SOME COMMENTS ON THE LAW OF SEPARATE CORPORATE IDENTITY

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I. INTRODUCTION

THERE IS A SIGNIFICANT gap between the underlying basis upon which the law treats large multi-corporate systems (or "empires" or "families") and the social and economic realities of their existence. All corporations, regardless of their size and the extent of integration of their separately incorporated holdings, are strongly presumed to be separate corporations.

Particularly with respect to the larger corporate families, the "separate entity" concept does not reflect the realities of corporate existence. If the law is to serve society adequately, it must reflect the realities of life.

Case law indicates that blind adherence to the "general rule" that companies separately incorporated are separate juridical persons, often leads to an illogical result. Consequently, the courts have attempted to elaborate innumerable exceptions, which have been applied inconsistently.

Traditionally, the separate identity of the corporation has been disregarded (or the "corporate veil" has been "pierced") only if the corporation was found to be the "alter ego" (or, variously, the "agency", "instrumentality", "adjunct," or "dummy") of another. Behind this, which appears to be an issue of fact, lie both a question of fact and a test of policy.

First, are the two ostensibly separate persons one person in reality? Second, if they are in fact one, why should the law continue to treat them as if they were separate? An affirmative answer to the first would seem to be a logical sine qua non to the second. The case would then devolve upon the test of countervailing policies.

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The purpose of this article is to review the law of separate corporate personality as concerns multi-corporate systems and to explore bases upon which the presently confused doctrines can be organized and re-ordered, investing words such as "alter-ego", "business adjunct", and "instrumentality" with specific meaning consistent with business reality.

The authors suggest as the paradigm of a unitary entity with many corporate charters, the situation of a corporation wholly owning a subsidiary which is engaged in some enterprise designed solely to further the business interest of the parent company, which has the same directors and managers as the parent, and is included with the parent in a consolidated balance sheet. It is acknowledged that the numerous and extremely complex variations of the above-mentioned paradigm are beyond the capacity of this paper to foresee or to resolve fully. The role of this article is nonetheless a positive one: to present the inadequacies of obsolete legal doctrine, and break the ground for its modernization, and for a clarification and articulation of the policy issues.

It is also proposed that, where a plaintiff can show a reasonable probability, on all the evidence available to him, that two or more corporations are parts of an integrated system of parent and subsidiary corporations, commonly controlled and managed, they be presumed, prima facie, to be one single juridical entity.

II. BRIEF HISTORY OF THE "SEPARATE ENTITY" CONCEPT: THE RISE TO CONFUSION

The familiar general rule is that a corporation properly formed and duly organized is a separate entity, distinct from its shareholders, and that shareholders are not liable for the debts of the corporation. This, however, was not always the case. As a matter of fact, as Dye[1] points out, historically, limited liability was a special privilege granted by legislative grace; and the evolution of this concept into today's legal "rule of thumb" was largely due to the early need in American economics to encourage risk capital investment by limiting the liability of the investor.[2] Even so, some legislatures were formerly suspect of the pitfalls inherent in such a concept. Until 1930, the California Constitution provided that all shareholders were liable for the total

1. Dye, *Inadequate Capitalization as a Basis for Shareholder Liability,* 45 So. CAL. L. REV. 823 (1972), at 831–34.

2. *See, e.g.,* Dodd, *The Evolution of Limited Liability in American Industry; Massachusetts,* 61 HARV. L. REV. 1351 (1948).

debts of the corporation in proportion to the number of shares they held in the corporation.[3]

At least two early cases made it clear that the separate entity presumption was here to stay. In *Chicago, Milwaukee and St. Paul Railroad Co. v. Minneapolis Civic and Commerce Association*,[4] the United States Supreme Court held that mere ownership alone of 100% of the stock of a subsidiary company did not create identity of corporate interest between the parent and the subsidiary, and that such ownership alone did not render the subsidiary an "alter-ego" or "instrumentality" of the parent so as to hold the parent liable for the torts of the subsidiary.

In *Cannon Manufacturing Corporation v. Cudahy Packing Company*,[5] the court applied the "mere ownership" rule to attempt to acquire jurisdiction over a non-resident parent company under more detailed circumstances. In that suit against Cudahy's wholly-owned subsidiary company, plaintiff attempted to bring the parent corporation (Cudahy) into the case as a defendant, by serving process on an agent of the subsidiary. Cudahy owned 100% of the capital stock of the subsidiary, and several individuals served as managers and directors of both the parent and the subsidiary corporations. The sole business of the subsidiary was to market Cudahy's products in North Carolina. The Court was presented with the question whether the parent could be said to be "doing business" through its subsidiary in North Carolina. The Court, per Justice Brandeis, held that Cudahy was not doing business in the State, for purposes of acquiring jurisdiction; this, in spite of the following acknowledgment:

> "Through ownership of the entire capital stock and otherwise, the defendant dominates the . . . [subsidiary], immediately and completely; and exerts its control both commercially and financially in substantially the same way, and mainly through the same individuals, as it does over those selling branches or departments of its business not separately incorporated which are established to market the Cudahy products in other States. . . . This corporate separation [of the North Carolina subsidiary] from the general Cudahy business was doubtless adopted solely to secure to the defendant some advantage under the local laws."[6]

The court felt bound, by the formal separation of the two corporations.

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3. CALIF. CONST. art. XII, § 3 (1879); *repealed* Nov. 4, 1930.

4. 247 U.S. 490 (1918).

5. 267 U.S. 333 (1925).

6. 267 U.S. at 335.

The general, classic statement of the requirement for disregarding an ostensibly separate corporate entity is that the subsidiary be merely an "alter-ego", "agency", or "instrumentality" of the parent corporation. Failing such a determination, the corporations in question are deemed separate and distinct persons under the law.[7]

As long ago as 1925, Ballantine questioned the direction the law was taking in using such ambiguous terms to define the exceptions to the general rule of separateness:

> "What is meant by such terms as 'adjunct', 'agency', 'instrumentality', 'creature' or 'mouthpiece'? What conditions must exist to warrant a court in treating the "A" corporation as the mere adjunct of the "B" corporation? The word 'agency' is often used as a synonym of 'adjunct', whatever that may mean, and as descriptive of a relation variously defined in the cases as 'alter ego', 'alias', 'device', 'dummy', 'branch', 'tool', 'corporate double', 'business conduit', 'instrumentality', etc., but all in the sense of 'means' through which a corporation's own business is actively prosecuted. It clearly appears that the word 'adjunct' and these other terms like 'business conduit', are too uncertain to be adopted as a test or rule of law to indicate when adherence to the doctrine of separate and distinct corporate entity will work injustice or amount to a perversion of corporate capacity."[8]

That the doctrine placed superficiality over substance is evidence by an article co-authored by William O. Douglas, four years after the *Cannon* decision, wherein it was confidently stated:

> "The observance of the following four standards will keep the business units from being treated as assimilated: (1) A separate financial unit should be set up and maintained. That unit should be sufficiently financed so as to carry the normal strains upon it. . . . (2) The day to day business of the two units should be kept separate. Normally each process can be tagged so as to identify it with the activity of one unit or with that of the other. Occasionally such tagging will be difficult in a case where the two businesses are merely units in a line of production. . . . (3) The formal barriers between the two management structures should be maintained. The ritual of separate meetings should be religiously observed. The activities of the individuals serving on the

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7. For a good discussion of the various rubric the courts use in categorizing the relationships between corporations, *see* Lowendahl v. Baltimore & O.R. Co., 287 N.Y.S. 62, 247 App. Div. 144, 287 N.Y.S. at 72-76 (1936). Also *see generally* 2 HORNSTEIN, CORPORATION LAW AND PRACTICE § 751-59 (1959 ed. and 1968 Supp); 18 AM. JUR. 2d *Corporations* § 14-17; 3d at 1123-46.

8. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CALIF. L. REV. 12 (1925), at 18, *cf.* similar language in New York Trust Co. v. Carpenter, 250 F. 668 (6th Cir. 1918), at 673.

> two boards can be tagged so that the individuals qua directors of the subsidiary can always be distinguished from the same individuals qua directors of the parent. . . . Separate meetings of the board are sufficient. . . . . The observance of the niceties of business efficiency are normally sufficient. . . . (4) The two units should not be represented as being one unit. . . ."[9] (Emphasis added)

If a corporation has done nothing amounting to a declaration against interest that separation is fictitious, the facade is to be honored. Almost fifty years later, this doctrine still enjoys substantial vitality.[10]

Of course, when the facts demand that they look beyond mere formalism, the courts may disregard the corporate entity, as being a mere "alter ego", "agency" or whatever. In a concededly hopeless attempt to derive from the cases a definition of such terms as alter-ego, instrumentality, etc., one commonly used research publication appropriately notes that the term "agent" is oftentimes used in other than its precise legal context, thus effectively hampering any meaningful analysis of the case. For example, we find such statements as:

> "In appropriate circumstances, parent corporations may be held liable for obligations of their subsidiaries on an actual agency theory (as distinguished from the use of 'agent' in the 'mere agent, instrumentality, adjunct or department' rubric)." (parenthesis is within the text)[11]

> "The court here was apparently referring to agency in the technical sense, and not in the sense in which it is used in many of these cases, to denominate a relationship of gross parental control."[12]

> "It is not clear whether the court here was referring to agency in the technical sense or in the sense of instrumentality."[13]

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9. Douglas and Shanks, *Insulation from Liability through Subsidiary Corporations,* 39 YALE L.J. 193 (1929).

