

# PARENT CORPORATION LIABILITY



With today's faltering economies, we are seeing more and more situations involving subsidiaries of multinational corporations breaching a reinsurance relationship, and subsequently becoming insolvent or filing for bankruptcy protection.

If you are one of those unlucky cedants when this happens, all is not lost. Under certain circumstances, the parent corporation of the subsidiary may be responsible for the liabilities of its subsidiary despite the separate legal entity status between the two.

Many US courts have held that a parent corporation may be liable for its subsidiary's actions/obligations when the parent utilizes its subsidiary's separate corporate form to defeat public convenience, commit fraud, or defend crime. This is the well-known piercing of the corporate veil. Piercing of the corporate veil, however, does not always have to involve fraudulent activities. Some courts have held that the parent may also be liable for the wrongful conduct of its subsidiary when the subsidiary is a "mere instrumentality" or the parent corporation's "alter ego."

In fact, under New York law, where many reinsurance arbitrations occur, the corporate veil will be pierced to achieve equity, even absent fraud, when a corporation has been so dominated by an individual or another corporation, and its separate entity so ignored, that it primarily transacts the dominator's business instead of its own and can be called the other's alter ego.

The following factors have been examined by the courts to ascertain whether a subsidiary is acting as a mere instrumentality of its parent:

1. The parent corporation owns all or most of the capital stock of its subsidiary;
2. The parent and subsidiary corporations have common directors or officers;
3. The parent corporation finances the subsidiary;
4. The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation;
5. The subsidiary has grossly inadequate capital;
6. The parent corporation pays the salaries and other expenses or losses of the subsidiary;
7. The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation;
8. In the papers of the parent corporation, or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial

responsibility is referred to as the parent corporation's own;

9. The parent corporation uses the property of the subsidiary as its own;
10. The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest; and,
11. The formal legal requirements of the subsidiary are not observed.

While no one of the above-referenced factors determines whether a parent corporation will be liable for its subsidiary's actions, when examined in their totality the two corporations may be considered so closely intertwined that they do not merit treatment as separate legal entities.

If this happens, what appears to be a fruitless collection effort against the multinational's subsidiary may actually turn into a collection effort against a parent corporation with deep pockets.

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