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Introduction

Under New York law, an entity that has failed to properly incorporate cannot assume liabilities or acquire rights.¹ As a result, unincorporated entities will typically lack capacity to enter into contractual agreements.² Within the context of bankruptcy, this may hinder a creditor's ability to maximize its recovery.³

A creditor that is adversely affected by a lack of corporate recognition will attempt to persuade a court to impose the doctrines of *de facto* corporation or corporation by estoppel.

These doctrines, which are matters of state law, provide unincorporated entities with the rights and obligations that a legally recognized entity would otherwise have.⁴

This article discusses the doctrines of *de facto* corporation and corporation by estoppel and their bankruptcy implications. Part I compares the two doctrines and analyzes the criteria courts use to determine whether an unincorporated entity should be found to have corporate

¹ See *TY Bldrs. II, Inc. v. 55 Day Spa, Inc.*, 167 A.D.3d 679, 681 (N.Y. App. Div. 2018).

² *Amazing Entertainment, Inc. v. Louis Lofredo Assoc.*, 88 F.Supp 2d 265, 271 (S.D.N.Y. 2000).

³ See *In re Maidan*, No. 8–19–77027–las, 2022 WL 4125034, at *6 (Bankr. E.D.N.Y. 2022) (finding that a creditor was not entitled to money held in escrow because it failed to prove that the debtor was a legally recognized entity).

⁴ See *Boslow Family Ltd. Partnership v. Glickenhau & Co.*, 7 N.Y.3d 664, 668 (N.Y. 2006) (recognizing the doctrines of *de facto* corporations and corporation by estoppel).

status. Part II further elaborates on the bankruptcy implications associated with the corporate status of unincorporated entities.

I. **The Doctrines of *De Facto* Corporation and Corporation by Estoppel are used to Ascribe Corporate Status to Unincorporated Entities.**

An unincorporated entity is defined as an entity that has failed to properly file its articles of incorporation with the secretary of state.⁵ As a result of its failure to properly incorporate, an unincorporated entity will lack legal recognition.⁶ Courts recognize the doctrines of *de facto* corporations and corporation by estoppel to ascribe corporate status to unincorporated entities. As more specifically set forth below, a *de facto* corporation requires “a party to show that it has made a colorable attempt to comply with the statutes governing incorporation[,]” whereas, the existence of a corporation by estoppel will depend on the recognition of an entity as a corporation based upon its business dealings.⁷

A. *An Overview of De Facto Corporations*

A *de facto* corporation is an entity which, despite a good faith effort, failed to properly incorporate.⁸ An unincorporated entity will be given *de facto* status based on the satisfaction of the following: (1) the existence of a law pursuant to which the corporation could be recognized; (2) a good faith attempt to organize the corporation thereunder; and (3) the exercise of corporate powers.⁹

To satisfy the first element, New York courts look to Section 403 of the New York Business Corporation Law as the operative statute used to recognize a corporation.¹⁰ Under Section 403 of the New York Business Corporation Law, “[u]pon the filing of the certificate of

⁵ Heifetz v. Rockaway Point Volunteer Fire Dep’t, 124 N.Y.S.2d 257, 260 (Sup. Ct. Kings Cnty. 1953).

⁶ *Id.*

⁷ *Glickenhau*s, 7 N.Y.3d at 668.

⁸ *See* *Cad v. Moore*, 68 A.D.327, 337 (N.Y. App. Div. 1902).

⁹ *See* *Matter of Hausman*, 13 N.Y.3d 408, 412 (N.Y. 2009).

¹⁰ NY CLS Bus. Corp. §403 (2023).

incorporation by the department of state, the corporate existence shall begin, and such certificate shall be conclusive evidence that all conditions precedent have been fulfilled and that the corporation has been formed under this chapter . . .” As such, Section 403 serves as the foundation of a court’s inquiry into whether an unincorporated entity has made a satisfactory attempt to incorporate.¹¹

Next, courts will consider whether there was a good faith attempt to organize pursuant to Section 403.¹² Merely executing articles of incorporation, and not attempting to comply with the statutory procedures to incorporate, will not be enough to demonstrate that a good faith attempt to incorporate was made.¹³ There must be a “colorable attempt to comply with the statutes governing incorporation’ prior to the exercise of corporate powers.”¹⁴

