March
2010
Volume 10
Issue 2

BEAN KINNEY & KORMAN PC
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Business Law Newsletter

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THE DEAD MAN'S STATUTE

By: James V. Irving

What sounds like the title of John Grisham's next novel is actually an arcane and well-established rule of evidence.

At age ten, William Ray Phillips left his home and moved in with his aunt and uncle, Wayland and Margaret Council, on their Sussex County farm. The Councils had no children and Phillips was described by another relative as "the closest thing they had to a son." After high school, Phillips attended college, graduating in 1970. He took a job in Petersburg where he worked until 1977, when his uncle Wayland invited him back to the farm for a talk.

According to Phillips, the only surviving witness to the discussion, he met with the Councils in their kitchen, where they made him an offer: if he would move back to the Council's farm, they would sell him a parcel of land to build a house for himself, his wife and child. After Wayland retired in 1980, Phillips would rent the farm and take over the farming operation. In return, the Councils promised to leave to him all of their assets, whether real or personal when the last of them died. Phillips accepted the offer. This Kitchen Agreement was entirely oral and no memorandum of it ever existed.

Phillips sold his home, purchased land from the Councils and built a house, commuting to his job in Petersburg. In 1980, Wayland retired and thereafter Phillips operated the farm. In 1982, Wayland died. His will provided that upon his death, all his property was to go to Margaret, or to Phillips if Margaret predeceased him. According to Phillips, Margaret told him at that time that her will was "just like it."

In the years that followed, Phillips continued to operate the farm. When the plant closed in Petersburg in 1987, Phillips turned down a transfer to Georgia and accepted a lower paying job in Hampton in order to fulfill his bargain. But then things began to change.

According to other witnesses, Margaret became eccentric, reclusive and angry after Wayland's death. In 1996, she revoked a power of attorney that she'd given to Phillips and had her attorney notify Phillips that she'd "made some changes in her estate plan." When Margaret died in 2005, her will directed that all of her property go to the Virginia Home for Boys and Girls. Phillips filed suit seeking enforcement of the 1977 oral Kitchen Agreement with the Councils. He faced two related hurdles: the Statute of Frauds and the Dead Man's Statute.

Under the Statute of Frauds, an alleged oral agreement like the Kitchen Agreement is presumptively unenforceable. However, an oral contract for the transfer of real property may escape the strictures of the Statute of Frauds if there is evidence of part performance. To prevail, the promisee must show that: 1) the parole agreement is certain and definite in its terms; 2) the acts of part performance, performed in pursuance of the agreement, were proved; and 3) that the agreement has been so far executed that a refusal of full execution would operate as a fraud upon him.

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In Virginia, the Dead Man's Statute provides that no judgment shall be entered against one incapable of testifying (such as by death) based upon the uncorroborated testimony of the adverse party.

At trial, Phillips successfully argued that his part performance of the agreement satisfied the requirements of the Statute of Frauds. Phillips also persuaded the trial court that even though he was the only surviving participant to the 1977 Kitchen Agreement, he had satisfied the requirements of the Dead Man's Statute because sufficient elements of the promise were corroborated by other evidence, including his move back to Sussex, his operation of the farm after Wayland's retirement, and his decision to stay in Virginia and turn down a higher paying job in Georgia in order to fulfill the bargain.

The trial Court agreed and ordered transfer to Phillips of Margaret's net personal estate and real property. The Home appealed. The Supreme Court reversed and entered judgment for the Home.

The Supreme Court held that Phillips could not meet the first or second prongs of the Statute of Frauds test because there was no competent, independent evidence of the Kitchen Agreement. Similarly, he could not escape the Dead Man's Statute because there was no evidence corroborating his claims. While the threshold is low - the corroboration, said the Court, "need not rise to the level of confirmation, but need only serve to strengthen the surviving witness' account" - Phillips could produce no proof of the existence of the contract or its essential terms that was independent of his own evidence.

Application of these rules can sometimes lead to apparent injustice but, without them, there would be an increased opportunity for fraud based upon alleged promises that can not be rebutted from beyond the grave. The lesson is simple: if it's important enough, get it in writing. If the promise-maker is serious, this will not be an unreasonable request.

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TAX LAW - Employers Beware: IRS to Commence Intensive Employment Tax Audits

By: Ronald A. Feuerstein, Esquire

In November, 2009, the Internal Revenue Service announced in Headliner Volume 280 its first "Employment Tax National Research Project" ("ET NRP") in 25 years. Last month, audits of employers under this new program commenced.

Justifying the need for this new initiative, IRS has stated that business practices regarding employment tax issues may have changed significantly since IRS' employment tax study in the 1980's.

Using rather cryptic wording, Headliner Volume 280, issued November 9, 2009, IRS states that the employment tax examinations will be conducted in order for IRS to collect data that will enable it to understand the compliance characteristics of employment tax filers.

According to IRS, the results of these employment tax audits will enable it to gauge more accurately the extent to which businesses properly comply with employment tax law and various related reporting requirements. IRS' objective in this undertaking is to obtain information that will assist IRS in developing criteria for selecting and auditing employment tax returns filed in the future that have the greatest compliance risk.

IRS' stated two goals for the ET NRP:

1. To secure statistically valid information for computing the so-called "Employment Tax Gap" and
2. To determine compliance characteristics in order to enable IRS to focus on the most noncompliant employment tax areas.

According to Headliner Volume 280, ET NRP will entail the IRS randomly selecting 2,000 taxpayer employers each year for 2010, 2011 and 2012.

IRS' pronouncement states that the employment tax examination under the new program will be comprehensive in scope. Employers selected for these special audits will receive notices from IRS describing its National Research Project process.