10. *See, e.g.,* Velendra v. Regie Nationale Des Usines Renault, 336 F.2d 292 (6th Cir. 1964), where a French automobile manufacturer wholly owned a New York corporation whose sole business was to import and distribute Renault automobiles in the United States. This New York distributor, in turn, wholly owned three retail dealerships in Michigan. Plaintiff was injured in Ohio, allegedly due to a manufacturer's defect in the Renault. He sued the three retailers in Federal Court in Michigan, naming also the New York distributor and importer, and the French manufacturer. The 6th Circuit dismissed the complaint against the distributor and the manufacturer because they were not "transacting business" in Michigan, and therefore the court had no personal jurisdiction over those two defendants. *But cf.* Regie Nationale Des Usines Renault v. Superior Court, 208 Cal. App. 2d 702, 25 Cal. Rptr. 530, for different result on similar facts.

11. *See* 38 A.L.R.3d at 1116. In general, *see* 1102 *et seq.* This section deals with the various courts' approaches to disregarding a corporation's identity in contract cases.

12. *Id.* note 11, at 1139.

13. *Id.* note 4, at 1141.

In fact, such classification is futile. A brief search of any of the various authorities and encyclopedias justifies the use of that word in discussing attempts to derive from any synthesis of the cases some useful definitions for the exceptions to the general rule that courts will presume the reality of separateness of the corporate entity.

Perhaps the inconsistency is best appreciated if we juxtapose for examination two cases from the 5th Circuit decided within six months of each other. In *Frazier v. Alabama Motor Club, Inc.*,[14] a holding company, National Enterprises, Inc. (National) was doing business only in Georgia, and was wholly owned by three individuals. National owned the majority of the stock of several other companies (all doing business outside Georgia); the balance of the shares being held by the same above-mentioned shareholders of National. These three people comprised the management and boards of all the corporations. The meetings of all the companies were conducted "separately" in the offices of National in Georgia and the records of each were separately maintained. The sole function of National was to perform all management functions for the other companies. The issue before the court was whether the subsidiary corporations were "doing business" in Georgia for venue purposes. The 5th Circuit held that they were, on the grounds that all companies were "integrated subsidiaries" of National.

Approximately six months later, the complicated facts in *Marcow v. Alcock*[15] came before the same court. In this case, three individuals, *A, B,* and *D,* comprised the entire management of Florida Corporation (Florida), a factoring concern, and held the overwhelming majority of its stock. When Florida began to get financially shaky, *A, B,* and *D,* created the Southern Corporation (Southern) as a creosoting concern; issued themselves $93,000 worth of Southern stock, and paid for it with a $500 check issued by Florida. In the meantime, *D* had loaned Florida money toward the purchase of yet another company, the FPC Corporation. Before finalizing the sale, however, the contract was changed so that Southern was to receive the assets of FPC Corporation. In settlement of a suit by a minority shareholder of Florida to block the purchase of FPC by Florida, for Southern, it was stipulated by *A, B, D,* and Florida that Southern was a wholly-owned subsidiary of Florida, and would guaranty Florida's debts. Recall that said debts include the original advance made to Florida by *D*. This stipulation was arranged and negotiated by *D*'s attorney, knowing that such a guarantee was *ultra vires* Southern's charter. Since *A, B* and *D* were

14. 349 F.2d 456 (5th Cir. 1965).

15. 356 F.2d 194 (5th Cir. 1966).

the sole shareholders of Southern, that company would be estopped to deny the stipulation or assert *ultra vires,* and thus *D*'s interests would be protected completely. Once FPC's assets were acquired, *A, B,* and *D* proceeded to mortgage all the assets of both Florida and Southern in order to recapitalize Florida. When Florida went bankrupt, the trustee in bankruptcy sued to set aside the mortgages as being in fraud of Florida's creditors. The issue was whether Southern's assets would be available to satisfy Florida's debts. The court held not, stating:

> "When it is considered here that the two corporations were located in different cities, were legally constituted, maintained separate books and records, and that the factoring business has failed where the creosoting business has succeeded, it becomes plainly apparent that no sufficient reason exists to disregard the separate corporate existence of Southern." (Emphasis added)[16]

The court did note that Florida had issued a $500 check for $93,000 worth of stock which went to *A, B* and *D,* and said that although this fact "tended to show an alter-ego relationship", it was far from sufficient.

The authors are unable to determine in which of these 5th Circuit cases the corporate entity concept was more blatantly abused. If a distinction was drawn on the basis of the criteria for determining jurisdiction and venues v. that for liability, the authors believe that such a distinction is spurious and legally unsound. The cases are plainly inconsistent and make no attempt to preserve or even identify the criteria for finding that the subsidiary is or is not an "alter-ego."

Similarly inconsistent cases abound, because the "rule" does not describe the reality of what the courts are doing. If words like "alter-ego", "instrumentality", "dummy", "device", "branch", "tool", "business conduit", "corporate double", "alias", "adjunct", "mouthpiece" or the like have any meaning, it is to indicate subservience, a thing to be used without resistance or pride by the parent corporation for objectives of its own.

But, it is not possible to use those words in that way in light of the facts of *Cannon v. Cudahy.*[17] For if by that definition one does not mean a relationship as that between Cudahy and its North Carolina subsidiary, then the fact of total control by the parent is not the criterion of the law at all. Courts, indeed, have frequently ignored the fact of such a relationship as not warranting piercing (although perhaps just as frequently they have been satisfied with that fact).

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16. 356 F.2d at 198.

17. *Supra* note 5.

In a courageous attempt to categorize and analyze the terms, an annotation concluded:

> "Some of the cases indicate that something on the order of moral culpability on the part of the parent is required to warrant holding it liable . . . , whereas others have held that the exercise of substantial control over the subsidiary is sufficient. It had been said that the fiction of corporate entity will be ignored when circumstances justify it, and when necessary to achieve equity. Still other cases, . . . considering disregard of corporate entity, have made no mention of a need for fraud or a substitute."[18]

Thus, the fact of control by the parent corporation over the subsidiary is not necessarily sufficient. Courts have habitually presumed that the corporation, by its very nature, is a fiction, and therefore it provides no grounds for piercing to prove that the specific defendant corporation is fictitious.[19] There has to be a reason beyond that fact, ringing in equity, to justify the court in noticing the fact that the corporate defendant is the alter ego of another, and disregarding its ostensible, separate existence.

The corporation is definitely not a fictitious person. It is a real social organization. It embodies goals, resources and actions of numerous individual persons united in a common cause. Each has a distinct personality independent of its individual members, which personality survives the death or departure of any of its members.

The problem arises from the fact that the corporate form can be used as a convenient form of accounting and of accountability. A particular corporation can certainly be a fiction, and many such fictitious corporations do exist.

So the question should be, what is the social organization, *in fact,* with which we are dealing. Otherwise the fictions obfuscate reality and distort the operation of the law.

To illustrate, suppose the rates of a telephone company are set by the Public Utilities Commission ("P.U.C.") on the basis of projected gross profits of 20% of capital. And suppose the telephone company purchases from a wholly-owned subsidiary, not under P.U.C. regulation, all of its apparatus at prices two times that charged by competitors for comparable equipment.[20] For what reason should the law permit reports to the legislature, applications to the P.U.C. for

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18. 38 A.L.R.3d at 1112

19. *See, e.g.,* International Shoe Co. v. Washington, 326 U.S. 310, 90 L. Ed. 95, 66 S. Ct. 154 (1945).

20. Similar allegations may be found in Smith v. Illinois Bell Tel. Co., 51 S. Ct. 282, 282 U.S. 133, 75 L. Ed. 255 (1930).

rate increases, public relations information, and so forth, to show modest profits (or even losses) which do not reflect the fact that a fictitious corporation over which it has complete control is the repository of a major portion of the telephone company's profits?

Or, suppose a corporation which designs and constructs projects such as nuclear power plants wholly owns an engineering corporation which is in the business of environmental impact studies. Why should it require expensive litigation to establish that an environmental impact report prepared by the subsidiary for a project of the parent would not satisfy the requirement for an independent report?

The result is simply that the criteria upon which to determine whether to act upon the realities of actual control or upon the formality of separate personality are so nebulous and unclear that they may be said not to exist. No one disagrees with the "rules" for disregarding the ostensibly separate corporate person. The cases dutifully recite the requirement that the subsidiary be found to be a mere "dummy", "alter-ego", "instrumentality", "adjunct or department", "puppet", or "tool".[21]

To distill any precise meanings of those words from the cases is impossible. The decisions seem to be made without reference to other cases. The application of the "rule" in the cases is not uniform, not certain, not consistent, not predictable. The cases defy reconciliation, and this is not law. The courts do not use these words to give guidance nor do they attempt at all to instill them with meaning by consistency with respect to the facts of the cases they purport to follow.

Further, there are many cases in which no pretense is made of following the "rule".[22] The decision may be based upon the policy dictates of the laws of trade and monopoly, or trading with the enemy, for example, and different criteria of judgment are applied.

