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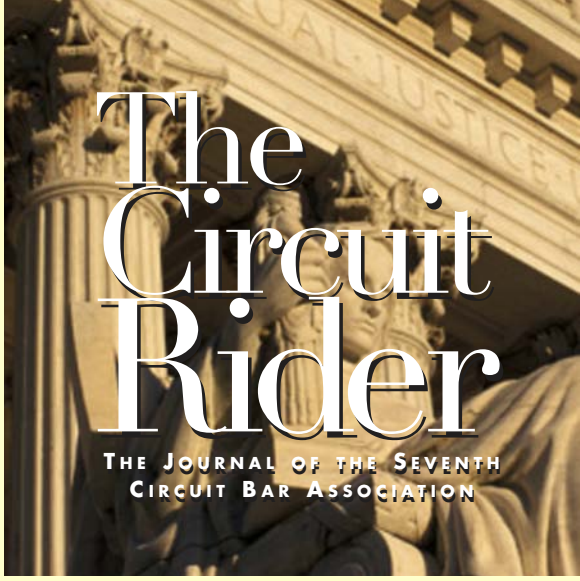

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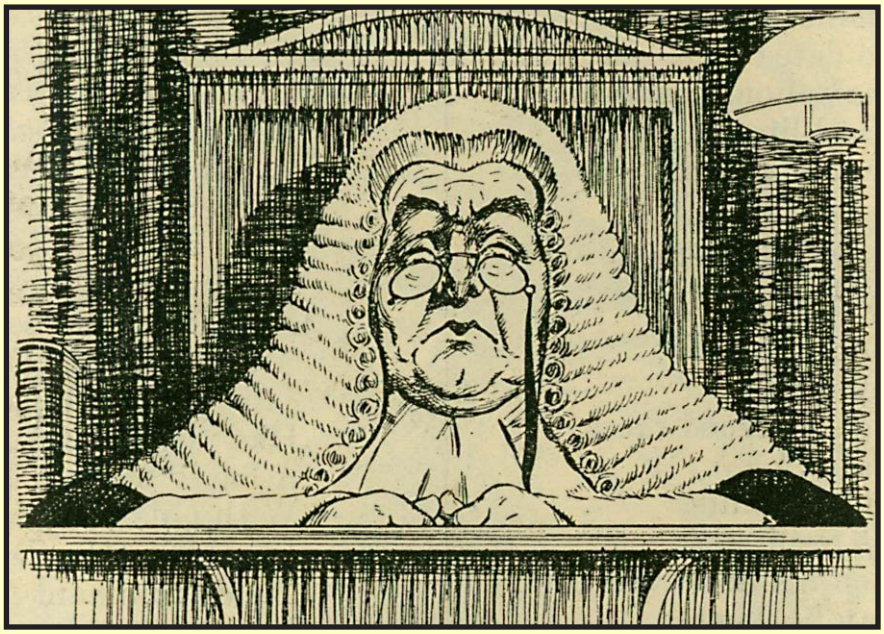

Personal Jurisdiction *and the* Parent-Subsidiary Relationship:

When will a Subsidiary Unintentionally Drag Its Parent Company Into Court?

*By Rebecca M. Klein**

Last year in *Daimler AG v. Bauman,* 134 S. Ct. 746 (2014) — a landmark case in the world of personal jurisdiction — the Supreme Court strictly limited the circumstances in which a court may assert general personal jurisdiction over a corporate entity. A court may assert jurisdiction "only when the corporation's affiliations with the State in which suit is brought are so constant and pervasive 'as to render [it] essentially at home in the forum State.'" For a corporation, the "paradigm" home states are "the place of incorporation and the principal place of business." *Id.* at 760 (internal quotation marks omitted).

This holding has received much attention as an important limitation on personal jurisdiction over corporations. But in a lesser-noticed move, *Daimler* also raised, but did not decide, another crucial personal jurisdiction question: When may a court assert personal jurisdiction over a foreign parent corporation based on the contacts of a domestic subsidiary? *See id.* at 758-60.

Although this issue comes up fairly frequently in the district courts, the Supreme Court has not yet directly addressed the issue. *Id.* at 759. While the *Daimler* Court rejected the Ninth Circuit's broad test, which mainly considered "whether the subsidiary performs services that are sufficiently important to the foreign corporation that if it did not have a representative to perform them, the corporation's own officials would undertake to perform substantially similar services," (*id.* (internal quotation marks omitted)), it declined to address any of the other tests employed by the other Courts of Appeals.

