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Liabilities of Individuals for Their Business's Debts

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LIABILITIES OF INDIVIDUALS FOR THEIR BUSINESS'S DEBTS

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I. GENERALLY

-Corporations: The ordinary rule is that a corporation is responsible for its own debts, and individuals or other entities who own, or are officers or directors of, the corporation, are not responsible for the corporation's liability. "Corporate officers may not be held personally liable on contracts of their corporations, unless they purport to bind themselves individually under such contracts. Westminster Constr. Co., Inc., 160 A.D.2d 867, 554 N.Y.S.2d 300, 301 (2d Dep't 1990). "Officers, directors or employees of a corporation do not become liable to one who has contracted with the corporation for inducing the corporation to breach its contract merely because they have made decisions and taken actions that resulted in the corporation's breaching its contract." Citicorp Retail Services, Inc. v. Wellington Mercantile Services, Inc., 90 A.D.2d 532, 455 N.Y.S.2d 98, 99 (2d Dep't 1982). Further, the rule in New York is that "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." Id. (quoting Murtha v. Yonkers Childcare Assn., 45 N.Y.2d 913, 915, 411 N.Y.S.2d 219, 383 N.E.2d 865 (1978)); Propoco, Inc. v. Ostreicher, 134 A.D.2d 580, 521 N.Y.S.2d 482, 484 (2d Dep't 1987).

-Limited Liability Corporations (LLC): If the LLC was formed correctly and managed as a separate legal entity from the member's personal assets, the members should be protected from most debts or liabilities arising out of the operation of the LLC's business, with the same exceptions as with corporations. Members of a LLC should take note: State LLC laws generally protect an LLC member from incurring personal liability for breach of contracts. A member of a LLC can be personally liable if the contract is improperly signed or if language in the contract makes the member personally liable, though. For example, an LLC member who signs a contract that does not include the LLC's name and the member's position with the LLC as part of the signature line runs the risk of personally liability. Furthermore, even in situations where the contract's signature line is correct, a member can be personally liable if there is a provision in the contract stating the member is liable. The LLC member must take care in signing LLC contracts to avoid personal liability.

- But see: Stuyvesant Fuel Serv. Corp. v. 99-105 3rd Ave. Realty LLC, 192 Misc. 2d 104 (Civil Court of the City of New York, Bronx County 2002): The court denied dismissal of a lawsuit against individual members of a LLC, noting that through its articles of organization, an LLC can impose personal liability on a member provided that the member files a written consent or specifically voted for the adoption of a personal liability provision. The Court concluded that the individual defendants' failure to provide the LLC's articles of organization prevented the Court from determining whether the defendants were personally liable for the LLC's obligations.

- **Limited Liability Partnerships (LLP):** New York Partnership Law §26(b) describes the liability protection for partners in registered LLPs, as follows: "Except as provided by subdivisions (c) and (d) of this section, no partner of a partnership which is a registered limited liability partnership is liable or accountable, directly or indirectly (including by way of indemnification, contribution or otherwise), for any debts, obligations or liabilities of, or chargeable to, the registered limited liability partnership or each other, whether arising in tort, contract or otherwise, which are incurred, created or assumed by such partnership while such partnership is a registered limited liability partnership, solely by reason of being such a partner or acting (or omitting to act) in such capacity or rendering professional services or otherwise participating (as an employee, consultant, contractor or otherwise) in the conduct of the other business or activities of the registered limited liability partnership."

- **Exceptions to Third-Party Liability Protection for partners in a LLP:** New York's full liability shield for partners in a LLP contains three exceptions for the following: (1) direct liability; (2) supervisory liability; and (3) liability imposed by partnership agreement. Individual partners remain personally and fully liable for any negligent or wrongful act they themselves committed or that was committed by a person under their direct supervision and control. N.Y. Pship. Law §26(c). However, the first two exceptions do not render the partner liable for the debts of the partnership generally. See, e.g. Jacobs v. Altorelli (In re Dewey & LeBoeuf LLP), 518 B.R. 766, 778 (Bankr. S.D.N.Y. 2014) ("Extending an individual LLP partner's liability to liability arising from that partner's wrongful conduct [including based on the conduct of someone the partner supervised] does not make that LLP partner liable for the debts of the partnership generally… .")

II. **Exceptions to the General Rule for Corporations, LLCs**: The exceptions to the general rule are other entities can be personally liable for the corporation's debt by (1) agreement (guarantee); (2) statute; or (3) judicial decision

III. Contractual Liability:

Generally:

Be careful about the language in the contract or how you sign a check if you are an officer or a member of a corporation, LLC or LLP:

A corporate buyer's shareholder who signed checks without indicating he was signing in corporate representative capacity, and who later stopped payment on checks, was held personally liable for amount of checks and service charges imposed, unless could show there was an understanding implicit in the course of dealings that he was acting in his personal capacity, only. Golden Distributors, Ltd. v. Garced, 134 BR at 769-70 (Bankr. S.D.N.Y. 1991) ("An authorized representative who signs his own name to an instrument (a) is personally obligated if the instrument neither names the person represented nor shows that the representative signed in a representative capacity; (b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity. N.Y. U.C.C. Law § 3-403(2) [McKinney 1964]. This statute must be strictly construed as imposing personal liability a maker of a check who fails to indicate his representative capacity on the instrument.")

In Losh Family, LLC v. Kertzman, 155 Wn.App. 458, 228 P.3d 793 (April 12, 2010), the Washington Court of Appeals ruled that where a lease assignment included language that "the lease was assigned to 'William and Teresa Grover as individuals, dba Grover International, LLC. ("dba" of course being the customary abbreviation for 'doing business as.')", the language in the assignment referred to the Grovers personally and the LLC's signature did not limit the assignment's imposition of personal liability on the Grovers. The court referred to the "long established principle that where an agreement contains language binding the individual signer, 'additional descriptive language added to the signature does not alter the signer's personal obligation.'" Losh Family, LLC, 155 Wn.App. at 463 (quoting Wilson Court Ltd. P'ship v. Tony Maroni's Inc., 134 Wn.2d 692, at 704, 952 P.2d 590 (1998)).

Guarantors/Suretyship/Guaranty/Guarantee: Miscellaneous

As reviewed in In re Lehman Bros. Holdings, 2019 Bankr. LEXIS 1734 (Bankr. S.D.N.Y. 5/30/19):

> A guarantee is a contractual promise by one party, the guarantor, to fulfill the debts or obligations of another party, the primary obligor, in the event of a default by such primary obligor. See Lakhaney v. Anzelone, 788 F. Supp. 160, 163 (S.D.N.Y. 1992); 38 AM. JUR. 2D Guaranty § 1 (2019). Under New York law, guarantees are governed by contract law and, like any other contract, a guarantee can only be made by mutual assent of the parties. See CavendishTraders, Ltd. v. Nice Skate Shoes, Ltd., 117 F. Supp. 2d 394, 400 (S.D.N.Y. 2000); Davis Sewing-Mach. Co. v. Richards, 115 U.S. 524, 525 (1885).
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> "Guaranties are distinguished in the law as being either general or special." EvansvilleNat. Bank v. Kaufmann, 93 N.Y. 273, 276 (1883). A "special" or "specific" guarantee identifies the benefiting creditor or underlying agreement being guaranteed, whereas a "general" guarantee is addressed to persons generally and may be enforced by anyone to whom it is presented. Seeid.; 38 AM. JUR. 2D Guaranty § 14. To enforce a general guarantee, a creditor must demonstrate that it had definite knowledge of

> the existence of the guarantee and that it acted in reliance on it when entering into the transaction with the primary obligor. See Fed. Deposit Ins. Corp. v.Schuhmacher, 660 F. Supp. 6, 8 (E.D.N.Y. 1984) ("It is, of course, elementary that a creditor's right to enforce a contract of guaranty must be based upon knowledge of the existence of the guaranty and that the credit must be extended in reliance thereof.") (citation omitted); 38 AM. JUR. 2D *Guaranty* § 14.

