Domination of a Subsidiary by a Parent

William J. Rands[*]

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Introduction

This Article examines piercing the corporate veil of a subsidiary to make its parent corporation liable for the subsidiary's obligations. More particularly, it focuses on what many of the cases seem to designate as the key component in the formulas for deciding whether to pierce the corporate veil: The parent corporation's domination of a subsidiary, either with respect to the transaction in question or generally. The number of cases regarding parent liability is

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* Professor of Law, University of Cincinnati School of Law. B.A., Centenary College; J.D., Tulane University; member of the Arkansas and Louisiana Bars. The author thanks his research assistants, John Meissenhelder, Mary Gloeckner, Marty Mailender, Dan Carlineo, and Chelsea Green for their assistance.

voluminous,[1] and most of the cases mention domination.[2] Are these references nebulous prattle or one of the obfuscating "mists of metaphor" long ago decried by Judge Cardozo?[3] Many veil-piercing cases are said to be no more than exercises in cataloguing a number of factors present in a situation to reach a normative conclusion that piercing is or is not appropriate.[4] Such factors are said to be numerous and often unhelpful.[5] Is domination a make-weight listing on such a laundry list, or an important, mandatory, or even conclusive factor? Should it be accorded any weight at all? Some non-lawyers in the business community likely would be startled to know that a parent could be penalized for paying close attention to its subsidiary's affairs. Conversely, several current commentators have proposed that parents should no longer be protected by limited liability and should be made liable for the debts of their subsidiaries.[6]

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1. In his monumental study, Robert B. Thompson found 637 cases involving corporate groups and piercing the corporate veil. Courts pierced the veil in 237, or 37.21% of those cases. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1055 (1991).

2. In his study, Thompson states that courts found "domination and control" in 551 cases and pierced the corporate veil in 314 of them, or 56.99%. *Id.* at 1063. Not all of the cases finding "domination and control" involved corporate groups. *Id.*

3. Perhaps the most well known of all aphorisms regarding American corporate law is the following observation made by Judge Cardozo in 1926: "The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it." Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926). Some of the many metaphors used in the caselaw include: "mere adjunct, agent, alter ego, alter idem, arm, blind, branch, buffer, cloak, coat, corporate double, cover, creature, curious reminiscence, delusion, department, dry shell, dummy, fiction, form, formality, instrumentality, mouthpiece, name, nominal identity, phrase, puppet, screen, sham, simulacrum, snare, subterfuge, tool." ELVIN R. LATTY & GEORGE T. FRAMPTON, BASIC BUSINESS ASSOCIATIONS: CASES, TEXT AND PROBLEMS 721 (1963).

4. *See* National Bond Fin. Co. v. General Motors Corp., 238 F. Supp. 248, 256 (W.D. Mo. 1964), *aff'd*, 341 F.2d 1022 (8th Cir. 1965); Douglas J. Gardner, Comment, *An Innovative Approach to Piercing the Corporate Veil: An Introduction to the Individual Factor and Cumulative Effects Analysis*, 25 LAND & WATER L. REV. 563, 564 (1990).

5. *See* Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 9 (1997).

6. The most persistent of such commentators has been Phillip I. Blumberg. *See* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: SUBSTANTIVE LAW § 5.01 (1987) [hereinafter LAW OF CORPORATE GROUPS]; Phillip I. Blumberg, *The Corporate Entity in an Era of Multinational Corporations*, 15 DEL. J. CORP. L. 283, 365-66 (1990); Phillip I. Blumberg & Kurt A. Strasser, *Corporate Groups and Enterprise Liability: Contracts and Torts*, 706 PRACTICING L. INST./CORP. 7 (1990). *See also, e.g.*, WILLIAM L. CARY & MELVIN ARON EISENBERG, CORPORATIONS: CASES AND MATERIALS 187 (7th ed. unabr. 1995); MELVIN ARON EISENBERG, THE LAW RELATING TO CORPORATE GROUPS 10-12 (M. Gillooly ed. 1993); Joseph H. Sommer, *The Subsidiary: Doctrine Without Cause?*, 59 FORDHAM L. REV. 227, 230 (1990). *Cf.* Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589,

I. LIMITED LIABILITY, GENERALLY

In the United States, the corporation is a distinct legal entity, separate and apart from its shareholders. Perhaps as a consequence of its status as a legal entity and as a result of a conscious policy decision to promote capital formation,[7] a corporation incurs its own liabilities and is legally responsible for payment of its obligations, whether created by contracts, torts, or statute. As a result of the corporation being responsible for its debts, the shareholders are not automatically liable for their corporation's obligations. Shareholders can become liable only on the basis of their own conduct, not merely from their status as shareholders. Hence, they are not ordinarily vicariously liable for their entity's obligations. This protection from liability for shareholders is, of course, called limited liability. Unless the shareholders engage in some type of offensive conduct, the risk of loss is limited to what they have put in (and left in) their corporation.

Limited liability has been a prevailing rule in the United States for more than a century.[8] It is "fundamental to the law of every jurisdiction in the United States."[9] The United States Supreme Court concluded that "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."[10] Limited liability as a policy has been lavished with praise approaching hyperbole. The President of Columbia University once called it "the greatest single discovery of modern times . . . . Even steam and electricity are far less important."[11]

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619 (1975).

7. According to Blumberg, the reality appears to have been that limited liability resulted from conscious policy decisions to stimulate economic activity "by encouraging wide-spread investment in corporate shares." Philip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 575-576, 604 (1986). *See also* Stephen B. Presser, *Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics*, 87 NW. U. L. REV. 148, 155 (1992).

8. *See* Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1879 (1991).

9. Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 2 (1978).

10. Anderson v. Abbott, 321 U.S. 349, 362 (1944).

11. 1 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 21 (perm. ed. rev. vol. 1990), *quoted in* Roger E. Meiners et al., *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 351 (1979). Meiners et al. quote, perhaps with some wryness, other praises to limited liability stating, for example, "This attribute of limited liability . . . is regarded by most persons as the greatest advantage of incorporation. Indeed, many immigrants doubtless possess full knowledge of this fact before coming within hailing distance of the Statue of Liberty." Meiners et al., *supra*, at 351-52 (quoting I. WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATE PROBLEMS 14 (1929)).

A. Debate Over Limited Liability as a Policy

Limited liability as a policy matter has been the focus of much recent debate among academicians. Two prominent scholars, Frank H. Easterbrook and Daniel R. Fischel, offer an economic theory in support of limited liability.[12] For example, they posit that rational investors made fully liable for the debts of the enterprises in which they invest would not choose to invest in more than a few entities.[13] They conclude that "[t]he increased availability of funds for projects with positive net values is the real benefit of limited liability."[14] Limited liability facilitates an effective allocation of risk of loss amongst the investors in the enterprise.[15] Two equally prominent scholars, Henry Hansmann and Reinier Kraakman, contest the Easterbrook and Fischel assertion that the role of limited liability is economically efficient and propose to replace limited liability for shareholders with pro rata liability compensating tort creditors.[16] More

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12. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985).

13. *Id.* at 90. *See also* LAW OF CORPORATE GROUPS, *supra* note 6, § 4.02.8; Theresa A. Galbadon, *The Lemonade Stand: Feminist and Other Reflections on the Limited Liability of Corporate Shareholders*, 45 VAND. L. REV. 1387, 1405 (1992); Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967). In addition to the diversification of portfolios, the law and economic theorists offer other benefits for a rule of limited liability. First, limited liability decreases the need of investors to monitor the actions of the managers, decreasing the cost of trading. Second, a rule of unlimited liability would create a need for an investor to monitor fellow shareholders, increasing the costs of trading. Third, limited liability creates an incentive for management to act efficiently. If they do not, the stock price will fall, the stock will become a bargain, the corporation will be taken over, and they will be displaced as managers. Fourth, without limited liability, wealthy investors, who have more to lose than poor investors, would assign a lower value to a particular security because the greater risk of liability would reduce the stock's value to the wealthy investor. In contrast, limited liability makes the shares of a single corporation fungible with one another and therefore facilitates trading. Fifth, limited liability encourages the managers to take business risks that they otherwise would not take. Sixth, unlimited liability would increase the cost of creditors who would be required to file expensive collection suits against shareholders scattered around the world. Seventh, limited liability in effect creates a contract term between the corporation, creditors, and investor. Thus, it eliminates the necessity for investors to incur the expense of contracting out of personal liability. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 4.02; LOUIS D. SOLOMON & ALAN R. PALMITER, CORPORATIONS: EXAMPLES AND EXPLANATIONS § 6.1 (1990); Robert Charles Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787, 825 (1979); Easterbrook & Fischel, *supra* note 12, at 94-97; Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 506, 515 (1976).

14. *See* Easterbrook & Fischel, *supra* note 12, at 97.

15. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 44-47 (3rd prtg. 1996).

16. Hansmann & Kraakman, *supra* note 8, at 1896. Hansmann and Kraakman assert that pro rata liability would eliminate the monitoring problems cited by Easterbrook and Fischel, and

importantly, they decry that limited liability leaves tort creditors uncompensated, while shareholders externalize the costs of doing business and reap great profits at society's expense.[17] Another scholar, Teresa A. Galbadon, concludes that an organization conceived by feminists would not feature limited liability, because feminist theory condemns attempts to personally profit while consciously risking injury to third parties.[18]

B. Policy of Limited Liability for Corporate Groups

There has been substantial opposition to limited liability for the constituent members of affiliated groups of corporations. Phillip I. Blumberg has led the charge against limited liability. He argues for "enterprise liability."[19] According to this view, all members of an affiliated group (the "enterprise") should be treated as one legal entity with this enlarged entity liable for the debts of any member of the group.[20] Blumberg argues that even if the Easterbrook and Fischel-type of justifications for limited liability—its contribution to the efficient working of the marketplace—is generally valid, these economic justifications are largely irrelevant with respect to the debts of members of an affiliated group of corporations.[21] For example, in most corporate groups, a parent corporation is the sole shareholder and is engaged to some degree in the management of the subsidiary. Thus, there would be no need to worry about the excessive monitoring costs that would exist if unlimited liability were the rule for the shareholders in free-standing corporations (i.e., shareholders of the parent corporation itself or of corporations that are not members of an affiliated group).[22] Blumberg acknowledges that limited liability encourages risk-taking by management, and this might be important in the case of a conglomerate that is considering an investment in areas unrelated to the existing businesses of the group.[23] He counterargues, however, that limited liability should not be permitted in a case of an integrated group where the additional investment represents a horizontal or vertical extension of activities already being

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because catastrophic tort liability is rare, most investors would not be deterred or would be able to diversify. *Id.* at 1907-09. *See also* CARY & EISENBERG, *supra* note 6, at 185-89; Presser, *supra* note 7, at 171.

17. Hansmann & Kraakman, *supra* note 8, at 1882-83; Presser, *supra* note 7, at 170. *See also* CARY & EISENBERG, *supra* note 6, at 186; Galbadon, *supra* note 13, at 1429-31. Referring to a possible elimination of limited liability and the taxicab company cases, Michael P. Dooley said, "[t]he tradeoff is that shareholder liability will result in fewer cabs and higher fares, but there is no obvious reason why accident victims should subsidize cab drivers." MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 53-54 (1995).

