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CORPORATE LIABILITY

It has been five years since the U.S. Supreme Court ruled in ***United States v. Bestfoods***, the landmark decision articulating key principals applicable to parent company liability. Yet, as the author points out in this article, the application of the ***Bestfoods*** guidelines is often complex, and parent companies remain at risk for the environmental, health, and safety liabilities generated by their subsidiaries. Environmental lawyer Brian Israel sets forth a number of measures shareholder corporations can take to reduce exposure to subsidiary liabilities without reducing their commitment to firm-wide policies.

Parent Companies Can Take Steps to Reduce Exposure at Subsidiaries

BY BRIAN D. ISRAEL

Corporations sometimes assume as part of their risk management that, absent veil-piercing, they are not at risk for the environmental, health and safety liabilities stemming from the acts of their subsidiaries. This is not true. In fact, as numerous recent cases have demonstrated, it has become easier and more common for plaintiffs to sue parent companies directly as a tortfeasor, without even alleging alter ego, veil piercing, or other similar theories.

Notwithstanding this trend toward pursuing direct shareholder liability, there are some easy and inexpensive steps companies can undertake that may greatly reduce their exposure to subsidiaries' liabilities.

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What's Happening and Why

More and more, plaintiffs, including both private parties and governments, are suing parent corporations for the environmental, health, and safety liabilities generated at the subsidiary level. Sometimes, a shareholder corporation is sued notwithstanding the fact that its investment in the subsidiary is relatively small or indirect. In one current workplace safety case, two shareholders are being sued for an accident even though the subsid-

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iary is no longer directly owned by those entities, and one shareholder held only 30 percent of the subsidiary's stock at the time of the incident at issue.

A. The *Greene* and *Montrose* Cases

In another important workplace safety case brought pursuant to the Federal Employers' Liability Act, 45 U.S.C. § § 51-60, the U.S. Court of Appeals for the Second Circuit held that a parent corporation could be liable as a railroad operator because of its pervasive ''hands-on participation in the budgeting, capital raising, marketing, advertising, real estate, risk management, and labor relations aspects of [the subsidiary's] operations'' and because the parent company provided security personnel to the subsidiary. *Greene v. Long Island Railroad Co.*, 280 F.3d 224, 239 (2d Cir. 2002).

The question in *Greene* was whether the Metropolitan Transportation Authority (MTA) was to be considered an ''interstate common carrier by railroad'' notwithstanding the MTA's contention that its subsidiary, the Long Island Railroad Co., not the MTA, operated the rail service in question. The Second Circuit acknowledged shareholder corporations are not normally liable for the torts of their subsidiaries, stating that

> while corporate ownership of a subsidiary and overlapping officers and directorates are not, without more, sufficient to impose liability on the parent for conduct of the subsidiary under a statute that does not itself pierce the corporate veil, the parent may nonetheless be liable for operations of the subsidiary in which the parent itself, wearing its parenting hat, participates.

Id. at 235-236.

In this case, the district court found, and the Second Circuit affirmed, that the parent company was not ''simply a holding company or a stockholder content to manage [the subsidiary] through overlapping formal corporate governance.'' Id. at 236. Rather, the parent was ''directly and integrally involved in essential business aspects of [the subsidiary's] operations.'' Id. at 239.

The enthusiasm toward suing corporate shareholders is also common in the environmental arena. In one ongoing matter, the federal government and state of California have sued the 50 percent shareholders of Montrose Chemical Corp. for many millions of dollars of environmental liability caused by the subsidiary's DDT manufacturing facility.[1] This environmental case is interesting because the subsidiary still exists, also was sued by the governments, and may have the ability to cover the liability. *United States v. Montrose Chemical Corp.*, C.D. Cal., No. 90-CV-3122, filed 6/18/90.

In *Montrose*, the U.S. government and California asserted that Chris-Craft, the parent company, was liable for the DDT contamination caused by Montrose, the subsidiary, because Chris-Craft ''designed, managed and operated the [subsidiary's] DDT plant.'' In particular, the plaintiffs pointed to management fees paid to the parent company as well as pervasive decisionmaking acts by shareholder employees related to environmental issues at the subsidiary. Despite the fact that much of the Montrose DDT case has been resolved, the shareholder liability of Chris-Craft, which is now News Publishing Australia Ltd., is still pending before the U.S. District Court in the Central District of California.

