

Corporate Update

CORPORATE LITIGATION

Potential Impact of Alter Ego Doctrine on Specific Jurisdiction

Thursday, April 13, 2023

A recent decision by the First Department serves as a reminder of the significant potential implications of the alter ego doctrine—specifically, its ability to subject corporate defendants to specific personal jurisdiction.

In *Clingerman v. Ali*, 212 A.D.3d 572 (1st Dept. 2023), the First Department found specific jurisdiction existed as to certain corporate defendant entities allegedly controlled by an individual defendant as a result of the alter ego doctrine.

Thus, the First Department found specific jurisdiction based on the individual's personal activities in New York even though the individual had sold the corporate entities ten years prior and the corporate entities themselves no longer had any ties to New York or even the United States.



By
**Lara
Flath**



And
**Judy
Flumenbaum**

In this article, we explore how New York courts assess whether or not a corporation is an alter ego of an individual and the potential implications for personal jurisdiction.

In many instances, whether jurisdiction exists as to a corporate entity and individual are assessed separately. But just as a plaintiff may be able to seek to pierce the corporate veil for liability through the alter ego doctrine, a plaintiff can seek to pierce the corporate veil to establish jurisdiction over a corporate entity. See *In re Platinum & Palladium Antitrust Litig.*, 61 F.4th 242, 274 (2d Cir. 2023).

In assessing whether or not a plaintiff has met its burden on this front, courts will apply the same test to assess whether a corporation

LARA FLATH is a complex litigation and trials partner at Skadden, Arps, Slate, Meagher & Flom. JUDY FLUMENBAUM is a complex litigation and trials associate at the firm. SOPHIE NGUYEN, an associate at the firm, assisted in the preparation of this article.

lacks a separate identity from an individual shareholder or entity.

In determining whether the complaining party has established that the owner of an entity, through domination of the entity, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice, courts will examine two operative criteria: (i) control and (ii) abuse.

With respect to control, courts assess the degree to which the individual dominates the corporation with respect to the alleged transaction. See *Tap Holdings, LLC v. Orix Fin. Corp.*, 109 A.D.3d 167, 174 (1st Dept. 2013).

With respect to abuse, courts will assess whether such domination was used to commit a fraud or wrong that resulted in the plaintiff's

The 'Clingerman' decision demonstrates how plaintiffs may be able to use the alter ego doctrine to establish specific personal jurisdiction over corporate defendants even if legal ownership ceased years prior.

injury. See *Baby Phat Holding Co. v. Kellwood Co.*, 123 A.D.3d 405, 407 (1st Dept. 2014).

In determining whether the alter ego doctrine should apply, New York courts do not apply "definitive rules" or a rigid test. *Id.* Rather, courts will examine the attendant facts and equities holistically. See *DePetris v. Traina (In re DePetris)*, 211 A.D.3d 939, 941 (2d Dept. 2022).

In determining the question of control, New York courts undergo a fact intensive inquiry considering factors such as the failure to adhere

to corporate formalities, inadequate capitalization, comingling of assets, use of funds for personal use, overlap in ownership, officers, directors and personnel, common office space, the degree of discretion demonstrated by the corporation, whether the corporations are treated as independent profit centers, and the payment or guarantee of the corporation's debts by the dominating entity. See *id.*; see also *TNS Holdings v. MKI Sec. Corp.*, 243 A.D.2d 297, 300 (1st Dept. 1997), *rev'd on other grounds*, 92 N.Y.2d 335 (1998).

With respect to abuse, New York courts do not require a showing of fraud—while fraud certainly satisfies the abuse requirement, other claims of wrongdoing short of actual fraud can suffice. See *Baby Phat Holding*, 123 A.D.3d at 407.

Clingerman illustrates how this flexible and fact intensive inquiry can potentially result in the alter ego doctrine having significant implications for establishing personal jurisdiction over corporate defendants. In this case, the corporate defendants, referred to as the "Silk Road Entities," were investment banking firms founded by individual defendant Alishar Ali starting in 2004. See Br. for Defs.-Appellants, *Clingerman v. Ali*, No. 2022-01326, 2022 WL 18779502, at *8 (1st Dept. filed Sept. 14, 2022).

In 2013, Mr. Ali sold the Silk Road Entities to an investor group. See *id.* He subsequently channeled at least \$10 million out of a fund controlled by the Silk Road Entities for his own personal use. See *id.* at *1. The sole investor in that fund then sued both Ali and the Silk Road Entities in New York state court, alleging

that Ali induced it to enter into a fraudulent Sales and Purchase Agreement and used the Silk Road Entities to misappropriate the fund's assets for his own benefit. See *id.* at *5.

The defendants moved to dismiss the action for lack of personal jurisdiction as both the Silk Road Entities and Mr. Ali lacked meaningful contacts with the United States: Ali was a resident of Uzbekistan, and the Silk Road Entities were all incorporated outside of the United States and did not have assets or conduct any business in the United States. See *id.* at 2.

Despite the defendants' arguments that Ali had few meaningful ties to the United States, Justice Robert Reed of the Commercial Division found that personal jurisdiction existed because Ali paid tuition to a school in New York City, attended a New York City gala in April 2013 and rented an apartment in New York for his family members. See Decision and Order on Motion, *Clingerman v. Ali*, No. 651001/2019, at 6, 14, 30 (N.Y. Sup. Ct. N.Y. Cnty. 2022).

The court also agreed with plaintiff's argument that Ali controlled the Silk Road Entities and used them for his own benefit in connection with the commission of the alleged fraud to the point that they were effectively his alter ego. See *id.* at 30-31.

Thus, Justice Reed found that the plaintiff had established specific jurisdiction with respect to the Silk Road Entities and denied the motion to dismiss on those grounds.

The Silk Road Entities—but not Mr. Ali—appealed and the First Department affirmed, finding personal jurisdiction over the Silk Road Entities based on the alter ego doctrine even though Ali had “not been an owner of defendants since January 25, 2013, the date that he purportedly sold these entities.” *Clingerman*, 212 A.D.3d at 1.

In reaching its decision, the First Department relied on the fact that Ali still “dominated and controlled” the Silk Road Entities, even though he was no longer their legal owner. The court also held that exercising jurisdiction over the Silk Road Entities did not offend due process because they had intentionally and repeatedly used New York bank accounts through Ali.

The *Clingerman* decision demonstrates how plaintiffs may be able to use the alter ego doctrine to establish specific personal jurisdiction over corporate defendants even if legal ownership ceased years prior.

Despite the fact that Mr. Ali had not owned the Silk Road Entities for 10 years and the Silk Road Entities had no connections to New York other than through Ali, the court still found personal jurisdiction under an alter ego theory because of how Ali dominated them in practice at the time of the alleged fraud.

Importantly, the flexible nature of the inquiry means that satisfying one prong can be enough: here, the court did not even need to reach whether or not the individual sought to abuse the corporate form.