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Alter Ego and Successor Liability Claims May Be Fair Game for Bankruptcy Trustees

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KEY POINTS

1. In a corporate chapter 7 bankruptcy, investigate the current source of the principal's income;
2. Research underlying state law to determine if successor liability and alter ego claims are property of the estate; and
3. Move quickly to gather bank records, financial documents and electronic discovery.

A business files for protection under Chapter 7 of the Bankruptcy Code. The trustee reviews the bankruptcy schedules, recent bank statements and other financial documents and it appears that the debtor is not operating and has no assets. However, the debtor's principal is driving a luxury vehicle, residing in a million-dollar home and living a lavish lifestyle. This story constantly repeats itself in South Florida and throughout the country. The explanation is often that the debtor's principal abandoned the debtor after experiencing a financial problem, but the principal cannot give up his or her standard of living. In order to continue funding the principal's lifestyle, the principal starts up a new company ("Newco") that performs the same business as the debtor.

Standing

The question becomes, does the trustee have standing to pursue Newco as an alter ego or for successor liability. Bankruptcy courts in Florida have answered the question in the affirmative. The Eleventh Circuit has set forth the following test: A bankruptcy trustee has standing to bring an alter ego claim pursuant to section 541 of the Bankruptcy Code when the trustee's claim is (1) a general claim common to all creditors, and (2) allowed by state law (together the "Icarus Test"). *Baillie Lumber Co. v. Thompson (In re Icarus Holdings, LLC)*, 391 F.3d 1315, 1317 (11th Cir. 2004) ("Icarus I").

The first prong of the Icarus Test is typically met without question. The principal's creation of Newco and diversion of the debtor's business to Newco harms the debtor and all of its creditors, thereby creating a claim common to all creditors. As to the second prong of the Icarus Test, Florida law was unclear on whether a company may bring an alter ego claim against its own insiders or whether only creditors of the corporation have standing to bring such a claim. *In re Kodsi*, 2015 WL 222493 (Bankr. S.D. Fla. Jan. 13, 2015); *In re Ortega T.*, 562 B.R. 538 (Bankr. S.D. Fla. 2016). Uncertainty under Florida law stemmed from the case *Seminole Boatyard, Inc. v. Christoph*, 715 So. 2d 987 (Fla. 4th DCA 1998). In *Seminole Boatyard,* Seminole Boatyard obtained a judgment against Florida Atlantic Marine ("FAM") for unpaid rent and pursued its principal, Robert Christoph ("Christoph") for payment of such amounts under the theory of alter ego. *Id.* at 988-89. FAM subsequently filed for bankruptcy, and Christoph reached an agreement with the trustee to purchase FAM's right to pursue potential claims against him, effectively releasing any claim the estate held against the purported alter ego. *Id.* at 988. The bankruptcy court's order emphasized that the court was making no ruling as to the issue of whether a creditor, owning a claim independent of the estate, may pursue a claim against Christoph, leaving that issue to be addressed in a court of competent jurisdiction. *Id.* Seminole Boatyard then filed claims against Christoph in state court and Christoph moved for summary judgment based on the release and the trial court ruled in his favor. *Id.* at 989. On appeal, the Fourth DCA reversed, holding that a trustee does not have standing to assert an alter ego claim on behalf of Seminole because Seminole was the real party in interest in the alter ego action. *Id.* at 990.

In a recent opinion denying a motion to dismiss a successor liability claim, Bankruptcy Judge Olson found that *Seminole Boatyard* appears to only govern a trustee's standing to bring an alter ego claim that the bankruptcy estate has previously released. *In re Sigma-Tech Sales, Inc.,* 2016 WL 4224090 (Bankr. S.D. Fla. July 31, 2016). "Thus, ... the court in Seminole Boatyard did not hold that Florida law denies trustees' standing to bring alter ego claims generally—but rather that court held that trustees do not have standing to assert claims *not belonging to the estate* on behalf of an individual creditor." *Id.* at *3 (*citing Seminole,* 715 So.2d at 990). The bankruptcy court went on to discuss recent Florida case law that supports the proposition that a trustee does have standing to bring an alter ego claim on behalf of a corporate debtor. *See, e.g., Moffatt & Nichol, Inc. v. B.E.A. Int'l Corp.*, 48 So.3d 896, 901 (Fla. 3d DCA 2010) (holding that "like a bankruptcy trustee, an assignee for the benefit of creditors has the exclusive authority to pursue fraudulent transfers and other 'choses in action' for the benefit of all creditors."); *In re Xenerga*, 449 B.R. 594, 599–600 (Bankr. M.D. Fla. 2011) (reasoning that the inherent duty of the trustee to represent all unsecured creditors of a debtor corporation makes the trustee the appropriate claimant in bringing suit against "abusive insiders who have harmed the general creditor body as a whole.").