In *United States v. Scophony Corporation of America*,[23] the Supreme Court distinguished the *Cannon* case as being a "manufac-

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21. *See, e.g.*, note 7, *supra*.

22. It even appears that the court can disregard the corporate identity where the result is to perpetuate a fraud against it. In Capitol Wine and Spirit Corporation v. Pokrass, 277 App. Div. 184, 98 N.Y.S.2d 291 (1950), *aff'd* 302 N.Y. 734, 98 N.E.2d 704 (1951), the court dismissed the complaint by a corporation, against former officers and directors, for waste and misappropriation of corporate assets, on the grounds that the corporation's sole shareholder was not a stockholder at the time of the wrong complained of. The court noted New York's strong policy on derivative suits, as evidenced by Section 61 of the General Corporation Law of New York: "In any action brought by a shareholder (on behalf of a corporation) it must be made to appear that the plaintiff was a stockholder at the time of the transaction of which he complains . . ." The court, in effect, used the state statute regulating derivative suits to dismiss a case which was brought by the corporation and was not a derivative suit at all.

23. 68 S. Ct. 855, 333 U.S. 795, 92 L. Ed. 1091 (1948).

turer/seller" case, and said therefore the approach in *Cannon* is not applicable to an anti-trust case involving a "holding company".

In fact, in spite of the "general rule" of separateness, the federal government reserves the right to deal with corporate families as a single entity when they feel it is necessary; federal statutes are worded in terms broad enough to reach entire enterprises when policy demands it.[24] Managerial experts expound on the efficiency to be gained by closely controlling a group of affiliated entities. Moreover, common sense and experience tell us that in the overwhelming majority of cases, when a corporation is controlled by another corporation, the business policies of the former are developed and formulated to benefit the latter, regardless of whether such policies could be detrimental to the controlled company. Finally, the cases herein cited suggest that the courts will reach far to find inter-corporate unity when a high social policy is at stake.

There is no discernible discomfort whatever in such cases that, having held Corporation *A* responsible for the anti-trust violations of Corporation *B*, the court, theoretically, could then rule that a creditor of Corporation *B*, now insolvent, cannot recover from Corporation *A* because Corporation *B* is not its "alter-ego", whatever that may mean.

Perhaps the full capriciousness of the doctrine becomes clear at this point in the fact that a parent company can conspire with its own subsidiary, wholly owned and fully integrated into the business of the parent, to restrain competition.[25]

Clearly, the question whether to pierce or not to pierce has come to be a question of policy, however inarticulately perceived, of balancing the reasons for treating members of a corporate empire as separate entities against the reasons for disregarding their fictitious separateness. It is a test of priorities, not a question of fact. Therefore, whether the subordinate is or is not a "dummy", "alter-ego", "puppet", or "instrumentality", is not a test at all, but rather a conclusion of law.

Yet the courts have been using the right words. It should be a test, and the words should mean what they would seem to import: that if a corporation is subservient to another which can use it for its own purposes as it might use a branch operation, then it is an alter ego, instrumentality, dummy, business conduit, adjunct and tool in fact. That is reason enough, prima facie, to treat them as a single entity at law, particularly in light of the increasing use of subsidiaries as the "tool", "instrumentality" or "business adjunct" of the parent, albeit in ever more sophisticated ways.

24. *See* discussion in text accompanying note 40 *et seq., infra.*

25. Perma Life Mufflers, Inc. et al. v. International Parts Corp. et al., 88 S. Ct. 1981, 392 U.S. 134, 20 L. Ed. 2d 982 (1968).

III. THE EVOLUTION OF MODERN CORPORATE BUSINESS METHODS

Recognizing at a relatively early date the rapidly growing sophistication of corporate business and management techniques, Profesesor Berle described the developments in these words:

> "As the scale of business enterprises enlarged, the process of sub-division began; hence subsidiary corporations wholly-owned or partly-owned; or holding companies combined into a series of corporations constituting a combined economic enterprise; and so forth. More often than not, a single large-scale business is conducted, not by a single corporation, but by a constellation of corporations controlled by a central holding company, the various sectors being separately incorporated, either because they were once independent and have been acquired, or because the central concern, entering new fields, created new corporations to develop them, or for tax reasons. In some instances, departments of the business are separately incorporated and operated as separate legal units."[26]

For example, in negotiations to consummate an acquisition by International Telephone and Telegraph (I.T.T.) of Hartford Insurance Company, Harold S. Geneen, Chief Executive Officer and Chairman of the Board of I.T.T. painted this rosey picture to the Board of Directors of Hartford:

> "Hartford could provide casualty insurance for I.T.T.'s employees, for their stockholders, for their life insurance companies in Europe, and for their other customers, including 2.7 million people holding Sheraton and Avis (both I.T.T. subsidiaries) credit cards. Hartford, too, could invest in Levitt's (another I.T.T. subsidiary) Land Banks in the Rayonier (another) land in Florida, and in Sheraton real estate abroad. Hartford and I.T.T., in other words, could march together toward a self-contained paradise: their customers and employees could be insured from the cradle to the grave, while they drove their I.T.T. rental car from their I.T.T. home to their I.T.T. hotel."[27]

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26. Adolph A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343 (1947). As illustrative of current business practice, Professor Berle explains that American Telephone and Telegraph Co. (AT&T) owns Western Electric Corporation, whose primary business is manufacturing apparatus for AT&T. In turn, Bell Telephone Laboratories, Inc., is owned 50% by AT&T and 50% by Western Electric Corporation, 47 COLUM. L. REV. 343, at note 3. Thus, we have three separate corporations all working for a common economic purpose; all interrelated; all controlled by the Board of Directors and Management of AT&T; and all *legally* separate.

27. ANTHONY SAMPSON, THE SOVEREIGN STATE OF I.T.T., Stein and Day (New York, 1973), at 151.

Local decisions are made and policies formulated on the basis of the advantages and disadvantages to the entire corporate family.[28] This is simply good business sense. It is easier and more efficient for the multi-corporate enterprise to maximize profits, minimize waste, and achieve other corporate goals if all phases of the corporate undertaking are centrally controlled.

Consider the comments of Robert W. Murphy in the HARVARD BUSINESS REVIEW,[29] describing organizational and managerial techniques from an efficiency standpoint:

> "Legally, as we all know, a subsidiary is controlled by its Board of Directors. The Board is elected by its stockholders. If the parent corporation is the single or dominant stockholder we assume that the management of the parent, by voting its stock, determines the make up of the subsidiary's board, which then elects and controls the president and other officers of the subsidiary. Thus, these officers report to the board, not to the president or group vice-president of the parent corporation. Such a procedure requires a committee type management and results in committee decision making.
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> "But in reality — at least in a large corporation — the president of a subsidiary should, and often does in fact, have a reporting relationship with the president or group vice-president of the parent. Where this is true, the actual line of command does not, therefore, follow the corporate form. It is more similar to the line of command between a division head and the top executives at headquarters." (Emphasis added)[30]

Greater internal flexibility and freedom from legal harassment by outside ownership interests can be gained by minimizing outside ownership interest in the subsidiary, and by keeping important decisions of subsidiary corporations under the close scrutiny of the parent or controlling corporation.

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28. In conducting an investigation into the locus of control over many foreign owned Canadian corporations, the Canadian government discovered:

> . . . [W]itnesses maintained that when important decisions affecting Canadian operations are made in the United States by American residents, such decisions are made in the interests of the American parent companies rather than in accord with the best interests of the Canadian public.

ELEVENTH REPORT OF THE STANDING COMMITTEE ON EXTERNAL AFFAIRS AND NATIONAL DEFENSE RESPECTING CANADA-U.S. RELATIONS, Second Session, 28th PARLIAMENT (Queen's Printer for Canada, 1970), at 37 [hereinafter cited as CANADA'S ELEVENTH REPORT].

29. Robert W. Murphy, *Corporate Division v. Subsidiaries*, HARVARD BUSINESS REV., Vol. 34, No. 6 (Nov.-Dec. 1956), at 83.

30. *Id.* at 90.

Consider the implications to the concept of corporate entity of the following:

> "On the last Monday of every month, a Boeing 707 takes off from New York to Brussels, with sixty I.T.T. executives aboard, including Geneen or one of his deputies, with a special office rigged up for him to work in. They stay in Brussels for four days, enveloped in their own company capsule, spending most of their time in one of the marathon I.T.T. meetings.
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> "A meeting is a weird spectacle . . . One hundred and twenty people are assembled in the big fourth-floor room . . . In the chairs sit the top men of I.T.T. from all over Europe, like diplomats at a conference.
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> "The meetings, whether in Brussels or New York, are the central ordeal of the I.T.T. discipline, the test that its men are attuned to the openness of the system . . . . For a newly joined manager — and especially from a company newly acquired by I.T.T. — the ordeal can be terrifying; there are stories of one man fainting as he walked in and of another rushing out to get blind drunk for two days. For the hardened I.T.T. man, it is no more than a routine test of sangfroid. 'You have to be prepared', said one of them . . ."[31]

The reason for top executives of "separate", "independent" corporations to subject themselves to such humiliating grillings is, in Geneen's words, "I want no surprises."[32]

Indeed, modern management has learned to govern far-flung corporate empires consisting of many nominally independent units. They have not acquired these skills by painstakingly looking over the affairs of one single corporation.