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In the absence of Supreme Court guidance on the issue, courts in the Seventh Circuit have continued to use the test adopted in *Central States, Se. & Sw. Areas Pension Fund v. Reimer Express World Corp.,* 230 F.3d 934 (7th Cir. 2000) (*"Central States"*): "[P]ersonal jurisdiction cannot be [based] on corporate affiliation or stock ownership alone where corporate formalities are substantially observed and the parent does not exercise an unusually high degree of control over the subsidiary." *Id.* at 943; *see, e.g., Kolcraft Enterprises, Inc. v. Artsana USA, Inc.,* No. 2014 WL 3865814, at *4 (N.D. Ill. Aug. 2, 2014) (applying the *Central States* test). While this test provides some guidance for district courts and litigants, it still leaves open an array of questions. Not surprisingly, the district courts in this Circuit have discussed a wide range of factors bearing on the issue and come to varying conclusions.

This article aims to provide guidance on when a foreign parent corporation will be subject to personal jurisdiction in the Seventh Circuit based on the contacts of a domestic subsidiary with the forum state.

The Central States Test:

In *Central States,* the Seventh Circuit made clear that "corporate ownership alone is not sufficient for personal jurisdiction." 230 F.3d at 943. Thus, owning an Illinois-based company will not generally subject a foreign parent corporate to personal jurisdiction in Illinois.[1] There are, however, two exceptions to this general rule: (1) a subsidiary's contacts may be imputed to the parent when a lack of corporate formalities allows a piercing of the corporate veil and (2) a subsidiary's contacts may be imputed to the parent when the parent exercises an "unusually high degree of control" over the subsidiary, such that the subsidiary is essentially acting as the parent's agent. *Id.* ("Constitutional due process requires that personal jurisdiction cannot be premised on corporate affiliation or stock ownership alone where corporate formalities are substantially observed and the parent does not exercise an unusually high degree of control over the subsidiary."). While these two exceptions may, in some contexts, be thought of as distinct, the factors involved in evaluating each often overlap, and courts sometimes analyze both together.

For the "lack of corporate formalities" exception to apply, "'(1) there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist; and (2) circumstances must exist such that adherence to the fiction of a separate corporate existence would sanction a fraud, promote injustice, or promote inequitable consequences.'" *Wells v. Edison Int'l, Inc.,* No. 09 C 1728, 2009 WL 1891801, at *4 (N.D. Ill. July 1, 2009) (quoting *In re Wallen,* 262 Ill. App. 3d 61 (Ill. App. Ct. 1994)).

For the "high degree of control" exception to apply, the parent must exercise "an unusually high degree of control such that the subsidiary's corporate existence is simply a formality." *Abelesz v. OTP Bank,* 692 F.3d 638, 658-59 (7th Cir. 2012) (internal quotation marks omitted); *cf. FAIP N. Am., Inc. v. Sistema s.r.l.,* No. 05 C 4002, 2005 WL 3436398, at *4 (N.D. Ill. Dec. 14, 2005) ("Although control is a requisite to establish specific personal jurisdiction, *total control is not.*").

In evaluating both of these exceptions, it is crucial to note that the Seventh Circuit has specifically stated that "a corporate parent may provide administrative services for its subsidiary in the ordinary course of business without calling into question the separateness of the two entities for purposes of personal jurisdiction." *Central States,* 230 F.3d at 945; *see also KM Enterprises, Inc. v. Global Traffic Techs., Inc.,* 725 F.3d 718, 733 (7th Cir. 2013) ("The activities of a subsidiary may suffice

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jurisdiction over the parent if there is some basis for piercing the corporate veil, such as the parent's unusual degree of control over the subsidiary, but this does not apply in the case of an ordinary parent-subsidiary relationship that observes corporate formalities."). Multiple district courts have declined to exercise jurisdiction when the contacts between the parent and the subsidiary were "ordinary" or "normal." *See, e.g., Team Impressions, Inc. v. Chromas Technologies Canada, Inc.,* No. 02 C 5325, 2003 WL 132498, at *3 (N.D. Ill. Jan. 16, 2003) ("In determining whether [the parent] exercises 'an unusually high degree of control' over [the subsidiary], the Court assumes some degree of control in the normal parent/subsidiary relationship.").

Factors That A Court May Consider:

Within the confines of the *Central States* test, courts have considered a wide array of factors in determining whether to exercise personal jurisdiction. Defining when control becomes "unusually high" or when a corporate relationship becomes too "informal" is generally a very fact-specific inquiry, and it is not always possible to put a precise definition on these terms. Although some courts have attempted to list relevant factors,[2] there is no one defined set of factors that all courts consider. However, surveying the application of the *Central States* test within the Seventh Circuit reveals an array of factors that courts have considered in making these determinations and of which counsel should be aware.

