

ILLINOIS SUPREME COURT EXPANDS LIABILITY FOR PARENT COMPANIES

In the recent Illinois Supreme Court decision, *Forsythe v. Clark USA*, No. 101570, 2007 WL 495292 (Ill. Feb. 16, 2007), the Court ruled that "direct participant liability" is a valid cause of action in Illinois. Through direct participant liability, a parent company can be held liable for the actions of its subsidiaries when it directs, controls or influences subsidiary actions that lead to a plaintiff's injury. Although direct participant liability has been recognized in other jurisdictions, the Illinois Supreme Court's recent ruling officially acknowledges such a claim in Illinois, and may even expand the scope of this legal theory beyond the traditional understanding.

The Facts

In *Forsythe*, two mechanics were killed by a fire while eating lunch at a refinery owned by Clark Refining and Marketing. The fire was caused by faulty valve replacement work on a pipe performed by mechanics who were not trained to make this type of repair. The plaintiffs (special administrators of the decedents' estates) filed suit against Clark Refining and its parent, Clark USA, basing their claims in negligence. Plaintiffs claimed that Clark USA breached its duty of reasonable care by imposing a business strategy on Clark Refining which required that it minimize operating costs (including those related to training, maintenance, supervision and safety), limit capital investments (thereby preventing Clark Refining from adequately ensuring the safety of the lunchroom), and by "failing to adequately evaluate the safety and training procedures at the refinery." Additionally, the plaintiffs claimed that Clark USA's cutbacks "forced Clark Refining to have unqualified employees act as maintenance mechanics." The trial court granted Clark USA's motion for summary judgment without explanation. The appellate court reversed and remanded the trial court's decision. Clark USA then appealed to the Illinois Supreme Court.

The Ruling

The Supreme Court addressed two issues in *Forsythe*. First, the Court had to decide whether Clark USA could be held liable under the direct participant liability theory based on its alleged control over Clark Refining's budget and the ensuing accident. Second, the Court had to decide whether the exclusive remedy provision of the Workers' Compensation Act would immunize

Clark USA from liability.

Clark USA argued that it could not be held liable for Clark Refining's negligence unless plaintiffs pierced the corporate veil. It argued that it did not owe a duty to the decedents because it was merely a holding company and was only connected to Clark Refining as a shareholder. It did not have any control over the day-to-day operations of Clark Refining and only set financial goals and an overall strategy to meet those goals consistent with its investor status. Plaintiffs, on the other hand, argued that Clark USA's liability was premised on its own acts and their effect on the accident – not merely upon its parent company relationship to Clark Refining.

The Court ruled that direct participant liability is a valid theory of recovery in Illinois and that the plaintiffs could recover against Clark USA if their claims were found to be true by a trier of fact. The Court indicated that "[w]here there is evidence sufficient to prove that a parent mandated an overall business and budgetary strategy *and* carried that strategy out by its own specific direction or authorization, surpassing the control exercised as a normal incident of ownership in disregard for the interests of the subsidiary, that parent could face liability" (emphasis in original). According to the Court, the key elements giving rise to direct participant liability are the parent's "specific direction or authorization of the manner in which an activity is taken" and foreseeability of injury. The Court stressed that mere budgetary mismanagement is not enough to subject a parent to liability.

Plaintiffs' evidence of Clark USA's influence over Clark Refining included: the creation and approval of Clark Refining's budget, the institution of a "survival mode" business plan, evidence that the board of directors of both Clark USA and Clark Refining met simultaneously, and the fact that the president of Clark USA, who was also the CEO of Clark Refining, oversaw the new budget of Clark Refining. The Court found that if plaintiffs could prove to the trier of fact that the decision-maker's alleged misconduct occurred while acting in his capacity as an officer of Clark USA, rather than as an officer of Clark Refining, Clark USA could be found liable under the direct participant liability theory. (continued . . .)

Apparently concerned about the impression that could be created by the majority opinion, the concurring opinion stated that the Court's ruling "does not alter the bedrock principle of limited liability for corporate shareholders and that direct participant liability is a very narrow exception to this general principle." The concurrence indicated that conduct consistent with investor status, such as monitoring of performance, supervision of finance and budget decisions and promulgation of general policies and procedures, will not give rise to direct participant liability. Rather, "the 'critical question' in deciding whether the parent can be held liable under a theory of direct participant liability is 'whether, in degree and detail, actions directed to the [subsidiary] by an agent of the parent alone are eccentric under accepted norms of parental oversight of a subsidiary's facility.'" The concurrence opined that it will be rare for a parent which observes corporate formalities to be viewed as interfering with the operations of a subsidiary sufficiently enough to expose it to liability. The concurrence indicated that Clark USA's actions were "eccentric" under the accepted norms of parental oversight and that its actions were contrary to the interests of Clark Refining, but advantageous to Clark USA.

Workers' Compensation Act

The Court also found that Clark USA could not use the exclusive remedy provision of the Act to its benefit. Clark Refining previously paid the decedent's estate pursuant to the Act. Clark USA argued that since the exclusive remedy benefit would be available to it under a veil piercing theory, it should also be available under direct participant liability. The Court rejected this argument, reasoning that "direct participant liability does not rest on piercing the corporate veil such that liability of the subsidiary is the liability of the parent." Therefore, because Clark USA was not the employer, it could not benefit from the immunity provided by the Act.

