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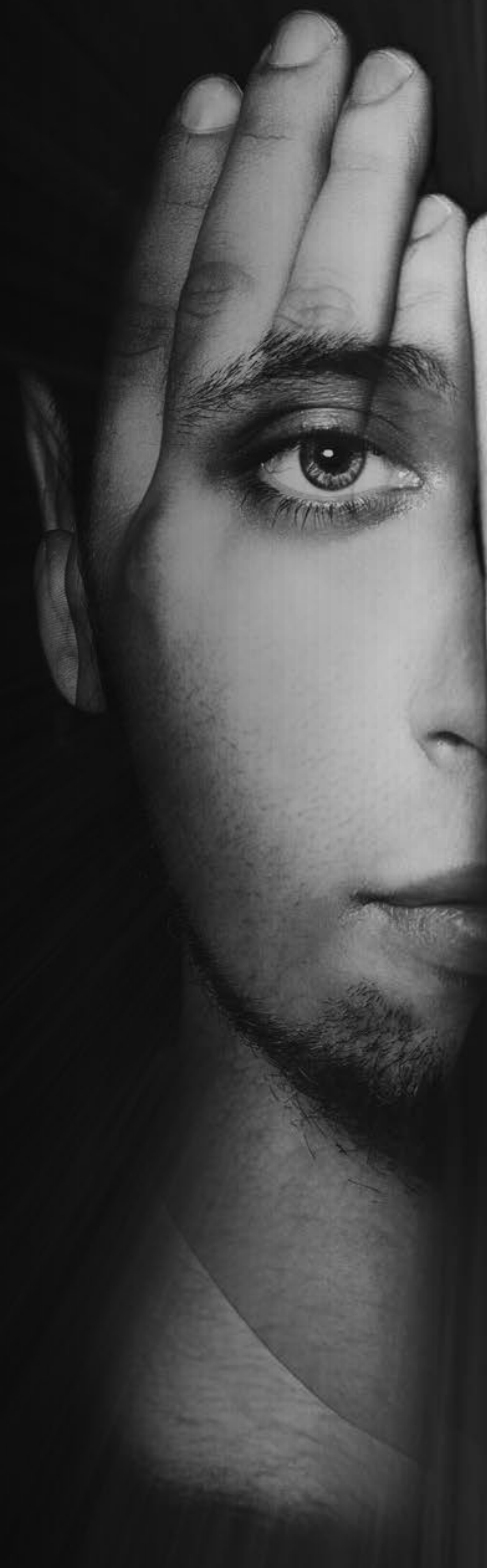
# The Alter Ego Article Doctrine in New York





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By Edward P. Yankelunas

For many generations, the corporation has been a key feature of the American enterprise system. By treating the corporation as a distinct entity separate and apart from its owner, the law has encouraged the innovation, entrepreneurship and industry that were the underpinnings of America's Industrial Revolution. Along with perpetual existence and transferability of ownership, the law permits a business to be incorporated for the very purpose of allowing the business owner to escape personal liability. Thus, ordinarily, the separate personalities of corporations and their owners "cannot be disregarded."[1] However, when the privilege to operate a business in the corporate form is abused, New York courts have disregarded the separate legal existence of the corporation and its owner and have pierced the corporate veil to hold business owners liable for the conduct and debts of the corporation.

