COMMENTARY TO DEAN FERSHÉE 'S PRESENTATION

George Kuney

Autumn Bowling:

Fantastic. We're ended a little bit early there. And so our faculty discussant is UT Law's Professor George Kuney. So, I'll go ahead and hand it over to him.

George Kuney:[1]

I have a few comments related to Dean Fershée 's presentation.

First, I share many of the same reactions as he does regarding the misuse of corporate terms, names, and titles. Naming and categorizing are very, very important in law. Precise wording is very important. I am let down when loose language works its way into judicial opinions and that loose language radiates outward and compounds the confusion.

Second, for a long time I have been doing a lot of work with corporate structures, successor liability, and piercing the corporate veil. A lot of that relates to bankruptcy, insolvency, and restructuring practice. What I've seen over the last twenty years is that plaintiffs' lawyers who are bringing lawsuits alleging something like veil piercing liability or corporate group liability are increasingly pleading without much specificity. For example, when faced with a subsidiary that is arguably liable for a tort but may not have deep pockets beyond available insurance, they seek to proceed against the parent or a whole corporate group because of general allegations of "control."[2] The overarching theme that they're using is some vague allegations relating to agency, actual or implied, and that this corporate

[1] The University of Tennessee College of Law, Lindsay Young Distinguished Professor of Law and Director of the Clayton Center for Entrepreneurial Law and the LL.M. in United States Business Law program.

[2] "Control group liability" is a special ERISA doctrine "whereby other entities can be responsible for the pension withdrawal liability of the sponsor of a pension plan based on common ownership." Cohen v. Jaffe, Raitt, Heure & Weiss, P.C., No. 16-CV-11484, 2017 WL 2833535, at *1 (E.D. Mich. June 30, 2017). It is not a doctrine with broad applicability in corporate or entity law.

group operates as a corporate group and is a "top down" organization. As a result, they assert that we should not look at all at the corporate formalities and not honor and respect the separateness of the entities. The whole corporate group should be liable for the torts (and presumably other liabilities) of any one subsidiary.

It used to be that the complaints I saw in this area were very precise and specifically alleged apparent agency,[3] actual agency,[4] piercing the corporate veil,[5] alter ego,[6] and the like. Now, these allegations have become very vague and unfocused. Perhaps this is part of a strategy to shelter these

[3] Although the exact formulations of the standard vary by jurisdiction, to establish an apparent agency relationship the plaintiffs must generally prove "(a) a representation by the purported principal; (b) a reliance on that representation by a third party; and (c) a change in position by the third party in reliance on the representation." Jackson Hewitt v. Kaman 100 So. 3d 19, 32 (Fla. Dist. Ct. App. 2011). Apparent agency or agency "does not arise from the subjective understanding of the person dealing with the purported agent, nor from appearances created by the purported agent himself; instead, 'apparent authority' exists only where the *principal* creates the appearance of an agency relationship." Izquierdo v. Hialeah Hosp., Inc., 709 So. 2d 187, 188 (Fla. Dist. Ct. App. 1998).

[4] Although formulations of the standard vary by jurisdiction, to establish an actual agency relationship between an operating subsidiary and a parent, the plaintiff must generally demonstrate: (1) acknowledgment by the parent that the subsidiary would act as it agent; (2) the subsidiary's acceptance of the undertaking; and (3) control by the parent over the subsidiary's actions that give rise to the plaintiff's injuries. *See, e.g.*, Ocana v. Ford, 992 So. 2d 319, 326 (Fla. Dist. Ct. App. 2008).

[5] Again, jurisdictional formulations vary, but, in general, "piercing the corporate veil is appropriate when three elements are present: (1) the corporation was a mere alter ego of the shareholder, (2) the corporate structure was used to perpetrate a wrong, and (3) piercing the corporate veil would achieve an equitable result. A claimant seeking to pierce the corporate veil must make a clear and convincing showing that each consideration has been met." Lykins v. Thomas (In re Thomas), No. 10–38306 MER, 2013 WL 6840527, at *5 (Bankr. D. Colo. Dec. 27, 2013).

