COMMERCIAL LITIGATION

Easy to Allege, Difficult to Substantiate

Piercing the corporate veil

By Leo K. Barnes Jr.

With plaintiffs seeking to maximize a source of recovery and defendants seeking to minimize the same, discovery in commercial matters may focus upon the liability of an individual shareholder for a claim asserted against a corporation. Plaintiffs are quick to name shareholders as defendants in their individual capacities and defense counsel rapidly characterize the same as an improper ploy to expand the asset pool for a potential recovery. The Court of Appeals was perfectly clear in *Murtha v. Yonkers Child Care Association*, 45 N.Y.2d 913, 411 N.Y.S.2d 219 (1978):

> A "director of a corporation is not personally liable to one who has contracted with the corporation on the theory of inducing a breach of contract, merely due to the fact that, while acting for the corporation, he has made decisions and taken steps that resulted in the corporation's promise being broken" []. "(A) corporate officer who is charged with inducing the breach of a contract between the corporation and a third party is immune from liability if it appears that he is acting in good faith as an officer * * * (and did not commit) independent torts or predatory acts directed at another"[internal citations omitted].

Nonetheless, one who dominates a corporation so to commit a fraud will not escape personal liability for acts performed as an officer or shareholder. *Matter of Morris v. New York State Dept. of Taxation & Fin.*, 82 N.Y.2d 135, 141, 603 N.Y.S.2 807 (1993) confirms that a party seeking to pierce the corporate veil, based upon allegations of shareholder fraud, must establish that "(1) the owners exercised complete domination of the corporation in respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury."

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Knowing that the Plaintiff, at the early stage of the litigation, may not have sufficient documented proof to substantiate a claim against an individual shareholder, defense counsel's knee jerk reaction to a defendant named in his personal capacity may be to move to resolve the claim via CPLR 3211 or 3212. But in all but the most clear cut cases, courts are not so accommodating because a plaintiff's theories of liability are premised upon factual allegations of the exercise of complete domination and control. "Veil-piercing is a fact-laden claim that is not well suited for resolution on a motion to dismiss." *First Bank of Americas v. Motor Car Funding*, 257 A.D.2d 287, 690 N.Y.S.2d 17 (1st Dep't 1999). Before dismissal can be granted, plaintiffs are entitled to obtain necessary discovery to ascertain whether grounds exist to pierce the corporate veil. Thus, a robust round of discovery is often necessary to determine whether a shareholder named as a defendant in his or her individual capacity so dominated the corporation so as to justify a piercing of the corporate veil.

Piercing may also occur absent fraud. "The corporate veil will be pierced to achieve equity, even absent fraud, when a corporation has been so dominated by an individual or another corporation 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." *John John LLC v. Exit 63 Dev. LLC*, 35 A.D.3d 540, 826 N.Y.S. 2d 657 (2nd Dep't 2006). In general, courts consider the following factors in determining whether a party's domination and control of a corporation, and abuse of the privilege of doing business in the corporate form, warrants piercing the corporate veil:

(1) the absence of the formalities and paraphernalia that are part and parcel of the corporate existence, *i.e.*, issuance of stock, election of directors, keeping of corporate records and the like, (2) inadequate capitalization, (3) whether funds are put in and taken out of the corporation for personal rather than corporate purposes, (4) overlap in ownership, officers, directors, and personnel, (5) common office space, address and telephone numbers of corporate entities, (6) the amount of business discretion displayed by the allegedly dominated corporation, (7) whether the related corporations deal with the dominated corporation at arms length, (8) whether the corporations are treated as independent profit centers, (9) the payment or guarantee of debts of the dominated corporation by other corporations in the group, and (10) whether the corporation in question had property that was used by other of the corporations as if it were its own.[1]

Mindful of the liberal scope of discovery,[2] demands may be broad and, depending upon which side of the "v" you are on, intrusive. Of course, the demands must be tailored on a case- by-case basis, but a cursory review of the ten foregoing factors which may determine whether domination or alter ego liability exists directs counsel to a host of relevant discovery demands which may include personal and corporate banking information, corporate resolutions, meeting minutes, and the like.

The result of that investigation may yield significant leverage (or vulnerability). See, e.g., *Fern Inc. v. Adjmi*, 97 A.D.2d 444, 602 N.Y.S.2d 615, (1st Dep't 1993)(Plaintiff established a cause of action for piercing the corporate veil so as to impose liability for the rent obligations of corporation upon the individual defendant where the corporation, as a mere alter ego of that defendant, had no assets, liabilities or income, no regularly elected officers or directors, and no bank accounts, and which had never transacted any business other than entering into the subject lease agreement) and *Latham Sparrowbush Associates v. Shaker Estates, Inc.*, 153 A.D.2d 788, 545 N.Y.S.2d 219 (3rd Dep't 1989)(corporation's separate identity was properly disregarded to recover unpaid rent against an individual where the individual was the sole shareholder of the corporation, the corporation had existed for more than 20 years without holding a corporate meeting, and the individual repeatedly reported the profit or loss of the corporation as a sole proprietorship on his income tax return).

In light of the potential for personal exposure, shareholders must implement procedures for regular interaction with an accountant and counsel to confirm compliance with fundamental formalities; in addition to fostering peace of mind, the undertaking will go a long way toward limiting personal liability.

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1 *Wm. Passalacqua Bldrs., Inc. v. Resnick Devs. S., Inc.*, 933 F.2d 131, 139 (2nd Cir. 1991).

2 CPLR 3101 mandates that there "shall be full disclosure of all matters material and necessary in the prosecution or defense of an action." The Court of Appeals has explained that the words "material and necessary" are to be liberally construed "to require disclosure, upon request, of any facts bearing on the controversy which will assist preparation for trial by sharpening the issues and reducing delay and prolixity." *Allen v. Crowell-Collier Pub. Co.*, 21 N.Y.2d 403, 406-07, 288 N.Y.S.2d 449 (1968). Thus, the CPLR "requires the disclosure of all evidence relevant to the case and all information reasonably calculated to lead to relevant evidence." *See also* Siegel, *New York Practice* § 344, at 525 (3rd Ed. 1999).