New York Law Journal

Pleading Alter Ego Liability in Commercial Lease Disputes

The COVID-19 pandemic has challenged commercial landlords to rely on various legal theories to protect their legitimate rights. This article discusses one such theory—the equitable ownership doctrine or the "alter ego" rule of liability.

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The COVID-19 pandemic has challenged commercial landlords to rely on various legal theories to protect their legitimate rights. As federal, state and local governments enact laws to protect tenants from evictions and/or the enforcement of personal lease guarantees, a landlord's counsel must seek avenues to press its clients' rights against any entity who may be liable for outstanding rent arrears due and owing under a commercial lease.

One such theory is the equitable ownership doctrine or the "alter ego" rule of liability. Often, a corporate entity, which did not sign as a tenant under the subject lease, nevertheless assumed responsibility for negotiating on behalf of, making key business decisions for, and paying rents for, the named tenant. In doing so, the former entity has taken dominion and control over the tenant to such an extent that it has become the alter ego of the tenant. Consequently, as the alter ego, it may be responsible for the tenant's breaches of the lease.

Pleading the Alter Ego Liability. A complaint that alleges alter ego liability will likely be confronted with a motion to dismiss, under CPLR §3211. However, the defendant's analysis in the context of CPLR §3211 is often incomplete and potentially misleading.

For example, a plaintiff is "not required to plead the elements of alter ego liability with the particularity required by CPLR 3016(b)[.]" *2406-12 Amsterdam Assoc.,* 136 A.D.3d 512 (1st Dept. 2016). In fact, the plaintiff is only required to "plead in a non-conclusory manner." Id.; see also *Olivieri Constr. v. WN Weaver St.*, 144 A.D.3d 765, 767 (2d Dept. 2016). Further, any insistence that allegations pleaded "upon information and belief" are insufficient is belied by applicable law. *Trustees of Empire State Carpenters Annuity v. Dykeman Carpentry,* No. 13 Civ. 1508, 2014 U.S. Dist. LEXIS 32251, at *12 (E.D.N.Y. March 12, 2014).

In other words, because most of the relevant facts are within the defendant's possession, the plaintiff would not be precluded from proceeding to the discovery stage for access to additional facts and documents thus far concealed from the plaintiff.

Accordingly, New York courts frown on disposing of alter ego allegations on a motion to dismiss because alter ego requires a highly fact-specific inquiry that is inappropriate at the pleading stage. See, e.g., *Kralic v. Helmsley*, 294 A.D.2d 234, 236 (1st Dept. 2002) ("[T]he issues raised with respect to a piercing of the corporate veil … raise factual questions not determinable on a pre-answer motion to dismiss."); *Trans Int'l v. Clear View Techs.*, 278 A.D.2d 1, 1-2 (1st Dept. 2000) (plaintiff sufficiently alleged alter ego liability by alleging "that the individual defendants are [the corporation]'s equitable owners, that [the corporation] was their alter ego, that they exercised complete dominion and control over [the corporation] and that equity requires that they be held liable for [the corporation]'s obligations to plaintiff"); *9 E. 38th St. Assocs., L.P. v. George Feher Assocs.*, 226 A.D.2d 167, 167-68 (1st Dept. 1996) (finding plaintiff adequately pled alter ego liability where "Defendant, as sole shareholder, is alleged to have exercised complete dominion and control over the corporation and to have fraudulently conveyed corporate assets to avoid the corporation's obligations under the lease"). In other words, because allegations of alter ego liability, like all veil piercing claims, are by definition, inherently fact driven, they are not typically susceptible to attack on a pre-answer motion to dismiss.

The 'Equitable Ownership' Doctrine and Pursuing Claims Directly Against the Alter Ego.
Typically, the alter ego defendant will claim that there is no privity of contract because it is not a party to the lease. However, a motion to dismiss on this ground ignores settled New York law establishing the "equitable ownership" doctrine that directly undermines this privity of contract defense.

"[A]s a general rule, a court will pierce the corporate veil or disregard the corporate form whenever necessary to prevent fraud or to achieve equity." *Hyland Meat v. Tsagarakis,* 202 A.D.2d 552 (2d Dept. 1994) (citing *Billy v. Consolidated Mach. Tool*, 51 N.Y.2d 152, 163 (1980)).

The specific pleading requirements for claims sounding in alter ego and veil piecing are well-settled: "A party seeking to pierce the corporate veil must establish that (1) the owners exercised complete domination of the corporation in respect to the transaction being attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in the plaintiff's injury." *Love v. Rebecca Development,* 56 A.D.3d 733 (2d Dept. 2008).

The first prong of New York's two-pronged veil piercing test relates to "complete domination," with the court's analysis focusing on whether the complaint, afforded every favorable inference, alleges that the alter ego dominated the tenant. See *Sheridan Broadcasting Corp. Small,* 19 A.D.3d 331, 332 (1st Dept. 2005).