A series of IOUs without a description of anything is insufficient to overcome the statute of frauds defense under NY GOL 5-701(a)(2) to show an enforceable guarantee, DeRosis v Kaufman, NYLJ 5/9/96 at 25 c.3, 1st

Merchants Bank of NY v. Kluger (NYLJ 12/4/95 at 26 c.3 (Sup Ct., AD, 1st Dept): in a case where the defendants argued that they received oral confirmation from a bank employee, with whom the company had substantial dealings, that a guaranty had been cancelled, and that they resigned from firm, the Court ruled: (1) where guarantee is continuing, applicable to after acquired obligations and terminable only by writing, not terminated by cessation of what one party may have regarded as a business relationship, and (2) alleged oral assurance that guaranty had been terminated, not even give rise to triable issue of fact. Accord, Chemical Bank v. Wasserman**,** 45 A.D.2d 703 (A.D. 1st Dept 1974), aff'd, 37 NY2d 249), and requirement of guaranty that notice be duly receipted for, precludes reliance on oral assurances (163 AD2d 164)

The mere recitation that a guaranty is absolute and unconditional does not void a fraudulent inducement defense. 7 F3rd 310, 316 (2nd Cir); 748 F2d 729 (2nd Cir); 574 NYS2d 803; 537 NYS2d 222; 512 NYS2d 107; 505 NYS2d 144; disclaimer must specifically track the allegations of fraud in order to nullify fraud defense. 563 NYS2d 783.

No presumption of validity of signature on guarantee, and the burden is on plaintiff to establish the validity if defendant does not admit this, Dana Commercial Credit Corp v Silva, NYLJ 10/4/96 at 27 c.2 (Sup. Ct, Suff Co, Underwood).

Hebrew Freeloan Society, Inc v Yeshiva Tifereth David D'Skloya, NYLJ 4/29/96 at 30 c.5 (Sup Ct, Kings Co): guarantor is allowed to use as defense to action, that if creditor modifies contractual obligation without its consent, it is released from liability; however, need formal enforceable modification of the underlying contract to do this, and showing that guarantor is not aware of the modification; and this cannot be legitimately argued when all that occurred was that the creditor gave the debtor a little more time to perform as an act of leniency to the Debtor. Waiver of full performance of the loan contract as an act of leniency to the debtor does not waive the time or terms under which the payment of the debt may be demanded, & rule is that delay permitted by the creditor without change in time when payment of the debt may be demanded does not const an extension of the time for payment, as this requires a binding contract discharging the debtor from obligations under original contract and substituting a new contract, thereby precluding the creditor from enforcing payment according to the terms of the original contact and conferring upon the debtor the right to withhold payment after the original debt becomes due (cite to 280 NY at 151). See also, e.g., Bier Pension Plan Trust v. Estate of Schneierson, 74 N.Y.2d 312 (NY Ct. App. 1989): an obligation could not have been altered

without the consent of the party who assumed the obligation and that a surety's undertaking could not have been altered without the surety's consent. The court held that an unenforceable agreement to give time was merely revocable permission to defer performance and that, if appellant retained the right to demand payment of the debt according to its original terms, respondent was not discharged.

Springing Guaranty: only liable where principal goes into Bankruptcy or fails to have involuntary bankruptcy filed against it dismissed or stayed within agreed upon period of time

IV. **Judicial Determination of personal liability**

1. Piercing the Corporate Veil, also known as alter ego liability: Piercing the corporate veil is an equitable remedy that is not warranted in all situations where an entity is insolvent or undercapitalized.

Generally:

Shantou Real Lingerie Mfg. Co. v. Native Group Int'l, 2019 U.S. Dist. LEXIS 46207 (S.D.N.Y. 3/15/19): Under New York law, "courts will disregard the corporate form, or, to use accepted terminology, pierce the corporate veil, whenever necessary to prevent fraud or to achieve equity." Morris, 82 N.Y.2d at 140, 603 N.Y.S.2d at 810 (internal quotation marks omitted). To pierce the corporate veil, a plaintiff must establish the following elements: (1) that the owner exercised complete domination over the corporation, and (2) that "such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury." New York State Electric and Gas Corp. v. FirstEnergy Corp., 766 F.3d 212, 229 (2d Cir. 2014) (quoting Morris, 82 N.Y.2d at 141, 603 N.Y.S.2d at 810); see also Wm. Passalacqua Builders, Inc. v. Resnick Developers South, Inc., 933 F.2d 131, 138 (2d Cir. 1991) (control by parent must be used "to commit a fraud or other wrong that causes plaintiff's loss"). New York law "will not allow the corporate veil to be pierced in the absence of a showing that this control 'was used to commit wrong, fraud, or the breach of a legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights, and that the control and breach of duty proximately caused the injury complained of.'" Freeman v. Complex Computing Co., Inc., 119 F.3d 1044, 1053 (2d Cir. 1997) (quoting Electronic Switching Industries, Inc. v. Faradyne Electronics Corp., 833 F.2d 418, 424 (2d Cir. 1987))…. "The veil-piercing standard is broadly worded and grants substantial equitable discretion to the court." American Federated Title Corp. v. GFI Management Services, Inc., 126 F. Supp. 3d 388, 402 (S.D.N.Y. 2015) (citing Brunswick Corp. v. Waxman, 599 F.2d 34, 36 (2d Cir. 1979)("What the formula comes down to, once shorn of verbiage . . . is that liability is imposed to reach an equitable result")). As a result, "veil piercing determinations are fact specific and differ with the circumstances of each case." Id. (quoting Thomson-CSF, S.A. v. American Arbitration Association, 64 F.3d 773, 777-78 (2d Cir. 1995) (internal quotations and modifications removed)).

EDNY: Nicholson v. Touchbase Global Servs., 2019 U.S. Dist. LEXIS 33420 (E.D.N.Y. 2/26/19): "New York law establishes two requirements to pierce a corporate veil and to hold an individual liable for corporate action: (1) the person must dominate the corporation, effectively dictating its action; and (2) the person must use that control to abuse[] the privilege of doing

business in the corporate form by perpetrating a wrong or injustice against the plaintiff such that a court in equity will intervene." Id. (internal quotation marks and citations omitted). See Lollo, 35 F.3d at 35 (finding special circumstances justifying individual liability in cases involving fraud or facts warranting piercing the corporate veil)."

In re Casale, 62 B.R. 889 (Bankr. E.D.N.Y. 1986), aff'd, 72 B.R. 222 (E.D.N.Y. 1987): the debtor "exercised complete dominion and control" over the corporation, the property had been transferred to hinder, delay and defraud creditors; and the failure to disregard the corporate form would result in fraud on the debtor's creditors." Id. at 894. The court reviewed New York law on piercing the corporate veil and concluded that the corporate form will be disregarded whenever necessary to prevent fraud or achieve an equitable result. Id. at 897, citing Walkovszky v. Carlton, 18 N.Y.2d 414, 417, 223 N.E.2d 6, 276 N.Y.S.2d 585 (1966). Factors considered by the New York courts in disregarding separate corporate existence as listed by the Casale court include use of the corporation to transact personal business; complete dominion and control over the corporation by a particular individual; and transfers made without consideration for purposes of defrauding creditors.

Upon the filing of a bankruptcy, the trustee alone has standing to prosecute the claim to pierce the corporate veil. Consequently, the creditors are prevented from pursuing the piercing claim unless and until it has been abandoned by the estate or the creditor obtains relief from the automatic stay. Keene Corp. v. Coleman (In re Keene Corp.), 164 B.R. 844 (Bankr. S.D.N.Y. 1994): see also, e.g., Gosconcert v. Hillyer, 158 (B.R. 24 (Bankr. S.D.N.Y. 1993) (a general alter ego cause of action, which did not accrue to a plaintiff individually and could be brought by any creditor, was properly asserted by a trustee in bankruptcy. Because of the generalized nature of plaintiffs' claims, the court found that plaintiffs lacked standing to assert their claims outside of the bankruptcy proceeding); In re 10th Ave. Record Distributors, Inc., 97 BR 163 (SDNY 1989): In re Casale, 62 B.R. 889 (Bankr. E.D.N.Y. 1986), aff'd, 72 B.R. 222 (E.D.N.Y. 1987)

Golden Distributors, Ltd. v. Save All Tobacco, Inc., 134 B.R. 770 (Bankr. S.D.N.Y. 1991): defendant employee was not liable for judgment obtained against defendant corporation because debtor had failed to establish that corporate form should be disregarded, as the defendant employee was not a shareholder, and because defendant employee was not liable for checks drawn on defendant corporation's account under statutory exception.

