MUNGER, TOLLES & OLSON LLP

560 MISSION STREET
TWENTY-SEVENTH FLOOR
SAN FRANCISCO, CALIFORNIA 94105-2907
TELEPHONE (415) 512-4000
FACSIMILE (415) 512-4077

355 SOUTH GRAND AVENUE
LOS ANGELES, CALIFORNIA 90071-1560
TELEPHONE (213) 683-9100
FACSIMILE (213) 687-3702

RONALD L. OLSON†
ROBERT E. DENHAM
JEFFREY I. WEINBERGER
CARY B. LERMAN
GREGORY P. STONE
BRAD D. BRIAN
BRADLEY S. PHILLIPS
GEORGE M. GARVEY
WILLIAM D. TEMKO
STEPHEN M. KRISTOVICH
JOHN W. SPIEGEL
TERRY E. SANCHEZ
STEVEN M. PERRY
MARK B. HELM
JOSEPH D. LEE
MICHAEL R. DOYEN
MICHAEL E. SOLOFF
GREGORY D. PHILLIPS
KATHLEEN M. McDOWELL
GLENN D. POMERANTZ
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JAY M. FUJITANI
O'MALLEY M. MILLER
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HENRY WEISSMANN
KEVIN S. ALLRED
BART H. WILLIAMS
JEFFREY A. HEINTZ
JUDITH T. KITANO
KRISTIN LINSLEY MYLES
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STEPHEN D. ROSE
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MARTIN D. BERN
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HOJOON HWANG
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C. DAVID LEE
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BRETT J. RODDA
SEAN ESKOVITZ
FRED A. ROWLEY, JR.
KATHERINE M. FORSTER
BLANCA FROMM YOUNG
RANDALL G. SOMMER
MARIA SEFERIAN
MANUEL F. CACHÁN
ROSEMARIE T. RING
JOSEPH J. YBARRA
TODD J. ROSEN
TRUC T. DO
MELINDA EADES LeMOINE
SETH GOLDMAN
GRANT A. DAVIS-DENNY
JONATHAN H. BLAVIN
DANIEL B. LEVIN
MIRIAM KIM
MISTY M. SANFORD
KATHERINE KU
HAILYN J. CHEN
BETHANY W. KRISTOVICH
SUSAN R. SZABO
KIMBERLY A. CHI
JACOB S. KREILKAMP
ERIC P. TUTTLE
HEATHER E. TAKAHASHI
KEITH R.D. HAMILTON, II
SORAYA C. KELLY
JEFFREY Y. WU
ALISSA BRANHAM
ADAM R. LAWTON
JENNY H. HONG

†A PROFESSIONAL CORPORATION

AARON SEIJI LOWENSTEIN
LAURA D. SMOLOWE
MATTHEW A. MACDONALD
MARGARET G. MARASCHINO
ESTHER H. SUNG
BENJAMIN J. MARO
MICHAEL J. MONGAN
KYLE A. CASAZZA
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CLAIRE YAN
ALLISON S. WOODS
JESLYN A. MILLER
MARK R. SAYSON
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RAY S. SEILIE
NICHOLAS C. SOLTMAN
ADAM I. KAPLAN
AMELIA L.B. SARGENT
KENNETH M. TRUJILLO-JAMISON
BRYAN H. HECKENLIVELY
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JENNIFER A. JONES
LAURA K. LIN
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TINA W. ARROYO
MARI OVERBECK
JESSE MAX CREED
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ERIC K. CHIU
SARAH L. GRAHAM
JESSICA BARCLAY-STROBEL
ZACHARY M. BRIERS
JENNIFER M. BRODER
CHRISTINA P. MONIODIS
JOHN P. MITTELBACH
SARAH GARBER
SAMUEL T. GREENBERG
CAROLINE M. McKAY
EMILY B. VIOLIETTA
WILLIAM J. EDELMAN
KEVIN L. BRADY
EMILY R.D. MURPHY
ELLEN MEDLIN RICHMOND
NICOLE S. PHILLIS
JORDAN D. SEGALL
DANIEL J. HARRIS
VICTORIA A. DEGTYAREVA
WESLEY T.L. BURRELL
CHRISTA L. CULVER
ANYA J. GOLDSTEIN
KAREN A. LORANG
KURUVILLA J. OLASA
MATTHEW D. ROWEN
KEVIN H. SCOTT
JUSTIN P. RAPHAEL
HANNAH E. SHEARER
ELIA HERRERA
ROBERT W. GRAY, JR.
THOMAS P. CLANCY
JOSHUA PATASHNIK
ERIC C. TUNG
GUHA KRISHNAMURTHI
JOSHUA S. MELTZER
SARA E. CROLL
ANDREW G. PROUT
THANE REHN
ADAM B. WEISS
ROSE LEDA EHLER
AMY L. GREYWITT
ANDREW Z. WOLSTAN