Under the second prong of New York's veil piercing test, courts will disregard the corporate form where it is necessary "to prevent fraud, illegality or to achieve equity." *Treeline Mineola v. Berg*, 21 A.D.3d 1028, 1029 (2d Dept. 2005). In this regard, "[a] plaintiff is not required to plead or prove actual fraud in order to pierce the corporate defendant's corporate veil but must prove only that the alter ego's control was used to perpetrate a wrongful or unjust act toward plaintiff**."** *Kelley v. Vikse*, No. 2307/04, 2004 N.Y. Misc. LEXIS 3062, at *11 (N.Y. Sup. July 28, 2004).

Significantly, regarding the first prong, the Appellate Division for the First Department, in *Tap Holdings v. Orix Fin.*, held that "[i]n determining the question of control, courts have considered factors such as the disregard of corporate formalities; inadequate capitalization; intermingling of funds; overlap in ownership, officers, directors and personnel; common office space or telephone numbers; the degree of discretion demonstrated by the alleged dominated corporation; whether the corporations are treated as independent profit centers; and the payment or guarantee of the corporation's debts by the dominating entity ... [n]o one factor is dispositive." 109 A.D.3d 167, 174 (1st Dept. 2013) (emphasis added).

With these principles in mind, a plaintiff's allegations of shared ownership, common officers/directors, common office space, the alter ego's control over bank accounts, domination of all decision making for the entity, and/or insufficient capitalization may satisfy those requirements. *37-18 N. Blvd v. Kings Overseas*, No. 171189/13, 2014 N.Y. Misc. LEXIS 4259 (N.Y. Sup. Sept. 14, 2014) (holding that corporation which, although not a signatory to the lease, was liable as the alter ego of tenant, based upon findings that it made certain payments of rent, held itself out as the entity responsible for the premises using the address of the premises as its business address, that the CEO of Kings Wear made the rental payments to the plaintiff, and caused injury to the plaintiff by stopping payment of rent and breaching the lease).

As to the "fraud or wrong" prong, that element refers to "abuse [of] the privilege of doing business in the corporate form to perpetrate a wrong or injustice against [the plaintiff] such that a court in equity will intervene." *Morris v. State Dep't of Taxation*, 82 N.Y.2d 135, 142 (1993). In this regard, a plaintiff must merely allege that the alter ego "engaged in acts amounting to an abuse or perversion of the corporate form," causing the plaintiff harm. *E. Hampton Union Free Sch. Dist. v. Sandpebble Builders*, 16 N.Y.3d 775, 776 (2011).

Under New York law, grossly undercapitalizing, or taking similar actions, to render a company judgment-proof can constitute a "fraud or wrong" sufficient for veil piercing purposes. See *Carte Blanche (Sing.) PTE, Ltd. v. Diners Club Int'l*, 758 F. Supp. 908, 917 (S.D.N.Y. 1991); *Network Enterprises v. APBA Offshore Productions*, No. 01 Civ. 11765, 2003 U.S. Dist. LEXIS 491, at *9 (S.D.N.Y. Jan. 15, 2003).

For example, in the commercial lease context, to demonstrate fraud or wrong, the complaint could allege that the alter ego created the "tenant" as an undercapitalized, judgment-proof shell, providing it with few, if any, revenue generating assets. As the Appellate Division for the Fourth department held in *Rotella v. Derner*, 283 A.D.2d 1026, 1027 (4th Dept. 2001) (citing *Walkovszky v. Carlton*, 18 N.Y.2d 414, 420 (1966)) held, there is "sufficient evidence of wrongdoing to justify piercing the corporate veil" where "an undercapitalized corporation is unable to pay a judgment debt" and there has been "disregard of corporate formalities."

Broad Financial Center v. 33 Universal, Index No. 650490/21, NYSCEF Doc. No. 46 (N.Y. Sup. Sept. 17, 2021) (Perry, J.), is particularly instructive in this regard. In *Broad Financial Center*, the landlord alleged that the tenant, a media company, spun off one of its valuable assets into a separate company (the alter ego), and the tenant's remaining brands were saddled with the lease obligations. Id. at 2. The landlord further alleged that the alter ego disregarded and misused the corporate form by dominating and controlling the tenant, and by handling decisions regarding the lease, such as negotiating subleases and a payment plan with the landlord that was never executed. Id. Relying on the Appellate Division decision in *Tap Holdings v. Orix Fin.*, supra, the court held that the landlord sufficiently alleged a cause of action for breach of contract based on the alter ego theory of liability. Id. at 5.

In sum, a complaint passes muster under CPLR §3211 and states a valid cause of action against an alter ego for breach of contract, where it has alleged a detailed scheme where an entity operated as an "alter ego" of the tenant and utilized its domination and control to defraud the landlord and deprive it of payment of the rent due under the lease.

Conclusion

The whole point of the veil piercing doctrine in a breach of contract context is to bind a non-signatory to the same obligations as a signatory. As such, if veil piercing law required that the dominating party be an actual signatory to the lease before imposing liability, it would be meaningless. After all, if the dominated party is already a signatory, it is bound by ordinary contract law. Therefore, when pleaded properly, a court may deny a motion to dismiss a complaint against a non-signatory of a lease, based upon the equitable ownership doctrine or "alter ego" theory of liability.

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