Corporate Empires: Past, Present, and Future

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ABSTRACT: For decades, the corporate world has been dominated by "Corporate Empires." Corporate empires are conglomerates comprising a parent and tens, even hundreds, of subsidiaries. Corporate empires differ from standalone companies not only in the scale and scope of their operations, but also in the interdependencies that exist among entities in the group and the international nature of their activities. Despite this commercial reality, no unique body of law for these entities has been developed. Corporate law evolved, and continues to evolve, with the standalone company as its exclusive focal point. This legal focus has driven a wedge between the law and the business world. In this Article, we set out to fill the gap between corporate law and its largest, and arguably most important, subject matters by advancing a set of legal principles, uniquely designed for complex corporate structures. To gain an insight into this world, we collected and analyzed statistical data on the largest one hundred corporations on the S&P 500 list over five-year intervals, beginning in 2004 and ending in 2021. Building on our empirical and theoretical foundations, we advance a core set of principles for complex corporations, designed to preserve the economic benefits of conglomerate structures while minimizing the costs. Specifically, we redesign the doctrines of liability and veil-piercing in conglomerates and corporate groups, repurpose fiduciary duties in wholly owned subsidiaries, redefine oversight liability, and advance a multivariegated approach to the challenge of cross-border activities.

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INTRODUCTION 1158

I. THE MODERN CORPORATE WORLD 1164

II. THE BUSINESS AND LEGAL LOGIC OF CORPORATE EMPIRES 1173
A. *THE BUSINESS LOGIC BEHIND CORPORATE EMPIRES* 1174
1. Transaction Costs 1174
2. Diversification 1175
3. Affirmative Asset Partitioning 1176
4. Specialized Management 1177
5. Internal Financing 1177
B. *LEGAL INCENTIVES TO ESTABLISH CORPORATE EMPIRES* 1178
1. Limited Liability 1178
2. Foreign Law 1179
3. Tax Advantages 1179

III. THE UNIQUE LEGAL CHALLENGES FACING CORPORATE EMPIRES 1181
A. *PARENT'S LIABILITY FOR A SUBSIDIARY'S MISDEEDS* 1181
B. *FIDUCIARY DUTIES IN CORPORATE EMPIRES* 1187
C. *VEIL-PIERCING* 1191
D. *OVERSIGHT LIABILITY* 1193
E. *THE CHALLENGE OF INTERNATIONAL OPERATION* 1197

IV. REDESIGNING CORPORATE EMPIRE LAW 1200
A. *PARENTAL LIABILITY AND VEIL-PIERCING* 1202
B. *FIDUCIARY DUTIES* 1207
C. *OVERSIGHT LIABILITY* 1210
D. *THE CHALLENGE OF CROSS-BORDER ACTIVITIES* 1214

CONCLUSION 1217

INTRODUCTION

Corporate law scholarship and policy maintain a strict "single firm focus."[1] On this view, the single firm is the relevant unit of analysis, and corporate law should be designed to suit the needs of standalone companies. The reality of public corporations is very different, however. As we will show in this Article, all the largest publicly traded companies in the last twenty years

1. Marcel Kahan & Edward Rock, *Systemic Stewardship with Tradeoffs*, 48 J. CORP. L. 497, 500 (2023).

have been conglomerates, broadly defined to include all corporate groups.[2] The largest public corporations are essentially "Corporate Empires."[3] The data we collected and analyzed substantiates this assertion. In December 2021, one hundred percent of the largest one hundred corporations on the S&P 500 were parent companies with tens, sometimes hundreds, of subsidiaries. Furthermore, most of the subsidiaries of U.S. parents are foreign. The reasons for the rise of corporate empires are varied and multifaceted ranging from asset partitioning and economies of scale and scope to desire to take advantage of limited liability and favorable tax regimes. In other cases, foreign sovereigns like China, India, Switzerland, and others encourage, and even force, parent-corporations wishing to do business in these countries to set up local subsidiaries.

Our goal in this Article is two-fold. Descriptively, we demonstrate the centrality of conglomerates to the modern business world. Normatively, we fashion a comprehensive legal approach to conglomerates.

We begin with the Article's descriptive goal. To study the phenomenon of corporate empires, also known as conglomerates, and the special challenges to which they give rise, we collected data in five-year intervals, beginning in 2004 and ending in 2019, along with 2021 updated statistics about the giants of the corporate world.[4] In the time period we studied, conglomerates dominated the S&P 500 list. In 2021, the one hundred largest corporations on the S&P 500 list were conglomerates. In that group, the average number of subsidiaries per parent was 160.71, an increase of almost seven subsidiaries per parent since 2019 (153.47).[5] Notably, a fair number of parents have hundreds of subsidiaries. In 2021, ThermoFisher Scientific Inc.

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2. We define a conglomerate as a corporate structure comprising a parent and at least one subsidiary. Our definition is broader than the traditional definition of the term, which distinguishes between conglomerates and corporate groups. Conglomerates are typically defined as "a business corporation producing products or services of several industries that are unrelated with respect to raw material sources, product development, production technology, or marketing channels." Neil H. Jacoby, *The Conglomerate Corporation*, FIN. ANALYSTS J., May–June 1970, at 35, 35. Unlike conglomerates, business groups (or concerns which are a type of business groups common in Europe) are less diversified, sometimes concentrated in a single particular industry, and the companies that operate within a business group have stronger business relationship compared to companies that operate within a conglomerate. *See* Tarun Khanna & Yishay Yafeh, *Business Groups in Emerging Markets: Paragons or Parasites?*, 45 J. ECON. LITERATURE 331, 331–33 (2007) (showing that while some countries' business groups have diversified, American business groups have not). For expositional purposes and for convenience's sake, we use the term "conglomerate" to refer to *both* types of corporate structures. We do so because the dividing line between conglomerates and corporate factors—whether the subsidiaries are in the same line of business—is of critical significance to economists and much lesser importance for legal scholars.

3. We use the terms "Corporate Empires" and "Conglomerates" interchangeably throughout the Article.

4. Gideon Parchomovsky & Asaf Eckstein, Corporate Empires: Past, Present, and Future Dataset (Oct. 9, 2023) (unpublished dataset) (on file with the *Iowa Law Review*) [hereinafter Corporate Empires Dataset].

5. *Id.*

and UnitedHealth Group Inc. had over one thousand subsidiaries each.[6] Pepsi Co. had 550 subsidiaries, Merck & Co. had 437 subsidiaries, Caterpillar had 412 subsidiaries, and Johnson & Johnson had 507 subsidiaries.[7] The lion's share of the subsidiaries of the top one hundred S&P 500 companies are wholly owned.[8]

The high number of subsidiaries is merely the beginning. Conglomerates employ tens of thousands of employees and consequently their impact on communities and the local economy far exceeds that of standalone firms. They operate in their own corporate fiefdom. In 2021, the average number of employees at the top one hundred conglomerates was 157,865,[9] while in 2019, the average was 133,342.[10] The average value of the largest one hundred conglomerates that year was $190.22 billion.[11]

In executing on the Article's normative goal—to design a unique legal framework for corporate empires—we begin by identifying the main legal differences in the treatment of standalone companies and conglomerates under extant law. The first difference concerns fiduciary duties. Consider the recent decision of Ben & Jerry's independent board to sue the parent Unilever board for diluting its brand integrity.[12] The dispute arose after Ben & Jerry's decided not to distribute its ice cream in the West Bank of Israel and Unilever's board overturned the decision.[13] But can a subsidiary's board vote to sue its parent? It is a fundamental tenet of corporate law that directors and officers owe a fiduciary duty to the corporation for which they work.[14] In a standalone corporation, the fiduciary obligations are directed to the corporation and its shareholders.[15] This is an immutable principle of corporate law. In the case of conglomerates, however, the Delaware Supreme Court ruled that the board of a wholly owned subsidiary owes a fiduciary duty to the parent company alone.[16] The Delaware Supreme Court's view stands in diametric opposition to the separate legal identity that animates corporate law. Effectively, the Delaware Supreme Court disregarded the separate corporate personality of wholly owned subsidiaries, effacing the distinction between the subsidiary and the parent. Given this ruling, one would have

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.* This figure includes both full-time and part-time employees.

10. *Id.* This figure includes both full-time and part-time employees.

11. *Id.*

12. City of St. Clair Shores Police & Fire Ret. Sys. v. Unilever PLC, No. 22 Civ. 5011, 2023 WL 5578090, at *4 (S.D.N.Y. Aug. 29, 2023).

13. *Id.* at *1–2.

14. *See* Polk v. Good, 507 A.2d 531, 536 (Del. 1986) ("In performing their duties the directors owe fundamental fiduciary duties of loyalty and care to the corporation and its shareholders.").

15. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1280 (Del. 1988).

16. *See* Anadarko Petrol. Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1177 (Del. 1988). For discussion and criticism, see *infra* Section III.B.

expected that the Delaware courts would have been more willing to pierce the corporate veil between parent and subsidiary. Surprisingly, however, the Delaware courts have been considerably more reluctant to pierce the corporate veil in conglomerates relative to standalone firms.[17] Not only are these rulings inconsistent on their face, but they have also attracted criticism from other state courts.

Second, take the issue of a parent's liability for the actions of a subsidiary. A parent company must implement a governance structure that enables it to adopt a strategy for the entire group. Naturally, a parent would like to see its subsidiaries thrive since their performance affects the entire corporate family. This impulse can lead parent companies to engage the management and board of subsidiaries and be involved in their operations. The upside is obvious. But what about the downside? What happens if a subsidiary is implicated in wrongdoing? As a general rule, the more a parent is involved in the day-to-day affairs of a subsidiary, the more likely it is to be liable for the misdeeds of a subsidiary.[18] This rule puts the parent in a catch-22. Too little involvement may lead to business failure; too much may result in the imposition of legal liability on the parent, which may be the undoing of an entire corporate empire.[19]

Third, and relatedly, conglomerates give rise to complex oversight issues. Large conglomerates have subsidiaries that operate in highly specialized markets. As the activities of subsidiaries become more complicated and distinct from the parent's, supervision proves to be a formidable challenge. As an illustration, consider the case of AIG Financial Products Corporation ("AIGFP"), a subsidiary of AIG group. The parent company and others in the AIG group did not understand exactly the nature of the business of the London division and naturally had no ability to supervise its operations.[20] The losses the subsidiary incurred in 2007 through 2008 from its activities in the credit default swap market have nearly triggered the collapse of the insurance

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17. For discussion, see *infra* Section III.C. *See* CHRISTIAN A. WITTING, LIABILITY OF CORPORATE GROUPS AND NETWORKS 340 (2018) ("Veil-piercing occurs less frequently as against parent companies than it does against individual shareholders."). It is interesting to note that the Delaware courts are more willing to order reverse veil-piercing in the case of conglomerates. *See* Manichaean Cap., LLC v. Exela Techs., Inc. 251 A.3d 694, 714 (Del. Ch. 2021) (holding that outsider reverse veil-piercing may be permissible in certain limited circumstances).

18. Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605, 612 (2005) [hereinafter Blumberg, *Corporate Groups*].

19. *See, e.g.*, William J. Rands, *Domination of a Subsidiary by a Parent*, 32 IND. L. REV. 421, 454 (1999) ("The current law is producing the wrong incentive, because it encourages parents to avoid exerting control over its subsidiaries."); *see also* N. Stevenson Jennette III, *Providing Safety Services to Subsidiaries: A Liability Trap for Parent Corporations*, 1990 DET. COLL. L. REV. 713, 716–17 (explaining that a parent company can be found liable for losses caused by a subsidiary if it provides safety services to the subsidiary and performs those services negligently).

20. Gretchen Morgenson, *Small Unit in London Pushed AIG into the Skid That Nearly Destroyed It*, N.Y. TIMES (Sept. 28, 2008), https://www.nytimes.com/2008/09/28/business/worldbusiness/28iht-aig.4.16538680.html (on file with the *Iowa Law Review*).

empire that had revenues of over $1 trillion and employed over one hundred thousand employees in 130 countries.[21]

This leads to the question: what are the oversight obligations of the parent's board vis-à-vis its subsidiaries? Under the *Caremark* standard, corporate fiduciaries must put in place an effective reporting system and respond to red flags to avoid liability for oversight failures.[22] But can the board of a parent be realistically expected to oversee hundreds of subsidiaries?[23]

Fourth, as we noted, virtually all conglomerates have foreign subsidiaries. For example, pharmaceutical giant Johnson & Johnson, has approximately 150 U.S. subsidiaries, but over 350 international subsidiaries.[24] Consequently, conglomerates face a uniquely nettlesome challenge that standalone companies were spared: they must comply with the law of not one, but of multiple sovereigns. This, of course, raises difficult conflict of law questions. A bank that has subsidiaries in Switzerland must comply with Swiss banking secrecy law and with the restrictions Swiss law imposes on a parent's ability to control Swiss subsidiaries.[25] German corporate law goes even further and sets forth a special corporate law for conglomerates. U.S. corporations operating in countries such as Russia and China must likewise respect local laws and regulations. As a leading compliance scholar wrote: "If individuals at a subsidiary in Mexico are bribing foreign officials, it may be well-known within the confines of that subsidiary, but it may not be known at the parent company, which will be held responsible for the conduct."[26] The challenge faced by conglomerates with foreign subsidiaries has become even greater as the United States started to enforce some of its law exterritorialy.[27]

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21. *Id.*

22. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970–71 (Del. Ch. 1996).

23. For discussion, see *infra* Section III.D.

24. Corporate Empires Dataset, *supra* note 4.

25. *See generally* Patrick Emmenegger, *Swiss Banking Secrecy and the Problem of International Cooperation in Tax Matters: A Nut Too Hard to Crack?*, 11 REGUL. & GOVERNANCE 24 (2017) (explaining Swiss banking secrecy laws and their unique issues with a tax evasion scandal); Sébastien Guex, *The Origins of the Swiss Banking Secrecy Law and Its Repercussions for Swiss Federal Policy*, 74 BUS. HIST. REV. 237 (2000) (explaining the history of Swiss banking secrecy laws). It is worth noting that U.S. companies have many subsidiaries in Switzerland and employ dozens of thousands of employees in Switzerland. *See, e.g.*, SWISS-AM. CHAMBER OF COM. & THE BOS. CONSULTING GRP., FOREIGN COMPANIES IN SWITZERLAND: THE FORGOTTEN SECTOR 10–11 (2006) (showing that as of 2003, U.S. firms employed 56,000 full-time employees in Switzerland).

26. Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 273 (2020).

27. *See, e.g.*, *The Trouble with America's Extraterritorial Campaign Against Business*, ECONOMIST (Jan. 19, 2019), https://www.economist.com/leaders/2019/01/19/the-trouble-with-americas-extraterritorial-campaign-against-business (on file with the *Iowa Law Review*) ("The United States leads the world in punishing corruption, money-laundering and sanctions violations. In the past decade it has increasingly punished foreign firms for misconduct that happens outside America. Scores of banks have paid tens of billions of dollars in fines. In the past 12 months several multinationals . . . have been put through the legal wringer."); *see also* Sarah C. Kaczmarek &

Another intriguing issue is how the law of conglomerates must adapt itself to the rise of "stakeholderism." The calls to reorient the purpose of corporations from narrow profit maximization for the shareholders to the achievement of broader social and environmental goals require a profound rethinking of the legal regime that applies to conglomerates. Can a parent company decide to dissolve a subsidiary to increase the profits of the group even when it imposes a dear price on the employees of the subsidiary and its creditors? If the answer is yes, should the board of the subsidiary do everything in its power to obstruct the plan or abide by the parent's wish? Should all the companies in a group act in a socially responsible way or is it enough that only a part does? These and other questions have received scant, if any, attention to date.

To address these questions, we construct a novel legal approach to conglomerates. Conglomerates are unique corporate entities in that they give rise to internal spillover effects. The fate of individual corporations within the group can affect the fortunes of the group, with its myriad stakeholders. For this reason, we reject the two extreme positions espoused by prior scholars: enterprise liability and entity liability. The doctrine of enterprise liability was endorsed, among others, by Professor Phillip Blumberg,[28] who believed that all the corporations in a conglomerate should be treated as one large corporate entity. We maintain that this approach is too coarse and may lead to the demise of conglomerates. We likewise reject the competing view of entity liability, which steadfastly adheres to the notion that each company within a group should be treated independently of the group as a whole. This view is overly formalistic and allows conglomerates to evade their social obligations and impose excessive risks on society.

Instead of these two approaches, we tailor an innovative legal regime that is sensitive to the specific features of conglomerates—benefits and risks

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Abraham L. Newman, *The Long Arm of the Law: Extraterritoriality and the National Implementation of Foreign Bribery Legislation*, 65 INT'L ORG. 745, 753–57 (2011) (giving examples of foreign conglomerates facing extra issues due to American enforcement).

28. Dean Blumberg should rightfully be viewed as the premier conglomerate scholar. His monumental body of work on the subject includes: PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS (1983); Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573 (1986); PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATUTORY LAW OF GENERAL APPLICATION (1989); PHILLIP I. BLUMBERG & KURT A. STRASSER, THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATUTORY LAW SPECIFICALLY APPLYING ENTERPRISE PRINCIPLES (1992); PHILLIP I. BLUMBERG, THE MULTINATIONAL CHALLENGE TO CORPORATION LAW: THE SEARCH FOR A NEW CORPORATE PERSONALITY (1993) [hereinafter BLUMBERG, THE MULTINATIONAL CHALLENGE]; PHILLIP I. BLUMBERG & KURT A. STRASSER, THE LAW OF CORPORATE GROUPS: PROBLEMS OF PARENT AND SUBSIDIARY CORPORATIONS UNDER STATE STATUTORY LAW (1995); Blumberg, *Corporate Groups*, *supra* note 18.

alike—and is suitable to the age of stakeholderism.[29] Specifically, we propose a series of legal reforms to such doctrines as parental liability for a subsidiary's misconduct, veil-piercing within corporate groups, the structure of fiduciary duties in conglomerates, the scope and limit of oversight liability between related corporations, and the challenge of international operations. Importantly, to meet the challenges posed by conglomerates, we venture beyond corporate law and complement it with private and public law doctrines to create the right mix of policy responses.

Structurally, the Article unfolds in four Parts. In Part I, we present our empirical analysis of conglomerates to offer a new and surprising view of the landscape of conglomerates. In Part II, we discuss the business and legal reasons that have led to the proliferation of conglomerates. While conglomerates present significant advantages to shareholders that cannot be captured by standalone firms, they give rise to serious risk that lawmakers must address. In Part III, we explain the law that pertains to parent-subsidiary relationships. Finally, in Part IV, we advance a new legal framework for addressing the challenge presented by conglomerates.

I. THE MODERN CORPORATE WORLD

Much like the universe that is comprised of individual celestial bodies alongside constellations of stars, the modern corporate world is populated by standalone corporations and conglomerates. While standalone corporations are often the relevant unit of analysis in standard corporate law classes, the lion's share of public corporations consist of conglomerates, or families of corporations.

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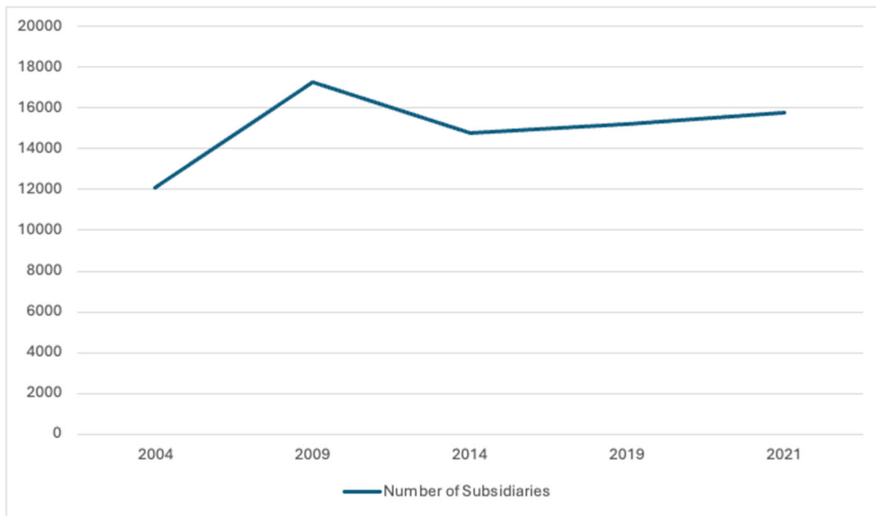
29. *See, e.g.*, Terry Baggett et al., *The End of Shareholder Supremacy*, N.Y. TIMES (Apr. 20, 2015), https://nytimesineducation.com/spotlight/the-end-of-shareholder-supremacy [https://perma.cc/X2RK-LLT4]; Michael Peregrine, *Larry Fink Goes On the Offense for Stakeholder Capitalism*, FORBES (Jan. 18, 2022, 4:51 PM), https://www.forbes.com/sites/michaelperegrine/2022/01/18/larry-fink-goes-on-the-offense-for-stakeholder-capitalism/?sh=228503fcc842 [https://perma.cc/3ML8-ZZUC].