Since Judge Olson's ruling in *Sigma-Tech*, three other bankruptcy courts in Florida have issued opinions holding that a bankruptcy trustee has standing to bring alter ego claims. *In re Hintze*, 2017 WL 3491748 (Bankr. N.D. Fla. Feb. 9, 2017); *In re Haisfield*, Case No. 3:13–ap–00065–PMG (Bankr. M.D. Fla. Oct. 12, 2016); *In re Ortega T.*, 562 B.R. 538 (Bankr. S.D. Fla. 2016). Several other circuits addressing the issue have found that alter ego/successor liability claims are property of the estate that can be brought by the trustee. *St. Paul & Marine Ins. Co.*, 884 F.2d 688 (2nd Cir. 1989); *In re Emoral*, 740 F.3d 875 (3rd Cir. 2014); *Steyr-Daimler-Puch of America Corp. v. Pappas*, 852 F.2d 132 (4th Cir. 1988); *Koch Refining*, 831 F.2d 1339 (7th Cir. 1987); *In re Icarus Holding*, LLC, 391 F.3d 1315 (11th Cir. 2004) and *Baillie Lumber Company*, 413 F.3d 1293 (11th Cir. 2005).

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About the Author

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Required Evidence

Now that it is settled that a trustee can bring successor liability and alter ego claims in Florida, what does the trustee need to prove? Under Florida law, a predecessor corporation's liability may be imposed on its successor corporation if (1) the successor assumes the obligations of the predecessor, (2) the transaction is a de facto merger, (3) the successor is a mere continuation of the predecessor, or (4) the transaction is a fraudulent effort to avoid the liabilities of the predecessor. *See Bernard v. Kee Mfg. Co.*, 409 So.2d 1047, 1049 (Fla. 1982); *Lab. Corp. of Am. v. Prof'l Recovery Network*, 813 So.2d 266, 269 (Fla. 5th DCA 2002).

To find a de facto merger, "there must be continuity of the selling corporation evidenced by the same management, personnel, assets and physical location; a continuity of the stockholders, accomplished by paying for the acquired corporation with shares of stock; a dissolution of the selling corporation; and assumption of the liabilities." *Amjad Muriun v. Azar*, 648 So.2d 145, 153-54 (Fla. 4th DCA 1998) (*citing Arnold Graphics Indus. v. Indep. Agent Ctr.*, 775 F.2d 38, 42 (2d Cir. 1985)). "The bottom-line question is whether each entity has run its own race, or whether there has been a relay-style passing of the baton from one to the other." *Onion Int'l Fin. Ltd. v. Hoiyong Gems Corp.*, 616 F.Supp. 351, 361 (D.R.I.1985). *See 300 Pine Island Assoc. v. Steven L. Cohen & Assoc*, 547 So.2d 255, 256 (Fla. 4th DCA 1989).

Under the mere continuation theory, liability is imposed when the successor corporation is merely a continuation or reincarnation of the predecessor under a different name. The key to establishing successor liability on a mere continuation theory is that there is a change in form, but not in substance. *Chicago Title Insurance Company v. Alday-Donalson Title Company of Florida, Inc.*, 832 So.2d 810, 815 (Fla. 2nd DCA 2002) (*citing Amjad Munim*, 648 So.2d at 153-54). Facts to consider when evaluating whether a successor entity is a mere continuation include (1) identity of the officers and shareholders of both predecessor and successor corporations, (2) same attorney and resident agent, (3) same business, (4) substantially the same customers, (5) substantially the same employees, (6) same toll-free telephone and fax numbers, (7) same accounting system and computerized data base. *Lab. Corp. of Am.*, 813 So.2d at 269.

To prove up alter ego, the Eleventh Circuit has stated that a claimant must establish that (1) the shareholder dominated and controlled the corporation to such an extent that the corporation's independent existence was in fact non-existent and the shareholder was in fact an alter ego of the corporation, (2) the corporate form must have been used fraudulently or for an improper purpose, and (3) the fraudulent or improper use of the corporate form caused injury to the claimant. *Eckhardt v. United States*, 463 F. App'x 852, 855-56 (11th Cir. 2012) (*quoting Gasparini v. Pordomingo*, 972 So.2d 1053, 1055 (Fla. 3d DCA 2008)).

Much of the evidence required to establish a successor liability claim is the same as required to prove an alter ego claim. The trustee will need the debtor's bank records, invoices, identity of customers and vendors, email correspondence and accounting records. Obtaining electronic discovery will be critical in proving up the intent portions of the trustee's claim. In cases where alter ego and successor liability claims exist, there are often strong fraudulent transfer claims against the debtor's principal and spouse. The result is that if the trustee prevails on its claims, the debtor's principal and spouse may suddenly be on the hook for a non-dischargeable judgment. *See, e.g., In re Sigma-Tech Sales, Inc.*, 570 B.R. 408 (Bankr. S.D. Fla. 2017) (entering a joint and several fraudulent transfer judgment against the debtor's principal and his spouse in addition to an alter ego judgment against the debtor's principal).