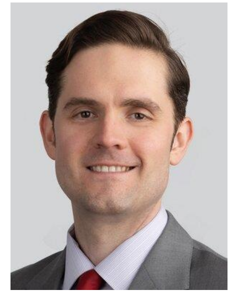
2nd Circ. Ruling Confirms Equitable Ownership Viability

By **Jeff Newton** (November 2, 2022)



Jeff Newton

What does it mean to own something? When should the law acknowledge that somebody really owns something, even if they don't formally own it?

And when will courts recognize the economic reality that one person — say, a judgment debtor — in truth owns something, notwithstanding that person's painstaking efforts to keep formal legal title in the hands of others?

The law has long recognized doctrines to disregard the existence, or pierce the veil, of corporate entities to which a debtor has transferred assets.

But what happens when a debtor acts to create value that ends up in the hands of another natural person — a straw owner — where traditional veil piercing, or fraudulent transfer doctrines, may not comfortably fit?

The U.S. Court of Appeals for the Second Circuit recently shed light on these questions in Gasson v. Premier Capital LLC, as a matter of New York law — a jurisdiction vital to creditors enforcing judgments against debtors residing in New York or using New York's banks to facilitate U.S. dollar payments.

The Second Circuit's analysis lights a path forward for judgment creditors to collect assets nominally owned by nondebtor natural persons, showing once again that, in the right circumstances, New York law can be flexibly applied to prevent judgment debtors from retaining the benefit of properties and businesses while frustrating payment of bona fide judgment debts.

The Decision in Gasson v. Premier Capital

In Gasson v. Premier Capital,[1] the primary question was whether the bankrupt, Gasson, was entitled to a discharge of a judgment debt or whether discharge could be denied under Title 11 of the U.S. Code, Section 727(a)(2) — which allows bankruptcy courts to withhold discharges if the debtor

> with intent to hinder, delay, or defraud a creditor … has transferred… or concealed … property of the debtor … within one year before the date of the filing of the petition.

In Gasson, the debtor was alleged to have concealed his interest in an entity called Soroban, a company set up amidst the debtor's financial difficulties that was formally owned by the debtor's wife.[2]

As recounted by the court, the debtor was Soroban's sole employee, provided all the services Soroban sold to clients, and signed checks and promissory notes on Soroban's behalf.[3]

Based on this record, the U.S. Bankruptcy Court for the Southern District of New York determined — and the U.S. District Court for the Southern District of New York affirmed — that the debtor did, in fact, have a property interest in Soroban, notwithstanding his efforts to vest sole legal title in the name of his wife.

Because state law governs property interests even in a federal bankruptcy proceeding,[4] the Second Circuit assessed the debtor's interest in Soroban under New York law.

Synthesizing the — relatively sparse — case law on the issue, the Second Circuit summarized the guiding principle as follows:

> [T]he persons exercising dominion and control over an asset and the benefits derived therefrom may be found to have a de facto property interest in that asset.[5]

The court declined to identify a "single list of factors that must be examined when determining if a property interest exists," but rather emphasized that "New York courts engage in a general inquiry aimed at assessing the totality of the circumstances."[6]

Among the factors identified by the New York Court of Appeals in Carothers v. Progressive Insurance Co. in 2019 — and implicitly endorsed by the Second Circuit — are:

- Whether the purported owners' dealings with the business were "designed to give [them] substantial control over the [business] and channel profits" to themselves;
- Whether they "exercised dominion and control" over business assets, including bank accounts;
- The extent to which business funds were used for "personal rather than corporate purposes";
- Whether they were responsible for "hiring, firing, and payment of salaries" for the employees;
- Whether "the day-to-day formalities of corporate existence were followed";
- Whether the business "shared common office space and employees" with other companies owned by the purported owners; and
- Whether other parties "played a substantial role in the day-to-day and overall operation and management" of the business.[7]

Finding these factors sufficiently covered by the lower courts' analysis in Gasson,[8] the Second Circuit affirmed the judgment and held that Gasson had indeed concealed an ownership interest in Soroban under New York law.

Notably, the Second Circuit did not analyze the judgment debtor's interest in Soroban through the lens of veil-piercing theories ordinarily applied when deciding whether to disregard the distinction between a debtor and a corporate entity.

As a result, the decision in Gasson seems to make clear that judgment creditors can plausibly assert a pure equitable ownership, alter ego-like theory under New York law to collect assets owned by nondebtor individuals, instead of the corporate entities that are normally the subject of veil-piercing applications.

This holding is consistent with a handful of other cases in New York County and the New York Appellate Division, First Department, over the past 20 years that have endorsed equitable ownership theories in the context of judgment enforcement, and brushed aside debtors' attempts to shield assets by vesting formal legal title in relatives, employees or other third parties.

Combined with the robust post-judgment procedures provided by the Civil Practice Law and Rules — most notably turnover proceedings directed at third parties — this equitable ownership theory could open up new avenues to recovery for judgment creditors faced with recalcitrant debtors.

Conclusion

Judgment debtors surely do not lack creativity when attempting to shield assets from creditors.

If the law did not keep up, debtors could be free to create, build and benefit from business ventures nominally owned by third parties, all while frustrating creditors holding valid, enforceable judgments.

Thankfully, the law does appear to be keeping up: The Second Circuit's decision in Gasson v. Premier Capital confirms the viability of the infrequently used — but now clearly recognized — theory of equitable ownership under New York law.

Judgment creditors seeking to defeat debtors' attempts to shield beneficially owned property from collection should carefully consider this theory when mapping out an enforcement strategy involving assets or individuals with a connection to New York.

Jeff Newton is an investment manager and legal counsel at Omni Bridgeway Ltd.

[1] 43 F.4th 37 (2d Cir. July 29, 2022).

[2] 43 F.4th at 40-41.

[3] Id.

[4] Butner v. United States, 440 U.S. 48, 55 (1979).

[5] Gasson, 43 F.4th at 42 (citing, inter alia, Andrew Carothers, M.D., P.C. v. Progressive Ins. Co., 33 N.Y.3d 389, 399 (2019)).

[6] Id. at 42.

[7] Id. at 42-43.

[8] The lower courts in Gasson had relied on the factors laid out in In re Carl, 517 B.R. 53, 65-66 (Bankr. N.D.N.Y. 2014). As observed by the Second Circuit, the court in Carl did not explicitly ground its own analysis in New York law, and therefore the case was not

technically of precedential value. However, the Second Circuit reasoned that the Carl factors are consistent with factors considered by the New York Court of Appeals in Carothers and other cases, and therefore the lower courts had not erred.