- surveys of caselaw re piercing the corporate veil: 138 BR 390 (B SDNY); 126 BR 504 (B SDNY); 816 F2d 1222, cert den. 484 US 848

Is it harder to pierce the corporate veil of a LLC? It has been held that a LLC is by design a more flexible entity, which is allowed, among other things, to maintain less formalities and to be managed by its members (owners). These distinctions and others may necessitate a different analysis when attempting to pierce the veil of an LLC. See, e.g., Baldwin v. Atlantis Water Sols., LLC (In re Atlantis Water Sols., LLC), 2018 Bankr. LEXIS 3395 (Bankr. D. Montana 2018) (in a case involving a **single member LLC**, where the plaintiffs were arguing that the debtor's sole member was the alter ego of debtor, and was thus liable for all actions of its wholly owned subsidiary, the Court held that the plaintiffs failed to point to any indicia of a subterfuge to defeat public convenience, wrongdoing, fraud or efforts to avoid personal responsibility, and "[w]hile

corporations are generally required to observe a variety of formalities in their governance and operations, LLCs are not. An LLC may consist of a single member. …An LLC can be managed directly by its members instead of managers or officers and directors. …In a member-managed LLC, a member is an agent of the LLC for the purposes of its business or affairs. … LLCs are not required to have an operating agreement. … Finally, and importantly, "the failure of a limited liability company to observe usual company formalities or requirements relating to the exercise of its company powers or management of its business is not a ground for imposing personal liability on the members or managers of the limited liability company.")

2. **Breach of fiduciary duty to creditors upon Insolvency**

-Courts have ruled that when a corporation is insolvent, its officers and directors stand in a position of trust not only to the corporation and its shareholders, but also to its creditors. See. e.g., Clarkson Co. v. Shaheen, 660 F.2d 506, 660 F2d 506 (2nd Cir. 1981), cert den., 455 US 990; New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 305 N.Y. 1 (1953).

This fiduciary relationship between an insolvent corporation's officers and directors and its creditors has been ruled to be a "sufficient trust relationship for the application of §523(a)(4)." See. e.g., Nahman v. Jacks (In re Jacks), 243 B.R. 385, 394 (Bankr. C.D. Cal. 1999) (citing Berres v. Bruning (In re Bruning), 143 B.R. 253 (D. Colo. 1992) (applying Colorado law); Committee v. Haverty (In re Xonics, Inc.), 99 B.R. 870 (Bankr. N.D. Ill. 1989) (applying Delaware law); and Bay 511 Corp. v. Thorsen (In re Thorsen & Co.), 98 B.R. 527 (Bankr. D. Colo. 1989) (applying Colorado law)).

-Although the Courts in these cases have referred to the position of trust, they are continued to be governed by the law of corporations and not of trusts, and directors are not actual trustees - indeed, they are still protected by the business judgment rule, Devereux v. Berger, 284 A2d 605 (Ct. Apps. Md. 1971); 99 BR 870; but see New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 305 NY 1 (NY Court of Appeals 1952), which can be read to impose greater duty where directors determined to liquidate outside of the ordinary context, there was no Court control of any kind, and where due to this, the directors were forced to account for the difference between fair market value of assets and the value actually received.

-Problem is that there is no fixed definition of insolvency here (going concern or liquidation value?), nor do the cases establish clearly how directors should establish solvency - how should conflicts or other issues, like risks to be invoked in operating corporation during and after workout, between shareholders and creditors be resolved in negotiating workouts?

-Clarkson Co. v. Shaheen, 660 F.2d 506, 660 F2d 506 (2nd Cir. 1981), cert den., 455 US 990: one officer and several directors were held personally to the bankruptcy trustee of a company for allowing the company to make $30 million of loans to insiders when the company was insolvent for less than adequate security, even though the directors were not even hinted to have alleged to have received any of these monies or to have done anything else improper in any way, and their only involvement was to approve the loans as directors, because, in the Court's view, the directors knew or should have known that the company was insolvent when the loan was made and that there was not sufficient consideration - even though, admittedly, it was only a balance sheet insolvency, and neither liquidation nor bankruptcy were imminently foreseeable, and the company was still an ongoing concern. The Court relied on the theory at New York Credit Men's

Adjustment Bureau, Inc. v. Weiss, 305 NY 1, that once a corporation was insolvent, directors had duties as trustees to creditors until it is clear that the corporation is no longer a going concern, and the Weiss Court further held that the trust doctrine applies even without a formal equity proceeding and even if corporation is technically solvent but insolvency is imminent, hence the directors there were held liable for conducting private auction sale of assets which netted only 1/3 of assets value; see also 115 BR 185 (Bankr. Minn.) (fiduciary duty on directors in favor of creditors when corporation is nearly or actually insolvent); 484 F.2d 998 (3d Cir) (regardless of corporate consent, assignment of mortgage to debtor's principal on morning of filing was violative of fiduciary duty to creditors).

-New York Credit Men's Adjustment Bureau, Inc. v. Weiss, 305 NY 1 (NY Ct. Apps. 1953): where directors sold off assets in good faith with no allegation of insider dealing, but without notice to creditors, the Court ruled: "We have had occasion to point out the nature of the obligation resting upon fiduciaries which is applicable to those, such as defendants, who are, in effect, trustees. There we said: 'Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions.' We have also pointed out that 'questions of bad faith as matters of fact' may be absent from a case and yet 'breaches of duty as matters of law' may be present. Trustees must be held to accountability for the performance of obligations thrust upon them by circumstances. The safety and protection of the trust res is of primary significance. If the assets - the trust fund for the creditors - were actually improvidently wasted or depleted as a result of defendants' unilateral action the plaintiff is entitled to recover the amount of the loss thus sustained. If, on the other hand, the assets were not thus wasted or depleted the defendants are not liable. Defendants are not to be cast in judgment solely because they neglected to give creditors notice of the sale. … Prima facie the assets in this case could have been sold for a sum of money sufficient to satisfy the creditors. As a matter of fact there was realized but $19,866.98, considerably less than half the sum owed to creditors. The creditors were not given individual notice of the sale and had no opportunity to protect their interests. While it is true, as earlier stated herein, that notice to the creditors was not required, nevertheless, the failure to so notify the persons primarily interested in the assets requires the imposition, in this statutory action for waste, upon the defendants of the burden of going forward to show that their action in selling the inventory at public auction resulted in obtaining full value under the circumstances in which they found themselves and did not occasion an improper or improvident depletion of the trust *res*. Defendants are the only ones who can furnish the information. The defendants should not be relieved of that burden of going forward on the present state of the record, even if, indeed, their action was prompted by a good motive, viz., to liquidate in an inexpensive manner. The burden of establishing the cause of action on the whole case, of course, remains upon the plaintiff." (Citations omitted)

-**However, note that this doctrine is not universally accepted, and has been explicitly rejected by the Delaware Supreme Court. See, e.g., North American Catholic Educational Programming Foundation Inc., v. Gheewalla, 930 A.2d 92, 103 (Del. Sup. Ct. 2007) ("creditors of a Delaware corporation that is either insolvent or in the zone of insolvency have no right, as a matter of law, to assert direct claims for breach of fiduciary duty against the corporation's directors . . . ," and (b) Delaware has no cognizable cause of action for deepening insolvency). The Bankruptcy Court for the Northern District of Illinois severely**

limited it in In re Bowers-Siemon Chemicals Co., 139 B.R. 436, 450 (Bankr. N.D. Il. 1992)("The trust fund doctrine has very limited application. It is an equitable remedy, developed to protect creditors of dissolved corporations.")