Rather, it is no secret that the rise up the career ladder leads through various members of the corporate family. For the "transient manager", the local company is only an intermediate post on the way to advancement in the absentee owner corporation. "Careers are made in the company, rather than in the community."[33] A lawyer might begin, for example, as staff attorney for an Argentine corporation, subsidiary to Chrysler International, a wholly-owned Swiss subsidiary of Chrysler Corporation. He might subsequently be made assistant general counsel to a separate subsidiary corporation in Brazil. Some years later he might become senior staff attorney for Chrysler Inter-

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31. Sampson, *supra* note 27, at 99-100.

32. *Id.* at 100.

33. Norton E. Long, *The Corporation, its Satellites, and the Local Community*, in Edward S. Mason, THE CORPORATION IN MODERN SOCIETY.

national and still later become Chrysler Motors vice-president, in Detroit, for international operations.

He would have served four legally separate and distinct corporate entities in the process. But he would never have suffered the deferral of any of his stock options, nor the loss of his pension plan, salary increases, rating advances, or seniority or other fringe benefits in the process. Yet, if at any time, he left the corporation to accept employment with Ford Motor Company he would have lost all seniority together with all fringe benefits which had accrued, and if in the future either he or Chrysler were interested in the resumption of his career with the Chrysler network, explorations and negotiations for an employment contract would begin anew.

Such instances of corporate family "personnel pools" seem to be quite common.[34] Moreover, it should be noted that the consequences of all the above-mentioned organizational and managerial inter-relationships can sometimes be quite disheartening to a minority shareholder of a subsidiary corporation, the efficiency of which is being tempered in favor of another subsidiary corporation.[35] But most importantly, the above discussion surely indicates that portfolio investment in independently controlled corporations is not the rule, but rather the

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34. In Taca International Airlines, S.A. v. Rolls-Royce of England, Ltd., 15 N.Y.2d 97, 204 N.E.2d 329 (1965), the court found that a British corporation was present in New York for purposes of jurisdiction, because of the presence of its wholly-owned retailer. The employee who was actually served was not an employee or officer of the parent, nor did the parent have any officer, bank account, telephone or directory listing in the jurisdiction. And despite the fact that the corporate papers, and details of day-to-day transactions, for sales and warranty services which the subsidiary had rendered on the parent's products were kept scrupulously separate, the court noted specifically:

> . . . [K]ey executive personnel in Rolls-Royce, Inc., where *former executives* of either the English or Canadian company and were assigned to their positions by the parent English company. There are frequent conferences among executives of the three companies at which the policies of Rolls-Royce, Inc., are determined. Rolls-Royce, Inc., employees who require technical training are given it by Rolls-Royce, Ltd., in England.
>
> . . . The principal personnel of Inc. or most of them are former Ltd. employees and key employees are exchanged both ways between *New York and England* and considered part of the *Rolls-Royce Employee* Group, (emphasis added)

15 N.Y.2d at 98-99, 204 N.E.2d at 330-31.

See also Flank Oil Co. v. Continental Oil Co., 277 F. Supp. 357 (10th Cir. 1967).

In the case of Kasel v. Remington Arms Co., 24 Cal. App. 3d 717. App. 101 Cal. Rptr. 314 (1972), noted that "Harmon as director of operations (of CDM) Co. it was an 'affiliate' of Remington Arms Co.), was on CDM's payrool from 1961 until June, 1965, when he left Mexico. However, he kept his Remington retirement fund and group insurance; he received a bonus from Remington while he was in Mexico (working for CDM). While he worked for CDM, Harmon reported directly to the vice-president of Remington." 24 Cal. App. 3d at 719; 101 Cal. Rptr. at 319. *See* discussion, *infra,* at note 65.

35. *See, e.g.,* Blaustein v. Pan-American Petroleum Corporation, 174 Misc. 601 (Sup. Ct. 1940); *modified,* 263 App. Div. 97, 31 N.Y.S.2d 934 (1st Dep't); *modified,* 293 N.Y. 281, 56 N.E.2d 705 (1944).

exception; especially for those corporations of any substantial economic size.[36]

It appears, therefore, that in most instances, corporate acquisitions of going concerns, or creation of new corporate entities, is for the purpose of furthering the entire business operations of the whole enterprise; probably all owned, and definitely all controlled, by the parent corporation. Such managerial practices are not necessary to facilitate a true "investment" interest in the shares of the subsidiary. Surely, one does not find the board of directors of a large acquiring corporation lazily sitting back clipping stock coupons of the newly acquired corporations. On the contrary, most large business entities are not in the investment business, but rather are in some phase of manufacturing or producing some services to be sold on the market; and most (if not all) capital expenditures are directly aimed at somehow furthering that central economic goal.

Take, for example, the twin cases of *Birnbaum v. Newport Steel Corporation,* and *Perlman v. Feldmann.*[37] Newport Steel Corporation had a steel supply during a period of acute steel shortage due to the

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36. This is especially true of multinational enterprises. "The present trend has been toward 100% ownership of foreign subsidiaries." G.P. Nowak, *The Multinational Corporation as a Challenge to the Nation State: A Need to Coordinate National Competition Policies,* 23 VAND. L. REV. 65 (1969), at 75. Canada has felt the brunt of this control in such proportions that the country conducted a special inquiry into the matter, wherein it found:

> In any event, the evidence presented to the Committee indicates that . . . in most cases the most basic and vital decisions would be made by the head office in the United States . . .
>
> . . . The thing that is common is, of course, that the parent company controls the voting stock . . .
>
> The point at issue is simply whose hand is on the lever. The point at issue is that we have at market prices as of 1968, $40 billion of American investments in this country, and there is a significant ambiguity on the question where primary control lies.

CANADA'S ELEVENTH REPORT, *supra,* note 28, at 37.

Out of concern for the future independence of Canada's economy, that nation's Minister of Trade and Commerce, Robert Winters, sent a letter to some 3500–4000 foreign-controlled subsidiary corporations, asking them to respect and adhere to Canada's economic politics. A portion of that letter reads:

> . . . The fact of foreign control leaves the subsidiaries open to external influences which may not always be consistent with their own best interests and those of the Canadian community at large . . .
>
> The Canadian government is desirous that subsidiaries be free to develop their full potential within the Canadian community. In this regard it is most important that subsidiaries should not have restrictive limitations placed upon their sound development by their parent organizations.

CANADA'S ELEVENTH REPORT, *supra* at 28. *See also* Business Week, No. 1910, April 9, 1966, at 34.

37. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (1952), *cert. denied,* 343 U.S. 956; Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955). (Same case under a different cause of action). For an extraordinary opportunity for insight into the business aspects and motives behind the decisions of a large conglomerate entity, *see* Sampson, *supra* at note 27.

Korean War. Wilport Steel Co. was a cartel made up of several "end users" of steel who were interested in maximizing their supply during this shortage. The result was a purchase by Wilport of the controlling block of shares of Newport; hardly for stock market investment reasons. Can the law now reasonably suggest that Newport will continue to do business independently and separately from Wilport?

Some courts have recognized that in order to properly characterize the relationship between the parent and subsidiary corporations, inquiry must be made into the reason why the parent holds any interest in the subsidiary in the first place. That is, an attempt must be made to determine whether the parent holds a "business" interest as opposed to an "investment" interest in the subsidiary:[38] one court described the "business" interest it found in these words:

> "A person would have to be blind to the economic facts of business life if he did not recognize that the activities of [California Commercial Company and California Oil Company] in this District are activities which in another less elaborate corporate set-up would be conducted directly by branch offices or agents. . . . It is Socal [Standard Oil Company of California] and not the subsidiaries, which is the defendant in this action. What is Socal? It is a large aggregation of invested capital which transacts its business through officers, agents, employees, and through subsidiaries, which in the drilling, production and marketing of oil operate as agents, employees or does the fact that this large business entity, for tax reasons or otherwise, decides to fragmentize its operations into numerous corporate subsidiaries, make the resulting operations of the subsidiaries any the less a part of transaction of business by Socal?
>
> . . . .

38. In United States v. Scophony Corp. of America, 333 U.S. 795 (1948), the parent British corporation claimed that it was not amenable to the jurisdiction of American courts in an anti-trust suit brought by the U.S. government. The British parent argued that it had ceased to transact business in the United States when its subsidiary corporation (American Scophony) was formed, and that in subsequently supervising the affairs of the subsidiary, it was merely protecting its investment in the subsidiary's shares. The court viewed the entire course of events, and concluded that the British parent had not created and maintained the American subsidiary as an investment, but merely as another means of transacting business; and that, therefore, the British corporation was transacting business in the United States, within the meaning of Section 12 of the Clayton Act. In another anti-trust case, where the government was not a party, Intermountain Ford Tractor Sales Co. v. Massey-Ferguson, Ltd., 210 F. Supp. 930 (1962), where a Canadian corporation owned several American subsidiaries, and where the operations in the United States were coordinated by an executive committee made up of officers of the parent and the several American subsidiaries, the court held that such joint supervision over domestic operations constituted "transacting business" by the parent corporation in the United States. In Taca International Airlines v. Rolls-Royce, Ltd., 201 A.2d 97 (N.J. 1964), where a British corporation wholly owned a domestic corporation, the court found the three entities all part of "one cohesive economic unit," since the only function of the domestic corporation was to distribute and service the goods of the British manufacturer and Canadian distributor. *But cf.* Velendra, note 10, *supra.*

> . . . [T]he entire corporate set up of the defendant shows that it is designed to operate to a substantial degree through separate corporate entities responding to the wishes and directions of the parent and providing revenues sought by the parent." (Emphasis added)[39]

There has arisen in this century a type of corporate activity, a corporate empire if you will, consisting of many affiliated corporations managed as an integrated, unified system, and not as separate autonomous, local entities. Yet, despite this sophistication of organizational methods, the law persists in beginning its analysis with the rather firm presumption of "separateness."

