

# **Who Do You Represent? Pitfalls and Perils of Representing an Organization**<sup>1</sup>

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## **Introduction**

In almost every long term care case, as well as other types of medical negligence cases, one or more of the defendants is some form of legal entity, usually a corporation. Long term care cases are extremely challenging to defend, but representing an organization such as a corporation provides additional issues and challenges in an already difficult environment, from both ethical and substantive standpoints. This paper will attempt to explore some of the most common issues that arise during the defense of an organization in a long term care action. Areas that will be discussed include:

1. Common ethical issues that arise in the defense of organizations in long term care cases;
2. Defending allegations of “corporate negligence”; and
3. Defending attempts to “pierce the corporate veil”.

Obviously, each of these topics could stand on their own as a full topic for a paper or legal treatise, but I have attempted to provide a general overview of these issues to assist the practitioner in recognizing and analyzing some of the more challenging aspects of representing organizations in these cases. The list is not exhaustive, and other issues do arise from time to time in these cases which are not included in this paper, but I felt the issues addressed were the most common and most practical for lawyers who are frequently involved in the defense of organizations in all types medical negligence cases.

## **I. Common Ethical Issues in the Defense of Organizations**

### **A. Who is the Client?**

Most organizations that are involved in the ownership and operation of long term care facilities are some form of corporate entity created by statute. Frequently, there are multiple

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corporate entities involved with the operation of a single facility. One corporation may own the real estate where the facility is located and the property is leased to a separate organization that holds the license and operates the facility. Still another organization may be involved in the management of the facility and may employ some of the workers. It can get very complicated, both for the prosecution of a claim and the defense.

However, when counsel is retained to represent an organization that operates a long term care facility, the first issue that must be addressed is who the client actually is. In the case of a corporate defendant, the actual client is the corporation itself and not the shareholders, board of directors or officers. Obviously, a corporation or other legal entity can only act through its agents and employees, but the actual client is the corporate entity itself and not the individuals involved in the ownership and operation of the entity. See Rule 1.13(a) of the North Carolina Rules of Professional Conduct. However, the rules do not prohibit the lawyer from also representing a director, officer, employee or shareholder at the same time he is representing the corporation, if there is no conflict. See Rule 1.13(g) of the North Carolina Rules of Professional Conduct.

The lawyer owes his duty to the legal entity and the Rules of Professional Conduct apply to this attorney-client relationship just as it would if the lawyer was representing an individual.

## **B. Representing Multiple Entities in the Same Lawsuit**

Frequently, several entities are involved at various levels in the ownership and operation of a long term care facility. An example of such a situation is Corporation A owns the building and leases it to Corporation B, who holds the license to operate the long term care facility. Corporation C is a management company that provides specific management services to the facility pursuant to a contract with Corporation B, and may even employ some of the workers at the facility. Further complicating matters, these corporations may have overlapping ownership and management. If suit is filed by a resident or resident's family arising out of care rendered at the facility, usually all three corporations would be named as defendants. If they are all insured under the same liability policy, can the defense counsel represent all three corporate defendants? The answer to that question, like so many legal ethics questions, is "it depends".

Rule 1.7 of the North Carolina Rules of Professional Conduct prohibits the representation of two or more clients if the representation involves a "concurrent conflict of interest." However, if the representation of one or more clients is not "materially limited by the lawyer's responsibilities to another client", then there is no conflict and the representation can go forward. Basically, if all the defendants are in agreement with their respective roles and responsibilities in the case, as well as the defense of the case, then it is likely that counsel can represent the multiple defendants subject to a reevaluation of the situation should a conflict or potential conflict arise between the defendants or their positions in the case. In the situation outlined above, if all three defendants agree that Corporation A had nothing to do with the operation of the facility and that Corporation B and C were jointly responsible for anything that happened at

the facility, and all three are in agreement as to how to defend the case, then a single lawyer should be able to defend all three.

A conflict exists and separate counsel is necessary, however, if the named corporate defendants are pointing fingers at each other and there is a dispute amongst the defendants as to who is potentially responsible for the events at the facility. Also, if one or more of the defendants has a separate liability insurance policy, then it is likely that separate counsel would be necessary for the various defendants given the potential for conflicts and competing interests of not only the defendants, but their separate insurers.

### **C. Representing the Corporate Defendant and its Employee**

In many cases, the facility and the alleged negligent employee or employees will be named as co-defendants in a long term care case and the crux of the allegations will be that the facility employee was negligent in their care and treatment of the resident and that the negligence is imputed to the facility employer through the doctrine of *respondeat superior*.

Generally speaking, defense counsel should be able to represent both the corporate employer and the employee in most instances. See Rule 1.13(g) of the North Carolina Rules of Professional Conduct. However, even in these situations a conflict may arise between the corporate employer and the employee, necessitating separate counsel. For example, if there is an allegation that the employee engaged in some form of intentional conduct against the resident, which is outside the course and scope of the employment arrangement, then it is likely that a conflict exists since the corporate defendant would likely take the position that they were not responsible for such conduct and any damages caused by such conduct.