For example, in *Matter of Hausman*, a woman transferred her ownership in real property to her children’s limited liability company that had executed its articles of incorporation but had failed to file the documents with the department of state until two weeks after the conveyance took place.¹⁵ The children argued that their company qualified as a *de facto* corporation at the time of the conveyance because a non-existent entity cannot receive title to real property, and that by subsequently executing the articles of incorporation, the children made a “colorable attempt” to incorporate.¹⁶ The court disagreed that this qualified as a “colorable attempt” and did not provide the limited liability company with *de facto* status since its articles of incorporation were not filed prior to the conveyance.¹⁷

¹¹ See *Rockaway Improvement, LLC v. Danco Transmission Corp.*, 801 N.Y.S.2d 138, 143 (Sup. Ct. Kings Cnty. 2005).

¹² See *id.* (looking to Section 403 to determine if the procedures to properly incorporate were satisfied).

¹³ *Hausman*, 13 N.Y.3d at 412.

¹⁴ *Id.*

¹⁵ *Id.* at 410.

¹⁶ *Id.* at 413.

¹⁷ *Id.*

There have been instances, however, where a “colorable attempt” to incorporate was made despite the entity entering into an agreement prior to filing its articles of incorporation. For example, in *Danco Transmission Corp.*, a lease agreement was executed four days prior to an entity properly filing its articles of incorporation.¹⁸ However, because the lease did not commence until after the incorporation took place, the court found that a good faith attempt to incorporate was made.¹⁹ Thus, as established in *Matter of Hausman* and *Danco Transmission Corp.*, if an unincorporated entity enters into a contract prior to filing its article of incorporation, to prove that a “colorable attempt” has been made the entity must establish that performance under that contract was not required until after it filed its article of incorporation.

Next, courts will look to the “exercise of corporate powers.” Under this prong of the analysis, an unincorporated entity must engage in activity that is consistent with the type of business that an entity was intended to conduct.²⁰ To demonstrate that an exercise of corporate power has occurred, courts consider among other things, the following corporate acts: (1) the passing of a corporate borrowing resolution, (2) the issuance of a Certificate of Resolutions authorizing a security agreement, (3) the creation of a corporate bank account, and (4) an application for a liquor license.²¹

In conclusion, so long as an unincorporated entity makes a “colorable attempt” to incorporate pursuant to Section 403 of the New York Business Corporation Law and exercises corporate powers, it will likely qualify as a *de facto* corporation.

B. *An Overview of Corporation by Estoppel*

¹⁸ *Rockaway Improvement, LLC v. Danco Transmission Corp.*, 801 N.Y.S.2d 138, 139 (Sup. Ct. Kings Cnty. 2005).

¹⁹ *Id.* at 143.

²⁰ *See Emery v. De Peyster*, 77 A.D. 65, 68 (N.Y. App. Div. 1902) (finding that an entity was not a *de facto* corporation where it “never got into business”).

²¹ *Bankers Trust Co. v. Zecher*, 426 N.Y.S.2d 960, 963 (Sup. Ct. Monroe Cnty. 1980).

The doctrine of corporation by estoppel serves as an alternative to the *de facto* corporation doctrine. Courts will apply the doctrine of corporation by estoppel when an entity: (1) is not fully formed when a contract was executed; and (2) despite the lack of corporate formation, another party has recognized an entity's corporate status.²² If these elements are satisfied, the party opposing corporate status will be precluded from arguing that the entity should not be provided legal recognition.²³

Generally, a party will be estopped from denying the incorporation of an entity if it benefits from its dealings with that entity. For example, in *55 Day Spa*, the defendant argued that the plaintiff lacked standing to enforce the terms of its contractual agreement since it was not properly incorporated when the contract was executed.²⁴ The Court disagreed with the defendant's argument and found that "[t]he evidence demonstrate[d] that the parties engaged in the subject business transactions and the defendants received the benefit of possession of the property. Consequently, the defendants [were] estopped from using the plaintiff's lack of proper incorporation to escape liability under the lease."²⁵

However, it is significant to note that a violation of a law unrelated to the legal existence of an entity will prevent a court from imposing the corporation by estoppel doctrine. This took place in *Equity Land Developers* where the defendant, Equity Land Developers, refused to pay the plaintiff, JCL Properties, a brokerage fee after it assisted in procuring a mortgage loan commitment for the defendant.²⁶ In support of its motion for summary judgment, Equity Land Developers argued that its contract with JCL properties was not enforceable since it was not yet

²² Rubenstein v. Mayor, 41 A.D.3d at 828–29 (N.Y. App. Div. 2007).