IV. EVOLUTION OF THE LAW: LOOK TO CONTROL

Clearly, the economic realities are commonly as Professor Berle described them. The choice of a corporate form for a subsidiary operation is for reasons of convenience to the total enterprise, and does not necessarily reflect any real independence or "separateness" of the subsidiary corporations.

The Federal Government has, for some time, recognized these realities, and has dealt with the real functioning enterprise where it has suited the government's purposes. It is no secret that when high public policy is at issue, corporate entities are casually disregarded; often without even acknowledging that it is taking place.

As early as 1939, the Federal government acted on knowledge of these same economic realities, when it enacted Section 482 of the Internal Revenue Code,[40] which provides for allocation of income between "two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, whether or not affiliated) owned or controlled directly or indirectly by the same interest,"[41] (parenthesis is within Section 482; emphasis added) if the Secretary of the Treasury decides it is necessary in order to more realistically reflect income. The Treasury Regulations promulgated under this section define control as follows:

> ". . . 'controlled' includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control which is decisive, not its form or the mode of its exercise . . ."[42] (Emphasis added)

39. Waldron v. British Petroleum Co., 149 F. Supp. 830 (S.D.N.Y. 1957), at 834-35.

40. 26 U.S.C. § 482.

41. *Id.*

42. Treas. Reg. § 1.482-1(3) (1968).

Obviously, the Treasury does not have to be concerned with separate corporate minute books.

Under the Trading With the Enemy Act,[43] the President, or any agency which he designates, is empowered during time of war or during any other period of national emergency declared by the President,

> "To designate, or otherwise, and under such rules and regulations as he may prescribe . . . investigate, regulate, direct, and compel, nullify, void, prevent, or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or national thereof has any interest, by any person, or with respect to any property, subject to the jurisdiction of the United States . . . ."[44] (Emphasis added)

By Executive Order,[45] the President has delegated this power to the Secretary of the Treasury who, in turn, has promulgated the Foreign Assets Control Regulations.[46] Within those regulations, the phrase "person subject to the jurisdiction of the United States" is defined to include:

> "(1) Any person, wheresoever located who is a citizen or resident of the United States;
>
> (2) Any person actually within the United States;
>
> (3) Any corporation organized under the laws of the United States or of any state, territory, possession or district of the United States; and
>
> (4) Any partnership, association, corporation or other organization wheresoever organized or doing business, which is owned or controlled by persons specified in (1), (2), or (3)."[47] (Emphasis added)

The government is aiming at control, and is not concerned with the fact that separate books and accounts are scrupulously and meticulously maintained. The broad wording of this regulatory scheme has often been used to frustrate contracts contemplated or even already entered into by American subsidiary corporations organized and existing under the laws of foreign countries with whom the United States

43. 50 U.S.C. App. § 1-44 (1964).
44. *Id.* at § 5(b)(1).
45. Executive Order 9193, 7 Fed. Reg. 5205 (1942).
46. 31 C.F.R. § 500.01-.808 (1967).
47. *Id.* at § 500.329(a).

is friendly.[48] In order to circumvent a judicial confrontation on this issue, since the subsidiary companies are, technically, citizens of the foreign host country, the desired result is effected simply by pressuring the American parent corporation who, in turn, ensures that the prohibited contract is either never entered into or not carried out.[49]

License exceptions to these provisions are occasionally granted, but only to the American parent corporation; not to the separate foreign subsidiary actually carrying out the transaction. Thus, the question of which country has jurisdiction over the foreign subsidiary is never brought to a head.[50]

QUERY: is this another indication as to how "separate" the subsidiary really is? Such "disregard for the corporate entity" has brought some angry responses from foreign host countries.[51]

The Coastal Shipping Act proscribes alien ownership of American licensed vessels. In *United States v. The Meachum*,[52] the court looked through an American corporation to find control by Chinese nationals in order to make a realistic determination of the personality of a ship. The Court found alien ownership despite the fact that the American company had obtained assurance from the Federal Maritime Commission, prior to purchasing the ship, that its citizenship would be deemed American. Separate books and accounts, and a board of directors composed entirely of American citizens had no effect on the court's decision, where the American company was economically controlled by a corporation controlled by Chinese nationals.[53]

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48. Canada and France have been among the main recipients of this extraterritorial enforcement of national security legislation. *See* Corcoran, *Trading with the Enemy Act and the Controlled Canadian Corporation*, 14 McGILL L.J. 174 (1968), at 191-201; and, Craig, *Application of the Trading with the Enemy Act to Foreign Corporations Owned by Americans*, 83 HARV. L. REV. 579 (1970). *See also* note 34, *supra*. For example of interference in Belgium, *see* New York Times, Feb. 7, 1968, 3:2.

49. When Canadians' inquiries about such matters are directed to the Canadian subsidiary companies, responses are sometimes received from the American parent corporations. *See* 14 McGILL L.J. 174, at 190-91, note 38.

50. *Id.* at 184.

51. The French gov't will appoint a receiver to effect the contract if such interference appears imminent. *See, e.g.*, Massardy v. Societe Fruehauf-France, Paris, 22 mai 1965, Gaz. Pal. 1965, 2.86. (An excerpted decision is translated in 5 *Int'l Legal Materials* 476 (1966). "Canada was outraged" at the Ford of Canada transaction frustrated by the United States, 14 McGILL L.J. 174, at 193; "the (Trading with the Enemy Act) is a challenge to Canadian Sovereignty over Canadian corporations, and it does have adverse economic impact in Canada." *Id.* at 208.

52. 107 F. Supp. 997 (1952), *aff'd* 207 F.2d 535, *cert. dismissed* 348 U.S. 801.

53. However, in Noe v. Federal Communications Commission, 260 F.2d 739 (1959), *cert. denied*, 359 U.S. 924, decided under a remarkably similar statute aimed at alien ownership or control of radio stations, 47 U.S.C. § 310, the court refused to find control by an international religious order, even though the alien head of the International Society of Jesus had direct influence and the power to control the makeup of the Board of Directors of the domestic corporation.

Anti-trust legislation has apparently been deemed so important that it has been enforced against corporations incorporated in foreign countries, and, concerning transactions between such foreign corporations exclusively, transactions which were entered into in countries in which they are legal. The criteria for application of such legislation are simply that the transactions be illegal under American law; that of the foreign corporations be controlled by American corporations.[54]

The Securities and Exchange Commission has also promulgated a broad definition of control: ". . . the possession, direct or indirect, of the power to direct or cause the direction of the management and the transactions affect the American market; and that one or more policies of a person whether through ownership of voting securities, by contract or otherwise."[55]

In *National Labor Relations Board v. Deena Artware, Inc.*[56] the defendant was charged with violation of fair labor practices, under the National Labor Relations Act. Because of Deena's refusal to carry out its backpay order, the Board petitioned to hold Deena and several of its subsidiaries in civil contempt. The Court of Appeals dismissed the petition and motion for discovery which were based upon the Board's allegations that the group of corporations were in fact "a single enterprise." The United States Supreme Court reversed, citing Berle,[57] and saying:

> "The several companies may be represented as one. Apart from that is the question whether *in fact the economic enterprise is one,* the corporate forms being largely *paper arrangements that do not reflect the business realities.* One company may in fact be operated as a division of another; one may be only a shell, inadequately financed; the affairs of the group may be so intermingled that no distinct corporate lines are maintained. These are some, though by no means all, of the relevant considerations. . . ."[58]

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54. *See, e.g.,* United States v. Watchmakers of Switzerland Information Center, Inc., 133 F. Supp. 40 (S.D.N.Y. 1955); United States v. Watchmakers of Switzerland Information Center, Inc., Civil No. 96-170, CCH TRADE REG. REP. ¶ 66145 (S.D.N.Y. 1954); United States v. Watchmakers of Switzerland Information Center, Inc. (S.D.N.Y. 1962), 1963 Tr. Cas. ¶ 70, 600; United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

55. 17 C.F.R. § 240.12b-2(f) (1973). One commentator indicates that the S.E.C. has construed the term "subject to a controlling influence" to include "susceptibility to domination," and that the courts have upheld this construction. *See The Controlling Interest Standard in Rule 10b-5 Mismanagement Cases,* 86 HARV. L. REV. 1007 (1973), at 1034, note 112.

56. 361 U.S. 398 (1960).

57. Berle, *supra* note 26.

58. 361 U.S. 398, at 403.

