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Association of Defense Counsel of Northern California and Nevada

ASCDC
Association of Southern California Defense Counsel

November 14, 2014

The Honorable Chief Justice Tani Cantil-Sakauye
and Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102-4797

Re: *Castañeda v. The Ensign Group, Inc.* (2014) 229 Cal.App.4th 1015
Supreme Court Case No. S222200
Second Appellate Dist., Division 6, Case No. B249119

Letter Brief of ASCDC and ADC-NCN, as amici curiae, in support of Petition for Review, or in the alternative, depublication

Dear Chief Justice and Associate Justices:

The Association of Southern California Defense Counsel ("ASCDC") and the Association of Defense Counsel of Northern California and Nevada ("ADC-NCN") respectfully urge the Court to grant review in *Castañeda v. The Ensign Group, Inc.* (No. S222200). The published *Castañeda* opinion represents a fundamental, dangerous shift in existing law that will expose parent companies to liability as "employers" for subsidiaries' employment activities even where the companies legitimately maintain all required indicia of separateness and no basis exists for alter ego liability. This Court should grant review to provide clarity and certainty on this important issue, or alternatively, depublish the decision to prevent the inevitable adverse impact on legitimate California businesses.

Interest Of The Requesting Organizations

ASCDC is an association of over 1,000 leading attorneys who specialize in defending civil actions in Southern and Central California. ASCDC is actively involved in assisting courts on issues of interest to its members.

ADC-NCN is an association of almost 900 attorneys primarily engaged in the defense of civil actions. ADC-NCN members have a strong interest in the development of substantive and procedural law in California. The Association's Nevada members are also interested in the development of California law because Nevada courts often follow the law and rules adopted in California.

The two associations are separate organizations, with separate memberships and governing boards. They coordinate from time to time on some matters of shared interest, such as this request. The members of both organizations have extensive experience with civil matters in general and extensive experience specifically defending corporations against employment claims. Both organizations have appeared as amicus curiae in numerous cases before this Court and Courts of Appeal across the state.

Why Review Should Be Granted

1. The Petition For Review Presents An Important Question Of Law Regarding When Holding And Other Parent Companies Can Be Held Liable As "Employers" For Subsidiary-Related Employment Conduct.

The petition for review concerns an important question of California law: When, if ever, can a holding or other parent company be held liable as an "employer" for subsidiary-related employment conduct? The trial court found that the circumstances would not support an alter ego claim, and the Court of Appeal did not disagree. Yet the Court of Appeal, in its published opinion, still held the parent company could be held liable as an additional "employer." In the past few years, this Court has confirmed the importance of determining when multiple entities might be considered "employers," by granting review in *Martinez v. Combs* (2010) 49 Cal.4th 35, and *Patterson v. Domino's Pizza* (2014) 60 Cal.4th 474. Granting review here will allow this Court to tie up loose ends that *Martinez* and *Patterson* leave open.

The opinion rejects the defendants' interpretation that *Martinez* compels a finding that the parent company was *not* an employer, and instead concludes that *Martinez* makes "ownership" and "control" the key to determining "employer" status. (See Typed opn. 3-4.) *Martinez*, however, did not involve a parent-subsidiary context or otherwise assess whether or when a company that owns a defendant-employer can be liable as an

additional "employer." This Court has the ultimate say as to whether the Court of Appeal properly interpreted and extended *Martinez*. It should seize the opportunity.

The opinion completely ignores *Patterson*. Although *Patterson* came out after the initial opinion in this case and the Court of Appeal modified its opinion *after* defendants brought *Patterson* to the Court's attention and after rehearing, the modified opinion does not mention *Patterson*. *Patterson* held that a franchisor cannot be liable as an "employer" (along with the employing franchisee) unless it exercised comprehensive control over the franchisee's "day-to-day" employment decisions. (See *Patterson*, *supra*, 60 Cal.4th at pp. 499, 503.) Amici ASCDC and ADC-NCN submit that *Patterson*'s analysis directly undermines the opinion's holding. Review will allow this Court to determine whether the opinion is consistent with *Patterson*. Absent review, California law on this important "employer status" issue will remain unclear.

2. The Opinion's "Some Control" Test Is Nebulous. It Deprives Parent Companies Of The Certainty And Predictability Required To Assess Business Risk Accurately, And It Will Open The Floodgates To Plaintiffs Suing Parent Companies As "Employers" Merely Because They Exercise "Some Control" Over Employing-Subsidiaries.

This Court has recognized the importance of clear, intelligible legal standards that permit California companies to predict business risk and liability exposure accurately. (See, e.g., *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.* (1994) 7 Cal.4th 503, 515 [noting contract-damage limitations encourage "commercial activity by enabling parties to estimate in advance the financial risks of their enterprise"]; *Foley v. Interactive Data Corp.* (1988) 47 Cal.3d 654, 683 ["predictability about the cost of contractual relationships plays an important role in our commercial system"].)

