

**THE THREAT IS REAL –
THE FIGHT FOR LIMITED LIABILITY IN ILLINOIS**

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The limited liability afforded by statutory protection to Illinois entities took another hit recently when the Illinois Supreme Court endorsed “direct participation” as a viable theory of tort liability under Illinois law. In *Forsythe v Clark USA, Inc.*, 2007 WL 495292 (Ill. Sup. Ct.), our state’s Supreme Court considered 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. Subsequently, the court recognized that the parent company’s “participation” in the subsidiary’s conduct subjects the parent to direct liability.

The court concluded that evidence of budgetary mismanagement, accompanied by the parent’s negligent direction or authorization of the manner in which the subsidiary accomplishes that budget could lead to liability for the parent. The elements required under the direct participant theory are a parent’s specific direction or authorization of the manner in which an activity is undertaken and the foreseeability of injuries. Budgetary mismanagement alone is insufficient. The court then remanded the case back to the trial court. (Just as importantly, the court also held that upon a finding of liability under the direct participation theory, the parent-defendant would not be protected by the exclusive remedy provision of the Workers’ Compensation Act available to the subsidiary because there is a direct action against the parent and not the subsidiary).

Furthermore, under the court’s analysis, once the parent company directed or authorized the manner in which an activity is undertaken, the company owed a duty of care to the plaintiff. The court explicitly asserted that their decision was based on policy-based factors courts use to determine whether a duty exists. The court stated that the corporation had a duty to utilize reasonable care in directing or authorizing the manner in which an activity is undertaken. Then when the duty was breached, the breach was the proximate cause of the injury. The court found that the corporation directed the implementation of the subsidiary’s budget in such a manner that there was a disregard for the interests of the subsidiary and dangerous conditions were created.

Illinois entities need to be wary of a number of possible ways that courts are allowing the erosion of limited liability afforded businesses. Holding corporations with subsidiaries is a common strategy to minimize risk for shareholders. These same shareholders are attempting the preservation of their investments by relying on law that explicitly limits liability. Apparently, mandatory capitalization laws, insurance requirements, product safety requirements, etc. are deemed insufficient by courts that allow novel theories that undermine limited liability protection provided to entities created under statutory authority.

The Illinois Supreme Court is following other jurisdictions around the nation that have endorsed theories that erode limited liability protection for entities. These theories have been upheld not just in a tort context but contract situations as well. One such theory is termed “single business enterprise” where business connections, common ownership and various other means are utilized to establish that two distinct entities are operating in a coordinated manner. Sound familiar?

And let's not forget the ever-popular veil piercing lawsuit. Cases raising veil-piercing issues are the most frequently litigated in all of corporate law and limited liability in Illinois continues to erode whenever there's a veil piercing lawsuit. Similarly, the court in *Forsythe* has opened the door to utilize another theory, direct participation, to disregard corporate form and impose liability against a statutory entity. As a starting point, Illinois courts may look at as many as eleven factors before piercing the veil. A renowned commentator on the erosion of limited liability has stated that these lists of possible factors used in veil piercing cases are aimed at satisfying particular public policy goals. However, later judges often capriciously modify (if remember at all) public policy aims. The furtherance of public policy aims is also a major component of the court's analysis in *Forsythe*.

Additionally, abuse must usually be demonstrated to pierce the corporate veil. However, abuse tends to become an elusive term when courts attempt to apply the word in litigation. In *Forsythe*, the opinion's analysis provides that a parent corporation power to control the subsidiary, by itself, does not impose a duty. However, an abuse of the power, by exerting too much control, could lead to liability for the conduct of its subsidiaries as an alter ego. This alter ego theory is not based upon any clear abuse but upon control exercised by a parent (or individual shareholder).

Still yet, the court's opinion also asserted that parent corporations are not held directly liable for their own wrongdoings but for their actions against third-parties through the agency of subsidiaries. Therefore, even in situations where corporations are deemed not to be alter egos of each other, liability is possible under an agency theory. Our supreme court has used the agency theory to support its decision to impose liability on the parent for the subsidiary's acts. The court reasoned that the subsidiary has the power to bind the parent because the subsidiary acted as the parent's agent in a transaction(s). However, since shareholders or parents always have the potential to control, an agency theory is always a viable option to bypass limited liability protection. The end result is a movement away from the stringent abuse standard utilized in veil piercing cases, where an alter ego must be established, to the more accessible agency theory where just the presence of control is seemingly sufficient to dispense with limited liability.

As is evident by the court decisions, not only in Illinois, but also across the country, the threat to eliminate the protection of limited liability is real. Companies conducting business in Illinois need to adjust their operating procedures to avoid the pitfalls associated with emerging theories that undermine limited liability protection. In particular, liability based upon the direct participant theory looks towards holding companies, and not their subsidiaries, for redress. An attachment of liability is moving away from being based upon reprehensible, abusive conduct and towards, simply based upon, shareholder control.