Figure 1: Number of Subsidiaries by Year[30]



Conglomerates or corporate groups are a relatively new idea. The idea that a corporation can own another corporation seemed unfathomable less than a century-and-a-half ago. All that changed in 1888 when New Jersey recognized the ability of one corporation to own the stock of other corporations.[31] New Jersey's deviation from common practice won it the dubious title: "The Traitor State."[32] Indeed, as one commentator notes, "the parent-subsidiary relationship and vast interlocking corporate webs were *de facto* prohibited in every state, with some minor exceptions."[33] New Jersey did not remain alone for long, however. In the early twentieth century, corporate groups and conglomerates became a major business form, pursuant to a period of mergers, followed by vertical integration.[34] The phenomenon of

30. The following graph shows the changes in the number of subsidiaries in 2004, 2009, 2014, 2019, and 2021. This is done for the leading one hundred companies in the S&P 500 by market capitalization, based on 10-K reports. *See* Corporate Empires Dataset, *supra* note 4.

31. Lonny Sheinkopf Hoffman, *The Case Against Vicarious Jurisdiction*, 152 U. PA. L. REV. 1023, 1051 (2004) (explaining how New Jersey was the first state allowing corporations chartered in New Jersey to own stock in a different corporation).

32. Meredith Dearborn, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, 97 CALIF. L. REV. 195, 203 & n.43 (2009).

33. *Id.* at 203.

34. Oliver E. Williamson, *The Modern Corporation: Origins, Evolution, Attributes*, 19 J. ECON. LITERATURE 1537, 1554–55 (1981) ("Three developments are particularly noteworthy in the evolution of the modern corporation in the 20th century. The first of these was the appearance of the multidivisional (or M-form) organization. Later developments are the conglomerate and the multinational corporation."); *see also id.* at 1557–60 (describing the evolution of conglomerates).

holding companies as we know them today followed suit and became prevalent by World War I.[35]

Over the next few decades, conglomerates spread through the corporate world like wildfire. By 1947, conglomerates had come to dominate the business world.[36] As Professor Adolf Berle pointed out, "[m]ore 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."[37]

The expansion of conglomerates reached a peak in the 1960s and 1970s. As Nitin Nohria, Davis Dyer, and Frederick Dalzell observed:

> By the late 1960s, the largest industrial corporations had evolved into nested multidivisional hierarchies. What had been divisions had split into multiple divisions, organized into Groups; then Groups clustered in Sectors. By the time the industrial corporation lumbered into the 1970s, a series of intermediate layers separated the operating divisions from corporate headquarters.[38]

This expansion was bolstered by government enforcement actions aimed to "prevent[] mergers between companies in the same line of business," which raised antitrust concerns, and pushed mergers involving companies from different industries.[39] As it became clear already in the 1960 to 1970s, the structure of conglomerate offers several business and legal benefits, as will be elaborated below.[40]

To gain a better understanding of the dominance of corporate empires we analyzed the annual Form 10-K reports of the largest one hundred U.S. corporations based on market capitalization—namely, the one hundred corporations that constitute the first tier of the S&P 500—in five-year intervals, beginning in 2004 and ending in 2019. We then collected and analyzed similar data regarding 2021 to ensure the most updated picture. From 2004 to 2019, approximately ninety-nine percent of the largest publicly traded companies in the United States were conglomerates., i.e., each member of the group had at least one subsidiary.[41] Although there were shifts

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35. ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 78 (1990).

36. *See* Adolf A. Berle, Jr., *The Theory of Enterprise Entity*, 47 COLUM. L. REV. 343, 343 (1947).

37. *Id.*

38. NITIN NOHRIA, DAVIS DYER & FREDERICK DALZELL, CHANGING FORTUNES: REMAKING THE INDUSTRIAL CORPORATION 102 (2002); *see also* John G. Matsusaka, *Takeover Motives During the Conglomerate Merger Wave*, 24 RAND J. ECON. 357, 357 (1993) ("One of the major business developments of the last half century has been the diversification of American firms. The process reached its zenith during the merger wave of the late 1960s and was carried to its logical extreme by the conglomerate firms that rose to prominence at that time.").

39. Claire A. Hill, Brian J.M. Quinn & Steven Davidoff Solomon, *Mergers and Acquisitions: A Cyclical and Legal Phenomenon*, *in* RESEARCH HANDBOOK ON MERGERS AND ACQUISITIONS 13, 20–21 (Claire A. Hill & Steven Davidoff Solomon eds., 2016).

40. *See infra* Part II.

41. Corporate Empires Dataset, *supra* note 4.

and changes in the realm of corporate empires, we did not observe a meaningful decline in the *overall number* of conglomerates. Overall, the number of conglomerates remained very high and relatively steady over the last seventeen years.[42]

The average number of *subsidiaries*, by contrast, underwent some changes. The average number of subsidiaries in 2009 represents an increase of 26.8 percent over the 2004 average.[43] But by 2014, the average number of subsidiaries reverted to the 2004 level and stayed roughly the same in 2019 and 2021.[44] That said, we observed a significant variance in the number of subsidiaries, both at the high end and the low end. Concretely, in 2004 and in 2009, Bank of America Corp. ("Bank of America") had the largest number of subsidiaries—1,137 in 2004 and 2,060 in 2009.[45] Indeed, in the 2000s, Bank of America adopted an aggressive acquisition strategy to expand its activities in the finance and banking industries.[46] This strategy culminated in Bank of America's 2008 acquisition of Merrill Lynch in the aftermath of the financial crisis.[47] In 2014, Wells Fargo & Co. replaced Bank of America atop the list of parents with the largest number of subsidiaries with a total of 1,427.[48] In 2019, it was UnitedHealth Group Inc. ("UnitedHealth"), that captured the title of the parent with most subsidiaries, with an impressive tally of 1,063 corporations.[49] Yet, this figure constitutes a drop of 48.4 percent from the record number of subsidiaries in our sample, observed in 2009.[50] As for the parent with most subsidiaries in 2021, UnitedHealth kept the lead with 1,856 subsidiaries, an increase of 42.72 percent relative to 2019.[51] The top ten conglomerates in terms of number of subsidiaries are listed in Table 1, below.

42. *Id.*

43. *Id.*

44. *Id.*

45. Bank of Am. Corp., Annual Report (Form 10-K) (Mar. 1, 2005); Bank of Am. Corp., Annual Report (Form 10-K) (Feb. 26, 2010).

46. *See, e.g.*, Jonathan Stempel & Joseph A. Giannone, *Bank of America to Buy Countrywide for $4 Billion*, REUTERS (Jan. 10, 2008, 6:17 PM), https://www.reuters.com/article/us-countrywide-bankofamerica-1-idUSWEN333220080111 [https://perma.cc/BWT2-5ZRB]; *Bank of America Buys Credit Card Firm MBNA*, NBC NEWS (June 30, 2005, 6:03 AM), https://www.nbcnews.com/id/wbna8414809 [https://perma.cc/3Z4F-BHAY].

47. Charlie Gasparino, *Bank of America to Buy Merrill Lynch for $50 Billion*, CNBC (Sept. 15, 2008, 2:00 AM), https://www.cnbc.com/id/26708319 [https://perma.cc/UP26-Q682].

48. Wells Fargo & Co., Annual Report (Form 10-K) (Feb. 25, 2015).

49. UnitedHealth Grp. Inc., Annual Report (Form 10-K) (Feb. 14, 2020).

50. *See supra* text accompanying note 45.

51. UnitedHealth Grp. Inc., Annual Report (Form 10-K) (Feb. 15, 2022); *see supra* text accompanying note 49.

Table 1: Top 10 Conglomerates by Number of Subsidiaries[52]

Rank / Year	2004	2009	2014	2019	2021
1	Bank of America [1,137]	Bank of America [2,060]	Wells Fargo [1,427]	UnitedHealth [1,063]	UnitedHealth [1,856]
2	Comcast [1,036]	Wells Fargo [1,725]	Morgan Stanley [844]	Thermo Fisher [1,036]	Thermo Fisher [1,150]
3	Morgan Stanley [725]	Morgan Stanley [1,258]	Thermo Fisher [809]	Linde plc [679]	Linde plc [619]
4	Wells Fargo [617]	Comcast [1,012]	PepsiCo [580]	Abbott Laboratories [586]	Abbott Laboratories [554]
5	PepsiCo [519]	Pfizer [594]	Caterpillar [518]	PepsiCo [546]	PepsiCo [550]
6	Danaher Corporation [513]	Thermo Fisher [593]	Pfizer [509]	Johnson & Johnson [514]	Johnson & Johnson [507]
7	ConocoPhillips [510]	Merck & Co. [550]	Medtronic Plc [474]	CVS Health [492]	CVS Health [502]
8	Pfizer [500]	JPMorgan Chase&Co. [524]	Merck & Co. [452]	Accenture Plc [491]	Merck & Co. [437]
9	Caterpillar [413]	Procter & Gamble [494]	Mondelez International [445]	Pfizer [458]	Caterpillar [412]
10	JPMorgan Chase&Co. [370]	PepsiCo [480]	Abbott Laboratories [389]	Medtronic Plc [437]	Medtronic Plc [381]

The number of subsidiaries also provides information about the structure of various industries. For example, in 2004, 2009, and 2014, the top ten list of parents with subsidiaries was dominated by companies from the banking and financial industry.[53] In 2019, by contrast, seven of the ten companies that sat atop the list of corporations with subsidiaries belonged to the health, pharmaceutical, and medical industries.[54] The banking and financial industries did not have a single representative among the top ten.[55]

52. Corporate Empires Dataset, *supra* note 4.

53. Bank of Am. Corp., Annual Report (Form 10-K) (Mar. 1, 2005); Morgan Stanley, Annual Report (Form 10-K) (Feb. 10, 2005); Wells Fargo & Co., Annual Report (Form 10-K) (Mar. 10, 2005); JPMorgan Chase & Co., Annual Report (Form 10-K) (Mar. 1, 2005); Bank of Am. Corp., Annual Report (Form 10-K) (Feb. 26, 2010); Wells Fargo & Co., Annual Report (Form 10-K) (Feb. 26, 2010); Morgan Stanley, Annual Report (Form 10-K) (Feb. 26, 2010); JPMorgan Chase & Co., Annual Report (Form 10-K) (Feb. 24, 2010); Wells Fargo & Co., Annual Report (Form 10-K) (Feb. 25, 2015); Morgan Stanley, Annual Report (Form 10-K) (Mar. 2, 2015).

54. UnitedHealth Grp. Inc., Annual Report (Form 10-K) (Feb. 14, 2020); Thermo Fisher Sci. Inc., Annual Report (Form 10-K) (Feb. 26, 2020); Linde plc, Annual Report (Form 10-K) (Mar. 2, 2020); Abbott Lab'ys, Annual Report (Form 10-K) (Feb. 21, 2020); Johnson & Johnson, Annual Report (Form 10-K) (Feb. 18, 2020); CVS Health Corp., Annual Report (Form 10-K) (Feb. 18, 2020); Pfizer Inc., Annual Report (Form 10-K) (Feb. 27, 2020); Medtronic Pub. Ltd. Co., Annual Report (Form 10-K) (June 19, 2020).

55. Corporate Empires Dataset, *supra* note 4.

It would be incorrect to assume, however, that all conglomerates in a certain sector behave in the same way. A comparison of Johnson & Johnson and Pfizer, for example, is revealing. While the number of subsidiaries of Johnson & Johnson more than doubled between 2004 and 2021, the number of Pfizer subsidiaries has not changed much in the first fifteen-year period that constitutes our sample; then, in 2021, it decreased forty-three percent.[56] In the same period, the number of subsidiaries of UnitedHealth grew more than nine-fold, from 194 in 2004, to 1,856 in 2021.[57]

The proliferation of subsidiaries within corporate empires has far-reaching legal implications. It gives rise to an intricate web of responsibilities and fiduciary duties that does not exist in standalone corporations. In this context, it is critical to draw a distinction between directors and officers in wholly owned corporations who, under Delaware law, owe a fiduciary duty to the parent, and directors and officers in non-wholly owned subsidiaries, whose duties are owed to the subsidiary.[58] Furthermore, in corporate families, the misconduct of a single subsidiary can lead to the imposition of liability on other members of the group, first and foremost, the parent.[59] In a standalone corporation, misconduct might result in the collapse of the company, whereas in conglomerates, misconduct by a single subsidiary may cause an entire corporate empire to crumble and fall.

At the low end of the subsidiary spectrum, one finds the technology giants. Interestingly, the three largest companies in the world, in terms of market cap—Apple Inc. ("Apple"), Alphabet Inc. ("Alphabet"), and Microsoft Corp. ("Microsoft")—sport a small number of subsidiaries. In 2019, Apple had fourteen, Alphabet five, and Microsoft eight subsidiaries respectively.[60]

56. Johnson & Johnson, Annual Report (Form 10-K) (Mar. 15, 2005); Pfizer Inc. (Form 10-K) (Feb. 28, 2005).

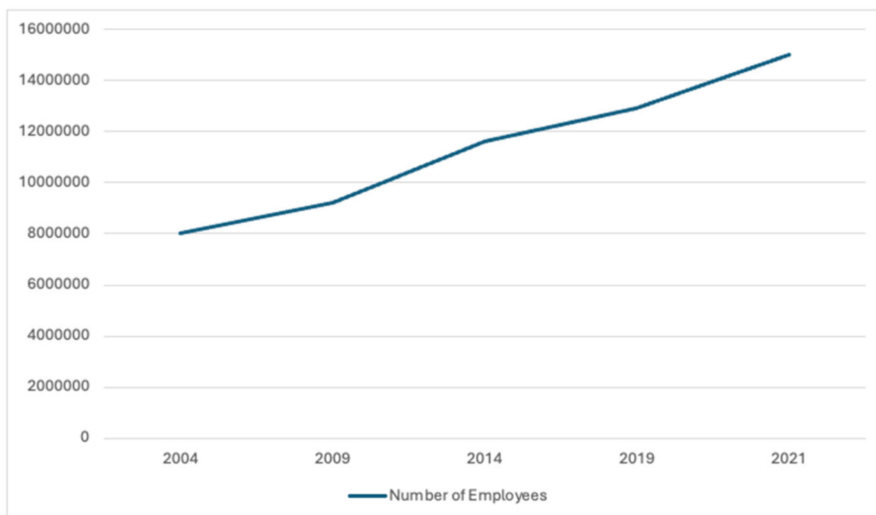
57. UnitedHealth Grp. Inc., Annual Report (Form 10-K) (Mar. 1, 2005); UnitedHealth Grp. Inc., Annual Report (Form 10-K) (Feb. 15, 2022).

58. For discussion, see *infra* Section III.B.

59. For discussion, see *infra* Section III.A.

60. Apple Inc., Annual Report (Form 10-K) (Oct. 30, 2019); Alphabet Inc., Annual Report (Form 10-K) (Feb. 3, 2020); Microsoft Corp., Annual Report (Form 10-K) (Aug. 1, 2019).

Figure 2: Number of Employees by Year[61]



The number of employees in the largest conglomerates is likewise staggering. The largest corporate employer since 2004 has been Walmart Inc. with 2.3 million employees in 2021, a workforce which exceeds that of several countries.[62] Amazon.com, Inc. occupied the second place since 2019 with 798,000 employees; it grew more than twofold in 2021, with more than 1.6 million employees.[63] Joining them in the top three was Accenture plc with 624,000 employees.[64] These numbers are important not only because they demonstrate the sheer size of modern conglomerates, but also because they demonstrate the potentially disastrous effects on local economies and communities of shutting down subsidiaries. As we will explain in Part IV of the Article, these potentially deleterious effects must be considered by policymakers in determining the appropriate legal regime governing conglomerates. The ten biggest employer conglomerates in 2004, 2009, 2014, 2019, and 2021 are listed in Table 2.

61. The graph shows the changes in the number of employees in 2004, 2009, 2014, 2019, and 2021. This is done for the leading one hundred companies in the S&P 500 by market capitalization, based on 10-K reports. *See* Corporate Empires Dataset, *supra* note 4.

62. Walmart Inc., Annual Report (Form 10-K) (Mar. 18, 2022).

63. Amazon.com, Inc., Annual Report (Form 10-K) (Jan. 30, 2020); Amazon.com, Inc., Annual Report (Form 10-K) (Feb. 3, 2022).

64. Accenture plc, Annual Report (Form 10-K) (Oct. 15, 2021).

Table 2: The Ten Leading Conglomerates at Number of Employees[65]

Rank / Year	2004	2009	2014	2019	2021
1	Walmart [1,700,000]	Walmart [1,400,000]	Walmart [2,200,000]	Walmart [2,200,000]	Walmart [2,300,000]
2	McDonalds [438,000]	United Parcel Service [408,000]	United Parcel Service [435,000]	Amazon [789,000]	Amazon [1,608,000]
3	United Parcel Service [384,000]	McDonalds [385,000]	McDonalds [420,000]	Accenture Plc [506,000]	Accenture Plc [624,000]
4	Home Depot [325,000]	Target Corporation [351,000]	Home Depot [371,000]	United Parcel Service [495,000]	United Parcel Service [534,000]
5	General Electric [307,000]	Home Depot [317,000]	Target Corporation [347,000]	Home Depot [415,700]	Home Depot [490,600]
6	Target Corporation [292,000]	General Electric [304,000]	Berkshire Hathaway [316,000]	Berkshire Hathaway [391,500]	Target [450,000]
7	Verizon [210,000]	Bank of America [284,000]	Accenture Plc [305,000]	Starbucks [346,000]	Starbucks [383,000]
8	United Technologies [210,000]	AT&T [281,000]	General Electric [305,000]	UnitedHealth [325,000]	Berkshire Hathaway [372,000]
9	Berkshire Hathaway [180,000]	Citigroup [269,000]	PepsiCo [271,000]	Lowe's Companies [320,000]	UnitedHealth [350,000]
10	Bank of America [175,742]	Wells Fargo [267,300]	Lowe's Companies [266,000]	CVS Health [290,000]	TJX [340,000]

Another important characteristic of modern conglomerates is their businesses' international scopes. In 2019, non-U.S. subsidiaries comprised 58.97 percent of the total number of subsidiaries, while U.S. subsidiaries comprised only 41.03 percent of the sample.[66] The pattern did not change in 2021, with non-U.S. subsidiaries comprising 55.3 percent of the total number of subsidiaries, while U.S. subsidiaries comprising only 44.7 percent of the sample.[67] To ensure that our findings have not been biased by a few large conglomerates with a disproportionately high percentage of non-U.S. subsidiaries, we ran tests for all the conglomerates in our sample. We found that the lion's share of all conglomerates has a substantial percentage of international subsidiaries. This means that large public corporations are not subject to a single legal regime, as is often assumed, but rather must comply with multiple legal regimes. A review of the multiple legal regimes that apply to conglomerates lies beyond the ken of this Article. Yet, we use two concrete examples of the mammoth challenge faced by conglomerates with foreign subsidiaries. First, many banks established subsidiaries in Switzerland, known for centuries as the banking capital of the world. The strict secrecy requirements under Swiss subsidiaries operate to make it very difficult for U.S.