OF COUNSEL

RICHARD D. ESBENSHADE†
ROBERT K. JOHNSON†
ALAN V. FRIEDMAN†
RONALD K. MEYER
ALLISON B. STEIN
SUSAN E. NASH
WILLIANA CHANG
MIRANDA KANE
BRAD SCHNEIDER

E. LEROY TOLLES
(1922-2008)

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Writer's Direct Contact
(213) 683-9259
(213) 593-2859 FAX
fred.rowley@mto.com

The Hon. 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 District, Division 6, Case No. B249119

Dear Chief Justice and Associate Justices:

In *Castañeda v. The Ensign Group, Inc.*, the Second Appellate District adopted a novel standard for determining a parent corporation's liability for employment claims brought by its subsidiary's employees. Under that standard, so long as a parent company "owns" its subsidiary and has "some control" over it, the parent can be treated as its subsidiary's employer for purposes of employment-related lawsuits—even if the parent's "control" is limited to administrative matters that have nothing to do with the basis of the lawsuit.

Applying this new standard, *Castañeda* held that the defendant parent corporation was not entitled to summary judgment on plaintiff's wage-and-hour claim simply because it owned and exercised "some" administrative control over the subsidiary employing him. This holding is at odds with the rule, set out by this Court in *Patterson v. Domino's Pizza LLC* (2014) 60 Cal.4th 474, that a corporation's liability for its affiliate's employment matters turns on its ability to control the specific operations at the heart of the plaintiff's case. *Patterson* held that a franchisor that does not exercise this sort of control over the relevant operations of its franchisee is entitled to summary judgment in a lawsuit brought by a franchisee employee. That holding

applies with equal force in the parent-subsidiary context, in which parent companies, like franchisors, may provide some administrative infrastructure for their subsidiaries, but frequently lack the ability to control the subsidiaries' employment decisions.

By ignoring *Patterson*, and the many appellate decisions requiring employee control by the parent corporation, the *Castañeda* opinion exposes parent companies to employment claims, and potentially other claims, arising out of subsidiary operations that the parent did not dictate and had no ability to change. If left standing, it would leave corporations in California uncertain about the scope and continuing validity of longstanding limitations on a corporation's liability, forcing reorganization and potentially driving them out of the state.

The Chamber of Commerce of the United States respectfully urges this Court to vacate the Court of Appeal's decision in *Castañeda* and remand the case for reconsideration in light of *Patterson*, which was issued after the Court of Appeal's first ruling in *Castañeda*. In the alternative, the Chamber urges the Court to depublish the decision in *Castañeda*.

I. Interest of the Chamber of Commerce of the United States

The Chamber of Commerce of the United States is the world's largest business federation, representing 300,000 direct members and indirectly representing the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country, including in California.

The companies that the Chamber represents routinely make decisions about the formation and structure of the entities through which they do business. To do so effectively, they must be able to reference and apply sensible rules delimiting a corporation's liability to the employees and creditors of its subsidiaries and affiliates. The Chamber thus has an acute interest in the proper and predictable application of those rules in the courts.

