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Negligent Undertakings Applied to Product Liability: How Parent Corporations Can Be Directly Liable for a Subsidiary Product

When does a parent corporation become liable for the product liabilities of its subsidiaries? Usually, the answer is found in the law of corporate veil piercing, often called alter ego liability. Corporations are well aware of the case law in any number of states outlining the conduct essential to maintaining the requisite separateness between parent and subsidiary. Adversaries, however, are simultaneously searching for more original and less-traveled paths to parent liability for subsidiary products. This is particularly true when products are sold by off-shore subsidiaries thinly capitalized and underinsured by U.S. product liability standards.

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The law of negligent undertakings, found in Restatement (Second) of Torts § 324A, offers a potential pathway of direct liability to a parent corporation's assets. This theory of liability is akin to the "Good Samaritan" doctrine, which requires a person who volunteers to assist another to use reasonable care or else risk liability for providing negligent assistance. Parent corporations can be subject to liability for providing seemingly routine services to their subsidiaries, should the performance of those services later be found to contribute in any way to injury of persons or property. Restatement (Second) of Torts § 324A provides as follows:

Liability to Third Persons for Negligent Performance of Undertaking

> One who undertakes, gratuitously or for consideration, to render services to another which he should recognize as necessary for the protection of a third person or his things, is subject to liability to the person for physical harm resulting from his failure to exercise reasonable care to protect his undertaking, if

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> (a) his failure to exercise reasonable care increases the risk of such harm, or
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> (b) he has undertaken to perform a duty owed by the other to the third person, or
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> (c) the harm is suffered because of reliance of the other or the third person upon the undertaking.

Determining when a parent corporation's routine services amount to the undertaking of a duty is an unclear area of law. Unlike veil piercing law, the case law and analyses of negligent undertaking claims generally have not produced bright line rules. While the question of whether a duty was undertaken is a legal one, the application of § 324A subsections (a), (b), and (c) are questions of fact which depend on the nature and extent of the act undertaken, rendering it difficult to determine precisely what conduct will constitute a negligent undertaking.

Dow Chemical: Parent Corporation Exposed

The potential consequences of § 324A are perhaps best demonstrated in *Dow Chemical v. Mahlum*, one of thousands of actions initiated during the 1990's regarding silicone gel breast implants. In *Dow Chemical*, the Supreme Court of Nevada upheld the judgment against Dow Chemical on plaintiff's claim of negligent performance. 970 P.2d 98 (Nev. 1998). It found that when Dow Chemical undertook the testing of liquid silicone -- regardless of its lack of knowledge that the silicone would ultimately be used in breast implants -- it created a duty to ultimate consumers, which it then negligently performed. The Court held that Dow Chemical provided its subsidiary, Dow Corning, the breast implant manufacturer, with continuing assistance, and that Dow Chemical's head toxicologist rendered advice on the types of tests to conduct, interpreted the results, and recommended additional tests along with other measures. Consequently, the Court determined that Dow Chemical undertook the duty of testing that Dow Corning owed to consumers, and that Dow Corning relied on Dow Chemical's expertise when developing silicone breast implants. Dow Chemical was therefore subject to direct liability for the injuries alleged by Dow Corning's consumers under § 324A.

It should be noted that most courts have maintained the opposite position, holding that a party who advises a manufacturer of consumer goods does not owe a duty to then-unknown individual purchasers of the manufacturer's goods, as it would impose virtually limitless liability on the party giving advice. Yet, the critical principle here is not that the claims for negligent performance against Dow Chemical had limited success, but rather that parent corporations cannot conclusively determine the viability of negligent undertaking claims. More importantly, parent corporations cannot predict the potential ensuing exposure, since the parameters for when a duty has been undertaken have not been defined. "Just when the duty is undertaken, when it ends, and what conduct is required, are nowhere clearly defined and perhaps cannot be."[1]

Pre-Sale Negligence vs. Post-Sale Duty-to-Warn: A Distinction Without A Difference

The Dow Chemical cases presented a situation of pre-manufacturing negligence, that is, Dow Chemical's liability was based on the negligent testing of what became a primary component in its subsidiary's product. Specifically, the Supreme Court of Nevada found that Dow Chemical's conduct was negligent because it obtained evidence through its studies that silicone was potentially harmful in humans, but never reported this information to the scientific or medical communities, or to the general public. Also rejecting the reasoning of *Dow Chemical v. Mahlum*, troubled by the breadth of potential liability, other courts have commented that Dow Chemical could not possibly have identified all of the potential consumers in order to provide the warning that the Supreme Court of Nevada believed appropriate.