The Implications

Parent companies should be mindful of this shift in the law. Previously, a parent could not be held liable for injuries to its subsidiary's employees or third parties affiliated with its subsidiary unless the parent directed or carried out the specific acts that caused the injury. For example, in the *Forsythe* setting, Clark USA might have been directly liable if its employees performed the faulty valve replacement, prescribed the valve replacement procedure, or selected unqualified persons to conduct the valve replacement. However, given the reasoning of the *Forsythe* Court, it now appears that any involvement by a parent in a subsidiary's decision-making process which could ultimately be tied to a plaintiff's injuries could expose it to litigation, and in some instances, liability. Additionally, though *Forsythe* specifically addresses the

parent's duty in a negligence paradigm, it also lays the groundwork for plaintiffs to argue for a similar result in other contexts, including employment cases and contract disputes.

Although the opinion states that promulgating general policies or supervising a budget is not enough to subject a company to direct participant liability, the reality is that what will now be required to subject a parent to litigation is much fuzzier. There is no longer a bright line standard whereby a parent will only be held liable if it was directly involved in the conduct giving rise to a cause of action. Instead, *Forsythe* seems to suggest that even when a parent engages in more generalized oversight of a subsidiary, it can still be directly liable if that oversight indirectly influenced the underlying conduct. There were, in fact, no allegations that Clark USA approved or disapproved of the personnel who worked on the pipes at Clark Refining, let alone directed or carried out the faulty valve replacement. The Court focused on the foreseeability of the effect that the budget cuts would have on the refinery, a highly dangerous environment. The concurring opinion framed the issue by stating that "the evidence raises a question as to whether defendant actively mandated aggressive cuts in its subsidiary's budget knowing that the budgetary cuts could only be accomplished by dramatic reductions in maintenance, training and safety."

Furthermore, the Court's ruling related to workers' compensation should not be overlooked. The *Forsythe* opinion permitted the plaintiffs to recover under the Act from Clark Refining, and then double-back to pursue what will most certainly be larger damages against the parent, Clark USA. This basically allows plaintiffs an opportunity to bypass the exclusive remedy provision of the Act, and threatens to undermine one of the key purposes of the Act in limiting the damages to be paid by employer organizations for workplace injuries. It may not be long before personal injury plaintiffs bring cases against parents routinely for amorphous activity. Plaintiffs will be able to recover more damages than the Act allows.

Practically, it will also be more difficult for a parent to win a motion to dismiss or summary judgment motion because the inquiry regarding its liability will be more factual. Similarly, the scope of discovery in corporate liability cases will likely broaden, entitling plaintiffs to the parents' documents in order to prove their case. Some parents will settle cases with plaintiffs in an effort to avoid the expense of litigation and intrusion into inter-company governance.

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Practical Suggestions for Minimizing Risk

There are a number of practical measures that parent companies can take to minimize the risk of being found liable based on the theory of direct participant liability:

- Directors and/or officers who act for both a parent and a subsidiary should take extra measures to document which "hat" they are wearing when making decisions affecting the subsidiary. Meetings of the respective boards of directors should be held separately and documented as such. Officers and directors should use the appropriate letterhead when taking actions for each respective company. Officers and directors should use the appropriate title which corresponds with the respective "hat" that they are wearing when making decisions or recommendations on behalf of the companies.
- Directors and/or officers (particularly those who hold positions within the parent and the subsidiary) should be extremely cautious about taking actions on behalf of the parent which could adversely affect the subsidiary. They should consider the possible indirect effects of these actions and whether they could later expose the parent company to liability.
- Parent companies should carefully consider whether their actions significantly impact their subsidiaries in a way that could be deemed "eccentric" as a parent. In other words, actions which parent companies do not customarily engage in with respect to their subsidiaries should be carefully considered or avoided.
- Parent companies should let subsidiaries make their own decisions and allow those decisions to be processed through the subsidiaries' normal channels. In this same vein, parent companies should not direct personnel decisions of subsidiaries. If, for instance, a parent feels that a certain individual needs to be terminated, it should at most make suggestions to the subsidiary to make an inquiry or undertake an investigation. However, it should not instruct the subsidiary to terminate employees. Parents must be careful not to override the discretion and judgment of directors and officers of the subsidiary. Additionally, parents and subsidiaries should document which decisions are made by their respective directors and officers. The subsidiary's decision-makers should document that they believe that the decisions they make are in the best interest of the subsidiary.
- While a parent company can monitor or perhaps even make overall budget recommendations to its subsidiaries, the parent must consciously avoid directing or controlling the manner in which the budget is allocated or implemented. A parent should make specific budgetary comments in the form of suggestions or recommendations to the directors of the subsidiary. It should allow the decision-makers of the subsidiary to make the actual decisions with respect to the budgets.
- As an investor, the parent company or substantial equity stakeholder must be cautious about taking too active a role in the management of its subsidiaries or portfolio company affairs. For example, private equity funds often become heavily involved in the oversight or management of portfolio companies, and they may be more exposed to claims based on direct participant liability.
- Companies should ensure that liability insurance packages cover all parents, subsidiaries, affiliates and their respective officers and directors.

For further information about the implications of this ruling and protective steps your company can take to minimize the risks of direct participant liability, you may contact any of the members of Goldberg Kohn's Labor & Employment Group. For more information about the Group's practice and experience, as well as biographical information about the Group's attorneys, [click here](#).

GOLDBERG KOHN BELL BLACK ROSENBLUM & MORITZ, LTD
TEL 312.201.4000 FAX 312.332.2196 WEB WWW.GOLDBERGGKOHNS.COM
55 EAST MONROE STREET SUITE 3300 CHICAGO ILLINOIS 60603-5792

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