- Breach of fiduciary duty:

> Decisions in Delaware and elsewhere have held that once a corporation is insolvent, directors and officers owe fiduciary duties not only to shareholders, but creditors as well. When directors and officers breach those duties, creditors as well as shareholders have standing to pursue derivative claims on behalf of the corporation.
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> However, the rules governing standing are different when the bankrupt entity is a limited partnership or limited liability company.
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> 1. Gavin/Solmonese LLC v. Citadel Energy Partners, LLC (In re Citadel Watford City Disposal Partners, L.P.), 2019 Bankr. LEXIS 1375 (Bankr. D. Del. 5/2/19), involved four related companies that were in chapter 11: one debtor was a Delaware limited partnership, and the other three were limited liability companies organized under the laws of North Dakota and Wyoming. The Official Creditors' Committee obtained court authority and sued an officer for breach of fiduciary duty. The plan created a liquidating trust to pursue causes of action and to be substituted as plaintiff in suits commenced by the Committee. After confirmation, Bankruptcy Judge Carey granted a motion to change the caption and substitute the liquidating trust as plaintiff in the committee's fiduciary duty suit. Later, the defendant filed a motion to dismiss under Rule 12(b)(1), contending the court lacked subject matter jurisdiction because the liquidating trustee had no standing. Judge Gross granted the motion of dismissal, ruling that the Liquidation Trust of a LLC or LP had no right to sue derivatively for breach of fiduciary duty on behalf of a LLC or LP, ruling that (1) under Delaware law, derivative actions only could be brought, as to LPs, by "a partner or an assignee of a partnership interest", and as to LLCs, by a "member or assignee of a limited liability company interest". Judge Carey ruled that for this reason, creditors of LPs and LLCs lack standing to sue derivatively on behalf of an LP or LLC. The Wyoming and North Dakota entities were all LLCs. Judge Carey said that the LLC statutes in those states are "substantively similar to that of Delaware, have been interpreted consistently with Delaware decisions and limit derivative actions . . . to members at the time an action is commenced." (2) as to the Wyoming and North Dakota LLCs, Judge Carey said that the LLC statutes in those states are "substantively similar to that of Delaware, have been interpreted consistently with Delaware decisions and limit derivative actions . . . to members at the time an action is commenced." He went on to cite a Wyoming Supreme Court decision "holding that an insolvent LLC's managers do not owe fiduciary duties to the LLC's creditors." (3) Likewise, Judge Carey said, the Colorado Supreme Court refused to extend fiduciary duties to creditors of insolvent LLCs, "regardless of standing."
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> 2. Delaware Bankruptcy Judge Kevin Gross similary ruled in In re HH Liquidation, LLC, 590 B.R. 211, 283-85 (Bankr. D. Del. 2018) that an Unsecured Creditors' Committee of an LLC had no standing to sue for breach of fiduciary duty because none

of the creditors was a member of the LLC. Thus, there was no "proper plaintiff." For lack of a plaintiff with standing, the court lacked subject matter jurisdiction.

3. In In re PennySaver USA Publishing LLC, 587 B.R. 445, 466-67 (Bankr. D. Del. 2018), Delaware Chief Bankruptcy Judge Christopher S. Sontchi of Delaware dismissed a chapter 7 trustee's derivative claims for lack of standing, because the plaintiff was not a member or an assignee of a member of an LLC, ruling "[t]he extension of fiduciary duties to non-directors, non-managers, and nonmembers is seemingly in conflict with Delaware LLC policy. The Delaware Supreme Court has never established this third-party fiduciary duty.

These cases show that the ability to assert derivative claims in bankruptcy must be examined carefully not only on the basis of whether the debtor was insolvent, but the type of entity involved and the law of the state of formation. Attention must be paid to this important issue of standing. Limited liability companies are a relatively recent development in the history of corporate law, and one cannot assume the same rules will apply to LLCs.

-In Miller v. McCown De Leeuw & Co. (In re The Brown Schools), 386 B.R. 37 (Bankr. D. Del. 2008), a private equity firm in bankruptcy lost a motion to dismiss a bankruptcy trustee's lawsuit against directors for operating a company and paying down over $98 million of debt while taking up to $4.6 million and a junior lien for themselves, rather than filing the company into Bankruptcy nearly two years earlier. The Chapter 7 trustee had contended that the private equity form was liable for the amount the insolvency of the company deepened (allegedly more than $22 million) while the private equity firm maintained the company outside bankruptcy and accomplished major asset sales. The Bankruptcy Court rejected the trustee's arguments of deepening insolvency, based on the Delaware Supreme Court's ruling in North American Catholic Educational Programming Foundation Inc., v. Gheewalla, 930 A.2d 92, 103 (Del. Sup. Ct. 2007) that Delaware has no cognizable cause of action for deepening insolvency, but denied the private equity's motion to dismiss because "[f]or breach of loyalty claims, on the other hand, the plaintiff need only prove that the defendant was on both sides of the transaction . . . ," after which the defendant has the burden "to prove that the transaction was entirely fair."

-the corporate opportunity doctrine is one aspect of the duty of loyalty and fair dealing owed by directors and officers to a corporation. The doctrine provides that corporate fiduciaries (generally only applies to directors, officer, or controlling shareholders) cannot, without consent, divert and exploit for their own personal benefit or advantage any opportunity that should be deemed an asset of the corporation, without first offering it to the corporation (94 Harv. L. Rev 997; 306 NY 172, 187-89 - 1954; 293 NY 281, 300 - 1944; 84 AD2d 796, 797 - 2nd Dept 1981). Obligation of loyalty implied by employer/employee relationship rests on rule that person who undertakes to act for another shall not in the same matter act for himself (100 AD2d 81, app dismissed, 63 NY2d 675; 21 AD2d 60, 66-67; 181 AD 157)

- American Motor Club, Inc. v. Neu, 109 B.R. 595 (Bankr. E.D.N.Y. 1990): The debtor filed a petition for relief under Chapter 11 of the Bankruptcy Code and subsequently instituted an adversary proceeding against defendant, who was a former director of the

debtor, to recover certain land alleged to have been purchased by defendant with corporate funds. In the alternative, the debtor sought damages and to have a constructive trust imposed upon the land. Defendant filed a motion for an order striking the notice of lis pendens filed by the debtor against the land. Analyzing the motion under the discretionary cancellation provision of N.Y. C.P.L.R. 6514(b), Bankruptcy Judge Duberstein held that the allegations of the debtor's complaint, taken as true, satisfied the requirements for the filing of a notice of lis pendens. The court noted that the allegations showed a direct relationship between the land and the director's wrongdoing in that the director was alleged to have appropriated corporate funds and to have used the funds as a down payment on the property. Further, the court noted that corporation's allegations, taken as true, demonstrated that defendant was unjustly enriched so as to warrant the imposition of a constructive trust on the property. “Where an officer or director has been found to have diverted corporate assets, he will be held accountable for the fruits of his wrongdoing.”

-Leading case on the corporate opportunity issue is Guth v Loft Inc, 5 A2d 503 (Del 1939), where Court imposed constructive trust in favor of a corporation on a principal's ownership interest in 2nd corporation he formed to own Pepsi, where company had manufactured and sold candies, syrups, beverages, and foodstuffs, but principal had decided to purchase formula for Pepsi in name of new corporation, and then used his position as principal to advance the personal investment in Pepsi by making the first company the chief customer of Pepsi and drawing on its working capital, plant facilities, employees, nd materials to help produce and promote the new business. The Court used four factor test: opportunity which was presented was (1) within the corporation's ability to undertake, (2) by its nature, within line of corporation's business and of financial advantage to it, (3) one in which the corporation has an interest or a reasonable expectancy, and (4) by embracing the opportunity, the individual's self-interest will be in conflict with corporation's interest. The Court further stated that if the opportunity presented was in individual capacity rather than official capacity, and opportunity was due to the nature of enterprise, not essential to the first business, and one in which it has no interest or expectancy, officer can treat it as his own, so long as not use corporate resources to exploit it.

-The above has since formed the departure point for all analysis: but Courts have not applied the 4-point test of Guth strictly (e.g., 221 A.D.2d 494, 497, allowing liability with only one or two of the factors). Instead, Courts have attempted to articulate various factors in applying this, but there is no bright line rule. Caselaw analysis is heavily fact intensive, with no one factor being dispositive. Flexibility and fairness are the watchwords: the ultimate question, always, is the fairness of the transaction and whether there has been appropriated for the individual something which in fairness should belong to the business. Johnston, 121 A2d at 923.