In addition, the employee may take the position that conduct by others in the organization was the cause of the incident and injury in question and that they were not. If that is the case, then a conflict would arise and separate counsel would be necessary.

Other potential conflicts include allegations of punitive damages against the corporate defendant and employee for the conduct of the employee, which the employee claims his employer participated in or condoned. If the employer denies participating in or condoning such conduct, then a conflict exists and separate counsel is required.

Another scenario is when the employee has his own separate liability policy from his employer, which happens from time to time especially with nursing personnel, then there is likely to be a conflict between the employer's insurer and the employee's insurer related to the conduct of the defense and litigation, which probably will require separate counsel. The same conflict would exist if the facility was self insured or didn't carry any liability insurance, but the employee defendant did. In that case, the defense counsel could not represent both the entity employer and the employee.

#### **D. Communications with Corporate Clients – Current Employees**

The attorney-client privilege and the attorney work product privilege extend to corporate clients. *Evans v. USAA*, 142 N.C. App. 18, 541 S.E.2d 782 (2001). The attorney-client privilege operates to protect confidential communications and their clients and its purpose is to encourage “full and frank communication” between attorneys and their clients. Since a corporate defendant can only act through its agents and employees, a frequent issue is who within an organization is protected by the attorney-privilege?

The burden of establishing the privilege rests with the claimant of the privilege. *Id.* A privilege exists if (1) the relationship of attorney-client existed at the time of the communication; (2) the communication was made in confidence; (3) the communication relates to the matter for which the attorney was retained; (4) the communication was made in the course of giving or seeking legal advice; and (5) the client has not waived the privilege. *Id.*, 142 N.C. App. at 32, 541 S.E.2d 791. How far down the employment chain does the privilege extend? In most long term care cases, the people involved in the care and treatment of the resident, and whose actions are called into question, are the staff – CNA’s, RN’s and LPN’s. Can counsel have privileged meetings with those employees in the defense of the organization without the fear of the contents of those meetings being subject to discovery?

No North Carolina case has analyzed the specific issue in detail, but the decision in *Evans* appears to have adopted the so-called “Upjohn test” which was named for the United States Supreme Court’s decision in *Upjohn Co. v. United States*, 449 U.S. 383 (1981). In *Upjohn*, the Supreme Court the so-called “control group” test in determining to which corporate employees the attorney-client privilege applied. Under the “control group” test, the privilege applied to communications with “upper management”, which would leave out a lot of other individuals in an organization. The Supreme Court broadened the protection to include lower level employees if certain criteria are met. Those criteria include: (1) communications with the attorney acting in his capacity as a lawyer for the organization; (2) communications were made at the direction of the organization to secure legal advice; (3) the employee was aware of the purpose of the communication; (4) the information sought was not available from upper management; (5) the communication concerned matters with the scope of the employees employment with the organization; and (6) the corporation treated the information confidentially.

It seems clear that these criteria can be met in most instances when discussing a resident’s care or a particular incident with the employee caregivers, especially those whose care has been questioned, and the attorney-client privilege should apply to those discussions and communications.

Another question that frequently arises in these cases is whether plaintiff’s counsel can ethically contact a represented corporate defendants current employees, primarily the staff who provided care to the resident, but are not “management” nor involved in the incident that gave rise to the lawsuit. According to Rule 4.2(a) of the North Carolina Rules of Professional Conduct, during the representation of a client, “A lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by

law or court order.” Comment 9 to Rule 4.2 specifically prohibits communication with a constituent of the organization, “who supervises, directs or consults with the organization’s lawyer concerning the matter or has authority to obligate the organization with respect to the matter or whose act or omission in connection with the matter may be imputed to the organization for purposes of civil or criminal liability.”

Consequently, it appears that it would be unethical for an attorney to communicate with an employee of an organization, who he knows is represented, when that employee was involved in the alleged act or omission that gives rise to the lawsuit. Given some of the broad allegations in long term care cases related to the care, treatment and supervision of a resident at a facility, and allegations of corporate or administrative negligence, it appears that there would be many instances where an opposing attorney could not ethically communicate with an employee of a represented organization in these cases, even if the employee is considered to be “rank and file”. However, the Rules do allow such communication in those instances where the employee is non-managerial; who has not communicated with counsel or participated in the defense of the case; and whose actions cannot be imputed to the organization to impose liability.

#### **E. Communications with Corporate Clients – Former Employees**

Anyone who is involved in long term care cases knows that there is high turnover among the staff at most residential care facilities, which makes the defense of these organizations very difficult. Frequently, the management and staff who were in place at the time of an alleged incident and who were actually involved in the alleged care that gives rise to a suit are no longer employed, for whatever reason, at the facility. Sometimes they have left on good terms and sometimes they have not. Obviously, counsel for the defendant organization needs to locate and speak to these ex-employees in order to properly defend most cases. This can be a challenge in and of itself, since many of those witnesses don’t want to be found or to cooperate, but an additional concern and issue is whether communications with the ex-employees is privileged and whether counsel for the plaintiff can communicate with the ex-employees without the consent of the lawyer representing the organization.