18. Galbadon, *supra* note 13, at 1430-31.

19. LAW OF CORPORATE GROUPS, *supra* note 6, §§ 6.01-.10, 13.01-.06.

20. *Id.*

21. *Id.* §§ 5.01-.02.

22. *See id.* § 5.01.

23. *Id.*

undertaken.[24]

Jonathan M. Landers discusses the liability of the constituent members of an affiliated group of corporations in the context of bankruptcy.[25] In this context, the dominant motivation of both the managers and the owners of the group likely will be to maximize the return for the enterprise as a whole.[26] The profitability of any particular member tends to be irrelevant, except as it contributes to the overall effort of the complete enterprise.[27] The managers and owners are, therefore, likely to depart the methods of management usually followed in the case of a single, unrelated, free-standing corporate unit.[28] For example, while the undisciplined movement of assets from an independent, free-standing corporation to its shareholders is likely to hinder that corporation's successful operation of its businesses, the movement of assets from one member of an affiliated group to another member in that group might actually help to maximize the overall productive use of the capital and resources of the enterprise of the full group.[29] Despite this reality, judges often require that, as a prerequisite for a parent's limited liability, a subsidiary should have a will separate and apart from its parent (as if it has some sort of incorporeal existence apart from the parent).[30] Moreover, the locus of decision-making power usually resides in the managers of the parent of the group and it makes decisions determined by the needs of the group as a whole. It is naive to believe that the parent's managers will remain silent if they disagree with the policies set by the subsidiary's managers (even if the subsidiary has its own set of managers).[31] Hence, the basic test in veil-piercing cases—that the parent's limited liability should be based on treating its subsidiaries as independent profit-making enterprises—does not comport with reality and is doomed to fail as an effective test. Moreover, if limited liability were eliminated for members of an affiliated group, especially for the parent corporation, the effect would be not to subject individual stockholders in the parent to risks greater than their individual investment, a result that might deter investments in the public markets.[32] Instead, only the entity responsible for the management of the subsidiary, i.e., the parent, would be held liable, and the larger group of shareholders, those in the parent, would not be held directly responsible for behavior over which they have merely theoretical control.[33]

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24. *Id.*
25. Landers, *supra* note 6, at 589.
26. *See id.* at 591.
27. *See id.*
28. *See id.*
29. *See id.* at 592.
30. *See id.*
31. *See id.*
32. *See id.* at 596.
33. *See id.* at 623-24. Landers states that creditors of a constituent corporation actually would be exposed to greater risks than creditors of a single corporation. For example, the availability of funds from the other affiliates reduces the practical importance of adequate initial capitalization for any particular member of the group. The danger of commingling assets and properties is greater

Not all commentators concede to Blumberg and Landers on their main premise. In one widely cited article, William P. Hackney and Tracey G. Benson seek to justify limited liability among affiliated groups:

> If a parent corporation is held liable for the obligations of its subsidiary, the shareholders of the parent are hurt, through the lowering of the value of their investment in the parent in the same way as if they themselves had been held liable and had been forced to sell a portion of their investment in a parent in order to pay the liability.[34]

Stephen B. Presser agrees that the original reason for allowing limited liability for shareholders is to encourage investment and that "subdividing risks," by allowing parents to reduce risks by incorporating subsidiaries, still serves the investment-encouraging rationale.[35] The parent's shareholders are those who profit by reducing the risks of liability to the parent. The more their risks are reduced, the greater their potential profit, and the more they are encouraged to invest in the parent's stock.[36]

C. Limited Liability in Closely Held Corporations

The focus of the Easterbrook and Fischel defense of limited liability is the publicly held corporation with widely dispersed and unrelated shareholders and a separation between the shareholders and managers. They justify limited liability by asserting that unlimited liability would impair the market's capacity to diversify risks and value shares. This justification does not apply to closely held corporations.[37] Thus, some commentators argue, limited liability should not be granted to the shareholders of closely held corporations, at least for torts. The normal predicate for making a principal vicariously liable for a tort committed by an agent is that the principal controlled the agent's activities. That normal predicate is missing in the case of publicly held corporations but not in closely

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between the affiliated corporations than between shareholders and independent, free-standing corporations. In affiliated groups of corporations, there is a greater chance that each member's economic viability is tied to that of other members of the group, so that each particular member may be unable to develop the independent profit-making activities expected of free-standing corporate entities. The managers of the parent are most interested in the overall return of the full enterprise. *See id.* at 596-97.

34. William P. Hackney & Tracey G. Benson, *Shareholder Liability for Inadequate Capital*, 43 U. PITT. L. REV. 837, 872-73 (1982). *See also* Johnson v. Flowers Indus., Inc., 814 F.2d 978, 980 (4th Cir. 1987).

35. Presser, *supra* note 7, at 173.

36. *See id.* at 175.

37. Easterbrook and Fischel note the reasons they offer to justify limited liability in publicly traded corporations are ill-fitting to closely held corporations. Easterbrook & Fischel, *supra* note 12, at 109-10. *See also* CARY & EISENBERG, *supra* note 6, at 186-87; Hansmann & Kraakman, *supra* note 8, at 1903 n.67.

held corporations where control and ownership are usually intertwined.[38]

Hansmann and Kraakman concede that a rule of unlimited liability would result in some businesses not being started, because putative owners would be unwilling to expose personal assets to the risks of a tort judgment.[39] But Hansmann and Kraakman like this result.[40] They think that such small firms should not exist and that one advantage of unlimited liability is that it would force such small ventures, which effectively are subsidized by tort victims, out of business.[41] Agreeing with Hansmann and Kraakman, Professor Melvin Eisenberg states:

> [U]nder a rule of shareholder liability for tort claims, wealthy shareholders would avoid investments in corporations that did not make adequate provision for tort claims through insurance. This would be a powerful incentive to corporations to adequately insure. That, in turn, would not only be a socially desirable result, but would further minimize a likelihood that liability would actually be imposed on shareholders.[42]

Limited liability for closely held corporations has its scholarly supporters. Larry E. Ribstein contends that limited liability is an efficient bargain in closely held as well as in publicly held corporations.[43] It serves the important functions in closely held firms of facilitating diversification of risks, separation of ownership and control, and reducing creditors' need to monitor shareholder wealth. Ribstein also notes that there is little reason for believing that limited liability in closely held corporations actually externalizes costs.[44] Indeed, it might be asked whether there is a significant proportion of legitimate tort claims that have not been satisfied from insurance or corporate assets.[45] David W. Leebron likewise supports limited liability for closely held corporations.[46] For many investors in closely held corporations, their closely held corporation stock represents only a part of their portfolio. For example, the investor may have a house, cash, other real estate, and perhaps a portfolio of other securities. If all of their other assets were exposed, they might choose not to invest in the closely

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38. *See* CARY & EISENBERG, *supra* note 6, at 186-87. *Cf.* Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 VAND. L. REV. 1, 36 (1994) (emphasizing parent's control of a subsidiary as a reason to pierce the veil of a subsidiary in order to attach liability to a parent).

39. Hansmann & Kraakman, *supra* note 8, at 1888.

40. *Id.*

41. *Id.*

42. CARY & EISENBERG, *supra* note 6, at 187-88.

43. Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 106 (1991).

44. *Id.*

45. *See* DOOLEY, *supra* note 17, at 54.

46. David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1629-30 (1991).

held corporation stock at all.[47] Leebron also contrasts the risk-bearing capacity of shareholders of publicly held corporations with shareholders of closely held corporations.[48] In the case of publicly held corporations, the large number of shareholders allows the loss and, therefore, the risk, to be spread among many investors.[49] Unlimited tort liability for closely held shareholders, however, would concentrate these losses on a small number of shareholders. Placing unlimited liability on the closely held corporation shareholder would likely result in underinvestment.[50] Presser has taken an historical approach to supply a defense to limited liability for the closely held corporation.[51] Without limited liability, it was believed that only the very wealthiest persons, such as New York's industrial titan John Jacob Astor, would have been able to invest in corporations.[52] As such, limited liability "reflects a venerable desire to help out smaller investors . . . reflects democracy as much as economics . . . [and] ought to be most sacred for smaller firms."[53]

D. Author's View on Policy of Limited Liability

Though the literature is laden with brilliant debate and analysis, the discussions of the economic impact of liability are generally theoretical and without empirical research support.[54] Considering the lack of supporting data, one senses that each scholar is making a normative judgement based on his or her political leanings and intuition. My view supports limited liability for publicly held corporations, closely held corporations and affiliated groups, at least as the general rule. By allowing investors to externalize some costs and thereby lower the cost for corporate stock, economic development likely will take place with synergistic effects that generate widespread benefits.[55] Furthermore, some investors might be inhibited from investing in stock, if they were to be made vicariously liable for all the debts of the corporation. As a result of limited liability, society probably benefits from an increased amount of economic activity.[56] Regardless, limited liability is not an absolute rule. Judges can temper its harshness in some cases by piercing the corporate veil.[57] Moreover, some of

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47. *See id.*

48. *Id.* at 1630.

49. *See id.*

50. *See id.*

51. Presser, *supra* note 7, at 156.

52. *See id.*

53. *Id.* at 163.

54. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 4.01. As Professor Eisenberg states, the real-world weight of the stock-market-efficiency argument is difficult to judge, even for publicly held corporations. CARY & EISENBERG, *supra* note 6, at 187.

55. *See* Presser, *supra* note 7, at 172.

56. *See* Thompson, *supra* note 1, at 1039-40.

57. Eisenberg states that piercing the corporate veil can act as a "safety valve that takes some of the pressure off the limited liability rule in the cases where the rule is most dubious." CARY &

the victims of insolvent corporations have the protective safety net of social legislation such as unemployment compensation.[58]

E. State Legislatures Ignore Debate and Expand Limited Liability

As stimulating as the academic debate has been, state legislatures have paid no attention to it. Not wanting to be left behind, virtually every state has enacted legislation that authorizes the creation of limited liability companies and limited liability partnerships, two types of entities that provide limited liability for their owners.[59] Perhaps the legislators ought to be concerned, like Hansmann and Kraakman, with the externalization of the tort costs created by firms within their borders. In truth, however, their ears are more attuned to the entreaties of their respective business communities. What the business community wants, the business community usually gets. Moreover, the notorious "race to the bottom" likely would doom the efforts of a Don Quixote in a state legislature who tried to transpose the Hansmann and Kraakman argument into legislation. The Hansmann and Kraakman rule would result in corporate flight across state lines—into states where the law provided the greatest degree of limited liability.[60]

II. TRADITIONAL VERBAL FORMULATIONS

The jurisprudence of piercing the corporate veil is almost uniformly deemed garbled. For example, Robert Charles Clark, of Harvard University Law School, has written:

> Despite the fact that different courts' lists of relevant factors bear a family resemblance to one another, a lawyer surveying a broad range of cases involving attempts to pierce the corporate veil might easily conclude that they are unified more by the remedies sought—subjecting to corporate liabilities the personal assets directly held by shareholders—than by repeated and consistent application of the same criteria for granting the remedy.[61]

Yet, surprisingly, the courts almost always merely use several verbiages to confront the hoary issue. One is traceable to Frederick J. Powell's *Parent and Subsidiary Corporations*[62] and another to California jurisprudence on the "alter

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EISENBERG, *supra* note 6, at 191.