Again, the Federal Government is not concerned with corporate bookkeeping, or separate officers or directors, and the like; but, rather, looks to the economic realities of the enterprise's existence. Indeed, the broad language of most federal statutes exhibits a governmental intent to obtain the desired results without stumbling over the separate entity concept. In effect, these statutes seem to say, "We don't care who you say you are; we will deal with who you really are; and who you really are depends only on who controls you." Moreover, neither the state or country of incorporation, nor the principal place of business is determinative, if even relevant.

At the executive policy making level, the government has been aware of the function of control, as have foreign governments. Once it is clear that what is important is not the formalities of separateness, nor even ownership, but rather actual control, then logically all countries should want foreigners to make portfolio investments in corporations under domestic control. In this sense, governments show a marked tendency toward logical behavior.

During the 1960's, Canada discovered in a very graphic way that it is control of policy decisions which is determinative of the corporation's personality in all but a legal sense. Concerned by the extensive ownership of the Canadian economy by foreign corporations, principally American, Canada launched a campaign to "repatriate control."[59]

To this end, measures were taken to enable Canadians to purchase shares in Canadian subsidiaries of foreign companies, only to discover, at length, that irrespective of majority ownership of shares by Canadians, there was no effect on the Board of Directors, the officers or the policies of the Canadian corporation.

The net result was that Canadians were contributing to United States corporations' capital pools which those corporations in turn reinvested in control of Canadian corporations. And the repatriation of real control by Canada will require very sophisticated legislation. This proposed legislation must be the embodiment of Canada's recognition of the realities of the multi-corporate enterprise.[60]

At the same time, the economic policy of the United States is encouraging this same type of activity by American corporations.[61] In short, we want foreigners to finance American control of investments abroad.

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59. *See* CANADIAN'S ELEVENTH REPORT, *supra* note 36.

60. *Id.*

61. United States President's Task Force. REPORT ON PROMOTING INCREASED FOREIGN INVESTMENT IN UNITED STATES CORPORATE SECURITIES AND INCREASED FOREIGN FINANCING FOR UNITED STATES CORPORATIONS OPERATING ABROAD. Washington Government Press Office, 1964 (36 p.). *See also Restrictions on United States Direct Investment Abroad,* 15 C.F.R. § 100.101-.804 (1968).

Products liability is an area in which the courts may become amenable to the idea of reaching the entity, irrespective of the persons described in the corporation's books. And this is entirely consonant with the policy of tort law to compensate the innocent victim of defective products at the expense of anyone in the chain of commerce, irrespective of the defendant's fault. Consider the following:

Assume the Food and Drug Administration requires that a certain pharmaceutical product, used for the treatment of diarrhea and disentery, be sold under prescription, and which a warning to the physician that in rare cases it may result in an optical disease with the possibility of blindness. The drug had previously been sold for many years in the United States without prescription.

In addition to being produced in the United States by an American corporation, the product is manufactured and dispensed in Mexico by a subsidiary of the United States corporation. The Mexican government does not require a prescription or a warning, and neither is given in Mexico. If an American tourist buys the drug in Mexico and is rendered blind, is it realistic to suppose that the court, either federal courts or those of his own state, will follow *Velendra*[62] and require that the action be brought in Mexico against the subsidiary?

It appears on the contrary that the tendency to find an identity between foreign subsidiaries and domestic parent in products liability cases, has already reached beyond this hypothetical, albeit under a somewhat different theory than presented herein. In a recent California case,[63] a California resident went hunting in Mexico, and there he bought shotgun shells made in Mexico, under Remington trademark and patent licenses, by a Mexican corporation 40% owned by Remington. A defective shell caused his gun to explode, injuring him. The California Court of Appeals allowed an action against the United States corporation finding "as a matter of law that Remington was an integral part of the composite business enterprise which placed the defective shell in the stream of commerce . . . ."[64]

The definition of enterprise may be too broad. Being a munitions industry and part of the Mexican defense establishment, it appears that the Mexican Corporation was, at all times from its inception, under the close supervision of the Mexican government to ensure that its Mexican character not be compromised. If that is true, then Remington's interest lay only in collecting its royalties for patent and trademark licenses, its payment for technical assistance and training, and

62. *Supra* note 10.

63. Kasel v. Remington Arms Co., 24 Cal. App. 3d 717, App. 101 Cal. Rptr. 314 (1972).

64. 24 Cal. App. 3d at 723; 101 Cal. Rptr. at 322.

its share of profits. It does not appear that Remington had voting control of the Mexican corporation, but rather had a minority position on the Board of Directors, the majority being three Mexican shareholders who owned all the remaining shares, and were not subservient to Remington.[65]

It seems clear, in any case, that in this area, as with areas of interest to the government, the courts need not allow a fictitious separateness of a subsidiary to defeat the claim against the parent where there exists a sufficiently important goal of the substantive law.

It is also clear that the test to determine the reality or fictitiousness of the separate existence of the subsidiary would not be the ritualistic formalities outlined by Douglas and Shanks.[66]

The Second Circuit, in *Boryk v. de Havilland Aircraft Co.*,[67] cites *Taca International Airlines, S.A. v. Rolls Royce of England, Ltd.*,[68] as indicating:

> ". . . New York's steady movement towards holding, that in determining whether a corporation has engaged in activities in the state, it is immaterial whether these are conducted through a branch or through a subsidiary corporation, even though the latter's formal independence has been scrupulously preserved."[69]

The corporation's own actions, moreover, especially with respect to the larger corporate families, indicate that they are a part of a "multi-national", "global", "worldwide", or "integrated" enterprise, and, indeed, that they are quite proud of it. Witness the popularity of consolidated balance sheets. If all the companies represented are, in fact, separate entities, of what possible relevance to investors is the information therein contained? It implies quite clearly that all the financial matters represented in the consolidated balance sheets are all really in the same pocket, and the corporations all represent one pool of finance, of capital, and of personnel; that these legally distinct corporate persons are in fact a unified, integrated and coordinated business empire. Consider the list of affiliated companies which can be found on almost any large company's annual report. I.T.T., for example, owns

65. Query, however, of what interest was it to Remington that its trademark be used on products to be sold in Mexico unless it was precisely to reach a market of Americans just such as the plaintiff, Kasel, with whom the Remington mark enjoys considerable good will? *See also* note 34 *supra*.

66. *See* note 9 *supra*.

67. 341 F.2d 666 (2d Cir. 1965).

68. *Supra* note 34.

69. 341 F.2d 666 at 668. There is dictum, dutifully *citing* Cannon, *supra*, that ". . . mere ownership by a foreign corporation of the stock of a subsidiary doing business in New York (presumably for purely 'investment,' as opposed to 'business' purposes) still does not subject the foreign corporation to the jurisdiction of New York." *Id.* at 668–69.

and controls 1,039 other corporations across the world.[70] Is it realistic to treat them as 1,040 separate corporations? Other more subtle manifestations of corporate unity may include inter-corporate personnel pools,[71] or group meetings between representatives of several ostensibly separate companies, to organize and discuss the operations on an entire international region.[72]

It seems likely that this is a common practice of conglomerates and inter-corporate empires. But even in less blatant circumstances, there is the "Watts line" connection between the subsidiary and a liaison officer such as a vice-president of the parent corporation, affording frequent consultations of a more irregular and informal sort.

This reality of inter-corporate unity is not a startling or new observation. Legal writers have known it for years.[73] The Congress and the executive branch both know and act upon it. Foreign governments know it; economists know it; business managers know it and write about it. And the courts, too, know it when they want to know it.

V. A CLARIFICATION OF CRITERIA FOR PIERCING

It should be recalled that the purpose of the doctrine of disregarding the separate corporate personality, variously stated, is precisely to prevent the corporate personality from being used to perpetrate fraud or public wrong, or to shield injustice.[74]

If we insist on the technical, ritualistic requirements of the classical tests, despite the evolution of the corporate empire as a complex social reality, we will obfuscate our view of realities with a flood of techni-

70. Sampson, *supra* note 27, at 125.

71. *See, e.g., supra* note 34 and accompanying text.

72. *See, e.g.,* Intermountain Ford Tractor Sales Co. v. Massey-Ferguson, Ltd., *cited* at note 38 *supra. See also* Sampson, *supra* note 27, at 129. "More than 200 days a year are devoted to management meetings at various organizational levels throughout the world. . . . New York, Brussels, Hong Kong, Buenos Aires . . ." Geneen, speaking boastfully about the growing efficiency of I.T.T. management, stated: "Today we have a coordinated management group in Brussels, which is our headquarters for Europe, which would comprise about 300 executives, and they monitor all of our operations in Europe." *Id.* at 101.

73. *See, e.g.,* Berle, *supra* note 26.

74. "What the formula comes down to, once shorn of verbiage about control, instrumentality, agency and corporate entity, is that liability is imposed to reach an equitable result." LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS (1936), at 191. Courts will disregard the corporate veil "where limited liability would be inequitable." 2 HORNSTEIN, CORPORATION LAW AND PRACTICE (1959 ed., and 1968 Supp.), at 265. ". . . when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons." United States v. Milwaukee Refrigerator Transit Co., 142 F. 247 (E.D. Wis., 1905), at 255. ". . . [I]t is well settled that where a holding company directly intervenes in the management of its subsidiaries so as to treat them as mere departments of its own enterprise, it is responsible for the obligations of those subsidiaries incurred or arising during its management." Consolidated Rock Products Co. v. Du Bois, 312 U.S. 510 (1941), at 523.

calities and defeat the very purpose of the doctrine. We must make the criteria for separateness of unity as sophisticated as the realities of corporate organization and management.