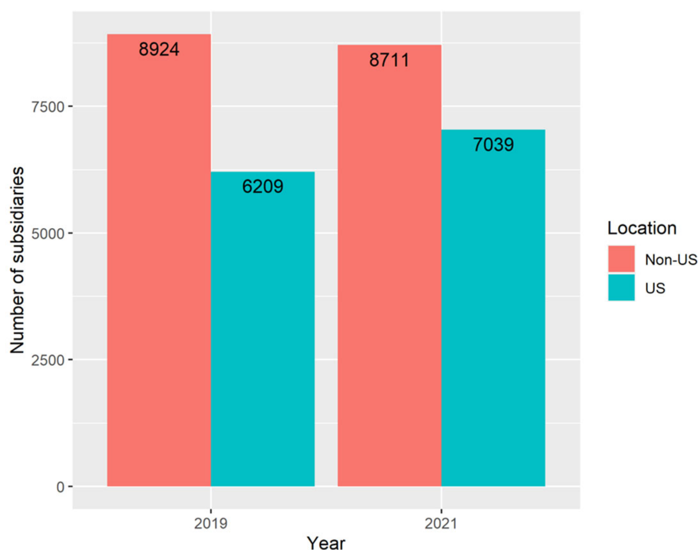
65. Corporate Empires Dataset, *supra* note 4.

66. *Id.*

67. *Id.*

parents to oversee the operations of their Swiss subsidiaries.[68] To make matters worse, Swiss law requires parents to give subsidiaries in Switzerland full autonomy.[69] Second, consider German law. Many subsidiaries in our sample are incorporated in Germany. Germany is unique in that it adopted a special corporate law for conglomerates and concerns.[70] The specific statutory arrangements, however, may vary dramatically from those adopted by Delaware law.

Figure 3: Number of Subsidiaries by Year[71]



The international operations of conglomerates present them with a dual challenge that standalone U.S. corporations are spared. First, from a pure business perspective, operating in a foreign country requires management to acquaint itself with an unfamiliar market environment whose defining characteristics are different from those of the U.S. market. Additionally, conglomerates with non-U.S. subsidiaries must adjust to a new commercial culture, with which they are not familiar. Business strategies that have proven

68. *See* Bernhard F. Meyer, *Swiss Banking Secrecy and Its Legal Implications in the United States*, 14 NEW ENG. L. REV. 18, 24–28 (1978).

69. *See* Karl Hofstetter, *Parent Responsibility for Subsidiary Corporations: Evaluating European Trends*, 39 INT'L & COMPAR. L.Q. 576, 590–91 (1990).

70. *Id.* at 578–83.

71. The bar chart shows the proportion of U.S.-based subsidiaries and non-U.S.-based subsidiaries belonging to the leading one hundred companies in the S&P 500 in 2019 and 2021. The data is based on 10-K reports. Corporate Empires Dataset, *supra* note 4.

themselves countless times in the United States, may fail completely in foreign countries.

The second challenge is legal. Operating in a foreign country requires parent companies to inform themselves of local laws and regulations, but also to adopt complex monitoring mechanisms to ensure compliance with said laws and regulations. The cost of compliance, though far from negligible, is the smaller challenge facing international conglomerates; the greater challenge is the risk to which conglomerates are concerned. In the last decade and a half, there is a sizeable increase in the enforcement actions taken by the U.S. Department of Justice ("DOJ") and other federal and state agencies against corporate entities.[72] It is hard to ignore the fact that a fair number of the corporations against whom investigations were started are conglomerates with non-U.S. subsidiaries that got in trouble.[73]

Furthermore, failure to comply with local laws may spark litigation not only against the directors who serve on the foreign subsidiary, but also against the parent's board. Hence, the individual directors who serve on the board of the parent must acquaint themselves with the laws and regulations of the countries in which subsidiaries operate. In addition, they must adopt effective oversight mechanisms to ensure adequate response to red flags. It should be noted that the oversight responsibilities of a parent board are far more complicated than those of a board of a standalone corporation. The challenge is obviously compounded by the existence of foreign subsidiaries.

II. The Business and Legal Logic of Corporate Empires

In this Part, we examine the business and legal incentives that led to the establishment of corporate empires. Large corporate groups yield substantial benefits to society, but at the same time, present considerable risks. Many corporate law scholars, beginning with Adolf Berle, have adopted a negative attitude toward conglomerates, viewing large corporate structures as an abuse of the corporate entity. The fear was that conglomerates would have a carte blanche to incorporate subsidiaries that engage in excessively risky activities with the benefits thereof inuring exclusively to the parent, while the risks would fall on creditors, employees, and society at large. We aim to understand the advantages inherent in conglomerates not only to present a more balanced picture, but also to devise better solutions to the challenges posed by conglomerates.

72. Asaf Eckstein & Gideon Parchomovsky, *The Agent's Problem*, 70 DUKE L.J. 1509, 1522 fig.1 (2021).

73. *SEC Enforcement Actions: FCPA Cases*, U.S. SEC. & EXCH. COMM'N (Oct. 2, 2023), https://www.sec.gov/enforce/sec-enforcement-actions-fcpa-cases [https://perma.cc/92UF-LASL].

A. The Business Logic Behind Corporate Empires

The propagation of corporations in our society in the last 140 years did not happen without reason. There are significant economic drivers behind the creation of new corporate entities. We begin our explication of the economic motivations to set up subsidiaries with classic literature on the choice between corporations and markets and then build upon it to highlight the specific incentives to set up elaborate corporate structures.

1. Transaction Costs

In his seminal article, *The Nature of the Firm*, Ronald Coase captured the essence of the choice between firms and markets as organizational forms—a choice widely known as the "make or buy dilemma."[74] Production of goods or services can take place via contractual interactions in the marketplace or within firms.[75] Contractual interactions involve transaction costs—defined as the cost of identifying one's contractual counterparty, negotiating an agreement, formalizing the agreement in the form of a contract, and enforcement costs.[76] Operation within a firm largely obviates these costs as firms are hierarchical structures, in which management can issue orders to the lower echelons.[77] At the same time, as corporations grow larger and more complex, it becomes increasingly difficult to manage all the necessary production functions within them. Hence, Coase predicted that firms would continue to increase in size only to the point where the cost savings from undertaking production within the firm is lower than the cost of organizing these functions through market transactions.[78]

Elaborating on Coase's insight, Oliver Williamson, another Nobel Prize laureate, proposed a refinement to Coase's theory. Williamson distinguished between standard transactions that do not require long-term relationships and idiosyncratic transactions that do.[79] Long-term relationships necessitate flexibility. Furthermore, the entire spectrum of eventualities that may arise in the context of such relationships cannot be contractually specified with sufficient precision.[80] One way to create the necessary governance structure for long-term, relation-specific transactions is to organize them within a

74. R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 388 (1937).

75. *Id.* at 388–89.

76. *Id.* at 388–92.

77. *See* R.H. COASE, THE FIRM, THE MARKET, AND THE LAW 34–36 (1988). "Within a firm, these market transactions are eliminated and . . . the entrepreneur-co-ordinator, who directs production" is substituted "in place of the complicated market structure with exchange transactions." Coase, *supra* note 74, at 388.

78. *See* Coase, *supra* note 74, at 392, 394–96.

79. Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233, 250–54 (1979).

80. *Id.* at 237.

firm.[81] The other way is to use a joint venture.[82] Firms are preferable to joint ventures when "human and physical assets become more specialized to a single use,"[83] or when it is advantageous to operate without revising, adjusting, or completing "interfirm agreements."[84] The benefits of integration are significant and have been proven empirically. According to estimates, up to forty percent of global production takes place in single corporate entities.[85]

The business historian Alfred Chandler summarized the reasons behind the growth of corporations, suggesting that the main driver of growth is the desire to achieve "[r]eductions in costs and efficient resource utilization . . . from the exploitation of economies of scale in production and distribution, from exploiting economies of joint production or joint distribution, or from reduction in the costs of transactions involved."[86] Economies of scale refer to cost savings that can be realized as the scale of production increases.[87] These savings may either result from a reduction in the per unit fixed cost when the output gets larger[88] or from a drop in the average variable cost emanating from a larger production scale. Economies of scope denote the phenomenon of a reduction in total cost.[89]

While transaction costs, economies of scale, and economies of scope explain the existence of corporations and their growth, they do not explain the proliferation of conglomerates. As Christian Witting acutely observed, conglomerates and corporate groups do not fit well under either of the prototypes analyzed by Coase and Williamson.[90] As we will demonstrate below, academic researchers have enumerated several additional reasons for establishing corporate groups: diversification, affirmative asset partitioning, specialized management, and internal financing.

2. Diversification

Established businesses may elect to expand their operations into related (or unrelated industries) to protect themselves from economic cycles or fluctuations. Likewise, diversification has the potential to create new revenue streams. In Witting's view, "[k]eys to successful diversification are the competence of the parent company in managing diverse businesses and—what is entirely consistent with this—the 'decentralization contract' by which

81. *Id.* at 250.

82. *Id.*

83. *Id.* at 252.

84. *Id.* at 253.

85. GEOFFREY JONES, MULTINATIONALS AND GLOBAL CAPITALISM: FROM THE NINETEENTH TO THE TWENTY FIRST CENTURY 40 (2005).

86. CHANDLER, *supra* note 35, at 17.

87. *Id.* at 17.

88. *Id.* at 23.

89. *Id.* at 17, 24.

90. *See* WITTING, *supra* note 17, at 30.

the parent sets financial performance targets but otherwise gives profit centre managers 'the freedom to make their own decisions.'"[91] Furthermore, information sharing with respect to related products by different units can help diversification succeed.

Witting cautions, however, that diversification is a risky strategy and that even expansion to closely related markets might fail.[92] As an example, he cites the failure of BP and Exxon to establish subsidiaries in the minerals market.[93] Despite the similarities between the oil and minerals sectors, the two oil giants did not know that success in the minerals business depends on obtaining access to cheap deposits.[94] He concludes that it is therefore unsurprising that "there has been movement away from strategies of radical business diversification and a return to 'core competencies.'"[95]

3. Affirmative Asset Partitioning

In their classic, *The Essential Role of Organizational Law,* Professors Henry Hansmann and Reinier Kraakman contended that affirmative asset partitioning, consisting of "the shielding of the assets of the entity from claims of the creditors of the entity's owners or managers"[96] is the principal economic advantage offered by incorporation. Affirmative asset partitioning offers creditors bonding and monitoring advantages that could not be attained contractually,[97] thereby reducing the cost of credit. Subsidiarization is a precondition to achieving affirmative asset portioning. Subsidiarization allows for a parent to allocate different asset types to separate subsidiaries.[98] In fact, asset partitioning can occur with finer gradation in corporate groups.[99] In such groups, it is possible not only to separate the assets of the parent from the assets of subsidiaries, but also to apportion different asset types to individual subsidiaries.[100] Hansmann and Kraakman are careful to note that there could be countervailing considerations, mentioning two in particular.[101] The first is bankruptcy.[102] Individual subsidiaries face a great risk of bankruptcy relative to large corporate entities with multiple divisions that can

91. *Id.* at 31 (quoting Andrew Campbell, Michael Goold & Marcus Alexander, *Corporate Strategy: The Quest for Parenting Advantage*, HARV. BUS. REV., Mar.–Apr. 1995, at 120, 128 (emphasis omitted)).

92. *Id.* at 32.

93. *Id.*

94. *Id.*

95. *Id.* (quoting Campbell et al., *supra* note 91, at 120).

96. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law,* 110 YALE L.J. 387, 390 (2000).

97. *Id.* at 392–93.

98. *See id.* at 399.

99. *Id.* at 399–401.

100. *Id.*

101. *Id.*

102. *Id.* at 400.

shift funds from one division to another.[103] The second concern is debtor opportunism.[104] The parent can drain one subsidiary of its assets and move them to another.[105] In fact, asset partitioning can occur with finer gradation in corporate groups. Indeed, Professor Lynn LoPucki has argued that U.S. conglomerates take advantage of this strategy by setting up subsidiaries in foreign countries and secreting assets in foreign havens in order to put them out of the reach of domestic creditors.[106] The use of subsidiaries is desirable from an economic standpoint when the advantages stemming from asset portioning outweigh the concerns to which subsidiarization gives rise.[107]

4. Specialized Management

Another reason to establish a corporate group is the benefit of specialized management. Consider a large single corporation that involves multiple lines of business. Its general management will face the Herculean task of mastering different business models in different economic sectors. As Chandler observed, effective management is a *sine qua non* of business growth and profitability and without it, diversification will fail.[108]

Organizing each line of business under a specialized management provides a superior solution for multibusiness enterprises. To perform its task well, management must be familiar with the specific aspects of the business in which the firm operates. It must know its suppliers, partners, consultants, and customers to streamline production and remain competitive. This is true even when the relevant lines of business are close or related. Alfred Sloan, the legendary President of General Motors, introduced this model when he decided to establish different divisions for cars, trucks, parts, and accessories.[109]

Of course, this organizational model requires a top executive team at the parent company to coordinate the actions of the different entities and monitor their performance. The management of the parent must therefore engage in high-level planning, establish reporting protocols for the entire group and enter contracts to provide goods and services for subsidiaries.

5. Internal Financing

A final reason to operate as a conglomerate is the availability of internal financing. Large successful businesses can raise money more cheaply. Corporate groups also have more assets at their disposal that they can use as securities. A critical advantage of corporate groups and conglomerates is that

103. *Id.*

104. *Id.*

105. *Id.* at 400–01.

106. Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 32–38 (1996).

107. Hansmann & Kraakman, *supra* note 96, at 401.

108. *See* CHANDLER, *supra* note 35, at 14–17.

109. JOHN MICKLETHWAIT & ADRIAN WOOLDRIDGE, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA 104–06 (2003).

they can obtain financing internally and will not necessarily need to borrow from external institutions. Witting notes that "[a] parent company might finance the operations of subsidiaries itself, or else establish a specialist financing arm to make loans to group companies."[110] For example, the Airbus Group bought the Salzburg Muenchen Bank, a private German lender, to provide loans to its business partners and suppliers.[111] It is also believed that larger businesses can attract better human talent by offering employees opportunities that cannot be found in standalone corporations.

B. Legal Incentives to Establish Corporate Empires

Economic reasons are by no means the sole motivation to engage in subsidiarization. The legal reasons to create corporate families are more powerful than the economic ones. Lawmakers, whether intentionally, or not, have crated various incentives schemes that intensified the proliferation of corporate entities.

1. Limited Liability

The most obvious legal motivation that drives subsidiarization is a familiar one: limited liability. The advantages of diversification, finance, and specialized management could also be achieved, albeit to a lesser degree, by establishing various divisions within a single large corporate entity. Divisionilization, however, does not create separate entities and cannot yield the advantages of limited liability. Limited liability enables risk taking by capping the loss shareholders might incur from their investment in the stocks of corporations. This, in turn, allows corporations to engage in business activities that involve greater risks and rewards than the shareholders would be willing to bear as individual market actors. Within corporate groups, the limited liability principle allows the parent to expose different subsidiaries to different risk levels, without jeopardizing the financial stability of the entire group. This, of course, may be a virtue or a vice, depending on one's perspective. Shareholders who enjoy the benefits of limited liability view it as a virtue; creditors, especially noncontractual ones, perceive it as a vice. Either way, the creation of pyramidal corporate structures offers individual shareholders, who invest their money in the parent, several degrees of separation from the risk-taking entity.

110. WITTING, *supra* note 17, at 32–33.

111. Michael Stothard, *Airbus to Create In-House Bank to Lend to Customers*, FIN. TIMES (Feb. 14, 2014), https://www.ft.com/content/48f07248-9569-11e3-8371-00144feab7de (on file with the *Iowa Law Review*); *Airbus Buys German Lender to Grow into Its Company Bank*, REUTERS (Feb. 14, 2014, 1:55 AM), https://www.reuters.com/article/uk-airbus-bank/airbus-buys-german-lender-to-grow-into-its-company-bank-idUKBREA1D09O20140214 [https://perma.cc/B3ZF-YRM9].

2. Foreign Law

The laws of certain foreign countries require corporations that wish to operate in their territory to establish local entities,[112] or at least to obtain the approval of the local regulator. For example, Swiss law requires banks that wish to provide financial services in the country to obtain the approval of the Swiss Financial Market Supervisory Authority ("FINMA").[113] Relatedly, in certain countries, foreign corporations must join forces with local entities to bid in such tenders. Such was the case in "Pharma 2020," in Russia, where a strong preference was expressed for local corporations, so only foreign corporations that teamed up with local ones were allowed to bid.[114] Such legal restrictions may be predicated on the sovereign's desire to subject corporations operating within certain sectors of its economy to be subject to the local law and regulations. They may also be effectuated, at least in part, by the desire to collect incorporation fees and corporate taxes.[115]

3. Tax Advantages

Realization of tax advantages is another important reason to establish subsidiaries in foreign countries. Setting up subsidiaries in various countries allows corporate groups to lower their tax liability not only in the relevant foreign country, but also overall. Various countries are eager to attract large corporations and are willing to offer them substantial tax concessions to lure them to come.[116] Corporations, for their part, are fully aware of the benefits they can derive from tax schemes that involve the use of foreign subsidiaries. The story of Apple's use of Irish subsidiaries to avoid paying taxes is a

112. WITTING, *supra* note 17, at 47–48.

113. BUNDESGESETZ ÜBER DIE BANKEN UND SPARKASSEN [BANKG] [THE SWISS FEDERAL ACT ON BANKS AND SAVINGS BANKS] Nov. 8, 1934, SR 952.0, AS 51 117 art. 3d (Switz.).

114. *See, e.g.*, Plea Agreement at 8, United States v. Teva LLC (Russ.), No. 16-cr-20967 (S.D. Fla. Dec. 22, 2016) ("In or around mid-2009, the Russian government announced a new strategy for the Russian Federation's domestic pharmaceutical industry, known as 'Pharma 2020.' The goals of the new strategy involved, among other things, an import phase-out and changes to the procurement of pharmaceutical products, primarily by establishing a preference for domestic products. . . . Under the law, as announced, repackaging of a foreign pharmaceutical product inside the Russian Federation could qualify for the domestic preference under Pharma 2020.").

115. U.N. COMM'N ON INT'L TRADE L., UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW: PART THREE: TREATMENT OF ENTERPRISE GROUPS IN INSOLVENCY, at 12–13, U.N. Sales No. E.12.V.16 (2012).

116. Recently, a group of 136 countries set a minimum global tax rate of fifteen percent for big companies, in order "to end a four-decade-long 'race to the bottom' by setting a floor for countries that have sought to attract investment and jobs by taxing multinational companies lightly, effectively allowing them to shop around for low tax rates." *See* Leigh Thomas, *Global Tax Deal Seeks to End Havens, Criticized for 'No Teeth,'* REUTERS (Oct. 8, 2021, 6:58 PM), https://www.reuters.com/business/finance/global-corporate-tax-deal-nears-holdouts-drop-objections-2021-10-08 [https://perma.cc/5LZ3-R6JX].

representative example.[117] Between 2009 and 2012, Apple made a $74 billion profit from its worldwide sales, yet paid virtually zero in taxes.[118] Apple achieved this by attributing its massive sales to its Irish subsidiaries that were subject to a tax rate that was lower than one percent.[119] While not all corporations were as fortunate as Apple, many of them used the same planning techniques to lower their tax exposure.[120]

The most common strategy used by conglomerates to reduce their tax liability is called transfer price manipulation. As its name suggests, this strategy involves manipulation of the prices of inputs and outputs among corporations in the group to reduce overall taxation.[121] Transfer price manipulation is an especially attractive strategy in the e-commerce arena, where "[a] typical ploy has been the use of low-tax jurisdictions from which to make internet sales, marked-up goods merely being 'distributed' by subsidiaries in high-tax jurisdictions rather than being subject to value-enhancing (and taxable) activity."[122]

Likewise, conglomerates can limit liability by engineering expenses, such as management fees, insurance payments and other costs, in a way that minimizes profits in high tax jurisdictions and increases them in low tax ones.[123] Another popular mechanism conglomerates employ is to concentrate their intellectual property rights in the hands of a foreign subsidiary operating in a low tax country. The subsidiary owner then licenses the rights to other entities within the group operating in high tax countries, typically for an inflated price. The use of this strategy creates deductible expenses for the group members operating in high tax countries, which dramatically reduces the taxable income of those entities.