58. *See* Manne, *supra* note 13, at 263.

59. *See* William J. Rands, *Passthrough Entities and Their Unprincipled Differences Under Federal Tax Law*, 49 SMU L. REV. 15, 29 (1995). Professor Ribstein expounds that limited liability should not be predicated upon incorporation. If limited liability is a good policy, it should be extended to the owners of unincorporated enterprises. *See* Ribstein, *supra* note 43, at 112.

60. *See* CARY & EISENBERG, *supra* note 6, at 190.

61. ROBERT CHARLES CLARK, CORPORATE LAW § 2.4, at 73 (1986).

62. FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS (1931). For a discussion of Powell's work, see Krendl & Krendl, *supra* note 9, at 22.

ego."[63]

In an effort to formulate clear veil-piercing rules, Powell formulated three tests for piercing the corporate veil in the context of parent and subsidiary corporations.[64] The first test, the "mere instrumentality" test, requires that the subsidiary corporation be under the complete control and domination of the parent corporation.[65] The second test, the "fraud or wrong" or "injustice" test, requires that the parent's control over the subsidiary be used to commit a fraudulent, wrongful or unjust act against the plaintiff.[66] The third test, the "unjust loss or injury" test, requires that the plaintiff must have been actually harmed as a result of the defendant's conduct.[67] All three tests must be met in order to pierce the subsidiary's corporate veil and impose liability on the parent.[68] Combining all three elements, Powell stated his formula of parent's corporate liability as:

> When the privilege of transacting business in corporate form has been illegally abused to the injury of a third party, he may disregard the corporate entity to the extent of holding the stockholders liable for the corporate obligations to him. In this way a civil remedy is provided for an unjust wrong or injury caused by the legal fiction of corporate entity.[69]

To help judges and attorneys determine when the requisite domination of the subsidiary is present, Powell provided a laundry-list of relevant factors,[70] not all

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63. *See, e.g.*, Rosen v. Losch, Inc., 44 Cal. Rptr. 377 (1965); Riddle v. Leuschner, 335 P.2d 107, 111 (Cal. 1959); Minifie v. Rowley, 202 P. 673, 676 (Cal. 1921).

64. POWELL, *supra* note 62, at 4-6.

65. *See id.*

66. *See id*.

67. *See id*.

68. *See* STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1.03[4] (1997).

69. POWELL, *supra* note 62, at 6.

70. The Powell factors are:

(a) The parent corporation owns all or most of the capital stock of the subsidiary.
(b) The parent and subsidiary corporations have common directors or officers.
(c) The parent corporation finances the subsidiary.
(d) The parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation.
(e) The subsidiary has grossly inadequate capital.
(f) The parent corporation pays the salaries and other expenses or losses of the subsidiary.
(g) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation.
(h) In the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.
(i) The parent corporation uses the property of the subsidiary as its own.

of which must be met. These factors also indicate the fraudulent or unjust character of the parent's control of the subsidiary.[71] Additionally, Powell listed a number of situations that would indicate a wrong or injustice and thus meet the second test. Unlike the alter ego test, only one of the following need to be met: actual fraud, violation of a statute, stripping the subsidiary of its assets, misrepresentation, estoppel, or tort.[72] Although actual fraud would satisfy the second test, it is not required in order to pierce the corporate veil.[73]

Powell indicated that his third test, loss or injury to the complainant, may be regarded as part of the second test, fraud or wrong, but the segregation of the two elements "promotes clarity and facilitates the application of the law."[74] In other words, it may be said that the parent corporation has not used its domination over the subsidiary to defraud or wrong the complainant, unless the complainant has unjustly suffered a loss or injury. Several jurisdictions have not adopted the third test and have relied on the alter ego/mere instrumentality and fraud or wrong tests to pierce the corporate veil.[75]

The leading case to adopt Powell's three-part test for piercing the corporate veil was *Lowendahl v. Baltimore & O.R. Co.*,[76] which stated the test as follows:

> Restating the instrumentality rule, we may say that in any case, except express agency, estoppel, or direct tort, three elements must be proved:
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> (1) Control, not mere majority or complete stock control, but complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and
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> (2) Such control must have been used 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) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.[77]

> (j) The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest.
>
> (k) The formal legal requirements of the subsidiary are not observed.

Id. at 9.

71. *See* discussion *infra* Part III.A.

72. *See* POWELL, *supra* note 62, at 54.

73. *See* Anderson v. Abbott, 321 U.S. 349, 362 (1944).

74. POWELL, *supra* note 62, at 82.

75. *See, e.g.*, Van Dorn v. Future Chem. & Oil, 753 F.2d 565 (7th Cir. 1985); Shapoff v. Scull, 272 Cal. Rptr. 480 (Cal. Ct. App. 1990).

76. 287 N.Y.S. 62 (N.Y. App. Div. 1), *aff'd*, 6 N.E.2d 56 (1936).

77. *Id.* at 76.

Though Powell himself would have called the first prong of his test the "instrumentality" test, his whole analysis has been referred to as the "instrumentality" rule.[78]

If a decision doesn't use the language traceable to the Powell analysis, it is likely to use the "alter ego" language developed by the California courts. One commonly repeated refrain is that the alter ego doctrine should apply and make a shareholder personally liable when there is "such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and that, if the acts are treated as those of the corporation alone, an inequitable result will follow."[79] It is possible to try to draw distinctions between this exceptionally amorphous language and Powell's "instrumentality" analysis,[80] but the consensus is that there is little difference between them.[81] The verbal formulations are virtually indistinguishable as to analysis, application, and result. They are often used by courts in the same sentence and should be regarded as interchangeable.[82]

III. Control as an Element in Piercing the Corporate Veil

A. *The Laundry-Lists*

Veil-piercing cases containing a laundry-list of relevant factors are so numerous that they are virtually innumerable.[83] Usually, the cases

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78. *See id.*

79. *E.g.*, Riddle v. Leuschner, 335 P.2d 107, 110-11 (Cal. 1959). This heavily quoted language can be traced to a landmark California case:

> First, that the corporation is not only influenced and governed by that person, but that there is such a unity of interest and ownership that the individuality, or separateness, of the said person and corporation has ceased; second, that the facts are such that an adherence to the fiction of the separate existence of the corporation would, under the particular circumstances, sanction a fraud or promote injustice.

Minifie v. Rowley, 202 P. 673, 676 (Cal. 1921). *See also* John F. Dobbyn, *A Practical Approach to Consistency in Veil-Piercing Cases*, 19 U. KAN. L. REV. 185, 186 (1971).

80. *See* LAW OF CORPORATE GROUPS, *supra* note 6, §§ 6.02-.03; 1 JAMES D. COX ET AL., CORPORATIONS § 7.16 (1995); Dobbyn, *supra* note 79, at 186-87.

81. *See, e.g.*, LAW OF CORPORATE GROUPS, *supra* note 6, § 6.03; J.S. COVINGTON, JR., BASIC LAW OF CORPORATIONS: CASES, TEXT AND ANALYSES 45 (1989); Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295, 331 (1996).

82. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 6.03 & n.13. Representative cases include *William Passalacqua Builders, Inc. v. Resnick Developers S., Inc.*, 933 F.2d 131, 138 (2d Cir. 1991); *House of Koscot Dev. Corp. v. American Line Cosmetics, Inc.*, 468 F.2d 64, 67 n.2 (5th Cir. 1972); *Weisser v. Mursam Shoe Corp.*, 127 F.2d 344, 349 n.11 (2d Cir. 1942).

83. *See, e.g.*, Lowell Staats Mining Co., Inc. v. Pioneer Uravan, Inc., 878 F.2d 1259, 1262-63 (10th Cir. 1989); United States v. Jon-T Chems., Inc., 768 F.2d 686, 691-92 (5th Cir. 1985); Nelson v. International Paint Co. Inc., 734 F.2d 1084, 1093 (5th Cir. 1984); Miles v. American Tel.

replicate (without attribution) the Powell factors.[84] The cases sometimes add or delete factors.[85] Some decisions say that they are testing for

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& Tel. Co., 703 F.2d 193, 195-96 (5th Cir. 1983); DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 685-87 (4th Cir. 1976); Steven v. Roscoe Turner Aeronautical Corp., 324 F.2d 157, 161 (7th Cir. 1963); Jacobson v. Buffalo Rock Shooters Supply, Inc., 664 N.E.2d 328, 331 (Ill. App. Ct. 1996); St. Peter v. Ampak-Division of Gatewood Prods., Inc., 484 S.E.2d 481, 488-89 (W. Va. 1997); Panamerica Mineral Servs., Inc. v. KLS Enviro Resources, Inc., 916 P.2d 986, 990 (Wyo. 1996).

84. POWELL, *supra* note 62, at 9. *See also* Taylor v. Standard Gas & Elec. Co., 96 F.2d 693, 704-05 (10th Cir. 1938), *rev'd on other grounds*, 306 U.S. 307 (1939); Great West Cas. Co. v. Travelers Indem. Co., 925 F. Supp. 1455, 1463 (D.S.D. 1996), *aff'd*, 111 F.3d 135 (8th Cir. 1997); Fidenas AG v. Honeywell Inc., 501 F. Supp. 1029, 1035 (S.D.N.Y. 1980); Duff v. Southern Ry. Co., 496 So.2d 760, 763 (Ala. 1986), Jackson v. General Elec. Co., 514 P.2d 1170, 1173 (Alaska 1973).

85. One article lists 31 factors used by courts to justify not piercing the corporate veil. They are:

1. The shareholder is not a party to the contractual or other obligation of the corporation.
2. The subsidiary is not undercapitalized.
3. The subsidiary does not operate at a deficit while the parent is showing a profit.
4. The creditors of the companies are not misled as to which company they are dealing with.
5. Creditors are not misled as to the financial strength of the subsidiary.
6. The employees of the parent and subsidiary are separate and the parent does not hire employees of the subsidiary.
7. The payroll of the subsidiary is paid by the subsidiary and the salary levels are set by the subsidiary.
8. The labor relations of the two companies are handled separately and independently.
9. The parent and subsidiary maintain separate offices and telephone numbers.
10. Separate directors' meetings are conducted.
11. The subsidiary maintains financial books and records which contain entries related only to its own operations.
12. The subsidiary has its own bank account.
13. The earnings of the subsidiary are not reflected on the financial reports of the parent in determining the parent's income.
14. The companies do not file joint tax returns.
15. The subsidiary negotiates its own loans or other financing.
16. The subsidiary does not borrow money from the parent.
17. Loans and other financial transactions between the parent and subsidiary are properly documented and conducted on an arm's-length basis.
18. The parent does not guarantee the loans of the subsidiary or secure any loan with assets of the parent.
19. The subsidiary's income represents a small percentage of the total income of the parent.
20. The insurance of the two companies is maintained separately and each pays its own

domination.[86] Others say they are testing for alter ego or instrumentality.[87]

Although sometimes decried, laundry-lists of relevant factors can be useful. They are useful in deciding debt-equity controversies under the tax law, and they can be useful for establishing guidelines in the veil-piercing context. Courts pierce the corporate veil when the shareholders fail to abide by a loose set of standards for responsible shareholder conduct, and it is possible to list incidents of bad shareholder conduct that courts do not, or at least should not, tolerate. Asset-stripping comes quickly to mind. The Powell list and its progeny, however, mix the innocuous with the noxious. For example, factor (a) on the list is mere stock ownership, which in no way by itself can be considered bad conduct, while factor (i) is asset-stripping, which obviously is bad conduct.[88]

The innocuous include factor (c), the parent financing the subsidiary, and factor (d), the parent subscribing to the subsidiary's stock or otherwise causes its incorporation.[89] What is the matter with incorporating and financing a subsidiary? Most subsidiaries would not exist if they were not incorporated and financed by a parent corporation.