The opinion does the exact opposite. It pronounces a vague, confusing liability standard that plaintiffs can manipulate easily into claims against virtually any parent company, particularly holding companies. The opinion's first sentence summarizes the holding as follows:

> A corporation with no employees owns a corporation with employees. If the corporation with no employees exercises *some control* over the

> corporation with employees, it also may be the employer of the employees of the corporation it owns.

(Typed opn. 1, emphasis added.) The reference to a "corporation with no employees owns a corporation with employees" exposes virtually any California holding company to liability as an "employer," because their officers and directors almost always have "some" control over subsidiaries. This is a huge, fundamental shift in California law. (See, e.g., *Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 545 [recognizing that subjecting a holding company to jurisdiction because it chose to invest in a business conducted through a subsidiary, rather than conduct the operations itself, would "swallow the distinction . . . between holding companies and operating companies"].)

Moreover, the "some control" standard is inherently vague and indefinite. *Some* can mean virtually anything. Nor does the rest of the opinion provide any intelligible limits. Instead, the opinion brims with broad comments that seemingly would apply to *any* parent-subsidiary relationship or *any* hierarchy of related corporations:

- "An entity that controls the business enterprise may be an employer even if it did not 'directly hire, fire or supervise' the employees." (Typed opn. 3.)

- "Here Ensign has more than a contractual relationship with Cabrillo. *Ensign owns Cabrillo.* It purchased it in 2009 and it owns all of its stock. A trier of fact could infer this evidence refutes Ensign's claims of lack of control and responsibility." (Typed opn. 4, emphasis in original.)

- "Castaneda's evidence showed Ensign's structural and management control over Cabrillo. Ensign owns Cabrillo and other 'cluster' or 'portfolio' companies that are involved in Cabrillo's operations." (Typed opn. 4.)

- "Castaneda presented evidence showing that Ensign acknowledged its centralized control over its cluster companies . . . . [¶] Castaneda also presented evidence showing a seamless flow of corporate officers between Ensign and its clusters." (Typed opn. 5.)

Such indicia of ownership and control are common to, and indeed an inherent aspect of, most parent-subsidiary relationships. Consequently, the opinion's vague "some control" test opens the floodgates to the employees of subsidiaries suing any parent company as a deep pocket for employment-related transgressions. Parent companies—as owners of the subsidiary—can almost always be said to exercise "some" control.

This Court should grant review to provide a clear and intelligible standard as to when the employees of subsidiaries can sue parent companies for employment-related transgressions—a standard that avoids exposing (as the published opinion does) virtually every California holding or other parent company to suit as an "employer."

3. The Opinion Undermines California Public Policy And Injects Confusion Into California Law By Potentially Eviscerating Settled Limits On Parent Company Liability For Subsidiary Conduct.

The opinion's "some control" test is more than just vague, confusing and limitless. It also contravenes California public policy by undermining the ability of legitimate parent companies to shield themselves from liability for their subsidiaries' employment-related conduct. The very reason that parent companies incorporate and create subsidiaries is to isolate liabilities. Public policy encourages such limited-liability structures: "[S]ociety recognizes the benefits of allowing persons and organizations to limit their business risks through incorporation . . . ." (*Las Palmas Associates v. Las Palmas Center Associates* (1991) 235 Cal.App.3d 1220, 1249.) "Limited liability is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted." (*Anderson v. Abbott* (1944) 321 U.S. 349, 362.)

Since public policy permits the incorporation of separate companies for the very purpose of isolating liabilities, California courts disregard corporate separateness and hold parent companies liable for subsidiary-related conduct "only in narrowly defined circumstances and only when the ends of justice so require." (*Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 301.) "[P]iercing the corporate veil" is "the rare exception, applied in the case of fraud or certain other exceptional circumstances." (*Dole Food Co. v. Patrickson* (2003) 538 U.S. 468, 475.) Courts hold parent companies liable for subsidiary-level conduct only where the companies are alter egos; and "[a]lter ego is

an extreme remedy, sparingly used." (*Sonora Diamond Corp. v. Superior Court*, *supra*, 83 Cal.App.4th at p. 539; accord, *Las Palmas Associates v. Las Palmas Center Associates*, *supra*, 235 Cal.App.3d at p. 1249 ["sound public policy dictates that imposition of alter ego liability be approached with caution"]; Friedman, Cal. Practice Guide: Corporations (The Rutter Group 2014) ¶ 2:51.1, p. 2-28 ["(i)n practice, courts regard the alter ego doctrine as a *drastic remedy* and disregard the corporate form only *reluctantly* and *cautiously*," emphasis in original].)

The opinion's "some control" test, in contrast, is not a sparing or cautious remedy. As the inherent nature of a parent-subsidiary relationship makes it easy to show that a parent has "some control" over the subsidiary, the opinion—under the guise of deeming the parent an additional "employer"—threatens to make parent-company liability the rule in employment cases, rather than the exception.