Finally, corporate empires are not shy about using their market power to negotiate favorable tax arrangements with foreign governments. For example, Apple negotiated a tax rate of less than two percent with the Irish government.[124] At the time, the standard tax rate in Ireland stood at twelve

117. Aidan Regan, *Apple Won't Have to Pay Nearly $15 Billion in European Taxes*, WASH. POST (July 15, 2020, 12:42 PM), https://www.washingtonpost.com/politics/2020/07/15/apple-wont-have-pay-nearly-15-billion-european-taxes (on file with the *Iowa Law Review*).

118. *Offshore Profit Shifting and the U.S. Tax Code—Part 2 (Apple Inc.): Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affs.*, 113th Cong. 10 (2013) (statement of Sen. John McCain) [hereinafter *Offshore Profit Shifting*].

119. *Id.* at 3–5 (statement of Sen. Carl Levin).

120. Rebecca M. Kysar, *Interpreting Tax Treaties,* 101 IOWA L. REV. 1387, 1418–21 (2016).

121. *See, e.g.*, Ian Griffiths & Simon Bowers, *Fresh Questions for Amazon Over Pittance It Pays in Tax*, GUARDIAN (May 16, 2013, 3:00 AM), https://www.theguardian.com/technology/2013/may/15/amazon-tax-bill-new-questions [https://perma.cc/Z85C-CZ4G]; *see also* Eduardo Baistrocchi, *The Transfer Pricing Problem: A Global Proposal for Simplification*, 59 TAX LAW. 941, 948–51 (2006) (discussing the mechanisms of transfer pricing).

122. WITTING, *supra* note 17, at 55.

123. *Id.*

124. *Offshore Profit Shifting*, *supra* note 118, at 5 (statement of Sen. Carl Levin).

percent.[125] Amazon entered a similar agreement with the government of Luxembourg and Starbucks structured a similar arrangement with the government of the Netherlands.[126]

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The discussion in this Part demonstrated that there are important business and legal rationales for the existence of corporate empires. It should be noted that the analysis took the perspective of these corporate giants, and not that of the public. While the interest of the public is of paramount importance, the benefits created by conglomerates for consumers in the form of lower prices should not be ignored. Obviously, this is only one consideration among many that lawmakers need to consider in fashioning the appropriate legal approach to conglomerates. In the next Part, we will lay out the full panoply of factors that lawmakers must consider with respect to conglomerates and construct a new legal regime to the colossi of the corporate world.

III. THE UNIQUE LEGAL CHALLENGES FACING CORPORATE EMPIRES

In this Part, we introduce and analyze the challenges to which complex corporate structures give rise. As we will show, many of the key governance features of standalone corporations change in corporate families. Specifically, we examine five key aspects: liability of a parent for a subsidiary's misconduct; obligations of a subsidiary's fiduciary toward the parent corporation; veil-piercing in a parent-subsidiary relationship; oversight responsibility of a parent's board vis-à-vis a subsidiary; and a parent's legal exposure due to the operations of foreign subsidiaries. We review these matters in order.

A. *PARENT'S LIABILITY FOR A SUBSIDIARY'S MISDEEDS*

In the case of single corporations, each corporation is responsible for its own misconduct. In corporate families, this is not necessarily true. A parent may be held responsible for a subsidiary's misdeeds. There are three legal routes to achieve this goal: direct liability, agency, and enterprise liability.

The conditions for imposing direct liability on a parent for the misdeeds of a subsidiary were summarized in an oft-cited article from 1929, by (then) Professor William O. Douglas and Professor Carrol Shanks. Douglas and Shanks suggested that direct liability should attach to a parent when "the

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125. *Id.*

126. Duncan Robinson & Stefan Wagstyl, *Berlin Takes Aim at Luxembourg Tax Deals*, FIN. TIMES (Nov. 18, 2022), https://www.ft.com/content/2e194acc-6a88-11e4-a038-00144feabdco (on file with the *Iowa Law Review*); Mike Corder, *EU Court: Dutch Tax Deal with Starbucks Is Legal*, AP NEWS (Sept. 24, 2019, 4:25 AM), https://apnews.com/article/4df9353c98f14763a69fdab563484 52c [https://perma.cc/K9R2-VJTN].

parent is directly a participant in the wrong complained of."[127] Ownership of stock cannot be the sole basis for imposing liability.[128] It must be shown that the parent used its power "to accomplish a specific result [to make] the parent a participator in or the doer of the act."[129]

This happens when there is "interference in the internal management of the subsidiary; an overriding of the discretion of the managers of the subsidiary."[130] As examples, Douglas and Shanks list cases in which a parent uses its latent power to cause a subsidiary to breach a contract or to commit a tort.[131] Douglas and Shanks further posited, that the "intervention or intermeddling by the parent in the affairs of the subsidiary and more particularly in the transaction involved" must exceed "the normal and orderly procedure of corporate control carried out through the election of the desired directors and officers of the subsidiary and the handling by them of the direction of its affairs."[132]

As commentators correctly pointed out, an agency relationship need not always be general; a subsidiary may serve as an agent of a parent for a specific transaction.[133] The contours of transaction specific agency were delineated in *Kingston Dry Dock Co. v. Lake Champlain Transportation Co.*, a case in which a contract creditor of a parent sought to sue its subsidiary.[134] Judge Hand wrote that for a corporation to be considered an actor in each transaction or a business, "it must take immediate direction of the transaction through its officers, by whom alone it can act at all."[135] He immediately proceeded to add that "[t]he test is therefore rather in the form than in the substance of the control; in whether it is exercised immediately, or by means of a board of directors and officers, left to their own initiative and responsibility in respect of each transaction as it arises."[136] Judge Hand further recognized that a

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127. William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193, 208 (1929).

128. *See id.* at 208–09.

129. *Id.* at 209.

130. *Id.* at 209.

131. *Id.* at 208 ("The parent has been held liable in a tort action for inducing the subsidiary by means of its stock ownership to breach a contract with the plaintiff.").

132. *Id.* at 218. Douglas and Shanks also suggested that to *avoid* liability a parent must abide by the following four principles. First, the parent must set up and maintain the subsidiary as a separate entity, adequately financed to sustain normal business pressures and risks. *Id.* at 196–97. Second, the daily operations of the two corporate entities should be kept apart. *Id.* at 197. Third, barriers between the managements of the two corporations should be set and maintained and the meetings of the two boards should be kept distinct. *Id.* Fourth, the two corporate entities should not be represented as a single unit to those with whom they interact. *Id.*

133. *See, e.g.*, Phx. Can. Oil Co. v. Texaco, Inc., 842 F.2d 1466, 1477 (3d Cir. 1988) (pointing out that a subsidiary can act as a parent's agent for the duration of one or more particular transactions).

134. Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 265–67 (2d Cir. 1929).

135. *Id.* at 267.

136. *Id.*

parent may be liable for the acts of its subsidiary if it supervised the execution of a specific transaction.[137]

The application of the doctrine of direct participation led to the imposition of liability on a parent for the misconduct of a subsidiary in a myriad of legal contexts.[138]

Two other, closely related, legal doctrines that may be used to impose liability on a parent for the acts of a subsidiary are agency and enterprise liability. Under both doctrines, however, the liability of the parent is considered derivative, rather than direct. Under general agency principles, if a subsidiary acts as a parent's agent and engages in wrongdoing, the parent would be liable for the harm caused by the subsidiary's actions. The imposition of liability on a parent typically requires a showing of a high degree of control of the parent over the subsidiary.[139] In *Berkey v. Third Avenue Railroad Co.*, Justice Cardozo, writing for the New York Court of Appeals, stated that for a parent to bear liability for the actions of a subsidiary, its dominion over the subsidiary must "be so complete" and "[the] interference [in its affairs] so obtrusive, that by the general rules of agency the parent will be a principal and the subsidiary an agent."[140] Although *Berkey* was a veil-piercing case, its influence extends far beyond this context, and Justice Cardozo's instruction is deemed applicable to all agency cases.

Indeed, as the Southern District of New York summarized the matter in *In re Parmalat Securities Litigation*, "[t]he element of control often is deemed the essential characteristic of the principal-agent relationship."[141] "To bind a principal, 'an agent must have authority, whether apparent, actual or implied.'"[142] The Restatement (Third) of Agency likewise provides that for there to be a principal-agent relationship, the principal must have the "right to control the agent's actions,"[143] and possess "the right throughout the duration of the relationship to control the agent's acts."[144]

The precise meaning of the term control standard was explicated by the D.C. Circuit in *Transamerica Leasing, Inc. v. La Republica de Venezuela*.[145] This case involved a suit against a Venezuelan shipping company, alleging that it was a mere instrumentality of the Venezuelan government, and thus, the government was responsible for contract breaches committed by the

137. *See id.*

138. Esmark, Inc. v. NLRB, 887 F.2d 739, 756 (7th Cir. 1989).

139. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(1) (AM. L. INST. 2006).

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

141. *In re* Parmalat Sec. Litig., 375 F. Supp. 2d 278, 290 (S.D.N.Y. 2005).

142. *Id.* (quoting Cromer Fin. Ltd. v. Berger, Nos. 00 Civ. 2284, 00 Civ. 2498, 2002 WL 826847, at *4 (S.D.N.Y. May 2, 2002)).

143. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(1) (AM. L. INST. 2006).

144. *Id.* § 1.01 cmt. c.

145. Transamerica Leasing, Inc. v. La Republica de Venezuela, 200 F.3d 843, 848–50 (D.C. Cir. 2000).

company.[146] The D.C. Circuit ruled that for there to exist a principal-agent relationship between a parent and a subsidiary the following four conditions must obtain: (1) the parent must manifest its will that the subsidiary acts on its behalf; (2) the subsidiary must agree to do so; (3) the parent must retain a right to control "the subsidiary with respect to matters entrusted to [it]"; and (4) the exercise of control by the parent must be more direct than by voting its shares in the subsidiary or appointing its directors.[147]

Delaware courts developed a somewhat different set of factors to determine whether a parent has the requisite degree of control over a subsidiary for a principal-agent relationship to arise, "includ[ing:] the extent of overlap of officers and directors, methods of financing, the division of responsibility for day-to-day management, and the process by which each corporation obtains its business."[148] Under Delaware law, no single factor is essential or outcome determinative.[149]

Another path to the imposition of liability on a parent for the actions of a subsidiary is through the concept of enterprise liability. The concept originated in a 1947 article by Adolf Berle.[150] Berle noted that ascribing a separate legal entity to corporations and allowing them to enjoy limited liability were unproblematic in the case of standalone corporations.[151] Conglomerates were different, though. Corporations comprising a conglomerate operated in unison in pursuit of a single goal. He was particularly concerned that subsidiaries would be set up to engage in risky ventures, while the parent, the main beneficiary from those activities, would be sheltered from liability.[152] To avert this result, Berle proposed using the concept of enterprise liability, which would enable holding a parent accountable for the actions of its subsidiaries.[153]

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146. *Id.* at 845–46.

147. *Id.* at 849.

148. Applied Biosystems, Inc. v. Cruachem, Ltd., 772 F. Supp. 1458, 1463 (D. Del. 1991).

149. *Id.*

150. *See generally* Berle, *supra* note 36.

151. *See id.* at 343.

152. *Id.* at 343–44, 353–54; *see also* Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1917 (1991) (noting that layered entity structures can be used to reduce corporate tort liability).

153. *See* Berle, *supra* note 36, at 344. Meredith Dearborn correctly

> [N]ote[s] that there may be more than one understanding of this term. Some commentators use "enterprise" liability to refer to horizontal piercing claims—where the assets of one subsidiary are accessed to pay the debts of a sister subsidiary. However, most commentators agree that "enterprise" refers to the unified economic group of corporations, and "entity" refers to the single, legal form of the corporation.

Dearborn, *supra* note 32, at 200 n.38 (citation omitted).

Professor Gregory Keating defined enterprise liability as "a general and distinctively modern theory of strict liability"[154] predicated on "the maxim that those who profit from the imposition of risk should bear the costs of the accidents that are a price of their profits."[155] Elaborating on this notion, Professor Rory Van Loo explained that enterprise liability "was seen as a means of breaking through increasingly complex and diffuse corporate structures to hold the larger corporation responsible."[156] There were even attempts to impose statutory liability on corporate parents for the wrongdoing of their subsidiaries. The two best known examples are the Employee Retirement Income Security Act ("ERISA")[157] and the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA").[158]

According to one commentator, ERISA "is a canonical example of enterprise principles in a federal regulatory context."[159] The statute, inter alia, addresses employer contributions to employee retirement plans.[160] It imposes liability on employers for terminating their participation in a program.[161] A major concern was that parent corporations might set up subsidiaries to avoid their statutory obligation. To address this concern, Congress provided in § 1301(b)(1) that "all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer and all such trades and businesses as a single employer."[162] In treating all corporations "under common control" as a single entity, the section effectively establishes an enterprise liability regime.[163]

It was likewise believed that CERCLA, too, establishes enterprise liability with respect to the cleanup costs of polluted sites. A series of rulings in the 1990s was interpreted by commentators to suggest that enterprise liability would soon govern liability for environmental harms.[164] However, these hopes were dashed by *United States v. Bestfoods*. In *Bestfoods*, the government sought to bring an action under § 107(a)(2) of CERCLA against CPC International

154. Gregory C. Keating, *The Theory of Enterprise Liability and Common Law Strict Liability*, 54 VAND. L. REV. 1285, 1287 (2001).

155. *Id.*

156. Rory Van Loo, *The Revival of Respondeat Superior and Evolution of Gatekeeper Liability*, 109 GEO. L.J. 141, 152–53 (2020).

157. 29 U.S.C. §§ 1001–1461 (2012).

158. 42 U.S.C. §§ 9601–9675 (1988 & Supp. 1993).

159. Dearborn, *supra* note 32, at 240.

160. *Id.*

161. *Id.*

162. 29 U.S.C. § 1301(b)(1) (2018).

163. *Id.*

164. Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295, 323–24 (1996); Peter S. Menell, *Legal Advising on Corporate Structure in the New Era of Environmental Liability*, 1990 COLUM. BUS. L. REV. 399, 406–08; Cindy A. Schipani, *Infiltration of Enterprise Theory into Environmental Jurisprudence*, 22 J. CORP. L. 599, 611–19 (1997).

Inc. ("CPC"), the parent of Ott Chemical Co., for the cleanup costs of a chemical plant the defunct subsidiary owned and operated.[165] The U.S. Supreme Court commenced its opinion by reiterating that "[i]t is a general principle of corporate law deeply 'ingrained in our economic and legal systems' that a parent corporation (so-called because of control through ownership of another corporation's stock) is not liable for the acts of its subsidiaries."[166] At the same time, "a corporate parent that actively participated in, and exercised control over, the operations of the facility itself may be held directly liable in its own right as an operator of the facility."[167] The enactment of CERCLA, said the Court, did not change "the entire corpus of state corporation law."[168] Therefore, liability can be imposed on the parent, CPC, only if it comes within the definition of the term "operator" under CERCLA,[169] or if an agent of the parent managed or directed the polluted facility.[170] The fact "that dual officers and directors made policy decisions and supervised activities at the facility" does not suffice to establish liability.[171]

Bestfoods made it significantly more difficult to assign liability to a parent for the acts of a subsidiary not only under CERCLA, but also under other statutes, stymying "a promising statute-based avenue for adapting respondeat superior to an economy marked by fragmented business structures."[172] Rory Van Loo reported that "observers also view *Bestfoods* as making subsidiaries more appealing and giving 'the enterprise a substantial chance to essentially judgment proof itself.'"[173] This observation has been empirically corroborated in a recent study. Sharon Belenzon, Honggi Lee, and Richard Patacconi have studied the effect of enterprise liability on asset portioning and corporate group growth in sixteen countries all over the world.[174] They found "that weaker enterprise liability encourages corporations (i) to more finely partition their assets into separate legally independent units and (ii) to grant these units more decision-making autonomy."[175] Interestingly, Meredith Dearborn suggested that although courts could not simply impose enterprise liability in regulatory cases in the aftermath of *Bestfoods*, they worked around

165. United States v. Bestfoods, 524 U.S. 51, 56–58 (1998).

166. *Id.* at 61 (quoting Douglas & Shanks, *supra* note 127, at 193).

167. *Id.* at 55.

168. *Id.* at 63 (quoting Burks v. Lasker, 441 U.S. 471, 478 (1979)).

169. *Id.* at 65–66.

170. *Id.* at 71.

171. *Id.* at 69–70.

172. Van Loo, *supra* note 156, at 153.

173. *Id.* at 154 (footnote omitted) (quoting Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 530 (2001)).

174. Sharon Belenzon, Honggi Lee & Richard Patacconi, *Towards a Legal Theory of the Firm: The Effects of Enterprise Liability on Asset Partitioning, Decentralization and Corporate Group Growth* 3–4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 24720, 2018), https://www.nber.org/system/files/working_papers/w24720/w24720.pdf [https://perma.cc/VFP5-7UMZ].

175. *Id.* at 3.

the decision by granting "veil piercing [more easily] in cases involving a federal statute or a particularly important federal policy."[176]

B. Fiduciary Duties in Corporate Empires

In the context of a parent and wholly owned subsidiary, the fiduciary duties of directors and officers in the subsidiary are not owed to the subsidiary, but rather to the parent. The leading case in this regard is *Anadarko Petroleum Corp. v. Panhandle Eastern Corp.*[177] In this case, the parent company (Panhandle) of a wholly owned subsidiary (Anadarko) planned to spin off a subsidiary, through a distribution of stock dividend by the parent, Panhandle.[178] Both boards approved the relevant agreements after the dividend was declared and prior to its distribution.[179] The dispute broke out after Anadarko argued that its former directors breached their fiduciary duties by modifying the agreements prior to the distribution at Panhandle's request.[180] The Delaware Court of Chancery ruled that Anadarko's former directors owed a fiduciary duty only to the parent corporation, Panhandle.[181]

On appeal, the Supreme Court of Delaware approved the decision, holding that "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders."[182] The Supreme Court further clarified that the parent and directors of a wholly owned subsidiary do not "owe fiduciary duties to the prospective stockholders of the subsidiary after the parent declares its intention to spin-off the subsidiary" and "that prior to the date of distribution the interests held by Anadarko's prospective stockholders were insufficient to impose fiduciary obligations on the parent and the subsidiary's directors."[183]

The same principles were reiterated in the Chancery Court's decision in *Trenwick America Litigation Trust v. Ernst & Young L.L.P.*[184] The Chancery Court's ruling was approved by the Delaware Supreme Court in a table decision.[185] In *Trenwick*, a bankruptcy reorganization related litigation trust brought suit against a publicly traded holding company and its directors for forcing wholly owned subsidiaries to take on high levels of debt to support the

176. Dearborn, *supra* note 32, at 237.

177. Anadarko Petrol. Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988).

178. *Id.* at 1172.

179. *Id.* at 1173.

180. *Id.* at 1174.

181. *Id.* at 1172.

182. *Id.* at 1174.

183. *Id.* at 1172.

184. Trenwick Am. Litig. Tr. v. Ernst & Young L.L.P., 906 A.2d 168, 192 n.66 (Del. Ch. 2006), *aff'd*, 931 A.2d 438 (Del. 2007).

185. *Trenwick*, 931 A.2d at 438.

parent's business strategy.[186] Rejecting this claim, then–Vice Chancellor Strine made it clear that "in a parent and wholly-owned subsidiary context, directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders,"[187] Vice Chancellor Strine emphasized that "[w]holly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created."[188] He further stated that "Delaware law does not embrace the concept that a director of a wholly-owned subsidiary owes a duty to second-guess the business judgment of its parent corporation,"[189] even "if the Trenwick America board took actions that made Trenwick America less valuable as an entity."[190]

As for the duties of a parent company toward wholly owned subsidiaries, Vice Chancellor Strine summarily concluded that no such duties exist, explaining that "[p]arent corporations do not owe such subsidiaries fiduciary duties. That is established Delaware law."[191] The picture that emerges from our analysis is clear: while the fiduciary duties of officers and directors are owed to the parent corporation, the parent owes no similar duties to wholly owned subsidiaries. Extant Delaware law completely disregards the independent corporate entity of wholly owned subsidiaries.[192]

Courts in other jurisdictions have followed *Anadarko*'s ruling according to which the directors of a wholly owned "subsidiary are obligated to manage the affairs of the subsidiary in the best interests only of the parent,"[193] emphasizing that "a wholly-owned subsidiary is to be managed solely so as to benefit its corporate parent."[194] Likewise, in *VFB LLC v. Campbell Soup Co.*,[195] the Third Circuit stated that because "a wholly-owned subsidiary has only one

186. *Trenwick*, 906 A.2d at 172.