Absence of freestanding business.
If a subsidiary is an entirely passive company formed solely to conduct the parent's business, a court may well assert personal jurisdiction over the parent based on the subsidiary's contacts with the forum state. *See, e.g., Zimmerman v. JWCF, LP,* No. 10-CV-7426, 2011 WL 4501412, at *6 (N.D. Ill. Sept. 28, 2011) (stating that jurisdiction may be present when the parent is "merely a holding company that has established many subsidiaries to carry out its business or is an umbrella company that exists merely to bid on projects or investments, merely for tax purposes, or to own the assets through which the parent conducts its business ventures") (internal quotation marks omitted)). For example, a court found personal jurisdiction when the parent formed the subsidiary "for the sole purpose of carrying out a development opportunity that [the parent] had selected and that [the parent] had chosen to pursue" and when "[f]ar from being a series of freestanding businesses that [the parent] just happens to own, the subsidiary companies are nothing but [the parent's] attempts to cabin off various aspects of its own business venture for legal and financial purposes." *Richard Knorr Int'l, Ltd. v. Geostar, Inc.,* No. 08 C 5414, 2010 WL 1325641, at *5 (N.D. Ill. Mar. 30, 2010).

Day-to-day management and decision-making.
Not surprisingly, the fact that a parent exercises control over the day-to-day management of its subsidiary is likely to weigh heavily in favor of jurisdiction. *See, e.g., Central States,* 230 F.3d at 945; *Nat'l Prod. Workers Union Ins. Trust v. Cigna Corp.,* No. 05 C 5415, 2006 WL 140544, at *2 (N.D. Ill. Jan 13, 2006). As a part of this inquiry, multiple courts have examined to what extent the parent company is involved in the decision-making processes of its subsidiary. This inquiry may consider whether the parent is involved in high level decisions such as whether to acquire a new company (which may be deemed ordinary parent control) and more minor decisions regarding the day-to-day operation of the business such as whether to hire lower level employees (which may not). S*ee, e.g., Bray,* 2007 WL 7366260, at *8 (discussing how the board of directors of the parent corporation was required to approve various actions of the subsidiary); *Zimmerman,* 2011 WL 4501412, at *5 (discussing how the subsidiary had authority to make employment and human resources decisions). If the parent is significantly involved in the decision-making processes of the subsidiary, it may weigh in favor of jurisdiction.

Failing to maintain separate corporate and financial records.
Many courts examine whether the parent and the subsidiary maintain separate books and records, financial statements and tax returns. *See, e.g., Central States,* 230 F.3d at 945 (discussing the maintenance of "separate books, records, financial statements, and tax returns" between parent and subsidiary);

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Poulsen Roser A/S v. Jackson & Perkins Wholesale, Inc., No. 10 C 1894, 2010 WL 3419460, at *3 (N.D. Ill. Aug. 26, 2010); *Bray v. Fresenius Med. Care Aktiengesellschaft Inc.,* No. 06 C 50197, 2007 WL 7366260, at *6 (N.D. Ill. Aug. 30, 2007). The core question is whether the companies' records, financial statements, and tax returns are separate enough to comply with all "corporate formalities" (as often discussed in a veil piercing analysis). *See Gruca v. Alpha Therapeutic Corp.,* 19 F. Supp. 2d 862, 869 (N.D. Ill. 1998). The common practice of presenting consolidated financial statements and tax returns should not weigh in favor jurisdiction as long as the proper procedures are followed for doing so. *Id.*

Mutual officers or directors.
The fact that a parent and a subsidiary have mutual officers or directors may weigh in favor of a finding that the parent exercises significant control over the subsidiary. *See, e.g., Bray,* 2007 WL 7366260, at *6; *but see Zimmerman,* 2011 WL 4501412, at *8 ("The existence of common officers of both the parent and the subsidiary . . . is insufficient to exercise personal jurisdiction over the nonresident parent."). Additionally, if the subsidiary's board meetings are in the same location as the parent's, this may weigh in favor of a finding of jurisdiction. *Montalbano v. HSN, Inc.,* No. 11 C 96, 2011 WL 3921398, at *3 (N.D. Ill. Sept. 6, 2011). This factor, standing alone, is unlikely to be enough to confer jurisdiction, but it is something that may be considered in context with other factors.

Provision of administrative or operational services.
As discussed above, the fact that a parent provides "administrative services for its subsidiary in the ordinary course of business" does not generally call into question the separateness of the two entities. *Central States,* 230 F.3d at 945. Examples include legal services, computers, insurance claims processing, insurance policy writing, and provision of equipment and maintenance. *Nat'l Prod. Workers Union Trust v. CIGNA Corp.,* No. 05 C 5415, 2007 WL 1468555, at *10 (N.D. Ill. May 16, 2007) ("CIGNA"). Related to the provision of these types of services is the question of whether the subsidiary is charged for and pays the parent for the services. *Id.* These types of payments would generally weigh against a finding of jurisdiction.