It doesn’t appear that the North Carolina courts have specifically addressed this issue, but many courts have taken an expansive view of the *Upjohn* case, discussed above, and have held that communications with former employees are protected if the *Upjohn* criteria are met. See, e.g., *In re Allen*, 106 F.3d 582 (4<sup>th</sup> Cir. 1997). This seems particularly apt in those situations where the former employee’s care and treatment of a resident have been called into question in the lawsuit and may be imputed to the organization in the case. Most defense counsel take the position that such communications are protected and in some situations counsel for the defendant organization are “retained” by the ex-employees for purposes of the lawsuit and any deposition. As will be discussed, *infra*, offering representation to former employees/witnesses involves additional ethical considerations outside of privilege issues.

A more complicated question is whether opposing counsel can communicate with an unrepresented former employee of a facility. If that person is a former management level person who participated in the defense of a case, or even a former staff employee who was previously involved with the defense of a case or who consulted with counsel, it appears that such

communications are privileged and opposing counsel cannot ethically communicate with those ex-employees. *See* 97 Formal Ethics Opinion 2. However, if the ex-employee did not participate in the defense of the organization or consult with counsel prior to leaving the employment of the organization, it appears that opposing counsel can communicate with the ex-employee even if that employee's conduct could be imputed to the organization. *Id.* This is the ABA approach and appears to be the approach of most states that have considered the issue. *See, e.g., Turnbull v. Topeka State Hospital*, 185 F.R.D. 645 (D. Kan. 1999). However, some states have ruled that such contacts are prohibited. *See, e.g., Armsey v. Medshares Mgmt. Services, Inc.*, 184 F.R.D. 184 (W.D.Va. 1998).

The question not specifically answered by the Rules or the Formal Ethics Opinion cited above is whether opposing counsel can communicate with an ex-employee whose conduct can be imputed to the organization in a case, who did not participate in the defense of the case while employed, but who has met with the organization's attorney relating to the defense of the case after leaving the employment of the organization. Based on the *Upjohn* analysis that such communications may be privileged, there is a strong argument that, while opposing counsel can communicate with those ex-employees, they cannot inquire into any privileged communications between defense counsel and the ex-employee. Apparently, most courts who have addressed this issue prohibit opposing counsel from asking the witness about privileged matters, although they can inquire as to the underlying facts related to the dispute. *See, e.g., Action Air Freight, Inc. v. Pilot Air Freight Corp.*, 769 F. Supp. 899 (E.D. Pa. 1991). Obviously, this is one of the many "gray" areas of legal ethics, but the safest course of action may be to avoid inquiry into communications between defense counsel and the ex-employee and simply communicate about the "facts" of the case.

#### **F. Offering Representation to Former Employee/Witness**

As previously referenced above, occasionally defense counsel will be retained to represent the former employee/witness related to the matter, primarily with respect to the deposition and testimony of that witness. If the ex-employee requests that the organization's attorney also represent him, and as long as there is no conflict or other ethical issue, then such representation is appropriate. However, primarily in the context of interviewing former employee witnesses and attending their depositions, there are times when it would be easier to protect communications with former employees if the attorney for the organization also represented the former employee. If the former employee doesn't ask to be represented by the organization's lawyer, can the attorney "offer" to represent the former employee?

Rule 7.3 of the North Carolina Rules of Professional Conduct governs contact with potential clients and states as follows:

A lawyer shall not by in-person, live telephone or real-time electronic contact solicit professional employment from a potential client when a significant motive for the lawyer's doing so is the lawyer's pecuniary gain, unless the person contacted: 1. is a

lawyer; or 2. has a family, close personal, or prior professional relationship with the lawyer.

Obviously, different lawyers can see this rule differently, but the main issues appear to be whether the “significant motive” of the offer of legal representation was for the lawyer’s “pecuniary gain”. Is it acceptable under the rule to offer to represent the former employee for free? That would seem to suggest that “pecuniary gain” was not the motive of the specific representation. However, an argument can be made that the offer to represent the former employee was made to make sure the communications between the attorney and the former employee were protected communications, which may enable the witness to perform better during the deposition, so that the defense of the case may be more successful, so that the lawyer for the organization would get more cases to defend and make more money in the long term, thereby making pecuniary gain the motive of the offer.

The solicitation of a client is a murky area of legal ethics and is fraught with potential misunderstanding and misinterpretation. Unfortunately, there doesn’t appear to be any opinion from the North Carolina State Bar on the specific issue, so the precise answer to this difficult question is not clear. However, the best course of action is probably to attempt to rely on the *Upjohn* analysis/argument outlined above to attempt to protect those communications and avoid the potential appearance of improper solicitation and the issues that may arise.

#### **G. Communication with the Facility Medical Director**

In many cases, the long term care facility has a Medical Director, who is usually a local medical doctor who has contracted with the facility to serve as the Medical Director. As part of his role as Medical Director, the doctor usually is involved with the development and implementation of various policies and procedures involving the operation of the facility and is certainly knowledgeable about what happens at the facility and how the facility and its workers operate. Furthermore, the Medical Director is usually the attending physician for many of the residents in the facility.