The trend toward suing corporate shareholders is most common now in safety and environmental contexts, although it is also observed in discrimination,[2] labor,[3] patent infringement[4] and other arenas.

The question then becomes why plaintiffs are turning to corporate shareholders instead of suing the local company directly involved in the conduct giving rise to the cause of action. With regard to workplace safety, a common motivation for an injured employee to pursue a claim against the subsidiary's investors is clear: the subsidiary is often the employer of the injured worker, and therefore may be immune from lawsuit pursuant to state workers' compensation laws.[5]

A second common reason for suing the parent corporation is also obvious; namely, the parent corporation often possesses greater assets than the subsidiary. A third reason for suing the parent company involves international corporations, or even large domestic companies. In these instances, plaintiffs may calculate that their story will play better in front of a jury if they sue a large international corporation rather than the subsidiary, which may be well known and respected in the community and may be a significant local employer.

B. The *Bestfoods* Case

An additional reason for plaintiffs, both private and government, to pursue these claims is the landmark U.S. Supreme Court case in the environmental field, *United States v. Bestfoods*, 524 U.S. 51 (1998) (46 ERC 1673; 110 DEN A-5, 6/9/98). In *Bestfoods*, the Supreme Court clarified the test for imposing certain environmental liabilities upon a corporate shareholder in cases where it was not appropriate to pierce the corporate veil between the parent and the subsidiary.

Among other things, the court instructed trial judges to look to whether the parent company was actually involved in the day-to-day operations of the subsidiary, whether the actions of dual officers or board members (i.e. individuals who serve both the parent and the subsidiary) are ''normal,'' and whether the shareholder merely articulated general policies or whether the shareholder was actually responsible for the implementation of those policies. As stated by the court, ''[t]he

[1] See *United States v. Montrose Chemical Corp.*, Memorandum in Support of Plaintiffs' Motion for Partial Summary Judgment of Liability of Defendant Chris-Craft Industries, Inc. for Response Costs, March 13, 2000 (Montrose Chris-Craft Memorandum), at 6.

[2] See, e.g., *Ferrell v. Harvard Industries Inc.*, 2001 WL 1301461 (E.D. Pa. 2001) (denying the parent company's motion for summary judgment in a workplace discrimination matter and stating that ''arguably, [the parent company] was directly responsible for the fact that Plaintiffs' complaints were not addressed, and responsible for the final, alleged retaliatory action'').

[3] See, e.g., *Pearson v. Component Technology Corp.*, 247 F. 3d 471 (3d Cir. 2001). In *Pearson*, the court considered whether a parent company should be liable for the sudden closure of a subsidiary-owned plant in violation of the Worker Adjustment and Retraining Notification Act regulations.

[4] See, e.g., *Ronald A. Katz Technology L.P. v. Verizon Communications Inc.*, No. 01-5627 (E.D. Pa. 2002) (citing *Bestfoods* for the proposition that normal shareholder control over the subsidiary will not create liability for the patent infringement torts of the subsidiary).

[5] The *Greene* case discussed above is somewhat unique in this regard. In that case, the plaintiff was employed by the parent, not the subsidiary, and sued pursuant to the FELA statute, which exists ''to provide a federal remedy for railroad workers who suffer personal injuries as a result of the negligence of their employer.'' *Greene*, 280 F.3d at 229 (citations omitted).

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critical question is whether, in degree and detail, actions directed to the facility by an agent of the parent alone are eccentric under accepted norms of parental oversight of a subsidiary's facility.'' Id. at 72.[6]

The *Bestfoods* case is helpful in that it clarified a difficult question of environmental law. But because the factors set forth by the Supreme Court are often fact-sensitive and frequently require expert testimony, it may now be easier for plaintiffs to survive early motions to dismiss and even motions for summary judgment.