II. The Court Should Vacate and Remand *Castañeda* in Light in *Patterson*

Castañeda did not mention, much less apply, this Court's decision in *Patterson*, which grounds a corporation's liability for its affiliate's alleged employment violations in the corporation's "right of general control over the *relevant* day-to-day operations" implicated by the lawsuit. (*Patterson*, *supra*, 60 Cal.4th at p. 503.) Under *Patterson*, a corporation may be liable to an affiliate's employee only if there is a clear nexus between the employee's claims and the corporation's area of operational control. (*Id.* at 478.) Because the *Patterson* standard would yield a different result than that reached in *Castañeda*, this Court should vacate and remand *Castañeda* for reconsideration in light of *Patterson*.

The plaintiff in *Patterson* alleged she was sexually harassed by a coworker during her employment at a Domino's Pizza franchise. She sued both the franchisee, who was undisputedly her employer, and the franchisor, Domino's Pizza LLC. In determining whether

there was a triable issue of fact as to the liability of Domino's for the alleged wrongful acts, this Court surveyed cases analyzing whether a corporation can be found to be the joint employer of its corporate affiliate's employee. It concluded that joint liability can be imposed only when the would-be defendant has assumed a high degree of control over day-to-day operations and employment matters, including the specific operations at the heart of the plaintiff's claims. (*Patterson*, *supra*, 60 Cal.4th at pp. 494, 497, 503 [joint liability appropriate where corporate affiliate of employer "has retained or assumed the right of general control over *the relevant* day-to-day operations"] [italics added].)

Applying this test, *Patterson* assessed the extent of control that the franchisor Domino's exercised over its franchisee's operations. This Court observed that the contract between Domino's and its franchisee placed responsibility for employment functions at the franchisee's store location on the shoulders of the franchisee. (*Patterson*, *supra*, 60 Cal. 4th at pp. 500-501.) It then went on to analyze the *practical* control that Domino's exercised over the franchisee's operations. This Court noted, for example, that Domino's:

- "[P]rovided new employees with orientation materials in both electronic and handbook form," (*id* at p. 501), including a "computer system . . . cover[ing] pizza-making, store operations, safety and security, and driving instructions." (*Id.* at p. 482.)

- Provided some training to the franchisee related to sexual harassment. (*Id.* at p. 482, fn. 3.)

- Provided advice to the franchisee related to hiring and firing decisions, through a Domino's "area representative." The representative told the franchisee to "get rid" of the employee accused of sexual harassment (*id.* at p. 502), and the franchisee testified in deposition that he felt he had to "say yes" to and "play ball" with the area leader (*id.* at p. 485).

Patterson held that these actions were inadequate to raise a triable issue of fact as to whether Domino's possessed or exercised the requisite control over the day-to-day operations relevant to addressing sexual harassment issues. (*Id.* at pp. 501-502.) Providing substantial administrative support, including training that bore directly on the plaintiff's claims, and advice about employment matters did not suffice to demonstrate that Domino's was the employer of the employee accused of misconduct. Accordingly, the Court concluded that Domino's was entitled to summary judgment. (*Ibid.*)

In *Castañeda*, the plaintiff offered even less evidence that the parent company, Ensign, possessed day-to-day control over the relevant operations of the subsidiary, Cabrillo. As a threshold matter, as the petition for review points out (Pet. pp. 9-10, fn.3), much of plaintiff Castañeda's supposed evidence of control related to contract services provided to Cabrillo by a third-party Ensign affiliate called Ensign Facility Services, Inc. ("EFS"). EFS provided a

"Service Center" with resources related to informational technology, human resources, accounting, and payroll systems, as well as "policy and training videos" for newly hired employees and operational advice from consultants. (Slip op. at pp. 5-6.) But even if these services could somehow be traced or ascribed to The Ensign Group—a connection the Court of Appeal did not attempt to establish—they would not have adequately demonstrated control under *Patterson*. As noted, *Patterson* held that the provision of a centralized computer system, training resources, and advice about operations did not support an inference of day-to-day control adequate to defeat summary judgment.