In some cases, the Medical Director has provided treatment to the resident at issue and has also served as the facility Medical Director. Can the attorney representing the facility communicate with the Medical Director? It is clear that the facility attorney cannot communicate with the Medical Director related to his role as the attending and treating physician of the resident. *Crist v. Moffat*, 326 N.C. 326, 389 S.E.2d 41 (1990) and RPC 162. However, the facility attorney can communicate with the Medical Director concerning his role as the Medical Director of the facility and other non-confidential matters, but not his role as the treating physician. If the attorney attempts to have such a limited communication with the facility Medical Director, he needs to be careful to avoid any unsolicited comments by the Medical Director about his role as the treating physician for the resident and must inform the doctor that he cannot participate in any discussions relating to the treatment of the resident if the doctor attempts to discuss treatment issues. See RPC 180.

Obviously, the line between “Medical Director issues” and “treating doctor issues” may be blurred from time to time or they may overlap, so great care must be observed to not cross into prohibited areas of communication.

## **H. Representing Organizations and their Liability Insurance Carrier**

In many personal injury/wrongful death actions against long term care organizations, the organization has liability insurance coverage and defense counsel is usually hired by the carrier to represent the insured organization in the lawsuit. This gives rise to what is known as the “tripartite relationship” between the organization/insured, insurer and the defense attorney. Obviously, there are many ethical and legal issues that arise from this relationship, which far exceed the scope of this manuscript and the grasp of the author, so this discussion will be limited to some of the more common issues that arise in long term care cases.

According to the North Carolina State Bar, when a lawyer is retained by an insurer to represent an insured in a liability matter, the attorney represents both as clients. *See* RPC 92. However, the lawyer’s primary duty of loyalty is to the insured. *Id.* Obviously, this can lead to some difficult situations for defense counsel, especially when coverage issues arise or there is the potential for an excess verdict (a frequent occurrence according to many plaintiff’s attorneys), or any other situation where a conflict between the insured and insurer may occur. In most instances of a dispute between the insurer and insured, defense counsel may not choose one side over the other and in many instances must recommend that the insured and insurer retain separate counsel to address the dispute. *See, e.g.,* 03 FEO 12.

In many instances, there may be an issue as to whether the allegations against the insured organization are covered under the liability policy (intentional conduct and punitive damages, to name but a few) and there may be a dispute between the insured and insurer about that issue. Defense counsel cannot get involved in that dispute and should recommend that separate counsel be retained by both the insured and insurer to resolve the dispute.

If defense counsel receives a settlement demand that is within policy limits, but exceeds counsel’s evaluation of the case, can defense counsel demand that the insured settle the case within policy limits? The unequivocal answer to that is “no”, according to the North Carolina State Bar. *See* RPC 91. However, defense counsel may inform the insurer of the organization’s desires related to settlement and may provide the insurer with his evaluation of the likelihood of an adverse verdict, the potential verdict range, and the settlement value of the case. 03 FEO 12.

What should counsel do in the event of a real risk of a verdict in excess of the insured organization’s policy limits in a case that is defensible from a liability stand point? Obviously, the attorney must inform both clients of his honest evaluation of the case, but he cannot demand that the insurer make a settlement offer up to the policy limits. Furthermore, he cannot recommend that they stipulate to liability in exchange for an agreement from plaintiff not to execute on any judgment in excess of the policy limits, although he must inform his clients of any offer from plaintiff’s counsel to enter into such a stipulation. *See* RPC 112. Counsel should

inform both clients to retain separate counsel to address any dispute with between the clients and to address potential excess verdict issues.

## **II. Defending Allegations of “Corporate Negligence”**

In many long term care cases, as well as in suits against other types of institutional health care providers, plaintiffs are including claims of “corporate negligence” against the entity defendants. Generally speaking, these allegations are directed toward the “administrative” or “management” personnel and are usually in addition to the clinical or direct care claims of negligence against the facility and its staff. For example, in a case involving a resident’s fall at the facility, the Complaint may contain allegations of Ordinary Negligence, Medical Malpractice and Corporate Negligence against the facility. The Ordinary Negligence and Medical Malpractice allegations are usually similar and are directed toward the actual clinical and direct care rendered by the staff and the decisions they made about the resident – was she properly assessed as a fall risk? Were proper fall precautions implemented? Were the fall precautions necessary at the time of the fall and were they being used appropriately at the time of the fall? These issues involve the direct care of the resident, primarily by the caregivers and healthcare providers at the facility.

On the other hand, the Corporate Negligence allegations are usually directed at the administrative side of the facility. These would include such allegations as whether the policies and procedures at the facility were appropriate to address residents who were at risk for falls; was the staff appropriately trained to deal with fall risk residents; did the facility have appropriate and adequate equipment to prevent falls; and was the facility adequately staffed to properly attend to residents who were fall risks and needed more assistance.

Both sets of allegations can be included in the same case and directed toward the same incident – the fall of the resident – but the defense of the Corporate Negligence allegations is very different from that of Medical Malpractice and Ordinary Negligence. The discovery is different, the law is different and the evidence necessary to prove and rebut these allegations is usually different.