187. *Id.* at 200 (quoting *Anadarko*, 545 A.2d at 1174).

188. *Id.* at 173.

189. *Id.* at 201.

190. *Id.* The only exception Vice Chancellor Strine was willing to recognize consisted of cases in which following the parent's instruction would make the subsidiary unable to meet its own legal obligations to others. *Id.* at 202–03.

191. *Id.* at 173.

192. *See also* Letter from John A. Hayes, Corp. Governance Comm. Chair, Bus. Roundtable, to Robert deV. Frierson, Sec'y, Bd. of Governors of the Fed. Rsrv. Sys. 4 (Feb. 2, 2015), https://www.federalreserve.gov/SECRS/2015/February/20150205/R-1503/R-1503_020215_129871_536677596018_1.pdf [https://perma.cc/H89R-6K6K] ("[U]nder Delaware law . . . the board of directors of a wholly-owned subsidiary has an obligation to oversee the subsidiary's operations in the best interests of the parent company and the parent company's shareholders.").

193. RSL Commc'ns PLC v. Bildirici, No. 04-cv-5217, 2006 WL 2689869, at *8 (S.D.N.Y. Sept. 14, 2006) (quoting Aviall, Inc. v. Ryder Sys., Inc., 913 F. Supp 826, 832 (S.D.N.Y. 1996), *aff'd*, 110 F.3d 892 (2d Cir. 1997)).

194. Cochran v. Stifel Fin. Corp., No. Civ.A. 17350, 2000 WL 286722, at *11 (Del. Ch. Mar. 8, 2000), *aff'd in part and rev'd in part on other grounds*, 809 A.2d 555 (Del. 2002). This sentence is also quoted in *Trenwick*. *Trenwick*, 906 A.2d at 201 n.92.

195. VFB LLC v. Campbell Soup Co., 482 F.3d 624, 635 (3d Cir. 2007).

shareholder: the parent,"[196] thus, "[t]here is only one substantive interest to be protected, and hence 'no divided loyalty' of the subsidiary's directors and no need for special scrutiny of their actions."[197]

Yet, not all courts have been willing to embrace Delaware's dogmatic position. Some courts have emphatically rejected it, pointing out that it is inconsistent with the principles of corporate law and puts the directors of wholly owned subsidiaries in a very difficult position. For example, in *First American Corp. v. Al-Nahyan*, the District Court for the District of Columbia, pointed out that "[t]he duties of the directors of wholly owned subsidiaries have not been articulated in the law," and that "[c]ase law leaves subsidiary directors wondering whether their duty runs primarily to the parent corporation as shareholder, to the subsidiary corporation itself as an entity, or even to other constituencies such as creditors, regulators, employees, and communities."[198]

The court then stated "that the directors of a wholly-owned subsidiary owe the corporation fiduciary duties, just as they would any other corporation," and that "the subsidiary has standing to sue for breach of those duties."[199] The court added that "[e]ven assuming the Virginia courts would follow *Anadarko*, they would understand it to apply only to the question of who are the shareholders to whom the directors of a wholly-owned subsidiary owe duties when the corporation is being spun off—the parent or the prospective purchasers."[200]

Similarly, a bankruptcy court in *Collins v. Kohlberg & Co.* (*In re Southwest Supermarkets, LLC*), suggested that the Delaware's Supreme Court's ruling in *Anadarko* should be confined to the facts of the case.[201] The court clarified that "[t]he facts of *Anadarko* did not raise the issue of whether any fiduciary duty was owed directly to the subsidiary"; rather, "[t]he only issue in *Anadarko* was whether fiduciary duties were owed to prospective shareholders, either in addition to or in lieu of duties owed to the sole shareholder, the parent."[202] Accordingly, the court concluded that "the significance of the key word 'only'" in *Anadarko* "was to distinguish whether duties might also have been due to the prospective shareholders, not to distinguish whether duties might also have been owed to the subsidiary itself."[203] The court stated that "[i]t would be a startling and dramatic departure from settled law to conclude that officers and directors do not owe any fiduciary duty to the corporation they

196. *Id.*

197. *Id.* (quoting Bresnick v. Franklin Cap. Corp., 77 A.2d 53, 56 (N.J. Super. Ct. App. Div. 1950)).

198. First Am. Corp. v. Al-Nahyan, 17 F. Supp. 2d 10, 26 (D.D.C. 1998) (alterations in original) (first quoting Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L.J. 287, 324 (1996); and then quoting *id.* at 289).

199. *Id.*

200. *Id.*

201. Collins v. Kohlberg & Co. (*In re* Sw. Supermarkets, LLC), 376 B.R. 281, 283 (Bankr. D. Ariz. 2007).

202. *Id.*

203. *Id.*

serve," and that "[i]t requires more than dictum to convince this Court that Delaware has made such a dramatic change in long-settled law."[204]

Delaware courts maintain that the fiduciary duties of directors in a wholly owned subsidiary are owed solely to the parent and that the parent's directors owe no duty to the subsidiary raises four principal concerns.[205] First, it effectively effaces the separate corporate entity of the subsidiary, turning it into a mere instrumentality designed for a single purpose: to serve the will of the parent. Despite the strong rhetoric of the Chancery Court in *Trenwick*, only six years earlier, in *Cochran v. Stifel Financial Corp.*, when the Chancery Court was asked to pierce a wholly owned subsidiary's veil, it annunciated that "[o]ur law has traditionally respected the separate existences of a parent corporation and its wholly-owned subsidiary," and that in adopting section 145 of the Delaware Code, "the General Assembly . . . did not assume that corporate parents invariably direct and control the directors of their subsidiaries."[206]

Second, although the view that the fiduciaries of a wholly owned corporation owe duties only to the parent may have intuitive appeals, it actually leads to absurd results. As one court pointed out, if the ruling in *Anadarko* were to read broadly (or literally),

> It would mean that when a director self-deals at the expense of his corporation, . . . the corporation itself cannot sue for breach of fiduciary duties if it happens to be wholly owned, though it would have such a cause of action if just one share of its stock were owned by someone other than the parent.[207]

Third, the view that a wholly owned subsidiary exists solely for the purpose of promoting the goals and policies of the parent does grave injustice to the multiple stakeholders who are invested in the subsidiary.[208] According to *Anadarko* and *Trenwick*, the parent can harm and even sacrifice a wholly owned subsidiary on the altar of the parent's goals.[209] This view ignores the

204. *Id.*

205. Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 200 (Del. Ch. 2006), *aff'd*, 931 A.2d 438 (Del. 2007) ("Our Supreme Court has made clear that, 'in a parent and wholly-owned subsidiary context, [sic] directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders.'" (quoting Anadarko Petrol. Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988))).

206. Cochran v. Stifel Fin. Corp., No. Civ.A. 17350, 2000 WL 286722, at *13–14 (Del. Ch. Mar. 8, 2000), *aff'd in part and rev'd in part on other grounds*, 809 A.2d 555 (Del. 2002) (denying motion to dismiss); *see also* Cochran v. Stifel Fin. Corp., No. Civ.A. 17350, 2000 WL 1847676, at *1 (Del. Ch. Dec. 13, 2000), *aff'd and rev'd on other grounds*, 809 A.2d 555 (Del. 2002) (granting summary judgment subsequently).

207. Collins v. Kohlberg & Co. (*In re* Sw. Supermarkets, LLC), 376 B.R. 281, 285 (Bankr. D. Ariz. 2007).

208. *See* Sternberg v. O'Neil, 550 A.2d 1105, 1124 (Del. 1988); Grace Bros. v. UniHolding Corp., No. Civ.A. 17612, 2000 WL 982401, at *12 (Del. Ch. July 12, 2000).

209. *Anadarko*, 545 A.2d at 1174; *Trenwick*, 906 A.2d at 201–02.

subsidiary's employees, suppliers, business partners' and entire communities that depend on the subsidiary. One could argue that these constituencies voluntarily assume the risk of being at the parent's mercy and therefore should not receive protection from the law. Yet, this argument assumes—unrealistically, in our opinion—that stakeholders who invested in the subsidiary were (1) aware of the vulnerable status of wholly-owned subsidiaries under Delaware law; and (2) could adequately protect themselves against the possibility that a successful subsidiary may be closed at a parent's order. It should be emphasized in this regard that not all stakeholders can protect themselves contractually. Employees, for example, ordinarily have no real bargaining power. Tort victims cannot protect themselves at all. And behind all stakeholders stand third parties that might be adversely affected by the parent's policies.

Fourth, it is difficult to explain why the existence of a single minority shareholder should matter more than that of multiple stakeholders. The existence of minority shareholders exerts a gravitational force on the fiduciary duties in the subsidiary corporation. Recall that once a minority shareholder enters the picture, rendering a subsidiary non-wholly owned, the duties of the fiduciaries are redirected to the subsidiary company. This raises the question of why the interests of one or a few shareholders should count more heavily than the interests of all the corporation's stakeholders.

C. Veil-Piercing

Given the disposition of the Delaware courts to disregard the separate corporate entity of wholly owned subsidiaries in the context of fiduciary duties, one would have expected the Delaware courts to be more willing to pierce the corporate veil of subsidiaries, relative to standalone corporations, and allow creditors to reach the parent. Surprisingly, this is not the case. According to an empirical study by Professor Peter Oh, Delaware courts are almost twice as likely to pierce the corporate veil of standalone corporations than of subsidiaries.[210]

The standard for piercing the veil in wholly owned subsidiaries was articulated by the Delaware Supreme Court in *Pauley Petroleum Inc. v. Continental Oil Co.*[211] Rejecting the claim that a Delaware parent and its Mexican subsidiary should be viewed as one entity, the Court wrote:

> There is, of course, no doubt that upon a proper showing corporate entities as between parent and subsidiary may be disregarded and the ultimate party in interest, the parent, be regarded in law and fact as the sole party in a particular transaction. This, however, may not be done in all cases. It may be done only in the interest of justice, when such matters as fraud, contravention of law or contract, public

210. Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81, 116–17 (2010).

211. Pauley Petrol. Inc. v. Cont'l Oil Co., 239 A.2d 629, 633 (Del. 1968).

> wrong, or where equitable consideration among members of the corporation require it, are involved.[212]

Determining whether to disregard the corporate form on these grounds requires a fact intensive inquiry, which may involve any of the following factors: "(1) whether the company was adequately capitalized for the undertaking; (2) whether the company was solvent; (3) whether corporate formalities were observed; (4) whether the controlling shareholder siphoned company funds; or (5) whether, in general, the company simply functioned as a facade for the controlling shareholder."[213]

Delaware is not an outlier in this sense. Two other empirical studies of veil-piercing point out that other state courts, too, are more reluctant to pierce the corporate veil of individual corporations than of subsidiaries. For example, a study by Professor John Matheson that surveyed all veil-piercing cases between 1990 and 2008, concludes that "[c]ourts seldom pierce the subsidiary's corporate veil, and do so much less often than in the overall universe of piercing cases, including the classic case of a small business with either one or a few individual owners."[214] Matheson adds that "substantive piercing in the parent-subsidiary context occurs approximately half as often as piercing does generally, and more than one-third less often than the most comparable database explored by other studies."[215] Similar findings were reported in an earlier empirical study conducted by Professor Robert Thompson. Thompson's survey of veil-piercing cases found slightly lower piercing rates where the defendant shareholder was another corporation than when the defendant was an individual.[216]

The marked disparity in veil-piercing cases between standalone corporations and conglomerates is intriguing for two reasons. First, there is no clear legal basis for the disparate treatment of natural persons and corporations in their role as shareholders. Courts seem to apply the same tests in both cases, yet, as empirical studies demonstrate, reach different results. As Professor Phillip Blumberg astutely observed:

> [N]o court . . . in a case involving the legal responsibility of a parent corporation for the acts of its subsidiary has examined as a matter of first consideration whether the doctrine of limited liability—developed

212. *Id.*

213. *See, e.g.*, Winner Acceptance Corp. v. Return on Cap. Corp., No. 3088, 2008 WL 5352063, at *5 (Del. Ch. Dec. 23, 2008). For further reading, see JOHN C. COFFEE, JR., RONALD J. GILSON & BRIAN JM QUINN, CASES AND MATERIALS ON CORPORATIONS 232 (9th ed. 2022).

214. John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091, 1097, 1108 n.51 (2009).

215. *Id.* at 1114.

216. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1056 n.108 (1991).

to protect investors from the debts of the enterprise—also shielded the parent from liability for the debts of a subsidiary.[217]

Second, the favorable treatment given to corporate parents, relative to individual shareholders, creates a perverse incentive to incorporate subsidiaries, as noted by Douglas and Shanks nearly a century ago.[218] The lower level of veil-piercing in parent-subsidiary relationship provides an incentive for individuals to incorporate two corporations, instead of one, thereby decreasing the probability of creditors reaching their personal assets.

D. Oversight Liability

Oversight liability has won itself the distinction of being "the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[219] Under Delaware case law, liability for oversight failure will be imposed on directors if they refrained, in bad faith, from implementing a reporting system within the corporation, or abstained from monitoring the information within the system. The contours of oversight liability were shaped in *In re Caremark International Inc. Derivative Litigation*.[220] The case was brought after a DOJ investigation revealed that Caremark used to pay doctors for referrals.[221] Chancellor Allen held that "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."[222] The chosen test, recognized Chancellor Allen, sets "quite [a] high" bar for plaintiffs.[223]

Professor Jennifer Arlen suggested that "Chancellor Allen recognized that this standard of review largely eliminate[d] any serious threat of director liability,"[224] yet he believed that the decision "would induce greater oversight over legal compliance because . . . directors would comply with a clearly articulated legal duty, even if not threatened with liability."[225]

The *Caremark* standard was clarified in *Stone v. Ritter*.[226] There, a derivative action was brought against the directors of AmSouth Bancorporation after it

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217. Phillip I. Blumberg, *Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity*, 24 HASTINGS INT'L & COMPAR. L. REV. 297, 302–03 (2001).

218. Douglas & Shanks, *supra* note 127, at 193 (attributing in part the increase in subsidiaries at the turn of the previous century to the lower exposure to liability that can be achieved in this way).

219. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996); *see also* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2036–42 (2019) (discussing "the rare path of survival" of failure-of-oversight claims against directors).

220. *In re Caremark*, 698 A.2d at 971–72.

221. *Id.* at 962–94.

222. *Id.* at 971.

223. *Id.*

224. Jennifer Arlen, *The Story of* Allis-Chalmers*,* Caremark*, and* Stone*: The Directors' Evolving Duty to Monitor*, *in* CORPORATE LAW STORIES 323, 326 (J. Mark Ramseyer ed., 2009).

225. *Id.*

226. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 368–70 (Del. 2006).

paid $50 million in fines and penalties for violations of banking and antimoney laundering laws committed by its employees.[227] The Delaware Supreme Court enunciated that *Caremark* establishes two paths for imposing liability on directors for failing to monitor:

> We hold that *Caremark* articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; *or* (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.[228]

As Professor Megan Shaner correctly observed, directorial liability for violations of oversight obligations requires a showing of scienter.[229] Professors Claire Hill and Brett McDonnell further noted that liability for failure to monitor necessitates bad faith, defined as "an intentional failure to act, in conscious disregard of one's duty to act."[230] Failures to act, however, are invariably passive.[231] Consequently, only in rare cases will plaintiffs succeed on oversight failures claims.[232] Hill and McDonnell proceeded to criticize the *Caremark* test as it was construed in *Stone*.[233] They posit that the financial crisis of 2008 proved that corporate boards failed to perform their monitoring duties adequately, allowing corporations to generate "enormous negative externalities for the greater society."[234]

Professor Donald Langevoort, by contrast, defended *Caremark* for taking account of the complexity of the modern corporate world and inherent limitations faced by boards:

> The overwhelming complexity is daunting—perhaps beyond even the collective brainpower of the C-suite to comprehend—yet can and must be managed to the extent possible. Like all enterprise risks, compliance risks emerge, move, and change in ways not always visible within the architectural sight lines of the firm.
>
> It is at least arguable that independent directors do not have the capacity to engage with this complexity, so that *Caremark* was wise to

227. *Id.* at 365.

228. *Id.* at 370.

229. Megan W. Shaner, *The (Un)Enforcement of Corporate Officers' Duties*, 48 U.C. DAVIS L. REV. 271, 306–07 (2014).

230. Claire A. Hill & Brett H. McDonnell, *Reconsidering Board Oversight Duties After the Financial Crisis*, 2013 U. ILL. L. REV. 859, 859.

231. *Id.* ("[C]onceptually, grammatically, and logically, most examples of 'failures' that come readily to mind are passive, not active . . . .").

232. *Id.* (noting that the precise formulation adopted in *Stone* makes is extremely difficult for plaintiffs to prevail).

233. *Id.* at 874.

234. *Id.* at 860.

demand almost nothing beyond asking that *some* compliance system exists. Independent boards have limited time, attention, and expertise, which should thus be deployed only when and where most useful.[235]

The scholarly interest in oversight liability has intensified in the last three years. In 2019 through 2020, four cases involving *Caremark* claims— *Marchand v. Barnhill*,[236] *In re Clovis Oncology, Inc. Derivative Litigation*,[237] *Hughes v. Hu*,[238] and *Teamsters Local 443 Health Services & Insurance Plan v. Chou*[239]—survived motions to dismiss. This prompted Professor Stephen Bainbridge to wonder: "[i]s *Caremark* still the hardest claim for plaintiffs to win in corporate law?"[240] Bainbridge was not alone. Professor Roy Shapira asked the same question and answered it affirmatively.[241] In 2021, a fifth case, *In re Boeing Co. Derivative Litigation*[242] joined the list after passing the motion to dismiss stage.[243]

Unsurprisingly, one of the five cases, *Chou*, involved wrongdoing by a subsidiary.[244] The case arose after AmerisourceBergen Corporations ("ABC") acquired Oncology Supply Pharmacy Services ("Pharmacy").[245] Pharmacy owned a direct subsidiary, Specialty, whose business was to acquire overfilled vials of oncology medications, pool the overfills that were not intended for

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235. Donald C. Langevoort, Caremark *and Compliance: A Twenty-Year Lookback*, 90 TEMP. L. REV. 727, 729–30 (2018); *see also* Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 972–81 (2009) (defending *Caremark* and the way it limits director liability exposure regarding alleged failures to exercise proper oversight); Stephen M. Bainbridge, Star Lopez & Benjamin Oklan, *The Convergence of Good Faith and Oversight*, 55 UCLA L. REV. 559, 579–81 (2008) (positing that *Caremark* can "open the door to expansive directorial liability").

236. Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019).

237. *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222, 2019 WL 4850188, at *1, *6 (Del. Ch. Oct. 1, 2019).

238. Hughes v. Hu, No. 2019-0112, 2020 WL 1987029, at *13–14 (Del. Ch. Apr. 27, 2020).

239. Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816, 2020 WL 5028065, at *1–2 (Del. Ch. Aug. 24, 2020).

240. *Is Caremark Still the Hardest Claim for Plaintiffs to Win in Corporate Law?*, PROFESSORBAINBRIDGE.COM (May 3, 2020, 2:26 PM), https://www.professorbainbridge.com/professorbainbridgecom/2020/05/is-caremark-still-the-hardest-claim-for-plaintiffs-to-win-in-corporate-law.html [https://perma.cc/TC9U-TEA8].

241. Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1861–66 (2021).

242. *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059934, at *25 (Del. Ch. Sept. 7, 2021) (allowing the suit against Boeing's management to go through, alleging oversight liability failures following two catastrophic plane crashes of the 737 MAX aircraft and lack of safety protocols).

243. *See, e.g.*, *In re* Massey Energy Co. Derivative & Class Action Litig., No. 5430, 2011 WL 2176479, at *20 n.139 (Del. Ch. May 31, 2011); La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 358–59 (Del. Ch. 2012), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013); *see also* Pollman, *supra* note 219, at 2023 (observing that the basis for liability in *Caremark* claims is a difficult theory).

