Piercing the Corporate Veil in the United States: New York Taxicabs and Other Scary Adventures

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1. Introduction

"Piercing the corporate veil" is a major concern for European, Asian, Latin American and other non-U.S. companies that do business in the U.S. through a U.S. subsidiary. The foreign parent company may fear that it will be "dragged" into U.S. litigation and be held liable for the actions of its U.S. subsidiary. Indeed, many plaintiffs' lawyers attempt to do just that in an effort to extract a higher settlement.

This article discusses the circumstances under which, under U.S. law, a parent or sister company may be liable for actions of another group member based on the relationship between the two companies. We do not discuss situations where such liability results from the parent or sister company's voluntary participation in a transaction or another consensual act (*e.g.*, the promise to be a guarantor of certain contractual obligations of a subsidiary). The limited length of this article does not allow us to provide a complete overview of the topic. Therefore, we do not deal with, for instance, the problems of corporate groups under bankruptcy and insolvency law, corporate groups linked by contract but not by stock ownership (*e.g.*, franchise agreements), or the difficulties that arise in litigations involving corporate groups.

We also discuss another context in which "piercing the corporate veil" plays an important role: that is, in determining whether a foreign parent company is subject to legal jurisdiction in the United States as a result of its ownership of the subsidiary corporation.

We conclude with some practical precautions that a parent of a corporate group can take to protect itself from the liabilities of its subsidiaries.

In this article, we provide the reader with a brief introduction to the United States legal system and overview of the law relating to corporate groups. In particular, we discuss the circumstances under which a parent or sister subsidiary

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1 This article is for informational purposes only and is not intended to be relied upon as legal advice. For more information on the matters discussed in this article, please contact the authors. Certain portions of this article are based in part on *Report from the United States* by Jan J.H. Joosten and Robert R. Hardy, which appeared in Volume 4, Issue 5 of *European Company Law.* We thank our summer associate Daniel Nuzzaci, who assisted with research and writing.

corporation of a corporate group may be held liable for actions of another group member based on the relationship between the two companies.

2. The United States Legal System

In order to fully appreciate the U.S. approach to "piercing the corporate veil", it is helpful to recognize some of the features and idiosyncrasies of the American legal system, many of which are unique compared to other legal systems around the world.

The American legal system developed as a product of the English common law. Consequently, judge-made case law is ubiquitous and American jurisprudence relies heavily on the principle of *stare decisis*, or respect for judicial precedent. Notwithstanding the judiciary's power to create common law, however, all case law must comply with the United States Constitution. Despite its inception in the English common law, the U.S. legal system has diverged from its ancestral roots in many ways. We list below a few characteristic aspects of the United States legal system that play important roles in corporate litigation:

- *Juries are one of the hallmark features of the American legal system.* In the United States, juries generally decide issues of fact and assess witness credibility, while judges decide issues of law. Juries are composed of ordinary citizens and, typically, contain between six to twelve members. The jury selection process varies by jurisdiction, but traditionally involves a process called *voir dire*, which allows the parties to eliminate jurors from a larger jury pool who are biased or unable to serve. In most jurisdictions, parties also receive a limited number of peremptory strikes, which allows them to eliminate a juror from the pool without providing a reason.
- *Contingency fees are permitted in the United States.* In the United States, attorneys working for plaintiffs (commonly referred to as "plaintiffs' lawyers") may work on a contingency basis. Under this system, plaintiffs do not pay their attorneys unless their case is won or a settlement is reached, at which point the attorney receives a pre-negotiated percentage of the winnings, typically between 20% and 40%. Although permitted, the contingency fee system remains somewhat controversial. Proponents of the contingency fee arrangement argue that it permits equal access to the courts and justice system, since it allows those of modest means to bring high-stakes lawsuits. Conversely, critics of the system argue that it promotes speculative litigation and encourages frivolous lawsuits by imposing no burden on those plaintiffs who lose.
- *The loser does not pay.* Unlike many non-U.S. jurisdictions, where the loser of a lawsuit is required to pay some or all litigation costs of the winner, the United States does generally not require losers to bear any of the defendant's litigation costs. The court does have discretion, however, to punish a litigant by ordering

him to pay some of the opponent's litigation costs if the court believes the lawsuit to be frivolous or in cases of extreme misconduct.[2]

