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Subsidiary: Doctrine without a Cause?

Cover Page Footnote
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THE SUBSIDIARY: DOCTRINE WITHOUT A CAUSE?

JOSEPH H. SOMMER*

INTRODUCTION

The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.¹

JUDGE Cardozo's observation is as accurate today as it was sixty years ago. The subsidiary corporation² is still misunderstood. It is commonly observed that the subsidiary organization exists to limit liability among affiliated corporations. This observation, however, is normatively wrong because the subsidiary's role in limiting liability is economically inefficient.³ In a more positive vein, the subsidiary is more than a device to limit liability; it is an extraordinarily powerful conflicts device in the law of international business organizations. Indeed, this aspect of the subsidiary is independent of its risk-shifting function.

The subsidiary structure operates as a conflicts device by minimizing the number of forums in which a suit may be brought. A unitary firm that has "minimum contacts"⁴ with several forums is usually subject to jurisdiction in each of these forums. A firm may, however, conduct ac-

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¹ Berkey v. Third Avenue Ry., 244 N.Y. 84, 94, 155 N.E. 58, 61 (1926).
² Here and throughout the paper, "subsidiary" refers to wholly owned subsidiaries.
³ The normative approach of this Article is almost exclusively economic.
⁴ In International Shoe Co. v. Washington, 326 U.S. 310 (1945), the Supreme Court adopted a standard for personal jurisdiction based on a party having "minimum contacts" with a forum. See id. at 316; R. Casad, Jurisdiction in Civil Actions § 2.02[4][b], at 2-22 (1983); J. Friedenthal, M. Kane & A. Miller, Civil Procedure § 3.10, at 123 (1985).

In rejecting International Shoe's claim that it was not subject to personal jurisdiction in Washington, the Court stated:

due process requires only that in order to subject a defendant to a judgment in personam, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice.'

International Shoe, 326 U.S. at 316 (quoting Milliken v. Meyer, 311 U.S. 457, 463 (1940)). Due process is satisfied "by such contacts of the corporation with the . . . forum as make it reasonable . . . to require the corporation to defend the particular suit which is brought there." Id. at 317. Although this test is fuzzy over a broad border, a far larger core of undisputed applications ensures that this doctrine is of immense practical utility.

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tivities in one of these jurisdictions through a subsidiary. If a suit against the firm arises from the subsidiary's activities, the firm is only subject to suit in this one jurisdiction, despite activities in other forums. The subsidiary thus serves a purpose similar to the one served by the forum non conveniens doctrine, but yields far more predictable results. The subsidiary is predominantly a transactional conflicts device, which is very different from the conflicts doctrines employed in litigation. When successful, transactional conflicts devices disguise the transjurisdictional nature of the transaction and break it down into a set of intrajurisdictional transactions, each of which is clearly within the jurisdiction of only one sovereign and can be adjudicated without recourse to the laws of other sovereigns. The most visible transactional conflicts devices are contractual forum and law-selection clauses, which are designed to simplify the judicial conflict-of-law task. Many other such devices exist. Yet successful transactional conflicts devices tend to be invisible to a legal community that gathers its core data from case law.

The subsidiary's conflicts function has been obscured by its grant of limited liability. These two functions are not decoupled in corporate law,

5. "[T]he forum non conveniens doctrine . . . permits a court having jurisdiction over an action to refuse to exercise its jurisdiction when the litigation could be brought more appropriately in another forum." J. Friedenthal, M. Kane & A. Miller, Civil Procedure § 2.17, at 88-89 (citations omitted). The word "appropriately" is what a judge chooses to make of it, and there seems to be no such thing as a straightforward forum non conveniens case. For example, a court's discretion to dismiss on forum non conveniens grounds is usually considered to be conditioned on the existence of an alternative forum having jurisdiction over all parties and having the ability to grant complete relief. See id. at 89. But even this rule, which may be the closest forum non conveniens comes to predictability, is not ironclad. See Islamic Republic of Iran v. Pahlavi, 62 N.Y.2d 474, 482-85, 478 N.Y.S.2d 597, 602-03, 467 N.E.2d 245, 250-51 (1984).

6. See supra notes 4-5; infra notes 129-32, 175-76 and accompanying text.


8. To illustrate the invisibility of the subsidiary's conflicts aspects, consider the business decision to coordinate planning with a supplier. There are three ways to do this: relational contract, purchase of assets to form a unitary organization or purchase of stock to form a subsidiary. All three methods accomplish the same economic goal, which is to replace market with governance incentives. But they have very different legal consequences, not only substantively, but jurisdictionally as well. See, e.g., Rush v. Savchuk, 444 U.S. 320, 329 (1980) (contractual ties alone do not convey jurisdiction); De Beers Consol. Mines, Ltd. v. United States, 325 U.S. 212, 220-22 (1945) (cannot establish antitrust jurisdiction through arm's-length contracting with parties over whom jurisdiction exists). If De Beers had used marketing subsidiaries within the United States, it may well have been subject to United States antitrust law. If it had a unitary organization, the United States would certainly have had jurisdiction. Therefore, choice of organizational form, like choice of domicile, is a transactional conflicts device.

As another example, the creation of a subsidiary is a potent tool in international tax planning. See generally European Ass'n for Legal and Fiscal Studies, Branches and Subsidiaries in the European Common Market: Legal and Tax Aspects 18-19 (2d ed. 1976) ("All the Member States of the Common Market have provided in their legislation for the avoidance, to a greater or lesser extent, of double taxation in regard to profits transferred from subsidiary to parent company . . . ."). The subsidiary plays an analytically different role in domestic tax planning. See infra note 55.
but rather are conjoined in a portmanteau called "subsidiary."\(^9\) Because liability limitation and legal personality are tightly intermingled, business people do not distinguish between lawsuits won due to limited liability and those won because of lack of jurisdiction over the subsidiary. Furthermore, the law of subsidiaries is remarkably contextual and doctrinal, which discourages lawyers from attempting to understand the subsidiary.

This Article attempts to unbundle the package by discussing limitation of liability and legal personality as two separate issues. Because legal personality serves a significant conflicts function and because this Article's analytic techniques (and normative criteria) are chiefly economic, this inquiry involves an economic discussion of conflicts law. The argument is developed in five sections, each standing for a separate proposition.

Section I argues that limited liability within the subsidiary organization cannot be justified using price theory. The analysis is almost exclusively economic and responds to a considerable body of literature. Section II demonstrates that limited liability and the subsidiary concept are distinct doctrines that can be conceptually separated, and are actually separated in the banking industry. The banking industry chooses not to use subsidiaries in circumstances in which other industries employ the device. (When the banking industry does use subsidiaries, they are rather different from those used by industrial corporations). Instead, the banking industry utilizes legal devices that apparently confer legal personality on the subsidiary without conferring limited liability on the parent. As a result, the distinction between the conflicts and limited liability roles of the subsidiary becomes manifest.

Having set the stage for a discussion of the subsidiary's conflicts role in Section II, I embark on a lengthy digression: Section III sketches an economic theory of conflicts. Any reader who is willing to believe that forum shopping is inefficient may skip this section, although it develops a general analytic framework that extends beyond forum shopping. Section IV, the continuation of Section II, demonstrates that the subsidiary is a useful conflicts device. The subsidiary's separate legal personality reduces the costs of forum shopping and helps eliminate inferior adjudicators from consideration.