[6] The standards are enunciated differently in various jurisdictions, but the essence of an alter ego claim is a lack of separateness between the two entities. So, for example "[t]here are two essential elements of an alter ego claim under California law: (1) a finding that there is such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist, and (2) that the failure to disregard the corporation would result in fraud or injustice. California recognizes two types of alter ego claims-generalized alter ego claims and particularized alter ego claims. The first alleges injury to the corporation giving rise to a right of action in it against defendants and the second involves causes of action that belong to each creditor individually. A general claim is property of the debtor corporation and becomes property of the bankruptcy estate. A particularized claim belongs to an individual creditor and does not become property of the estate." In re Landmark Fence Co., No. ED CV10-00143-AHM, 2010 WL 4924739, at *3 (C.D. Cal. Dec. 3, 2010).

claims from being easily dismissed at the motion stage by preventing a direct and focused attack on them.[7] It is very hard to knock out their vague agency/control group theories with a defense summary judgment motion, which keeps the lawsuit alive through trial, which, in turn, increases the settlement value of the lawsuit. This is an area where a motion for a more definite statement could and probably should be used early and often at the inception of the case, prior to answering the complaint.[8]

Third, I am disturbed by the jurisdictions that treat piercing the corporate (or other) veil and alter ego theories as questions for the jury.[9] Rather, I think that doctrines like this, which are sweeping and often based upon multi-factor tests expressed as non-exclusive lists, should be reserved for the judge entirely. This is the approach taken with the contract doctrine of unconscionability, which also threatens to become unmoored in its application if placed in the province of the jury.[10] I can hold forth on what I think about juries for a long time but I won't because I just got a two minute warning flash, but even the best instructed juries are often hard

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[7] *See, e.g.*, George v. Youngstown State Univ., 966 F.3d 446 (6th Cir. 2020) (Summary judgment was not warranted in a former university professor's Title VII retaliation claim because there were disputed material facts with respect to pretext, particularly as the professor's evidence suggested that the university had several faculty retirements and stable enrollment when it terminated him).

[8] *See* FED. R. CIV. P. 12(e) ("(e) Motion for a More Definite Statement. A party may move for a more definite statement of a pleading to which a responsive pleading is allowed but which is so vague or ambiguous that the party cannot reasonably prepare a response. The motion must be made before filing a responsive pleading and must point out the defects complained of and the details desired. If the court orders a more definite statement and the order is not obeyed within 14 days after notice of the order or within the time the court sets, the court may strike the pleading or issue any other appropriate order.").

[9] *See, e.g.*, Bryant v. Optima Int'l, 792 S.E.2d 489, 497 (Ga. Ct. App. 2016) ("When litigated, the question of whether the alter ego doctrine applies is for the jury, unless there is no evidence sufficient to justify disregarding the corporate form . . . ."); Logtale, Ltd. v. Ikor, Inc., No. 11-cv-05452-EDL, 2015 WL 12942493 at *1 (N.D. Cal. Dec. 1, 2015) (jury instructed "as to the elements and relevant factors to consider in making a determination of whether alter ego liability exists"); Oost-Lievense v. North Am. Consortium, P.C., 969 F. Supp. 874, 880 (S.D.N.Y. 1997)("[A]ny claim of veil piercing based on an alter ego theory must be left for a jury. Resolution of the alter ego issue is heavily fact specific.").

[10] U.C.C. § 2-302 cmt. 3 ("The present section is addressed to the court, and the decision to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of facts.").

pressed to accurately apply fine legal distinctions. Many times juries will come in the middle of a range of outcomes, when the actual result should be one of the end points or the other.[11]

As the use of limited liability entities has proliferated, combined with the broad adoption of blanket lien financing covering all of an entity's assets, operating subsidiaries have been rendered solvent for ordinary commercial purposes, such as paying their bills, but insolvent apart from any insurance coverage they may have if a tort judgment is rendered against it.[12] This is further compounded by the fact that insurance requirements for various activities, where they exist,[13] appear to be decreasing in real terms, due to the effect of inflation.

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[11] For example, consider a lawsuit where, if the plaintiff wins, she ought to be awarded $500,000, or if she loses, she should get zero. The jury comes back and awards $40,000 because well, although we find for the defendant, the plaintiff was hurt and "should get something." Of course, this can be fixed with a motion for judgment notwithstanding the pleadings, but the jury's behavior is the point.