Any attempt at synthesis of all existing case law to discern what the law is leads, as we have shown, exactly nowhere. But if we are selective and look for guidance, there are cases which do serve to build up the law in the light of those realities. And, although their use in the law is spotty and somewhat irregular, the concepts do exist by which we can define our criteria with some specificity so that we can affect the purpose of the doctrine.

In the technical, formal tests themselves, there is an element of estoppel; in effect, that not having observed the formalities of separateness, the owner or parent cannot demand that the world observe the identity of the corporation. If he has co-mingled his funds with the corporation's funds, he cannot now interpose the corporate personality against an injured plaintiff. Likewise, direct intervention by the parent company in the transaction giving rise to the cause of action may result in the parent's liability for the acts of the defendant-subsidiary.[75]

This hardly occurs, however, in a corporation able to hire minimally competent counsel. To arrange the formally separate character of parent and subsidiary (i.e., the contracts between them, the separate accounts, minute books, meetings of directors or shareholders of one filial corporation after another, in the same room, on the same day, with largely the same people and identically worded motions, reports and waivers of notice), is really more in the realm of choreography than law. The subsidiary is no less fictitious for the painstaking charade.

There is a reality involved which resembles playing children's games like "Simon says". (Simon says "adjourn the meeting of Corporation *A*, then convene the meeting of Corporation *B*, and *then* make decisions for Corporation *B*").

Instead of the Board of Directors of Corporation *A* making a decision as to the affairs of Corporation *B* before "changing hats," there is a "nerve center" for the entire group of corporations, in which control is exercised by the parent corporation by means of a unified computer data processing center. As described of I.T.T., this means that the chief executive officer of the parent company is the only person with all the information.[76] The management of the subsidiary act

75. Kingston Dry Dock Co. v. Lake Champlain Transportation Co., 31 F.2d 265 (2d Cir. 1929), at 267.

76. ". . . behind it all there was . . . the personality of only one man . . . In fact, the more diverse and far-flung the company, the more it seemed to rest on one man."

upon the information which they are given. The decisions for the "empire" as a whole depend upon control of all the information. Like any imperial system, it requires that all communications between the "colonies" go through the "mother country," not between the "colonies" directly. The computerized data processing center serves as the Home Office, as it were, the only place where all of the information of all of the component parts of the empire is gathered. Since corporate information relevant to policy making is private and is not made available to the subsidiaries, to say nothing of the public or the government, it means that the small group around the president of the holding company, who have access to all the relevant information, are in control of the policy decisions of all the corporations of the empire. The result is the same as if the decision were made and evidenced in a formal way. The same principle of estoppel should apply.

Instead of simple, crude commingling of funds, paying the bills of subsidiary from the parents' pocket, or vice versa, there is now consolidated financing of the entire empire and consolidated balance sheets given out to the money market. The same principle of estoppel should govern this more sophisticated, yet more substantial financial unity.

Instead of identical management personnel, serving several corporations at the same time, there is a common personnel pool, or "group", as it was described in the case of *Taca International Airlines, S.A. v. Rolls Royce of England, Ltd.* and the other cases hereinbefore discussed in Note 34, *supra,* consisting of middle level and top management personnel shifting between filials from time to time in a closed system *vis-à-vis* corporations foreign to the particular "empire." There may be institutionalized meetings to coordinate policy as in the *Massey Ferguson* case,[77] and to consolidate feelings of solidarity and social control among top executives of the overall group, as described concerning the monthly meeting of I.T.T. group executives.[78] Again the same principle should apply.

Sampson, *supra* note 27, at 125–26. "To rule over his thousand companies, Geneen developed his unique system of controls." *Id.* at 128. "As the basic safeguard, Geneen has his special band of comptrollers, in each of the companies, reporting directly to the chief comptroller in New York . . . (who is), above all, the secret eye of Geneen." *Id.* at 131. "It was essential to the defense of the corporate castle that I.T.T. should have its own intelligence system . . . a copy of every cable that comes into the Park Avenue building, whether it deals with sales figures or a lunch date with a mistress, goes to top management." *Id.* at 136.

77. *Cited* at note 38 *supra.*

78. *See* Sampson and accompanying text *supra* note 31.

What arises from the foregoing analysis is more in the nature of a checklist of indicia than a formula for proof:[79]

—voting control over the subsidiary

—the inclusion of the subsidiary in a consolidated balance sheet on other financial report of the parent.

—a subsidiary engaged exclusively in an aspect of the parents' business as in *Taca International Air Lines v. Rolls Royce, Ltd.,* the *Flank* case,[80] the *Scophony* case,[81] the *Velendra* case,[82] the *Waldron case,*[83] etc.

—personnel pool including:

—seniority ranking, insurance benefits or stock options which continue to accrue if the employee leaves the employ of the filial corporation to assume a position with another;

—numerous middle level and top executives whose careers have moved through several of the filial corporations;

—frequent policy coordinating meetings, or conferences with supervising directors of the parent,[84] liaison officers of such committees as the North American Operations Committee described in the *Massey Ferguson* case.[85]

There is no way to establish which indicator might be the most significant in a particular close case in the future, or how many elements need to be present to justify treating parent and subsidiary as a unit. The question, in brief, is "does this corporation have a mind of its own?"

To return to the case of *Newport Steel,* for example, the subsidiary was not wholly-owned but the parent did have clear control. Wilport's purposes could surely have been achieved without placing

79. Professor Loss has proposed that the following factors, among others, are relevant in finding control and controlling influence; amount of stock held; number of representatives on Board of Directors or other strategic decision making committees; demonstrated influence in past transactions; and power to "break quorum" by abstaining from attending stockholders meetings or giving a proxy. These factors are relevant in determining "control" even under those federal statutes which do not attempt to define "control." 2 LOSS, SECURITIES REGULATION (Supp. to 2d Ed. 1969) 778-89, *cited in* 86 HARV. L. REV. 1034.

80. Both cited *supra* at note 34.

81. *Supra* note 38.

82. *Supra* note 10.

83. *Supra* note 34.

84. Sampson and accompanying text, *supra,* note 31.

85. Cited *supra* note 38.

people from its personnel pool in control of Newport's board of directors or offices, unless the Newport officers and directors were to attempt to resist the inevitable by refusing to pattern the business to Wilport's needs. Nor should it be determinative that Newport may have continued to conduct certain business apart from the business of Wilport. A controlling shareholder, of course, is entitled to elect people whom he trusts to sit on the Board of Directors, and this is not necessarily sinister. But the fact remains that Wilport is undeniably in control of Newport, and Newport has adapted the nature of its business to the needs of Wilport, becoming, in reality, a functional "adjunct", etc., of Wilport.

To illustrate, suppose that prior to the sale of Feldmann's shares to Wilport, a creditor had loaned money to Newport, which was then in the happy position of a supplier in a short market, with dynamic leadership and a bright future.

Newport as a captive subsidiary of Wilport is quite a different corporation from the Newport with whom the creditor dealt when he loaned the money, and he should have recourse to the parent for his claim.

In the *Perlman* case, since the court realized that the recovery would otherwise innure only to the benefit of Wilport, the new controlling shareholder, pro rata distribution was made to the minority shareholders of Newport.

Legally, of course, control of the supply belonged to Newport alone. It did not belong to the shareholders of Newport. If we are to regard the corporation's separate personality, the proceeds of the sale of control belonged to Newport, not to its shareholders. And, if we are to regard the fiduciary duties of directors and officers of the separate person, it should make no difference that the parent corporation, Wilport, which now owns controlling interest in the subsidiary, has no other interest in the subsidiary than to make of it a supplier of steel to the parent. The directors and officers of the subsidiary, which the parent will now elect, are obliged to make their decisions solely in the best interests of their corporation, which, officially, is the subsidiary, Newport.

But to give recovery to the subsidiary would clearly be a charade, rendering the shareholders' recovery in their derivative action illusory, of benefit only to the controlling shareholder, Wilport. Having refused to rescind the sale and restore Newport's independence, the granting of recovery pro rata to the minority shareholders of the subsidiary clearly implies that the parent legally can cause the subsidiary to conduct business in a way that is not necessarily in its best interest, but

rather in the best interest of a total inter-corporate empire. Here, that empire includes both Newport and Wilport, and the main concern of the persons in control is for Wilport.

To act upon that fact in the Newport cases is merely to recognize what is plainly true. Further, justice demands that the law generally conform to fact not legal fiction; in this case, the fact that a subsidiary may be managed for the benefit of an economic entity not co-extensive with itself, and that the interests of the one do not necessarily coincide with those of the other. Indeed, it may be in the interest of the empire to jettison one of its component subsidiaries entirely, as in *Zahn v. Transamerica Corporation*[86] and *Blaustein v. Pan American Petroleum Corporation.*[87] Those who have dealings with the disfavored subsidiary should have recourse to the empire for their claims.

