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Business Law Newsletter

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PIERCING THE CORPORATE VEIL

By James V. Irving

As Judge Stephen S. Mitchell of the U.S. Bankruptcy Court for the Eastern District of Virginia noted in Cummings v. Atlis Systems, Inc. on April 10, 2008, piercing the corporate veil is an extraordinary remedy designed to prevent investors from manipulating the privilege of limited liability to the knowing disadvantage of those who deal with the corporation.

In October 2003, Valerie Cummings sold the stock of her business, Unique Nurses, Inc., to Allegiance Staffing, Inc. Allegiance was wholly owned by Atlis Systems, Inc, which in turn was controlled by Keith Cunningham.

In December of 2007, Cummings filed a voluntary petition for chapter 11 reorganization. Within that action, she brought suit against Cunningham, Atlis, Allegiance and Unique claiming damages resulting from the aftermath of the sale. The suit sought damages for breach of contract and breach of fiduciary duty, as well as a declaration that her salary repayment and non-competition obligations were unenforceable.

As part of the October, 2003 sale terms, Allegiance was to assume Unique's debts, some of which were guaranteed by Cummings. Additionally, Cummings was to be employed by Unique and was to receive stock in her old company and in Allegiance by way of a stock incentive grant.

According to the Complaint, Cummings never got the promised stock and the liabilities of Unique were never paid. Although most of her claims appeared to run to Allegiance, she sought judgment against the deep pocket and the decision maker. Her claims against Cunningham were based upon the theory that he had actual and legal control over all three companies; that he had conducted his business in order to maximize the profits of Atlis at the expense of Unique and Allegiance by, for example, shifting expenses; and that Atlis, Allegiance and Unique were operated as alter egos of Cunningham. The defendants moved to Dismiss, with Atlis and Cunningham taking the position that none of the four counts stated a claim as to them because any wrongful conduct was attributable to Allegiance or Unique.

In particular, Atlis and Cunningham contended that since they were not

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parties to either the October 2003 stock purchase agreement or the employment agreement, the claims against them were without basis. Cummings argued that because Cunningham "failed to treat the three corporations as independent entities," she was entitled to seek damages against Cunningham as well as the parent company (Atlis).

Without deciding whether Maryland or Virginia law applied, Judge Mitchell reviewed the case law in both jurisdictions and favorably cited diverse rationales. Relying on a 2003 Virginia case, Mitchell denied most of the Motion to Dismiss, noting that the corporate veil may be pierced if the entity is used to evade personal debts, commit fraud, commit injustice, gain unfair advantage, or when the individual and the corporation are operated as one.

The presumption in favor of corporate liability protection is well established in Virginia law and courts always hesitate to breach that shield. However, Cummings reminds us that corporations must operate independently from the will of their shareholders and that the liability protection afforded by the corporate status is not absolute. It can be forfeited in the case of egregious circumstances or fraudulent conduct.

EFFECTIVENESS OF ARBITRATION AGREEMENTS

By James V. Irving

Over the years, trial courts have demonstrated a notable willingness to lighten their dockets by enforcing arbitration agreements between parties. On March 6, 2009, The Honorable James P. Jones of the U.S. District Court in Big Stone Gap, Virginia handed down an opinion enforcing arbitration over the objection of the Plaintiffs who argued that the underlying contract containing the arbitration clause was never effective and could not be enforced. The case is A&G Coal Corp. v. Integrity Coal Sales, Inc.

Beginning in November 2006 and continuing through early 2008, Integrity purchased coal on several occasions from Plaintiffs A&G and Meg-Lynn Land Company. Each sale and delivery was pursuant to a written purchase order signed by Integrity and one or both of the two Plaintiffs. The dispute arose from a September 2007 Purchase Order that was to govern sales and shipments for calendar 2008 (the "2008 PO"). All Parties signed the 2008 PO.

In February 2008, A&D advised Integrity that they would no longer do business with Integrity due to Integrity's alleged breaches of the Purchase Order governing the 2007 shipments ("2007 PO"). When Integrity demanded deliver of coal under the 2008 PO, Plaintiffs asked the Federal Court to declare that they were not obligated to provide it. Integrity responded by moving to Dismiss or, in the alternative, compel arbitration, asserting that the dispute was subject to binding arbitration pursuant to the agreement between the parties embodied in the Purchase Orders.

The 2008 PO, like all other purchase orders between the parties, contained, as part of the General Terms, an agreement to arbitrate "any dispute or controversy arising from or relating to the parties to this agreement." However A&G and Meg-Lynn argued that they were not obligated to arbitrate disputes arising from the 2008 PO because two specific conditions precedent to the enforceability of the 2008 PO had not been met: the prior Purchase Order had not been completed, and Plaintiffs had not commenced the delivery of coal under the 2008 PO. Plaintiffs argued that since the dispute before the bar dealt exclusively with 2008 deliver obligations and since 2008 PO was unenforceable, Integrity could not rely on the arbitration clause contained among its terms.

