

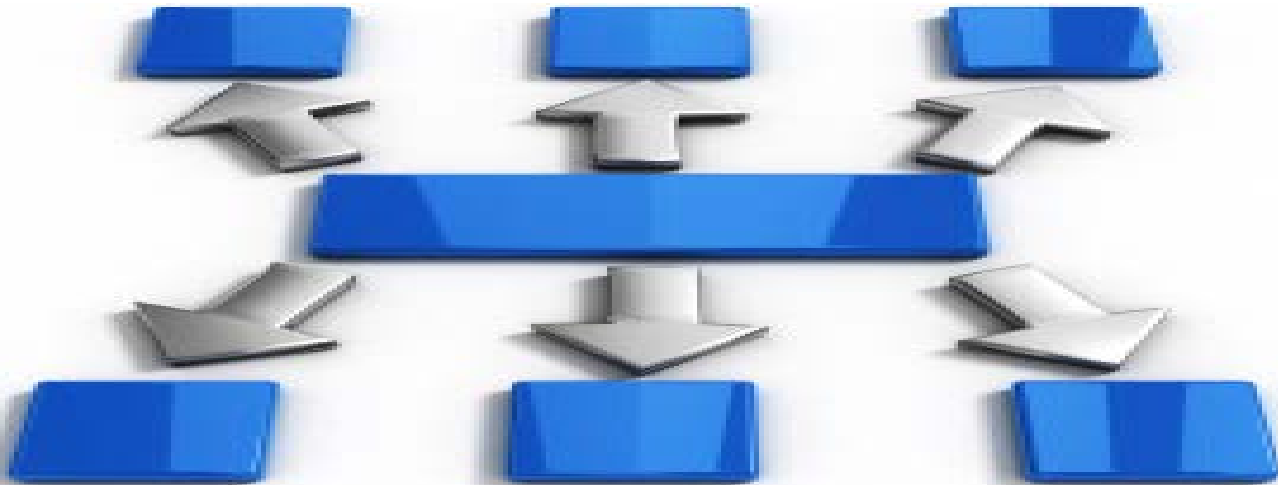
Relationships Between Parent and Subsidiary Corporations: Implications for Litigation

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Presented by Jim Huston
and Jim Edwards

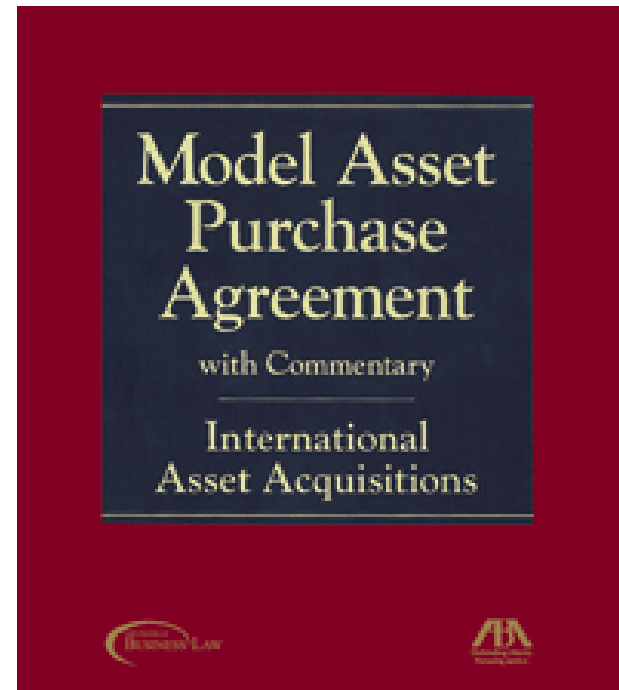
Why Subsidiaries?

- Common reasons:
 - New line of business unrelated to current business
 - New business carries risk unacceptable to parent
 - Shareholder reasons
 - Shield parent's assets



Purchase v. Asset Purchase

- How do you want to structure your deal? What makes sense?
- Different litigation implications



Asset Purchase

- Parent purchases assets of corporation → forms new subsidiary made up of assets.
- Can parent escape **tort** liability? It depends.
- What do asset purchase documents say about liability?
- Do well-worded asset purchase agreements help? Yes.
- Are asset purchase documents dispositive? No.

Asset Purchase

Generally Recognized Exceptions to Rule of Successor Non-Liability

- Agreement of assumption
- Consolidation or merger
- Transfer of assets was fraudulent
- “Mere continuation”



Parent Liability

Non-Traditional Tests for Successor Liability

- **Two Non-Traditional Tests (limited exceptions)**
 - “Continuity of Enterprise”
 - “Product Line Successor Rule”
- **Only adopted in a minority of states**

Continuity of Enterprise

- Successor held liable for predecessor's operations if there is "basic continuity of enterprise"
- Does not depend on requirement of common ownership like the generally recognized "mere continuation" exception
- Based on "public or social policy under which it has been determined that, irrespective of fault, a party should be held liable for the acts of another." *Nissen Corp. v. Miller*, 594 A.2d 564, 633 (Md. 1991)
- No bright line test
- Adopted in Alabama, Alaska, Michigan, Mississippi, Pennsylvania