The first four sections pose a puzzle: limited liability appears inefficient while juridical separateness appears beneficial. But the subsidiary doctrine, as applied by the courts, exalts limited liability and belittles juridical separateness. Assuming that corporate law is generally "efficient," Section V attempts to explain why limited liability has not gone the way of ultra vires\(^10\) and other obsolete corporate doctrines.

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9. They are decoupled only in the obscure "separate entity" doctrine of banking law. See infra notes 60-65 and accompanying text.
I. THE ECONOMICS OF LIMITED LIABILITY

This section demonstrates that the risk-shifting provided by subsidiary limited liability is usually not beneficial. Limited subsidiary liability is not, therefore, justifiable as a general rule of corporate law.

A. Limited Liability As Risk-Shifting

1. Limited Liability and Shareholders

Limited liability is certainly justifiable at the shareholder level, if not at the subsidiary level. The conventional microeconomic explanation for limited liability lies in the enterprise's ability to shift risk to its creditors. The enterprise bears full risk up to a threshold amount, but shifts any additional risk to creditors. Limited liability is therefore an insurance policy against insolvency that the firm's creditors provide to the firm's shareholders. This risk shifting is clearly efficient if the creditors are better insurers than both the shareholders and specialized insurance providers. Creditors are superior insurers in three circumstances: if they are better able to assess or to protect against the risk of insolvency than the shareholders or specialized insurers, if creditors are more risk accepting than the shareholders or if creditors are better able to reduce the cost of bankruptcy.

Creditors are frequently better able to assess default risk than shareholders, especially when shareholders are passive investors in publicly held corporations and creditors are sophisticated institutions, such as

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13. It is important to note that "creditors" is a heterogeneous concept. Many creditors, such as employees and small suppliers, are poor insurers. The worst insurers are involuntary creditors—tort victims. Even some of the better creditors might be poor insurers in a particular situation. For example, bank loan syndications are an acknowledgment by the syndicate members that they cannot efficiently insure alone. Nevertheless, many creditors are better insurers than shareholders and limited shareholder liability is not always an inefficient outcome.
commercial banks or institutional investors. In such cases, creditors are at least as good as outside insurers. Creditors are often more risk-accepting than shareholders, especially when shareholders are private individuals who wish to avoid risking their entire wealth on a single venture. In public corporations, creditor liability is better than shareholder liability in reducing the costs of bankruptcy because it is _ex ante_ cheaper for creditors to swallow their losses than to pursue a large number of shareholders.

A more sophisticated and powerful explanation of shareholder limited liability concentrates on capital market imperfections. Unlimited liability requires that shareholders possess a great amount of information about each other because the value of their shares is affected by their fellow shareholders' creditworthiness. Under unlimited liability, wealthier shareholders, possessing deeper pockets, will raise the value of all other shareholders' stock. Conversely, poorer shareholders will depress the value of other shareholders' stock. If shareholders cannot monitor each others' wealth, adverse selection may result, leading to ownership of shares primarily by the judgment-proof. Limited liability thus makes informationally imperfect public securities markets possible. Of course, if shareholders have some way of monitoring each others' wealth, unlimited liability might be workable. Lloyd's of London provides such an example.

2. Limited Liability and Subsidiaries

These price-theoretic explanations provide strong support for limited liability on behalf of diffuse individual shareholders and some support for limited liability on behalf of close corporations. Price-theoretic explanations do not, however, explain limited liability for sole corporate shareholders.

Risk-shifting arguments are possible but weak. The subsidiary need not be used to compartmentalize the risk of wealthy individuals because a set of separately owned corporations suffices. While it is true that trade creditors might suffer a smaller percentage loss of wealth than parent corporations in the event of subsidiary insolvency, this argument should be counterbalanced by the greater monitoring, contracting and moral hazard costs of the subsidiary structure. Finally, public shareholders (already enjoying limited liability) are _ex hypothesi_ the most risk-accepting stakeholders of the firm, because they receive the residual share.

14. Commentators were at least intuitively aware of this in 1929: "The corporate device has lent itself peculiarly well to the public marketing of securities . . . ." Douglas & Shanks, _Insulation from Liability Through Subsidiary Corporations_, 39 Yale L.J. 193, 193 (1929).

15. Lloyd's is a loose association of underwriters. It insures risk by asking wealthy individuals to invest their assets in a particular insurance pool. The system works only because Lloyd's underwriters can select the investors, thus reducing adverse selection problems.

16. See _infra_ notes 19-28 and accompanying text.
Monitoring arguments are implausible. Certainly, the parent company is best situated to assess the risk of subsidiary default: it possesses far better information than trade or financial creditors. Because no public market in wholly owned subsidiary shares exists, the role of unlimited liability in facilitating securities markets is irrelevant. Special governance arguments favoring limited liability may be adduced in some cases, but they scarcely seem general enough to justify the prevalence of the subsidiary form.

3. Limited Subsidiary Liability Creates Costs in Contract

Not only does the subsidiary form bear few microeconomic advantages, but it is also more costly in some ways than unitary organizations. Subsidiaries are less creditworthy than unitary organizations because there is no guarantee that an individual subsidiary will be run with profit-maximizing intent. The management of the parent firm might choose to strip the subsidiary of its productive assets, absorb them into other parts of the enterprise and leave the subsidiary's creditors to foot the bill upon the subsidiary's bankruptcy. This sort of opportunistic behavior is not easy to control legally because it is difficult to distinguish asset-stripping from the type of asset redeployment that occurs even in non-opportunistically managed subsidiaries. Because sophisticated creditors are aware of this risk, they will take steps to make opportunism less profitable by factoring these costs into any unguaranteed credit they extend to subsidiaries.

17. Note that these arguments hinge on the single ownership of the subsidiary. Multiple ownership decreases the owner's incentives to gather information, increases cross-monitoring costs, and decreases the owners' ability to control the corporation. But cf.: Salomon v. Salomon & Co., 1897 App. Cas. 22, 44-45, 1895-9 All E.R. 33 ("How does it concern the creditor whether the capital of the company is owned by seven persons in equal shares, with the right to an equal share of the profits, or whether it is almost entirely owned by one person, who practically takes the whole of the profits?"). The problems involved in monitoring public corporations were present and known in 1776. See A. Smith, An Inquiry into the Nature and Causes of the Wealth of Nations 700 (E. Cannan ed. 1937).

18. The bank holding company is exemplary. See infra notes 57-59 and accompanying text. Nonrecourse lending, which confers limited liability without the subsidiary, is not unknown, although such lending is usually collateralized. For a particularly sophisticated use of limited liability to reduce sovereign risk, see R. Brealey & S. Myers, Principles of Corporate Finance 751 (2d ed. 1984).

19. This is true for all types of limited liability. See Fischel, The Economics of Lender Liability, 99 Yale L.J. 131, 134 & n.11 (1989). The subsidiary merely exacerbates this problem by permitting a single firm to create multiple opportunities for opportunistic behavior. Reverse asset stripping is also possible. A faltering enterprise may attempt to create a preference in bankruptcy by pushing assets into subsidiaries with favored creditors. This behavior will also be thwarted by unitary liability. Such behavior was well known in 1932. "One of the advantages of this financial secrecy [afforded by consolidated accounts] lies in the opportunities which it gives to directors to manipulate the contractual and financial relations between the subsidiary companies and the holding company." J. Bonbright & G. Means, The Holding Company 35 (1932).

