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CONSUMER NEWS

Cost-Cutting Schemes Could End up Costing Parent Corporations

By Jeremy LaMarche[1]

The Supreme Court of Illinois recently handed down a decision that may force parent companies to be more cautious when implementing new budgetary, financial, and marketing schemes. Recently, the Court decided *Forsythe v. Clark USA, Inc.* and held that a parent company could be liable to a subsidiary's employee.[2] The Court stated that the employee must prove that the parent company directed or authorized the implementation of its subsidiary's budget while disregarding the discretion and interests of the subsidiary.[3]

In 1995, Clark USA, a holding company, decided to implement a strategic business plan whereby it would replenish its cash reserve by decreasing capital spending to minimum sustainable levels.[4] In order to accomplish this, the Directors of Clark USA created a new budget for its subsidiary, Clark Refining, which was aimed at positioning the subsidiary corporation as a low cost refiner and marketer.[5] The Directors of both the parent and subsidiary met several times in order to discuss the implementation of the new budget.[6] Paul Melnuck, who served as President of Clark USA as well as CEO of Clark Refining, oversaw the planning.[7]

In 1996 and 1997, plaintiffs Marguerite Forsythe and Eliza-

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[2] Forsythe v. Clark USA, Inc., 2007 WL 495292 at * 12 (Ill 2007).

[3] Forsythe, 2007 WL 495292 at * 12.

[4] *Id.* at *2.

[5] *Id.*

[6] *Id.*

[7] *Id.*

beth Szabla, as special administrators of the estates of their late husbands, filed suit against Clark Refining and other defendants.[8] The plaintiffs later added the parent company, Clark USA, as a defendant.[9] On March 13, 1995, the plaintiffs' husbands Michael Forsythe and Gary Szabla, two mechanics who worked at Clark Refining, were killed in a fire on the job.[10] Other Clark Refining employees caused the fire when they attempted to replace a pipe's valve without first ensuring that the flammable materials in the pipe had been depressurized.[11] The plaintiffs alleged that Clark USA breached its duty of reasonable care when it implemented its budget strategy.[12] More specifically, the plaintiffs alleged that Clark USA breached its duty by forcing Clark Refinery to employ unqualified employees as maintenance mechanics in order to conform to the new budget strategy.[13] After the close of discovery, the trial court granted summary judgment in favor of Clark USA.[14] Subsequently, the plaintiffs appealed and the Illinois Appellate Court reversed and remanded the summary judgment ruling.[15] Following that decision, Clark USA petitioned the Supreme Court of Illinois for leave to appeal, and the Court granted the defendant's petition.[16]

There were two issues in front of the Supreme Court of Illinois in *Forsythe v. Clark USA*.[17] The first issue was whether a parent company could be held liable under a theory of direct participant liability for controlling its subsidiary's budget in a way that led to a workplace accident.[18] The second issue was, if such a theory of direct participation liability is recognized, whether the exclusive-remedy provision of the Workers' Compensation Act immunizes a parent company from liability.[19] The exclusive-remedy provision of

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[8] Forsythe, 2007 WL 495292 at * 2.

[9] *Id.*

[10] *Id.* at * 1.

[11] *Id.*

[12] *Id.*

[13] Forsythe, 2007 WL 495292 at * 1.

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

[18] Forsythe, 2007 WL 495292 at * 1.

[19] *Id.*

the Act prohibits an employee from bringing an action against his or her employer if compensation is already provided under the Workers' Compensation Act.[20]

Ultimately, the Supreme Court of Illinois held that direct participation liability is a valid theory of recovery under Illinois law.[21] The Court stated that in order for a parent company to be held liable to a third party or an employee under this theory of recovery, it must be shown that the parent company mandated an overall business strategy and carried out that strategy through specific direction or authorization, surpassing the control exercised as a normal incident of ownership, in disregard for the interests of the subsidiary company.[22] The Court further noted that the key elements of direct participation liability included a parent company's "specific direction or authorization of the manner in which an activity is undertaken" as well as foreseeability that an injury will occur.[23] Further, the Supreme Court of Illinois held that the exclusive remedy provision of the Workers' Compensation Act did not bar suit against a parent company under a theory of direct participation liability.[24] The Court affirmed and remanded the case back to the circuit court to determine whether the direct participation theory should be applied to these particular facts.[25]

