

Piercing the veil

Parent corporations may be liable for the sins of their subsidiaries, according to Calvin McNulty

project as its own.

In another case, however, the court held that the parent and subsidiary corporations were found to be separate personalities and did not permit piercing even where:

- the parent owned 100% of the subsidiary;
- the parent company participated in the subsidiary's board of directors;
- there was a 'cross-pollination' of officers involved in decision-making and daily operations;
- there was active participation by the parent officials in certain matters; and
- the parent had financial control of the subsidiary.

Here, the court stated that the factors simply revealed, "a parent that took an active interest in the affairs of its subsidiary."

While there is no official mere instrumentality test, over the past few decades, an informal list has developed and is used by some courts:

- the parent owns all or most of the capital stock of its subsidiary;
- the parent and subsidiary corporations have common directors or officers;
- the parent finances the subsidiary;
- the subsidiary has grossly inadequate capital;
- the parent corporation pays the salaries and expenses or losses of the subsidiary;
- the subsidiary has substantially no business except with the parent or no assets except those conveyed to it by the parent;
- in the papers of the parent, or in the statements of its officers, the subsidiary is described as a department or division of the parent, or its business or financial responsibility is referred to as the parent's own;
- the parent uses the property of the subsidiary as its own;
- the directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent in the latter's interest; and
- the formal legal requirements of the subsidiary are not observed.

It should be noted that, while no single factor determines whether a parent 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. **GR**

By Calvin J McNulty

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With today's faltering economies, there is an increasing number of subsidiaries of multinational corporations breaching reinsurance relationships, and subsequently becoming insolvent or filing for bankruptcy protection. For the unlucky cedants stuck in the middle of these situations, all is not necessarily 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 uses 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', though this does not always need to involve fraudulent activities. In fact, under New York law, 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. It is quite clear, however, that the courts must

examine each case on an individual basis. In one case, the court held that the two subsidiaries were the alter egos of the parent company and permitted piercing when the following factors were present:

- all of the subsidiaries' capital and credit was provided by the parent;
- one subsidiary purchased all of its supplies from the parent;
- one of the subsidiaries was grossly undercapitalised;
- the directors and officers of the subsidiaries were the officers and directors or employees of the parent company and the sons of the president of the parent company;
- the parent handled the payroll of one of the subsidiaries;
- officers and employees of the parent company rendered gratuitous services to the subsidiaries;
- the policies and decisions of the subsidiaries were determined by the parent's president;
- one subsidiary received no profit;
- one subsidiary was dissolved with its debt written off upon the completion of a project;
- the offices of all three corporations were at the same address; and
- the correspondence from the parent revealed that it considered the subsidiary's