Protecting Foreign Parent Corporations from Personal Jurisdiction in the US

This Article discusses the issues that US courts consider in determining whether a US corporation's US contacts may subject its foreign parent to the jurisdiction of US courts. It also examines what foreign parent corporations can do to limit their exposure to lawsuits in the US.

This Article: know-how was first published by Practical Law Company on its PLCLaw Department web service at *http://usld.practicallaw.com/5-502-8077*

Philip D. Robben and Michael J. Maloney, Kelley Drye & Warren LLP

Non-US corporations can manage the risk of lawsuits presented by their US operations by using properly structured subsidiaries. This Article discusses the issues that US courts consider in determining whether a US corporation's US contacts may subject its foreign parent to the jurisdiction of US courts. It also examines what foreign parent corporations can do to limit their exposure to lawsuits in the US.

SUBSIDIARIES

Most large non-US companies doing business in the US do so through subsidiaries. This allows the parent company to manage the risk from its US operations. Plaintiffs in US litigation, however, often seek to disregard the corporate form of a subsidiary doing business in the US to hold the non-US parent company directly liable (known as piercing the corporate veil). This is often done by a lawsuit against the subsidiary and its non-US parent. The plaintiffs' goal may be to reach a "deep pocket," increase settlement value or obtain broad discovery of the parent corporation (itself an incentive for defendants to settle).

One of the most significant factors courts consider in deciding whether to pierce the corporate veil is the structure of the relationship between the parent and the subsidiary. US courts regularly reject attempts to pierce the corporate veil and exercise jurisdiction over foreign corporate parents when the relationship between the parent and the subsidiary is such that the two companies may be seen as truly separate entities (even though they may share common, if not identical, goals).

PROVING PERSONAL JURISDICTION

Personal jurisdiction is a court's power to adjudicate the rights and obligations of particular persons, corporations or other legal entities within its jurisdictional reach (in contrast, subject matter jurisdiction concerns the court's power to adjudicate particular types of causes of action and disputes). Personal jurisdiction is based on the facts and circumstances of each case. For corporations that are neither incorporated nor domiciled in the US, personal jurisdiction is fact-specific and not always easy to establish. Therefore, companies must understand the US personal jurisdiction rules and the hurdles they present to a plaintiff when formulating a plan to reduce a foreign parent company's exposure to personal jurisdiction in the US.

To establish personal jurisdiction over a non-resident defendant, a plaintiff generally must demonstrate that the:

- Defendant received proper notice of the lawsuit.
- Exercise of jurisdiction over the defendant is in accordance with the law and meets certain minimum standards of fairness.

For many non-US companies, proper notice means service of process in accordance with the Hague Convention.

However, service of process under the Hague Convention does not, by itself, assure that a US court has personal jurisdiction over the foreign corporation. The question of personal jurisdiction over non-resident defendants generally focuses on whether the:

- Assertion of jurisdiction is authorized by a state statute.
- Exercise of jurisdiction under state law is consistent with basic due process requirements mandated by the US Constitution.

Bases for Personal Jurisdiction under State Law

General Jurisdiction

General jurisdiction over a defendant exists where the defendant engages in continuous and systematic conduct in the forum state, including:

- Doing business in the forum state.
- Selling goods in the forum state.
- Maintaining an office within the forum state.
- Employing persons in the forum state.

If a court finds that it has general jurisdiction over a defendant, the court may exercise jurisdiction over the defendant for any cause of action that falls within the court's subject matter jurisdiction. Moreover, the defendant may be sued in the forum state for conduct occurring anywhere in the world. For example, if a UK holding company is found to be subject to the general jurisdiction of a New York state court, the UK holding company may be sued in New York for any cause of action that falls within the subject matter jurisdiction of the New York state court (although there may be a separate issue on whether New York is the proper venue under the doctrine of forum non conveniens).

Specific Jurisdiction

In contrast to general jurisdiction, specific jurisdiction relates to a defendant's specific contacts with the state that gave rise to the lawsuit. To find specific jurisdiction, a plaintiff must establish a minimum level of contacts between the defendant, the forum and the litigation.

Each state has its own statutes (known as long-arm statutes) or court rules that authorize its courts to exercise personal jurisdiction over non-resident defendants who have sufficient contacts with the forum state. These statutes may apply to actions pending in state or federal court. Long-arm statutes vary from state to state but generally allow courts to exercise personal jurisdiction over non-resident defendants where the lawsuit arises from either the:

- Defendant's actions within the forum state (for example, a breach of contract case arising out of a business transaction completed within the forum state).
- Plaintiff's injury within the forum state (for example, in-state injuries caused by a defective product manufactured by the defendant outside the forum state).

Some long-arm statutes also permit a lawsuit to be brought for injuries occurring outside the state under certain circumstances. Companies must carefully examine the long-arm statute of the particular forum state, as some permit suits against non-resident defendants on more liberal terms than others.