### **A. What is an allegation of “corporate negligence?”**

A corporate negligence action is essentially a claim against an entity (long term care facility, hospital, or the like) for actions that violate duties that flow directly from the health care facility to the patient. This is a basis for liability that is separate and distinct from *Respondeat Superior* or vicarious liability. *See Bost v. Riley*, 44 N.C. App. 638, 262 S.E.2d 391 (1980). The *Bost* case seems to be the genesis of the corporate negligence doctrine in North Carolina, although the court felt that the doctrine had been “implicitly accepted and applied in a number of decisions” in North Carolina. *Id.* 44 N.C. App. at 647, 262 S.E.2d at 396. Examples given by the court include: the duty of a hospital to make a reasonable inspection of equipment used on

patients and remedy defects in *Payne v. Garvey*, 264 N.C. 593, 142 S.E.2d 159 (1965); the duty to provide adequate and proper equipment for the use intended in *Starnes v. Hospital Authority*, 28 N.C. App. 418, 221 S.E.2d 733 (1976); the duty to disobey instructions of a physician that are known to be clearly negligent or dangerous in *Byrd v. Hospital*, 202 N.C. 337, 162 S.E.2d 738 (1932); the duty to have adequate safety rules regarding handling of medication in *Habuda v. Hospital*, 3 N.C. App. 11, 164 S.E.2d 17 (1968); and the duty adequately investigate the credentials of physicians practicing at the hospital in *Robinson v. Duszynski*, 36 N.C. App. 103, 243 S.E.2d 148 (1978). See also *Blanton v. Moses Cone*, 319 N.C. 372, 354 S.E.2d 455 (1987).

As can be seen, most of these “duties” seem to deal with administrative or procedural functions of a given facility, although it can be difficult at times to distinguish between what is “administrative” and what is “clinical” when discussing corporate negligence claims, especially in long term care cases. For example, when there are allegations that the facility failed to adopt and implement adequate policies and procedures related to some aspect of resident care, is that an “administrative” function or does it involve “clinical” care? As in other areas of the law and the defense of organizations in long term care cases, there are “gray” areas that can impact on how these cases are handled – both from the plaintiff and defense perspective.

## **B. “Corporate Negligence” and Procedural Pitfalls**

### **1. N.C.R. Civ. Proc. Rule 9(j)**

While a corporate negligence claim involves an action against a health care facility, it may preclude the defense from using one very valuable tool: N.C.R. Civ. Proc. Rule 9(j). In most negligence actions against health care providers, including skilled nursing facilities, this rule requires plaintiffs to retain an expert that they think can qualify to testify in court, to review the case and be willing to testify in court that the defendant has committed some act of medical negligence. The Rule also requires that this be certified in the complaint, or otherwise face dismissal of the action. However, this rule only applies to allegations that involve “professional services” and is not required when the allegations against the facility only involve “ordinary negligence”. The Court of Appeals has defined “professional services” as “an act or service ‘arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill, and the labor or skill involved is predominantly mental or intellectual rather than physical or manual.’” *Lewis v. Setty*, 130 N.C. App. 606, 608, 503 S.E.2d. 673, 674 (1998) (quoting *Smith v. Keator*, 21 N.C. App. 102, 105-06, 203 S.E.2d 411, 415 (1975)).

It is frequently the case that corporate negligence allegations, by their very nature, have little to do with the furnishing of professional services, but is administrative functions of the organization. However, that is not always the case, and occasionally the defense can make an argument that the Plaintiff needed a 9(j) certification in a corporate negligence claim, thereby potentially finding a ground for dismissal. After summarizing a series of prior cases, the Court of Appeals determined in *Estate of Waters v. Jarman*, 547 S.E.2d. 142, 145, 144 N.C. App. 98, 103 (2001) that corporate negligence actions brought against a hospital which pertain to clinical patient care constitute medical malpractice actions; however, where the corporate negligence claim arises out of policy, management or administrative decisions, such as granting or

continuing hospital privileges, failing to monitor or oversee performance of the physicians, credentialing, and failing to follow hospital policies, the claim is instead derived from ordinary negligence principles.

Examples of administrative claims are negligent grant of privileges to a physician, failure to adequately monitor and oversee physicians, negligent selection and supervision of physicians, and failure to adequately assess the credentials of the physicians prior to granting privileges. *Waters*, 144 N.C. App. at 102-104, 547 S.E.2d at 145-146. (Also see *Taylor v. Vencor*, 136 N.C. App. 528, 525 S.E.2d. 201 (2000) (Wrongful death claim against nursing home for failure to adequately supervise plaintiff's elderly mother while she smoked cigarettes was not medical malpractice)).

Examples of claims that are found to be medical malpractice claims for purposes of requiring a 9(j) certification are: claims against a hospital for failing to obtain informed consent prior to performing a blood transfusion, failure to promptly report test results, failure of an emergency room doctor to see a patient despite requests from the patient's daughter. *Waters*, 144 N.C. App. 98 at 102-104, 547 S.E.2d at 145-146.

