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Beneficially Held Corporations and Personal Jurisdiction Over Individuals

Philip D. Robben and Cliff Katz, Kelley Drye & Warren LLP

Attorneys with clients who are not residents of the US but own interests in US companies may find themselves needing to protect their clients from being haled into US courts. Depending on the state in which the plaintiff brings the lawsuit, courts have varying degrees of authority (jurisdiction) over defendants not found within the state.

To gain jurisdiction over a non-US resident, plaintiffs' counsel commonly try to impute to the non-US resident the acts of a US company in which the non-US resident has some interest (a tactic known as "piercing the corporate veil"). Plaintiffs seek to establish the validity of bringing a non-US resident into US courts based on the contacts with the state of that US company, despite the infrequent or even nonexistent contacts of the person himself with the state.

This Article considers how a non-US resident can defend against US lawsuits by challenging the court's jurisdiction over him and in particular looks at:

- Personal jurisdiction.
- Piercing the corporate veil.
- How to determine whether a nonresident is subject to the personal jurisdiction of the state by a two-part analysis of personal jurisdiction.
- Practical steps to prevent a court from deeming a US company an owner's alter ego.

In addition to examining two cases heard in Florida and Kentucky, this Article emphasizes to general counsel the importance for corporations subject to US jurisdiction to maintain corporate formalities to protect against exposing non-US residents, who may have an ownership interest in these corporations, to litigation in US courts.

OVERVIEW OF PERSONAL JURISDICTION

A person cannot be forced to defend a lawsuit in a court in the US unless the plaintiff establishes that the court's authority extends over the defendant. The court's authority over a person or business entity is referred to as personal jurisdiction. A determination of personal jurisdiction depends on:

- The nature and extent of a defendant's contacts with the jurisdiction where the court is located.
- The fairness of defending a lawsuit in that jurisdiction.

For example, a New York court has personal jurisdiction over a resident of New York who commits a tort in New York against another resident of New York. It is more difficult to determine personal jurisdiction in cases where a plaintiff names a non-US resident (a corporation or an individual) as a defendant to a lawsuit in the US. Commonly, the non-US resident has few direct contacts, if any, with any US jurisdiction. In these cases, the plaintiff frequently attempts to impute the contacts of a corporation residing in the US to the non-US resident.

PIERCING THE CORPORATE VEIL

Generally, a corporation's acts cannot be imputed to the corporation's stockholders or persons with ownership interests (owners) because they are separate legal entities. However, under certain circumstances, where the owner exercises sufficient control over the corporation, a court may be asked to disregard this separateness and hold an owner accountable for the actions of the corporation Plaintiffs generally attempt to pierce this corporate veil by using an agency or alter ego theory. While the requirements to establish that a corporation is actually the agent or alter ego of the defendant vary from jurisdiction to jurisdiction, they tend to be stringent.

TWO-PART ANALYSIS OF PERSONAL JURISDICTION

To determine whether a non-resident is subject to the personal jurisdiction of the state and federal courts of the US, courts generally engage in a two-part analysis:

- Does the non-resident's contacts with the jurisdiction satisfy the legal requirements of the jurisdiction?
- Would the exercise of personal jurisdiction be consistent with the Due Process Clause of the 14th Amendment of the US Constitution (Due Process Clause)?

Specific and General Jurisdiction

Both federal and state courts look at state law requirements for jurisdiction in the state where the court is located. State requirements are usually found in a statute or rule of civil procedure but may also exist as uncodified common law as set out by the courts. Although the requirements vary from state to state, personal jurisdiction can be established using a theory of either specific or general jurisdiction.

Specific Jurisdiction

A court has specific jurisdiction over a defendant when the lawsuit arises from the acts of the defendant occurring in or closely connected with the jurisdiction. To determine what activities can form the basis for jurisdiction, many states have enacted long-arm statutes that set out situations in which an individual or corporation comes under a state's jurisdiction. These statutes tend to limit the jurisdiction of the court.