According to IRS, records pertaining to employment tax returns and issues that arise in the examination will be subject to review during these audits. IRS advises that employers who are audited should have all of their records available in order to expedite the examination.

Months prior to issuance of Headliner 280, IRS officials, in speeches to the payroll industry and the American Bar Association's Tax Section, gave some details of what these special payroll audits will focus upon.

One of the most contentious areas that will receive great scrutiny by IRS agents will be "worker classification," which refers to whether a worker is properly classified as an independent contractor rather than as an employee. This issue has been a "hot button" topic with IRS for decades. Given a huge so-called "Tax Gap" for Federal payroll tax and self-employment tax that has been estimated by some at $200 Billion, IRS clearly has large proposed deficiencies and collections in its sights on worker classification issues alone. If a business classifies an employee as an independent

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contractor, approximately 30% in payroll taxes can be saved, reflecting both an incentive for noncompliance, as well as the large amount of tax, interest and penalties that could be at stake in an audit.

The worker classification issue includes section 530 relief issues. Section 530 refers to the Revenue Act of 1978, not to the Internal Revenue Code. Section 530 itself, has been a thorny issue for IRS since 1978.

Another important issue IRS will focus upon is the relatively new Internal Revenue Code section 409A, which was enacted in 2004 and created a sea-change in deferred compensation. In general, it applies a complex set of rules and traps for the unwary to stock option plans, cash bonus compensation plans, severance plans, and many other structures as well.

Other issues IRS plans to address in these audits include fringe benefits, executive compensation, reimbursed expenses, as well as a number of other areas.

Employers should be prepared in the event they are notified of an audit by IRS.

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NOTICE PLEADING

By: James V. Irving

The American concept of "Notice Pleading" arose when the Federal Rules of Civil Procedure were adopted in 1938. One of the goals of the new rules was to relax the common law tradition requiring exactitude and precision in pleading in compliance with procedural form. While certain claims - notably fraud - still require specificity, a Complaint filed under the Federal Rules is sufficient if the claim for relief contains "a short and plain statement of the claim showing that the pleader is entitled to relief." Such a claim will not be dismissed "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim."

In a Memorandum Opinion issued on November 17, 2009, Judge Robert E. Payne of the U.S. District Court for the Eastern District of Virginia commented negatively on the quality of the Plaintiffs' pleading but refused to dismiss several counts of the Amended Complaint in reliance on the Notice Pleading standards.

James River v. Kehoe et al. arose as complicated business tort litigation brought by way of a Complaint and a twelve count Amended Complaint. Defendants moved to dismiss several counts of the Amended Complaint for inadequately pleading of the claims based upon the following facts:

In 2007, James River began searching for a strategic partner to acquire the company through merger. As a result, a company called Fortress investigated that possibility subject to a Non-Disclosure Agreement that restricted Fortress' use of any information gained during the due diligence period leading up to the proposed merger. Ultimately, the Fortress proposal fell through and a different company acquired James River. Thereafter, James River alleged, its former president, Michael Kehoe along with the Managing Director of Fortress, helped form Kinsale for the purpose of competing with James River, and improperly used James River material for that purpose.

The Plaintiffs, three related companies collectively referred to as James River, sued three related corporations called "Kinsale" and six individuals involved with the formation of the Kinsale business group. James River contended that Kinsale and the individual defendants engaged in a "deceitful scheme and conspiracy" that "harmed James River through unlawful acts." The twelve counts included the full litany of business torts claims without a great deal of specificity as to which defendant did what. In fact, Judge Payne observed that it was the scattershot pleading approach to the Amended Complaint that invited the Defendants' dismissal motion that was before the Court.

Judge Payne's opinion noted that his prior Order permitting a limited amendment of the original Complaint had been intended to achieve "clarity, precision and brevity" and that the Amended Complaint left much to be desired. However after expressing his dissatisfaction with the Plaintiffs' pleading, he noted that under the Federal Rules "alleging plausible grounds 'simply calls for enough facts to raise a reasonable expectation that discovery will reveal evidence'."

Ultimately, the Court dismissed the Restitution/Unjust Enrichment Count, but only because it was redundant. He dismissed the Conversion Count, but with leave to Amend to specifically identify the basic information of what was converted by whom. Despite the sloppiness of the pleading and Judge Payne's obvious impatience, James River's claim will go forward. Whether the claims survive closer scrutiny at trial remains to be seen.

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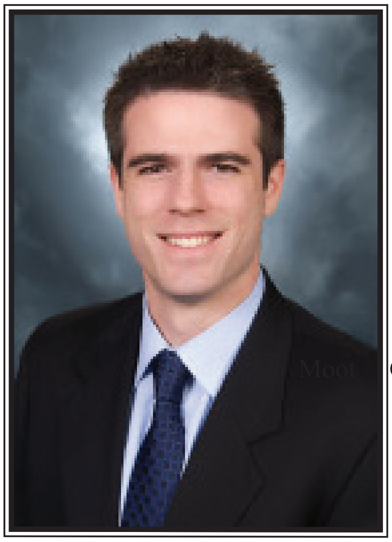

Mr. Groh's practice is focused on civil litigation, which has included disputes involving business matters, real estate claims, construction litigation, commercial landlord-tenant disputes, claims under the Perishable Agricultural Commodities Act, employment discrimination matters, product liability, maritime issues and foreign sovereign immunities claims. He has litigated in local Virginia as well as Federal trial courts, and has practiced before the United States Court of Appeals for the Fourth Circuit.

Mr. Groh is admitted to practice in Virginia, and is a member of the Alexandria and Fairfax Bar Associations. He is a graduate, *cum laude*, of the University of Pennsylvania, and received his law degree from George Mason University, where he was a member of the Moot Court Board.

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