-determination of whether it’s an opportunity depends on whether the corporation has an "interest" or "tangible expectation" in the opportunity (293 NY at 300; 380 F2d at 899,

2nd Cir) - this means something less than ownership, but more than desire or hope. In Alexander & Alexander of NY Inc. v Albert G. Rubin & Co (NY) Inc., NYLJ 6/15/89 at 21 c.4 (AD, 1st Dept, 6/8/89), Court rejected the argument that this includes areas into which corporation could easily expand, unless the person was in control of the corporation

-An important consideration is whether, at inception of the relationship, the parties understood or it is reasonable to conclude that parties understood that employer, officer, or director would simultaneously pursue other interests, even ones related to or in comp with corporation (380 F2d at 900)

· What about legal inability or the fact that the corporation couldn't undertake the opportunity due to financial inability or for other reasons unwilling to undertake: is this sufficient to excuse the taking of the opportunity? Courts have split on this, with some Courts holding that this does not in and of itself excuse the officer for taking the opportunity for himself, as an employer is owed undivided loyalty, especially if the claimed inability can be easily eliminated. Alexander & Alexander of NY Inc. v Albert G. Rubin & Co (NY) Inc., NYLJ 6/15/89 at 21 c.4 (AD, 1st Dept, 6/8/89). However, on at least one occasion, a Court held that a corporation in bankruptcy is incapable of having an opportunity usurped based on its financial inability to capitalize on the opportunity, American General Corp. v Texas Air Corp., 13 Del J Corp L 173, 181 (Del. Ch. 1987). But the Delaware Supreme Court has rejected an insolvency in fact test which would preclude the finding of corporate opportunity only where corporation is practically defunct – the Court stated that a number of options and standards are available for determining financial inability, including without limitation, a balancing standard, a temporary insolvency standard, or a practical insolvency standard. 653 A2d 275, 279 n.2

-Thorpe v CERBCO Inc, 611 A.2d 5 (Del. 4/10/96): opportunity was to sell a company which was a parent company's only profitable subsidiary; controlling shareholders rejected this offer and instead told buyer that would only sell their controlling interest in the parent company. Other shareholders were never informed of the opportunity, and when they suggested to the controlling shareholders that the profitable company be sold, this was rejected, and the controlling shareholders said they would vote their shares against it. Thereafter, the minority shareholders of the parent company sued for corporate opportunity, and the controlling shareholders defended on the theory that they had the right to sell their controlling shares for a control premium and if they would have done what the other stockholders wanted, they would have hurt themselves as would have lost profitable subsidiary and been left with ownership of two subsidiary corps which were unprofitable, leaving their stock practically valueless. The Delaware Supreme Court held that the duty of loyalty existed, and the controlling shareholders had wrongfully diverted corporate opportunity. Since they had been approached in their capacity as directors of subsidiary and parent, The Court found they had a duty to apprise the Board of offer to sell the profitable subsidiary and to allow the disinterested directors to act on behalf of the company in the negotiations. Note, however, that Court went on to deny transactional

damages in that the Court determined that the directors could have still lawfully vetoed the transaction as controlling shareholders once it was explored, and the Court only held the controlling shareholders liable for: value received by them in the course of their negotiations (controlling shareholders had received $75,000 in connection with letter of intent arrangement); the amount of the expenditures made by the parent company to assist in same (legal fees and due diligence costs); and incidental damages.

In In re PennySaver USA Publishing LLC, 587 B.R. 445, 466-67 (Bankr. D. Del. 2018), Chief Bankruptcy Judge Christopher S. Sontchi of Delaware, dismissing a chapter 7 trustee's derivative claims for breach of fiducariy duty against LLC members for lack of standing, wrote: "There are three ways fiduciary duties can be established. Primarily, fiduciary duties in LLCs are governed by the limited liability company agreement. In the absence of an LLC agreement or where the LLC agreement is silent, the Delaware Chancery Court has found consistently a default rule that the manager or director of the LLC owes fiduciary duties to fellow LLC members and the LLC. **Finally, in rare and highly fact-specific instances, a fiduciary duty of loyalty has been found if the defendant had actual control over an LLC which control was not granted under the LLC agreement. '[T]he bare conclusory allegation that a [defendant] possessed control is insufficient. Rather, the Complaint must contain well-pled facts' showing that the alleged controller 'exercised actual domination and control' over the subject entity or its directors....". …** The extension of fiduciary duties to non-directors, non-managers, and nonmembers is seemingly in conflict with Delaware LLC policy. The Delaware Supreme Court has never established this third-party fiduciary duty, although the Delaware Chancery Court has consistently found this duty to exist. The law originates from USACafes where a fiduciary duty absent from the LP agreement was found to exist because the defendant, a director of the general partnership, exercised actual domination and control over the limited partnership. In Bay Center Apartments, the Delaware Court of Chancery again applied the third-party fiduciary duty theory to the Defendant but also emphasized the fact that the defendants failed to argue against the existence of that duty. … The Trustee does not allege that the Defendants owed fiduciary duties to the Debtors under any limited liability agreement. The Defendants here are also not alleged to be managers of the Debtors' LLCs despite the existence [**31] of the LLC agreements, and, thus, have no default fiduciary duties either. The Trustee seeks to allege that the Defendants controlled the Debtors' LLCs because they allegedly helped to facilitate the Fraudulent Transfers and benefited specifically from the Salary Payments. The allegations that the Defendants helped facilitate allegedly fraudulent transfers and benefited from one such transfer alone are insufficient to show that the Defendants exercised actual control over any of the Debtors' LLCs. ,,, **Because the Trustee fails to allege sufficiently that the Defendants exercised actual domination and control over the Debtors', the Trustee has failed to plead adequately that the Defendants owed a fiduciary duty to the Debtors, and there is no need to examine whether that, nonexistent, duty was breached.**

V. Statutory Liability

1. NY Business Corporation Law (BCL):

a. under BCL Section 719, directors of a corporation who vote for or concur in any of the following corporate actions shall be jointly and severally liable to the corporation for the benefit of its creditors or shareholders, to the extent of any injury suffered by such persons, respectively, as a result of such action:
(1) The declaration of any dividend or other distribution to the extent that it is contrary to the provisions of paragraphs (a) and (b) of section 510 (Declaration and payment of Dividends or other distributions in cash or property when currently the corporation is insolvent or would thereby be made insolvent, or when the declaration, payment or distribution would be contrary to any restrictions contained in the certificate of incorporation).
(2) The purchase of the shares of the corporation to the extent that it is contrary to the provisions of section 513 (Purchase or redemption by a corporation of its own shares if the corporation is then insolvent or would thereby be made insolvent).
(3) The distribution of assets to shareholders after dissolution of the corporation without paying or adequately providing for all known liabilities of the corporation, excluding any claims not filed by creditors within the time limit set in a notice given to creditors under articles 10 (Non-judicial dissolution) or 11 (Judicial dissolution).
(4) The making of any loan contrary to section 714 (Loans or guarantees of loan to directors, where the particular loan or guarantee is not approved by the shareholders, with the holders of a majority of the votes of the shares entitled to vote thereon constituting a quorum, but shares held of record or beneficially by directors who are benefitted by such loan or guarantee shall not be entitled to vote or to be included in the determination of a quorum; or the board determines that the loan or guarantee benefits the corporation and either approves the specific loan or guarantee or a general plan authorizing loans and guarantees.)

b. Under NY BCL Section 720, an action may be brought against one or more directors or officers of a corporation (by a corporation; receiver; trustee in bankruptcy; officer; director; judgment creditor; or stockholder, voting trust certificate holder, or the owner of a beneficial interest in shares, by way of Shareholders' derivative action brought in the right of the corporation) to procure a judgment for the following relief:
(1) Subject to any provision of the certificate of incorporation; authorized pursuant to paragraph (b) of section 402, to compel the defendant to account for his official conduct in the following cases: (A) The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge. (B) The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties. (C) In the case of directors or officers of a benefit corporation organized under article seventeen of this chapter: (i) the failure to pursue the general public benefit purpose of a benefit corporation or any specific public benefit set forth in its certificate of incorporation; (ii) the failure by a benefit corporation to deliver or post an annual report as required by section seventeen hundred eight of article seventeen of this chapter; or (iii) the neglect of, or failure to perform, or other violation of his or her duties or standard of conduct under article seventeen of this chapter.
(2) To set aside an unlawful conveyance, assignment or transfer of corporate assets, where the transferee knew of its unlawfulness.
(3) To enjoin a proposed unlawful conveyance, assignment or transfer of corporate assets, where there is sufficient evidence that it will be made.

Excellent review and survey of caselaw on these provisions in In re Argo Communications Corp., 134 B.R. 776 (Bankr. S.D.N.Y. 1991) and Wedtech Corp. v. Biaggi & Ehrlich, 137 B.R. 575 (Bankr. S.D.N.Y. 1992)

In In re Dino & Artie's Automatic Transmission Co., 68 B.R. 264 (Bankr. S.D.N.Y. 1986), Sections 513 and 719 were invoked to set aside an insolvent corporation's repurchase of stock, and to equitably subordinate a mortgage lien given by the debtor corporation to secure a stock repurchase agreement, to the claims of general unsecured creditors.