However, some states, such as Kentucky, Pennsylvania and Tennessee, grant courts jurisdiction to the full extent of the Due Process Clause even though they have a long-arm statute (see *Mother Doe I v. Sheikh Hamdan Bin Rashid Al Maktoum Civil Action No. 07-293-KSF, 2008 U.S. Dist. LEXIS 93758, at **7-8 (E.D. Ky. Nov. 18, 2008*), citing *National Grange Mut. Ins. Co. v. White, 83 S. W.3d 530, 533-34 (KY. 2002)*).

The following is a non-exhaustive list of acts that can typically form the basis of jurisdiction under a long-arm statute if performed within the state:

- Operating a business.
- Transacting business.
- Engaging in a business venture.
- Contracting to supply goods or services.
- Contracting to insure a person or property.
- Regularly soliciting business.
- Having an office.
- Committing a tort.
- Causing injury to persons or property.
- Breaching a contract in the state by failing to perform acts required by the contract to be performed in the state, such as making payment to a party located in the state.
- Breach of a fiduciary duty.
- Owning real property.
- Holding a lien or mortgage on real property.

(See *Florida Long-Arm Statute, § 48.193, Fla. Stat.; Illinois Long-Arm Statute, 735 ILCS § 5/2-209; Kentucky Long-Arm Statute, Ky. Rev. Stat. § 454.210 and New York Long-Arm Statute, CPLR § 302.*)

Other states, such as California, do not specify how jurisdiction can be established and instead simply provide that jurisdiction can be exercised on any basis consistent with the state and US constitutions (see *California Long-Arm Statute, Cal. Code Civ. Proc § 410.10*).

General Jurisdiction

General jurisdiction is found when the defendant's contacts with the state are "substantial, continuous, and systematic", regardless of whether or not the lawsuit arises from such activities. If the defendant is not subject to the general jurisdiction of any particular state, a federal court can exercise personal jurisdiction over the defendant if it would be consistent with the US Constitution and federal laws (see *Federal Long-Arm Statute, Fed. R. Civ. P. 4(k)(2)*).

Due Process

If the legal requirements of general or specific jurisdiction are satisfied, the court then considers whether the exercise of jurisdiction is consistent with due process.

A defendant must have "minimum contacts" with the state for a court in that state to exercise personal jurisdiction over that defendant (*Due Process Clause*). To have minimum contacts with a state, the defendant must engage in some act to purposefully avail itself of the privileges of conducting activities within that state, therefore invoking the benefits of the state's laws, such that the defendant should reasonably anticipate being required to defend a lawsuit there (see *International Shoe Co. v. Washington, 326 US 310 (1945); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297 (1980)* and *Burger King v. Rudzewicz, 471 US 462, 475 (1985)*).

A court may not exercise jurisdiction over a defendant if it would offend notions of fair play and substantial justice (see *International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945)*). Factors considered by courts in evaluating traditional notions of fair play and substantial justice include the:

- Burden the exercise of jurisdiction will impose on the defendant.
- Interests of the forum state in adjudicating the dispute.
- Plaintiff's interest in obtaining convenient and effective relief.
- Interstate judicial system's interest in obtaining the most efficient resolution of controversies.
- The shared interests of the state in furthering fundamental substantive social policies.

(See *Mother Doe I v. Sheikh Hamdan Bin Rashid Al Maktoum, Civil Action No. 07-293-KSF, 2008 U.S. Dist. LEXIS 93758, at **10-11* citing *Asahi Metal Ind. Co. v. Superior Ct. of Cal., 480 U.S. 102, 113-14 (1987)* and *World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286, 297 (1980)*.)

PERSONAL JURISDICTION IN FLORIDA

In *Mother Doe I ex rel. R.M. v. Al Maktoum, Case No. 06-22253-CIV-ALTONAGA/Turnoff, 2007 U.S. Dist. LEXIS 54918; 20 Fla. L. Weekly Fed. D 988 (S.D. Fla. July 30, 2007)*, the plaintiffs brought a lawsuit in the US District Court for the Southern District of Florida, alleging that the defendants participated in kidnapping, trafficking and enslaving young boys to serve as jockeys in camel races in the United Arab Emirates (UAE). On July 30, 2007, the case was dismissed because the court lacked personal jurisdiction over the defendants.