244. *Teamsters*, 2020 WL 5028065, at *7.

245. *Id.* at *1–2.

patient use, and sell them illegally to cancer patients.[246] In 2017, the DOJ filed a criminal information against Specialty.[247] As part of a civil settlement with the DOJ, ABC agreed to pay $625 million.[248] In 2019, a group of ABC shareholders sued in the Delaware Court of Chancery, claiming that ABC's directors and several of its officers failed to implement compliance policies and monitoring systems that covered its subsidiaries, and thereby breached their oversight duties.[249] The court denied the defendants' motion to dismiss, holding that they ignored red flags in the form of an outside counsel report that pointed to gaps in "Specialty's mission critical compliance mechanisms," a *qui tam* suit filed by Specialty's COO, which exposed the illegal use of overfills, and a subpoena the DOJ served on Specialty.[250]

In a recent article, Chief Justice Veasy and Justice Norman of the Delaware Supreme Court described the oversight responsibilities of directors as follows:

> To oversee the corporation's activities effectively, directors must ensure they have sufficient knowledge and information about the corporation's business, especially its mission-critical operations, and compliance programs that are required by state and federal law. The board's oversight responsibilities also require it to establish and monitor programs relating to matters such as cybersecurity, data-privacy, ESG, and, most recently, COVID-19.[251]

Naturally, as the corporate structure becomes more complicated, so does the task of directors. As the number of subsidiaries grow, the parent's board will find it increasingly difficult to implement compliance and reporting systems that ensure adequate information flows within the group. The oversight challenge is compounded in conglomerates comprising entities specializing in different lines of business. In such cases, the task of the parent's board is not limited to a single mission critical operation, but rather to multiple mission critical operations. To discharge its oversight duties the parent board must familiarize itself with a complex web of laws and regulations, lest it misses or misconstrues a red flag. Of course, the parent board need not perform all information gathering tasks alone. It can rely on

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246. *Id.*

247. *Id.* at *6.

248. Press Release, U.S. Dep't of Just., AmerisourceBergen Corporation Agrees to Pay $625 Million to Resolve Allegations that It Illegally Repackaged Cancer-Supportive Injectable Drugs to Profit from Overfill (Oct. 1, 2018), https://www.justice.gov/opa/pr/amerisourcebergen-corporation-agrees-pay-625-million-resolve-allegations-it-illegally [https://perma.cc/3SPT-TRRB].

249. *Teamsters*, 2020 WL 5028065, at *14.

250. *Id.* at *19–24.

251. E. Norman Veasey & Randy J. Holland, Caremark *at the Quarter-Century Watershed: Modern-Day Compliance Realities Frame Corporate Directors' Duty of Good Faith Oversight, Providing New Dynamics for Respecting Chancellor Allen's 1996* Caremark *Landmark*, 76 BUS. LAW. 1, 27 (2020–2021) (footnote omitted).

the subsidiaries' boards, officers, committees, accountants, and counsels. But ultimately, responsibility of overseeing the operations of the entire group lies with the parent board.[252] Overseeing the operations of a conglomerate is an arduous task. It becomes daunting when one or more of the entities are based or operating in foreign countries.[253]

E. *The Challenge of International Operation*

As shown in Part I, a substantial number of corporate empires have foreign subsidiaries. The international nature of conglomerates is not surprising. The expansion to foreign countries is driven by the desire to take advantage of local expertise or lower production costs (or both). While the decision to acquire or incorporate foreign subsidiaries yields important potential benefits to the group, it is also fraught with peril. Operating in a foreign environment requires conglomerates to adjust to unfamiliar business cultures and new legal and regulatory regimes. Furthermore, those legal environments may not be as congenial to the group as its home country.[254]

To impose stricter controls on the operation of U.S. corporations in foreign countries, Congress enacted a series of laws to extend American jurisdiction to illegal acts committed abroad by individuals and corporations that are either based in or publicly listed in the United States. The most famous example of this phenomenon is the Foreign Corrupt Practices Act ("FCPA").[255] The FCPA was enacted in 1977 to curb corruption in international business transactions.[256] Until 1998, the FCPA has been relatively dormant; law enforcement authorities made relatively sparse use of it and prosecutions were relatively rare.[257] Then everything changed.

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252. For elaboration and discussion, see *infra* Section IV.C.

253. *See generally* Elizabeth Pollman, *The Supreme Court and the Pro-Business Paradox*, 135 HARV. L. REV. 220 (2021) (describing the Court's recent cases involving multinational corporations and the probusiness label).

254. *See, e.g.*, Fabian Jintae Froese, Dylan Sutherland, Jeoung Yul Lee, Yipeng Liu & Yuan Pan, *Challenges for Foreign Companies in China: Implications for Research and Practice*, 18 ASIAN BUS. & MGMT. 249, 252 (2019) ("China appears to be using domestic legal, regulatory and government interventions to favor its domestic firms.").

255. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494.

256. The text of the FCPA states its goals as follows:

> [T]o make it unlawful for an issuer of securities registered pursuant to section 12 of [the Securities Exchange Act of 1934] or an issuer required to file reports pursuant to section 15(d) of such Act to make certain payments to foreign officials and other foreign persons, to require such issuers to maintain accurate records, and for other purposes.

Id.

257. *See, e.g.*, Barbara Black, *The SEC and the Foreign Corrupt Practices Act: Fighting Global Corruption Is Not Part of the SEC's Mission*, 73 OHIO ST. L.J. 1093, 1096–108 (2012) ("[T]he SEC began to enforce the FCPA in earnest in the early 2000s."); Brandon L. Garrett, *Globalized Corporate Prosecutions*, 97 VA. L. REV. 1775, 1829 (2011) ("While for decades FCPA prosecutions were rare, they accelerated after 1998.").

Although FCPA investigations began to pick up as of the early 2000s, it is widely believed that the turning point was the Siemens case. In 2008, German industrial giant Siemens pleaded guilty and agreed to pay $800 million for violations committed by its subsidiaries operated in Argentina, Bangladesh, and Venezuela.[258] After Siemens came an ever-growing list of renowned corporations that found themselves subject to criminal investigations, settlements, and astronomic penalties because of their subsidiaries. In 2017, the Swedish telephone firm, Telia Company AB, agreed to just under $1 billion in total penalties for FCPA offenses committed by its subsidiary operating in Uzbekistan.[259] In 2019, Swedish telecom Ericsson agreed to pay $1.06 billion to resolve FCPA violations of its subsidiary from Egypt.[260] That same year, Walmart and its Brazilian subsidiary paid the DOJ $137 million.[261] According to reports, Walmart also spent an additional $900 million on an internal investigation and improvements in its compliance program.[262] At the top of the list stands Goldman Sachs, which reached an over $2.9 billion resolution with the DOJ and the U.S. Securities and Exchange Commission ("SEC") in October 2020 because of FCPA violations by a Goldman Sachs subsidiary operating in Malaysia.[263]

The FCPA has become a model for additional legislation. The Money Laundering Control Act of 1986 has broad extraterritorial application, allowing U.S. enforcement authorities to assert jurisdiction over any "conduct [that] occurs in part in the United States."[264] In 2018, pursuant to this

258. Press Release, U.S. Dep't of Just., Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations and Agree to Pay $450 Million in Combined Criminal Fines (Dec. 15, 2008), https://www.justice.gov/archive/opa/pr/2008/December/08-crm-1105.html [https://perma.cc/QC7B-VR9E] ("Coordinated Enforcement Actions by DOJ, SEC and German Authorities Result in Penalties of $1.6 Billion.").

259. Press Release, U.S. Dep't of Just., Telia Company AB and Its Uzbek Subsidiary Enter into a Global Foreign Bribery Resolution of More than $965 Million for Corrupt Payments in Uzbekistan (Sept. 21, 2017), https://www.justice.gov/opa/pr/telia-company-ab-and-its-uzbek-subsidiary-enter-global-foreign-bribery-resolution-more-965 [https://perma.cc/43EJ-NQJJ].

260. Press Release, U.S. Dep't of Just., Ericsson Agrees to Pay over $1 Billion to Resolve FCPA Case (Dec. 6, 2019), https://www.justice.gov/opa/pr/ericsson-agrees-pay-over-1-billion-resolve-fcpa-case [https://perma.cc/L5SQ-6WK3].

261. *See* Press Release, U.S. Dep't of Just., Walmart Inc. and Brazil-Based Subsidiary Agree to Pay $137 Million to Resolve Foreign Corrupt Practices Act Case (June 20, 2019), https://www.justice.gov/opa/pr/walmart-inc-and-brazil-based-subsidiary-agree-pay-137-million-resolve-foreign-corrupt [https://perma.cc/XU76-Z739].

262. Dylan Tokar, *Analysis: Walmart's Spend-and-Tell Strategy Paid Off in Bribery Settlement*, WALL ST. J. (June 26, 2019, 6:45 PM), https://www.wsj.com/articles/analysis-walmarts-spend-and-tell-strategy-paid-off-in-bribery-settlement-11561585841 (on file with the *Iowa Law Review*).

263. Press Release, U.S. Dep't of Just., Goldman Sachs Charged in Foreign Bribery Case and Agrees to Pay over $2.9 Billion (Oct. 22, 2020), https://www.justice.gov/opa/pr/goldman-sachs-charged-foreign-bribery-case-and-agrees-pay-over-29-billion [https://perma.cc/SLK6-MY7R]; Press Release, U.S. Sec. & Exch. Comm'n, SEC Charges Goldman Sachs with FCPA Violations (Oct. 22, 2020), https://www.sec.gov/news/press-release/2020-265 [https://perma.cc/N4TQ-QUAT].

264. 18 U.S.C. § 1956(f).

authorization the DOJ launched an investigation against Danske, Denmark's largest bank, relating to the bank's branch in Estonia.[265] Similar legislation can be found in Europe. The Third EU Money Laundering Directive requires all member states to verify that all EU financial institutions implement customer due diligence protocols not only within the European Union, but also in foreign countries in which they operate.[266]

The trend toward extraterritorial enforcement is strengthening. The Anti-Money Laundering Act of 2020, effective as of January 1, 2021, empowers the DOJ and the Department of the Treasury ("Treasury") to issue subpoenas for the financial records of non-U.S. banks maintaining a correspondent account with an American financial institution.[267]

Furthermore, on June 3, 2021, President Biden presented a "Memorandum on Establishing the Fight Against Corruption as a Core United States National Security Interest."[268] The memo is predicated on the view that "[c]orruption corrodes public trust" in foreign nations, and—because of its cross-border nature—"threatens United States national security . . . and democracy itself."[269] The threat emanates from "[a]nonymous shell companies, opaque financial systems, and professional service providers [that] enable the movement and laundering of illicit wealth, including in the United States."[270] The memo highlights the significance of the Corporate Transparency Act.[271] It adopts an interagency approach to the problem, calling on the Departments of Justice, Treasury, Homeland Security, Energy, and State, among others, to complete and file within two hundred days their recommendations to the President.[272]

While extraterritorial enforcement may well be a necessary component in the fight against illicit corporate behavior, it poses a daunting challenge to international conglomerates, forcing them to comply not only with the law of the parent but also with the multiple laws and regulations that apply to their

265. Press Release, U.S. Dep't of Just., Danske Bank Pleads Guilty to Fraud on U.S. Banks in Multi-Billion Dollar Scheme to Access the U.S. Financial System (Dec. 13, 2022), https://www.justice.gov/opa/pr/danske-bank-pleads-guilty-fraud-us-banks-multi-billion-dollar-scheme-access-us-financial [https://perma.cc/FD7M-RHGQ].

266. Directive 2005/60, of the European Parliament and of the Council of 26 October 2005 on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing, 2005 O.J. (L 309) 15, 29–31.

267. Anti-Money Laundering Act of 2020, Pub. L. No. 116-283, § 6308, 134 Stat. 3388, 4590–94.

268. Memorandum on Establishing the Fight Against Corruption as a Core United States National Security Interest, 2021 DAILY COMP. PRES. DOC. 1 (June 3, 2021).

269. *Id.*

270. *Id.*

271. *See* Corporate Transparency Act, Pub. L. No. 116-283, § 5336, 134 Stat. 4605, 4633 (2021).

272. Memorandum on Establishing the Fight Against Corruption as a Core United States National Security Interest, *supra* note 269, at 2–3.

subsidiaries.[273] Take China, for example. The Chinese legal environment is characterized by a comparatively weak and fast evolving judicial and regulatory institutional environment: scholars have stated that "[t]here is great flux in regulatory change across a broad range of spheres, including: environmental regulation and pollution prevention; capital/financial sector regulation; housing and real estate regulation; labor markets; and digital media content, to name but a few areas."[274]

The challenge is compounded by the fact that the laws of certain foreign countries impose restrictions on the parent's ability to intervene in the operations of a subsidiary or even seek information from it. For example, Swiss law imposes extensive restrictions on the ability of Swiss subsidiaries to share information with their parents.[275] Moreover, it prevents parents from directing the operations of Swiss subsidiaries, except via broad group policies.[276] The law of Germany also varies dramatically from U.S. law. The German Stock Corporation Act of 1965 adopted a very broad concept of enterprise liability, "allow[ing] (and even mandat[ing]) a court to penetrate all horizontal and vertical 'corporate separateness barriers' within a collective, polycorporate business enterprise as the rule and without exception."[277]

The preceding discussion demonstrates that international corporate empires must comply with an intricate system of laws and regulations. To navigate the legal labyrinth, they must adopt elaborate compliance systems that account for all the risks and exposures that may affect the group. They must constantly update themselves of regulatory changes that affect the operations of member entities and respond to them in a timely fashion. The cost of meeting these challenges is substantial (to say the least), but the cost of failing to comply could be astronomical. International conglomerates always bear the first cost; occasionally they also bear the second.

IV. REDESIGNING CORPORATE EMPIRE LAW

In this Part, we design a new legal approach to sprawling corporate empires. To date, two approaches have dominated the literature on

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273. PWC, SUBSIDIARY GOVERNANCE: AN UNAPPRECIATED RISK 1 (2013), https://www.pwc.com/gx/en/legal/entity-governance-compliance/publications/assets/subsidiary-governance.pdf [https://perma.cc/4MVX-RENL] ("In recent years, domestic and international regulatory developments and the enforcement of those regulations have forced multinational companies to focus on the governance and management of all entities within their group.").

274. Froese et al., *supra* note 254, at 251 (citations omitted).

275. *See, e.g.*, BUNDESGESETZ ÜBER DIE BANKEN UND SPARKASSEN [BANKG] [THE SWISS FEDERAL ACT ON BANKS AND SAVINGS BANKS] Nov. 8, 1934, SR 952.0, art. 4quinquies (Switz.). Article 4 of the Swiss Federal Act on Banks and Savings Banks of 1934 limits Swiss subsidiary banks from transmitting information or documents not publicly available to their parent companies and sets strict regulatory rules with specific conditions in doing so. *Id.*

276. *Id.*

277. René Reich-Graefe, *Changing Paradigms: The Liability of Corporate Groups in Germany*, 37 CONN. L. REV. 785, 786 (2005).

conglomerates. The first approach is to treat each corporation as a separate entity, whose actions and omissions should be evaluated separately. Even under this approach, if a parent and a subsidiary acted together, liability will be imposed on both. Ordinarily, however, no responsibility should be assigned to the parent for the acts of a subsidiary, and vice versa. The competing approach views all the corporations in the group as a single entity. This approach is rooted in the view that all the entities comprising a conglomerate or a corporate group operate with a single interest in mind: to maximize the profits of the *group*. Accordingly, the law should disregard their separate corporate personalities and treat them as one whole. Adopting enterprise liability would prompt parents to monitor operations of subsidiaries, thus preventing the potential externalization of risks onto innocent third parties.

As we will show, these two polar approaches fail to capture the unique characteristics of conglomerates.[278] The entity liability approach fails to pay sufficient heed to the interconnectedness of the members of a conglomerate. It represents a highly formalist conception of the law that treats all corporate entities in the same way. Consequently, it fails to offer adequate protection to potential tort victims that interact with subsidiaries. Philip Blumberg, for example, called the entity liability approach "anachronistic" and "dysfunctional."[279] The enterprise liability approach suffers from the opposite problem. It assumes that the parent can control the operations of its subsidiaries. This assumption of complete control is too strong. Such control often does not exist in reality. Worse yet, if the law required such a high degree of parental control, it might have rendered the establishment of conglomerates unworthwhile. This, in turn, would be undesirable for several reasons. First, conglomerates provide a valuable organizational form. They present economic advantages that standalone corporations cannot produce. Treating all the entities that comprise a conglomerate as a unitary whole for liability purposes would dramatically reduce the incentive to use it. Second, as we explained in Part III, sometimes the law itself forces corporations to establish local subsidiaries if they wish to operate within the relevant jurisdiction. Third and finally, the imposition of enterprise liability would inflict harm on multiple stakeholders, such as

278. It is worth noting that Virginia Harper Ho argues that multinational firms are not "simple hierarchies, characterized by unidirectional, top-down governance and control," but rather a structure that is characterized by complexity and flexibility that have gained little attention in the legal literature. *See* Virginia Harper Ho, *Team Production & the Multinational Enterprise*, 38 SEATTLE U. L. REV. 499, 502 (2015).

279. PHILLIP I. BLUMBERG, KURT A. STRASSER, NICHOLAS L. GEORGAKOPOULOS & ERIC J. GOUVIN, BLUMBERG ON CORPORATE GROUPS § 182.06 (2d ed. 2023); *see also*, PETER T. MUCHLINSKI, MULTINATIONAL ENTERPRISES & THE LAW 77 (2d ed. 2007) (1995) ("It is clear that existing legal forms of business organization . . . were simply not designed to correspond with such extensive business structures as [multinational enterprises].").

employees, suppliers, and business partners, of entities within a conglomerate that were not engaged in any wrongdoing.

For these reasons, we reject the two polar approaches to conglomerates. In their stead, we set out to fashion a legal framework that is designed to preserve the economic advantages of conglomerates while minimizing the attendant risks. The legal approach we advocate is sensitive to the unique features of conglomerates. What distinguishes conglomerates from standalone corporations is not only their scale and the scope of their operations, but also the interfirm dependencies they display. The collapse of a single entity within a conglomerate may trigger the failure of the entire group. Hence, we contend that lawmakers must adopt a contextual approach to the challenge of conglomerates and adopt specific solutions to the different challenges posed by conglomerates.

A. Parental Liability and Veil-Piercing

Although imposition of liability on a parent for the misdeeds of a subsidiary and veil-piercing are analytically distinct topics—and indeed, in Part III, we analyze them separately—they give rise to the same question: when should a parent be held responsible for the actions of a subsidiary? As we explained, courts have recognized two forms of parental liability: direct and indirect.[280] A parent will be directly liable for the misconduct of a subsidiary if it actively participated in the wrongdoing. A parent will be held indirectly responsible for the behavior of an errant subsidiary if it had the requisite degree of *control* over it, either generally or with respect to the specific transaction or conduct that gave rise to the harm.

Veil-piercing is considered a more extreme measure than mere imposition of liability. When a court pierces the veil of a subsidiary, it disregards its separate legal personality and elides the personality of the subsidiary with that of the parent. From the vantage point of creditors, veil-piercing allows them to reach the assets of the parent. In that sense, it leads to the same result as imposition of liability on the parent—whether direct or indirect. It should, therefore, come as no surprise that the veil-piercing and liability tests developed by courts share many similarities.

Veil-piercing tests have attracted scathing criticism from commentators for being helplessly unpredictable and vague.[281] All jurisdictions, including Delaware,[282] use multifactor tests to decide veil-piercing cases. One thing is

280. *See* Douglas & Shanks, *supra* note 127, at 204–08.

281. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985) ("'Piercing' seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled.").

282. For discussion, see *supra* Section III.C.

clear, however: if a subsidiary served as a mere façade[283] or instrumentality of the parent[284] or was established fraudulently in "contravention of law or contract,"[285] Delaware courts would be willing to disregard the corporate entity of a subsidiary.[286] Similarly, veil-piercing determinations under California law turn on the question of whether a subsidiary is merely the "alter ego" of the parent.[287] If the answer is yes, the entity of the subsidiary would be disregarded.