20. See infra text accompanying notes 26-27. If these steps are successful, subsidiaries may well seem to be operating as non-opportunistic separate profit centers. See Pos-
Another problem with opportunism lies in the very nature of the debt contract. A great advantage of using debt rather than equity financing is that debt financing entails far lower monitoring costs. Because equityholders receive the residual share of a firm's profits, debtholders can rely, to a large extent, on the equityholders' self-centered rationality: in order to make a profit, equityholders must pay debtholders. Therefore, debtholders know that equityholders must operate the firm to maximize profit. Debtholders, then, merely have to ensure that the firm is not run in too risky a fashion, and must safeguard against fraud. I do not argue that the decision to extend credit is easy; I simply contend that monitoring an ordinary debt contract, once credit is extended, is fairly straightforward.

The subsidiary corporation, however, is one of the rare business entities that may display altruistic behavior. It is not in business to make money for itself, but rather it exists to generate profits for its parent or its parent's shareholders. This possibility of altruism, or opportunism, makes monitoring the subsidiary more risky (or more expensive) than monitoring a similarly-sized unitary firm.

It is important to distinguish misrepresentation from opportunism. A firm may wish to use the subsidiary to misrepresent its creditworthiness for the purposes of obtaining a loan. Opportunism refers to post-loan behavior (moral hazard) while misrepresentation refers to the debtor's pre-loan condition (adverse selection). Although the subsidiary fosters opportunism, it both increases and decreases the prospects for misrepresentation. The subsidiary's ability to increase misrepresentation is obvious: affiliates have incentives to make creditors believe that they are part of a unitary structure. It is possible, however, for the subsidiary to decrease misrepresentation.

As Posner points out, creditors may be better able to evaluate the creditworthiness of specialized subsidiaries, rather than the creditworthiness of large unitary enterprises. These creditors may have specialized credit-rating skills, or may simply be unable to appropriate the gain from rating a large enterprise when they only have to deal with a small subset of the enterprise. Posner's point is analytically correct, although it tends to underestimate the flexibility of market behavior. There are economies of scale in evaluating the creditworthiness of larger unitary enterprises that many creditors cannot capture. The factoring and debt-rating businesses exist largely to counter this scale problem. More significantly, the beneficiaries of improved subsidiary monitoring are likely to be short-
term creditors, who must worry more about misrepresentation than opportunism. Such creditors are ex hypothesist unwilling to inquire into the financial structure of the other affiliated corporations.

Long-term creditors, however, who have the most to fear from opportunism, generally transact around limited subsidiary liability by forcing debtors to use de facto unitary organization.\textsuperscript{23} Loan agreements typically refer to borrowers and their subsidiaries and lump the debt of these organizations together for calculating indebtedness restrictions.\textsuperscript{24} Only under special circumstances are subsidiaries restricted from the scope of the covenant, particularly when the excluded subsidiary is in the finance business.\textsuperscript{25} Therefore, any short-term creditor who wishes to use its specialized skills (or save work) in monitoring a compartmentalized subset of the business will find limited liability of only limited aid, because it must reckon with the de facto decompartmentalization of liability that long-term creditors may have created.

In this connection, the bank holding company subsidiary is noteworthy. Regulators desire to monitor closely the health of bank subsidiaries within the holding company structure, which may include unregulated nonbanking subsidiaries. Monitoring is done by bank examinations, a task that is analogous to one performed by short-term creditors when they monitor an ordinary subsidiary. Unlike such short-term creditors, however, bank examiners have two backups: one entails examination of the bank holding company while a second method, more significant in this context, is statutory regulation. Bank holding companies are extremely restricted in the sort of interaffiliate credit that they may legally extend. Sections 23A and 23B of the Federal Reserve Act permit banks to give their holding company affiliates only loans fully secured against good collateral, while permitting them to transfer assets only at fair market prices.\textsuperscript{26} Sections 23A and 23B protect bank subsidiary creditors in a way that the nonbanking law governing subsidiaries simply cannot.

As illustrated, the interests of short-term creditors in avoiding misrepresentation through monitoring irreconcilably conflict with the interests of a subsidiary's long-term creditors, who seek to avoid opportunism by extending unsecured credit within the subunits of the holding company. Because long-term creditors are usually more powerful and sophisticated than short-term creditors, they will often win, leaving short-term creditors a de facto unitary structure without their knowledge. A single creditor cannot reverse this problem contractually, although a creditor may demand better terms in a partial effort to transact around limited liabil-

\begin{footnotesize}
\footnote{23. Opportunism of the sort described above is not possible for a unitary organization, which must be run as a profit center to be run rationally.}
\footnote{25. See id. at 1168. The finance industry, especially banking, is characterized by unique rules. See infra notes 26, 57-59 and accompanying text.}
\end{footnotesize}
ity. Banking regulators, who represent the interests of short-term bank depositors, protect them through Sections 23A and 23B and the source-of-strength doctrine, described below in Section II-B. The subsidiary structure is rational only under these very special conditions.

A corporation, then, probably obtains cheaper credit if it does not have intersubsidiary limited liability, or if it guarantees its subsidiary's debts. The two alternatives are functionally identical unless the parent organization faces bankruptcy. Either alternative is superior to limited subsidiary liability.

Despite the credit disadvantages, most industries use the subsidiary form. An entity may wish to employ the subsidiary form for several reasons: to obtain tax benefits, to reduce tort liability or to benefit from the subsidiary's conflicts advantages. The banking industry, however, is sufficiently constrained by credit considerations to avoid using subsidiaries. Bank deposits are generally considered low-risk investments and banks have every incentive to keep them so. Their low risk means that risk-averse depositors (creditors) do not demand a large risk premium, which keeps the cost of a bank's liabilities low. An efficient contract, therefore, shifts as much bank risk as possible onto the bank's stockholders and as little risk as possible onto the depositors.

27. See, e.g., Berle, The Theory of Enterprise Entity, 47 Colum. L. Rev. 343, 356-57 (1947) (subsidiary at disadvantage because it must subordinate its finances to its parent's); Landers, supra note 11, at 593 (low capitalization of subsidiary places cost of business "on the creditors of the corporation and, through them, on the public as a whole.").

28. This approach is taken in German law. Aktiengesetz of 1965 §§ 302-03, 322 (translated in II Groups of Companies in European Laws: Legal and Economic Analyses on Multinational Enterprises 272-73, 284 (K. Hopt ed. 1982)). As far as I know, only German law permits such automatic veil-piercing. It would be interesting to compare the German and Anglo-American historical experience, especially because the common law efficiency hypothesis has been adduced for subsidiary limited liability. See Easterbrook and Fischel, supra note 11, at 89.


There are other reasons why limited liability may be less attractive to banks than to other businesses. For example, opportunistic inter-affiliate behavior is far easier for banks than most other organizations because bank assets are more liquid than the assets of most other business organizations. The inter-affiliate transfer of bank assets is regulated by Sections 23A and 23B of the Federal Reserve Act. See 12 U.S.C. § 371c-1 (1988).