In Le Cafe Creme v. Le Roux (in Re Le Cafe Creme, Ltd.), 244 B.R. 221 (Bankr. S.D.N.Y. 2000), a corporate Chapter 11 debtor brought on an adversary proceeding to recover payments previously made to its departing shareholders, and to equitably subordinate shareholders' claims based on their alleged misconduct. Insofar as relevant here, Bankruptcy Judge Brozman held that: "shareholders' misconduct, in converting their equity interests into secured debt at time when the debtor was insolvent, warranted subordination of their claims, under NY BCL 513, stating that "[a] transfer of assets made by a corporation in violation of section 513(a)…is avoidable under section 544(b) of the Bankruptcy Code. See In re Eljay Jrs., Inc., 106 B.R. 775, 781-782 (S.D.N.Y. 1989). A corporation may not make installment payments to purchase its own shares of stock when it is insolvent or would be rendered insolvent, even though the stock purchase agreement may have been made when the corporation had a surplus sufficient to cover the entire purchase price, and title to the stock has been transferred. See In re Flying Mailmen Service, Inc., 539 F.2d 866 (2d Cir. 1976). Having already found that the Debtor was insolvent when it executed the Purchase Agreement and made the Payments on account of the Stock Purchases, I conclude that the Payments to the LeRouxs on account of the Stock Purchases violated section 513 of the Business Corporation Law. …"

Can corporate waste be ratified? Drobbin v. Nicolet Instrument Corp., 631 F. Supp. 860 (S.D.N.Y. 1986): "Once a prima facie showing is made that directors have a self-interest in a particular corporate transaction, the burden shifts to them to demonstrate that the transaction is fair and serves the best interests of the corporation and its shareholders." Norlin Corp. v. Rooney, Pace Inc., supra, 744 F.2d at 264 (New York law). … [The Plaintiffs] argue that …a purported ratification is a nullity as a matter of law. In their favor, there is authority for the propositions that "waste or a gift of corporate assets are void acts and cannot be ratified," as opposed to voidable acts, which can be; and that "a clearly inadequate consideration invokes the same principles as the absence of consideration," Aronoff v. Albanese, 85 A.D.2d 3, 446 N.Y.S.2d 368, 370 (2nd Dept. 1982). Applying these principles, [a director] could not in law execute a valid ratification of a transaction diluting [the company's] stock for a manifestly inadequate consideration. … But I need not reach the issue because, in any event, a ratifying director must be truly independent and free of duress. …Assuming arguendo that this transaction was capable of ratification by an independent director free of duress, I decline to so characterize the wretched" director in that case.

2. **<u>Liability for fiduciary taxes/trust fund taxes</u>** (taxes withheld from employees' wages such as income or social security taxes, which are required to be held in trust for US treasury or the State, or taxes collected from customers on sales, which are required to be held in trust for the State)

-employees and payees receive credit for the amount withheld even if not remitted to government

-Pertinent federal statutes include 26 USC Sections 3102(a), 3402(g), and 7501(a) which provide for liability for withholding; and 26 USC Section 6672 which imposes a penalty (this is not a punishment, it is a revenue collection device, through imposition of personal liability) (no provision for interest) upon any person required to collect, truthfully account for, and pay over any tax imposed [by Internal Revenue Code] who willfully fails to pay it over.

> -Note that there is a 2-tier test under Section 6672: duty and willfulness. Assessment creates prima facie case of liability and person against whom penalty is levied, then must prove not liable by preponderance of evidence. 664 F.Supp 43 (EDNY); note that test here is of substance rather than of form and therefore cases are dependent on their facts, 48 BR at 811

See also 26 USC 3505(b): PERSONAL LIABILITY WHERE FUNDS ARE SUPPLIED: "If a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose."

Re necessary quotient of willfulness under Section 6672: willfulness here does not necessarily have same meaning as under criminal law; leading case in 2nd Circuit is 505 US 506 (2nd Cir), <u>cert den</u>, 421 US 979, where the Court held that conduct amounting to no more than mere negligence is insufficient here, but needn't show evil motive or intent to defraud; "willful" can be where voluntary, conscious, and intentional as opposed to accidental, and may also include reckless disregard for obvious or known risks, or failure to investigate or to correct mismanagement after having noticed that withholding taxes have not been remitted. It has been held to be a defense where an officer acted under mistaken but reasonable belief that another officer was remitting taxes to IRS, 970 F2d 1344 (4th Cir), and president of corporation has been held not to be liable where there was a CFO who never conferred with the president, and the president assumed payment was being made, 116 BR 515 (B ED MI).

-"responsible person" is defined at 6671(b) as an officer or employee of corporation who is under duty to perform the act in respect of which the violation occurs.

-Caselaw establishes that this can be anyone, whether individual or as part of group, who exercises ultimate authority over the corporation's financial affairs (505 US 506, 511, 2nd Cir, cert den, 421 US 979), or any other person who has significant control over corporation's affairs and parts in decisions concerning what bills should or should not be paid and when, and thus, determines whether the US or other creditors will be paid (664 F.Supp 43, SDNY; 48 BR 809, EDNY), but a person is not a responsible person just because he or she happens to be a corporate officer (635 F2d 293, 296, 4th Cir). Courts have enumerated factors which are looked to in this inquiry, including: the identity of individual who signed quarterly tax returns and other returns; identity of the officers, directors and shareholders; identity of the individual who hired and fired employees; and identity of individual who was in control of financial affairs of corporation, 539 F.Supp 117, affd, 705 F2d 442. The most important consideration is whether had control of corporation's checkbook or funds, since the person deciding whether government will be paid or not is really the determinative factor, 137 BR at 618 - however, note that needn't have only "final" word as to which creditors will be paid in order to be held liable as responsible person here, and it can be sufficient if the individual has significant control over disbursement of funds, see 900 F.2d 543 (2nd Cir), see also 652 F.Supp 464, 467 (EDNY) (final in this context means significant rather than exclusive control)

-26 USC 6601(e)(2)(A) imposes interest on assessable penalties, independent of employer's responsibility for interest - but see that IRS is entitled to only one satisfaction, 936 F2d 707 (2nd Cir)

-Common Law Doctrine of application of payments: the recipient of a voluntary payment may apply the payments as it determines in its discretion, unless otherwise expressly directed how the payment should be applied in the payment instrument or in an otherwise governing agreement or contract. (A creditor usually may apply involuntary collections to an outstanding debt of its choice, see, e.g., 960 F2d at 863).

-A Bankruptcy Court has the power, **if** it finds that this is necessary for a chapter 11 reorganization plan's success (and also finds that the plan is feasible, etc.) to order payments under the plan to be considered voluntary by IRS under 105, and to authorize the allocation of payments to the principal amount due on trust fund taxes. United States v. Energy Res. Co., 110 S. Ct. 2139 (1990)("Energy Resources")

- Direction of allocation of tax payments was disallowed in a chapter 13 case by a Mississippi Bankruptcy Court in In re Donaldson, 586 B.R. 822 (Bankr. N.D. Miss. 2018), where the debtor was paying trust fund tax liability incurred by a non-debtor charitable organization for which debtor served as CEO. The Court stated: "Energy Resources does not reach cases where a third party would benefit. … Accordingly, the Court does not have the authority to order the IRS to reallocate the prepetition application of the … Funds to [the]various liabilities."

In re Aba Recovery Serv., 110 B.R. 484 (Bankr. S.D. Ca. 1990): chapter 11 trustee can direct application of payments

-Note that 6672 liability is separate and distinct from employer's liability for trust fund taxes, and a compromise of the claim against the debtor does not compromise the claim against the officers, unless otherwise expressly agreed to by the IRS.

IRS can go after responsible persons without being required to first exhaust collection efforts on corporation

Sales taxes: NY Court of Appeal held in Lorenz v Division of Taxation and Finance of the State of NY, 87 NY2d 1004 (1996) that an individual who was a fiduciary, is liable for assessed penalties and interest as much as the principal which was withheld and not paid over, per NY Tax L. Sections 1131(1), 1132(a) and 1133(a)(7), and the liability for assessed penalties and interest on "any person failing to pay or pay over any tax shall be liable to a penalty [and] interest" not just limited to corporation.