- *Discovery is an important part of litigation.* Once a lawsuit has begun, each party may request information (*i.e.*, witness testimony, documents, internal and external emails, etc.) pertinent to the lawsuit through a process called pre-trial discovery; the other side is then required to produce this information.[3] While there are some limitations on the type of materials that litigants can obtain from their opponents (*e.g.*, attorney work product and privileged information need not be disclosed), the inclination in the American legal system is towards full disclosure. Discovery typically accounts for a substantial portion of total litigation costs; one study found that, in 2008, Fortune 200 companies spent on average $620,000 per case in discovery litigation costs alone. [4]
- *Qui tam lawsuits allow private citizens to bring suit on behalf of the government.* Under the *qui tam* provisions of the federal False Claims Act, private citizens may bring a civil action in the name of the federal government in cases of fraud against the government.[5] *Qui tam* suits align government interests with private interests and incentivize citizens to act as "whistle-blowers" by awarding up to 30% of damages, plus reasonable attorneys' fees, to private parties who initiate these lawsuits.[6] For example, in 2012 Maersk settled a lawsuit that alleged it had overcharged shipments to U.S. military forces in Afghanistan and Iraq for $31.9 million. The whistleblower who had initiated the suit, Jerry Brown, was entitled to $3.6 million of that settlement.[7] Like contingency fee arrangements, *qui tam* suits remain somewhat controversial in the United States, as supporters contend that they are necessary to protect the government against fraud, while critics argue that they stimulate frivolous lawsuits.

3. Corporate Limited Liability

American corporation law is based on the principle that each corporation is a separate legal person, with its own rights and obligations distinct from those of its shareholders, and on the principle of corporate limited liability. The latter principle holds that shareholders (whether individuals or entities, such as parent corporations) are not responsible in law for the acts or obligations of the corporation in which they hold shares. The liability of a shareholder is thus limited to losing the

2 Fed. R. Civ. P. 11.
3 Fed. R. Civ. P. 26.
4 Lawyers for Civil Justice, Civil Justice Reform Group, *Litigation Cost Survey of Major Companies*, U.S. Chamber Inst. for Legal Reform 15 (2010).
5 31 U.S.C. § 3730(b)(1) (2010) ("A person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government.").
6 Christina Orsini Broderick, Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 Colum. L. Rev. 949, 953 (2007).
7 Press release, U.S. Dep't of Justice, Maersk Line to Pay US $31.9 Million to Resolve False Claims Allegations for Inflated Shipping Costs to Military in Afghanistan and Iraq (Jan. 3, 2012) (available at http://www.justice.gov/opa/pr/2012/January/12-civ-002.html).

value of his shares. For example, the Delaware General Corporation Law[8] provides that, except as a corporation may otherwise provide in its certificate of incorporation,

> "the stockholders of a corporation shall not be personally liable for the payment of the corporation's debts except as they may be liable by reason of their own conduct or acts."[9]

The "except" is important, because status as a shareholder does not immunize the shareholder from personal liability if he independently engages in or participates with the corporation in a wrongful act.

These doctrines of separate personality and limited liability also apply to corporations that are part of a corporate group or business enterprise.[10] In a number of areas, however, American law has found the automatic application of these doctrines unacceptable. Courts and legislatures have developed a variety of approaches permitting the attribution of legal responsibility for a corporation's obligations to the other members of its corporate group. According to some commentators, this attribution of rights and responsibilities from one actor in a common economic enterprise to another in particular settings represents the "emerging law of corporate groups."[11]

A. Separate Identity of Parent and Subsidiary: the Corporate Veil

The chief condition under which a shareholder enjoys corporate limited liability is that the shareholder must respect the separate corporate identity of the corporation, and must not abuse it. A shareholder who uses a corporation as a private purse, for example, making no distinction between the corporation's funds and his own, is likely to find that the corporation's creditors are not required to make that distinction either.

