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LITIGATION REVIEW



Res Judicata and Piercing The Corporate Veil

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A recent decision by Supreme Court Justice Thomas F. Whelan of Suffolk County provides instructive guidance on the manner and timing of asserting claims against corporate officers or shareholders in the context of a transaction involving the corporation with which they are affiliated.

In *Rosen v. Kessler*, 26718-06, Justice Whelan held that plaintiffs were barred by the doctrine of res judicata from bringing a subsequent action against a corporate officer to enforce a judgment obtained against the corporation, where the same individual had been dismissed from the earlier case against both the corporation and the individual, albeit not necessarily based on the same legal theories.

In *Rosen*, the plaintiffs initially brought an action against a corporate construction contractor and its president alleging various causes of action arising from a residential construction contract, including breach of contract, breach of warranty, negligence and fraud. See [Rosen v. Watermill Development Corp.](#), 1 A.D.3d 424, 768 N.Y.S.2d 474 (2d Dep't 2003). Both defendants in that prior litigation moved to dismiss several causes of action alleged in the complaint. The court below granted the motion in part, but denied that part of the motion seeking to dismiss the causes of action against the corporate officer in his individual capacity.

The Appellate Division, Second Department, reversed in part, dismissing all claims against the corporate officer. The case caption was then modified by the court below to reflect the complete dismissal against the corporate officer and to confirm that the corporation was the only remaining defendant. A judgment was then entered against the corporation under CPLR 3126. Apparently without adequate remedy against the corporation, plaintiffs then instituted a new action against the same individual under Article 52 of the CPLR to hold the corporate officer liable for the debt of the corporate judgment debtor under the theory of piercing the corporate veil.

The individual defendant moved to dismiss that subsequent action under CPLR 3211(a)(5), on the ground that the action was barred by the doctrine of res judicata by virtue of the previous dismissal. The main issue was whether the earlier dismissal by the Appellate Division was determinative of plaintiffs' current attempt to establish personal liability under the specific legal theory of piercing the corporate veil.

The individual defendant moved to dismiss that subsequent action under CPLR 3211(a)(5), on the ground that the action was barred by the doctrine of res judicata by virtue of the previous dismissal. The main issue was whether the earlier dismissal by the Appellate Division was determinative of plaintiffs' current attempt to establish personal liability under the specific legal theory of piercing the corporate veil.

The issue was not entirely straight forward because there are different factual foundations and legal theories upon which a corporate officer can be held personally liable, even where the contract between the parties was entered into solely by the corporation, without the individual signing in a personal capacity. For example, an individual corporate officer can be held personally liable for his own torts, such as "fraudulent acts or false representations in which he participates, even though his actions may be in furtherance of the corporate business." *A-1 Check Cashing Serv. v. Goodman*, 148 A.D.2d 482, 538 N.Y.S.2d 830 (2d Dep't 1989). On the other hand, one of the traditional, independent bases upon which to pierce the corporate veil is by "establish[ing] that the owners, through their domination, abused the privilege of doing business in the corporate form to perpetrate a wrong or injustice against [a] party such that a court in equity will intervene." *Morris v. New York State Dept. of Taxation and Finance*, 82 N.Y.2d 135, 142, 603 N.Y.S.2d 807, 811 (1993).

Given the different legal theories for establishing a basis to hold a corporate officer or shareholder liable in a corporate transaction, plaintiffs argued that they never really sought to "pierce the corporate veil" as such in the previous action, apparently relying upon the traditional "domination" theory in the Article 52 action. Supporting this argument was language in the previous Appellate Division decision focusing on certain of the theories for holding a corporate officer personally liable, such as whether he signed the contract in an individual capacity or whether he fraudulently induced plaintiffs to enter the contract.

The Appellate Division did not specifically mention or address the traditional "domination" theory of piercing the corporate veil.

The plaintiffs therefore contended that the prior dismissal of the corporate officer did not preclude them in the judgment enforcement proceeding from trying to collect under the judgment against the corporation from the individual.

