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Subject: Jay Adkisson, Chris Riser and David Slenn on *Transfirst Group, Inc. v. Magliarditi* - U.S. District Court Holds that Nevada Law Permits Piercing of Nevada LLLs, Nevada Partnerships, and Nevada Trusts

"This Opinion once again illustrates, as have so many similar opinions before it, that a labyrinthine legal structure alone does not provide asset protection. Here, the debtor set up a complex asset protection structure that might have worked, but ignored it, and committed the mortal debtor sin of personally using and benefitting from the assets outside the confines of the structure.

We also see the application of the ancient legal maxim delicatus debitor est odiosus in lege – 'the extravagant debtor is condemned in the eyes of the law.' A debtor who continues to live a wealthy lifestyle should expect no sympathy from the court. So it was here - another case where the debtor claims to have no money to pay creditors, but maintains a wealthy lifestyle including residences in Las Vegas and Southern California. Is it really any wonder that courts frequently go out of their way to help creditors against such debtors?"

Jay Adkisson, **Chris Riser** and **David Slenn** provide members with important commentary on *Transfirst Group, Inc. v. Magliarditi.*

Jay Adkisson and **Chris Riser** are partners of **Riser Adkisson LLP**, with their offices in California, Nevada and Georgia. **Dave Slenn** is a partner of **Shumaker, Loop & Kendrick LLP**[i] with his office in Florida, practicing in the areas of tax, estate and business planning with an emphasis on risk mitigation. Jay and Chris practice in the area of creditor-debtor and asset protection law. Chris and Dave are past Chairs of the ABA's Committee on Asset Protection Planning.

Here is their commentary:

EXECUTIVE SUMMARY:

The U.S. District Court for the District of Nevada, applying the *Erie Doctrine*, has held that Nevada law permits the piercing of Nevada LLCs, Nevada partnerships, and Nevada trusts.

FACTS:

Three creditors, collectively referred to as Transfirst, obtained a $4+ million judgment for fraud against Dominic J. Magliarditi in the U.S. District Court for the Northern District of Texas.

The Texas federal court granted a Temporary Restraining Order (TRO) to stop Dominic from disposing or concealing assets, but denied the order as to certain Magliarditi-related entities because it lacked jurisdiction over those entities. The Texas federal court noted that Dominic had engaged in "postjudgment discovery abuses, as evidenced by Magistrate Judge Paul Stickney's order sanctioning him . . .." Thereafter, the Texas federal court transferred the case to the U.S. District Court for the District of Nevada, where Dominic and his wife, Francine Magliarditi, claim their residence. The Nevada federal court soon reinstated the TRO and applied it to the Magliarditis and Magliarditi-related entities.

Meanwhile, Transfirst filed a new action in Nevada federal court against Dominic, Francine, and various entities and trusts alleged to be Dominic's alter ego, and also asserting that various transfers between the Magliarditis and the entities were fraudulent transfers.

The Nevada federal court held an evidentiary hearing on whether Transfirst was entitled to a Preliminary Injunction. Before discussing the opinion, let us briefly recall the Erie Doctrine, which requires a federal court sitting in diversity jurisdiction or engaged in post-judgment enforcement proceedings to apply state law. In such cases, the federal court often must attempt to ascertain how a state supreme court would rule on unresolved legal issues. Although these federal court interpretations of state law are not binding, lower state courts often give them considerable weight. Now back to our case.

To obtain a Preliminary Injunction, Transfirst had to show: (1) a likelihood of success on the merits, (2) that irreparable harm was likely in the absence of the injunction, (3) the balance of relative hardships favored Transfirst, and (4) the injunction was in the public interest.

Starting with the issue of whether Transfirst was likely to succeed on the merits, the Court looked at Nevada's alter ego laws, noting that Nevada allows the piercing of the corporate veil to assert the liabilities of the entity against its owner, and "reverse piercing" which causes the liabilities of the owner to be imputed to the entity.

The Magliarditis argued that alter ego cannot apply to an LLC under Nevada law, because Nevada law provides that a charging order is the exclusive remedy regarding a debtor's interest in an LLC. The Court noted that the Supreme Court of Nevada has never directly addressed the issue of whether alter ego applies to Nevada LLCs, but that other federal courts applying Nevada law had ruled that it would, the exclusivity of a charging order notwithstanding.