Personal jurisdiction under Florida law requires the plaintiffs to satisfy two requirements: establish jurisdiction under the Florida Long-Arm Statute and be consistent with the Due Process Clause. Under the Florida Long-Arm Statute, the plaintiffs can establish jurisdiction using either specific or general jurisdiction. The plaintiffs could not use a theory of specific jurisdiction because the lawsuit did not arise from the defendants' contacts with Florida. Instead they alleged a theory of general jurisdiction. In Florida, a court has general jurisdiction over a nonresident who is "engaged in substantial and not isolated activity within the state" regardless of whether or not the lawsuit arises from such activities (*§ 48.193(2), Fla. Stat.*).

The plaintiffs alleged that:

- The defendants' contacts with Florida related to the contacts of corporate entities, which were beneficially held for the defendants.
- These corporate entities were qualified to do business in Florida, held assets in Florida, operated as agents for the defendants, and were directed by the defendants.

Imputing a Corporation's Acts to a Stockholder

In general, the acts of a corporation cannot be imputed to a stockholder to establish personal jurisdiction, unless the corporation is the alter ego of the defendant. In this case, the plaintiffs denied reliance on an alter ego theory and instead argued that the assets of the corporations and the corporations' acts can be imputed to the defendants because the corporations were beneficially held for the defendants, or, in other words, the defendants were indirect owners of the corporations.

The court refused to carve out an exception to the requirement of meeting the alter ego test and held the court lacked personal jurisdiction over the defendants.

The court also held that, even if the plaintiffs had relied on an alter ego theory, they would have failed to establish jurisdiction. Under Florida law, a corporation is considered the alter ego of a shareholder if it is both:

- A mere instrumentality of the defendant.
- Used for improper conduct, such as to defraud creditors.

Ownership and extensive involvement in the business of the corporation conducted in Florida is insufficient, by itself, to pierce the corporate veil. The court held:

> "If courts were to attribute corporate acts to every individual who is involved in establishing or is intimately involved with a corporation, or whose picture is featured on a corporation's website, the corporate form would be rendered completely meaningless."

(See *Mother Doe I ex rel. R.M. v. Al Maktoum, 2007 U.S. Dist. LEXIS 54918, at *28.*)

PERSONAL JURISDICTION IN KENTUCKY

On September 11, 2007, the plaintiffs filed another action against one of the defendants in federal court in Kentucky. The court found that the exercise of personal jurisdiction over the defendant would violate the Due Process Clause and dismissed the case (see *Mother Doe I v. Sheikh Hamdan Bin Rashid Al Maktoum, Civil Action No. 07-293-KSF, 2008 U.S. Dist. LEXIS 93758, at *3 (E.D. Ky. Nov. 18, 2008)*).

As in the Florida case, the plaintiff could not rely on the theory of specific jurisdiction and instead used a theory of general jurisdiction not specified in the Kentucky Long-Arm Statue. Kentucky permits jurisdiction over a defendant to the fullest extent allowed by the US Constitution. Under the US Constitution, for a court to exercise general personal jurisdiction over a defendant, the defendant's contacts with the forum must be substantial, continuous and systematic.

While there is no set formula for determining whether contacts are sufficiently substantial, continuous and systematic, and courts may rule differently, a combination of the following contacts may lead to a finding of general personal jurisdiction:

- Maintaining an office in the state where business is carried on, including payment of salaries and correspondence.
- Maintaining bank accounts within the state with substantial balances of company funds.
- Using a bank within the state to act as a transfer agent for the stock of the company.
- Holding directors' meetings within the state.
- Supervising activities of the company from the office within the state.

