

NY Fraud Ruling Shows High Bar To Prove Director Liability

By **Robert Quirk and Muhammad Faridi** (March 30, 2020, 5:39 PM EDT)

Do the directors who oversaw the fraudulent conveyance of a corporation's assets face direct liability for it? Not unless the entities were shams and the directors exerted total dominion and control, according to Justice Andrew Borrok's recent decision in *Acacia Investments BSC(c) v. West End Equity I Ltd.* in the New York Supreme Court's Commercial Division.[1]

In *Acacia*, Justice Borrok allowed fraudulent conveyance claims to proceed against the entities involved in an alleged transfer of judgment-debtors' assets to a new family of companies, but did not allow direct claims against the directors of the entities. He held that Delaware law does not create a claim for director liability, and that there was no factual basis for piercing the entities' corporate veils to hold the directors liable for the alleged fraud.

Background

The dispute in *Acacia* arose from a defaulted commercial real estate loan. In 2007, TAIB Bank loaned \$17 million to five West End entities,[2] secured by a \$10 million guarantee from the West End entities' parent company DCD America Inc. to finance the purchase of two office buildings in Washington, D.C. *Acacia Investments*, loaned the West End entities \$3.25 million as part of the same transaction.

The TAIB loan defaulted in 2010, and TAIB sued the West End entities and DCD in New York State Supreme Court. TAIB ultimately prevailed, and obtained a judgment in December 2016 against the West End entities for more than \$40 million, and against DCD for more than \$17 million.

For two years, TAIB attempted to collect the judgment, including through extensive post-judgment discovery. According to the complaint in *Acacia*, that post-judgment discovery revealed that DCD had fraudulently transferred its assets through a dissolution of the company that began as early as 2009 and was completed on Dec. 31, 2012.

Allegedly, the directors of DCD created AION Partners LLC, AION Realty LLC and AION Holdings Inc. to carry on the same business that DCD had conducted. Most of DCD's employees began working at AION Partners, and AION Partners took over DCD's office lease and phone and fax numbers.



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DCD transferred some of its contracts to the AION entities, and properties listed in DCD's portfolio in 2008 are now listed as part of the AION portfolio on the AION Partners website. Five of these properties were purchased before AION Partners was formed.

The AION entities allegedly did not pay DCD for the business they assumed from DCD, and discovery into the details of the transfer from DCD to AION was impaired by the fact that DCD's financial records were not retained, despite the active litigation between TAIB and DCD throughout the time of the dissolution.[3]

The Acacia case was brought in 2018 by Acacia against the West End entities, DCD, the AION entities, as well as DCD directors Siraj Dadabhoy, Shabir Randeree and Michael Betan court, alleging (1) actual fraudulent conveyance against the AION entities and the individual defendants; (2) constructive fraudulent conveyance against the AION entities and the individual defendants; (3) accounting against the AION entities, DCD, and the individual defendants; (4) piercing the corporate veil against the AION entities and the individual defendants; and (5) director liability against the individual defendants.

Although Acacia's complaint named the West End entities as defendants, it did not assert any specific claims against them, and TAIB is not a party to the Acacia case.[4]

The AION entities and the individual defendants moved to dismiss all of the claims against them. Justice Borrok allowed Acacia's fraudulent conveyance claims to proceed against the AION entities, but not against the individual defendants. He also dismissed Acacia's claim for an accounting, and clarified that corporate veil-piercing is not a separate claim but rather a theory of liability that potentially applied to the AION defendants (but not the individual defendants).

Fraudulent Conveyance

The AION entities advanced two primary defenses to Acacia's claims for actual and constructive fraudulent conveyance. First, they argued that Acacia had not identified the allegedly fraudulent conveyances with sufficient specificity to satisfy the pleading requirements for a fraudulent conveyance claim under CPLR 3016(b).

Second, they argued that Acacia had failed to allege fraudulent intent in support of its actual fraudulent conveyance claim. Justice Borrok rejected both arguments and allowed the claims to proceed.