The principle of corporate limited liability tends to assume practical importance in several situations: (i) where the corporation lacks sufficient assets to meet its obligations or to pay a judgment; (ii) where an adversary in litigation seeks to obtain personal jurisdiction over a parent based on the presence in the U.S. of the subsidiary (or vice versa); (iii) where a litigation adversary of a subsidiary seeks information from its parent through the process of civil discovery; (iv) where an adversary seeks to bind a parent to a judgment against a subsidiary; and (v) where an adversary seeks to recover punitive damages scaled to the assets of the parent, rather than just those of the subsidiary.

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8 Business corporations in the United States are organized under state law, with each state having its own business corporation statute. The most popular state of incorporation is Delaware. Both the statutes and the judicial decisions relating to corporation law vary to some extent from state to state. This article provides a synthesis of the prevailing American view on the matters discussed.

9 Del. Code Ann. Tit. 8, § 102(b)(6).

10 There is no generally accepted definition of a "corporate group" in the United States.

11 *See* Phillip I. Blumberg et al., *Blumberg on Corporate Groups* § 6.02, at 7 (Aspen Publishers, 2d ed. Supp. 2009).

Any of these situations may lead an adversary to attempt to penetrate the limited liability of a corporation through a process known as “piercing the corporate veil”. This requires the adversary to persuade a court to disregard the separate identities of corporation and parent/shareholder for one of the purposes just enumerated. The classic example, found in some early cases, is the fleet of taxicabs in which each automobile is owned by a separate corporation, each of which has no asset other than the automobile.[12] A plaintiff injured by one taxi would try to obtain compensation from the assets of the shareholder controlling the entire fleet, on the ground that it would be unfair to allow the shareholder, as the real owner of the taxi, to avoid paying for the injury. The plaintiff would often be successful if the shareholder had been careless about preserving the distinct identities of the corporations he controlled, and if it seemed unfair, to allow him to escape liability.

Whether a plaintiff today can persuade a court to look past the corporation with which the plaintiff is in contact, and allow him to reach the parent (or shareholder), turns on the specific facts of the case. Modern American jurisprudence requires that a plaintiff show three elements to pierce the corporate veil: (1) lack of independent existence between the subsidiary and parent, disregard of corporate formalities, or excessive exercise of control, (2) abuse of the corporate form in pursuit of a fraudulent purpose, and (3) a causal relationship to the plaintiff’s loss.[13] The first element contemplates a lack of real-world existence of the subsidiary resulting from an exercise by the parent of such a high degree of control over the affairs of the subsidiary that it is reduced to a “mere agency” of the parent, comparable to a division.[14] The courts have in this regard spoken in terms of the subsidiary being a “mere instrumentality”, “alter ego”, “puppet”, “sham” or “adjunct” of the parent corporation.[15] The second element is a use by the parent of the subsidiary for an improper purpose that amounts to an abuse of the privilege of carrying on business as a corporation.[16] The final factor requires a plaintiff to show a causal connection between the defendant’s wrongful act and the injury sustained by the plaintiff.

12 *See*, *e.g.*, Walkovszky v. Carlton, 223 N.E.2d 6 (N.Y. 1966).

13 *See* Phillip I. Blumberg et al., *Blumberg on Corporate Groups* § 10.03[B], at 8 (Aspen Publishers, 2d ed. Supp. 2013-2).
Traditionally, the United States distinguishes between three principal variants in veil piercing: the “alter ego” doctrine, the “instrumentality” doctrine, and the “identity” doctrine. Some authors believe that, in spite of different formulations, these doctrines are essentially the same. *See, e.g.*, Karen Vandekerckhove, *Piercing the Corporate Veil: A Transnational Approach*, 78 (Alphen aan den Rijn: Kluwer Law International) (2007).