A good example of how *Bestfoods* has created fact issues that make it possible for plaintiffs to survive early motion practice is the Delaware Sand & Gravel Superfund Site litigation. In a Comprehensive Environmental Response, Compensation, and Liability Act allocation case brought by BP Amoco against two former shareholders, the district court held that there were sufficient facts alleged to bring a direct liability cause of action against one of the parent companies, Sun Oil. *BP Amoco Chemical Co. v. Sun Oil Co.*, 166 F. Supp. 2d 984, 990 (D. Del. 2001). However, the court decided the allegations against the other parent, FMC, were not sufficiently specific to prove it acted as a joint operator of the facility. Id. at 993. On a subsequent motion to reconsider, the court reversed itself, finding it should have paid more attention to the alleged ''environmental'' actions of FMC at the subsidiary. The court thereby allowed BP Amoco to proceed against FMC for contribution and to develop facts relevant to a direct liability analysis under *Bestfoods*. *BP Amoco Chemical Co. v. Sun Oil Co.*, 200 F. Supp. 2d 429, 435 (D. Del. 2002).

Moreover, while *Bestfoods* is sometimes viewed as a narrow environmental case, its implications are much broader. The case is cited more and more in a wide array of contexts, including personal injury claims,[7] discrimination,[8] patent infringement,[9] personal jurisdictional,[10] and others.

Some Easy Steps to Take

The principal challenge for a responsible corporation is to affect behavior at the subsidiary without creating a basis for liability. While it is never possible to inoculate oneself completely from legal exposure, there are some measures that can be taken to reduce risk.

A. Corporate Separateness

First, as in the past, subsidiary corporations should regularly and robustly maintain all corporate formalities. These formalities include, among other things, separate boards, regular board meetings, separate bank accounts, separate letterhead, and adequate capitalization. Corporations are familiar with these factors in the context of derivative liability, or ''piercing the corporate veil.'' In our experience, courts also will look to these issues when considering whether the shareholder is directly liable for the acts of the subsidiary. In addition, the fact that a company and its shareholder are explicitly separate and independent will often improve the dynamics for settlement discussions and improve the shareholders' posture on a motion for summary judgment.

B. Articulation of Policies

Second, parent companies must pay close attention to the policies communicated to their subsidiaries, and, as importantly, the *manner in which those policies are articulated*. For instance, with regard to safety compliance, parent companies could simultaneously stress ''safety'' while also reminding the subsidiary that it is the subsidiary's obligation, not the parent's, to implement and police all safety procedures. This dual message makes clear the parent company takes safety seriously, while also making it very clear the subsidiary is ultimately responsible for implementing corporate policies and ensuring the subsidiary's operations are run safely and properly. Of course, the appropriate message will differ for each company, depending upon the type of business and corporate structure. Similarly, the parent company must assess the most effective and appropriate method for monitoring the subsidiary's performance without assuming operational control.

C. Dual Officers

Third, parent companies must clearly define the role of ''dual-hat'' wearers. A dual-hat wearer is any individual who has a role at both the parent company and the subsidiary company, and generally includes dual officers and directors. While the Supreme Court in *Bestfoods* held that it is common and appropriate for parent companies and subsidiaries to share officers and directors and such arrangements will not themselves create shareholder liability for the acts of the subsidiary, there are important limitations that must be considered. Specifically, the court stated that

> it cannot be enough to establish liability here that dual officers and directors made policy decisions and supervised activities at the [subsidiary's] facility. The Government would have to show that, despite the general presumption to the contrary, the officers and directors were acting in their capacities as [parent] officers and directors, and not as [subsidiary] officers and directors when they committed those acts.

Bestfoods, 524 U.S. at 68.

That is, the individual, when wearing the subsidiary's hat, must act on behalf of the subsidiary, and in the sub-

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[6] On remand, the federal district court found that the actions of the parent company and its employees were not ''eccentric under accepted norms of parental oversight of a subsidiary facility,'' and, accordingly, the parent company should not be liable as an operator. *Bestfoods v. Aerojet-General Corp.*, 173 F. Supp. 2d 729, 749-755.