Obviously, most of the cases that have addressed the issue of corporate negligence have been hospital cases, but administrative issues frequently come up in defending nursing home cases and it is not always easy to determine whether the allegations are for medical malpractice or "ordinary" corporate negligence. In many cases, plaintiff's counsel plays it safe and includes an expert certification in the complaint, even if there is a chance that the case only involves administrative negligence rather than clinical negligence. However, most cases contain allegations of both and the claim is usually that the administrative negligence gave rise to the clinical negligence, so plaintiff will have in essence "two bites at the apple" to establish negligence on the part of the facility.

## ***2. Common Discovery Issues in Corporate Negligence Cases***

As mentioned above, discovery relating to a corporate negligence claim can be much different than discovery in a relatively "simple" medical negligence claim involving a clinical event at a facility. Since plaintiff is trying to show administrative negligence in the corporate negligence claim the relevant documents and witnesses are much different than in a clinical claim. Usually, the document requests for a corporate negligence claim include policies and procedure manuals, personnel files, staff work schedules, facility budgets, other financial documents, incident reports for residents, QA reports, and other documents that the facility may have relating to the operation of the facility and not necessarily related to the resident or event at issue. Furthermore, the facility witnesses who are deposed are not just the staff, who was involved in the incident or resident at issue, but may include the director of nursing, administrator, financial officer, other corporate officers and maybe even the shareholders or owners of the organization. Corporate negligence allegations frequently cause discovery in the case to morph into something much greater than the incident and resident at issue, and may involve individuals within the organization who have no knowledge of the particular incident or resident.

**Incident Reports** – Plaintiff’s discovery requests frequently ask for all incident reports prepared at the facility relating to the resident in question, and in corporate negligence cases they frequently ask for incident reports relating to other residents who may have been involved in a similar incident in a relevant time frame. Depending on the purpose of the incident report and the facility’s policy related to preparing the incident report, the plaintiff may be entitled to discovery of the incident reports pertaining to the resident and incident in question. In the recent case of *Hayes v. Premier Living*, 181 N.C. App. 747, 641 S.E.2d 316 (2007), the North Carolina Court of Appeals held that incident reports that were prepared by nursing home staff following “unusual occurrences” and which were not prepared or reviewed by the facility’s quality assurance committee, were subject to discovery in a nursing home case. See also *Cook v. Wake County Hospital System*, 125 N.C. App. 618, 482 S.E.2d 546 (1997), where the Court of Appeal held that a hospital accident report prepared following an accident, in accordance to hospital policy of preparing accident report after all such occurrences, was not prepared in anticipation of litigation and subject to discovery.

Consequently, it appears that an incident report prepared as a matter of routine following any unusual occurrence at a facility, will be subject to discovery. However, if the document is prepared in anticipation of litigation or for use by a qualified peer review committee, then it may not be subject to discovery. If the incident reports requested do not pertain to the resident at issue in the case, but concern other residents and incidents, then defendant probably can assert other objections to producing that information, such as confidentiality and relevance in an effort to protect those documents from discovery.

**Peer Review** – As suggested in the discussion above concerning the discovery of incident reports, some documents requested may be protected by the relatively new statute codified at N.C. Gen. Stat. § 131E-107 providing discovery protection for nursing home peer review committee documents. The statute indicates that documents a duly appointed peer review or quality assurance committee considers, which are not otherwise discoverable (such as the resident’s medical records), and produces are not subject to discovery. Therefore, if the facility prepares a document pertaining to an incident or care of a resident, and it is prepared specifically for the use and consideration of a qualified peer review committee, then those documents may not be subject to discovery in a civil action.

**Discovery of Organization’s Financial Information** – Another area that plaintiffs frequently seek information regarding are the organization’s financial records. Most frequently, they seek tax returns, budgets, cost reports, employee salary information, bonus plans, and other sensitive documents. Usually, the information sought is justified on the basis that plaintiff has included a claim for punitive damages in their complaint and they argue that the discovery of financial information is appropriate when seeking punitive damages, since evidence of a defendant’s ability to pay punitive damages is admissible in a punitive damage case. See N.C. Gen. Stat. § 1D-35(2). However, plaintiffs also seek discovery of an organization’s financial records in compensatory damage cases in support of a corporate negligence claim.

As discussed above, some corporate negligence claims involve allegations of underfunding and understaffing of the long term care facility, and an argument can be made that

some level of financial information is discoverable in order to investigate or support such claims. Other corporate administrative claims may also form the basis of a request for financial information, although I am not aware of any North Carolina cases that have addressed the issue of discovery of financial information in a corporate negligence case seeking only compensatory damages.

Generally speaking, defendants usually object to the production of financial information and seek a protective order until an appropriate showing can be made related to a punitive damage claim and even then defendants seek to limit the nature and scope of the financial information provided. *See, e.g., Blount v. Wake Electric Membership Corp.*, 162 F.R.D. 102 (E.D.N.C. 1993). Furthermore, based on the plain language of 1D-35(2), which limits evidence of a defendant's ability to pay punitive damages to "its revenues or net worth", the defendant organization may take the position that discovery of financial information in a punitive damage claim should be limited to the revenues and net worth of the organization at the time of trial, since that is all the jury is allowed to consider in determining the amount of punitive damages to award.