## Piercing the Veil Between the Corporation and Its Owner

As reflected by Judge Benjamin Cardozo's 1926 opinion in *Berkey v. Third Avenue Railway Co.*,[2] "general rules of agency" were then considered the basis for imposing personal liability on business owners for the "perversion of the privilege to do business in a corporate form."[3] Under that analysis, "whenever anyone uses control of the corporation to further his own rather than the corporation's business, he will be liable for the corporation's acts 'upon the principle of *respondeat superior* applicable even where the agent is a natural person.'"[4] Over time, the instrumentality rule developed in New York as the most "practical and effectively applicable theory for breaking down corporate immunity where equity requires . . . to circumvent fraud or other legal wrong."[5] Under the instrumentality rule, the issue is whether the business owner has completely dominated the business and used the corporation as an instrumentality to do the owner's personal business. If that question is answered in the affirmative and the owner's conduct has harmed a third party – typically a creditor – the court may conclude that the corporation is the owner's alter ego, that neither the corporation nor the business owner has a separate personality, and may hold the owner responsible for the acts and debts of the corporation. As the Third Department aptly stated in *Rohmer Associates v. Rohmer*, where a "corporate entity has been so dominated by an individual . . . and its separate entity so ignored that it primarily transacts the dominator's business instead of its own and can be called the other's alter ego, the corporate form may be disregarded to achieve an equitable result."[6] That reasoning has been applied in New York to pierce the veil of limited liability companies.[7] Notably, as the New York Court of Appeals emphasized in *Morris v. State Department of Taxation & Finance*, "[w]hile complete domination of the corporation is the key to piercing the corporate veil, especially when the owners use the corporation as a mere device to further their personal rather than corporate business . . . such domination, standing alone, is not enough; some showing of a wrongful or unjust act toward [a third party] is required."[8]

Such action presupposes that the dominated corporate entity has an underlying obligation or liability to the party asking the court to pierce the corporate veil. A request for such a ruling is not an independent cause of action.[9] Moreover, although preponderance of the evidence is the applicable standard of proof – not clear and convincing evidence[10] – due to the long-standing reluctance of New York courts to disregard the corporate form, the party asking the court to use the court's equitable powers to pierce the corporate veil bears a "heavy burden"[11] of showing the requisite domination and resulting inequitable consequences. That showing should include demonstrating a "causal relationship" between misuse of the corporate form and harm suffered by the party asking the court to pierce the veil.[12]

An evaluation of a claim that the corporate form should be disregarded under the alter ego doctrine is a case-specific analysis that is "equitable in nature" and dependent on the "attendant facts and equities."[13] No one factor is dispositive. The following factors are typically relied upon by the courts in New York to hold a business owner responsible for the debts and conduct of the entity dominated by the owner:[14]

- The owner shuttles funds in and out of personal and corporate bank accounts.
- The owner uses corporate funds and property for personal purposes and obligations.
- The corporation or limited liability company (LLC) is under-capitalized.
- There is a lack of corporate formalities (i.e., issuance of stock, election of directors, keeping corporate records, etc.).
- Common office space and telephone numbers are used by the corporation or LLC and the individual business owner.
- There is an overlap in ownership, officers, directors and personnel.

## Proof of Fraud Is Relevant, but Not Essential

Significantly, it is not necessary to plead or prove fraud in order to pierce the corporate veil in New York. In fact, as the U.S. Court of Appeals for the Second Circuit ruled in *Passalacqua Builders, Inc. v. Resnick Developers South Inc. et al.*, it would be error for a court to instruct a jury "that plaintiffs were required to prove fraud" to pierce the corporate veil, stressing that "New York law . . . permits the corporate form to be disregarded where excessive control alone causes the complained of loss."[15] According to the court, the "critical question is whether the corporation is [a] 'shell' being used by the [business owners] to advance their own purely personal rather than corporate ends."[16]

Nevertheless, even if not essential, proof of fraud is certainly relevant.[17] Indeed, being able to show fraud can only help the party seeking to pierce the corporate veil because facts demonstrating fraud will increase the likelihood that the court will use its equitable powers to disregard the corporate form. Such showings would include the classic "indicia of fraud" – that is, the transfer of corporate funds between family members initiated by the dominating business owner, the owner retaining control of the funds after the transfer and the lack of consideration for the transfer.[18] For example, in *Colonial Surety Co. v. Lakeview Advisors, LLC*, the judgment debtor formed a limited liability company of which he was the manager and sole principal. In affirming the "reverse-piercing" of the LLC, the Fourth Department noted that the debtor not only used the LLC's funds for personal expenses but also used the LLC's funds to "make payments to his wife in lieu of his salary."[19]