> I predict that, despite this statute, the Supreme Court of Nevada would hold that LLCs are subject to alter ego under the appropriate circumstances. It is questionable whether the statute even applies given the facts in this case. Dominic is not a member of any of the LLC defendants, so Transfirst is not seeking to satisfy the judgment out of a member's interest in the LLCs. Thus this situation does not fall within the statute's terms. Instead, Transfirst is asserting the LLCs are shams and thus essentially non-entities . . ..
>
> Moreover, alter ego is an equitable doctrine aimed at doing justice. ... The defendants have not suggested any reason why Nevada would prohibit its citizens from abusing the corporate form and using a corporation as an instrumentality of fraud but allow that same conduct through an LLC. ... There may be situations where it would be inequitable to apply alter ego to an LLC, such as where the policy concerns ... about forced association would come into play. But here, if the LLCs are Dominic's alter egos, no such concerns arise. I therefore will apply alter ego analysis to the LLC defendants. [Internal citations omitted.]

So, alter ego could be used to pierce or reverse-pierce an LLC in Nevada[ii], but what about a Nevada partnership? Noting that the Nevada

Supreme Court had only addressed alter ego in an unpublished decision, the federal court simply adopted the same reasoning that it just used for Nevada LLCs:

> For the same reasons discussed above regarding LLCs, I predict the Supreme Court of Nevada would apply alter ego to partnerships where justice required it. As with LLCs, there may be times when it would be inequitable to apply alter ego to a partnership (e.g., where that would force a third party to be partners with someone with whom it did not choose to associate itself). But to hold that alter ego never applies to a partnership may countenance a fraud. As with LLCs, the defendants have not suggested any reason why Nevada would prohibit its citizens from abusing the corporate form and using it as an instrumentality of fraud but allow that same conduct through a partnership.

This now brings us to the critically important issue involving whether the Magliarditis' Nevada trusts were subject to alter ego piercing. If a Nevada trust could be busted through an alter ego claim, the creditor protections afforded by the Nevada trust statutes could be rendered ineffective in some cases, particularly for self-settled trusts and for family-run trusts that are, shall we say, "loosely administered."

Once again, allow us to digress briefly. Once upon a time, in a Republic that now seems far, far away, Nevada was a thinly-populated state that lacked for many things, including a sizeable population of attorneys or a a substantial court system. Heck, it was only earlier this year that Nevada finally seated its three-person Court of Appeals. Consequently, Nevada traditionally has borrowed heavily from the law of its much larger populated neighbor across the desert and Sierras to the West. In fact, even as recently as 2004, the U.S. Ninth Circuit Court of Appeals stated that "Where Nevada law is lacking, its courts have looked to the law of other jurisdictions, particularly California, for guidance." *Eichacker v. Paul Revere Life Ins. Co.*, 354 F.3d 1142, 1145 (9th Cir. 2004) (quotation omitted).

Noting that the Nevada Supreme Court had not spoken on the issue of trusts and alter ego, and that, in the absence of such guidance, California law should be considered, the federal court held:

> The Supreme Court of Nevada has not addressed whether a trust

> can be an alter ego. As with LLCs and partnerships, I predict the Supreme Court of Nevada would apply alter ego to trusts if justice required it. Under California law, it is "well-settled that a trust created for the purpose of defrauding creditors or other persons is illegal and may be disregarded." *In re Schwarzkopf*, 626 F.3d 1032, 1037 (9th Cir. 2010) (quotation omitted) (citing California authority and finding trusts were alter egos); *see also Wood*, 572 P.2d at 762 ("If it were alleged and proven that the two trusts in question were themselves alter egos of the Wenckes, those trusts would essentially drop out as independent legal entities ...."). ... Moreover, the defendants have not given any reason why Nevada would countenance a sham, regardless of its form. For all the reasons discussed above with respect to LLCs and partnerships, and in light of California and Ninth Circuit authority, I will apply alter ego analysis to the trust defendants.

As an aside, this position is in accord with rulings in other states. "[N]early every court to have addressed the issue . . . has concluded that alter ego liability should apply to trusts to the same it extent it applies to other legally created fictions."[iii]

Having determined that Nevada law would apply alter ego veil piercing to Nevada LLCs, partnerships and trusts, the Court next addressed whether Transfirst had proven its alter ego case. Under Nevada law, Transfirst had to prove three things:

> (1) The LLC, trust or partnership, was de facto influenced and governed by the person asserted to be the alter ego;
>
> (2) There was such a unity of interest and ownership such that the person and the alleged alter ego were inseparable; and
>
> (3) Adherence to the fiction of separateness would, under the circumstances, sanction a fraud or promote injustice.