The Court agreed with Plaintiffs that the condition precedent issue could be dispositive if this were the only agreement between the parties, but hesitated to rule on the enforceability of the 2008 PO, because to rule in Plaintiff's favor would be to effectively decide the case without arbitration. Relying on

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case law establishing that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration," Judge Jones noted that all prior POs between the parties contained identical language, requiring arbitration of any dispute. The Court relied on this broad language, ruling that whether or not the 2008 PO was enforceable, the prior agreements required arbitration. Presumably, this would have required arbitration of a dispute unrelated to the contract, such as a tort claim between the parties.

While not incorrect on the law, the Court's ruling in A&G demonstrates the strength of the presumption on favor of arbitration. If it's possible to move a case to arbitration, a trial court usually will. Before signing a contract, both parties should carefully consider not only whether they'd prefer arbitration, but precisely what issues and what circumstances should be arbitrated. In doing so, the parties should presume that a reviewing court will give the provision a broad reading.

RESIDENTIAL MORTGAGES AND UNDERWATER PROPERTY

by Thomas W. Repczynski

Bankruptcy laws are generally designed to provide debtors with a fresh start on their financial lives. To be sure there are a host of limitations, restrictions and exceptions which impinge upon the freshness of that new start. One long standing limitation is the inability of residential property homeowners to eliminate mortgage loan liabilities in excess of their homes' value. In the current marketplace, where most area jurisdictions are facing substantial declines in home values, many homeowners find themselves "upside down": owing more to the mortgage companies than their home is worth. Unfortunately, filing for bankruptcy provides little help because Bankruptcy Courts are not authorized to approve a Plan of Reorganization that calls for anything less than full payment to the primary mortgage lender. This limitation is particularly controversial because bankruptcy courts are permitted to compromise virtually every other type of financial obligation, including, for instance, the debtor's brand new vehicle if the Kelly Blue Book value is less than what the debtor paid for it.

Recent speculation in the press has suggested that an amendment to the law providing this type of relief to upside down homeowners was all but a foregone conclusion. However, on April 30, the Senate voted against adding this arrow to a debtor's quiver, instead embracing the countervailing concern voiced by mortgage lenders struggling to regain their financial footing.

Lenders lend with an appreciation of their risk of loss and the related ability to mitigate any such loss and the interest lenders charge for the money they lend is a direct reflection of this perceived risk. Any reduction of lenders' rights in their collateral necessarily serves to increase the perceived risk of loss and, consequently, the amount of interest to be charged to compensate for the increased risk. Extending to homeowners the ability to wipe out personal liability on mortgage deficiencies would also wipe out the lenders' chance to benefit from future market upswings when the collateral properties regain their temporary value loss.

While other work-out options remain viable and available for debtors, it appears that upside down homeowners will have to accept the bargain they have struck and await the inevitable market upswing.

Contact Us

2300 Wilson Boulevard, 7th Floor
Arlington, Virginia 22201
703·525·4000 fax 703·525·2207
www.beankinney.com

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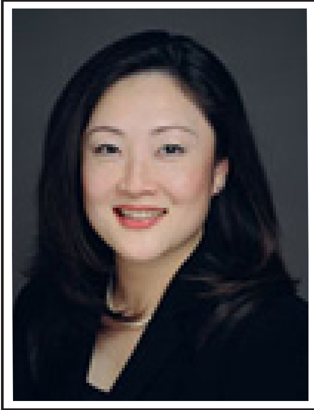

Jennifer Lee is an associate with the firm. She focuses her practice on business and corporate law; commercial transactions; government contracting; loan transactions and workouts; and estate planning. Ms. Lee represents and counsels small to mid-sized businesses from formation to exit.

Ms. Lee is a graduate of Binghamton University where she received her Bachelor of Arts with honors in Psychology and her Master of Arts in Experimental Psychology. She received her Juris Doctor from American University's Washington College of Law. While in law school Ms. Lee interned at the Office of Chief Counsel in the Enforcement Division of the United States Securities and Exchange Commission, the United States Department of Justice-Federal Programs Branch, and the D.C. Department of Insurance, Securities, and Banking.

Ms. Lee is the secretary and co-chair of the Events Committee for APABA-Va. She is also the firm's liaison in its strategic partnership with the D.C. Minority Business Enterprise Center – a business consulting agency funded by the Department of Commerce and overseen by the Department of Commerce's Minority Business Development Agency.

This newsletter was prepared by Bean, Kinney & Korman, P.C. as a service to clients and friends of the firm. The purpose of this newsletter is to provide a general review of current issues. It is not intended as a source of specific legal advice. © Bean, Kinney & Korman, P.C. 2009.

2300 WILSON BOULEVARD, 7TH FLOOR
ARLINGTON, VA 22201

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