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But what if a parent corporation could identify all of the potential consumers? What if, rather than pre-manufacturing involvement, a parent became involved post-sale and post-notification of a defect in a subsidiary product? If the root of Dow Chemical's liability for negligent performance was its failure to warn potential consumers of possible harm, then the obligation to warn consumers for a parent corporation that becomes involved post-sale is arguably even more compelling. This reasoning is precisely what should give parent corporations cause for concern.

Parent corporations with thinly capitalized and underinsured subsidiaries will undoubtedly become involved when these subsidiaries are facing product liability claims. Parents may inspect the subsidiary's product for the alleged defect, implement new protocols for quality control, or conduct internal investigations. However, it is unlikely that parent corporations would directly issue a warning to consumers. Parent corporations may instead naturally, and reasonably, assume that the duty to warn

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[1] Prosser and Keaton, Law of Torts, § 56, at 379 (5th ed. 1984).

the subsidiary's consumers lies with the subsidiary. Yet, the reasoning applied in the Dow Chemical cases suggests otherwise.

Applying the reasoning followed in *Dow Chemical v. Mahlum*, when allegations of product liability arise, plaintiffs seeking deeper pockets may argue that a parent corporation involved in post-sale inspections has undertaken duties owed by its subsidiaries to consumers. For example, the parent has arguably undertaken the duty to inspect the allegedly defective product. Once a parent has undertaken such a duty, under the reasoning of the Supreme Court of Nevada, it may be held to have assumed this responsibility for itself, and that its inspection that is necessary for the protection of consumers. In contrast to Dow Chemical, however, a parent corporation dealing with a defect discovered post-sale may be able to identify actual and potential consumers. Therefore, a parent corporation that has undertaken the duty of inspection potentially has a subsequent, logical duty to itself warn consumers of the defective product in order to mitigate, or perhaps prevent, harm altogether. If a parent corporation fails to discharge these duties with reasonable care, it could find itself subject to direct liability. Such an argument would allow plaintiffs to reach a parent's assets without ever using the veil piercing law that parent corporations are well-prepared to combat.

Preventing Fires Instead of Fighting Fires

What can a parent corporation do to protect itself from the potential of direct liability for a negligent undertaking? One easy answer is to warn the subsidiary's consumers. However, this would place a parent in the direct and public role of defending a product that it did not manufacture. A better answer may be to approach negligent undertaking liability as alter ego liability. Corporations avoid alter ego liability by maintaining the requisite separateness between parent and subsidiary, essentially compelling subsidiaries, in some instances, to fight their own fires. Negligent undertaking liability should receive the same treatment. Parent corporations need to perform a cost-benefit analysis to determine whether rescuing the subsidiary is worth potentially exposing the parent's assets. A parent corporation may want to reconsider an active role in a subsidiary's affairs, even if its involvement would not abuse the corporate form.

Yet, maintaining corporate separateness for the purpose of avoiding negligent undertaking liability does not necessarily require parent corporations to take a complete "hands-off" approach to dealing with a subsidiary's defective product. Parents can be involved in managing the situation, as long as certain limits are observed. Parent corporations should avoid taking on responsibility for the inspection and investigation of a subsidiary's defective product where possible. Instead, parents can perform more limited, carefully defined responsibilities, such as recommending an expert or institution to inspect a defective product rather than facilitating and supervising an inspection internally.

Parent corporations can do what Dow Chemical could not have known was necessary, which is to develop written policies in advance memorializing the parent's intention to serve a limited role and delineating the parent's restricted authority, along with the scope of its involvement. It must ensure its employees understand the purpose behind the policies, and the potential implications to the parent corporation should the letter of the policies not be followed. A writing will be the proof a parent needs to demonstrate to a factfinder that its role was too limited to amount to any undertaking that could serve as the basis for direct liability. If a parent corporation structures its conduct accordingly, it can reduce its risk of getting embroiled in its own fires while helping its subsidiary fight theirs.