[12] *See* Lynn M. LoPucki, Abstract, *The Death of Liability*. 106 YALE L.J. 1, (1996) ("Based on systems/strategic analysis, this paper predicts the complete failure of legal liability system. Liability is the system by which injured persons recover money damages from those who injure them. The system operates through the entry and enforcement of judgments by the courts. The paper argues that the system is vulnerable to defeat by a variety of judgment proofing techniques which can be categorized as secured debt strategies, ownership strategies, exemption strategies, and foreign haven strategies.").

[13] Consider corporate groups that feature operating subsidiaries that provide medical services. According to the Galagher Healthcare Industry Insights Blog: "No federal law requires doctors to carry medical malpractice insurance, but some states do. Whether or not doctors are required to have insurance depends upon the state where they practice. Roughly 32 states require no medical malpractice insurance and have no minimum carrying requirements. The other 18 states break down roughly into two groups—states that require minimum levels of insurance and states that require medical professionals to have some insurance to qualify for liability reforms in their state. . . . The following states do not require medical malpractice insurance nor do they have minimum carrying requirements: Alabama, Alaska, Arizona, Arkansas, California, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Iowa, Kentucky, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington and West Virginia. Even though these states have no requirement for medical malpractice insurance nor minimum carrying requirements, many physicians still face requirements to obtain malpractice insurance in certain situations. Many hospitals require physicians with visiting privileges to obtain malpractice insurance. And some healthcare insurance plans require any doctor who participates in their coverage to have malpractice insurance." Donavan Weger, Going Bare—Are

These trends, taken together, provide a reason for plaintiffs' attorneys to turn to piercing or successor liability claims to seek some recovery for their clients. They are just doing it in a very unfocused fashion, again, probably strategically to keep the case alive with the threat of an adverse verdict at trial for the defendant. This is all the more reason to keep determinations of alter ego, veil piercing, and successor liability firmly in the hands of the judge, not the jury. If there is a solution to the problem of uncompensated victims, it lies with the legislature and an increase in required insurance coverage for licensed and permitted activities that are prone to tort liability. That solves the problem by creating a shared risk pool, distributing that risk of loss across society. It also provides an incentive to the operating units to conduct themselves in a careful and prudent fashion, avoiding negligence, due to the function of insurance ratings and the potential for lower premiums. Thus, we can have a system that provides a fund to compensate victims while still respecting the separate entity status of the individual entities within a corporate group.

The title of this talk was *Limited Liability Gone Wild*, but I would say it's veil piercing and similar doctrines that have gone wild in response to the expanded use of LLCs and other limited liability entities as the equivalent of watertight compartments in a ship, so that if one subsidiary takes a hit due to a tort judgment, the balance of the enterprise is largely unaffected. Combined with low or no adequate insurance coverage at the operating subsidiary level, the search for justice for victims has driven the plaintiffs' bar in that direction. It is up to the legislature to increase insurance requirements to take the pressure off of entity law to bend and be more

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Doctors Required to Have Malpractice Insurance?, GALLAGHER HEALTHCARE: INDUS. INSIGHTS BLOG, (last visited December 2, 2020), https://www.gallaghermalpractice.com/blog/post/going-bare-are-doctors-required-to-have-malpractice-insurance. And in states that do have required medical malpractice coverage, that amount can be woefully low. *See, e.g.*, Professional Liability Insurance, CONN. DEP'T PUB. HEALTH (2021), https://portal.ct.gov/DPH/Practitioner-Licensing--Investigations/Podiatry/Professional-Liability-Insurance ("individuals licensed and providing direct patient care services, are required to maintain professional liability insurance or other indemnity against liability for professional malpractice. The amount of such insurance or indemnity for claims against injury or death for professional malpractice must be not less than five hundred thousand dollars ($500,000) for one person, per occurrence, with an aggregate of not less than one million five hundred thousand dollars ($1,500,000). In the event that a licensee fails to maintain such insurance or indemnity coverage, the Connecticut Medical Examining Board may restrict, suspend, revoke, limit the right to practice or take action in accordance with Section 19a-17, Connecticut General Statutes.").

liberal in granting what was always intended to be "extraordinary" relief.[14] And, with that, I think I'll end my comments there and turn it over to the next commentator.

[14] *See, e.g.*, Hambleton Bros. Lumber Co. v. Balkin Enters., 397 F.3d 1217, 1228 (9th Cir. 2005)("in Oregon piercing the corporate veil is an extraordinary remedy which exists as a last resort . . . .").