14 *See* Phillip I. Blumberg et al., *Blumberg on Corporate Groups* § 10.03[B], at 8 (Aspen Publishers, 2d ed. Supp. 2013-2).

15 Phillip I. Blumberg., *Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity*, 24 Hastings Int’l & Comp. L. Rev. 297, 307 (2001) [hereinafter *Multinational Corporations*].

16 *See Oddenino & Gaule v. United Fin. Group*, No. 98-55431, 1999 U.S. App. LEXIS 29506, at *3 (9th Cir. Nov. 4, 1999) (“an inequitable result arises when the existence of an unsatisfied creditor is coupled with an abuse of the corporate form, such as a misrepresentation of the corporate structure to creditors or undercapitalization”).
Courts are divided as to whether bad faith is required to fulfill the second element of the test. *See, e.g.*, *RRX Indus. Inc. v. Lab-Con, Inc.*, 772 F.2d 543, 546 (9th Cir. 1985) (holding that bad faith is not essential); *but see, e.g.*, *Cambridge Elecs. Corp. v. MGA Elecs.*, 227 F.R.D. 313, 331 (C.D. Cal. 2004) (“California courts generally require some evidence of bad faith conduct.”).

Although not explicitly listed in many judicial articulations of the veil-piercing test, courts always require proof of causation when it is placed in controversy.

Occasionally, courts have considered a second test in determining whether to pierce the corporate veil. This test, known as the "undercapitalization" or "inadequate capitalization" theory, requires a plaintiff to show that a parent corporation or corporate group has intentionally established its subsidiary with insufficient capital to meet expected liabilities of the business they are conducting.[17] Although this theory has been rejected as a stand-alone *per se* test in numerous jurisdictions, many courts consider it a relevant factor in their veil-piercing analyses.[18]

Piercing the corporate veil is an extreme step, which U.S. courts take rarely and reluctantly. As a practical matter, a parent corporation runs a higher risk of exposure if it or its personnel participate in or interfere with the activities of a subsidiary outside of normal corporate channels. For example, if personnel of the parent who do not have positions with the subsidiary attend meetings or otherwise interact with third persons on matters related to the subsidiary's business, that participation could be enough to expose the parent to a claim, based on the parent's own conduct, arising out of any resulting transaction.

Some commentators have argued that, when seeking to pierce the corporate veil, contract creditors should carry a heavier burden of proof than that required from plaintiffs in tort cases.[19] Proponents of this double standard claim that such a policy promotes corporate limited liability's historical justification of encouraging investment and also has economic substantiation because contract creditors have a prior opportunity to investigate the financial situation of corporations with whom they deal and to adjust their terms and conditions (*e.g.*, interest rates) accordingly.[20] Despite these well-founded arguments, courts have traditionally refused to distinguish between contract and tort creditors in veil-piercing cases.[21] However, there has been an increasing trend towards veil piercing in toxic tort cases in the federal court system.[22]

There is no uniform law on veil piercing in the United States. Federal law and the laws of the different states have different veil-piercing doctrines, and similar fact patterns may give rise to contradictory results.[23]

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17 Stephen B. Presser, *Piercing the Corporate Veil* 67 (Thomson Reuters, 2014 ed.).

18 *Id.* at 69.

19 *See, e.g.*, *id* at 87-99; *see also* Robert W. Hamilton et al., *Cases and Materials on Corporations Including Partnerships and Limited Partnerships* 281-282 (West Publishing Co., 5th ed. 1994).

20 Presser, *supra* note 17, at 88.

21 *See* Phillip I. Blumberg et al., *Blumberg on Corporate Groups* § 58.02[G], at 15 (Aspen Publishers, 2nd Ed. Supp. 2012-1) ("This illustrates vividly the indiscriminate application of the concepts of traditional piercing-the-veil jurisprudence without regard to the nature of the particular area of law in issue.").