The plaintiff in *Castañeda* also offered his own testimony that he believed he was "hired" by Cabrillo and Ensign (slip op. at p. 7), and pointed out "Ensign Group" signs at the Cabrillo facility. Crucially, however, the plaintiff presented no evidence directly demonstrating that Ensign "assumed the traditional right of general control an 'employer' or 'principal' has over . . . *relevant* day-to-day aspects of the workplace behavior of the franchisee's employees." (*Patterson*, *supra*, 60 Cal.4th at p. 503, italics added.) Castañeda never showed, in other words, that Ensign set his hours and wages, controlled his meal breaks, or established compulsory wage-and-hour policies for its subsidiaries. Under *Patterson*, then, Ensign was entitled to summary judgment.

In refusing to grant Ensign summary judgment, the *Castañeda* Court placed great significance on the fact that "*Ensign owns Cabrillo*." (Slip op. at p. 4 [italics in original].) But *Patterson* placed no such talismanic significance on the formal relationship between the employer entity and the affiliate alleged to be a joint employer. Instead, *Patterson* rejected the notion that the franchisor-franchisee arrangement should "*automatically* saddle the franchisor with responsibility for employees of the franchisee" because such a rule would "violate" the legitimate "operational division" between franchisee and franchisor. (*Patterson*, *supra*, 60 Cal.4th at p. 478.) The same holds true in the parent-subsidiary context; grounding parent company liability on the parent's ownership of its wholly owned subsidiary would violate the "well recognized" distinction between parent and subsidiary. (Friedman, et al., Cal. Practice Guide: Corporations (The Rutter Group 2014) ¶ 2:52.7) The result would be to erode the basic principle that "a parent corporation will *not* be held liable for its subsidiary's debts simply because of its stock ownership or the existence of common directors and officers." (*Ibid.*)

Because *Castañeda* glosses over the distinction between parent and subsidiary corporations, its reasoning cannot be squared with *Patterson*'s respect for the "operational divisions" among affiliated entities. Under the reasoning of *Castañeda*, if the parent owns the subsidiary, and the parent exercises "some control" over the sub, then summary judgment should be denied. (Slip op. at p. 1.) But virtually all parent/subsidiary relationships would meet this standard, making the *Castañeda*'s test both unworkable and in tension with the requirement that an employment defendant "exhibit the traditionally understood characteristics of an 'employer.'" (*Patterson*, *supra*, 60 Cal.4th at p. 478.) The Court should grant review, vacate the decision below, and remand the case for reconsideration in light of *Patterson*.

III. In the Alternative, the Court Should Depublish the Opinion in *Castañeda*

In the event this Court decides against granting review, it should depublish the opinion in *Castañeda* to minimize its adverse impact on the law governing parent company liability for subsidiaries' employment matters. In holding a parent corporation liable to its subsidiaries employees merely because the parent owned the subsidiary and exercised "some control" over it, *Castañeda* departed from prior cases holding that "the mere fact of common ownership and financial control" is insufficient to establish parent corporation liability, and that day-to-day operational control is instead required. (*Laird v. Capital Cities/ABC, Inc.* (1998) 68 Cal.App.4th 727, 740; *Maddock v. KB Homes, Inc.* (C.D.Cal. 2007) 631 F.Supp.2d 1226, 1238-1242; *Cellini v. Harcourt Brace & Co.* (S.D.Cal. 1999) 51 F.Supp.2d 1028, 1034.) If widely adopted, the *Castañeda* Court's reasoning would expand parent corporations liability for their subsidiaries' employment-related actions. To guard against such liability, many corporations in California would be faced with the choice of reorganizing or moving subsidiary operations outside the state. Depublication would help avoid these results.