Although courts frame the matter differently, they point to the same vital question: was there a real reason for the existence of the corporate entity for which veil-piercing is sought? If a subsidiary serves no real purpose, except to shelter the parent and its shareholders, while externalizing risk to creditors, separate legal entity should be ignored. If the point and purpose of subsidiarization, or its only effect, is to keep the parent removed from socially undesirable activities, such as mass torts, irresponsible financial behavior, or unlawful transactions, there is absolutely no reason not to attribute responsibility for the losses to the parent.

Outside of the category of cases where a subsidiary serves no purpose but to shelter the parent, the issue of parental liability turns on control. This is true for both indirect liability and veil-piercing. Control over a subsidiary constitutes a strong basis for viewing it indirectly liable for the subsidiary's misconduct.[288] Similarly, a parent's domination and control over a subsidiary may entitle the subsidiary's creditors to pierce the corporate veil.[289] The question thus arises: what constitutes "control?" This question is not unique to conglomerates; it arises with respect to standalone corporations, as well. Control was defined differently for different purposes in federal[290] and state

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283. *See, e.g.*, Applied Biosystems, Inc. v. Cruachem, Ltd., 772 F. Supp. 1458, 1463–66 (D. Del. 1991) (noting that a showing of fraud or inequity is required for courts to pierce the corporate veil).

284. *See* WITTING, *supra* note 17, at 339 ("The most widely recognised ground of veil-piercing in the United States is the so-called instrumentality doctrine."); *see also* Zaist v. Olson, 227 A.2d 552, 558 (Conn. 1967) ("The instrumentality rule requires, in any case but an express agency, proof of three elements: (1) Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own; and (2) Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest or unjust act in contravention of plaintiff's legal rights; and (3) The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.").

285. Pauley Petrol. Inc. v. Cont'l Oil Co., 239 A.2d 629, 633 (Del. 1968).

286. *See, e.g.*, Banks v. Banks, No. 2022-0428, 2022 WL 17261512, at *5–6 (Del. Ch. Nov. 29, 2022).

287. *See, e.g.*, Riddle v. Leuschner, 335 P.2d 107, 111 (Cal. 1959) (holding that veil-piercing is warranted when "there was such unity of interest and ownership that the separate personalities of the corporations and the individuals no longer existed" and that, if the acts are treated as those of the corporation alone, an inequitable result will follow).

288. *See supra* Section III.A.

289. *See supra* Section III.C.

290. I.R.C. § 1563.

statutes[291] and in court decisions.[292] Control is generally understood as the ability to influence the actions and decisions of a corporation.[293]

There is very broad consensus among courts that ownership of stock in a subsidiary does not suffice to establish control.[294] Not everyone agrees with this view. Proponents of enterprise liability disagree. Phillip Blumberg, an avid champion of enterprise liability, advocated a very broad conception of control, according to which control subsists in the parent's voting of its stock in a subsidiary.[295] Massimo Colombo and Marco Delmastro have shown, however, that control is not nearly as straightforward as Blumberg appears to suggest. An empirical study they conducted reveals that as the number of levels in an organization increases, it affects the allocation of power and authority within the organization.[296] They observed that "more complex organizational structures are characterized by greater decentralization of authority."[297] They concluded that as the size of an organization grows, so does the tendency to delegate authority.[298] The reason is that complexity increases information costs for top management.[299] These findings are

291. DEL. CODE ANN. tit. 8, § 203(c)(4) (2023) defines control as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise."

292. In 1994, in the seminal case *Kahn v. Lynch Communications Systems, Inc.*, the Delaware Supreme Court described two scenarios in which a stockholder could be found a controller under Delaware law: where the stockholder (1) owns more than fifty percent of the voting power of a corporation or (2) owns less than fifty percent of the voting power of the corporation but "*exercises control* over the business affairs of the corporation." Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110, 1113–14 (Del. 1994) (quoting Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)).

293. The seminal article on this topic is Adolf A. Berle, Jr., *"Control" in Corporate Law*, 58 COLUM. L. REV. 1212 (1958).

294. *See, e.g.*, Dole Food Co. v. Patrickson, 538 U.S. 468, 474–75 (2003) ("A basic tenet of American corporate law is that the corporation and its shareholders are distinct entities. . . . A corporate parent which owns the shares of a subsidiary does not, for that reason alone, own or have legal title to the assets of the subsidiary; and, it follows with even greater force, the parent does not own or have legal title to the assets of the subsidiary . . . ."); Krivo Indus. Supply Co. v. Nat'l Distillers & Chem. Corp., 483 F.2d 1098, 1104 (5th Cir. 1973) ("[A]n examination of the case law in this area indicates that the fact that the allegedly dominant corporation held an ownership interest in another, allegedly subservient, corporation does not, *per se*, resolve the question of control."); Owl Fumigating Corp. v. Cal. Cyanide Co., 30 F.2d 812, 812 (3d Cir. 1929) ("[O]wnership of capital stock of one corporation by another does not alone create identity of interests or the relation of principal and agent between the two . . . ."); Ky. Elec. Power Co. v. Norton Coal Mining Co., 93 F.2d 923, 926 (6th Cir. 1938) (similar).

295. BLUMBERG, THE MULTINATIONAL CHALLENGE, *supra* note 28, at 245. It should be noted that other advocates of enterprise liability wish to do away with the concept of control altogether and premise liability on the mere existence of the enterprise.

296. MASSIMO G. COLOMBO & MARCO DELMASTRO, THE ECONOMICS OF ORGANIZATIONAL DESIGN: THEORETICAL INSIGHTS AND EMPIRICAL EVIDENCE 89 (2008).

297. *Id.*

298. *Id.*

299. *Id.*

corroborated by empirical studies of mergers and acquisitions, which create and grow conglomerates.[300] Acquirers, however, sometimes elect not to integrate acquired companies into the organization. The decision not to integrate may be motivated by the desire to preserve the independence of the acquired corporation or to prevent departure of talent.[301] In addition, integration may be suboptimal when the acquired corporation operates in a new line of business or a different market.[302]

Given the subtleties of control in conglomerates, we propose that courts adopt a *rebuttable presumption* of control with respect to wholly owned subsidiaries with respect to liability for tortious and criminal acts. The parent will be able to rebut the presumption by adducing evidence that the subsidiary at issue had a high degree of independence, either generally or with respect to the activity that harmed third parties. For example, a parent may show that it rarely directed the operations of the subsidiary or that the subsidiary's board enjoyed a high degree of operational independence and was free to disregard the will of the parent. To prevent manipulations, say, by apportioning one percent of the subsidiary's stock to a third party to thereby render it *non*-wholly owned, we call on courts to maintain the same presumption even for *non*-wholly owned subsidiaries by adopting a policy that establishes a continuing relationship between the parent's level of holdings and its presumed control. For example, if a parent owns ninety percent of a subsidiary's stock, a court can still use our rebuttable presumption of control, but the presumption would be weaker than in the case of a wholly owned subsidiary. The parent can show, for instance, that it has difficulties in nominating directors of the subsidiary or convincing the subsidiary to distribute dividends. This can be the case in circumstances where a regulatory agency conditions appointment of directors on its approval. The parent can also provide well-pled facts or business reasons from which it is reasonable to infer that it could not prevent the subsidiary board from freely exercising its independent judgment in considering a proposed merger or other significant deal. Finally, the parent can show that because of legal or regulatory limitations, it cannot receive certain important information from its subsidiary.[303] As the ownership of the parent decreases, the rebuttable

300. *See* David Faulkner, Satu Teerikangas & Richard J. Joseph, *Introduction*, *in* THE HANDBOOK OF MERGERS AND ACQUISITIONS 1, 4 (David Faulkner, Satu Teerikangas & Richard J. Joseph eds., 2012) (describing "the long-term managerial and organizational hurdles involved in operating merged organizations").

301. *See* Duncan Angwin, *Merger and Acquisition Typologies: A Review*, *in* THE HANDBOOK OF MERGERS AND ACQUISITIONS 40, 57 (David Faulkner, Satu Teerikangas & Richard J. Joseph eds., 2012).

302. WITTING, *supra* note 17, at 50.

303. For example, Article 47 of the Swiss Federal Act on Banks and Savings Banks of 1934 prohibits Swiss subsidiaries from sharing information on clients with their parents; generally speaking, the Swiss Financial Market Supervisory Authority may prohibit the transmission of certain information from a Swiss banking corporation to its controlling parent. *See* BUNDESGESETZ

presumption of control will become weaker still. We also suggest that the rebuttable presumption be removed upon a showing by a parent that it adopted and *implemented* group policies to protect public health and safety, and that its subsidiary acted in blatant violation of said policies.

In so far as veil-piercing is concerned, we do *not* mean to jettison the other tests developed by courts. On the contrary, we strongly support retaining them. It should be noted, though, that some of the general tests developed by courts in veil-piercing are less applicable to conglomerates. For example, courts are more willing to pierce the corporate veil when a shareholder commingles her assets with those of the corporation.[304] Yet, commingling of assets occurs infrequently in the case of conglomerates, as parents are careful to keep the assets separate from those of their subsidiaries.[305] Hence, this factor is unlikely to help creditors.

Other tests, by contrast, are fully applicable to conglomerates. Chief among those is inadequate capitalization.[306] As opposed to veil-piercing cases involving a standalone corporation, where capitalization can be assessed only with respect to that entity, in the case of conglomerates, it is possible to examine whether there was a pattern of undercapitalization. A showing by plaintiffs of pervasive undercapitalization within a certain conglomerate should constitute a strong reason to allow creditors to reach the parent. A pattern of undercapitalization is prima facie evidence that the parent intended to externalize risks on creditors. In such circumstances, the separate personality of the entities involved should be disregarded.

Other tests that were specifically designed to address parent-subsidiary relationships are also important. For example, courts should continue to inquire whether "the daily operations of the two corporations are not kept separate"; whether "the subsidiary does not observe the basic corporate formalities, such as keeping separate books and records and holding shareholder and board meetings"; whether the two corporations file financial reports and taxes separately; and whether "the parent pays the salaries" of the subsidiary's employees.[307]

Furthermore, courts should be more willing to pierce the corporate veil within conglomerates in cases involving tort victims. Multiple commentators pointed out that conglomerates are especially prone to impose risks on the

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ÜBER DIE BANKEN UND SPARKASSEN [BANKG] [THE SWISS FEDERAL ACT ON BANKS AND SAVINGS BANKS] Nov. 8, 1934, SR 952.0, arts. 4quinquies, 47 (Switz.).

304. *See, e.g.*, Matheson, *supra* note 214, at 1114 (explaining that things "such as commingling of assets and failure to follow corporate formalities, may simply appear less often in corporate group cases").

305. *See id.*

306. Douglas G. Smith, *Piercing the Corporate Veil in Regulated Industries*, 2008 BYU L. REV. 1165, 1174–76.

307. United States v. Jon-T Chems., Inc., 768 F.2d 686, 692 (5th Cir. 1985). For a comprehensive summary of the tests, see *id.*

public because they allow management to concentrate risky activities in the hands of a single subsidiary that is not adequately insured.[308] Hence, we join other commentators in calling on courts to recognize veil-piercing more readily in cases involving tort victims who sue conglomerates.

We would like to emphasize that the protection of third parties should not rely exclusively on corporate law doctrines. Regulation and taxation must play a key role in this context. A comprehensive discussion of the need for regulation to curb the taking of excessive risk by corporations is well beyond the scope of this Article. That said, corporations in many industries including financial services, insurance, automobile manufacturing, and pharmaceuticals are subject to stringent regulation,[309] as they should. Regulation is preemptive in nature, designed to stem risks before they arise. Naturally, regulation has its costs. As Professor Steven Shavell has pointed out, regulation is a prophylactic measure that applies to violators and nonviolators alike.[310] Hence, the imposition of regulation raises operation costs, is typically territorial in nature and therefore does not cover the operations of foreign subsidiaries. Notwithstanding these limitations, regulation is an essential complement to private litigation.

Taxation, too, can be used to help individuals who were harmed by conglomerates. It is possible to impose a special tax on corporations and use the proceeds to compensate victims. Ideally, the tax should be calibrated to the *excess* risk conglomerates impose on third parties. However, it is impossible to reach this level of precision. Consequently, optimal deterrence cannot be reached.[311] Nonetheless, the money collected from the imposition of a conglomerate tax can be distributed to victims of conglomerate wrongdoing. The main virtue of this mechanism, insofar as compensation is concerned, lies in its ability to help victims of insolvent corporations and conglomerates.

B. Fiduciary Duties

As we established in Section III.B, Delaware law takes the position that the fiduciary duties of directors in wholly owned corporations are owed to the parent. This position not only disregards the separate entity of the subsidiary, but also the interests of the subsidiary's employees, suppliers, business

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308. *See, e.g.*, Berle, *supra* note 36, at 355–57; Easterbrook & Fischel, *supra* note 281, at 111 ("[T]he moral-hazard problem is probably greater in parent-subsidiary situations because subsidiaries have less incentive to insure."); Hansmann & Kraakman, *supra* note 152, at 1880–81 (describing how subsidiarization has been used to reduce exposure to tort liability).

309. *See* David L. Cohen, *Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?*, 51 OKLA. L. REV. 427, 435–38 (1998) (discussing the role of state regulation in protecting creditors).

310. Steven Shavell, *A Fundamental Enforcement Cost Advantage of the Negligence Rule Over Regulation*, 42 J. LEGAL STUD. 275, 275 (2013) ("[C]ompliance . . . tends to be assessed before, or independently of, the occurrence of harm . . . .").

311. A.C. PIGOU, THE ECONOMICS OF WELFARE 381 (4th ed. 1960).

partners, and even creditors. It allows the parent to sacrifice the subsidiary to promote the greater interest of the good. Granted, the parent as the sole shareholder of a wholly owned subsidiary can do with it whatever it likes. What is special about Delaware's law in this respect is that it prevents the directors of the subsidiary from opposing the plan of the parent; on the contrary, they are obliged to obey the parent's will.

Delaware's stance presents two challenges. First, by directing the duties of directors of wholly owned subsidiaries to the parent, Delaware law reduces the incentive of the subsidiary's board to voice criticism of the parent's plans for the subsidiary. On its face, this does not appear problematic. After all, the parent's full ownership of a subsidiary means the parent fully internalizes the costs and benefits of its decisions. At the same time, the parent may not be in the best position to assess the potential future prospects of a particular subsidiary. This is especially true in large conglomerates and holding companies. And while the board and management of wholly owned subsidiaries are supposed to share their private information with the parent, they may choose not to share it to the fullest possible extent in order to avoid conflict with the parent.

Second, and more critically, Delaware's position is out of step with the philosophy of stakeholderism. Delaware law treats the shareholders as the only relevant group whose interests are worthy of legal protection. Yet, many practitioners and theorists believe that this view is outmoded and that corporate fiduciaries ought to take into account the interests of various groups and constituencies, including those of the public at large.[312] As Professors Jill E. Fisch and Steven Davidoff Solomon explain, there is "a broad[] effort to reorient corporate decision-making away from economic

312. In 2019, the Business Roundtable announced its commitment to "lead their companies for the benefit of all stakeholders." *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,'* BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/382D-T22H]. The CEOs committed to "deliver value" not just to their shareholders but also to their employees, customers, suppliers, and communities. *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Oct. 2020), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationOctober2020.pdf [https://perma.cc/CMR8-WMXE]; *see also* Martin Lipton, Steven A. Rosenblum & Karessa L. Cain, *Thoughts for Boards of Directors in 2020*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Dec. 10, 2019), https://corpgov.law.harvard.edu/2019/12/10/thoughts-for-boards-of-directors-in-2020 [https://perma.cc/Y22J-YN2R] ("[T]he board has a fiduciary duty to promote the best interests of the corporation, and in fulfilling that duty, directors must exercise their business judgment in considering and reconciling the interests of various stakeholders and their impact on the business of the corporation."); Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE, Apr. 15, 2020, at 1, 2 (finding that "*shareholders*, not management, have been the driving force behind the environmental, social, and governance principles that often align with stakeholder governance").

value maximization in favor of broader societal objectives, not simply as a choice, but as an affirmative obligation."[313]

Both challenges are exemplified by Ben & Jerry's board's decision to sue its parent Unilever.[314] Ben & Jerry's has a tradition of embracing socially progressive values.[315] In 2021, Ben & Jerry's decided to discontinue the sale of its ice cream products in Jewish settlements in the West Bank.[316] The decision prompted a political controversy, which led Unilever, Ben & Jerry's parent, to sell the Ben & Jerry's brand and trademark right to an Israeli businessperson.[317] Unilever believed that it was acting in the best interest of the *entire* group.[318] Ben & Jerry's, by contrast, maintained that Unilever's action diluted its brand and on July 1, 2022, its board, in a 5–2 vote decided to commence legal action against the parent.[319]

As we noted elsewhere, the fiduciary duties of care and loyalty "are the twin pillars on which corporate law is constituted."[320] The duty of care requires a fiduciary to exercise "a level of care that an ordinarily careful and prudent person would employ under similar circumstances."[321] The duty of loyalty imposes on a fiduciary "an undivided and unselfish loyalty to the corporation demand[ing] that there . . . be no conflict between duty and self-interest."[322]

313. Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309, 1310 (2021). Some prominent scholars argue that there is a gap between the way managements express their commitment to stakeholderism and their true commitment to this idea. *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 133 (2020); Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 370–80 (2021). Finally, see Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2628–34 (2021), for a discussion of the challenges of those who advocate moving away from value maximization toward stakeholderism.

314. *See* City of St. Clair Shores Police & Fire Ret. Sys. v. Unilever PLC, No. 22-cv-5681, 2023 WL 5578090, at *1 (S.D.N.Y. Aug. 29, 2023); Ben & Jerry's Homemade, Inc. v. Conopco, Inc., No. 22-cv-5681, 2022 WL 4239941, at *1 (S.D.N.Y. Aug. 22, 2022).

315. *See City of St. Clair Shoes Police*, 2023 WL 5578090, at *1.

316. *See id.* at *1.

317. *See id.* at *3.

318. *See id.*; Press Release, Unilever, Unilever Reaches New Business Arrangement for Ben & Jerry's in Israel (June 29, 2022), https://www.unilever.com/news/press-and-media/press-releases/2022/unilever-reaches-new-business-arrangement-for-ben-jerrys-in-israel [https://perma.cc/HSC7-ZQK2].

319. Bob Van Voris, *Ben & Jerry's Sues Parent Unilever to Block West Bank Ice Cream Deal*, BL (July 6, 2022, 3:16 AM), https://www.bloomberg.com/news/articles/2022-07-05/ben-jerry-s-sues-unilever-to-block-west-bank-ice-cream-deal (on file with the *Iowa Law Review*); *see also* Ann Lipton, *For Whom Are Ben & Jerry's Corporate Managers Trustees?*, BUS. L. PROF BLOG (July 9, 2022), https://lawprofessors.typepad.com/business_law/2022/07/for-whom-are-ben-jerrys-corporate-managers-trustees.html [https://perma.cc/VLC2-CAZA] (providing background on the unique corporate structure of Ben & Jerry's).

320. Asaf Eckstein & Gideon Parchomovsky, *Toward a Horizontal Fiduciary Duty in Corporate Law*, 104 CORNELL L. REV. 803, 804 (2019).

321. *Id.* at 812.

322. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

It was construed as encompassing both an affirmative and a negative dimension. Affirmatively, it requires the fiduciary "to protect the interests of the corporation committed to his charge" with her utmost scrupulousness.[323] Negatively, it obliges the fiduciary to abstain from profiting at the corporation's expense or depriving it of an advantage or benefit.[324] Under *Anadarko* and its progeny, fiduciaries in wholly owned subsidiaries must only consider the interest of the parent to whom they owe their duties and disregard the fate of employees, suppliers, business partners, and creditors of the *subsidiary* itself.[325] Any deviation might constitute a violation of the duty of loyalty toward the parent company.