22 Presser, *supra* note 17, at 100.

23 *Multinational Corporations*, *supra* note 15, at 307 ("This is one of the most unsatisfactory areas of the law. With hundreds of irreconcilable decisions and shifting rationales, it functions in an almost inscrutable manner.").

B. *Collective Operation of a Single Integrated Enterprise Doctrines*

In addition to the piercing doctrines, there is a second set of doctrines that support the disregard of the entity view. These doctrines attribute legal rights and obligations to the corporate enterprise and its components solely on the basis of the existence of a common business, control and extensive integration of operations, and management of the enterprise. These doctrines include: (i) the single business enterprise doctrine, (ii) the intragroup decentralization and delegation doctrine, (iii) the fragmentation of the enterprise doctrine, and (iv) the enterprise doctrine.[24] Most of these doctrines have been accepted only in a limited number of jurisdictions or have been applied only with respect to specific subject matters.

C. *Agency and Quasi-Agency*

Common-law agency provides an alternative route to imposition of liability on a parent corporation for acts of its subsidiary. In a parent-subsidiary relationship, however, an agency relationship satisfying the common-law requirements seldom arises. This is because the common law requires not only control, but also, *inter alia*, a consensual transaction (the parties must agree that the subsidiary (the agent) is acting for the parent (the principal)).

The courts of a number of states have recognized a "quasi-agency" relationship for purposes of attributive intragroup jurisdiction in situations where the common law standards are not met.[25] Under this quasi-agency theory, these courts uphold attributive jurisdiction in the group setting on the basis of excessive control alone.

D. *Legislation*

There have also been legislative efforts to introduce or reinforce group liability. Especially since the 1930s, Congress has increasingly defined the scope of statutes and administrative regulations in functional terms, instead of conceptual terms, through introduction of the concept of control and the imposition of liability on controlling persons for statutory violations of members of the group.[26] For example, under the Federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), parent corporations can be held liable for the toxic waste cleanup expenses of their subsidiaries under one of two theories.[27] First, corporations can be held liable under a derivative theory of liability when

24 Phillip I. Blumberg et al., *Blumberg on Corporate Groups* § 10.03[E], at 11 (Aspen Publishers, 2d ed. 2005).
25 *Id.* at § 10.04[B], at 14.
26 *Multinational Corporations*, *supra* note 15, at 311-16 (citing examples such as the Securities Act of 1933, the Securities and Exchange Act of 1934, the Foreign Corrupt Practices Act, the Age Discrimination in Employment Act and the Americans with Disabilities Act).
27 James T. O'Reilly, *Superfund & Brownfields Cleanup* § 8.13 (West 2013 ed.). *See also U.S. v. Bestfoods*, 524 U.S. 51 (1998) (holding that parent corporations can be held liable under CERCLA on either a derivative theory of liability or a direct theory of liability).

traditional corporate veil piercing is warranted. Second, corporations can also be held liable under a direct theory of liability when the parent corporation has demonstrated significant involvement and control in operating its subsidiary's facility. Similarly, under the Federal Foreign Corrupt Practices Act ("FCPA"), American corporations and other corporations subject to the FCPA have been held liable for the abuses of their subsidiaries under theories of agency, piercing the corporate veil, and successor liability.[28]

Many states have done the same with numerous insurance regulatory statutes and other statutes, particularly those regulating sale and distribution of alcoholic beverages and the conduct of gambling enterprises.

4. Foreign Parent Companies with U.S. Subsidiaries: Personal Jurisdiction

In order to pierce the corporate veil and hold a parent company liable, a U.S. court will need to establish that it has personal jurisdiction over the parent company. In a domestic context, this may be relatively straightforward. In the case of a foreign parent company, however, personal jurisdiction is not always easy to establish. This is good news from the perspective of foreign parent companies.