In addition, a bank's unitary structure enhances portfolio diversification. The general advantages of diversification are discussed by Black, Miller and Posner in their discussion of bank holding companies. Because bank holding companies are remarkably similar to unitary banking enterprises on the liability side of their balance sheet, the argument applies more strongly to large unitary organizations. See Black, Miller & Posner, supra, at 392-94; infra notes 57-59 and accompanying text. Finally, banks' tort exposure to personal injury, if not lender liability, is smaller than that of most industries.
4. Limited Subsidiary Liability Generates Costs in Tort

Although limited liability increases the cost of credit to a subsidiary's shareholders, parties can generally transact around the subsidiary if the problems are sufficiently troubling. Even if they cannot alter the perverse incentives of subsidiary limited liability, they may at least exact a price for these incentives. The subsidiary is even worse in the case of torts. Torts may be viewed as involuntary contracts that are not explicitly negotiated between tortfeasor and victim because the negotiation costs are too high. Viewed this way, tort compensation is a sort of *ex post* negotiation with the victim that internalizes the cost of risk to the most efficient risk avoider. This *ex post* negotiation is possible only if a tortfeasor is solvent or insured. Limited liability permits corporations to foil this process and externalize risk by segmenting themselves into small and relatively judgment-proof subsidiaries. Although corporations benefit from this aspect of subsidiary organization, society as a whole loses. All benefits to corporations are offset by resulting detriment to victims, and hazardous activities are insufficiently deterred.

As Easterbrook and Fischel have pointed out, corporations have incentives to insure against tort liability despite limited liability to shareholders. Bankruptcy is costly and shareholders may be willing to purchase some liability insurance to lower the probability of bankruptcy. This reasoning, however, works only for unitary organizations. The bankruptcy costs of a subsidiary are uniquely low. The chief bankruptcy loss that Easterbrook and Fischel adduce is a loss of managerial human capital specificity. Such a loss is likely to be minimal if a subsidiary becomes bankrupt because subsidiary management can generally move back to the parent corporation with ease. Because specific physical capital can also flow back to the parent, although perhaps at going-concern rather than liquidation prices, subsidiary bankruptcy costs are extraordinarily low to the parent company.

Assuming that use of a subsidiary reduces a parent's costs, though at society's expense, why would any firm wish to purchase tort liability insurance instead of compartmentalizing risk into subsidiaries? One partial explanation may be that firms can compartmentalize only so far. Any court will pierce the corporate veil if each bolt in a factory is separately incorporated. If the plant site has specific assets and must legally be

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33. See Easterbrook & Fischel, *supra* note 11, at 107-08.
34. Indeed, relationships with creditors, as opposed to victims, need not be substantially disrupted.
35. Courts might not pierce the veil, however, if every pair of taxis in a fleet was separately incorporated. See *Walkovszky v. Carlton*, 18 N.Y.2d 414, 418-20, 223 N.E.2d
treated as a unit, insurance, even of the plant subsidiary, is possibly desirable. The plant subsidiary, however, is not as well insured as the whole corporation, which has more assets available to tort creditors and more specific assets that demand insurance.

One argument remains for limited subsidiary liability in tort. Abolishing the subsidiary will not eliminate the desire to externalize risk, and other available means may be used. A company with deep pockets does not need to establish a separate subsidiary to commit its torts because it can hire a judgment-proof "independent" firm to do so. 36 This arrangement might be more costly than a similar arrangement performed with subsidiaries. Although the social costs of limited liability are preserved upon moving to independent contractors, the private costs of transacting around limited liability are added.

This argument, while superficially plausible, encounters some difficulty upon closer scrutiny. If the private costs of using independent contractors exceed the private benefits of using them to commit torts, this method of externalizing risk becomes unattractive and abolishing subsidiary limited liability reduces inefficient activity levels. Therefore, when coordination costs 37 are extremely high, abolishing limited liability works. When coordination costs are extremely low, abolishing limited liability does little because risk externalization through independent contracting creates few additional social costs. Abolishing the subsidiary is costly in tort only in the case of intermediate coordination costs.

The cases in which coordination costs are substantial but not overwhelming lend themselves relatively well to traditional agency analysis. 38 The agency criterion for such situations is relatively simple: was the contract made chiefly to shift tort liability to the judgment-proof? (Alternatively, could the defendant adduce any convincing reason for not doing the work in-house?) This analysis is functionally similar to respondeat superior. 39

It is difficult, then, to justify the subsidiary's limitation of affiliate liability in straightforward microeconomic terms. Using a subsidiary raises transaction costs in contract and externalizes risk in tort. In fairness to

6, 7-10, 276 N.Y.S.2d 585, 588-91 (1966). The court's refusal to pierce the veil is incorrect even though the defendant corporation was not a subsidiary, but rather was owned by an individual. This individual ownership obviates governance arguments and the well-developed market for automobile liability insurance obviates risk-aversion arguments.

36. This objection may be phrased in an alternative fashion. A genuinely free-standing company of a certain size is better able to externalize its tort costs than an otherwise identical subsidiary if the subsidiary does not enjoy limited liability.

37. Coordination costs refer to the costs of using independent contractors minus the costs of using an integrated company while holding liability consequences constant.


the subsidiary, drawing conclusions from simple economic theory is risky. Similar arguments have demonstrated that the security interest should not exist. But if lack of microeconomic evidence is not proba-
tive of limited liability's inefficiency, such evidence is nonetheless suggestive.

B. Veil-Piercing and Equitable Subordination

The limited liability granted by the subsidiary is not absolute and some legal doctrines, such as "piercing the corporate veil," ignore the subsidiary form. The corporate veil can be pierced in tort, contract and bankruptcy. All three have a straightforward microeconomic justification as rational introductions of liability when limited liability is assumed. These economic justifications, however, are difficult to reconcile with the case law. The actual case-law criteria for piercing the veil generally disregard the economic criteria.

This Article's economic analysis encourages routinely piercing the corporate veil in contract unless perhaps the parties have agreed to respect the veil. The case law, however, does not routinely pierce the veil in contract. Rather, courts pierce the veil in contract when the subsidiary form misled a creditor into entering an agreement. This exception is rational if one accepts limited liability in the first place. If a subsidiary misrepresents itself as the parent organization, creditors will deal with the subsidiary as if it were backed by the full faith and credit of the par-

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42. The leading New York case is still Lowendahl v. Baltimore & Ohio R.R., 247 A.D. 144, 156-58, 287 N.Y.S. 62, 75-76 (1st Dep't), aff'd, 272 N.Y. 360, 6 N.E.2d 56 (1936). In Lowendahl, the court refused to pierce the corporate veil and did not hold the corporation's individual shareholders personally liable. The Lowendahl criteria for veil-piercing are complete domination of the subsidiary by the parent and use of this domination to commit fraud or wrong that proximately caused injury to the plaintiff. See Lowendahl, 247 A.D.2d at 157, 287 N.Y.S. at 76. The court rejected the plaintiff's claim for failing to demonstrate that the shareholders exercised such total control over the corporation when the cause of action arose. See Lowendahl, 247 A.D.2d at 156-62, 287 N.Y.S. at 76-81. A mere breach of contract on the part of the subsidiary, even with the knowledge of the parent, does not satisfy the Lowendahl test.

43. This follows from the analysis in Section I-A. It is feasible, however, to formulate another argument. A general rule of liability forces the subsidiary to reveal its status if it wants contractually created limited liability. Any rule that increases the information available in a transaction (if it does not decrease the incentives to create such information) is ceteris paribus desirable.