The "some control" test also will allow employment plaintiffs to circumvent settled restrictions that California courts have imposed on alter ego liability to protect limited-liability structures. To pierce the corporate veil and hold a parent liable as an alter ego for subsidiary-level conduct, a plaintiff must prove: "(1) such a *unity of interest and ownership* between the corporation and its equitable owner that no separation actually exists, and (2) an *inequitable result* if the acts in question are treated as those of the corporation alone." (*Leek v. Cooper* (2011) 194 Cal.App.4th 399, 417, emphasis added.) "[*B*]*oth* of these requirements must be found to exist before the corporate existence will be disregarded . . . ." (*Associated Vendors, Inc. v. Oakland Meat Co.* (1962) 210 Cal.App.2d 825, 837, emphasis in original.)

The opinion's "some control" yardstick for deeming holding and other parent companies an "employer" is incompatible with, and will allow employment plaintiffs to end run, the "unity of interest" requirement for alter ego liability. Under alter ego law, a parent company's mere ownership and control of a subsidiary is not a sufficient basis to hold the parent liable, because "[t]he mere fact of sole ownership and control does not eviscerate the separate corporate identity that is the foundation of corporate law." (*Katzir's Floor & Home Design, Inc. v. M-MLS.com* (9th Cir. 2004) 394 F.3d 1143, 1149 [applying California law].) "[D]omination of ownership and control . . . is not significant in isolation." (*Mid-Century Ins. Co. v. Gardner* (1992) 9 Cal.App.4th 1205, 1215.) Rather, there must be "such a unity of interest and ownership . . . that *no separation*

actually exists . . . ." (*Leek v. Cooper*, *supra*, 194 Cal.App.4th at p. 417, emphasis added; accord, *Mesler v. Bragg Management Co.*, *supra*, 39 Cal.3d at p. 300.) The opinion's "some control" test radically departs from this settled liability limit.

The "some control" standard also will permit employment plaintiffs to side step the second alter-ego requirement—the need for an "inequitable result." The required "inequitable result" is more than a need to ensure the payment of claims; rather, there "must be some conduct *amounting to bad faith* that makes it inequitable for [the owner] to hide behind the corporate form." (*Leek v. Cooper*, *supra*, 194 Cal.App.4th at p. 418, emphasis added; accord, *Westinghouse Electric Corp. v. Superior Court* (1976) 17 Cal.3d 259, 279 ["separate corporate or partnership existence will not be disregarded except in instances of bad faith"]; *Cleaning & P. Co. v. Hollywood L. Service* (1932) 217 Cal. 124, 129 ["(b)ad faith in one form or another must be shown before the court may disregard the fiction of separate corporate existence"].) The alter ego doctrine prevents "corporations from *misusing* the corporate laws by the device of a *sham* corporate entity formed for the purpose of *committing fraud or other misdeeds*." (*Sonora Diamond Corp. v. Superior Court*, *supra*, 83 Cal.App.4th at p. 538, emphasis added.) Liability applies only where the statutory privilege of limited-liability laws is "abused" or "perverted," instead of "used for legitimate business purposes." (*Mesler v. Bragg Management Co.*, *supra*, 39 Cal.3d at p. 300.)

The opinion's "some control" test, in contrast, permits the imposition of liability on parent companies as additional "employers" without any showing of bad faith or abuse of limited-liability laws. Under the opinion, entirely legitimate parent companies, formed in reliance on settled California law that respects and encourages the use of limited-liability structures, are subject to suit by their subsidiaries' employees under the guise of being deemed an additional "employer."

In sum, the opinion's vague, confusing "some control" test will let plaintiffs circumvent settled restrictions that California courts have traditionally and uniformly imposed to limit parent-company liability. This Court should grant review to clarify California law and prevent a limitless "some control" yardstick that will substantially increase parent-company liability for subsidiary-related employment conduct.

Alternative Request For Depublication

Given the threat to California public policy, if this Court is not inclined to grant review, it should order depublication of the opinion. (9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 816, p. 886 [Supreme Court can depublish opinions where "the opinion is thought to contain erroneous or mistaken statements of law and should not be citable as a precedent"].)

Conclusion

The Court of Appeal's published opinion injects great uncertainty into California corporate and employment law. It allows the employees of subsidiaries to sue parent companies over subsidiary-related employment conduct even where the requirements for alter ego liability are absent. It pronounces a vague, limitless "some control" test that will open the floodgates to employment claims against parent companies. ASCDC and ADC-NCN respectfully request that the Court grant the petition for review to clarify and resolve California law on this important issue. At a bare minimum, the opinion should be depublished.

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PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES:

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is 5900 Wilshire Boulevard, 12th Floor, Los Angeles, California 90036.

On November 14, 2014, I served the foregoing document described as **LETTER BRIEF OF ASCDC AND ADC-NCN, AS AMICI CURIAE, IN SUPPORT OF PETITION FOR REVIEW, OR IN THE ALTERNATIVE, DEPUBLICATION** on the interested parties in this action by placing a true copy thereof enclosed in sealed envelopes as stated below.

BY MAIL: I caused such envelope to be deposited in the mail at Los Angeles, California. The envelope was mailed with postage thereon fully prepaid as follows:

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Executed on November 14, 2014, at Los Angeles, California.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Anita F. Cole