Before *Castañeda*, an employment plaintiff claiming an employment relationship with a particular entity could only overcome summary judgment by presenting evidence that the entity (1) had knowledge of, and "the power to prevent," the alleged violations (*Martinez v. Combs* (2010) 49 Cal.4th 35, 70); or (2) that the entity exercised control over the day-to-day operations underlying the plaintiff's claims (*id.* at p. 71; *Laird*, supra, 68 Cal.App.4th at p. 740; see also *Patterson, supra*, 60 Cal.4th at p. 503). The courts of appeal have likewise consistently looked to decisionmaking authority and indicia of control over the relevant aspects of the employment relationship in determining joint employment liability. (See, e.g., *Guerrero v. Superior Court* (2013) 213 Cal.App.4th 912, 949 [demurrer of county on ground that county was not joint employer of provider of in-home care services to a disabled individual should have been overruled where the county authorized the hire of the worker, determined the specifics tasks the worker would perform, determined how the worker would be paid, and could effectively terminate the worker]; *Vernon v. State* (2004) 116 Cal. App. 4th 114, 126-27 [employment discrimination plaintiff did not adequately plead that state exercised significant control over his employment, including training him, controlling disciplinary, promotion, or termination decisions, or "determin[ing] the specific nature of the daily work he performed"]; *cf. Estrada v. Fedex Ground Pckg. Sys., Inc.* (2007) 154 Cal.App.4th 1, 10 [the "essence" of the common-law test for distinguishing an employee from an independent contractor is "control of details"].) These principles also hold true in the parent-subsidiary context, in which "the critical inquiry requires an examination of which entity made the final decisions" related to the relevant employment matters. (*Cellini, supra*, 51 F.Supp.2d at p. 1034; accord *Maddock, supra*, 631 F.Supp.2d at pp. 1238-40.)

Under either the "power to prevent" or "control" standards, the touchstone is the entity's involvement in and decisionmaking authority over the operations relevant to the

plaintiff's claims. Thus, in *Martinez v. Combs*, produce merchants who had a business relationship with the farmer who employed the plaintiff agricultural workers were held *not* to be plaintiffs' joint employers because the merchants had no power to prevent plaintiffs from working without pay and did not exercise control over plaintiffs' wages and hours. (*Martinez*, *supra*, 49 Cal.4th at pp. 70-72.) This approach is consistent with *Patterson*'s focus on the degree of control the franchisor exercised over the relevant franchisee operations.

In the face of this authority, *Castañeda* took the novel step of placing decisive weight on a factor unrelated to control. According to *Castañeda*, The Ensign Group's *ownership* of Cabrillo was a load-bearing factor in treating Cabrillo's employees as employees of its parent corporation. (Slip op. at pp. 1, 4.) But *Castañeda* offered no relevant authority for this novel principle, and there is none. To establish the relevance of corporate ownership, *Castañeda* pointed to a single internal quotation from *Martinez* stating that "the basis of liability is the owner's failure to perform the duty of seeing to it that the prohibited condition does not exist." (Slip op. at p. 4.) But a reading of *Martinez* makes clear that the Court below misconstrued this sentence and its import. The quoted sentence is drawn from a 1917 case from a New York appellate court that interpreted an early prohibition on child labor. (See *Martinez*, *supra*, 49 Cal.4th at p. 69 [citing *People ex rel. Price v. Sheffield Farms* (1917) 180 A.D. 615].) *Martinez* interpreted the *Sheffield Farms* case and others like it as establishing that where "a proprietor" of a business fails to stop misconduct occurring within the enterprise, "*while having the power to do so*," the proprietor may face liability as an employer. Thus *Sheffield Farms*, as interpreted by this Court in *Martinez*, stands for the proposition that a person who has "power over"—i.e., the ability to control—employment matters may be deemed an employer. Far from treating *ownership* alone as "refut[ing] . . . claims of lack of control and responsibility" (*Castañeda*, slip op. at p. 4), *Martinez* made very clear that, where an entity has no "power to prevent" the alleged employment law violations, its "business relationship" with the employer "does not transform [it] into the employer." (*Martinez*, *supra*, at p. 70.)