Nevada law considers facts such commingling of funds, undercapitalization, diversion of funds, treating the assets as one's own, and a failure to observe formalities. Each case turns on the totality of its own facts and circumstances.

Dominic and Francine argued that they had entered into a transmutation agreement – an agreement to change community property to separate

property, or vice versa – claiming that half of their property was Francine's sole and separate property, and that she could do with her sole and separate property as she pleased without any of her transfers being imputed to Dominic.

However, Nevada doesn't require a debtor legally to own the alleged alter ego entity for a creditor to succeed. Rather it is sufficient that such person controls the entity and is the decision-maker. The evidence in the Magiliarditis' case showed that although Francine nominally was the trustee or controlling person, in fact. Dominic handled everything:

> Francine testified she was in control of the entities but she knew nothing about the entities' businesses or assets, and when she needed money, she asked Dominic for it and he decided from which company the funds were drawn.

Francine's testimony can be boiled down to the inescapable conclusion that she was clueless as to what was going on in the various Magliarditi entities. She said that she knew neither what "her" entities did, nor what assets they held. These are not good facts when trying to defend an alter ego challenge.

Additionally, Dominic used the funds in the LLCs and partnerships to pay for his own personal expenses, flying lessons, gym memberships, etc. The books and records of these entities also contained entries of undocumented loans and unexplained transfers. Only Dominic knew what had really transpired, and Francine had no clue. Thus, it was not dispositive that Francine had separate ownership through the transmutation agreement, since Dominic had *de facto* control of the assets.

Next up is the issue of whether the alleged alter ego was used to commit a wrong, such as to recognize them as separate would be to sanction an injustice. The Court thought it did:

> Finally, Transfirst has shown that adherence to the corporate fiction of a separate entity would sanction a fraud because Dominic is using these entities to shield his assets from a substantial judgment while he helps himself to the entities' assets. Transfirst has been unable to recover its judgment against Dominic for years, despite Dominic having virtually unfettered control over substantial assets.

> The evidence shows Dominic has arranged the transactions (including hundreds of thousands of dollars in unexplained deposits and transfers) and undocumented loans to frustrate and impede Transfirst's collection efforts. Transfirst also has shown a likelihood of success in demonstrating Francine is not an innocent property owner who would be harmed by piercing the veil. Francine knew about the judgment but nevertheless placed Dominic in control of all entity assets. She admits she could require Dominic to explain each of the transfers in the various ledgers but she does not want to do so. Transfirst has shown Francine has, at a minimum, enabled Dominic's efforts to evade the judgment. Consequently, Transfirst has shown a likelihood of success on the merits of its alter ego claim.

Transfirst also alleged that the Magliarditis and their various entities engaged in fraudulent transfers. While there was a dispute as to whether Texas or Nevada fraudulent transfer law should apply, the Court held that it really didn't make any meaningful difference at this stage and applied the Nevada Uniform Fraudulent Transfers Act (NUFTA).

The Magliarditis argued that Transfirst didn't have a valid fraudulent transfer claim, because all the transfers were from entities or trusts that were not debtors. However, the court held to the that if a debtor's alter ego made a transfer, the debtor himself (here, Dominic) made the transfer.

The Court also held that there was substantial evidence that fraudulent transfers were made by Dominic and his alter egos:

> Transfirst has shown a likelihood of success on the merits of its claims that Dominic, through the alter egos, transferred funds with the actual intent to delay, hinder, or defraud Transfirst in its efforts to collect on the judgment. The transfers bear many of the badges of fraud identified in the statute. The transfers were to insiders, as the transfers were between entities nominally owned by Francine but controlled by Dominic. Dominic retained control over the entities and their funds. The transfers were concealed through unexplained deposits and transfers, and undocumented loans. Before the transfers at issue, Dominic had been sued by Transfirst and many transfers were made after judgment was entered. As to insolvency, Dominic claims to have no assets himself, although he

> regularly causes the entities to pay his personal expenses.

The court found that Dominic transferred his assets into the alter ego entities and trusts to evade his creditors, tried to shield those assets as Francine's separate property, while having control over and personal use of those assets. These facts made it likely that Transfirst would ultimately win on the merits.

Transfirst also successfully demonstrated a likelihood of irreparable harm to the Court, which found that Dominic, based on his past conduct, would continue to dissipate his assets to keep them from his creditors. The balance of hardships also favored Transfirst, since the Magiliarditis's own argument that they had taken no distributions from the entities and trusts demonstrated they had other funds available and could access those other funds for living expenses.