With respect to the specificity of the pleading, the court emphasized that "section 3016(b) may be met when the facts are sufficient to permit a reasonable inference of the alleged conduct." [5]

Justice Borrok cited to the numerous allegations in the complaint: (1) the transfer of contracts from DCD to the AION entities; (2) the transfer of over \$5 million from DCD; (3) the transfer of property from DCD's portfolio to AION Partners' portfolio; (4) the transfer of DCD's contractual rights to AION Partners; (5) the transfer of asset management responsibilities from DCD's subsidiary to AION Partners; (6) "the transfer of all assets to the AION Entities, and Messrs. Randeree and/or Dadabhoy"; and (7) "a DCD subsidiary changing its name to 'AION.'" [6]

Turning to whether Acacia adequately pled fraudulent intent to support its claim for actual fraudulent conveyance, the court emphasized that "the intent to commit fraud is to be divined from the surrounding circumstances." [7]

The AION entities argued that no fraudulent intent could be inferred because the allegedly fraudulent transfers were made “out in the open.”[8] The court rejected this defense. Justice Borrok noted that the original loan’s maturity date was extended to 2011 in 2009, which allegedly “lulled TAIB into not pursuing its rights while DCD siphoned away its assets.”[9]

The court also pointed to the allegations that “DCD purposefully failed to retain records and otherwise obstructed or evaded TAIB and/or Acacia’s efforts at obtaining discovery.”[10] Justice Borrok emphasized that “[t]he AION entities cannot have it both ways: They cannot fail to retain records and produce evidence in response to information subpoenas and then also criticize Acacia for lacking sufficient details regarding same.”[11]

Finally, the court noted “although the creation of AION may have been made public, the transfers for what Acacia alleges to be zero consideration were not.”[12] Taking these allegations together, the court allowed the claim for actual fraudulent conveyance to proceed.

The court then noted that constructive fraudulent conveyance does not require an intent to defraud. A plaintiff need only show that the defendant was a defendant in an action for money damages and engaged in a transaction that rendered it insolvent without receiving fair consideration.[13]

Given the allegations that DCD’s assets were transferred to the AION entities for “no consideration,” Justice Borrok held that Acacia’s constructive fraudulent conveyance claim was adequately pleaded.

Accounting

The AION entities argued that Acacia was not entitled to an accounting because it had no fiduciary duty to Acacia. The court agreed that “[t]he right to an accounting rests on the existence of a trust or fiduciary relationship regarding the subject matter of the controversy at issue,”[14] and dismissed Acacia’s claim for an accounting.

Corporate Veil Piercing

Justice Borrok noted that corporate veil piercing is not a separate claim, and formally dismissed the separate veil-piercing cause of action. But he reiterated that “the right to pierce the corporate veil is ‘established when the facts and circumstances compel a court to impose the corporate obligation on its owners, who are otherwise shielded from liability.’”

He also noted that, “while the specific cause of action for piercing the corporate veil must be dismissed, the AION entities may still be liable for the fraudulent conveyance causes of action.”[15]

Director Liability

After allowing the fraudulent conveyance claims to proceed against the AION entities, the court turned to the claims against the individual defendants: (1) a claim for director liability, and (2) a veil-piercing theory seeking to impose liability against the individual defendants for all of the claims in the complaint.

As a threshold matter, Justice Borrok noted that Delaware law applied under the internal affairs doctrine because all of the relevant entities were formed under Delaware law.[16] He then held that Delaware law did not provide for a direct claim against the directors of a corporation by a third-party creditor, relying on the Supreme Court of Delaware’s decision in *North American Catholic Educational*

Programming Foundation Inc. v. Gheewalla.[17]

In Gheewalla, creditors of a corporation were permitted to assert derivative claims against the directors of an insolvent corporation, but were not permitted to assert direct claims.[18] Direct claims were not permitted because such claims would “create a conflict of interest between ... [the] directors’ duty to maximize the value of the insolvent corporation for all those having an interest in it, and the [proposed] direct fiduciary duty to individual creditors.”[19]

Acacia attempted to distinguish Gheewalla by arguing that it applied only to insolvent corporations, while DCD was actually dissolved. In an attempt to bolster this argument, Acacia pointed to Sections 280 and 281 of Delaware’s corporate dissolution statute,[20] which provides directors with a safe harbor if they elect to follow the statutory procedure.