Prior to the Supreme Court of Illinois' decision in *Forsythe*, a parent corporation could not be held liable for the acts of its subsidiary unless the corporate veil could be pierced.[26] This only occurred when the parent company exercised "complete domination" over the subsidiary and its decision-making.[27] Under this theory, the party seeking to pierce the corporate veil must make a substantial showing that the corporation is really a dummy or sham for another dominating entity.[28] The decision in *Forsythe* will not do away with the re-

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[20] Workers' Compensation Act, 820 Ill. Comp. Stat. 305/5 (1995).

[21] Forsythe, 2007 WL 495292, at *8.

[22] *Id.*

[23] *Id.*

[24] *Id.* at *11.

[25] *Id.* at *12.

[26] Brooks, Edward & Walls. *Court Allows Another Way to Pierce the Veil.* Chi. Daily Law Bull., February 2, 2006, *available at* www.drinkerbiddle.com/.../ 74bac382-38f2-48c1-b9fc-06e9b0f8eca1/ CourtAllowsAnotherWayToPierceTheVeil.pdf (last visited May 8, 2007).

[27] Brooks, Edwards & Walls, *supra* note 26.

[28] Jacobson v. Buffalo Rock Shooters Supply Inc., 278 Ill.App.3d 1084, 1088 (Ill. App. Ct. 1996).

quirements of the corporate veil theory in Illinois, however.[29]

The Supreme Court of Illinois stated in its opinion that the direct participation theory of liability will only give rise to a duty in "limited circumstances."[30] The Court pointed out that the direct participation theory of liability is not like piercing the corporate veil where the liability of the subsidiary is the liability of the parent.[31] Rather, this form of liability is assigned when the "parent's direct participation" supersedes the discretion and interest of the subsidiary and creates conditions that lead to a dangerous activity such as limiting the budget of the subsidiary.[32] However, the decision in *Forsythe* will make parent companies more vulnerable to potential liability for the control they assert over their subsidiaries.

As a result of the direct participation theory of liability, parent companies might find themselves entertaining lawsuits from plaintiffs other than employees of their subsidiaries. For example, this theory of recovery would likely allow a non-employee of the subsidiary to recover from a parent company if the individual happens to be injured while on the subsidiary's job site or by a subsidiary's employee.[33] Further, this theory of liability may be used in scenarios where poor financial decisions by the parent company cause financial injury to the subsidiary and ultimately to those with a financial interest in the subsidiary.[34]

Among other things, the Supreme Court of Illinois has put parent companies on notice that the financial and safety consequences of their decisions should be considered and weighed prior to implementing any major cost-cutting schemes. Parent companies will no longer be able to fully direct the finances of a subsidiary while at the same time hiding behind the exclusive remedy provision of the Workers' Compensation Act.

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[29] Brooks, Edwards & Walls, *supra* note 26.

[30] Forsythe, 2007 WL 495292, at *12.

[31] *Id.* at *11.

[32] *Id.*

[33] Susan Condon. *Illinois Opinion Increases Liability Exposure of Parent Corporations*. CM Reports. (August 2005) *available at* http://www.clausen.com/dir_docs/firm_pubs/fab31a04-60ef-48ee-a615-f8a58736f65a_pdfdocument.pdf

[34] Kirk Hartley, Mindy Finnigan & Kevin Mueller. *Parent Companies—Safe, Or Not, When Bad Things Happen At Subsidiaries?* (April 2006). http://www.butlerrubin.com/web/br.nsf/0/9365A27FF400AA7A86257145006D0F89/$FILE/w0022594.pdf