One might argue, however, that a contract to respect the veil shall be deemed unenforceable, as it is difficult to understand how such a contract could be rational in the absence of a law like Section 23A of the Federal Reserve Act. See supra text accompanying notes 22-27.
The subsidiary will thus get the favorable credit terms of a unitary organization, while preserving its liability advantages. Piercing the corporate veil in this case serves precisely the same function as misrepresentation remedies do in contract law.

In contrast, the economic justification for veil-piercing in tort can best be attributed to the "frolic and detour" doctrine of vicarious employer liability, in which no liability is placed on the parent if the parent's monitoring costs are too high. Most employee activity is not considered a frolic and thus triggers vicarious employer liability. Yet most subsidiary actions escape corporate veil-piercing even when the subsidiary seems to have been created expressly to avoid liability. The question remains why the employer is held to a far higher standard than the corporate parent.

Even though economic analysis indicates that the corporate veil is senseless in tort, tort is not a per se ground for disregarding corporate separateness. Generally, courts will respect the corporate veil if the subsidiary acts independently of the parent, but will attribute the subsidiary's acts to the parent if the subsidiary does not display sufficient separation from the parent. In addition, courts pierce the corporate veil when the doctrine "would work fraud or injustice" or where the corporate form is "interposed to defeat legislative policies." It is difficult to describe the law of veil-piercing with any more precision, and it has been aptly called "jurisprudence by metaphor or epithet. . . . The metaphors are no more than conclusory terms, affording little understanding of the

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44. See, e.g., Fisser v. International Bank, 282 F.2d 231, 239-41 (2d Cir. 1960) (evidence insufficient to establish that parent corporation acted as subsidiary's alter ego even though subsidiary was undercapitalized); Walkovszky v. Carlton, 18 N.Y.2d 414, 420-21, 276 N.Y.S.2d 585, 589, 223 N.E.2d 6, 8-9 (1966) (refusing to pierce corporate veil because plaintiff failed to allege that owners used each subsidiary to conduct personal activities while obtaining limited liability). But see Minton v. Cavaney, 56 Cal.2d 576, 578, 223 Cal. Rptr. 641, 643, 364 P.2d 473, 475 (1961) (minority rule that undercapitalization alone sufficient to merit veil-piercing).

45. See generally Annotation, Liability of Corporation for Torts of Subsidiary, 7 A.L.R.3d 1343, 1349 (1966) (parent corporation must exercise degree of control beyond that normally present in parent-subsidiary relationship for court to pierce veil).

46. This separation is usually predicated on the degree of control a parent exercises over a subsidiary. See, e.g., Sisco-Hamilton Co. v. Lennon, 240 F.2d 68, 69 (7th Cir. 1957) (allowing suit against parent for subsidiary's actions where such actions under parent's control); Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929) (subsidiary becomes parent's agent where they share common officers who direct both companies); Lowendahl v. Baltimore & Ohio R.R., 247 A.D. 144, 157, 287 N.Y.S. 62, 76, aff'd, 272 N.Y. 360, 6 N.E. 56 (1936) (parent's control over subsidiary key factor in deciding whether to pierce corporate veil).

47. First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba, 462 U.S. 611, 629-30 (1983). Federal courts are beginning to embrace policies that favor veil-piercing. See, e.g., United States v. Kayser-Roth Corp., 910 F.2d 24, 27 (1st Cir. 1990) (parent can be liable under CERCLA if parent completely owns subsidiary, exercises concomitant general authority and is actually involved in subsidiary's activities); Note, Piercing the Corporate Veil: The Alter Ego Doctrine Under Federal Common Law, 95 Harv. L. Rev. 853, 853 (1982) ("Federal common law should look to federal statutory authority rather than to state corporation law when deciding whether to pierce corporate veil.")
considerations and policies underlying the court's action and little help in predicting results in future cases." In all, the law of veil-piercing is chaotic. It is based on the wrong supposition and often yields unpredictable results.

Not only are courts too restrictive in piercing the corporate veil, they frequently use standards that make little economic sense. For instance, courts in some jurisdictions seem solicitous of the subsidiary's capitalization. Although a thinly capitalized subsidiary is more likely to be a vehicle for fraud, tort or opportunism than a well-capitalized subsidiary, it seems curiously ineffective to use a proxy inquiry when a more genuine fraud, tort or opportunism inquiry could easily be made.

Like veil-piercing, equitable subordination is a rational doctrine if limited liability is assumed. Both veil-piercing and equitable subordination are designed to minimize the corporation's incentives to use subsidiaries to defeat contract or tort claims. Under this doctrine, the parent's claim to the subsidiary's assets in bankruptcy is subordinated to those of outside creditors. Together with the law of fraudulent conveyances, this doctrine makes it more difficult for a parent to gut a subsidiary in order to expropriate wealth from creditors. Similar in theory to equitable subordination are cases in which the subsidiary's creditors extended credit on the assumption that the subsidiary will operate as a profit maximizing entity separate and apart from the parent. The doctrines of eq-

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49. See, e.g., Luckenbach S.S. Co. v. W.R. Grace & Co., 267 F. 676, 681 (4th Cir.) (given small capital base as compared to parent and their similar management structure, strong presumption that subsidiary and parent should be treated as one organization in deciding whether to pierce veil), cert. denied, 254 U.S. 644 (1920); Minton v. Cavaney, 56 Cal.2d 576, 578, 15 Cal. Rptr. 641, 643, 364 P.2d 473, 475 (1961) (subsidary's undercapitalization valid reason to pierce corporate veil). The Minton court pierced the veil solely because the subsidiary was undercapitalized. See Minton, 56 Cal.2d at 578, 15 Cal. Rptr. at 643, 364 P.2d at 475. This is virtually tantamount to per se disregard of corporate separateness because plaintiffs will not need to reach the parent of an adequately capitalized subsidiary except for jurisdictional purposes.


51. The leading case is Taylor v. Standard Gas & Elec. Co., 306 U.S. 307 (1939) ("Deep Rock"). In Taylor, a corporate parent sued to recover loans it had made to its subsidiary (Deep Rock Oil Corp.) before the subsidiary declared chapter 11 bankruptcy. See Taylor, 306 U.S. at 309-11. The court rejected the parent's claim. See id. at 323-24. Instead, the court ignored the subsidiary's corporate form because the parent exercised total control over the subsidiary and compelled it to enter into transactions that benefited the parent but harmed the subsidiary. See id. at 320.

52. Cf. 11 U.S.C. § 548(a) (1988) (Bankruptcy Act defines fraudulent conveyance as when debtor transfers an "obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became ... indebted").

53. See American Protein Corp. v. AB Volvo, 844 F.2d 56, 60 (2d Cir.), cert. denied, 488 U.S. 852 (1988). This case is cited for its fact pattern, not its pro-defendant result.
suitable subordination and fraudulent conveyances, however, proceed in the same Rube Goldberg fashion as the doctrine of veil-piercing. Starting with the incorrect presupposition that limited subsidiary liability should be the norm, the law creates unpredictable counter-doctrines designed to undo the damage wrought by limited subsidiary liability.

C. Summary of the Economic Argument

Banks and other businesses use limited shareholder liability because shareholders are less capable of assuming or assessing risk than other creditors, and public securities markets depend on limited liability. As a result, banks are less prone than other businesses to limit affiliate liability. Bank creditors (depositors) tend to be more risk-averse than general business trade and financial creditors.