As for the public interest requirement, the Court succinctly stated:

> The public has an interest in ensuring that judgments issued by courts and affirmed on appeal are enforced, and in preventing judgment debtors from unlawfully transferring and otherwise dissipating assets instead of paying their judgment creditors. The public interest therefore weighs in favor of granting the preliminary injunction.

In other words, sayeth the Court, the public interest will always favor creditors.

Transfirst failed, however, to persuade the Court to appoint a receiver for Dominic, because the entities and trusts were not conducting a business in a manner that warranted a receiver, the receiver would be costly, and the injunction freezing the assets made a receiver unnecessary. Under this same rationale, however, the Court denied the Magliarditis' request to increase the amount of the bond that Transfirst was required to post as a condition of obtaining the Preliminary Injunction.

COMMENT:

This Opinion once again illustrates, as have so many similar opinions before it, that a labyrinthine legal structure alone does not provide asset protection. Here, the debtor set up a complex asset protection structure that might have worked, but ignored it, and committed the mortal debtor

sin of personally using and benefitting from the assets outside the confines of the structure.

We also see the application of the ancient legal maxim *delicatus debitor est odiosus in lege*, - "the extravagant debtor is condemned in the eyes of the law." A debtor who continues to live a wealthy lifestyle should expect no sympathy from the court. So it was here - another case where the debtor claims to have no money to pay creditors, but maintains a wealthy lifestyle including residences in Las Vegas and Southern California. Is it really any wonder that courts frequently go out of their way to help creditors against such debtors?

The problem is fundamentally one of clients (1) having some common sense and knowing when they should live an (at least somewhat) austere lifestyle, and (2) being able to actually follow the legal structure that was created for them. You can create the very best asset protection structure for a client, but if the client ignores the structure and treats its assets as his own - good luck defending that. Prior newsletters address how a trust may be ignored when one exerts substantial control over the trust.[iv]

This opinion shouldn't be unduly concerning regarding Nevada law. Even if the rationale of this opinion is followed by Nevada state courts, it simply would mean that Nevada alter ego law is the same as that of most other states.

A "best practice" of asset protection is that proper planning should work if challenged under the laws of any state. Presuming that the laws of a particular state will always apply, or that the laws of a particular state will be better others, is folly. Those perpetually looking for the "best" jurisdiction are simply on a long snipe hunt. Further, this opinion also illustrates, again, that one often cannot predict how a particular court will interpret the law which faced with the peculiar facts before it.

"Bad facts make bad law!" you may say. True, but at the end of the day, bad law is still law. All too often, it takes on a life of its own and grows and expands. Also, it depends on which side you are on, for the "bad law" suffered by the loser will be seen as "good law" for the winner, who will champion it as the correct result. You have to deal with it as it is, and not simply presume that someday the courts will eventually get it to come out the way you have originally hoped.

Will Nevada state courts apply the rationale of this federal court decision? The answer probably will depend on the facts of each case until a case finds its way to a Nevada appellate court. In a run-of-the-mill case, a state court may consider the Nevada legislature's generally pro-debtor slant and reject an alter ego claim. On the other hand, if a case involves an attempt to avoid a casino debt, well, remember that "the House always wins".

Nevada is not a particularly litigious state, and the number of creditor-debtor cases has dramatically decreased now that most of the fallout of the 2008 financial crisis has been resolved. It may be a quite while before the Nevada Supreme Court gets the opportunity to consider these alter ego issues, and until that time, this opinion will probably state the law in Nevada.

Stay tuned.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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Transfirst Group, Inc. v. Magliarditi, 2017 WL 2294288 (D.Nev., May 25, 2017).

CITATIONS:

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[i] The opinions expressed are those of the authors and do not necessarily reflect the views of Shumaker, Loop & Kendrick, LLP or its clients. This commentary is for general information purposes and is not intended to be and should not be taken as legal advice.

[ii] Such relief is also expressly provided in Florida's Revised Limited Liability Company Act. *See* Fla. Stat. Ann. § 605.0503(c). ("This section does not limit any of the following: *** (c) The availability of the equitable principles of alter ego, equitable lien, or constructive trust or other equitable principles not inconsistent with this section.")