Castañeda's focus on parent corporation ownership of a subsidiary also cannot be squared with *Laird v. Capital Cities/ABC, Inc.*.[1] *Laird* analyzed whether a parent company was entitled to summary judgment on plaintiff's claims of employment discrimination by the parent's subsidiary. The court acknowledged that some *federal* Title VII cases analyze "common ownership or financial control" as a factor in determining whether a corporation is a plaintiff's employer within the meaning of Title VII, but noted that "common ownership or control alone is *never enough* to establish parent liability." (*Id.* at p. 738, italics added.) Instead, "the critical question is 'what entity made the final decisions regarding employment matters related to the person claiming discrimination?'" (*Ibid.*) Considering the parent corporation's ownership, *Laird* observed, "would create a triable issue of material fact in every case" because "these facts

[1] *Laird*'s resolution of issues related to waiver of evidentiary objections (which is not relevant to this case) was disapproved in *Reid v. Google, Inc.* (2010) 50 Cal.4th 512.

exist in every parent-subsidiary situation." (*Ibid.*) *Laird* thus did not place analytic weight on the parent company's ownership of plaintiff's employer, but deemed summary judgment warranted based upon the plaintiff's failure to demonstrate the parent's control over the subsidiary's employment decisions. (*Id.* at pp. 742-743.)

In inserting the previously irrelevant question of ownership into the joint employment analysis, *Castañeda* borrowed heavily from the alter ego doctrine. Under that doctrine, "[b]efore a corporation's obligations can be recognized as those of a particular person," the plaintiff must show (1) "unity of interest" between the person or corporation resisting liability and the other corporation, and (2) an "inequitable result" that would follow from a decision to respect the corporation as a separate entity. (*Leek v. Cooper* (2011) 194 Cal.App.4th 399, 411.) Some of the factors *Castañeda* deemed crucial, including Ensign and Cabrillo's joint ownership (slip op. at p. 4) and their overlapping corporate officers (*id.* at p. 5), are frequently cited in analyzing the "unity of interest" aspect of alter ego liability. (*E.g., Baize v. Eastridge Cos.* (2006) 142 Cal.App.4th 293, 303.) But the alter ego cases considering these factors require that the parent corporation abuse the corporate form, using it "to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose." (*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538.) *Castañeda*, however, does not even mention that requirement, instead finding that ownership alone "refutes . . . claims of lack of control and responsibility." (Slip op. at p. 4.) This new rule creates a gaping exception, in employment cases, to the "well recognized" principle that "[t]he law permits the incorporation of businesses for the very purpose of isolating liabilities among separate entities—i.e., parent and subsidiary corporations." (Friedman, et al., Cal. Practice Guide, *supra*, ¶ 2:52.7, citation and quotation marks omitted.)

Castañeda thus relieves employment plaintiffs of the burden of demonstrating either that a parent corporation abused the corporate form, becoming its subsidiary's alter ego, or that the parent's pervasive control over the relevant day-to-day employment matters transformed it into the plaintiff's employer. Instead, under *Castañeda*, a plaintiff need only prove that the defendant parent owns the subsidiary and exercises "some control"—which may be nothing more than "the degree of direction and oversight normal and expected from the status of ownership," including "common characteristics [such] as interlocking directors and officers, consolidated reporting, and shared professional services." (*Sonora*, *supra*, 83 Cal.App.4th at pp. 540-541.) *Castañeda*'s novel "ownership-plus-some-control" test thus considerably diminishes, and, in the case of a wholly owned subsidiary, arguably eliminates, an employment plaintiff's burden to demonstrate that a parent' company's separate corporate form ought not to be respected.

The practical result will be to expose parent corporations in California to claims by the employees of their wholly owned subsidiaries. If *Castañeda* is allowed to stand and becomes widely adopted, the effect on corporations would be significant. The "parent" or "holding" company structure is in fact a venerable and legitimate means of defining the universe

of risks and liabilities faced by the relevant company. (See *Toho-Towa Co. v. Morgan Creek Productions, Inc.* (2013) 217 Cal.App.4th 1096, 1107 ["[S]ociety recognizes the benefits of allowing persons and organizations to limit their business risks through incorporation."].) Clearly delimiting the scope of the parent corporation's liabilities allows investors and lenders to assess not just the corporation's general creditworthiness, but also its exposure to employment and tort liabilities. *Castañeda* upsets this useful and predictable system by creating a new rule for employment liabilities.