(See *Perkins v. Benguet Consol. Mining Co., 342 U.S. 437, 445-47 (1952).*)

Jurisdiction must also fit with the Due Process Clause (see *Due Process*).

Defendants' Alleged Contacts with Kentucky

The plaintiffs based their claim of personal jurisdiction largely on the defendant's involvement in a horse breeding and racing company in Kentucky (Shadwell Farm LLC). The plaintiffs alleged that the defendant had personal involvement in management decisions at Shadwell Farm. The defendant countered with an affidavit from his personal advisor and president of Shadwell Farm that stated, among other things, that:

- The defendant does not own any property in Kentucky in his personal capacity.
- The defendant does not conduct business in Kentucky in his personal capacity.
- The defendant does not employ anyone in Kentucky in his personal capacity.
- The defendant has no role in Shadwell Farm's day-to-day operations.
- Shadwell Farm has its own independent assets, management and board of directors.
- The defendant only occasionally visited Kentucky.

The defendant's affidavit further stated that Shadwell Farm is owned by a company with no place of business in the US, which in turn was held by a trust that also had no place of business in the US. Although the defendant is a beneficiary of the trust, he is not an agent, shareholder, director or officer of Shadwell Farm. That is, the plaintiffs' allegations of the defendant's contacts with Kentucky largely relied on imputing the acts of a corporation in which the defendant may have had an indirect ownership interest.

The Kentucky court held that the defendant's contacts with Kentucky were not substantial, continuous and systematic. Having an ownership interest in a company with contacts to Kentucky cannot itself satisfy the requirements of general personal jurisdiction.

- They were largely based on hearsay evidence from web sites and newspaper articles.
- The business filings relied on did not show that the defendant was an officer, owner or manager of Shadwell Farm or that he employed agents in Kentucky.

The plaintiffs sought a more lenient standard for piercing the corporate veil whereby it would be sufficient that a corporation is beneficially held for an individual for the acts of the corporation to be imputed to that individual. The court rejected this keeping to the well-established principles of personal jurisdiction and corporation law and reaffirmed the importance of the corporate form.

Factors in Determining Traditional Notions of Fairness

The court held that even if the defendant's contacts were substantial, continuous and systematic, it could not exercise personal jurisdiction over the defendant because it would be unreasonable and inconsistent with traditional notions of fairness. The court considered the following factors in formulating its decision:

- The defendant's alleged conduct occurred solely in the UAE.
- The defendant made only a few visits to Kentucky.
- The defendant was alleged to be merely a beneficiary of a trust that owns a horse breeding and racing operation in Kentucky.
- Kentucky had little interest in the dispute because the:
  - defendant was not a resident of Kentucky;
  - events had no connection to Kentucky;
  - alleged contacts to Kentucky had no relationship to the allegations; and
  - evidence and witnesses related to the plaintiffs' allegations are not located in Kentucky.

PRACTICAL STEPS FOR US CORPORATIONS

Although the specific facts of the child jockey cases are unique, the broader principles are applicable to international businesses' interests in the US. The courts' rulings in these cases serve as a useful reminder about how business activities can affect exposure to potential litigation. For example, if a non-US resident owner manages a US corporation in a manner that disregards corporate formalities, a court may deem the corporation to be the alter ego of the non-US resident owner. Non-US residents not subject to personal jurisdiction in US courts, but with ownership interests in corporations subject to US jurisdiction, must remain mindful of the consequences of their involvement in the activities and management of US corporations. In doing this, they can take the following steps to minimize the risk that a court will deem their US-based corporations as their alter egos. The US corporation should:

- Comply with corporate formalities, including setting up a board of directors and holding meetings on a regular periodic basis.
- Be adequately capitalized and have its own assets.
- Have its own officers and other employees.
- Keep separate books, records and offices.
- Not commingle finances with the non-US resident or entity.
- Maintain an arm's length relationship with the non-US resident or entity.

These steps, which are the minimum a company should take, will help demonstrate that the corporation is an entity with its own existence.