The noxious includes factor (e), where the subsidiary has grossly inadequate capital; factor (h), where the parent holds out its subsidiary as a department or division of the parent or refers to the subsidiary's business or financial

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premiums.

21. The purchasing activities of the two corporations are handled separately.
22. The two companies avoid advertising as a joint activity or other public relations which indicate that they are the same organization.
23. The parent and subsidiary avoid referring to each other as one family, organization, or as divisions of one another.
24. The equipment and other goods of the parent and subsidiary are separate.
25. The two companies do not exchange assets or liabilities.
26. There are no contracts between the parent and subsidiary with respect to purchasing goods and services from each other.
27. The subsidiary and the parent do not deal exclusively with each other.
28. The parent does not review the subsidiary's contracts, bids, or other financial activities in greater detail than would be normal for a shareholder who is merely interested in the profitability of the business.
29. The parent does not supervise the manner in which the subsidiary's jobs are carried out.
30. The parent does not have a substantial veto power over important business decisions of the subsidiary and does not itself make such crucial decisions.
31. The parent and subsidiary are engaged in different lines of business.

Krendl & Krendl, *supra* note 9, at 52-55 (footnotes and citations omitted).

86. *See, e.g.*, Carte Blanche (Singapore) PTE., Ltd. v. Diners Club Intn'l, 2 F.3d 24 (2d Cir. 1993).

87. *See, e.g.*, Riddle v. Leuschner, 335 P.2d 107, 111 (Cal. 1959); Lowendahl v. Baltimore & O.R. Co., 287 N.Y.S. 62, 76 (N.Y. App. Div. 1), *aff'd*, 6 N.E.2d 56 (1936).

88. POWELL, *supra* note 62, at 9.

89. *See id.*

obligations as its own; factor (i), which refers to asset-stripping or commingling of parent and subsidiary assets; and factor (k), which refers to dispensing with corporate formalities for the subsidiary.[90] All of these are considered bad shareholder conduct and add, at the very least, cumulative weight toward piercing the corporate veil.

Factor (f), where the parent pays salaries and expenses or losses of the subsidiary, and factor (g), where the subsidiary does business only with the parent or has no assets except those conveyed to it by the parent, may arouse suspicions of commingling and treating the subsidiary as a department, respectively.[91] Yet it is hard to understand why factor (f) (especially) should be a ground for piercing the corporate veil. If the parent pays salaries or other expenses for the subsidiary, it is actually helping the subsidiary. This indirectly helps the creditors of the subsidiary, whose primary interest is the solvency of the debtor. Why should the parent be stripped of limited liability for financially helping the subsidiary? If the subsidiary is doing business only with the parent, the conduct described in factor (g), the parent may be taking the subsidiary's goods or services at cost or less. That would be noxious conduct, because in that situation, the parent actually would treat the subsidiary as a department or a division and not as profit-making enterprise. But if the parent is paying a fair market value for the subsidiary's goods or services, why is there a reason to complain? Factor (g), thus, seems to be basically neutral. Its relevance depends on the price paid by the parent for the goods or services.

The third grouping focuses on factors relevant to the parent's control over the subsidiary. They belong on a list, if control is considered as either a requirement for, or a factor tending to assist a plaintiff in, piercing the corporate veil. Factor (a), the parent owning all or most of the stock of the subsidiary, shows that the parent has the power to control the subsidiary's activities.[92] Factor (b), the parent and subsidiary having interlocking directorates, comes closer to showing that the parent actually exercises control over the subsidiary.[93] The parent has its own employees in position to make decisions for the subsidiary. Neither factor is actually noxious, but is relevant to the extent that control over the subsidiary is relevant.

B. Intrusive Daily Control

Excessive "control" by the parent over the subsidiary is sometimes said to be a *sina qua non* for piercing the corporate veil of the subsidiary to hold the parent liable. The parent's ability to control the subsidiary is not enough.[94] The parent

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90. *See id.*

91. *See id.*

92. *See id.*

93. *See id.*

94. *See, e.g.*, Craig v. Lake Asbestos of Quebec, Ltd., 843 F.2d 145, 152 (3d Cir. 1988); Jemez Agency, Inc. v. CIGNA Corp., 866 F. Supp. 1340, 1345 (D.N.M. 1994); Scalise v. Beech Aircraft Corp., 276 F. Supp. 58, 62 (E.D. Pa. 1967); Scott v. AZL Resources, Inc., 753 P.2d 897,

always has that, and if that were enough, parents would never have limited liability for the debts of their subsidiaries.[95] The parent does not excessively control the subsidiary merely by determining its general policies, exercising supervision[96] or controlling its finances and expenses.[97] The control required is "domination." This usually means intrusive, hands-on, day-to-day control with the parent often leaving no discretion whatsoever to the subsidiary.[98] Moreover, courts frequently say that they require domination with respect to the transaction attacked.[99]

In one case, the parent exclusively controlled the subsidiary's bank account, allowed the subsidiary no discretion in buying and merchandising, and arranged insurance and advertising for the subsidiary without consulting the subsidiary.[100] The two companies had common officers and directors, which, by itself, is almost never considered to constitute excessive control.[101] The court concluded that this micromanaging was "domination" and satisfied the control requirement for piercing the corporate veil.[102]

In another case, the majority shareholder of the parent so dominated the operations of the entities that he even dictated to the subsidiary's bookkeeper which bills to pay, when to pay them, and to what extent they should be paid.[103] The majority shareholder of the parent had complete and exclusive control of the subsidiary's fiscal policy. These circumstances constituted domination and

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901 (N.M. 1988).

95. *See, e.g.*, Johnson v. Flowers Indus., Inc., 814 F.2d 978, 980 (4th Cir. 1987); United States v. Jon-T Chemicals, Inc., 768 F.2d 686, 691 (5th Cir. 1985).

96. *See* Carsten Alting, *Piercing the Corporate Veil in American and German Law—Liability of Individuals and Entities: A Comparative View*, 2 TULSA J. COMP. & INT'L L. 187, 228-29 (1995).

97. *See id.*

98. *See* Krivo Indus. Supply Co. v. National Distillers and Chem. Corp., 483 F.2d 1098, 1106 (5th Cir. 1973); *In re* Catfish Antitrust Litig., 908 F. Supp. 400, 416 (N.D. Miss. 1995); Japan Petroleum Co. (Nigeria) Ltd. v. Ashland Oil, Inc., 456 F. Supp. 831, 841 (D. Del. 1978).

99. *See, e.g.*, Radaszewski v. Telecom Corp., 981 F.2d 305, 306 (8th Cir. 1992); American Protein Corp. v. AB Volvo, 844 F.2d 56, 60 (2d Cir. 1988); Land v. Midwest Office Tech., Inc., 979 F. Supp. 1344, 1349 (D. Kan. 1997); Fleming Cos., Inc. v. Rich, 978 F. Supp. 1281, 1303 (E.D. Mo. 1997); Lane v. Maryhaven Ctr. of Hope, 944 F. Supp. 158, 163 (E.D.N.Y. 1996); National Bond Fin. Co. v. General Motors Corp., 238 F. Supp. 248, 255 (W.D. Mo. 1964); Lowendahl v. Baltimore & O.R. Co., 287 N.Y.S. 62, 76 (N.Y. App. Div. 1 1936); B-W Acceptance Corp. v. Spencer, 149 S.E.2d 570, 576 (N.C. 1966).

100. Consolidated Sun Ray, Inc. v. Oppenstein, 335 F.2d 801 (8th Cir. 1964). *See also* Krendl & Krendl, *supra* note 9, at 25.

101. *See* Hystro Prods., Inc. v. MNP Corp., 18 F.3d 1384, 1390 (7th Cir. 1994); Steven v. Roscoe Turner Aeronautical Corp., 324 F.2d 157, 161 (7th Cir. 1963); *American Protein Corp.*, 844 F.2d at 57; Northern Ill. Gas Co. v. Total Energy Leasing Corp., 502 F. Supp. 412, 417 (N.D. Ill. 1980).

102. *Consolidated Sun Ray*, 335 F.2d at 808.

103. Atlantic Tobacco Co. v. Honeycutt, 398 S.E.2d 641, 645 (N.C. Ct. App. 1990).

satisfied the control requirement for piercing the corporate veil.[104]

One case involved claims asserted by asbestos victims against the parent of a subsidiary engaged in the mining and distribution of asbestos.[105] The parent owned 67.3% of the subsidiary's stock, which is an unusually low percentage for a veil-piercing case, but obviously is high enough to give the parent control over the subsidiary.[106] Nevertheless, the parent placed only three directors on the subsidiary's board, including the parent's chairman.[107] Despite the presence of a mere minority on the subsidiary's board, the Federal District Court for the Eastern District of Pennsylvania found that the parent's control over the subsidiary was "actual, participatory, and pervasive" and thereby satisfied New Jersey's alter ego requirement of dominating control.[108] The parent's chairman wielded complete power over the subsidiary's board, because there was a tacit understanding with the other subsidiary directors never to intervene in the decision-making process.[109] The membership of the parent's chairman on the subsidiary's board resulted in the parent's "omnipresence" in the minds of the subsidiary board members.[110] Moreover, the parent told its shareholders that it would take direct management responsibility for the subsidiary's mining operations and would closely scrutinize its capital expenditures. The chairman promised to report back regularly to the parent's shareholders. The subsidiary, the district court concluded, was nothing more than an "operating division" of the parent.[111]

The Third Circuit Court of Appeals reversed, determining that the parent's involvement in the subsidiary's financial and managerial affairs was neither constant nor day-to-day.[112] It noted that both parent and subsidiary maintained separate books, records, bank accounts, offices and staff, and that each consulted its own financial advisors, accountants and stockbrokers.[113] It determined that the district court's notion of the parent's "omnipresence" on the subsidiary's board was insufficient to meet the control requirement for piercing the corporate

104. *See id.* at 645.

105. Craig v. Johns-Manville Corp., No. 82-0321, 1987 U.S. Dist. LEXIS 4075 (E.D. Pa. June 3, 1987), *rev'd*, Craig v. Lake Asbestos of Quebec, Ltd., 843 F.2d 145 (3d Cir. 1988). This case is discussed in Richard S. Farmer, Note, *Parent Corporation Responsibility for the Environmental Liabilities of the Subsidiary: A Search for the Appropriate Standard*, 19 J. CORP. L. 769, 775-79 (1994).

106. *See Craig*, 1987 U.S. Dist. LEXIS at *8.

107. The parent was a United Kingdom corporation and called its chairman the "managing director." *Id.*

108. *Id.* at *52.