In the wake of the published *Castañeda* decision, parent corporations with subsidiaries operating in California are faced with several unattractive options. First, they may choose to maintain their current corporate organization and face exposure in employment lawsuits which they may have little practical ability to avoid. Under *Castañeda*, courts may focus on the fact of formal ownership to impose liability on a parent corporation, without examining whether the parent and subsidiary might have structured their relationship such that the parent does not hire or control the employees whose daily actions are the source of labor and employment claims. A parent company held liable in this circumstance would face liability for the acts of individuals whom the parent might not even be able to discipline or fire. Expanding liability in this way could create turmoil for parent companies without meaningful deterrence of labor and employment violations.

Second, parent companies may choose to restructure their operations, devolving administrative functions such as human resources and payroll to operating subsidiaries in the hope that the parent in such a decentralized organization will no longer exercise "some control" and can thus escape *Castañeda* liability. This sort of reorganization would undermine the efficiencies of parent/subsidiary structures, requiring subsidiaries of the same parent company to maintain redundant administrative policies and operations. And even those corporations undertaking such reorganization might still face potential liability due to *Castañeda*'s focus on ownership. Finally, a parent corporation facing *Castañeda* may attempt a more radical reorganization, spinning off wholly owned subsidiaries, or can simply cease to do business in the state.

The Court can, and should, avoid visiting these adverse consequences on California businesses. By depublishing *Castañeda*, it can minimize the decision's potentially destabilizing effect on the California law governing parent-subsidiary liability.

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For these reasons, the Chamber urges this Court to vacate the decision in *Castañeda* and remand it for reconsideration in light of this Court's recent decision in *Patterson*. In the alternative, this Court should order *Castañeda* depublished, to avoid confusion in the law

of parent-corporation liability and to prevent *Castañeda*'s adverse impacts on corporations whose subsidiaries operate in California.

The Chamber thanks the Court for considering its views.

Respectfully submitted,

Fred A. Rowley, Jr.

PROOF OF SERVICE

STATE OF CALIFORNIA, COUNTY OF SAN FRANCISCO

At the time of service, I was over 18 years of age and **not a party to this action**. I am employed in the County of San Francisco, State of California. My business address is 560 Mission Street, Twenty-Seventh Floor, San Francisco, CA 94105-2907.

On December 5, 2014, I served true copies of the following document(s) described as

U.S. CHAMBER OF COMMERCE AMICUS LETTER

on the interested parties in this action as follows:

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Executed on December 5, 2014, at San Francisco, California.

Barbara Palomo

SERVICE LIST

John Castañeda v. The Ensign Group, Inc., et al.

Virginia Reyes Villegas
Villegas/Carrera LLP
170 Columbus Avenue, Suite 300
San Francisco, CA
Counsel for Plaintiff and Appellant

Hernaldo Jose Baltodano
Erica Flores Baltodano
Baltodano & Baltodano LLP
1411 Marsh Sreet, Suite 102
San Luis Obispo, CA
Counsel for Plaintiff and Appellant

Allison Lee Ehlert
Ehlert Appeals
2543 Edwards Avenue
El Cerrito, CA
Counsel for Plaintiff and Appellant

John F. Querio
Horvitz & Levy LLP
15760 Ventura Boulevard, 18th Floor
Encino, CA
Counsel for Defendants and Respondents

Dawn Terri Collins
Ogletree Deakins
400 S Hope Street, Suite 1200
Los Angeles, CA
Counsel for Defendants and Respondents

Lisa Perrochet
Horvitz & Levy, LLP
15760 Ventura Boulevard, Suite 1800
Encino, CA
Counsel for Defendants and Respondents

Honorable Dodie A. Harman
San Luis Obispo County Superior Court
1035 Palm Street, Dept. 3
San Luis Obispo, CA, 93408
Trial Court, Case No. C110466

California Court of Appeal
Second Appellate District, Division Six
Court Place
200 East Santa Clara Street
Ventura, CA 93001
Court of Appeal, Case No. B249119