Westlaw Error

Interestingly, the plaintiffs argued that the Appellate Division never used the expression "piercing the corporate veil" in its decision, but rather Westlaw's editor erred in using the terminology in its "Headnote" describing the court's decision. In fact, the appeals court did not refer to the doctrine of piercing the corporate veil per se, but did cite decisions that loosely referred to "piercing the corporate veil" in contexts other than the traditional one involving "domination" of the corporation by the corporate officer:

"The Supreme Court erred, however, in failing to dismiss the eighth cause of action alleging breach of contract insofar as asserted against the defendant Gordon Kessler. The evidence established that Kessler entered into the contract of sale, and the related contracts, in his corporate capacity as President of the defendant Watermill Development Corp. (see *Madison Home Equities v. Echeverria*, 266 A.D.2d 435, 698 N.Y.S.2d 703; *Gottelher v. Viet-Hoa Co.*, 170 A.D.2d 648, 567 N.Y.S.2d 71; *Gold v. Royal Cigar Co.*, 105 A.D.2d 831, 482 N.Y.S.2d 32)."

In response to these arguments, Justice Whelan found that even though the Appellate Division did not specifically use the term "piercing the corporate veil," it did rule that the allegations did not justify holding the individual personally liable at all. Further, the court found that the Appellate Division "did not preserve plaintiffs' right to maintain a second action as against defendant Kessler . . . nor did the Appellate Division indicate that the decision was not made on the merits."

More significantly, in addressing the issue of res judicata, the court observed:

Under New York's transactional analysis approach to res judicata, 'once a claim is brought to a final conclusion, all other claims . . . are barred, even if based upon different theories or if seeking a different remedy' (*83-17 Broadway Corp. v. Debcon Fin. Servs. Inc.*, ___ AD3d ___, ___ NYS2d ___ [2007 WL 1086847] [2d Dept 2007], citations omitted).

Further, the court noted that "res judicata bars not only those claims which were raised herein but those which could have been raised in the prior action . . . Thus, the doctrine of res judicata as public policy, prevents courts from wasting limited resources with continued relitigation of previously adjudicated claims and it 'would be meaningless if a party could split its cause of action merely to ensure that each alternative theory received individualized attention.'"

Under these principles, the court held that not only was the issue of piercing the corporate veil specifically addressed by the Appellate Division in the prior action, but even if it had not been raised, since plaintiffs could have asserted all such theories in the prior action, they were barred from attempting to do so later in an Article 52 enforcement proceeding.

Similar Case

A Third Department case with similar facts helps to flesh out the subtle yet important distinctions in the manner and timing of seeking to hold a corporate officer or shareholder liable for corporate debts or in connection with a corporate transaction.

In *Rebh v. Rotterdam Ventures Inc.*, 252 A.D.2d 609, 675 N.Y.S.2d 234 (3d Dep't 1998), the plaintiffs obtained judgments totaling over \$800,000 against a corporation that no longer had significant assets. They therefore sought to pierce the corporate veil and hold the parent company liable for its subsidiary's debts and to set aside, as fraudulent, certain transactions entered into between the corporate judgment debtor and an individual defendant, "which plaintiffs allege were part of a deliberate scheme of corporate asset shifting, intended to place [the judgment debtor's] assets out of their reach."

The Third Department affirmed the denial of defendants' motion to dismiss, holding that the court below "properly rejected defendant's assertion that the present action is barred by collateral estoppel or res judicata."

The court found that:

[a]lthough named as a defendant in plaintiffs' initial lawsuit charging, inter alia, breach of an employment contract and a lease, [the corporate shareholder] was let out of that action because it was not a signatory to either of the subject documents. During the course of that litigation, the issue of piercing the corporate veil, though briefed, was neither pleaded in the complaint nor directly addressed by any court, and the fraudulent conveyance claim was never raised.

The court further found "[a]s neither of these issues was 'actually determined in the prior proceeding' . . . the doctrine of collateral estoppel does not prevent their consideration at this juncture." Finally, the court ruled that the claims presently before it sought "different kinds of relief and require the application of a different body of law."

Conclusion

The lessons learned: Counsel should carefully consider all potential theories of recovery against corporate officers or shareholders in the context of a corporate contract or other transaction.

If the officer or shareholder is named as a defendant in the initial action, omitting available legal theories that could hold the officer or shareholder individually liable for the corporate debt will likely bar any later attempt to hold the officer or shareholder individually liable.

Thus, either all available legal theories should be pursued at the outset or the individual should not be named as a defendant until a basis for the claim arises or enforcement of any corporate judgment is sought.

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