109. *See id.*

110. *Id.* at *50.

111. *Id.*

112. Craig v. Lake Asbestos of Quebec, Ltd., 843 F.2d 145, 155 (3d Cir. 1988).

113. *Id.* at 152.

veil.[114] "[P]otential control," it said, "is not enough."[115]

In another case, the United States and the Commonwealth of Massachusetts sought to hold a parent liable for the cost of cleaning the contamination caused by a subsidiary of the New Bedford Harbor and the Accushnet River.[116] The court looked closely for suggestions of pervasive control by the parent company over the subsidiary's hazardous waste disposal policies for an indication that the parent company treated the subsidiary as a mere instrumentality; however, it rejected the plaintiff's pleas that the special problems of cleaning up hazardous waste should be addressed by lowering the standards that make affiliated corporations responsible for the obligations of each member of the group.[117] The parent, the court noted, used a system where all subsidiaries and operating units deposited cash receipts into individual locked box accounts.[118] The parent provided a loan guarantee for the subsidiary, which enabled the subsidiary to obtain lower interest rates on its loans. Loans by the parent to the subsidiary were repaid through intercompany billing instead of formal loan agreements.[119] The parent required the subsidiary to seek prior parental approval for large capital expenditures. It caused the subsidiary to change several accounting procedures, and the subsidiary had to submit financial reports to the parent during the year.[120] The subsidiary's logo was changed to include the parent's

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114. *Id.*

115. *Id.* The court may have been influenced by the fact that the subsidiary had previously operated independently. *See also* LAW OF CORPORATE GROUPS, *supra* note 6, § 11.03.

116. *In re* Accushnet River & New Bedford Harbor Proceedings Re Alleged PCB Pollution, 675 F. Supp. 22 (D. Mass. 1987). This case involved liability for cleaning up hazardous waste sites under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, usually referred as "CERCLA." 42 U.S.C. §§ 9601-15 (1994 & Supp. II 1996). The court declined to forge new theories of parental liability for its subsidiary's obligations. *In re Accushnet River & New Bedford Harbor Proceedings*, 675 F. Supp. at 25-26, 30-35. Other cases are to the contrary. *See, e.g.*, United States v. Nicolet, Inc., 712 F. Supp. 1193 (E.D. Pa. 1989); United States v. Kayser-Roth Corp., 724 F. Supp. 15 (D.R.I. 1989), *aff'd*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 498 U.S. 1084 (1991); Idaho v. Bunker Hill Co., 635 F. Supp. 665 (D. Idaho 1986). These cases have been widely discussed in the literature. *See, e.g.*, George W. Dent, Jr., *Limited Liability in Environmental Law*, 26 WAKE FOREST L. REV. 151 (1991); Evelyn F. Heidelberg, Comment, *Parent Corporation Liability Under CERCLA: Toward a Uniform Federal Rule of Decision*, 22 PAC. L.J. 854 (1991); Lynda J. Oswald & Cindy A. Schipani, *CERCLA and the "Erosion" of Traditional Corporate Law Doctrine*, 86 NW. U. L. REV. 259 (1992); John S. G. Worden, *CERCLA Liability of Parent Corporations for the Acts of their Subsidiaries*, 30 IDAHO L. REV. 73 (1993); David S. Bakst, Note, *Piercing the Corporate Veil for Environmental Torts in the United States and the European Union: The Case for the Proposed Civil Liability Directive*, 19 B.C. INT'L & COMP. L. REV. 323 (1996); Charles E. Dadswell, Jr., Note, *The Corporate Entity: Is There Life After CERCLA?*, 7 COOLEY L. REV. 463 (1990).

117. *In re Accushnet River & New Bedford Harbor Proceedings*, 675 F. Supp. at 32.

118. *Id.* at 34.

119. *See id.*

120. *See id.*

initials. The parent and subsidiary used the same law firm in much of their litigation. The parent purchased an umbrella insurance policy that covered the subsidiary.[121]

The court concluded that the parent's activities did not show an inordinate level of integration and control as to justify piercing the subsidiary's corporate veil.[122] The centralized cash management system was not the equivalent of the intermingling of funds. The court said that if it were "keeping score," the centralized cash management probably would want to check on the "piercing" side of the ledger.[123] The quarterly and annual reports to the parent did not represent an intrusion into the subsidiary's business, as the right of shareholders to be informed is recognized in many public and closely held corporations.[124] Likewise, shareholder control over significant expenditures is not a disregard of corporate separateness.[125] The court also concluded that the parent had respected the separateness of the subsidiary in important ways. It noted that the subsidiary actually was not a "shell" corporation, as evidenced by the subsidiary's $17 million dollar net worth, which was five times more than what it was when the subsidiary had been purchased several years previously. Under the ownership of the parent, the subsidiary had remained profitable. The subsidiary negotiated its own contracts, developed its own customers, arranged its own loans, developed its own budgets, created its own marketing and sales program, hired and fired its own employees, maintained its own financial records and accounts, and regularly conducted board of directors meetings.[126] Although the parent influenced the philosophy and management of the subsidiary, the court noted that this was true of all majority shareholders.[127] The court ruled that the circumstances did not justify piercing the corporate veil.[128]

In a Second Circuit case, a corporation with a claim against a New York corporation sought a judgment against the New York corporation's Swedish parents.[129] The district court fastened legal liability on one of the foreign parents and the subsidiary's veil was pierced at least in part because two of the parents' officers and directors, who were also directors of the subsidiary, came to New York and voted at the subsidiary's board meeting to wind down the subsidiary's affairs, resulting in the subsidiary's default on a contract.[130] The Second Circuit reversed.[131] Citing the famous *Lowendahl* case, the Second Circuit said,

121. *See id.*
122. *Id.*
123. *Id.*
124. *See id.* at 34.
125. *See id.*
126. *See id.* at 35.
127. *Id.*
128. *Id.*
129. American Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988).
130. *See id.* at 62-63.
131. *Id.* at 62.

"[c]ontrol is the key."[132] The parent must exercise complete domination with respect to the transaction attacked. The Second Circuit found that "[t]he strongest piece of evidence to support control was the existence of the interlocking directorates. This commonplace circumstance of modern business [did] not furnish such proof of control as will permit a court to pierce the corporate veil."[133] Not only did the parent not exert control with respect to the particular contract in question, the subsidiary maintained its own corporate and financial records, held independent board meetings, and maintained separate corporate offices.[134] Though the parent supplied the subsidiary with working capital from time to time, there was not evidence that the subsidiary received financing specifically for the contract in question. There was no evidence of shareholder misbehavior such as asset-stripping.[135]

In a Fourth Circuit case, employees brought suit against their employer (a subsidiary), its parent, and another subsidiary, claiming that the parent replaced the plaintiffs with younger employees from the other subsidiary, in violation of the Age Discrimination in Employment Act.[136] The parent, the Fourth Circuit concluded, retained the benefits of limited liability, even though it exercised some control over its subsidiary.[137] If shareholders were liable whenever they exercised their rightful control, limited liability would become a meaningless fiction, the court reasoned.[138] The majority shareholder is entitled to exercise the normal incidents of stock ownership, such as the right to choose directors and set general policies, without forfeiting the protection of limited liability.[139] The court found a parent company can become the employer of a subsidiary's workers by exercising excessive control in one of two ways. First, it could control the employment practices and decisions of the subsidiary.[140] If it hired and fired the subsidiary employees, routinely shifted them between the two companies, and supervised their daily operations, the parent would then be found to be their employer.[141] Second, the parent might dominate the subsidiary's operations by treating it as its alter ego.[142] The subsidiary might be highly integrated with the parent's business operations, as evidenced by the commingling of funds and assets, the use of the same workforce and business offices for both corporations, the severe undercapitalization of the subsidiary, and the failure to observe basic corporate formalities such as keeping separate

132. *Id.* at 60.
133. *Id.*
134. *See id.*
135. *See id.*
136. Johnson v. Flowers Indus., Inc., 814 F.2d 978, 978 (4th Cir. 1987).
137. *Id.* at 980.
138. *Id.*
139. *See id.* at 980-81.
140. *See id.* at 981.
141. *See id.*
142. *See id.*

books and holding separate shareholder and board meetings.[143]

The plaintiff produced no evidence that the parent excessively interfered with the subsidiary's business operations.[144] The subsidiary's management was responsible for the daily decisions in vital areas of production, distribution, marketing, and advertising. The subsidiary had a separate board of directors and corporate officers, kept its own business records, and maintained separate bank accounts.[145] Three of the subsidiary's four directors were officers of the parent, and the parent exercised oversight of the subsidiary's activities. However, the court considered those facts to be characteristic of a parent-subsidiary relationship not amounting to domination of the business practices of the subsidiary.[146] In particular, the court found no evidence that the parent controlled the employment practices and decisions of the subsidiary because the parent never hired, fired, promoted, paid, transferred, or supervised any subsidiary employee.[147]

In an effort to bring some cohesion to the judicial discussions of control, Blumberg summarizes by noting that the courts' evaluation of intergroup *tort* liability have emphasized four factors: (1) parental participation in daily operations; (2) parental determination of important subsidiary policy decisions; (3) parental determination of subsidiary business decisions while bypassing subsidiary managers; and (4) parental issuance of instructions to the subsidiary personnel or the use of parental personnel in the conduct of the subsidiary affairs.[148] The courts in most cases, however, usually acquiesce in the reality of the exercise of control by the parent and determine the parent's liability on the basis of other factors.[149] Essentially, the courts discuss the exercise of control, but control is not usually the critical question.[150]

It would be more accurate to say that piercing the corporate veil is such a confused area of the law that the requirement of control, as with all the other requirements, is treated erratically by the courts. A determination of what constitutes excessive control is a difficult job for a judge because the "separateness" of a parent and subsidiary corporation is formalistic. It is unrealistic to think that a parent and a subsidiary are truly separate, making it hard for a judge to determine when they are not separate. If the subsidiary is treated as an economically viable entity, a higher degree of control by the parent over the subsidiary is tolerated. If something appears amiss, however, such as the manipulation of corporation assets or extensive economic integration, the judge will strictly scrutinize the extensiveness of control. If control is extensive, it will be a factor favoring piercing the corporate veil. If control is not extensive, it will

143. *See id.*
144. *See id.*
145. *See id.* at 982.
146. *Id.*
147. *Id.*
148. LAW OF CORPORATE GROUPS, *supra* note 6, § 10.02.
149. *See id.*
150. *See id.*

be a factor weighing against piercing the corporate veil.

IV. CONTROL AS PROOF THAT A SUBSIDIARY IS THE PARENT'S AGENT

In addition to piercing the corporate veil of the subsidiary to reach the parent, a claimant against the subsidiary may be able to invoke agency principles to reach the parent. Justice Cardozo noted this possibility long ago in *Berkey*,[151] stating that "[d]ominion may be so complete, interference so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent."[152] If the subsidiary is acting as the parent's agent, the parent may then be held liable under normal agency principles without resorting to piercing the corporate veil.[153] If a subsidiary corporation acts as an agent for the parent corporation, the parent should be liable for the acts of the agent subsidiary within the scope of the agency.[154] In *Walkovszky v. Carlton*,[155] the court referred to the agency principle of respondeat superior and concluded that a shareholder should be liable when its corporation is acting as its agent.[156] If a corporation is an agent for the shareholders, perhaps there should be no quarrel in making the shareholders liable because a corporation may, like a natural person, be an agent of natural or artificial persons.[157] As the Krendls and Blumberg have pointed out, however, agency requires a consensual undertaking between the parties and rarely arises in piercing the corporate veil, because the subsidiary typically is acting in its own behalf, not on behalf of its parent or with the intent of binding its parent.[158]

Nevertheless, several cases, especially in New York, have used agency principles to make the parent liable for the debts of the subsidiary.[159] By finding

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151. Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (1926).