[7] See, e.g., *Greene v. Long Island Railroad Co.*, 280 F.3d 224, 239 (2nd Cir. 2002), discussed above.

[8] See, e.g., *United States v. Days Inn of America Inc.*, 151 F.3d 822 (8th Cir. 1998). In this Americans with Disabilities Act (ADA) case, the court considered whether Days Inn should be liable for the alleged inaccessibility of a hotel in Wall, South Dakota, built and operated by a franchisee under a licensing agreement. ''Although relating to a different federal statute, the Supreme Court's opinion in *Bestfoods* provides this court with helpful direction.'' Id. at 826. Referring to the language in *Bestfoods* holding that a parent '' 'must manage, direct, or conduct operations specifically related to' the violation,'' the Eighth Circuit concluded that for a party to bear responsibility for an inaccessible facility under the ADA, it must ''possess a significant degree of control over the final design and construction of the facility.'' Id. at 826. (quoting *Bestfoods*, 524 U.S. 51, 66 (1998)). The court remanded for a factual determination of whether Days Inn knew that the hotel did not comply with the ADA. If Days Inn did know, the court directed that it should be held liable for the violations ''inasmuch as it retained ample power to require compliance with the ADA.'' Id. at 827.

[9] See, e.g., *Ronald A. Katz Technology L.P. v. Verizon Communications Inc.*, No. 01-5627 (E.D. Pa. 2002).

[10] See, e.g., *Doe v. Unocal Corp.*, 248 F.3d 915, 926 (9th Cir. 2001).

sidiary's best interest.[11] Shareholder companies may be able to reduce significantly exposure caused by dual officers and directors by regularly articulating to such individuals the nature and limits of their role at the subsidiary. Of course, the parent company should ensure dual officers and directors are not allowed to take actions, ''plainly contrary to the interests of the subsidiary yet nonetheless advantageous to the parent.'' Id. at n.13.

D. Dispatched Employees

A potentially more complicated, yet very common, situation occurs when the parent or shareholder dispatches employees (as opposed to officers or directors) to the subsidiary. While this frequently occurs among domestic companies, it is even more common with global firms, where the parent company sends individuals to foreign subsidiaries for a period of time. In this circumstance, the dispatched employee often retains a relationship with both entities. In theory, the dual-officer rationale of *Bestfoods* and *Raytheon* should apply equally to dual employees. Nonetheless, in at least one instance, the *Montrose* case discussed above, the government argued that dispatched employees do not share the same presumption as shareholders' officers or directors. Specifically, the Department of Justice argued, ''The fact that [the subsidiary's president] was an employee of the parent, as opposed to an officer, is a distinction that makes all the difference in this case. An individual who is a dual officer of two corporations can credibly 'change hats' in order to represent one corporation or the other.'' An employee of the parent, according to the department, cannot.[12]

In any event, the shareholder may be able to reduce the risk associated with such dispatched employees by establishing clear guidelines for such individuals and ensuring these guidelines are articulated often and followed consistently. These guidelines should address explicitly the role of dispatched employees at the subsidiary and the conduct expected of them. Finally, to the extent that the anticipated role of a dispatched employee extends beyond activities ''consistent with the parent's investor status, such as monitoring of the subsidiary's performance, supervision of the subsidiary's finance and capital budget decisions, and articulation of general policies and procedures,'' the parent may want to consider explicit measures to ensure the role of the dispatched employee at the subsidiary is advisory as opposed to authoritative. *Bestfoods*, 524 U.S. at 72.

[11] The U.S. Court of Appeals for the Tenth Circuit recently tackled this issue when it reversed a lower court opinion finding that a minority shareholder company was liable for Superfund costs generated at the subsidiary's facility. *Raytheon Constructors Inc. v. Asarco Inc.*, 10th Cir., No. 00-1500, 3/11/03 (56 ERC 1024; 50 DEN A-4, 3/14/03). In *Raytheon*, the district court found that a minority shareholder was liable because the president of the shareholder was also the chairman and president of the subsidiary. The district court noted that this dual officer was ''the primary liaison'' between the shareholder and the subsidiary, and this dual officer was heavily involved in environmental decisionmaking for the subsidiary. The Tenth Circuit rejected this reasoning, noting that there was nothing in the record to indicate that the dual officer undertook any of his actions ''while wearing any hat other than his [subsidiary] president hat.'' Id.