²³ *Id.*

²⁴ TY Bldrs. II, Inc. v. 55 Day Spa, Inc., 167 A.D.3d 679, 680 (N.Y. App. Div. 2018).

²⁵ *Id.* at 681.

²⁶ JCL Prop., LLC v. Equity Land Dev., LLC, 102 A.D.3d 745, 745 (N.Y. App. Div. 2013).

incorporated when the contract was executed.²⁷ In response, JCL Properties argued that the court should apply the corporation by estoppel doctrine to prevent Equity Land Developers from benefitting from its lack of corporate status.²⁸ Ultimately, the court granted the defendant's motion and did not impose the doctrine of corporation by estoppel because an unincorporated entity cannot obtain a broker fee pursuant to Real Property Law Section 442-d.²⁹ In support of its conclusion, the court reasoned that, as a matter of law, it will not impose the doctrine of corporation by estoppel when a different law is violated.³⁰

In sum, although the doctrines of *de facto* corporations and corporation by estoppel have distinguishing characteristics, both doctrines provide a lifeline for entities that have failed to follow the necessary procedures to properly incorporate but should nonetheless be treated as a valid corporation.

II. The Corporate Status of an Unincorporated Entity may have Implications in a Bankruptcy Proceeding.

The corporate status of an unincorporated entity may have significant bankruptcy implications. Because unincorporated entities lack capacity to enter into contractual agreements, the validity of a creditor's claim against a debtor may depend on its corporate status or the corporate status of the debtor. Pursuant to Federal Bankruptcy Procedure Rule 3001, a proof of claim must state the identity of the creditor whose proof of claim it is.³¹ As a result, unincorporated creditors will attempt to obtain the rights and obligations of a legally recognized entity by demonstrating that it is either a *de facto* corporation or by requesting that a court impose a corporation by estoppel. This is what occurred in *In re Maidan*.

²⁷ *Id.* at 746.

²⁸ *Id.* at 745.

²⁹ *Id.* at 746.

³⁰ *Id.*

³¹ *See* FED. R. BANKR. P. 3001.

In *In re Maidan*, the plaintiff (“Creditor”) entered into a loan agreement with his father (“Debtor”) to cover the initial deposit for the purchase of real property.³² The loan was made on behalf of Harrison Realty, an unincorporated entity established by the debtor.³³ Pursuant to the loan agreement, the plaintiff would advance \$81,500 to cover the initial deposit for the contract of sale on the condition that funds were earmarked at the closing of a sale of the property for the repayment of the loan.³⁴ Because Harrison Realty was an unincorporated entity when the loan agreement was executed, the trustee of the bankruptcy estate argued that the plaintiff was not entitled to the escrowed funds and was at best an unsecured creditor because Harrison Realty did not have capacity to enter into the agreement.³⁵ In response, plaintiff attempted to persuade the court to classify Harrison Realty as a *de facto* corporation or alternatively invoke corporation by estoppel.³⁶

The court found that Harrison Realty did not qualify as a *de facto* corporation and declined to invoke the doctrine corporation by estoppel.³⁷ In support of its conclusion, the court reasoned that Harrison Realty: (1) failed to make a “colorable attempt” to file its articles of incorporation, (2) failed to draft an operating agreement prior to the date of the loan agreement, (3) made no attempt to achieve legal status with the state, and (4) limited its corporate actions to this singular agreement.³⁸ As a result, because Harrison Realty failed to qualify as a *de facto* corporation, the plaintiff lost its status as a secured creditor.

In re Maidan is an example of how a bankruptcy deals with issues regarding corporate status and illustrates the issue an unincorporated entity faces if it does not qualify as a *de facto*

³² *In re Maidan*, No. 8–19–77027–las, 2022 WL 4125034 at *6 (Bankr. E.D.N.Y. 2022).

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 19.

³⁸ *Id.* at 20–21.

corporation; it will be difficult for a creditor to recover as much as it would have, had both parties to a contract properly incorporated with the state.

Conclusion

Based on the foregoing, the state law issue of determining the rights and privileges afforded to unincorporated entities can have significant bankruptcy implications. If an unincorporated entity cannot obtain corporate status through the doctrines of *de facto* corporation or corporation by estoppel, a creditor will have difficulty maintaining its status as a secured creditor in bankruptcy.