We maintain that the time has come for Delaware to reverse, or at least substantially revise, *Anadarko* to restrict its applicability, per our explanation below. The fiduciary duties of directors and officers in wholly owned subsidiaries should be owed to the subsidiary, and not the parent. Affecting this change is necessary to allow the subsidiary's board and management to consider and grant protection to the interests of the subsidiary's stakeholders. Reversing *Anadarko* would lead to a more balanced and equitable corporate culture. *Anadarko* can continue to apply only to that subgroup of wholly-owned subsidiaries that have been set up, but have not participated in any market activities and do not have employees. This is the case, for instance, in circumstances where the parent creates the subsidiary specifically to acquire a target company, by way of a reverse triangular merger, where the parent creates the subsidiary for the purpose of merging it into the target company.[326] Another example would be a shell company without activity.

C. OVERSIGHT LIABILITY

The detection of problems, misconduct, and legal violations is among the foremost challenges facing conglomerates. Failure to detect and respond to wrongdoing can expose the corporation to severe criminal sanctions and its board and management to derivative actions. Hence, it is not surprising that firms expend considerable resources on compliance.[327] Richard Cyert and James G. March observed that a significantly greater percentage of managerial resources is allocated to internal matters than to external interactions of the

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323. *Id.*

324. *Id.*; *see also* Brehm v. Eisner, 746 A.2d 244, 257–58 (Del. 2000) (affirming dismissal of breach of loyalty claims based upon evidence of lack of personal benefit to director who approved the transaction).

325. *See* Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79, 113–15 (explaining the *Anadarko* holding and possible ways to interpret it).

326. RONALD J. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 528–32 (1986).

327. William S. Laufer & Matthew Caulfield, *Wall Street and Progressivism*, 37 YALE J. REGUL. BULL. 36, 42 (2019) ("[A]n estimated 15 [percent] to 20 [percent] of the operating costs of financial institutions go[] to governance, risk, and compliance (GRC) expenditures . . . .").

firm.[328] Similarly, Professor Veronica Root reports that "[o]rganizations from all over the world, out of fear of sanction, harm, retribution, or ridicule, initiate programs aimed at making certain that their employees and members maintain compliance with external and internal norms and requirements."[329] Despite their best efforts to achieve a perfect level of compliance, the results are at best mixed.[330]

Detecting wrongdoing within medium size and large corporations is not as easy as it may seem. Corporations are complex organizations that are characterized by a very large number of internal and external interactions. All it takes is one errant employee to get a corporation in trouble. Overseeing the operations of the firm is a primary responsibility of the board, in charge of identifying misconduct within the organization. But the board cannot be expected to detect and respond to every illegal act committed within the firm. The board has inherent limitations. It is not omniscient and it must allocate its finite resources to other tasks, as well. The *Caremark* test reflects this understanding. Under *Caremark*, liability for breach of oversight duties will be imposed on a director if she utterly failed to implement a reporting system or consciously failed to monitor its operations.[331]

Although *Caremark* does not specify which reporting system should be implemented, the expectation is that the reporting system selected by the board would correspond to the size of the corporation and the scale of its operations.[332] Yet, the decision which system to implement is a business decision protected by the business judgment rule.[333] The *Caremark* standard also ensures that only directors who violated their good faith obligations to the corporation would bear liability for failure to monitor.[334] This would happen when a red flag is waved, and a director consciously disregards it.[335]

Caremark has been criticized for being overly protective of boards.[336] Although this criticism may be relevant in the case of standalone corporations, we maintain that it is the right standard for assigning liability to

328. RICHARD M. CYERT & JAMES G. MARCH, A BEHAVIORAL THEORY OF THE FIRM 205–06 (2d ed. 1992).

329. Veronica Root, *The Compliance Process*, 94 IND. L.J. 203, 205 (2019).

330. *Id.* ("[E]very year seems to bring another set of significant scandals within organizations.").

331. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 368–70 (Del. 2006) (construing the *Caremark* standard).

332. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

333. *Id.* at 970 ("Obviously the level of detail that is appropriate for such an information system is a question of business judgment.").

334. *Id.* at 971 ("[I]n my opinion only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.").

335. *Stone*, 911 A.2d at 370.

336. *See, e.g.*, Robert T. Miller, *Wrongful Omissions by Corporate Directors:* Stone v. Ritter *and Adapting the Process Model of the Delaware Business Judgment Rule*, 10 U. PA. J. BUS. & EMP. L. 911, 949 (2008).

the *parent's board* in a corporate empire. The entities within a corporate empire sometimes operate in different industries and are subject to different regulatory regimes. Each entity has its own board that is tasked with the duty of overseeing its operations. The parent's board is required to ensure compliance within the entire group, relying on the subsidiaries' boards and the reporting system they choose to implement within each subsidiary. If a subsidiary board fails to detect misconduct inside it, chances are that the parent board will not know of it and will fail to address it. Under Delaware law, the parent is expected to respond to red flags. However, the definition of a red flag may be different in the case of a corporate empire. The parent's board is the ultimate address for all the complaints arising within the group. As Herbert A. Simon pointed out "a wealth of information creates a poverty of attention."[337] Directors are not expected to proactively search for red flags. They must act, however, when a red flag is brought to their attention. The decisions in *Caremark*, *Stone*, and *Citibank* underscore that the flags should be clear, significant, and noticeable.

We would like to emphasize that our proposal is not meant to leave smaller problems unaddressed. It must be borne in mind that every entity in a conglomerate has its own board and under *Caremark*, it is expected to respond to red flags that arise within it.[338] The scope of the parent's board oversight obligations must be tailored to the organizational reality of the conglomerate.[339]

The international nature of conglomerates further complicates the task of the parent's board. In *In re Puda Coal, Inc. Stockholders Litigation*,[340] Chancellor Strine explained the special challenge faced by independent directors on international corporations as follows:

> [I]f the assets are in Russia, if they're in Nigeria, if they're in the Middle East, if they're in China, that you're not going to be able to sit in your home in the U.S. and do a conference call four times a year and discharge your duty of loyalty. That won't cut it. That there will be special challenges that deal with linguistic, cultural and others in terms of the effort that you have to put in to discharge your

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337. Herbert A. Simon, *Designing Organizations for an Information-Rich World*, *in* COMPUTERS, COMMUNICATIONS, AND THE PUBLIC INTEREST 37, 40 (Martin Greenberger ed., 1971).

338. In this respect, it is worth referring to the Model Business Corporation Act: "This need to inquire is not a component of ongoing oversight, and does not entail proactive vigilance, but arises under section 8.31(a)(2)(iv) when, and only when, particular facts and circumstances of material concern . . . surface." MODEL BUS. CORP. ACT § 8.31(a)(2)(iv) cmt. 1(E) (AM. BAR ASS'N 2023).

339. Regina F. Burch, *Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron*, 6 WYO. L. REV. 481, 498 (2006) ("[D]irectors cannot ignore red flags generated by internal control systems if those red flags are numerous, serious, directly in front of the directors, and indicative of a corporate-wide problem.").

340. Transcript of Oral Argument and the Ct.'s Ruling at 1, 21, *In re* Puda Coal, Inc. S'holders Litig., No. 6476-cs, (Del. Ch. Feb. 6, 2013).

duty of loyalty.[341]

Then, Chancellor Strine proceeded to admit that there are many corporations on the boards of which he would not serve either "because the industry's too complex" or because "all the flow of information is in the language that I don't understand, in a culture where there's, frankly, [no adequate] legal strictures or structures or ethical mores."[342]

Failure to exercise adequate oversight over the operations of subsidiaries may not only lead to the imposition of civil liability on the members of the parent's board, but may also expose the parent itself to criminal liability. While the protective *Caremark* standard governs the civil liability of *directors and officers* of the parent, it is irrelevant to the criminal liability of the parent itself. In the last two decades, there has been a spike in the enforcement actions of the DOJ and other federal agencies against corporations.[343] These enforcement actions ordinarily lead to agreements that involve the imposition of heavy fines.[344] In such investigations, fines are ordinarily imposed both on subsidiaries and parents—on subsidiaries for committing a violation and on parents for failing to detect it and prevent it.[345] The use of fines has become a convenient way to put money in the public coffers.[346] At the same time, this method of meting out justice may be ruinous to conglomerates. The imposition of heavy fines on the parent every time a subsidiary violates the law can jeopardize the financial stability of the conglomerate as a whole. It can also undermine the incentive to establish subsidiaries or expand operations to certain industries or countries. It is also likely to push conglomerates to stop important operations executed by subsidiaries that are necessary for the existence of the conglomerate.

Conglomerates are a convenient target for law enforcement agencies.[347] But as Professor John Coffee persuasively argued, the filing of criminal charges against the *individuals* responsible for the wrongdoing provides a better way of achieving deterrence and securing justice.[348]

In conclusion, it is worth noting that imposing exaggerated oversight duty on the parent is likely to cause it to invest too many of its resources for

341. *Id.*

342. *Id.* at 22.

343. Eckstein & Parchomovsky, *supra* note 72, at 1518; Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 IOWA L. REV. 507, 512 (2020).

344. Eckstein & Parchomovsky, *supra* note 72, at 1518–25.

345. *See id.* at 1524.

346. *Id.* at 1518.

347. *See generally* JOHN C. COFFEE, JR., CORPORATE CRIME AND PUNISHMENT: THE CRISIS OF UNDERENFORCEMENT (2020) (offering proposals to punish corporate malfeasance).

348. John C. Coffee, Jr., *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386, 387 (1981) (offering ways "to focus the incidence of corporate penalties on those most able to prevent repetition and to increase the efficiency of corporate punishment without employing *in terrorem* penalties").

this mission. A 2013 survey by Deloitte found that sixty-eight percent of respondents indicated that boards of parent companies spent a substantial amount of time on the oversight of their subsidiaries.[349]

D. The Challenge of Cross-Border Activities

As our analysis in Part I demonstrated, corporate empires are by and large international. They expand their operations into foreign markets to increase revenues by doing business in lucrative markets, lower production costs, tap into local expertise, or take advantage of more lenient regulation or taxation. Cross-border operations by conglomerates present a challenge for U.S. lawmakers and regulators. Conglomerates can work around the restrictions imposed upon them by incorporating subsidiaries in foreign countries and moving production facilities or services centers out of the United States. Doubtless, such actions could be disadvantageous to the local economy.

It should be noted, however, that shifting activities to foreign countries where costs are lower reduces prices for American consumers and creates jobs in foreign markets. Hence, it is unclear in the abstract if the net effect of international conglomerates is negative or positive, causing heated debate among economists.[350] Furthermore, it is important to underscore two additional points about the challenge of cross-border operations. First, this challenge is not unique to corporate empires. It is equally possible to incorporate standalone corporations in foreign countries to take advantage of the laxer regulatory regimes or favorable tax treatment they offer. In fact, it is not even necessary to set up a separate entity to take advantage of lower costs abroad; it is possible to realize cost-savings contractually by formalizing agreements with foreign businesses. Second, incorporation in foreign countries with more lenient legal and tax regimes than those of the United States is only a problem if it imposes negative externalities in the United States by exposing American citizens to risk or harm. The upshot of the discussion is that the use of foreign subsidiaries is mainly problematic insofar as it exposes individuals or the environment to an increased risk of harm.

Although we readily admit that there is no easy solution to the challenge of cross-border operations, lawmakers have an impressive array of tools to

349. DELOITTE, GOVERNANCE OF SUBSIDIARIES: A SURVEY OF GLOBAL COMPANIES 10 (2013), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/risk/Corporate%20Governance/in-gc-governance-of-subsidiaries-a-survey-of-global-companies-noexp.pdf [https://perma.cc/79P5-XKNQ].

350. *See, e.g.*, Timothy R. Burch & Vikram Nanda, *Divisional Diversity and the Conglomerate Discount: Evidence from Spinoffs*, 70 J. FIN. ECON. 69, 92–93 (2003); Manuel Amman, Daniel Hoechle & Markus Schmid, *Is There Really No Conglomerate Discount?*, 39 J. BUS. FIN. & ACCT. 264, 286 (2012); Silvia Bressan & Alex Weissensteiner, *The Financial Conglomerate Discount: Insights from Stock Return Skewness*, INT'L REV. FIN. ANALYSIS, Feb. 6, 2021, at 1, 1.

address it.[351] First, the sheer size of the U.S. market confers upon American lawmakers' powers that their peers in most other countries do not have. Legislators and regulators can impose *de facto* standards for the rest of the world. Consider the well-known California Effect. Given the size of the California market, the regulatory settings adopted by California often become the de facto standards for all other states.[352] It does not make economic sense for local and foreign manufacturers to establish two types of products, one for California and the other for the rest of the country.

Similarly, if the United States does not trust the approval process of new drugs or food products in another country, it can simply bar importation of said goods until they receive the imprimatur of the Food and Drug Administration ("FDA"). Occasionally, it will not even be necessary to bar importation; the mere fact that the FDA did not approve a certain product may itself deter consumers from purchasing it. A similar strategy can be employed for other goods and services. Hypothetically, at least, the SEC or IRS could establish two reporting protocols, one for corporations that use accounting firms that are certified in the United States and one for those that do not. Similarly, the Federal Reserve may restrict or block the ability of foreign corporations to engage in correspondent banking in the United States.

Second, in appropriate cases, the United States can enact laws that enable it to extend its jurisdiction to foreign territories, as exemplified by the FCPA. Section 3 of the FCPA criminalizes the bribing of officials in foreign countries. This provision formed the basis for commencing enforcement actions against corporations and imposing serious fines upon them.

Third, the United States can combat harmful practices undertaken by conglomerates by cooperating with other sovereigns. Tax scholars have suggested that the response to tax evasion by conglomerates should come in the form of harmonization. An attempt at orchestrating such a response can be found in the OECD countries' attempt to establish a minimum tax rate on corporate earnings.[353] The goal of the measure was to battle base erosion and profit shifting ("BEPS"). It banned the practice known as the "double Irish,"

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351. There are also constraints and limits on regulatory arbitrage. For further reading, see generally Elizabeth Pollman, *Tech, Regulatory Arbitrage, and Limits*, 20 EUR. BUS. ORG. L. REV. 567 (2019).

352. *See, e.g.*, Remi Moncel, *Cooperating Alone: The Global Reach of U.S. Regulations on Conflict Minerals*, 34 BERKELEY J. INT'L L. 216, 231 (2016) ("[David] Vogel observed that from the 1970s to 1990s, California regularly set the country's most stringent automobile emission standards, after which other states and the federal government would raise their own standards to California's level. He termed this 'ratcheting upward of regulatory standards' across political jurisdictions the 'California Effect.'" (footnote omitted) (quoting DAVID VOGEL, TRADING UP: CONSUMER AND ENVIRONMENTAL REGULATION IN A GLOBAL ECONOMY 259 (1995)).

353. ORG. FOR ECON. CO-OPERATION AND DEV., PUBLIC CONSULTATION DOCUMENT: GLOBAL ANTI-BASE EROSION PROPOSAL ("GLOBE") – PILLAR TWO 30 (2019), https://web-archive.oecd.org/2019-11-13/533178-public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf [https://perma.cc/QR92-VM7Q].

that was used by Apple, Google, and Facebook (now Meta), to shift profits from high tax jurisdictions to low-tax jurisdictions through the utilization of Irish subsidiaries.[354] Multinational cooperation is difficult to achieve not only because coordination costs are high, but also because certain countries will always have an incentive to defect.[355] However, the United States can use its international clout to induce cooperation.

Fourth, and finally, the American public and private financial institutions can—and do—play an important role in combatting illegal and unethical practices of international conglomerates. In the age of networks, the public wields unprecedented power. Members of the public can use modern communication technology to voice concern over unethical business and labor practices, and in appropriate cases, may even call for the imposition of boycotts on international conglomerates. The recent consumer boycotts of Nike and H&M are vivid examples.[356] Conglomerates can ill afford to ignore the power of public sentiment. This is a lesson that Facebook learned the hard way, after initially resisting public pressure to change its ad policy, but ultimately realizing that it is a losing strategy.

Institutional investors and stock exchanges can also influence the behavior of conglomerates. Institutional investors can do so through guidelines; stock exchanges can do it via their listing rules.[357] The power of institutional investors and stock exchanges was demonstrated in the campaign to diversify corporate boards. The impetus for the change came from the "Big Three"—BlackRock, Vanguard, and State Street.[358] It was capped by Nasdaq's change of its rules to require listed companies to have "at least one director who self-identifies as female and at least one director who self-identifies as either an Underrepresented Minority [sic] or LGBTQ+," or explain why no such directors exist.[359] Similar initiatives can be considered to induce conglomerates

354. Sam Schechner, *Tax Change Aims to Lure Intellectual Property Back to the U.S.*, WALL ST. J. (Jan. 24, 2018, 5:30 AM), https://www.wsj.com/articles/companies-explore-whether-u-s-can-replace-double-irish-1516789801 (on file with the *Iowa Law Review*).

355. Ireland provides a vivid illustration of this difficulty. Ireland joined the BEPS project but found other creative ways for offering low effective taxes to U.S. corporations.

356. *See, e.g.*, Ian Bremmer, *Facing Boycotts H&M and Nike Are Learning the New Price of Doing Business in China*, TIME (Apr. 1, 2021, 5:24 AM), https://time.com/5951759/china-boycotts-nike-hm [https://perma.cc/X3X2-M4AY] (explaining how these firms face boycotts because of reports of widespread human-rights abuses and forced labor in China's Xinjiang province).

357. Asaf Eckstein, *The Rise of Corporate Guidelines in the United States, 2005–2021: Theory and Evidence*, 98 IND. L. J. 921, 925–28, 934 (2023).

358. Michal Barzuza & Gideon Parchomovsky, *An Economic Theory of Board Diversity* 11–15 (Working Paper, 2023) (on file with the authors); *see also* Ross Kerber & Jessica DiNapoli, *BlackRock Adds Diversity Target for U.S. Boardrooms*, REUTERS (Dec. 18, 2021, 5:05 PM), https://www.reuters.com/markets/us/blackrock-adds-diversity-target-us-boardrooms-2021-12-14 [https://perma.cc/5QB8-SHNH] (noting growing trend of pushing for board diversification).

359. Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, to Adopt Listing Rules Related to Board Diversity and to Offer Certain Listed Companies Access to a

to adopt fair employment practices, clean production technologies, and a safe work environment.

Conclusion

In this Article, we shined a spotlight on the corporate empires, the largest corporate entities that constitute a considerable percentage of all largely traded corporations. These denizens of the corporate realm occupy a substantial percentage of its space but undeservedly receive little scholarly attention. Conglomerates and corporate groups have been the main engine of economic activity in the U.S. economy and worldwide. Virtually all the largest corporations proudly bear the badge of corporate empires. From a legal standpoint, conglomerates pose challenges different in degree and in kind from standalone corporations. What differentiates them from single corporations is not only the scale and scope of their operations and their international business presence, but also the delicate web of inter-firm ties they display. For all these reasons, conglomerates call for a distinct legal approach that is sensitive to their unique characteristics. Our goal was to lay out the foundations of conglomerate law. While it is not impossible to develop every last detail of the legal approach to conglomerates in a single article, we addressed the most fundamental facets that have preoccupied conglomerate and corporate law scholars, offering a new approach to each. Our guiding principle was to try to preserve the economic benefits of conglomerates while minimizing the costs. Specifically, we redesigned the doctrines of liability and veil-piercing in conglomerates and corporate groups, proposed a different design of fiduciary duties in wholly owned subsidiaries, refined the legal regime to oversight liability, and advanced a multivariegated approach to the challenge of cross-border activities. To this end, we deployed legal tools not only from within corporate law but also private law doctrines and tax and regulatory instruments. It is our hope that the foundations we laid in this Article will provide a basis for a new body of law that is specifically designed for corporate empires.

Complimentary Board Recruiting Service, 86 Fed. Reg. 44424, 44424–25 (Aug. 6, 2021); *see also Nasdaq to Advance Diversity Through New Proposed Listing Requirements*, NASDAQ (Dec. 1, 2020, 7:15 AM), https://www.nasdaq.com/press-release/nasdaq-to-advance-diversity-through-new-proposed-listing-requirements-2020-12-01 (on file with *Iowa Law Review*). The final rule was amended to allow firms with small boards (five or fewer board members) to have only one minority director. Order Approving Proposed Rule Changes, 86 Fed. Reg. at 44426 & n.25.