Another fraud-based argument that has persuaded New York courts to pierce the corporate veil is "constructive fraud," which consists of the transfer of corporate assets without consideration in order to put assets beyond the reach of creditors. In *EAC of New York v. Capri 400, Inc.*,[20] the petitioner in that CPLR Article 52 proceeding sought to enforce a judgment against a corporation that had sold a restaurant business to the petitioner. The contract provided that the corporate seller hold a mortgage for $350,000 on the real estate involved in the transaction. However, at closing the mortgage was executed in favor of the corporation's owner, who then kept most of the sale proceeds, allegedly in payment of a loan owed to him by the corporation. The owner also claimed that he was entitled to a "dividend distribution" from the corporation in the amount of $346,000, which justified the assignment to him of the $350,000 mortgage. When the petitioner sought to pierce the corporate veil and enforce its judgment against the corporation's owner, the owner conceded his domination of the corporation. This turned the court's attention to whether the owner utilized his domination and control to perpetrate a "fraud or wrong against petitioners which resulted in their injury." Holding that the owner had engaged in a "constructive fraud" that injured the petitioner, the Third Department said:

> Here, the wrongful act consisted of a fraudulent transfer of corporate assets by [the owner], as director and officer of the corporations, to himself, as an individual. Even without proof of intent to defraud, constructive fraud may be shown where the debtor transfers assets without fair consideration and the debtor becomes insolvent. . . . [The owner's] transfer of all corporate assets – namely the mortgage – from [the corporation] to himself cannot be considered a conveyance in good faith, as it rendered the corporation insolvent at the expense of [the corporation's] creditors, namely petitioners.[21]

## Piercing the Veil Between Corporations

The alter ego doctrine has also been applied in New York to pierce the veil between corporations when affiliate or subsidiary corporations are used by a dominating parent corporation to engage in wrongful conduct. As stated by the U.S. District Court for the Southern District of New York in *Trabucco v. Intesa Sanpaolo, S.p.A*,

> [u]nder New York Law, one corporation is considered to be mere alter ego when it "has been so dominated by . . . another corporation . . . and its separate identity so disregarded, that it primarily transacted the dominator's business rather than its own." . . . Then, the dominating corporation will be held liable for the actions of its subsidiary . . . Alter ego cases typically involve the determination of "which corporate parties may be cast in damages for the breach" of a contract. . . . In this analysis, control is the key.[22]

the policyholder-plaintiffs alleged that after obtaining approval from the New York State Superintendent of Insurance to restructure an insurance corporation and its related subsidiaries and affiliates, the corporate parent allegedly stripped approximately $5 billion in cash and securities from the subsidiary insurance company for no consideration in violation of the N.Y. Debtor and Creditor Law and the parent's common law duties. Concluding that the policyholders' "complaint adequately states a claim for abuse of the corporate form that may support a declaration piercing the corporate veil of the [subsidiary insurance company]," the Court of Appeals reinstated the policyholders' claims that the parent "abused its control of its wholly-owned subsidiary . . . by causing it to engage in harmful transactions that now shield billions of dollars in assets from plaintiffs and expose them to significant liability."[26]

**Constructive fraud consists of the transfer of corporate assets without consideration in order to put assets beyond the reach of creditors.**

The following are factors considered by the courts in New York in determining whether the alter ego doctrine should be used to pierce the veil between corporate entities.[23] Again, no one factor is dispositive and "all need not be present to support a finding of alter ego status":[24]

- the absence of corporate formalities such as issuance of stock, election of directors, etc.;
- inadequate capitalization;
- whether funds are put in and taken out of the corporation for personal rather than corporate purposes;
- overlap in ownership, officers, directors and personnel;
- common office space, address and telephone number for the corporate entities;
- the amount of business discretion displayed by the allegedly dominated corporation;
- whether the related corporations deal with the dominated corporation at arm's-length;
- whether the corporations are treated as independent profit centers;
- the payment or guarantee of debts of the dominated corporation by other corporations in the corporate group;
- whether the dominating corporation in question uses property owned by the dominated corporation as if it were its own.

