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Recent Developments: VF Corp. v. Wrexham Aviation Corp.: Seller's Nondisclosure of Potential Tax Liability to Buyer Does Not Constitute Fraud Where Seller Lacks Knowledge of Final Tax Estimate and Relies upon the Advice of Counsel

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VF Corp. v. Wrexham Aviation Corp.

The Court of Appeals of Maryland, in *VF Corp. v. Wrexham Aviation Corp.*, 350 Md. 693, 715 A.2d 188 (1998), held that non-disclosure of potential tax liability does not constitute fraud where seller lacked knowledge of the final assessment and did not regard the preliminary tax estimate as material. The court further held that relying on the advice of an attorney, with respect to disclosure of the potential tax liability was evidence that the seller lacked the intent to deceive.

Wrangler Aviation, Inc. ("Wrangler"), an airfreight company, was a wholly owned subsidiary of VF Corporation ("VF"). VF began efforts to sell Wrangler because Wrangler was experiencing financial difficulties. In preparation for the impending sale, VF engaged an independent auditor to conduct an audit and prepare financial statements concerning Wrangler.

Following negotiations and full disclosure of Wrangler's current financial position, Wrexham Aviation Corporation ("Wrexham") contracted to buy Wrangler for nine million dollars. On the day before the sale was to be finalized, a field auditor informed Wrangler's treasurer that Wrangler had improperly received tax refunds of \$278,229.22 from the State of North Carolina. The field auditor also informed Wrangler's treasurer that the initial proposed liability after adding

SELLER'S NON-DISCLOSURE OF POTENTIAL TAX LIABILITY TO BUYER DOES NOT CONSTITUTE FRAUD WHERE SELLER LACKS KNOWLEDGE OF FINAL TAX ESTIMATE AND RELIES UPON THE ADVICE OF COUNSEL

By Walter W. Green

penalties and interest was \$372,199.45, but that this amount was not a final assessment due to the appeals process and the possibility of abatement of the interest and penalties.

Frank Pickard ("Pickard"), VF's treasurer and the person in charge of negotiations with Wrexham, was informed of the potential tax liability. Pickard consulted with VF's legal counsel regarding whether disclosure of the potential tax liability was required. VF's attorney advised that a tax audit in such a preliminary stage was too indefinite to merit disclosure. Relying on the advice of counsel, VF completed the sale of Wrangler to Wrexham without disclosing information concerning the potential tax liability. Less

than a week after the sale, the State of North Carolina made a proposed assessment of \$353,984.14 for reimbursement of the tax refund including interest and penalties. Under a negotiated agreement, Wrexham paid \$189,336.31 to satisfy the tax liability.

Wrexham sued VF in the Circuit Court for Baltimore City alleging that VF fraudulently misrepresented Wrangler's financial position and that VF breached the contract of sale by not fully disclosing Wrangler's true financial position. The jury found VF liable for \$535,000.00 under breach of contract. The jury also found VF liable for fraud and granted \$189,336.31 in compensatory damages as well as \$21.4 million in punitive damages. The Court of Special Appeals of Maryland affirmed both the contract and tort awards for compensatory damages, but vacated the punitive damages award and remanded the case for a post-verdict review.

VF challenged the award of compensatory and punitive damages under the tort count, alleging that the elements of fraud were not met, and therefore, the tort issue should not have been submitted to the jury. *VF Corp.*, 350 Md. at 702, 715 A.2d at 192. Countering this argument, Wrexham claimed that VF intended to misrepresent the financial position of Wrangler, asserting that Pickard received

Recent Developments

material information regarding the tax audit and “knowingly and willfully” withheld this information from Wrexham to ensure completion of the sale. *Id.* at 705, 715 A.2d at 194. The court of appeals, however, rejected Wrexham’s argument. *Id.*

The court of appeals began its analysis by examining the elements that must be proven by clear and convincing evidence to recover damages in an action based on fraud. *Id.* at 703-04, 715 A.2d at 193. The court stated that in order to prove fraud there must be, in pertinent part, a false representation made knowingly and intentionally, that was relied upon, and it must result in a compensable injury. *Id.* The court focused its analysis on the intent and knowledge elements. *Id.*

In so doing, the court noted that the deliberate intent to deceive is the basis for recovery of damages in a tort action for fraud. *Id.* at 704, 715 A.2d at 193 (citing *Ellerin v. Fairfax Savings*, 337 Md. 216, 652 A.2d 1117 (1995)). To establish fraud, the court explained that the defendant must have actual knowledge that the representation is false or, act with such reckless indifference by not determining the truth or falsity of the representation. *Id.* But, “negligence or misjudgment, ‘however gross,’ does not satisfy the knowledge element.” *Id.* (quoting *Ellerin*, 337 Md. 216, 652 A.2d 1117). Unless the intent to defraud is present, the court recognized that merely telling a “bare naked lie” will not support

an action for fraud. *Id.* (citing *McAleer v. Horsey*, 35 Md. 439, 453 (1872)).

In the instant case, the Court of Appeals of Maryland concluded that the evidence adduced at trial failed to establish the intent and knowledge elements by a clear and convincing standard. *Id.* at 705, 715 A.2d at 194. In so concluding, the court relied on Pickard’s testimony that he lacked knowledge of whether the tax audit was complete and that he believed the potential liability was inconsequential when compared with Wrangler’s revenues and expenses. *Id.* at 708-09, 715 A.2d at 194-96.

Although Wrexham asserted that Pickard was a seasoned executive who knew that he was required to disclose “material contingent liabilities,” Pickard’s testimony evidenced that he believed disclosure concerned a legal issue, and accordingly consulted VF’s attorney. *Id.* at 707, 712, 715 A.2d at 194, 197. Pickard was advised by counsel that he was under no duty to disclose since the audit was in the preliminary stages and revealed only the potential for liability. *Id.* The court stated that whether disclosure is mandatory is a question of contract interpretation and should be treated as a legal matter. *Id.* at 713-14, 715 A.2d at 198. The court concluded that seeking and relying on the advice of legal counsel “not only constitutes no evidence of fraud, but is evidence to the contrary.” *Id.* at 714, 715 A.2d at 198.

In *VF Corp. v. Wrexham Aviation Corp.*, the court held that the circumstantial evidence adduced at trial did not satisfy the clear and convincing standard required to prove fraud. Although VF’s treasurer had questions regarding the disclosure of information, seeking legal advice and following such advice evidenced a lack of intent to defraud. The Court of Appeals of Maryland reasoned that relying on legal advice may be compelling evidence that no fraud has occurred. The court’s holding sends a message that obtaining legal advice for certain matters can effectively combat the intent element of fraud.