- See also, e.g., Matter of Dong Ming Li v. Commissioner of Taxation & Fin., 65 A.D.3d 763, 883 N.Y.S.2d 735, 2009 N.Y. App. Div. LEXIS 6044 (Parties responsible for sales and use tax are similarly liable for penalties and interest accrued on any unpaid taxes. Petitioners themselves were ineligible for amnesty based upon their convictions in relation to the tax in question); In the Matter of the Petition of ZOHIR LAHAM for Revision of Determinations or Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period March 1, 2004 through February 28, 2007., 2015 N.Y. Tax LEXIS 278 (New York Tax Appeals Tribunal) (Petitioner, as a responsible officer of V & Z, was personally liable for the penalties imposed upon the corporation. Penalties may be abated upon the showing of reasonable cause and a lack of willful neglect.); In the Matter of the Petition of DONG MING LI for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1995 through August 31, 1997 (The amount of a corporation's liability for which an officer or employee under a duty to act may be held liable, though denominated a "tax determination," includes not only tax, but also interest and penalty, including the penalty for fraud); In the Matter of the Petition of XIU YING ZHENG for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1995 through August 31, 1997; In the Matter of the Petition of YI BAO ZHENG for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1995 through May 31, 1997, 2007 N.Y. Tax LEXIS 156 (New York Tax Appeals Tribunal)(The amount of a corporation's liability for which an officer or employee under a duty to act may be held liable, though denominated a "tax determination," includes not only tax, but also interest and penalty, including the penalty for fraud); In the Matter of the Petitions of GENERAL BUILDING APPLIANCE CORP. AND JOSEPH INGRALDI for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period September 1, 1995 through February 28, 1999, 2004 N.Y. Tax LEXIS 173 (a responsible officer under Article 28 is personally liable for the penalty and interest owed by the corporation)

3. Fair Labor Standards Act (FLSA) & Relevant NY State Law

A corporate officer is individually liable under the FLSA for failure to comply with a corporation's minimum wage obligations, where the officer is personally responsible for making

or not making required payments, 712 F2d 1509 (1st Cir), cited with approval at Sasso v Cervoni, 985 F2d 49 (2d Cir. 1993)

NY BCL Section 630 imposes joint and several liability on the 10 largest Shareholders of a non-publicly traded corporation (defined as being corporation whose shares are not listed in national securities exchange or regularly quoted in an over-the-counter market by one or more members of a national or an affiliated securities association) for all debts, wages or salaries due and owing to any of the corporation's laborers, servants or employees other than contractors, for services performed by them for such corporation; and Section 630(b) expressly provides that "wages or salaries shall mean all compensation and benefits payable by an employer to or for the account of the employee for personal services rendered by such employee. These shall specifically include but not be limited to salaries, overtime, vacation, holiday and severance pay; employer contributions to or payments of insurance or welfare benefits; employer contributions to pension or annuity funds; and any other moneys properly due or payable for services rendered by such employee."

4. **CERCLA**: Shore Realty, 759 F2d 1032 (2nd Cir): where it's present owner of facility, officer or shareholder of company can be liable as operator under CERCLA "if specifically sanctioned or directed or actually participated in maintenance of nuisance" even though the owner had argued that he did not dispose of the substances or contribute to their release

5. **ERISA**

Mertens v. Hewitt Assocs., 113 S. Ct. 2063 (1993): *ERISA does not authorize suits for money damages against nonfiduciaries who knowingly participate in a fiduciary's breach of fiduciary duty.* ERISA § 502(a)(3) permits plan participants to bring civil actions to obtain "appropriate equitable relief" to redress violations of the statute or a plan. Assuming, *arguendo*, that this creates a cause of action against nonfiduciaries who knowingly assist in a fiduciary's breach of duty, requiring respondent to make the plan whole for the losses it sustained would not constitute "appropriate equitable relief." *What petitioners in fact seek is the classic form of legal relief, compensatory damages. We have held that similar language used in another statute precludes awarding damages. ... And the text of ERISA leaves no doubt that Congress intended "equitable relief" to include only those types of relief that were typically available in equity, such as injunction,* ***mandamus****, and restitution*. Given ERISA's roots in the law of trusts, "equitable relief" could in theory mean all relief available for breach of trust in the common-law courts of equity, which would include the relief sought here. Since *all* relief available for breach of trust could be obtained from an equity court, however, that interpretation would render the modifier "equitable" superfluous; that reading would also deprive of all meaning the distinction Congress drew between "equitable relief" and "remedial" and "legal" relief throughout ERISA. *ERISA § 502(l), which authorizes the Secretary of Labor to assess a civil penalty based on the monetary recovery in actions against "other person[s]" who knowingly participate in a breach of fiduciary duty*, can be given meaningful content without adopting petitioners' theory. (Italics added.)

Lowen v. Tower Asset Management, 829 F.2d 1209 (2nd Cir. 1987): holding an individual officer liable for unpaid corporation's ERISA liability; "Neither the separate corporate status of the three

corporations nor the general principle of limited shareholder liability afford protection where exacting obeisance to the corporate form is inconsistent with ERISA's remedial purposes. Parties may not use shell-game-like maneuvers to shift fiduciary obligations to one legal entity while channeling profits from self-dealing to a separate legal entity under their control….The Supreme Court has "consistently refused to give effect to the corporate form where it is interposed to defeat legislative policies." First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba, 462 U.S. 611, 630, 77 L. Ed. 2d 46, 103 S. Ct. 2591 (1983). In determining whether to disregard the corporate form, we must consider the importance of the use of that form in the federal statutory scheme, see Schenley Distillers Corp. v. United States, 326 U.S. 432, 437, 90 L. Ed. 181, 66 S. Ct. 247 (1946) (per curiam), an inquiry that generally gives less deference to the corporate form than does the strict alter ego doctrine of state law. Capital Tel. Co. v. FCC, 162 U.S. App. D.C. 192, 498 F.2d 734, 738-39 (D.C. Cir. 1974). …A failure to disregard the corporate form in the circumstances of the present case would fatally undermine ERISA."

In Bankruptcy Code Section 523(a)(4) context: Where individual Debtor was CEO and fiduciary of business that failed to pay health insurance premiums to a health plan which were 100% funded by business's employees, and Debtor was shown to have used these funds in his own favor, including prioritizing paying his own line of credit before paying anything toward the health insurance premiums, debt held to be nondischargeable as defalcation under Bankruptcy Code Section 523(a)(4). In re Harris, 2018 U.S. App. LEXIS 21537 (8th Cir. 8/3/18); see also, e.g., Eavenson v. Ramey, 243 B.R. 160, 166 (N.D. Ga. 1999) (finding debtor used employee contributions as general funds); In re Johnson, 2007 U.S. Dist. LEXIS 12969, 2007 WL 646376, *5 (S.D. Tex. Feb. 26, 2007) (finding debtor permitted employee contributions to be commingled with corporate accounts); O'Quinn, 374 B.R. at 175 (finding debtor failed to apply employee withholdings to fund insurance premiums); In re Weston, 307 B.R. 340, 343 (Bankr. D.N.H. 2004) (finding debtor failed to adequately fund health plan with employee contributions); In re Gunter, 304 B.R. 458, 462 (finding debtor diverted employee withholdings to pay other business expenses); In re Coleman, 231 B.R. 393, 396 (Bankr. S.D. Ga. 1999)(finding debtor was fiduciary with respect to employee contributions to ERISA funds withheld from employee paychecks).In re Gott, 387 B.R. at 24 (ERISA Funds); In re Johnson, 2007 U.S. Dist. LEXIS 12969, 2007 WL 646376, at *5 (S.D. Tex. Feb. 26, 2007) (ERISA funds); In re O'Quinn, 374 B.R. 171, 175 (Bankr. M.D.N.C. 2007); In re Gunter, 304 B.R. 458, 462 (Bankr. D. Colo. 2003) (health and dental benefits provided … were part of an "employee welfare benefit plan" within the meaning of ERISA); In re Coleman, 231 B.R. 393, 396 (Bankr. S.D. Ga. 1999)(ERISA funds; "Debtor argued that he cannot be a fiduciary because the plans in question were not maintained by his corporation, over which he arguably had control, but rather by a third party, the Local 508 Funds. Debtor is incorrect. All that is required to hold that the debtor was a fiduciary is a showing that the he exercised any discretionary authority or control with respect to disposition of plan assets. Employees' contributions to the Funds are plan assets pursuant to regulations issued by the Secretary of Labor.")

In In re Kern, 542 B.R. 87 (Bankr. E.D.N.Y. 12/10/15), Bankruptcy Judge Trust ruled that the failure by the owner/control person of a closely held company to cause the company to make contributions totaling $1.369 million to the company's ERISA-qualified benefit funds is not

defalcation while acting in a fiduciary capacity under § 523(a)(4) of the Bankruptcy Code, without evidence of the owner's misuse or misappropriation of funds collected from employees that weren't remitted. The Court therefore ruled that this claim against the owner was dischargeable in his personal Bankruptcy case.