152. *Id.*

153. *See, e.g.*, Robert C. Downs, *Piercing the Corporate Veil—Do Corporations Provide Limited Personal Liability?*, 53 UMKC L. REV. 174, 190-91 (1985); *Liability of a Corporation for Acts of a Subsidiary or Affiliate*, 71 HARV. L. REV. 1122, 1123 (1958).

154. *See, e.g.*, Solar Int'l Shipping Agency, Inc. v. Eastern Proteins Export, Inc., 778 F.2d 922 (2d Cir. 1985); Publicker Indus., Inc. v. Roman Ceramics Corp., 603 F.2d 1065 (3d Cir. 1979); Acme Precision Prods., Inc. v. American Alloys Corp., 422 F.2d 1395 (8th Cir. 1970), *remanded*, 347 F. Supp. 376 (W.D. Mo. 1972), *rev'd on other grounds*, 484 F.2d 1237 (8th Cir. 1973); Downs, *supra* note 153, at 191.

155. 223 N.E.2d 6 (N.Y. 1966).

156. *Id.* at 7-8.

157. *See* NORMAN D. LATTIN, THE LAW OF CORPORATIONS ch.1 § 14 (1959).

158. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 6.06.1; Krendl & Krendl, *supra* note 9, at 3 n.9. *See also* Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929).

159. *See* AFP Imaging Corp. v. Ross, 780 F.2d 202, 204 (2d Cir. 1985); Glacier Gen. Assurance Co. v. G. Gordon Symons Co., Ltd., 631 F.2d 131, 134 (9th Cir. 1980); Rapid Transit Subway Constr. Co. v. City of New York, 182 N.E. 145, 150 (N.Y. 1932); Whitehurst v. FCX Fruit & Vegetable Serv. Inc., 32 S.E.2d 34, 40 (N.C. 1944); Elvalsons v. Industrial Covers, Inc., 525

that the subsidiary is the agent of the parent and is acting within the scope of its agency, the court obviates the necessity of piercing the corporate veil. This may make an easier case for a plaintiff by relieving the need to overcome the frequently expressed judicial reluctance to pierce the corporate veil. Moreover, though the plaintiff would need to show domination to establish the principal-agent relationship, there would be no need to satisfy the other elements of piercing the corporate veil, e.g., the "fraud or wrong-injustice" test proposed by Powell.

However, it is more common for courts mentioning agency to merely list it as one of the numerous conclusory metaphors for piercing the corporate veil.[160] The courts are often plainly confused, using agency as a synonym for instrumentality in one paragraph and then in its correct sense in another.[161] For example, in an Idaho case,[162] the court used a corporate veil-piercing/alter ego analysis to reject the plaintiff's product liability claim against the parent of a sailboat manufacturer.[163] There was nothing unusual in its analysis. In dissent, however, one justice first clearly stated agency principles as a method for making a parent liable for its subsidiary's obligations.[164] He stated that a parent may be liable for the actions of its wholly-owned subsidiary regardless of whether the subsidiary's separate corporateness is recognized.[165] Where the subsidiary is dominated by the parent, he said, separate corporate entities might be recognized, treating the parent as principal and the subsidiary as agent, thus making the acts of the subsidiary in effect the acts of the parent.[166] The parent's liability may be premised upon the actions of the subsidiary under agency principles.[167] In the next paragraph, just as clearly, the justice iterated typical alter ego phraseology, saying that the corporate identity may be disregarded where there is such a unity of interest and ownership that the separate personalities of the corporation and shareholder no longer exist and where an inequitable result would ensue if the separate personality is not disregarded.[168] Returning to agency principles, and quoting from Justice Cardozo in *Berkey*, he stated that dominion may be so complete that the general rules of agency should apply.[169] Further garbling his analysis, he next discussed an environmental case where liability attached because the parent had the capacity to control and profited exclusively from the

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P.2d 105, 111-12 (Or. 1974); LAW OF CORPORATE GROUPS, *supra* note 6, § 6.06.

160. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 6.06.2; FLETCHER ET AL., *supra* note 11, § 43; LATTIN, *supra* note 157, ch.1, § 14; Krendl & Krendl, *supra* note 9, at 3 n.9.

161. *See* Krendl & Krendl, *supra* note 9, at 3 n.9.

162. Ross v. Coleman Co., Inc., 761 P.2d 1169 (Idaho 1988).

163. *Id.*

164. *Id.* at 1197.

165. *Id.*

166. *See id.*

167. *See id.*

168. *Id.* He then used the terms "alter ego," and "mere instrumentality." *Id.*

169. *Id.* at 1198.

actions of its subsidiary.[170] The justice ended his analysis by again referring to alter ego principles in one paragraph and agency concepts in the next paragraph.[171]

What should be made of the agency argument as a rationale for making one corporation responsible for the obligation of another corporation within its affiliated group? First, most of the cases mentioning agency are really corporate veil-piercing cases and apply the Powell instrumentality test or the California alter ego test, not agency principles. These indiscriminate references to agency principles are at best superfluous in an attempt to bolster the argument. At worst, they are confounding, as demonstrated by the Idaho Supreme Court justice's confusion.[172]

Second, some cases, notably in New York, have followed Justice Cardozo's lead in *Berkey*, finding that an excessive degree of intrusive control over a subsidiary—particularly over its daily operations—makes the subsidiary an agent for its parent and, therefore, its parent liable as the subsidiary's principal.[173] The importance of this rationale is that a claimant need only show control to attach liability to the parent for the subsidiary's obligations. The plaintiff would not be required to prove anything supplemental, such as unfairness or fraud.

Is this a good, helpful analysis that could prove useful in deciding these cases? This author does not think so. A better analysis would be that intrusive control by the parent makes the parent itself the actor in the transaction. By dint of its intrusive control the parent is committing the wrongs complained of by the plaintiff. There would be no need to resort to the doctrine of respondeat superior to make the parent liable because the parent is committing the wrongful act by itself. The parent could be held directly liable without using agency principles (or without piercing the corporate veil). The relationship does not involve the subsidiary acting as an agent for the parent; the parent is acting for itself. Such an analysis might have an unfortunate policy result, however, by inducing the parent to refrain from paying close attention to its subsidiaries' conduct.

Third, in those instances when an agency relationship actually exists between a parent and a subsidiary, and the subsidiary acts within the scope of its agency, there is a valid obligation created upon the parent. In one case, the court said that a jury could determine that a parent was liable on an agency theory if (1) the

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170. *Id.* The case discussed was *Environmental Protection Department v. Ventron Corp.*, 440 A.2d 455 (N.J. Super. Ct. App. Div. 1981).

171. *Ross*, 761 P.2d at 1199.

172. A federal judge has noted the confusion caused by using the term "agent" in corporate veil-piercing cases. *See* Mobil Oil Corp. v. Linear Films, Inc., 718 F. Supp. 260, 266 n.9 (D. Del. 1989).

173. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 6.06.2. *See also supra* note 159 and accompanying text. Other jurisdictions that have referred to agency principles include Connecticut, Montana, South Dakota, and the Fifth Circuit. *See, e.g.*, Krivo Indus. Supply Co. v. National Distillers & Chem. Corp., 483 F.2d 1098 (5th Cir. 1973); Zaist v. Olson, 227 A.2d 552 (Conn. 1967); Hando v. PPG Indus., Inc., 771 P.2d 956 (Mont. 1989); Glanzer v. St. Joseph Indian Sch., 438 N.W.2d 204 (S.D. 1989).

parent manifested that the subsidiary would act for the parent as the parent's agent, (2) the subsidiary accepted the undertaking, and (3) the parties understood that the parent was in control of the undertaking.[174] For example, a manufacturing corporation could incorporate a subsidiary to act as its agent for distributing its manufactured products to wholesalers. Parent and subsidiary could clearly delineate the agency relationship to the customers. If the parent failed to fill an order taken by the subsidiary as its agent, the parent would be liable for the breach of contract.

It must be noted that there are few cases with such a clearly demarcated principal-agent relationship.[175] A well-advised entity might not find much of a reason to use a subsidiary as a sales agent, if the parent is going to be liable anyway. It might avoid the extra complexity and bookkeeping by using its own sales department rather than a subsidiary. Or if it does use a subsidiary, it would be better advised to avoid clearly delineating a principal-agent relationship between itself and its subsidiary. Instead, it should tell the subsidiary to act as if it is an independent distributor and not as an agent. Informally, the subsidiary probably would feel like it is really only an agent for the parent (and the actual sales people working for the subsidiary may make the mistake of saying they work for the parent), but form often wins the day in corporate law and probably no one would conclude that an agency relationship exists.

If, as usually is the case, there is no formal agency relationship between the parent and the subsidiary, the subsidiary may still, in all practicality, be acting as the parent's agent. It is hard to see why the plaintiff should not be allowed to try to prove such a relationship. If the subsidiary is indeed an agent of the parent, the parent as principal should be made liable for the subsidiary's acts. One almost has to believe that the analysis in this situation would probably replicate that needed in the instrumentality and alter ego cases, and the confusion would remain. Additionally, full-scale adoption of an implied agency rationale might mean more liability for parent corporations. In all likelihood, states do not want such an increase in liability.[176] Blumberg and other commentators want to eliminate limited liability for corporate groups,[177] though one might speculate that even they may not welcome what may be merely an incremental increase in liability and the likely accompanying confusion in the courts.

V. CONTROL THAT MAKES THE PARENT DIRECTLY LIABLE RATHER THAN VICARIOUSLY LIABLE (PARENT AS A DIRECT OBLIGOR)

Courts using the Powell analysis almost always require "complete

174. Glanzer v. St. Joseph Indian Sch., 438 N.W.2d 204, 207-08 (S.D. 1989).

175. *See, e.g.*, NLRB v. Deena Artware, 361 U.S. 398 (1960); Ross v. Coleman Co., Inc., 761 P.2d 1169 (Idaho 1988); Pennsylvania Eng'g v. Islip Resources Recovery Agency, 710 F. Supp. 456 (N.Y. 1989).

176. *See supra* notes 34-36 and accompanying text.

177. *See supra* notes 19-24 and accompanying text.

domination . . . in respect to the transaction attacked."[178] If the parent exerts intrusive control over the transaction in question, perhaps, as noted above, the parent is making itself an actor in the transaction and can be deemed the party that is committing the wrongful act by itself. Therefore, it may be possible to hold the parent directly liable without piercing the corporate veil (or resorting to agency principles).