### **C. Defending the Corporate Negligence Claim**

Whether corporate negligence claims are claims based on negligence of the long term facility or other health care entity for administrative or clinical deficiencies, plaintiff still must establish all the elements to their claim: (1) duty, (2) breach, (3) causation, and (4) damages. In many cases when plaintiff is trying to rely on some type of administrative error to establish negligence on the part of the facility, the most difficult part of the case for the plaintiff, and most easily attacked by defendants, is the requirement to prove a causative link between the alleged administrative malfeasance and the injury to the resident. For instance, in a case where plaintiff is trying to establish the corporate negligence of an organization in failing to properly staff a facility, it may be difficult in some cases to establish a link between the short staffing and the alleged incident that caused the injury. Can the plaintiff establish that the lack of staff on that day had anything to do with the care being rendered by the staff that was there and would the incident or injury have been avoided had extra staff been in place? On the other hand, the mere evidence that the facility was short staffed and the possible reasons for such short staffing may cause an inflamed jury to overlook the niceties of plaintiff's burden of proving a causative link.

As mentioned above, many cases involve a plaintiff alleging that there was negligence in providing clinical care to the resident (Medical Malpractice) and that one of the reasons the clinical care was deficient was due to the administrative negligence of the facility (Corporate Negligence). In essence, this causes defense counsel to have to defend on two fronts: (1.) the care rendered by the staff; and (2.) the management of the facility. However, the separate negligent acts joined to cause only one injury- the injury or death of the resident. Why, then, do both types of allegations need to be included in such a case? Theoretically, multiple acts of negligence by the facility, corporate or otherwise, should not have an impact in the amount of compensatory damages awarded by the jury for the single injury or death. Furthermore, it seems that the pursuit of the corporate negligence theory is more difficult to establish and the causation

aspect mentioned above almost always plays a role in the defense of corporate negligence cases. The amount and complexity of the discovery necessary to establish a corporate negligence allegation is also quite different than simply establishing what happened in the clinical care setting and whether the clinical care violated the standard of care. As a defense lawyer involved in long term care cases, I have my own theories as to why corporate negligence claims are pursued in cases where there are also clinical negligence allegations, but I have often wondered why plaintiffs want to clutter and complicate a good liability case with an oftentimes dry and complex corporate negligence allegation, which is probably not necessary.

### **III. Defending Attempts to “Pierce the Corporate Veil”**

#### **A. Overview**

A fairly recent development in the defense of organizations in long term care cases are attempts by plaintiffs to “pierce the corporate veil” at various stages and for various reasons in the litigation. Surely, there are numerous reasons for this tactic, but it has made the defense of these cases more cumbersome and complicated, and has forced defense counsel to reacquaint themselves with arcane concepts of corporate law that had long been forgotten. And, after all, there is a reason most of us went into litigation instead of corporate law.

There are several reasons why a plaintiff may want to try to pierce the corporate veil to impose liability on the shareholders or owners of the corporate entity for the injury or death of the resident.

First, the plaintiff has obtained a judgment in the case and the corporate entity that is responsible for the payment of the judgment is unable to pay it due to inadequate insurance, lack of assets and/or the dissolution of the responsible corporate entity. In that situation, the plaintiff may attempt to pierce the corporate veil in order to obtain satisfaction of an already existing judgment or obligation on the part of the corporation when there is no other source for payment. Basically, it is a collection action to enforce the existing judgment.

The second reason to try to pierce the corporate veil, and one seen more commonly in long term care cases, is to try to impose liability on the owner/shareholders for the negligent acts of the corporate entity. Basically, if the corporation was a “mere instrumentality” of the shareholders, then the shareholders would also be responsible for the torts of the controlled corporation, similar to that of the corporation being responsible for the torts of its employees and agents. *See, e.g., Muse v. Charter Hospital*, 117 N.C. App. 468, 452 S.E.2d 589 (1995). Generally, these claims are presumptively brought in the underlying action and before there is any obligation on the part of the corporate defendant, thereby causing defense counsel to defend the corporate veil allegations at the same time the liability suit is being defended.

The third, and perhaps the most difficult concept to grasp and defend, is to try to show some type of improper conduct on the part of the owner/shareholders which directly led to the

negligent conduct and injury alleged in the complaint. Basically, this is a “corporate negligence” allegation that tries to impose direct liability on the owners of the corporate facility (as discussed above) for wrongdoing committed at the facility, as opposed to just the facility itself. It has been argued that this is not really a “pierce the corporate veil” allegation, although the allegations of corporate negligence and piercing the corporate veil are frequently blended and confused. Again, these claims are almost always brought in the main case against the facility and try to trace the events that gave rise to the injury or death of the resident directly to the shareholders who were not present at the time of the incident and who were likely not even involved with the daily operations of the facility. It’s an attempt to impose corporate negligence liability on the layer above the corporation – the owner/shareholder – which also makes the defense of the case much more complicated.

