the fraud count but allowed the case to proceed under the breach of contract theory. After Judge Pattisal retired from the bench, both parties petitioned the new Judge to reconsider Pattisal's rulings. On April 30, 2003, Judge Jonathan M. Apgar handed down an opinion ruling for the newspaper on both counts.

Judge Apgar had no difficulty in sustaining Judge Pattisal's finding on the fraud count. Fraud requires the allegation that the statement upon which the plaintiff relied was false and known to be false at the time it was made. The court held that an alleged promise that the victim's picture would not appear in the paper, or would be rendered unrecognizable, could not constitute fraud, since the alleged promise dealt with a future event.

Judge Apgar also ruled that the victim could not pursue a breach of contract claim against the paper irrespective of whether the reporter had actually committed the paper to withholding or doctoring the photographs. The Judge ruled that the failure to honor such a promise may be a matter of journalistic ethics, but that a promise of confidentiality from a news gathering source is "at best a moral obligation. Such a moral obligation does not give rise to contractual liability."

The line between the business world and the world of news is sometimes narrow. In particular, increased success can lead to media attention. While it has been said that there is no bad publicity, businessmen and women should be aware of the limited protection provided by a news media's promise of confidentiality.

NON-COMPETITION CLAUSE HELD UNENFORCEABLE

By James V. Irving, Esq.

When McGladrey & Pullen, LLC sold the Harrisonburg, Virginia branch of its national accounting practice to a locally owned entity in 2001, both parties believed the transfer included several agreements restricting employee competition. Almost immediately, one of McGladrey's former employees began soliciting protected clients, apparently in violation of the restrictive covenant he had signed with McGladrey. But when the Buyer and Seller joined forces to put an end to this competition, they learned how difficult it can be to enforce non-competition agreements in Virginia. The case is McGladrey & Pullen, LLP v. Shrader.

Just prior to the date of the sale, Shrader allegedly downloaded customer lists and other sensitive information from McGladrey's data base. After the sale, he began using that information to compete against the acquiring entity. The two firms sued Shrader for, among other things, Breach of the Restrictive Covenant, violation of the Virginia Computer Crimes Act, Unfair Competition, and Tortious Interference with a Business Relationship.

On August 11, 2003, Judge John J. McGrath, Jr. dismissed the restrictive covenant-based claims brought by both plaintiffs. McGrath ruled that the acquiring company had not received formal assignment of the Non-Competition Agreement, and that McGladrey no longer had standing to sue, since they had withdrawn from the Harrisonburg marketplace and could not be damaged by the competition of their former employee.

Shrader still faces considerable risk under the remaining counts. In particular, the Court was not impressed by Shrader's argument that he was authorized to access the computerized information when he down-loaded it; the Court noted that he was only authorized to access the information for legitimate business purposes.

Business tort cases are often brought as packages of inter-related claims. Because they are always strictly construed, agreements restricting competition are generally the most difficult to sustain through the preliminary stages. Claims of Tortious Interference with a Business Contract or Opportunity are fact driven and less likely to be dismissed, but may require greater proof of knowledge, motive, and intent.

The Virginia statutes and case law governing business torts present an overlapping system of theories, each subject to particular defenses. Thus far, Shrader has prevailed on the law. If the facts reported in Judge McGrath's opinion are true, he may have a more difficult time at trial.

Meet Our Lawyers…

JENNIFER A. BRUST

Jennifer Brust has been a shareholder at Bean, Kinney & Korman since 1996. Her practice focuses on representing clients in the areas of commercial and civil litigation, including contract and real estate disputes, bankruptcy and creditor's rights. She actively litigates in both the federal and state courts in Virginia, Maryland and the District of Columbia. She counsels and represents clients in adoption cases and is a member of the American Academy of Adoption Attorneys. In addition, she presides over disputes as a Commissioner in Chancery for the Arlington County Circuit Court.

Jennifer grew up in a large family in up-state New York. She received her undergraduate degree from Princeton University and her law degree from the George Mason University School of Law, and joined Bean, Kinney & Korman as an associate upon graduation from law school.

Throughout her career, Jennifer has found time to serve the community. She is a Past President of the Arlington County Bar Association and served on the Association's Board of Directors for many years. She has also served on the Arlington County Economic Development Commission and on the Board of Directors for the Friends of Argus and Aurora Houses. She is currently a member of the Virginia State Bar Council, the Arlington County and Northern Virginia Bankruptcy Bars and the Walter P. Chandler American Inn of Court.

Jennifer has been married to Colin Uckert for twelve years. They have a son and a daughter. When not busy with her law practice and family activities, Jennifer enjoys working out and coaching her children's sports teams.

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For over four decades, Bean, Kinney & Korman has been a leading Northern Virginia law firm that has continuously grown and diversified to meet the needs of its expanding community of clients and their increasingly complex legal needs. While we have grown in size and greatly expanded the depth and breadth of our capabilities, we have remained committed to those fundamental elements of value that are integral to our practice philosophy: experience, versatility, dedication to service, flexibility and efficiency.

Our responsive and exceptional quality service, coupled with our sensitivity to client needs, has established a professional reputation in which we take great pride. We are dedicated to achieving exceptional results for our clients in every matter we are entrusted to handle, mindful of each client's resources and unique circumstances. Delivering greater value to our clients day in and day out is how we will continue our reputation as one of the most highly regarded law firms in the Washington metropolitan region.

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