[12] See Montrose Chris-Craft Memorandum, at 20. The court denied the governments' motion for summary judgment, but has not ruled yet on Chris-Craft's liability.

For example, on remand in *Bestfoods* the district court found shareholder liability was not appropriate where the agent of the parent offered relevant advice and recommendations to the subsidiary but did not control the subsidiary's decisionmaking. The court stated, ''contrary to the governments' representations, nothing in the record shows that [the agent of the shareholder] had authority to require anything.'' *Bestfoods v. Aerojet-General*, 173 F. Supp. 2d at 749-751. While this analysis was directed to an agent, not a dispatched employee, limiting the role of dispatched employees to an advisory capacity could offer an additional layer of protection to the shareholder.

Alternatively, it may be appropriate in some circumstances for the shareholder to consider severing its formal employer relationship with the dispatched individual.

E. Difficult Incidents

The parent company must carefully consider the manner in which it responds to incidents at the subsidiary. For example, if there is an environmental release of chemicals at the subsidiary's plant and the parent company quickly assumes all responsibility for the investigation and cleanup of that release, the shareholder may later be accused of operating the plant or assuming a legal duty of care. Of course, on the other hand, the parent company wants the problem resolved expeditiously. Navigating this tension takes careful planning *prior* to incidents to ensure problems are addressed appropriately, without creating undue risk for the parent company. Careful prior planning also will reduce the possibility that representatives from the parent company say or write things that can later be misinterpreted in the context of litigation.

F. Regulatory Compliance

Ensuring compliance with regulatory requirements presents a difficult challenge for parent companies. On the one hand, the parent company would like to know its subsidiaries are complying with applicable legal requirements, particularly in important and complex areas such as environmental and safety regulations. On the other hand, plaintiffs may allege in litigation that parental efforts to ensure compliance constitute ''day-to-day'' operational control at the subsidiary level. Furthermore, micro-management by the parent company will not necessarily result in more compliance since the operators of the facility are likely to possess much greater expertise regarding plant processes and, in some cases, regulatory requirements.

Steering a way through this conflict is difficult, but not impossible. For instance, the parent company can stress, as a matter of corporate policy, the importance of regulatory compliance, while simultaneously stressing that implementation of this responsibility rests at the local or subsidiary level. Second, the parent company may want to generally monitor relevant benchmarks, such as safety incidents, notices of violations, near-misses, and the like.

Where third-party compliance audits are necessary, it may be prudent for the subsidiary to commission such efforts, while allowing the shareholder to review the results. Subsequent to the audit, however, it should remain the subsidiary's responsibility for the proper implementation of any recommendations. Of course, these principles will differ in application depending

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upon the governance structure of the firm and the particular areas of expertise possessed by the shareholder.

G. Shareholder Liability Audits

In some cases, where there are complex corporate structures, numerous subsidiaries or contractual relationships between the related entities, it may be worthwhile to conduct a "shareholder liability audit." The goal is to ensure all employees, officers, and directors understand their respective functions and understand the importance of balancing a close relationship between the companies, on the one hand, and corporate separateness and distinctness, on the other.

H. Preparing for Litigation

Finally, there are numerous other issues equally applicable in this arena, as in many others, when companies think about reducing risk. For instance, shareholders need to examine the adequacy of their insurance coverage, the completeness of their document retention policies, and the understanding by employees of the importance of maintaining corporate confidences. These, along with other issues, often prove critical in the context of litigation.

Conclusion

In sum, a shareholder should be able to take effective and efficient measures in an effort to reduce the risk and severity of litigation stemming from the acts of their subsidiaries. With a few relatively simple steps, risk reduction can be achieved without undermining a shareholder's commitment to firm-wide policies. Too often, unfortunately, little attention is given to these issues and important opportunities are missed. Of course, appropriate actions must be tailored carefully to meet the individual needs and structure of each firm.