Product Line Successor Rule

- Provides a remedy against successor corporation for personal injury from a defective product
- Creates greatest potential for unanticipated successor liability
- Criteria
 - Destruction of the plaintiff's remedies against the original manufacturer caused by the successor's acquisition of the business
 - Successor's ability to assume the original manufacturer's risk spreading role
 - Fairness of requiring successor to assume a responsibility for defective products is burden attached to the original manufacturer's good will which is now enjoyed by the successor in the continued operation of the business

PLS Rule: Causation

- Causation requirement example: *Kline v. Johns-Manville*, 745 F.2d 1217 (9th Cir. 1984)
 - Unarco manufactures “Unibestos”
 - 1962 → Pittsburg-Corning buys Unibestos **product line** from Unarco, and manufactures Unibestos until 1972
 - 1981 → Plaintiffs file complaints as a result of inhaling asbestos during Unarco’s ownership of the product line
 - 1982 → Unarco files for bankruptcy
 - Plaintiffs ask court to impose liability on Pittsburg-Corning
 - Is Pittsburg-Corning liable?

PLS Rule: Causation

- Court held Pittsburgh-Corning not liable
 - No causation
 - Pittsburgh-Corning did not play a role in destroying the plaintiffs' remedies
 - It was not the sale of the Unibestos line to Pittsburgh Corning that caused Unarco to petition for bankruptcy
 - The company continued to operate after selling the product line and could answer for any liabilities
 - The bankruptcy of Unarco ten years later did not change the legal obligations of Pittsburgh-Corning

Purchase of Entire Corporation

- Can a parent be held liable for tort of subsidiary? Generally no—presumptively regarded as separate and distinct legal entities.
- Do plaintiffs try to get to parent anyway? Generally yes.
 - How? Two ways:
 - 1) Direct parent liability
 - Negligent performance of an undertaking
 - Direct participation liability
 - 2) “Piercing the corporate veil”

Direct Parent Liability

- Direct liability can arise when one company undertakes some action on behalf of the subsidiary
- Negligent Performance of an Undertaking
 - Subsidiary fails to take reasonable steps to ensure the safety of a third person in reliance on the parent's reasonable care in performing an undertaking
- May occur when:
 - Parent controls health and safety matters at a subsidiary
 - When subsidiary relies on health and/or safety research conducted by parent
 - When parent promotes its involvement in the product manufactured by subsidiary

Direct Parent Liability

- Direct Participation Liability

- When parent actively participates in decision to commit the relevant wrong and where the parent's participation was outside the normal channels of corporate decision-making
- E.g., having a chief science officer that makes decisions for both
- Parent exercised **specific control** over tortious act



Piercing the Corporate Veil

- Focus on whether subsidiary operates as truly independent organization, free from the control or influence of its parent. “Alter ego” test considers the follow:
 - Is subsidiary adequately capitalized?
 - Does parent finance subsidiary?
 - Does parent own all/most of subsidiary’s stock?
 - Does parent pay salaries and other expenses/losses of subsidiary?
 - Is the subsidiary insolvent?
 - Commonality of officers, directors etc.

Ways to Avoid Parent Liability

- Maintain corporate formalities
- Respect corporate barriers
- Keep daily operations separate
- Don't wear too many hats at once



Maintain Corporate Formalities

- What does this mean?
 - ***Strict compliance with all organizational documents***—directors and officers should have thorough understanding and abides by restrictions contained in the documents. Require good record keeping.
 - ***Conduct business under the correct corporate name***—failure to do so may create ambiguity about which corporate entity is acting. Ambiguity may lead to inference that entity is not operating as a truly independent organization.
 - ***Maintain separate finances***—avoid comingling funds. Undercapitalization may be reason to pierce the corporate veil. Parent risks the appearance that new entity was formed to do its bidding while avoiding the risk of large financial loss.

Respect Corporate Barriers



"Oh!...your people are my people?
Well, that should make things a lot simpler."

Keep Daily Operations Separate

- Courts consider:
 - Does the parent exercise control over the recruitment, hiring, and work assignments of subsidiary's offers and other employees?
 - Do the parent and subsidiary maintain separate payrolls?
 - Do the parent and subsidiary conduct separate advertising?
 - Does the subsidiary solicit customers and negotiate contracts on its own behalf?
 - Does the subsidiary have independently established prices for the products it manufactures?
 - Does the subsidiary issue invoices, checks, drafts and other similar instruments in its own name?

Implications for Litigation

- Foreign parent subject to jurisdiction in U.S. courts
- Subject parent to discovery
 - Expensive
 - Fishing expeditions
 - Electronic discovery
- Open the door to larger damages
 - Consider the potential for punitive damages if assets of parent put before jury rather than just the subsidiary
- Other implications
 - Insurance
 - Annual reports
 - SEC filings

QUESTIONS?