Multi-employer health or pension benefit fund (MEP): Employers do not become ERISA plan sponsors or fiduciaries merely by contributing to a MEP. Many MEP plan documents broadly define "plan assets" to include all contributions required to be made to the MEP, including any unpaid contributions. In claims for unpaid contributions, MEPs frequently argue that contributing employers, and executives who control company finances, are ERISA fiduciaries as to the unpaid contributions. A court ruling that unpaid contributions are plan assets can thus create fiduciary liability for company executives as well as the company, including in bankruptcy under Section 523(a)(4) of the Bankruptcy Code. However, in general, unpaid contributions by employers to MEPs are not plan assets. In Field Assistance Bulletin 2008-1, the Department of Labor reiterated its position that an employer contribution becomes an asset of a MEP only when the contribution has been made. **However, the 2nd and 11th Circuits recognize an exception to this general rule where the plan documents expressly define the fund to include future unpaid contributions by employers.** See *Bricklayers & Allied Craftworkers Local 2, Albany, N.Y. Pension Fund v. Moulton Masonry & Constr., LLC*, 779 F.3d 182 (2d Cir. 2015); and *ITPE Pension Fund v. Hall*, 334 F.3d 1011 (11th Cir. 2003). **In concluding that unpaid contributions can be plan assets at the time of nonpayment, the 2nd and 11th Circuits have treated employers (and potentially owners and officers) — who control the money contractually owed to the MEP — as MEP fiduciaries. Section 3(21) of ERISA defines a fiduciary to include any individual who "exercises any discretionary authority or discretionary control respecting management of [a] plan or exercises any authority or control respecting management or disposition of its assets."** The 6th, 9th and 10th Circuits have declined to apply this exception. See *Board of Trustees of Ohio Carpenters' Pension Fund v. Bucci (In re Bucci)*, 493 F.3d 635 (6th Cir. 2007); Glazing Health & Welfare Fund v. Lamek, 896 F.3d 908 (9th Cir. 2018); and *Navarre v. Luna (In re Luna)*, 406 F.3d 1192 (10th Cir. 2005).

6. **WARN ACT**: No personal liability under WARN Act according to every Court I have found that has directly considered it, unless can pierce the corporate veil. However, while the WARN Act may not provide direct liability for individuals, under Louisiana law, an individual may be held liable for damages sustained as a result of a corporation's unlawful acts, if the business entity is merely an "alter ego" of the individual. Although no circuit court has decided the issue, in Cruz v. Robert Abbey, Inc., 778 F.Supp. 605 (E.D.N.Y.1991), the United States District Court for the Eastern District of New York held that individuals may not be held liable under the WARN Act, stating: In the Court's view, the statute, regulations and legislative history indicate that Congress defined "employer" as a "business enterprise" and intended a "business enterprise" to mean a corporate entity--i.e. corporation, limited partnership, or partnership--not an individual. .... Since it is also clear that neither the statute, the regulations nor the legislative [sic] makes any reference to 'persons,' let alone to persons who are the 'alter-ego' of a corporation, the Court finds that WARN does not apply to individual persons. See, e.g. survey re no personal liability of principals at Hollowell v. Orleans Regional Hosp. , 1998 WL 283298, E.D. La. 1998, as follows: In Williams v. Phillips Petroleum Corporation, 23 F.3d 930 (5th Cir. 1994), cert. denied, 513 U.S. 1019, 115 S.Ct. 582, 130 L.Ed.2d 497 (1994), the Fifth Circuit declined to

address the issue whether individuals may be held liable for WARN Act violations, stating: "Because we dismiss all defendants for failure to state a valid WARN claim, we need not address the issue of whether WARN permits liability to be imposed on individual defendants such as Allen and Silas. We note that individuals are excluded by WARN's plain terms, as WARN covers only an "employer," defined as a "business enterprise" that employs "100 or more employees." 29 U.S.C. § 2101; Wallace v. Detroit Coke Corp., 818 F.Supp. 192, 194 (E.D. Mich. 1993). Construing a similar definition of "employer" in title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e(b), we recently held that a natural person who does not otherwise qualify as an "employer" cannot be held liable for backpay. See Grant v. Lone Star Co., 21 F.3d 649, 653 (5th Cir. 1994). Williams, 23 F.3d at 933 n. 1. Thus, the Fifth Circuit declined to decide the issue but indicated that individuals may not be held liable for WARN Act violations."

7. **Lanham Act/patent/copyright**: The case law is uniform and consistent throughout the United States that a corporate officer who is actively involved in a violation of the Lanham Act can be held individually liable. See, e.g., Transgo, Inc. v. Ajac Transmission Parts Corp., 768 F.2d 1001 (9th Cir. 1985) (officer or director is liable for acts he authorizes or directs or in which he participates); Donsco, Inc. v. Casper Corp., 587 F.2d 602 (3d Cir. 1978) (corporate president found individually liable because he arranged the marketing and distribution of infringing product); Mead Johnson & Co. v. Baby's Formula Service, Inc., 402 F.2d 19, 23 (5th Cir. 1968) (remanded for determination ascertaining which individual defendants caused infringing acts); Marks v. Polaroid Corporation, 237 F.2d 428, 435 (1st. Cir. 1956) (liability found in family corporation in which directors actively participated in business and directly contributed to corporation's infringement), cert. denied, 352 U.S. 1005 (1957); Polyglycoat Corp. v. C.P.C. Distributors, Inc., 534 F. Supp. 200, 204 (S.D.N.Y. 1982) (allegation that corporate officer personally participated in violation is sufficient to withstand motion to dismiss). See also McCarthy on Trademarks Vol. 2, § 25.03[2] (1993).

New York law is consistent with the position of the federal courts. Generally, under New York law a corporate officer who participates in the commission of a tort, even while acting within the scope of his corporate duties, may be held personally liable. See West Indian Sea Island Cotton Ass'n v. Threadtex, Inc., 761 F. Supp. 1041, 1054 (S.D.N.Y. 1991) (citations omitted) (complaint alleging participation of corporate officer in corporation's fraudulent acts states cause of action against the individual defendant).

The standard for a determination of whether participation in a Lanham Act violation is sufficient to warrant individual liability was set forth in Polo Fashions v. Branded Apparel Merchandising, Inc., 592 F. Supp 648 (D. Mass 1984). Polo was an action for trademark infringement and unfair competition and involved the sale of counterfeit "Polo by Ralph Lauren" shirts. The defendants were a clothing wholesaler and its corporate president. In discussing whether or not the individual defendant was personally liable for infringing acts he committed while acting on behalf of the corporation, the court held that corporate officers will be personally liable if they are the "moving, active conscious force behind [the defendant corporation's] infringement." Polo Fashions, 592 F. Supp. at 652 (quoting Marks v. Polaroid, 237 F.2d 428, 435 (1st. Cir. 1956), cert. denied, 352 U.S. 1005 (1957).

The Eastern District of New York followed the Polo reasoning in Bambu Sales, Inc. v. Sultana Crackers, Inc., 683 F. Supp. 899 (E.D.N.Y. 1988), a case dispositive in this matter. In Bambu, the defendants were officers of a corporation that was sued for an alleged infringement of a trademark on "Bambu," a cigarette paper. Id. at 901. Defendants argued that they should not be personally liable for the infringement because they were not the manufacturers of the offending product but rather merely purchased the counterfeit paper from a foreign "jobber" and then resold it. Id. at 913-914. The court disagreed however, and Judge McLaughlin found three of the four defendants personally liable for the violation. Id. at 914. Defendant Gulack had purchased the paper; defendant Brooks personally "instructed his buyer concerning the purchase and subsequent resale"; and defendant Brian Gold "arranged for the purchase and resale of the paper and personally received the merchandise." Id. The fourth defendant, Bernard Gold, had no involvement in the "wrongful act" and was dismissed from the case. Id.

In National Survival Game, Inc. v. Skirmish, U.S.A., Inc., 603 F. Supp. 339 (S.D.N.Y. 1985), the Court agreed that corporate officers who participated in the alleged infringement in the course of their corporate duties may be jointly and severally liable with the defendant corporation. Id. at 341. This Court found the allegations of personal participation in the wrongful acts contained in plaintiff's complaint were sufficient to withstand a Rule 12(b)(6) motion to dismiss.