Due Process

In addition to finding that a particular long-arm statute has been satisfied, courts must consider whether the exercise of personal jurisdiction over a non-resident defendant comports with due process (a test of fairness rooted in the US Constitution). Generally, a state's exercise of personal jurisdiction over a non-resident defendant may satisfy due process if the following three elements are satisfied:

- The defendant has "minimum contacts" with the forum state.
- The defendant "purposefully availed" itself of the privilege of conducting activities in the forum state.
- The court's exercise of jurisdiction over the non-resident defendant is fair and reasonable.

When a lawsuit involves activities that fall squarely within the provisions of a state's long-arm statute, due process is usually satisfied. When the nature of the defendant's contacts with the state are disputed or when the activities at issue do not fall squarely within the terms of the state's long-arm statute, the court must conduct a comprehensive due process analysis of the non-resident defendant's contacts with the forum state.

BASES FOR PIERCING THE CORPORATE VEIL

In many cases, a parent corporation's only contact with the forum state is its ownership of stock in a subsidiary located (or doing business in) that state. Merely owning an in-state subsidiary's stock is rarely sufficient to establish personal jurisdiction (whether general or specific) over a foreign parent. Instead, to impute the subsidiary's jurisdictional contacts to the foreign parent, plaintiffs must persuade the court that the corporate form should be disregarded because the parent and the subsidiary are not truly separate companies. To succeed in disregarding the corporate form, a plaintiff must generally demonstrate that:

- The parent exercises significant control over the subsidiary.
- An injustice to the plaintiff will result if the corporate veil is not pierced.

Some jurisdictions may also require the plaintiff to prove that the parent used the corporate form to perpetrate a fraud on the plaintiff before subjecting the foreign parent to personal jurisdiction in the US. Other jurisdictions do not require evidence of fraud to establish personal jurisdiction over a foreign parent, although they may be reluctant to hold the parent liable for its subsidiary's conduct without evidence of fraud.

Plaintiffs generally make one of two arguments in their attempts to prove that the parent exercises significant control over the subsidiary (and therefore the corporate form should be disregarded), namely:

- The subsidiary is the parent's agent.
- The subsidiary is the parent's alter-ego.

Agency

Under the agency theory, a plaintiff seeks to establish jurisdiction over a parent corporation on the grounds that its subsidiary was an in-state agent of the parent. To prevail on this argument, a plaintiff must typically establish that the:

- Parent intended for the subsidiary (the alleged agent) to act for the parent.
- Subsidiary agreed to act as the parent's agent.
- Parent exercised total control over the subsidiary.

In some circumstances, the plaintiff may need to establish a close connection between the cause of action and the purported agency.

An agency relationship between a parent and its subsidiary does not need to be expressed. Instead, the relationship may be established by reasonable inferences derived from evidence of the relationship. However, courts do not ordinarily find an agency relationship without extraordinary control of the subsidiary by the parent company. Common ownership of stock of two or more companies and common management, without additional oversight or control, is generally insufficient to establish an agency relationship.

Alter-ego

Under the alter-ego theory of piercing the corporate veil, the presumption that a parent and its subsidiary are separate corporations may be overcome by evidence that the subsidiary is completely controlled by the parent. When determining whether a subsidiary is an alter-ego of its parent, courts consider many factors, including whether the:

- Parent owns all of the stock in the subsidiary.
- Subsidiary is adequately capitalized.
- Corporate formalities are observed.
- Parent and subsidiary share corporate officers and directors.
- Subsidiary has its own offices, employees and bank accounts.
- Parent pays the salaries of the employees of the subsidiary.
- Parent siphons money out of the subsidiary.
- Subsidiary pays formal dividends.
- Subsidiary and parent share administrative services, employees or insurance arrangements without proper, arm's length compensation between them.
- Parent uses the subsidiary's property as its own.
- Subsidiary's function is a mere façade for the parent company.

The alter-ego analysis is fact-specific and courts have broad discretion in deciding whether the evidence supports an alter-ego finding. However, courts generally hold that a parent's normal exercise of control over its subsidiary is insufficient to justify piercing the corporate veil. For a court to disregard the corporate form, the control must be so complete that the subsidiary has no separate mind, will or existence of its own.

MANAGING RISK

There are many steps that non-US companies can take to minimize the risk that a US court will pierce the corporate veil and exercise personal jurisdiction over them under either an agency or alter-ego theory.

Properly capitalizing and insuring the subsidiary are by far the most important steps to prevent a successful veil piercing argument, as this substantially weakens the possibility that the plaintiff will suffer an injustice if the corporate form is not disregarded. US courts are less likely to extend their jurisdictional reach over foreign parent companies if the plaintiff can collect the full amount of a money judgment against a properly capitalized US corporation.

Additional steps to counter agency or alter-ego veil piercing theories include:

- Complying with corporate formalities.
- Properly filing the subsidiary's articles of incorporation.
- Properly issuing all stock certificates.
- Creating the subsidiary's own bank account, separate from the parent's.
- Documenting the reasons for the subsidiary's capital structure and the level of capital used.
- Fully documenting any loan to or from the parent company and using an arm's length interest rate.
- Keeping a balance between debt and equity that is appropriate to the type of business it operates.
- Having the subsidiary hire its own employees, paid from the subsidiary's own funds.
- Creating the subsidiary's own board of directors.