[iii] *Bash v. Williams*, No. 5:16 CV 257, 2016 WL 1592445, at *3 (N.D. Ohio Apr. 20, 2016). ("*See, Smith v. S.E.C*., 432 Fed. Appx. 10 (2nd Cir. Aug. 8, 2011)("we assumed that New York courts would allow the veil of a trust to be pierced in situations where the complete domination of a trust has been shown" and the moving party can show fraud or another wrong was committed); *In re Schwarzkopf*, 626 F.3d 1032 (9th Cir. 2010)("It is well-settled [under California law] that a trust created for the purpose of defrauding creditors or other persons is illegal and may be disregarded."); *Vaughn v. Sexton*, 975 F.2d 498 (8th Cir. 1992)("the concept of personal liability for the obligations of an entity considered to be an alter ego of an individual is frequently employed in relation to corporations...[and] we see no reason why the alter ego concept should not have the same effect in the case of a trust."); *Acheff v. Lazare*, 2014 WL 894491 (D. New Mex. Jan. 29, 2014)("Under New Mexico law, the Delos Trust is Mr. Edelman's alter ego and the trust veil should be disregarded..."); *Dexia Credit Local v. Rogan*, 2008 WL 4543013 (N.D. Ill. Oct. 9, 2008)("To pierce the veil of the trusts, Dexia must show that they and Rogan have such unity of interest that their

separate personalities no longer exist, and that there are circumstances such that continuing to recognize their separateness would sanction a fraud or injustice."); *In re Gillespie*, 269 B.R. 383 (Bankr. E.D. Ark. 2001)(although alter ego doctrine is most often applied to corporations, "it also applies to trusts."); *Bracken v. Early*, 40 S.W.3d 499 (2000)(Ct. App. Tenn. 2000)("The Trial Judge, in effect, found that defendant is the 'alter ego' of the trust, and we agree under all the circumstances the defendant is liable to the plaintiff for the monies received.") *William L. Comer Equity Trust v. United States*, 732 F.Supp. 755 (E.D. Mich. 1990)("[w]hile the Court uncovered no precedent analyzing the 'alter ego' theory of property ownership in the context of a trust, cases involving corporate entities provide appropriate guidance.").")

[iv] *Jay Adkisson on In re Schwarzkopf & the Benefits of Telling Clients to Just Let Go*, LISI Asset Protection Planning Newsletter #166 (December 2, 2010). ("The important lesson of Schwarzkopf is that if the settlor retains substantial control over a trust, it may be invalidated as the settlor's alter ego even if the settlor retains no beneficial interest. This is very important, because many clients will demand very substantial control over the trusts that they create. But the compliment to control is alter ego: the more control of the settlor, the more likely the trust will be deemed the alter ego of the settlor. Yet, such control may effectively negate the protections of the trust. Clients need to be shown the Schwarzkopf opinion and advised that if they want their trusts to provide asset protection, they are going to have to unclench their fingers, forget the puppet strings, and, to use a phase from the 1970's, simply let go."); *see also*, *Pennell on US v. Evseroff: Trust Ignored for Asset Protection Purposes,* LISI Asset Protection Planning Newsletter #201 (May 31, 2012). ("Indeed, experienced practitioners in this arena report that advisors and reputable trust companies will not assist a client who is looking to dodge existing creditors, spousal or child support obligations, tax liabilities, or to engage in any form of criminal activity. But even that form of planning may not suffice to defeat the alter ego or nominee theories, which are novel today but may find currency in the future as more cases involving the asset protection trust concept reach the courts.").

Notwithstanding the approach taken in other states, Florida law has been interpreted as very favorable to debtors when it comes to the application of alter ego. Arguably, this factor should be considered, as one of many,

when analyzing jurisdictions for purposes of dynasty trust planning. *Miller v. Kresser*, 34 So. 3d 172, 176 (Fla. Dist. Ct. App. 2010) ("There is no law in Florida suggesting that a beneficiary's creditors may reach trust assets in a discretionary trust simply because the trustee allows the beneficiary to exercise significant control over the trust. It is only when a beneficiary has received distributions from the trust, or has the express right to receive distributions from the trust, that the creditor may reach those distributions."). In Florida, courts have been reluctant to apply alter ego, finding the terms of the trust agreement paramount to any actions taken in contravention. "Because, under Florida law as it stands, the Court must look to the "terms of the trust" and not extrinsic evidence, the Court accepts the bankruptcy court's recommendation that Florida law would not permit alter ego liability with respect to an irrevocable trust." *Bash v. Williams* at 5.