It is possible for Newport's business to be integrated into Wilport's such that, in the future, with the shortage past, Wilport will have reaped the benefit of Newport's position. Newport will be jettisoned and the creditor left to settle for his portion of the bankrupt corporation. This can be done without involving "waste or spoilation" of the subsidiary, nor any contract between parent and subsidiary which is illegal, improper or in any way violative of the duties to Newport of its directors, officers or majority shareholders, nor any sale of materials at less than minimal "fair market value", nor any overt interference by officers of Wilport in Newport's actions.

VI. THE BURDEN OF PROOF

Assuming this to be a fact in any particular case, it is nevertheless a fact which would be quite impossible for the plaintiff to discover or to prove.

It is not difficult to imagine the difficulties of plaintiff's counsel in proving that the nature and frequency of telephone conversations between parent and subsidiary are such as to justify a determination of interference in the day to day operations of the subsidiary, as required by the classical doctrine, in order to warrant "piercing". Discovery needed by the plaintiff merely to know which records might be relevant to him would, no doubt, be opposed unless the information sought were first described with great specificity, since the requirement would otherwise be extremely burdensome and onerous to the corporation. Perhaps even worse, if the corporation eventually complied with the request for records, plaintiff's counsel could be inundated in paper,

86. 162 F.2d 36 (3d Cir. 1947).

87. *See* note 35 *supra.*

mostly concerning correspondence and conversations which are mainly trivial in relation to his specific case.

It is clear that whatever information of this type exists is quite firmly in the control of the corporation which is alone capable of assessing its importance, and capable, for the most part, of preventing access to that information by opposing counsel or the rest of the world.

What showing of fact should be demanded of a plaintiff to justify a determination of unity of a parent and subsidiary? How specific must plaintiff's facts be? For example, it is not possible, where a holding company controls the policy making of many subsidiaries, to show that on a specific date, during a specific conference or telephone conversation between specifically named individuals, the managers of the subsidiary were instructed to enter into a specific contract or liquidate a particular part of its operations or investments in another of its filials.

As in seemingly every proposition concerning entity and control, there are abundant cases in which the courts have not made such requirements to support a finding of "a puppet-puppeteer relationship."[88] And, of course, there are cases beyond number in which it is held that interlocking directorates, even identical membership of the boards of directors of two corporations, do not render their distinct identities fictitious.[89]

Final arrangements between parent and subsidiary are bound to be complex and consideration for specific items impossible to allocate. Rather, as part of a large and complex package contract between them, items for which a concrete fair market value might be determinable will be mixed in with other items with no objective fair market value, such as new patents, trade marks and designs, options to the subsidiary, and the very computer "services", "technical assistance" and business management "advisers" by which the parent may take actual control over policy and management of the subsidiary.

Because the entire contract is a package, and everything on the one side is consideration for everything on the other, it is impossible to show that contractual arrangements are, as a matter of law, unfair. It is likewise impossible for a plaintiff to prove that the decision-making process of the subsidiary has its center in the executive suite of the parent, short of commissioning, for every case, a team of sociologists, psychologists, anthropologists or other experts in anthropoid behavior to document the line of status, deferrence and command.

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88. *See, e.g.,* Zahn v. Transamerica Corporation, 162 F.2d 36 (3d Cir. 1947).

89. *See, e.g.,* 38 A.L.R.3d 1127, 7 A.L.R.3d 1354.

Yet it should come as a shock to no one were he to be told that the entire legal staff of the regional office of an "independent" foreign subsidiary of an American automobile manufacturer was transferred from Mexico City to Caracas inside of 2 weeks and that the transfer was on orders from the parent in Detroit. Again, everyone involved with corporate empires knows that such orders come from the parent company; that the entire advantage of "integration" is to maximize the effectiveness of top managerial brains by placing management of the parent company in actual control of a corporate empire.

It is not reasonable to place upon plaintiff the burden of proving such a wealth of detail where the company has exclusive access of all documents and information concerning the relevant transactions, sole control over the very existence of documents in the first place, and abundant impetus to suppress the evidence, and where there are sufficient facts available, read in the light of universal practice, to indicate a very substantial probability of real control.

It makes better sense to utilize the approach followed in the case of *Flank Oil Company v. Continental Oil Company*[90] and *Taca International Air Lines v. Rolls Royce of England, Ltd.*[91] If plaintiff can demonstrate a substantial likelihood, showing indicia such as those aforementioned, that the subsidiary is functionally the equivalent of a branch operation, then the presumption should be one of identity, subject to a showing by parent of cause why their separate personalities should be observed.

There remains the problem of the kind and extent of control the doctrine should contemplate. It should still be the result that "mere ownership" of the ability to control the corporation is not sufficient grounds to disregard its existence. If the controlling shareholder behaves as any smaller shareholder *vis-à-vis* the management and direction of the corporation, there is certainly reason to find that it is not the "tool" or "alter-ego" of the shareholder.

If a trust fund, for example, were to hold a controlling block of shares of a corporation, but never voted its shares, it would do violence to the words which we are attempting to edify to call the corporation a tool, instrumentality, alter ego, etc.

Similarly, suppose a manufacturing company purchased a dairy company, not because it wished to enter the dairy business, but only to own, for future expansion, land which is self-supporting in the

90. Cited *supra* note 34. In a civil antitrust suit brought against Humble Oil Co., the court found Standard Oil Co. of New Jersey "found and transacting business" in Colorado through its wholly-owned subsidiary, Humble, simply because New Jersey Standard was the "nerve-center" where the major policy decisions of Humble were made.

91. Cited note 34 *supra*.

meantime. To be sure, the fact of the intention to liquidate the dairy in the vague future might materially affect decision-making and cause the dairy to operate marginally at best. But, there might be justification for a refusal to treat the dairy and its owner corporation as the identical person, depending upon additional facts.

If there were immediate plans to liquidate the dairy and this appeared to be a material factor in the decision to allow the dairy's condition to deteriorate, to the injury of another, then actual control should be found and the owner should answer for the subsidiary.

If, on the other hand, the injury resulted from ill-advised decision-making by the dairy on which the owner corporation had no bearing, it would be a sensible law to treat the owner corporation as any ordinary shareholder.

The courts seem to recognize this distinction between actual control and merely the ability to control. Otherwise, it would be pointless to look into the question whether the parent company has a "business interest" or an "investment interest" in the subsidiary. The question must be raised not only for the purpose of describing the fact of the parent's control irrespective of the meticulous observance of the "niceties" of separateness. It is also important because if the parent can show that it has an investment interest only, there may be cause to respect the subsidiary's separate identity, despite the ability of the parent to control it.

But, it should be enough that it reasonably appear from all the evidence available that the parent actually controls a subsidiary within the jurisdiction to render the parent amenable to service, and to give the court jurisdiction over the parent, and to render the one liable on account of the other, and bound by decrees issued against the other.

Thus, if voting control is clear, as where the subsidiary is wholly owned,[92] and the parent's business purposes indicate that the subsidiary is the functional equivalent of a branch operation of the parent as illustrative in the cases of *Newport Steel, Taca, Scophony, Flank, Waldron,* etc. discussed *supra,* then the parent is subject to the personal jurisdiction of the court, and service on the subsidiary should constitute service on the parent. And, this should be so irrespective of the phraseology of the jurisdictional requirements. If the court has jurisdiction over the subsidiary, it should have jurisdiction over the parent.[93]

92. United States v. United Shoe Machinery Co., 234 F. 127 (D.C. Mo. 1916); Taca International Air Line v. Rolls-Royce of England, Ltd., *supra* note 34.

93. Over 20 years ago, the court in Steinway v. Majestic Amusement Co., et al., 179 F.2d 681 (10th Cir. 1949), made the following appropriate observation:

> It may be that the *more realistic philosophy* of the later cases will eventually lead to the recognition of these acts (controlling stock ownership in the subsidiary, and voting by proxy for "dummy" management as legally sufficient to sustain

By the same token, an appearance by the subsidiary should constitute an appearance by the parent. Similarly, satisfaction of a judgment or compliance with a decree should constitute such action on the part of the parent.

Once the fact of control of the subsidiary as an "instrumentality" is thus established, it is clearly a policy question. Unless the party urging a finding of separateness can adduce compelling reason otherwise, they should be treated as one and the same entity. If I.T.T. has rational justification for treating its tightly-ruled empire as 1,040 separate entities, or if the Justice Department Anti-Trust Division has some compelling reason to hold that a ventriloquist can conspire with his dummy, then let them articulate it. The presumption should follow the facts as illuminated by common experience.

Beyond the factual problem, there is the question, open to the parties and to the court, whether there exists some substantial reason to treat the "alter ego" as if it had a separate identity. *Capital Wines and Spirits v. Pokrass*[94] presents circumstances in which the law might wisely find reason to ignore the shareholders control out of preference for the prophylactic effect of punishing the former officers who had looted the corporation. If the Court of Appeals of New York considers it more important to the development of society and the administration of justice to prevent a windfall to an innocent shareholder who would be debarred from bringing a derivative suit, then let it articulate and justify that preference.

But let counsel be put on notice that it is indeed a policy question. Let it be fought in the open, and not hidden under the rubric of a question of fact.

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asserted jurisdiction over the non-resident corporation. And, we might now say for ourselves that any such assertion of "physical power" would not offend "traditional notions of fair play and substantial justice."

(Emphasis added), 179 F.2d at 684.

94. *See* note 22 *supra*.