Acacia argued that the individual defendants’ decision not to avail themselves of these procedures exposed them to direct claims.[21] Justice Borrok rejected this argument. He explained that, while these statutes “provide a mechanism through which the directors could elect to proceed to potentially protect themselves from ‘future claims arising from the decision to distribute the corporation’s assets on dissolution,’” failure to proceed with this mechanism “simply does not create a basis for liability or otherwise confer standing.”[22]

In contrast, Gheewalla “addressed the standing issue head on and held that only derivative claims may be asserted by creditors of a[n insolvent] corporation.”[23]

Justice Borrok also rejected Acacia’s attempt to invoke section 720 of New York’s Business Corporation law. He held that this section is procedural, and “simply has no bearing on this issue,” which is controlled by Delaware corporate law.[24]

Veil Piercing

After dismissing the director liability claims, Justice Borrok rejected Acacia’s attempt to impose personal liability on the individual defendants under a veil-piercing theory. Again turning to Delaware law, he noted that “a corporate veil can be pierced to hold individual directors liable for the obligations of a corporation only if the corporation is a ‘sham and exist[s] for no other purpose than as a vehicle for fraud.’”[25]

Justice Borrok reasoned that, while the complaint sufficiently alleged facts that showed abuse of the corporate form as between DCD and the AION entities, there were no allegations that the individual defendants themselves had demonstrated the complete domination and control of the entities necessary to impose liability on them for the corporations’ alleged wrongdoing.[26]

Conclusion

Under the Commercial Division’s decision in Acacia, creditors cannot lodge direct claims against the directors of an insolvent Delaware company merely because the directors oversaw the fraudulent transfers that rendered the company insolvent. As the facts in Acacia show, a fraudulent transfer by an entity does not constitute the type of fraud required to justify piercing the corporate veil to reach individual directors.

Rather, to reach the directors, the pleading must show that the directors themselves exerted total

dominion and control over the entities and that the entities were mere shams existing for no purpose other than carrying out fraud. However, Acacia leaves the door open for recovery against the entities that received the fraudulent transfers.

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[1] 66 Misc. 3d 1224(A), 2020 BL 58902 (N.Y. Sup. Ct. N.Y. Cnty. 2020).

[2] The West entities are West End Equity I, Ltd., West End Equity II, Ltd., West End Equity III, Ltd., West End Equity IV, Ltd., and West End Equity V., Ltd.

[3] Acacia, 2020 BL 58902, at *2-3.

[4] See, complaint, Acacia Investments, B.S.C.(c) v. West End Equity I, Ltd., No. 161709/2018, (N.Y. Sup. Ct. N.Y. Cnty. Dec. 14, 2018) (Dkt. No. 1).

[5] Acacia, 2020 BL 58902. at *4 (quoting Pludeman v. North Leasing Sys., Inc., 10 N.Y.3d 486, 492, 980 N.E.2d 184, 860 N.Y.S 2d 422 (N.Y. 2008)).

[6] Id. at *4.

[7] Id. at *5 (citing Eurycleia Partners, LP v. Seward & Kissel, LLP, 12 N.Y.3d 553, 910 N.E.2d 976, 883 N.Y.S.2d 147 (N.Y. 2009)).

[8] Id. at *5.

[9] Id. at *5.

[10] Id. at *5.

[11] Id. at *5.

[12] Id. at *6.

[13] Id. at *6 (citing N.Y. Debt. & Cred. Law § 273-a).

[14] Id. at *6 (quoting DiTolla v. Doral Dental IPA of N.Y., LLC, 100 A.D.3d 586, 587, 953 N.Y.2d 155 (2d Dep't 2012)).

[15] Id. at *3 (quoting Tap Holdings, LLC v. Orix Fin. Corp., 109 A.D.3d 167, 174, 970 N.Y.S.2d 178 (1st Dep't 2013)).

[16] Id. at *8.

[17] 930 A.2d 92 (Del. 2007).

[18] *Acacia*, 2020 BL 58902, at *8-9 (citing *Gheewalla*, 930 A.2d at 101-02).

[19] *Id.* at *9 (quoting *Gheewalla*, 930 A.2d at 103).

[20] Del. Code Ann. tit. 8, §§ 280 and 281.

[21] *Acacia*, 2020 BL 58902. at *9.

[22] *Id.* at *10 (quoting *In re Rego Co.*, 623 A.2d 92 at 97 (Del. Ch. 1991)).

[23] *Id.* at *10.

[24] *Id.* at 10-11.

[25] *Id.* at *12 (quoting *Wallace v. Wood*, 752 A.2d 1175, 1184 (Del. Ch. 1999)).

[26] *Id.* at *12.