To establish personal jurisdiction over a non-resident defendant, the plaintiff must show that the defendant received adequate notice of the lawsuit and that exercise of jurisdiction over the defendant comports with traditional notions of fair play and substantial justice. The exercise of jurisdiction must be consistent with the due process requirements of the U.S. Constitution.

A court can exercise either general jurisdiction or specific jurisdiction over a defendant.

A. General Jurisdiction

To establish general jurisdiction over a defendant corporation, the plaintiff must show that the defendant engages in continuous and systematic conduct in the forum state such that it would not be unfair to hail it into court there.[29] A court finding of general jurisdiction over a defendant corporation means that the court can exercise jurisdiction over the defendant for any cause of action within that court's subject matter jurisdiction. Furthermore, it means that the defendant corporation can be sued in the forum state for conduct occurring anywhere in the world. In recent years, the U.S. Supreme Court has greatly narrowed the applicability of general jurisdiction. In its 2011 decision *Goodyear Dunlop Tires Operations, S.A. v. Brown*,[30] the Supreme Court held a finding of general jurisdiction is only

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28 Evan P. Lestelle, Comment, *The Foreign Corrupt Practices Act, International Norms of Foreign Public Bribery, and Extraterritorial Jurisdiction*, 83 Tul. L. Rev. 527, 533 (2008).
29 *Int'l Shoe Co. v. State of Wash.*, 326 U.S. 310, 317 (1945).
30 131 S. Ct. 2846 (2011).

permitted if a corporation is "at home" in the forum state. Merely doing business in a state is not sufficient to be considered "at home" there. The Supreme Court recently further clarified and narrowed the constitutional limitations of general jurisdiction in *Daimler AG v. Bauman.*[31]

In *Bauman*, a group of Argentinian plaintiffs brought suit against Daimler AG, a German corporation, in the U.S. District Court for the Northern District of California based on the tortious acts of Daimler's Argentinian subsidiary. Plaintiffs argued that the California court had general jurisdiction over the German corporation because Daimler's American subsidiary, Mercedes-Benz USA LLC (a Delaware limited liability company, headquartered in New Jersey), did business in California. The court ultimately decided that it would be unjust to hold the German-based corporation accountable in the United States for tortious conduct committed in Argentina, simply because Daimler owned an unrelated American subsidiary that did business in California. Before *Bauman*, a corporate parent might have been subject to general jurisdiction in any state in which its subsidiaries operated. Now, courts can no longer assert jurisdiction over a corporate parent solely based on its subsidiary's presence in the jurisdiction.

Consequently, plaintiffs will find it increasingly difficult to establish general jurisdiction over foreign parent corporations and, thus, more challenging to successfully pierce the corporate veil against foreign defendants. Foreign parent companies should be careful not to create other potential grounds for general jurisdiction, *e.g.*, by doing business in the U.S. directly (without going through their U.S. subsidiary) or by initiating litigation in the U.S. courts.

B. Specific Jurisdiction

Specific jurisdiction is a more narrow form of personal jurisdiction that can arise when a defendant's contacts with the forum state are not sufficiently continuous and systematic to give rise to general jurisdiction, but give rise to the liabilities forming the basis of the lawsuit.[32] Through a state's "long-arm" statute, state and federal courts within the state's physical boundaries can exercise jurisdiction over a foreign parent corporation based on the American subsidiary's specific contacts with the state that gave rise to the lawsuit. Long-arm statutes vary between states, but they typically allow courts to exercise specific personal jurisdiction when the lawsuit arises from: (1) the defendant's actions in the forum state or (2) the plaintiff's injury in the forum state.