## **B. The Law of Piercing the Corporate Veil**

The objective of incorporation is to create a separate legal entity with all of its attendant attributes, such as the independent right to own corporate property and to exercise corporate powers and the limitation of liability to corporate assets. See §2.208 in Robinson’s North Carolina Corp. Law. Indeed, the most fundamental feature of a corporation is limited liability: the proposition that each shareholder is not liable for the corporation’s acts or debts beyond the agreed purchase price for such shareholder’s shares. See §11.01 in Robinson’s North Carolina Corp. Law.

The most obvious purpose for disregarding the corporate entity, or “piercing the corporate veil,” is denial of the privilege of limited liability in order to reach beyond the corporate assets of an insolvent corporation and reach into the assets of the corporation’s owners.<sup>2</sup> The Fourth Circuit, applying North Carolina law, described piercing the veil as “a method of imposing liability on an underlying cause of action”. *Strawbridge v. Sugar Mountain Resort, Inc.*, 243 F.Supp.2d 472, 479 (2003); citing *Shearson Lehman Hutton, Inc. v. Venners*, 165 F.3d 912 (table), 1998 WL 761505 at 82 (4<sup>th</sup> Cir. 1998). As the Fourth Circuit stated: “Thus, piercing the corporate veil is derivative and is not an independent cause of action.” *Strawbridge*, 243 F.Supp.2d 472 (2003). This being said, piercing the corporate veil appears in complaints against skilled nursing facilities as if it were a separate cause of action instead of a derivative equitable remedy.

A ruling that a corporate entity should be disregarded is founded in equity and is therefore necessarily based on a balancing of the equities to determine whether the requested redress of injustice outweighs the need to respect validly established legal form and relationships. A corporation’s separate and independent existence is not to be disregarded lightly and North Carolina jurisprudence provides an outline of the factors to be considered in balancing these equities.

The *Glenn v. Wagner* decision is the most-cited case discussing the process of disregarding the corporate entity and held piercing invokes an equitable doctrine to be applied on

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<sup>2</sup> The difference between agency law and piercing the corporate veil is under agency principles, only the negligent officer and the corporate entity will be liable. If the corporate veil is pierced, all of the officers jointly and severally will be liable to pay the judgment.

the carefully examined facts of each case, and the burden is on the party asserting the claim to establish the existence of circumstances that would justify disregarding the corporate entity. 313 N.C. 450, 329 S.E.2d 326 (1985), *rev'g* 67 N.C. App. 563, 313 S.E.2d 832 (1984). Despite the burden being on the asserting party, piercing allegations in a complaint are difficult to defend because there are no concrete “defenses.” The defense of a request to pierce would be in the form of a motion for summary judgment on that allegation.

The *Glenn* analysis or “instrumentality rule” to determine whether to pierce the corporate veil is outlined as follows<sup>3</sup>:

- 1- Control: complete domination of finances, policy, and business practice in respect to the transaction attacked so that the corporate entity as to the transaction had at the time no separate mind, will or existence of its own and;
  - o Relevant factors to consider to determine sufficient control: inadequate capitalization; noncompliance with corporate formalities; complete domination and control of the corporation so that it has no independent identity; or excessive fragmentation of a single enterprise into separate corporations
- 2- Use: of such control by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff’s legal rights and;
- 3- Proximate cause: between such control and use and the injury or unjust loss complained of.

### C. Defending a Piercing the Corporate Veil Case

As discussed above, allegations to pierce the corporate veil come in several different forms and can be directed at different aspects of a long term care case. However, the “elements” of such a claim are the same and plaintiff, in theory, must prove those elements to pierce the corporate veil, regardless of the purpose of the allegations. Consequently, the defense of any “PCV” case would obviously include trying to prevent plaintiff from establishing the elements of the claim set out in the *Glenn* case.

In addition, if plaintiff tries to assert a piercing the corporate veil allegation as a separate cause of action, a strong argument exists that it is a “derivative claim”, similar to a claim for loss of consortium, and that any separate cause of action to try to establish a “direct” and separate claim against the shareholders should be dismissed. See e.g. *Strawbridge v. Sugar Mountain Resort*; *Muse v. Charter Hospital*; and *Cooper v. Ridgeway*, 362 N.C. 431, 666 S.E.2d 107 (2008). Furthermore, if the allegations are that the corporation’s corporate veil should be pierced to pay any prospective judgment in the case, before any liability is established, then dismissal of those claims should be sought for being premature.

Finally, in theory proximate cause, as with claims of corporate negligence, creates the greatest hurdle for the plaintiff seeking to pierce because the exercise of control over a corporate entity is difficult to link to the basis for most actions against facilities – medical negligence. The dominating control of the owners of a corporation is usually not the cause of the injury to the

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<sup>3</sup> Adapted from the summary in §2.10[2] Robinson’s North Carolina Corp. Law.

plaintiff; it may cause a lack of recovery if the corporation does not have the funds to pay the full judgment, but it likely did not proximately cause the incident and injury they are asserting.