For example, the court in *CIGNA* found that: "While this [annual] statement shows that CIGNA Corporation [the parent company] provides administrative and/or operational services to LINA as its subsidiary, (*e.g.,* legal services, computers, claims processing, policy writing, and provision of equipment and maintenance), and that it advances certain costs to LINA during the year for these services, the statement does not show that CIGNA Corporation controls LINA in a day-to-day operational and/or management sense. For example, there is no evidence that CIGNA Corporation provides the payroll for LINA employees and/or that LINA does not have its own employees and its own budget for paying them. To the contrary, the financial statements reveal that the cost of services provided by CIGNA Corporation to operating subsidiaries is charged back to the subsidiaries." *Id.* (citation omitted).

A common example of an administrative or operational service that a parent company might provide its subsidiary is employee benefits (*e.g.,* health insurance). The fact that the parent provides benefits to the employees of the subsidiary is something that the court may take into consideration, but it is not a dispositive factor in determining the presence of personal jurisdiction over the parent. *CIGNA,* 2007 WL 1468555, at *11. Courts will likely find that provision of such benefits falls within the confines of the "normal" parent-subsidiary relationship and does not constitute "the type of day-to-day control or management of the subsidiary necessary to satisfy the *Central States* test." *Id.*

Companies holding themselves out as a single entity.
Another factor that frequently arises is the way in which the company (either the parent or the subsidiary) holds itself out in sources such as the company website, press releases, or annual SEC reports. The court may consider factors such as whether the parent conducts significant advertising on behalf of the subsidiary. *See Montalbano,* 2011 WL 3921398, at *3. But courts have not been willing to base a finding of jurisdiction on such factors. Thus, the existence of a "passive" website that mentions both the parent and the subsidiary, but does not do any interactive sales,

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has not lead to jurisdiction. *CIGNA,* 2007 WL 1468555, at *11. Additionally, courts have stated that the fact that the parent mentioned the subsidiary in its press releases or annual reports or used the terms "we" or "our" in referring to both companies is not a dispositive factor in determining whether jurisdiction is present. *See Wells,* 2009 WL 1891801, at *4-*5; *Gruca,* 19 F. Supp. 2d at 868.

Corporate structure.

Courts frequently consider the corporate structure and the degree of separation between the parent and the subsidiary. A direct "parent-child" relationship is more likely to lead to a finding of jurisdiction than a structure where many other companies stand between the parent and the subsidiary at issue. *See, e.g., CIGNA,* 2007 WL 1468555, at *5. However, the fact that the subsidiary is a direct corporate subsidiary or only one level below the parent on the corporate chain is not dispositive and is unlikely to lead to a finding of jurisdiction in the absence of other factors. *Wells,* 2009 WL 1891801, at *4.

Profiting from the activities of the subsidiary.

The mere fact that a parent profits from sales of the subsidiary is not dispositive in the jurisdictional analysis and likely will not be given significant weight. *See Bray,* 2007 WL 7366260, at *5 ("Presumably, many parent corporations earn indirect revenue from the sales of their subsidiaries, and yet the general rule remains that parent companies are not subject to jurisdiction simply because of a subsidiary's contacts with the state.") (citing *Purdue Research Foundation v. Sanofi-Synthelabo, S.A.,* 338 F.3d 773, 788 n.17 (7th Cir. 2003))).

Conclusion

While personal jurisdiction may not be the first thing that corporate decision-makers are thinking about when structuring relationships between parents and subsidiaries, it could later turn out to be the decisive factor in whether a lawsuit against a parent company can move forward. Counsel on both sides of the aisle should be aware of the *Central States* test and its factors, and should use knowledge of these factors in determining how to proceed on personal jurisdiction questions. Outside of "extreme" examples, a parent company that observes the appropriate formalities and maintains only a "normal" level control over its subsidiary should be able to win dismissal of suits asserting jurisdiction based solely on the forum contacts of its subsidiary.

Notes:

[1] For the purposes of discussion, this article assumes that the hypothetical parent corporation has no other ties or "contacts" with the forum state, aside from ownership of the domestic subsidiary. Of course if a parent corporation has other in-state contacts or does business in the forum state, those factors would be highly relevant to the jurisdictional analysis. This article intends only to examine the scenario in which a parent corporation's only contact with the forum state is ownership of a domestic subsidiary.

[2] For example, one court stated that "Illinois courts look at factors such as: 'inadequate capitalization; failure to issue stock; failure to observe corporate formalities; nonpayment of dividends; insolvency of the debtor corporation; nonfunctioning of the other officers or directors; absence of corporate records; commingling of funds; diversion of assets from the corporation by or to a shareholder; failure to maintain arm's length relationships among related entities; and whether the corporation is a mere facade for the operation of the dominant shareholders.'" *Wells,* 2009 WL 1891801, at *5 (quoting *Jackson v. Buffalo Rock Shooters Supply, Inc.,* 278 Ill. App. 3d 1084 (Ct. App. 1996)).