The test for specific jurisdiction affords plaintiffs several procedural advantages. For example, the necessary contacts a plaintiff must demonstrate for the court to exercise specific jurisdiction over a defendant are much lower than those needed to assert general jurisdiction. Additionally, plaintiffs need not show that the

31 134 S. Ct. 746 (2014).
32 *Bauman*, 134 S. Ct. at 761 ("jurisdiction can be asserted where a corporation's in-state activities are not only 'continuous and systematic, but also give rise to the liabilities sued on'") (citing *Int'l Shoe*, 326 U.S. at 317 (1945)).

subsidiary or the parent company is incorporated or has its principal place of business in the forum state. In return for these advantages, however, plaintiffs are limited to bringing lawsuits specifically deriving from conduct or occurrences within the forum state. Ultimately, the procedural strategy used by plaintiffs seeking to reach the deep pockets of foreign corporate defendants will rely heavily on the facts of the case. Parent corporations should prepare for these lawsuits by limiting their contacts with forum states they do not wish to litigate in and by observing corporate formalities designed to ensure limited liability.

5. Practical Precautions

A parent company may wish to take precautions to protect itself from the liabilities of its U.S. subsidiaries, both to avoid providing any basis for piercing the corporate veil, and to guard against liability on the basis of any of the other doctrines discussed in this article. Such precautions could include:

- *Leaving the business of the subsidiary to the subsidiary.* To the extent possible, the affairs of the subsidiary should be dealt with by personnel on the payroll of the subsidiary, rather than by personnel of the parent. The subsidiary should also be able to explain what its business is, and how it differs from its parent's.
- *Allowing the subsidiary to make decisions by a process that follows normal corporate structures of decision-making.* For example, to the extent that the parent can put a structure in place that allows it to exercise its power by voting its shares to elect directors, rather than by interfering directly in the subsidiary's day-to-day management, it will make the parent/subsidiary distinction clearer.
- *Keeping the subsidiary's funds separate from those of the parent.* Nothing makes a court more suspicious of the separate corporate identity of a subsidiary than the perception that the parent has used the subsidiary's funds as though they were its own. Parent and subsidiary may use the same bank, but should have separate accounts. Both companies should account carefully for any transfers of funds between the companies. Assets of one company should not be used to secure loans to another, and repayment should always be made to the entity from which the funds came.
- *Properly capitalizing the subsidiary.* A subsidiary should have (or have access to) enough capital to carry on its business and meet its normal obligations.
- *Insuring the subsidiary adequately.* Probably the single most effective protective measure that a subsidiary can take to protect its parent is to carry enough insurance to cover any claim that it can reasonably anticipate.
- *Properly identifying the subsidiary.* All contracts and correspondence should make it clear which corporation is engaging in any particular piece of business. Letterhead of the subsidiary should always be used for the subsidiary's business. The subsidiary should hold any necessary licenses and should make any required registrations in its own name.
- *Identifying personnel properly.* It may well be necessary for business reasons for one person to exercise functions for both the parent and the subsidiary, but

anyone who does so should have been properly appointed or elected to an appropriate position with the subsidiary. Such a person should take care to make it clear both to outsiders (by, for example, using the correct business card) and to others in the company when he is acting for the parent and when he is acting for the subsidiary. No one other than an officer or other properly designated agent of the subsidiary should ever sign a contract or other legal document on behalf of the subsidiary.

- *Organizing the management of the subsidiary.* To the extent possible, the directors and officers of the subsidiary should not all be the same as those of the parent.
- *Keeping proper records of corporate decision-making.* Certain decisions must be made by the subsidiary's board of directors, such as election of officers and appointment of auditors. The subsidiary should keep contemporaneous records that will permit it to show that its board of directors has held meetings to make such decisions, or that it has acted by unanimous written consent where that is appropriate.
- *Providing any centralized services in such a way as not to suggest improper control.* It is perfectly proper for a parent company to provide centralized services (such as finance or data processing) to its subsidiaries. However, the parent company should do so in a way that provides a service, not that disguises control, and it should charge related expenses to the entity that has received the service. A parent company may also want to manage contacts with financial institutions or lawyers centrally, on behalf of all subsidiaries. This should not present a problem, but it is advisable for the parent to do this as a service to its subsidiaries under the terms of an agreement between them, or for the person acting on behalf of the subsidiary to have a position with the subsidiary in addition to whatever position he holds with the parent.