It is difficult to explain why limited subsidiary liability is the general rule, especially when limited affiliate liability usually increases the \textit{ex ante} costs of credit. The standard reasons for stockholder limited liability, including lower creditor risk aversion, creditors' superior ability to monitor the business and informational advantages accruing from limited liability, generally do not apply to limited affiliate liability. Domestic tax considerations partially explain the current subsidiary form,\textsuperscript{52} as do tort insulation and the prevalence of corporate acquisitions.\textsuperscript{56}

Such alternative explanations for maintaining the subsidiary organization are not reassuring to an observer biased towards the hypothesis that most business behavior maximizes social welfare. The corporate acquisitions explanation is predatory unless one believes that bondholders in acquired organizations had voluntarily negotiated their bond indentures so that their investment value declines in case of a takeover. It is almost

\textsuperscript{54} See \textit{supra} text accompanying note 29. Subsidiary bank structures usually exist only as a response to anti-branching legislation, such as the McFadden Act. \textit{See} 12 U.S.C. § 36 (1988).

\textsuperscript{55} Analytically, international taxation is very different from domestic taxation, because domestic (federal or intrastate) taxation does not involve conflicting jurisdictions and the problems of multiple or zero taxation. At this point, I refer only to domestic taxation.

\textsuperscript{56} Many subsidiaries were once independent firms. Assuming that as independent firms, their trade and financial creditors had not requested special protection, the acquiring firm has no reason to shift risks from the acquired firm's creditors to itself. I shall not analyze whether independent firms' creditors should have included such protection when they extended credit.

Acquisitions pose an interesting problem for tort creditors. The acquired firm presumably committed torts in a privately efficient fashion. As a consequence, it had committed torts at a higher rate than a firm with deeper pockets would have perpetrated. As discussed above, this is justifiable if no organized insurance market for these torts exist. \textit{See supra} notes 11-15, 31-39 and accompanying text. Without limited liability, then, the acquired firm will commit fewer torts in the future. Should the acquiring firm be held responsible for the excess pre-acquisition torts? In other words, should courts pierce the veil if the old torts bankrupt the newly acquired subsidiary? Again, I shall not analyze this issue of successor liability.
impossible to assess the social welfare consequences of subsidiary organization for the purpose of domestic tax law.

Then why subsidiaries? Subsidiaries do provide insulation from tort liability, although this insulation is probably not welfare-enhancing. A better justification for the subsidiary can be found by examining the special banking law of limited affiliate liability. The banking industry, with its different credit requirements, illuminates the subsidiary doctrine.

II. SPECIAL FORMS OF AFFILIATION IN BANKING

Two legal doctrines attest to the special liability needs of banks. The first, the source-of-strength doctrine, can be understood as a rational allocation of insolvency risk between the firm and its creditors. In this respect, the source-of-strength doctrine is an analogue of the subsidiary doctrine applicable to the financial services industry. The second, the separate entity doctrine, is explicable as a pure conflicts rule without adventitious risk-shifting components.

A. The Source-of-Strength Doctrine

The source-of-strength doctrine governs the liability of subsidiaries within bank holding companies. This doctrine treats the affiliates of bank holding companies as pseudo-subsidiaries in which affiliate liability is only partially limited. In these organizations, the central holding company is responsible for maintaining the strength of each of the banking subsidiaries. This ultimately means that strong banks and nonbanks within the subsidiary structure are liable for the weaknesses of the constituent subsidiary banks. Neither the parent nor the subsidiaries, however, is liable for failures in the nonbanking subsidiaries. The source-of-strength doctrine thus creates a unidirectional subsidiary organization, with the parent responsible for banking but not nonbanking affiliates.

The source-of-strength doctrine is easy to rationalize in terms of received price theory. Consider a multidivisional company engaged in

57. See Board of Governors v. First Lincolnwood Corp., 439 U.S. 234, 252-53 (1978); 12 C.F.R. § 225.4(a)(1) (1990); 52 Fed. Reg. 15,707 (1987). This doctrine has been considerably vitiated by MCorp Fin., Inc. v. Board of Governors, 900 F.2d 852, 860-62 (5th Cir. 1990), and may no longer possess significant legal force. In MCorp, the court held that the powers conferred upon the Federal Reserve’s Board of Governors by the Bank Holding Company Act did not include the power to compel a parent to transfer assets to its troubled subsidiary after the parent declared bankruptcy. See id. at 862. In addition, the court held that the Board’s power to restrict unsafe and unsound banking practices did not include the ability to mandate such a transfer. See id. at 863.

The source-of-strength doctrine was originally articulated by the Federal Reserve System. It is therefore important to reiterate that my views, on the source-of-strength doctrine as well as other issues, do not necessarily represent those of the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York or any of the other components of the Federal Reserve System.

58. A different justification for the source-of-strength doctrine is proposed in Fischel, Rosenfield & Stillman, The Regulation of Banks and Bank Holding Companies, 73 Va. L. Rev. 301, 336-38 (1987). That article argues that the source-of-strength doctrine is
several industries, including banking. This company wishes to maximize its total return on capital, which will entail shifting capital within divisions as the performance of the divisions dictates. The company may see a high investment return outside the banking division, which then requires taking capital from the bank and lowering the bank's capitalization to a point that might concern creditors (or regulators). Shifting assets to more highly valued uses is systemically efficient, but it entails higher risk to the banking subsidiary. The source-of-strength doctrine permits the conglomerate to perform this capital reallocation but requires that the capital of the conglomerate as a whole remain available to the bank. Thus, the bank's safety remains unchanged from what it would have been with a higher capital ratio but no source-of-strength doctrine, while the conglomerate as a whole is more profitable than it would have been if it were not able to perform the capital reallocation.  

B. The Separate Entity Doctrine

The separate entity doctrine holds that bank branches are not obligated to fulfill the legal obligations of other branches unless one of these branches wrongfully refuses to perform. "Wrongful" refusal is predicated on the law of the obligated branch. The separate entity doctrine does not exist in general corporate law and is applicable only to banks. This seemingly odd doctrine is best viewed as a form of the subsidiary doctrine that does not provide limited liability.

Although it may appear odd, an unlimited-liability subsidiary has a real function. The subsidiary is a portmanteau that not only limits liability but also establishes a separate legal personality that has consequences beyond risk shifting. Consider Rush v. Savchuk, which involved a liability insurance policy. The plaintiff sued defendant Rush in Minnesota state court, asserting jurisdiction on the grounds that the defendant's insurance company did business in Minnesota, even though Indiana was Rush's domicile and the location of the accident. The Supreme Court ruled that the Minnesota court did not have jurisdiction because the personality of the insurance company could not be attributed to the defendant, even though the insurance policy assured that Rush designed to keep companies free of leverage. If this assumption is correct, its conclusion that the source-of-strength doctrine is senseless is also correct.

59. Something resembling the source-of-strength doctrine might generally be useful in parent-subsidiary relations. Debt guarantees permit creditors (or, in the case of banks, regulators) to monitor closely the creditworthiness of an individual subsidiary closely, while permitting the firm a good degree of interdivisional financial flexibility. Such guarantees become far more complex in the case of system-wide insolvency, in contrast to the insolvency of only a constituent unit of the system. Complicated questions of the priorities of debtors of healthy and unhealthy subunits emerge. German bankruptcy law might shed some light on this subject. See supra note 28.


62. See id. at 322.
was, in many ways, a nominal defendant. Legal personality, therefore, helps reduce the number of forums in which an entity is subject to jurisdiction.