The N.Y. Court of Appeals was called upon to pierce the veil between corporations in *ABM AMRO Bank N.V. v. MBIA Inc.*,[25] a case resulting from the deterioration of the world financial markets that began in 2007. There,

Likewise, in *Last Time Beverage Corp. v. F&V Distribution Co., LLC,* the plaintiff-judgment creditor obtained a judgment against a limited liability company (LLC) relative to various soft drink distribution agreements. It sought to pierce the LLC's corporate veil to hold a related corporation responsible for the judgment on the grounds that the LLC and the corporation were controlled by the same owner. The proof presented to the court showed that the LLC and the alter ego corporation had overlapping ownership, officers and personnel, that both entities used the same office space, that the LLC was undercapitalized without a "substantial loan" from the related corporation, and that both entities failed to observe corporate record-keeping formalities. The Second Department upheld the ruling of a referee that the LLC and the corporation were "jointly and severally liable" under the agreements at issue and that the LLC and the corporation "were alter egos of [their owner] and, accordingly, of one another."[27]

Similarly, in *N.Y. District Council of Carpenters Pension Fund v. Perimeter Interiors Inc.*, a union asserted a claim for ERISA contributions. Both the corporation that employed union carpenters and a related non-union corporation were dominated by the same individual owner. The non-union corporation never signed the relevant union collective bargaining agreement (CBA). The court noted the existence of evidence satisfying certain of the corporation-to-corporation alter ego factors listed above, such as common employees and commingled funds. As for wrongful conduct, the court found the business owner secretly used the non-union corporation to receive and distribute wages covered by the CBA for which ERISA contributions were payable. After finding that both the union and non-union corporations were "alter egos of one another," the court concluded that the non-union corporation was just as obligated as the union corporation under the CBA to pay the required contributions.[28]

## Reverse Piercing

Courts traditionally pierce the corporate veil to hold a controlling shareholder personally liable for a corporate debt. However, where the business entity and its controlling owner are alter egos, under the reverse-piercing doctrine the "piercing flows in the opposite direction and makes the corporation liable for the debt of the [owner]."[29] As long as the required showing is made, "[t]he direction of the piercing [traditional or reverse] is immaterial."[30] "In both situations there is a disregard of the corporate form, and the controlling shareholders [or business owners] are treated as alter egos of the corporation and vice versa."[31] In effect, since the business owner and the corporation are alter egos, they are merely two sides of the same coin.

Reverse-piercing has also been applied between corporations to hold a subsidiary liable for the debts of its parent. While applying veil piercing in that context may not be common or traditional, as Judge Learned Hand wrote in 1929 in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*, "it would be too much to say that a subsidiary can never be liable for a transaction done in the name of a parent."[32] Under recent cases applying New York law, the courts have held that a creditor may "reach the subsidiary through its parent, or in other words, to collapse . . . the parent, into . . . the subsidiary."[33] Guided by the same "rules that govern straight veil piercing," using reverse piercing a court may "hold a subsidiary liable for the debts of its parent."[34]

The court's description of reverse piercing among corporate entities in *Miramax Film Corp. v. Abraham et al.* is instructive. Noting that reverse piercing the veil of a dominated business entity to impose liability on the dominating entity may be "rare" but "appropriate in cases where the alter ego is being used as a 'screen' for the dominating entity," the U.S. District Court for the Southern District of New York stated:

> If it is found that a shell corporation was used by a dominating entity as a means to commit a fraud or other wrongful act against a plaintiff, then the legal fiction of corporate separateness vanishes, and the dominating entity and the shell corporation are deemed a single unit. This would render the assets of the dominating entity and the shell corporation to be deemed one and the same.[35]

Put another way, since the dominating parent corporation and the dominated subsidiary are alter egos of each other, and since piercing between alter egos flows in both directions, the subsidiary is liable for the debts and conduct of the parent, just as the parent is held liable for the debts and conduct of the subsidiary.