This analysis tends to fail in contract cases. Nothing in contract law says that intrusive parental control over the subsidiary, even for the contract in question, makes the parent liable on a contract that specifies the subsidiary as the contractual obligator. Indeed, it is not unusual at all that someone who is not a party to a contract exerts dominating and intrusive influence on a contracting party and still is not made liable on the contract. Obvious examples are the highly publicized contracts between sports franchises and athletes. Agents/advisors regularly exert dominating control over negotiations for their clients, yet no one suggests that the agents/advisors are personally liable on the contract. This is not to say that an intrusively dominating party cannot get itself into trouble. With so much power over the contracting party, the dominating party probably has a fiduciary duty which that party may breach. The controlling party may not keep its mouth completely closed, allowing any representations it makes to evolve into misrepresentation. This creates opportunities for actionable misrepresentations. A relatively common problem occurs when the parent creates confusion for the other contracting party as to whether the subsidiary or the parent is the contracting party on its side of the deal. Under a fraud or misrepresentation theory, the other contracting party may have a direct action against the parent.[179]

A somewhat similar problem regarding parents and subsidiaries is the use of a common public persona where the affiliated corporations are held out to the public as a single enterprise.[180] Persons dealing with a subsidiary may be misled into thinking they are doing business with a group or with the parent. This can be a ground for piercing the corporate veil,[181] but confusion as to the identity of the obligor on the contract also may result in making the parent the obligor on the contract. If the parent represents that it stands behind or considers itself liable for the obligations of its subsidiary, it likely will be estopped from denying liability.[182] If the parent leads a plaintiff to reasonably believe that the parent is a party to the contract, it also may be held liable on the contract.[183] If the parent misleads the other contracting party as to the credit worthiness of its subsidiary,

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178. *See supra* note 99 and accompanying text.

179. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 19.21. *See, e.g.*, Carnival Cruise Lines, Inc. v. Oy Wartsila Ab, 159 B.R. 984 (S.D. Fla. 1993); Stacey-Rand, Inc. v. J.J. Holman, Inc., 527 N.E.2d 726 (Ind. Ct. App. 1988); Hideca Petroleum Corp. v. Tampimex Oil Int'l, Ltd., 740 S.W.2d 838 (Tex. Ct. App. 1987).

180. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 19.08

181. *See, e.g.*, FMC Fin. Corp. v. Murphree, 632 F.2d 413 (5th Cir. 1980).

182. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 19.18.

183. *See id.*

the parent may be liable on the contract.[184] These instances of contract liability are not based on control, though control is almost always present in these cases. The plaintiff should be able to make the parent liable on the contract without having to pierce the corporate veil of the subsidiary, due to the existence of an independent basis for making the parent directly liable on the contract, such as misrepresentations or the parent making itself a de facto contracting party.

However, these types of misconduct help a plaintiff pierce the corporate veil. The wrongful conduct satisfies the wrongful or inequitable conduct requirement for both the instrumentality and alter ego tests. Also, there is likely a causal relationship between the wrongful conduct and the plaintiff's problem, especially in the cases involving some sort of misrepresentation, thereby satisfying the causation element in jurisdictions requiring a causal connection for piercing the veil.

Torts present a much different analysis. If a parent exerts complete control of the subsidiary, can it be said that torts committed by the subsidiary are really being committed by the parent, who by virtue of its complete domination, is the real actor? Perhaps. One potential problem for the parent occurs when the parent provides safety services to its subsidiary. It is then possible to predicate limited liability against the parent based on the Good Samaritan Doctrine as set forth in the Restatement (Second) of Torts.[185] Under this theory, liability can attach to the parent if it undertakes to provide safety services and thereafter performs those services negligently.[186] The parent can create a duty for itself, and therefore potential liability, by inspecting a subsidiary's plant for potential safety problems or by inspecting specific machines or instruments.[187] Several cases have imposed liability on a parent where its inspection of the subsidiary's premises disclosed unsafe conditions went uncorrected.[188] In some cases, courts have imposed direct tort liability on a parent when an employee/officer of the parent made a critical decision which resulted in tort liability.[189] Often, however, that person has a position with both the parent and the subsidiary, and the court is likely to decide that the wrongful act was committed while the person was acting on behalf of the subsidiary instead of the parent. Consequently, the parent is exculpated from direct tort liability.[190] This is a formalistic result, but again, form often wins out in corporation law.

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184. *See id.*

185. RESTATEMENT (SECOND) OF TORTS § 324A (1965).

186. *See* N. Stevenson Jennette, III, *Providing Safety Services to Subsidiaries: A Liability Trap for Parent Corporations*, 3 DET. C.L. REV. 713, 716 (1990).

187. *See id.*

188. *See, e.g.*, Johnson v. Abbe Eng'g Co., 749 F.2d 1131 (5th Cir. 1984); LAW OF CORPORATE GROUPS, *supra* note 6, § 14.05.4.

189. *See* Jardel Co., Inc., v. Hughes, 523 A.2d 518, 526 (Del. 1987); LAW OF CORPORATE GROUPS, *supra* note 6, § 10.02 (Supp. 1997).

190. *See, e.g.*, United States v. Jon-T Chems., Inc., 768 F.2d 686, 691 (5th Cir. 1985); Alting, *supra* note 96, at 228-29.

VI. CONTROL AND FRAUDULENT CONVEYANCE LAW

In a provocative work, Robert Charles Clark postulates that the "ancient" body of law known as the law of fraudulent conveyances could provide a useful framework for resolving issues that are now analyzed under the jurisprudence of piercing the corporate veil, the equitable subordination doctrine, and the dividend statutes.[191] Fraudulent conveyance law contains principles and rules that are easy to grasp and have fairly definite meaning when applied to real cases. Clark contends that many, if not most, veil-piercing cases are simply substitutes for fraudulent conveyance actions.[192] The problem consists of the corporation, that is, the managers, who are usually also the shareholders in closely held corporations, taking steps to increase the riskiness of the loan after the terms have been already set. This offensive conduct, called the problem of supervision, largely provides the context of both fraudulent conveyance law and piercing the corporate veil.[193] Thus, although academics have long been enamored by the issue of the adequacy of initial capitalization,[194] the crux of most of the cases is self-dealing on the eve of insolvency. "As is often said," Clark repeats, "a fraudulent conveyance is but a reflex of an insolvent man."[195] That form of noxious behavior on the brink of insolvency has been the focus of litigation and legal doctrine for both veil-piercing and fraudulent conveyance.

Clark, it seems, presupposes control. For who besides those in control has the power on the eve of insolvency to remove assets out of the corporation and to place them beyond the reach of corporate creditors? However, control, by itself, does not suffice as a basis. Instead, it is the wrongful conduct since the shareholders cannot be penalized for exercising control. Thus, the shareholders would only lose out if they had engaged in unacceptable behavior.

VII. CONTROL AS A FACTOR FOR PIERCING CORPORATE VEIL PROVIDES DISINCENTIVE FOR CAUTIOUS BEHAVIOR

Virtually all of the cases on this issue discuss control as a factor for piercing the corporate veil of a subsidiary.[196] Control also has been made an important factor in some of the CERCLA cases where the exertion of control by a parent

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191. ROBERT CHARLES CLARK, CORPORATE LAW § 2 (1986).

192. *Id.* § 2.4.

193. *See id.* § 2.4 n.5 (citing Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976)).

194. *See id.*

195. *Id.* Clark asks whether inadequate capitalization by itself leads to piercing the corporate veil. A careful review of the caselaw says, "[v]ery rarely, if at all. But many courts do consider it a relevant factor." *Id.* § 2.41 (citing Gray v. Kenneth R. Ambrose, Inc., 727 F.2d 279 (3d Cir. 1983)). Clark opines that judges have experimented with the notion of requiring an affirmative duty to capitalize corporations, but as the near absence of cases basing piercing solely on inadequate capitalization shows, the courts have not gone far toward that notion. *Id.*

196. *See* PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: STATUTORY LAW § 2.02.3 (1989).

over a subsidiary makes the parent the "operator" of a hazardous waste site owned by its subsidiary. This status of "operator" is sufficient to invoke liability under the statute.[197] One justification for the imposition of this type of liability is the tort-like principle that the party causing the harm ought to be held accountable for the injuries thereby inflicted.[198] The normal predicate for imposing vicarious liability upon the principal for a tort committed by an agent is that the principal had control over the agent's physical activities.[199] With regard to the potential liability of the shareholders of publicly held corporations, where power is vested in the board and the officers rather than in the public shareholders, that predicate is missing. It is not missing, however, in the case of a parent that has full control over its subsidiary.[200] Hansmann and Kraakman propose that shareholder liability should be seen as a standard problem of tort law more than a problem of corporate law.[201] Underlying this theory and analysis is the normative assertion that those persons who stand to benefit from the activities of an enterprise should bear its costs, including tort costs.[202] The emphasis on control places the focus on the party who caused the injury. The wrongdoer was the one with control; therefore, the one in control should suffer the costs.[203]

The law and economics scholars, one would think, would not consider control a relevant factor for removing limited liability. Instead, they would posit that a cost-benefit analysis reveals that limited liability produces a net gain for society as a whole.[204] Assuredly, they know that majority shareholders have control over their corporations. Also on the side of limited liability are the judges who take to heart the concept of the corporation as a separate entity, perhaps unduly so. For example, some judges are unwilling to make a parent liable for wrongs by the subsidiary when the individual wrongdoer is an officer of both the parent and the subsidiary, but is wearing his or her subsidiary "hat" and not his or her parent "hat" when he commits the wrong.[205] Clearly, the emphasis is heavily on form: In the "hat" cases, not only does the parent have the power to exert control over the subservient corporation, it is actually doing it.

While there is little merit in slavish adherence to the concept of a corporation as a legal entity and the "hats" worn by one of its managers, there is merit in both of the conflicting rationales at play here: making parties accountable for the wrong that they do versus limited liability producing a net gain for society.

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197. CERCLA § 196(a)(2), 42 U.S.C. § 9607(a)(2) (1994).

198. *See, e.g.*, Hansmann & Kraakman, *supra* note 8, at 1916.

199. *See* LAW OF CORPORATE GROUPS, *supra* note 6, § 14.03; CARY & EISENBERG, *supra* note 6, at 186; Thompson, *supra* note 38, at 39.

200. *See* CARY & EISENBERG, *supra* note 6, at 186-87.

201. Hansmann & Kraakman, *supra* note 8, at 1916.

202. *See id.*; *see also* CARY & EISENBERG, *supra* note 6, at 187.

203. *See* Hansmann & Kraakman, *supra* note 8, at 1916.

204. *See, e.g.*, Presser, *supra* note 7, at 150.

205. *See supra* note 190 and accompanying text.