The subsidiary is thus a dual-function device. It not only limits liability, but it also establishes legal personality and is thus a key tool in transactional conflict of laws. Banks cannot afford to conjoin limited liability with separate legal personality but can still benefit from separate legal personality for their branches. The separate entity doctrine is best understood as a means of conferring legal personality without limited liability.

The previous section has argued that limited liability does not enhance welfare. What about the subsidiary's other function of conferring personality? Are the conflicts consequences of legal personality welfare-enhancing? If so, the subsidiary can be salvaged as an efficient device. The next two sections shall explore whether the subsidiary is a welfare-enhancing conflicts device.

III. TOWARDS AN ECONOMIC THEORY OF CONFLICTS

This section attempts to demonstrate that forum shopping is generally inefficient. (In the course of doing so, it also sketches the outlines of an economic theory of conflicts.) The next section builds on this section (but may be read independently) and discusses the merits of the subsidiary as a prophylactic against forum shopping. Forum shopping is possible only if multiple forums have jurisdiction to hear a case, if they have different substantive laws, and if their choice-of-law rules yield different results. Although all of these conditions are required for successful fo-

63. See id. at 330.
65. This legal personality is provided through an ill-understood amalgam of several doctrines: the "Act of State" doctrine, conflict of laws, sovereign immunity and the separate entity doctrine. See generally Heininger, Liability of U.S. Banks for Deposits Placed in Their Foreign Branches, 11 Law & Pol. in Int'l Bus. 903, 907-08 (1979) (discussing limitations on general rule that home office bank liable for deposits in foreign branches); Smedresman & Lowenfeld, supra note 29, at 742 (whether a foreign bank branch is treated as a separate legal personality depends on questions of "attachment of funds, enforcement of a subpoena, and implementation of the tax or securities laws").
66. Professor Korn expressed these criteria more carefully: The problem of forum-shopping arises when four conditions exist. First, the . . . law governing judicial jurisdiction allows the courts of more than one state to act in a single case. Second, the federal law governing legislative jurisdiction allows application of the law of any of two or more states . . . . Third, under the choice-of-law doctrine of the states having judicial jurisdiction, the courts . . . could reach different conclusions as to which of the conflicting local rules should be applied. Fourth, the probable conclusion of one or more of the permissible forums . . . is predictable at the time that the plaintiff commences suit. Korn, The Choice-of-Law Revolution: A Critique, 83 Colum. L. Rev. 772, 782-83 (1983). Professor Korn's definition can apply to defendants' forum shopping as well as plain-
Because conflicts law tries to solve the problem of divergent substantive laws, such laws must be taken as an exogenous fixed variable in a conflicts discussion. I neglect choice of law only for practical reasons. The subsidiary doctrine, although it has some implications for choice-of-law analysis, is generally considered a jurisdictional device. More generally, jurisdictional doctrines are far more effective than choice-of-law principles in resolving conflicts. American choice-of-law analysis is notoriously manipulable. Jurisdictional principles, based generally on a “minimum contacts” or “fair play” due process test, are better able to cabin judicial discretion than are choice-of-law principles. Further-

67. Although this discussion is weighted heavily towards jurisdiction, many of the arguments are equally applicable to choice of law.

68. This is even recognized by the Supreme Court. See Piper Aircraft v. Reyno, 454 U.S. 235, 252 n.18 (1981). Section 6 of the Restatement (Second) of Conflict of Laws gives judges a choice of seven normative criteria in making a conflicts determination. “It is not suggested that this list of factors is exclusive.” Restatement (Second) of Conflict of Laws § 6 comment c (1969). This list includes the following factors:

(a) the needs of the interstate and international systems,
(b) the relevant policies of the forum,
(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
(d) the protection of justified expectations,
(e) the basic policies underlying the particular field of law,
(f) certainty, predictability and uniformity of result, and
(g) ease in the determination and application of the law to be applied. See id. at § 6(2). Given these flexible criteria, any competent judge could find the law of any forum applicable to any case. Fortunately, much of the Restatement reduces the malleability of Section 6. Nevertheless, choice of law is still a notoriously murky inquiry.

69. Compare Restatement (Second) of Conflict of Laws § 6 (1969) (addressing choice-of-law principles) with Restatement (Second) of Conflict of Laws §§ 27-55 (1969) (discussing jurisdictional principles over individuals); Restatement (Third) of the Foreign Relations Law of the United States §§ 402-21 (1986) (same). See Shreve, Interest Analysis as Constitutional Law, 48 Ohio St. L.J. 51, 57 (1987) (“The incidental effect of due process restrictions on territorial jurisdiction can be significant in checking choice-of-law abuses. The particular reach of these restrictions . . . should be considered in order to determine whether . . . [a] doctrine directly addressing choice of law is even necessary.”).

The rules of jurisdiction, although more determinate than choice-of-law rules, are also somewhat subject to manipulation. See Provident Nat’l Bank v. California Fed. Sav. & Loan Ass’n, 819 F.2d 434, 436 (3d Cir. 1987) (a banking case, finding Pennsylvania court could assert general jurisdiction over California thrift that “maintained no Pennsylvania office, employees, agents, mailing address, or telephone number. It had not applied to do business in Pennsylvania, did no advertising in Pennsylvania, and paid no taxes there”).

The only ironclad choice-of-law doctrine of which I know, the “internal affairs doc-
more, to the extent that they are governed by constitutional standards, jurisdictional principles are promulgated by one body, the United States Supreme Court. Standardized conflicts rules minimize the opportunities for forum shopping. In contrast to the Supreme Court's long involvement with jurisdictional rules, the Court has only recently begun to regulate state choice-of-law rules.70

This section first discusses some general, economically expressible goals for a conflicts regime. Once these goals are postulated, this Article establishes that contract and tort must receive very different treatment, and that these goals differ depending on the institutional regime71 in which conflicts laws are embedded. The final subsection is a detailed discussion of the economics of forum shopping. This Article's restricted normative perspective implies that my analysis will not respond to most of the literature in the field.72 My theory does not have to embrace fields of law, such as family or criminal, which have significant noneconomic (or even non-consequentialist) goals.

A. Goals

This Article posits three basic goals for commercial conflicts doctrine: existence, uniqueness and optimality.73 These goals are general and can

trine" of corporate law, has been constitutionalized, possibly to set it apart from its more malleable cousins and have it more closely resemble the conflicts law with teeth—jurisdiction. See McDermott, Inc. v. Lewis, 531 A.2d 206, 216-17 (Del. 1987); see also Buxbaum, The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporate Law, 75 Calif. L. Rev. 29, 34-35 (1987) (federal courts in danger of constitutionalizing internal affairs doctrine).

70. See, e.g., Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 821-22 (1985) (state may not use jurisdiction as argument when considering issue of choice of substantive law); Allstate Ins. Co. v. Hague, 449 U.S. 302, 307-13 (1981) (state must have sufficient interest in litigation to apply its substantive law); see also Korn, supra note 66, at 786 (to determine legitimate exercise of jurisdiction, Supreme Court focuses on sufficiency of state interest).