## Substance Over Form

Moreover, in reviewing a request to pierce the corporate veil under the alter ego theory, New York courts will not place form over substance.[36] The accounting treatment of a transaction is not dispositive. A court will not permit accounting mechanisms to trump the facts and to be improperly used to shield assets from creditors, or to otherwise engage in wrongful conduct. Rather, the focus is not on the accounting treatment of a transaction, but on the reality of the actual conduct of the dominating business owner or corporation, and whether the conduct is fraudulent or inequitable and has caused harm.

Consider the following example: A judgment debtor is the owner of a business that he controls; the owner uses funds deposited in the corporate bank account for purely personal purposes and transfers corporate funds from that bank account to his wife for no consideration. In opposing the judgment creditor's claim that the corporation and the owner are merely alter egos, the business owner relies on financial statements and tax returns showing that his use of corporate funds for personal purposes, as well as the transfer of corporate funds to his wife, are treated as distributions of corporate earnings to the owner. Further assume, however, that in order to evade his judgment creditor, the owner never takes possession of the alleged corporate distributions by depositing the funds in his personal bank account. Focusing on the reality that the owner never had possession of the alleged distributions of income, which enabled him to evade his personal judgment creditor, a New York court will likely reject the judgment debtor's accounting explanation and hold that the owner and corporation are alter egos of each other and will pierce the veil of the corporation to prevent the owner from using the corporation to frustrate the rights of the judgment creditor.

## Conclusion

With a certain literary flair, the U.S. Court of Appeals for the Second Circuit stated in *Brunswick Corp. v. Waxman* that the law in New York relative to piercing the corporate veil "is hardly as clear as a mountain lake in springtime."[37] One reason for this statement is that equity is not an exact science. Considered "impossible to define completely," equity has been described as a means to ameliorate "harsh or otherwise undesirable effects resulting from a strict application of any particular rule of law."[38] In the context of corporations, a strict application of the law would leave a court without the ability to fashion a remedy when the corporate form is used to evade a judgment or some other obligation, or is otherwise abused at the expense of a third party. Fortunately, however, settled notions of equity provide New York courts with the power to pierce the corporate veil in order to strike the proper balance between the laudable policy behind the legal fiction of the separate identity of a corporation and its owner, and the "need to protect those who deal with the corporation."[39] Although the burden of convincing a court to pierce the corporate veil is heavy, if that burden is satisfied by the "attendant facts and equities," New York courts have not hesitated to disregard the fiction of corporate separateness in order to achieve a fair and just result. ■

1. *Port Chester Elec. Constr. Corp. v. Atlas et al.*, 40 N.Y.2d 652, 656 (1976).

2. 244 N.Y. 84, 95 (1926).

3. *Id.*

4. *Walkovszky v. Carlton*, 18 N.Y.2d 414, 417 (1966) (quoting *Rapid Tr. Subway Constr. Co. v. City of N.Y.*, 259 N.Y. 472, 488 (1932)).

5. *Lowendahl v. Baltimore & Ohio R.R. Co.*, 247 A.D. 144, 156 (1st Dep't), *aff'd*, 272 N.Y. 360 (1936); *see also Brunswick Corp. v. Waxman*, 459 F. Supp. 1222, 1229 (E.D.N.Y. 1978), *aff'd*, 599 F.2d 34 (2d Cir. 1979).

6. 36 A.D.3d 990, 991 (3d Dep't 2007).

7. *Last Time Beverage Corp. v. F&V Distrib. Co., LLC*, 98 A.D.3d 947 (2d Dep't 2012); *Grammas v. Lockwood Assoc., LLC*, 95 A.D.3d 1073 (2d Dep't 2012); *Colonial Sur. Co. v. Lakeview Advisors, LLC*, 93 A.D.3d 1253 (4th Dep't 2012).