However, making control the fulcrum for deciding a parent's liability produces a problem: A parent may choose to avoid exercising control over its subsidiary in order to ensure that its liability remains limited. Indeed, that is exactly the advice that some lawyers give to their corporate clients. This became especially true after several CERCLA cases held that exerting control made a parent the operator of its subsidiary's hazardous waste facility.[206] For example, one author posits that a lawyer has two ways of minimizing the impact of environmental risk on a corporation's bottom line.[207] The first is for the lawyer to tell the parent that it could significantly limit the impact of environmental risks merely by establishing a subsidiary corporation to conduct the hazardous waste activities.[208] The second is that the corporate lawyer could attempt to directly influence the distribution of environmental risks for the corporation by advising the parent to employ risk prevention strategies.[209]

The first is a traditional strategy frequently used by corporate lawyers. By avoiding behavior that causes the veil to be pierced under traditional veil-piercing doctrine, the parent corporation can stake a strong claim to insulation from the subsidiary's liabilities.[210] Proper behavior, the author notes, includes "*avoiding direct oversight of operations* (especially hazardous waste decisions)."[211] The author noted that many corporate lawyers today continue to view the risk-insulating approach as a viable method of limiting environmental liabilities.[212]

However, the author prefers the second lawyering strategy of directly influencing the distribution of environmental risks through a risk prevention strategy. Under this approach, the parent can minimize environmental risks by overseeing the production process to ensure that the costs of production and the creation of environmental risks are appropriately balanced. A lawyer seeking this objective could recommend, for example, regular environmental audits or the establishment of other structural mechanisms for oversight of environmental risks.[213]

The author noted that the first approach of merely suggesting establishment of a subsidiary has the "advantage" for the lawyer of requiring relatively little

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206. *See, e.g.*, United States v. Bestfoods, 118 S. Ct. 1876, 1887 (1998) (holding that veil-piercing is necessary to hold a parent derivatively liable as the operator of a subsidiary's facility unless the parent's conduct is so specifically related to the hazardous waste activity that it should be considered the operator of the hazardous waste facility).

207. Peter S. Menell, *Legal Advising on Corporate Structure in the New Era of Environmental Liability*, 1990 COLUM. BUS. L. REV. 399, 402 (1990).

208. *See id.* at 402-03.

209. *See id.* at 403.

210. *See id.* at 404-05. The parent should adequately capitalize the subsidiary to ensure proper record-keeping, not siphon funds excessively from the subsidiary, and observe corporate formalities of the subsidiary. *See id.*

211. *Id.* (emphasis added).

212. *Id.* at 406 & n.25.

213. *See id.* at 403.

knowledge or effort to learn about the client's business.[214] Mere general knowledge of corporate law would suffice. In contradistinction, the objectives of a risk prevention strategy could not be implemented without understanding much about the nature of the client's business, including such things as the potential effects of risk reduction approaches on consumer demand for products, availability of investment funds, and worker and community relations.[215] It is not difficult to determine which of the two approaches most lawyers would select. Should a parent really be made to disengage itself from addressing safety issues in its wholly owned subsidiary, upon pain of losing limited liability? Lawyers find this advice suitable for all types of corporate activity and not just for CERCLA. In one article the author, a practitioner, gives the following corporate law advice:

> *Do not let a parent corporation official participate in the day-to-day management of the subsidiary corporation.
>
> *Do not let a parent corporation official become personally involved with, or direct, the subsidiary's safety operations.
>
> *Do not have the parent corporation agree to provide "comprehensive safety services" or "accident prevention services" to the subsidiary.
>
> *Have the subsidiary corporation create its own safety organization, including an insurance department and safety and loss prevention department.
>
> *Ensure that the subsidiary corporation's management is in charge of overall safety operations, and appoints a named safety coordinator or director.
>
> *If a parent corporation provides safety suggestions or guidelines to the subsidiary, these guidelines should explicitly state that the subsidiary's management, and *not* the parent corporation, is responsible for implementing any safety suggestions or guidelines presented by the parent corporation.
>
> *If a parent corporation must inspect a subsidiary's facility, it should keep its necessary inspections brief and, if possible, limit them to routine checks for compliance with OSHA regulations.
>
> *Do not inspect the subsidiary's plant alone; take members of the subsidiary's safety team along.
>
> *Do not represent that the parent corporation's inspections are for the purpose of "alerting" the subsidiary corporation or the subsidiary corporation's employees to safety hazards.
>
> *Do not represent, orally or in writing, that the parent corporation's safety inspections are for the purpose of relieving the subsidiary corporation of safety responsibility. In fact, state the opposite in writing.
>
> *Do not let the employees of the subsidiary corporation know that

214. *Id.*
215. *See id.* at 403-04.

> the safety inspections took place.
>
> *Do not accept payment for the parent corporation's safety inspections.
>
> *If a parent corporation must review accident reports or accidents at the subsidiary's plant, take along a member of the subsidiary's safety organization.
>
> *If a subsidiary's maintenance records are reviewed, do so in conjunction with a member of the subsidiary's safety organization.
>
> *If any suggestions are rendered as the result of any inspections or investigations made by the parent corporation, offer them as "general safety suggestions"—*not* as suggestions specific to an accident or injury.[216]

This advice comes about as the result of saying that control is a factor leading to liability for the parent. Do we want lawyers to be giving advice like this? Even in the popular press it has been mentioned that a parent makes a mistake by admitting in a tort case that it exercised control over the subsidiary that engaged in the wrongful conduct. For example, following the catastrophic explosion in Bophal, India in 1984, the *Wall Street Journal* reported that lawyers for the victims were nearly gleeful from comments by Union Carbide that it exerted control over its Indian subsidiary:

> "We were delighted by their statements," says David Jaroslawicz, a personal injury lawyer who has filed a $20 billion suit against Union Carbide in New York. The company's efforts to compare safety standards in the Indian plant with those in its West Virginia facility, including statements that safety standards were set by company headquarters in the US, "practically decide the question . . . ."
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> * * *
>
> [To counter such damaging admissions,] a Union Carbide spokesman [said], "We've said they (the Indians) operated the plant from the beginning."[217]

In another case, the estate of racecar driver Mark Donohue sued Goodyear Tire & Rubber Co., a United States company, because a Goodyear tire blew out during one of Donohue's races.[218] Donohue's attorneys were presented with the problem that the tire had actually been manufactured by a wholly-owned subsidiary situated in the United Kingdom. Goodyear, however, had an even bigger problem, because the company's press releases and annual reports indicated a great degree of control over the British operation from the United States. Goodyear's former chief executive tried to distance the United States

216. Jennette, *supra* note 186, at 724-25.

217. James B. Stewart, *Suits Against Union Carbide Raise Issues for Lawyers, Multinationals*, WALL ST. J., Dec. 17, 1984, at 37.

218. *See* Richard Greene, *Peeking Beneath the Corporate Veil*, FORBES, Aug. 13, 1984, at 58.

parent company from its United Kingdom subsidiary by arguing that the United States headquarters had no control over the subsidiary. His apparent dissembling did not deceive the trial court judge, however, who allowed the estate to pierce the United Kingdom corporation's corporate veil to get to the United States parent.[219]

The current law is producing the wrong incentive, because it encourages parents to avoid exerting control over its subsidiaries. Competent lawyers are warning managers, "Stay away from the subsidiary, especially safety issues and hazardous waste site problems, or the courts will hold you liable." Do we really want managers to intentionally avoid pressing issues that affect their subsidiaries? The better policy is to let parents use sound business judgment regarding the operations of their subsidiaries. Parents should be encouraged to impose safety standards for their subsidiaries and to send their officers to inspect the subsidiaries' facilities. The subsidiaries are the parent's property just as much as any other assets held by the parent in its own name. Assuredly, the parent does not want the subsidiary's plant to suffer destruction. Attention is far more likely to ensure that the subsidiary run a safe ship than does inattention. The parent's shareholders presumably do not want any corporate property to be destroyed.

VIII. The Landers Model of a Well-Behaved Corporate Group

Jonathan M. Landers describes the type of behavior that a putative, thoughtful legislature, which accepts limited liability as the norm for corporate groups, would expect from a corporate group to preserve limited liability for its constituent membership.[220] Such a legislature would permit separate incorporations with its intended privilege of limited liability to encourage an existing business to expand into a new field, to permit the insulation of parts of the business from risks of other parts of the business when the separate areas might exist as an independent entity, and to satisfy legal or administrative requirements.[221] An attempt to divide one business into a number of mutually dependent units would probably not be a proper basis for bestowing limited liability in each member of the group.[222] Various types of abusive behavior, such as placing assets in one company and liabilities in another, would not be a justifiable basis for limited liability either.

In addition to requiring a justifiable basis for separate incorporation, the model would require both economic viability and the observance of procedural

219. *Id.*

220. Landers, *supra* note 6, at 620-22. Like the works of Professor Blumberg, Landers does not support limited liability for members of an affiliated group. He favors enterprise liability, meaning that a parent should be liable for the obligations of its subsidiaries without the necessity of piercing the subsidiary's corporate veil. *Id.* at 617. The actual focus of the Landers article, however, is the issue of equitable subordination in bankruptcy.

221. *See id.* at 621.

222. *See id.*

formalities.[223] First, each member of the affiliated group must have adequate capitalization to carry out its intended business.[224] Second, the affiliated group must be organized and managed to ensure that each member of the group has a realistic potential for profitability.[225] For example, in one case a subsidiary was forced to pay its parent management fees equal to its net earnings.[226] This was not acceptable behavior. Third, the subsidiary cannot be excessively dependent on the parent.[227] It would be unacceptable if the subsidiary's sole function was to service the parent and investors would be unlikely to organize an independent, free-standing corporation to engage in those same transactions.[228] Fourth, the parent should treat its subsidiary as a separate entity.[229] This means that the corporate formalities must be observed, assets and properties must not be commingled, and the public image of the subsidiary as a separate corporation must be preserved.[230] In summation, these putative legislatures would expect each member of the affiliated group to be treated as if it was an economically viable, free-standing corporation.

IX. THE PROPOSAL

A. Retain Limited Liability as the Norm for Members of an Affiliated Group of Corporations

As discussed above, this author supports limited liability as the norm, both generally and more specifically, for the members of an affiliated group of corporations. This may not be more than a normative judgment, but this author suspects that the granting of limited liability to a parent corporation encourages investment and economic development, producing a net benefit for society as a whole.

B. Delete Control as a Factor for Piercing the Corporate Veil

Control should not be a factor in the tests for stripping the parent of its limited liability. Though this may be contrary to the tort principle of making an actor responsible for its own conduct, the emphasis on control induces parent corporations to steer clear of health and safety issues affecting its affiliates. This undesirable behavior is the opposite of what the law should encourage.

223. *See id.*
224. *See id.*
225. *See id.*
226. Joseph R. Foard, Co. v. Maryland, 219 F. 827 (4th Cir. 1914).
227. *See* Landers, *supra* note 6, at 622.
228. *See id.*
229. *See id.*
230. *See id.*

C. Use of the Landers Model of a Well-Behaved Corporate Group as a Prerequisite for the Parent's Limited Liability

Adherence to the Landers model of proper behavior for a corporate group should be a prerequisite for sustaining the parent's limited liability. In a nutshell, the model requires that the parent structure the subsidiary so that it has a realistic potential for profitability. More particularly, the parent should adequately capitalize its subsidiary, avoid treating it as a department or a division, and avoid commingling or stripping its assets. Though the standard of conduct may not comport with the group's dominant motivation, which is to maximize a return for the enterprise as a whole, this author is willing to take the normative stance that adherence to this informal code of good conduct is the price that a parent corporation should be required to pay to preserve its limited liability. The law can say, "Treat your subsidiary like an independent, profit-making enterprise, and we will give you limited liability. That is what we ask of other corporations, and we ask it of you, too." Creditors should not be able to require any more than that.