8. 82 N.Y.2d 135, 141–42 (1993).

9. *First Keystone Consultants, Inc. v. Schlesinger Elec. Contractors*, 871 F. Supp. 2d 103, 124 (E.D.N.Y. 2012); *Robinson v. Day*, 103 A.D.3d 584, 588 (1st Dep't 2013).

10. *Rotella v. Derner*, 283 A.D.2d 1026 (4th Dep't 2001).

11. *TNS Holdings Inc. v. MKI Sec. Corp.*, 92 N.Y.2d 335, 339 (1998).

12. *Giordano v. Thompson*, 438 F. Supp. 2d 35, 48 (E.D.N.Y. 2005).

13. *Morris v. State of N.Y. Dep't of Taxation & Fin.*, 82 N.Y.2d 135, 141 (1993).

14. *Miramax Film Corp. v. Abraham, et al.*, 2003 U.S. Dist. LEXIS 21346 at *22–23 (S.D.N.Y. 2003); *Millennium Constr., LLC v. Loupolover*, 44 A.D.3d 1016, 1017 (2d Dep't 2007); *John John, LLC v. Exit 63 Dev., LLC*, 35 A.D.3d 540, 541 (2d Dep't 2006).

15. 933 F.2d 131, 141 (2d Cir. 1991).

16. *Id.* at 138.

17. *Julien J. Studley, Inc. v. Lefrak*, 48 N.Y.2d 954 (1979); *Rotella*, 283 A.D.2d 1026.

18. *FDIC v. Conte*, 204 A.D.2d 845, 846 (3d Dep't 1994).

19. 93 A.D.3d 1253, 1255 (4th Dep't 2012).

20. 49 A.D.3d 1006 (3d Dep't 2008).

21. *Id.* at 1007 (internal citations omitted).

22. 695 F. Supp. 2d 98, 107 (S.D.N.Y. 2010).

23. *Passalacqua Builders, Inc.*, 933 F.2d at 139.

24. *N.Y. Dist. Council of Carpenters Pension Fund v. Perimeter Interiors, Inc.*, 657 F. Supp. 2d 410, 421 (S.D.N.Y. 2009) (quoting *C.E.K. Indus. Mech. Contractors, Inc. v. N.L.R.B.*, 921 F.2d 350, 354 (1st Cir. 1990)).

25. 17 N.Y.3d 208 (2011).

26. *Id.* at 229.

27. 98 A.D.3d 947, 950–51 (2d Dep't 2012).

28. 657 F. Supp. 2d 410, 421–22 (S.D.N.Y. 2009).

29. *Sweeney, Cohn, Stahl & Vaccaro v. Kane*, 6 A.D.3d 72, 75 (2d Dep't 2004).

30. *State of N.Y. v. Easton*, 169 Misc. 2d 282, 290 (Sup. Ct., Albany Co. 1995).

31. *Sweeney, Cohn, Stahl & Vaccaro*, 6 A.D.3d at 76.

32. 31 F.2d 265, 267 (2d Cir. 1929).

33. *Sec. Investor Prot. Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293, 320 (S.D.N.Y. 1999).

34. *Id.* at 321.

35. 2003 WL 22832384, *10 (S.D.N.Y. Nov. 25, 2003) (citations omitted).

36. *Wajilam Exports (Singapore) PTE. LTD v. ATL Shipping Ltd. et al.*, 475 F. Supp. 2d 275, 282 (S.D.N.Y. 2006); *Vebeliunas v. Babitt*, 2002 U.S. Dist. LEXIS 1271, *29 (S.D.N.Y. 2002).

37. 599 F.2d 34, 35 (2d Cir. 1979).

38. 55 N.Y. Jur. 2d, Equity, § 1, p. 423 (1986).

39. *Passalacqua Builders, Inc.*, 933 F.2d at 139.


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