71. For a discussion of institutional regimes, see infra notes 93-99 and accompanying text.

72. There have been very few economic analyses of conflicts law. Baxter's "comparative impairment" principle is the only other detailed economic analysis of which I am aware and he takes an approach that is quite different from mine. See generally Baxter, Choice of Law and the Federal System, 16 Stan. L. Rev. 1, 18 (1963) (court should consider which state's objective will be least damaged by subordination). Richard Posner sketched an approach to the economics of conflicts that resembles mine, but as far as I know, he has never developed it. See R. Posner, The Federal Courts: Crisis and Reform 304-07 (1985).

73. For a discussion of these three goals, see infra notes 76-81 and accompanying text. These goals pertain to conflicts rules, not to conflicts decisions. Almost all conflicts decisions will eventually choose a unique adjudicator and law; a decision, by its very nature, picks one alternative from many. The trick is to formulate a set of rules that will provide a predictable, unique and appropriate adjudicator and law from the facts of the case. Professor Dane makes the interesting point that the very notion of rules as autonomous from the decisions that create these rules implies something akin to a uniqueness goal. See Dane, Vested Rights, "Vestedness," and Choice of Law, 96 Yale L.J. 1191, 1245 (1987).
apply to even noncommercial fields. Because these goals are economically articulable, the weight given them is simpler in commercial law. It is important to emphasize that these goals are arbitrary. They are economically cognizable but are not efficiency goals, and they are justifiable only through the appropriateness of the economic analysis based on them.\footnote{74}{It is not difficult to justify the existence goal: existence is necessary because if no cases are heard, no law exists and then actors are undeterred. It takes more effort to justify the uniqueness goal. See infra notes 100-114 and accompanying text.}

The most basic conflicts goal is existence: an applicable law and forum should exist. Conflicts rules should ensure that some forum accepts jurisdiction over a private dispute.\footnote{75}{This appears simple but can be trickier than it seems. If sovereign A does not view a certain fact as giving rise to a cause of action and sovereign B does, is existence violated if sovereign B refuses to hear the case? Existence, as the term is used in this Article, is not violated if sovereign A is willing to accept jurisdiction and then dismisses the claim because it fails to state a cause of action cognizable in the courts of A.} It is factually difficult but logically possible to imagine a conflicts regime that does not provide a forum for litigation between two parties.\footnote{76}{For example, sovereign A could have a rule that all disputes arising under the laws of A could only be heard in the courts of B. If sovereign B has a rule that disputes arising under the laws of A will not be heard in its courts, the property of existence is not satisfied.} Existence of an appropriate forum may be more problematic in litigation among multiple parties,\footnote{77}{See Helicopteros Nacionales de Colombia, S.A. v. Hall, 466 U.S. 408, 419 n.13 (1984).} but this Article shall assume existence.\footnote{78}{A few cases may actually turn on existence. See, e.g., Phoenix Canada Oil Co. v. Texaco, Inc., 78 F.R.D. 445, 455-56 (D. Del. 1978) (doubtful existence of viable foreign forum powerful factor in deciding not to dismiss on forum non conveniens grounds).} Existence also means that some sovereign is responsible for a regulated or taxed activity.

An applicable law should also be unique. Ideally, only one forum should govern each dispute or only one sovereign should control each activity. (In practice, uniqueness rules will generally minimize the number of forums, but will not necessarily reduce the number to one.) Uniqueness obviously reduces uncertainty and, less obviously, minimizes inefficient rent-seeking behavior and maximizes activity levels. Two classes of legal devices serve these economic goals. One class is designed to provide \textit{ex post} uniqueness, which ensures that only one adjudicator will hear a dispute. This class is more commonly viewed as preventing double or multiple liability and includes such doctrines as res judicata, mandatory joinder, interpleader and the law of judgments. In general, these devices work well. The rare cases in which \textit{ex post} uniqueness is threatened, however, cause attorneys great concern.

Far more common is the problem of \textit{ex ante} uniqueness or forum shopping. \textit{Ex ante} uniqueness is not regulated nearly as satisfactorily as \textit{ex post} uniqueness. The devices that are supposed to ensure \textit{ex ante} uniqueness, such as forum non conveniens, choice of law and jurisdiction,
do not yield the predictable results generally guaranteed by the devices that yield \textit{ex post} uniqueness.

The analytical bane of \textit{ex ante} uniqueness is the goal of optimality. Rules designed to select the "best"\textsuperscript{79} adjudicator or rule are likely to arrive at multiple or indeterminate adjudicators or rules. To reduce forum shopping, a uniqueness rule must be rigid. Optimality rules tend to be more flexible.\textsuperscript{80} Because little optimality is generally gained by dividing a case among multiple adjudicators, \textit{ex post} uniqueness seldom conflicts with optimality.

\section*{B. Contract, Tort and Optimality}

This subsection attempts to develop an economically-cognizable optimality goal in conflicts. Such a goal is feasible if all aspects of a dispute, including conflicts, are viewed strictly as bilateral disputes between two parties. Economic theory has long been concerned with analyzing such disputes, and a surprising amount of insight is gleaned from treating conflicts as part of a simple contract or tort dispute. Setting aside conflicts for a moment, I start by reviewing the economic analysis of contract or tort.

The most significant economic difference between contract and tort is that the parties establish their duties in contract, while society imposes duties in tort. From this perspective, contract law shares the same deterrence and compensation goals as tort law. The deterrence goal, which assures efficient behavior, is more attractive and interesting to an economist than the compensation goal. This is not to say that the compensation goal plays no role. Although the wealth transfer from the defendant to the plaintiff has no inherent economic interest, assuming the usual rejection of intersubjective utility comparison, the possibility of compensation assures deterrence because it provides the cheapest monitor of the contract an incentive to do so.\textsuperscript{81} If another party (such as the state) is the cheapest contractual monitor, plaintiffs need not receive compensation because the state assures deterrence through regulatory fines or criminal penalties.

But there is an important distinction between contract and tort. Contract rules are generally designed to further the intent of the agreeing parties and therefore other state interests are usually unimportant.\textsuperscript{82} In

\textsuperscript{79} For a discussion of the "best" adjudicator or rule, see infra notes 81-92 and accompanying text.

\textsuperscript{80} See generally Restatement (Second) of Conflict of Laws § 6 (1969) (flexibility run rampant).

\textsuperscript{81} The \textit{ex post} decision made by the plaintiff to seek damages is pure rent-seeking behavior. It is only justified by its \textit{ex ante} deterrence consequences. \textit{See} Posner II, supra note 11, at 184-85. Victim compensation also plays a role when the victim is capable of reducing the costs or frequency of the tort, a complication that is assumed away in this Article's discussion.

\textsuperscript{82} Some contractual rules, such as duress, usury or disclosure laws, go to the genuineness of consent. Others, such as the contractual limitations posed by antitrust law,
tort, however, the state, not the plaintiff, has "contracted" for optimal
deterrence with the defendant. In this idealized scenario, the defendant
knows the law and adjusts activity levels accordingly. Viewed this way,
the laws of the state do not enforce the intent of the parties; they are the
intent of the parties when conjoined with defendant's activity levels. In
contrast to contract law, where the plaintiff negotiated for a deterrence
structure with the defendant, tort plaintiffs have no *ex ante* role. Their
only role is as *ex post* enforcers of deterrence.

Contract law and tort law both attempt to establish optimal deter-
rence. An ideal conflicts rule also seeks optimal deterrence. In the case
of contract law, the deterrence is set by the parties, and the conflicts law
of contracts, just like the ordinary law of contracts, attempts to imple-
ment the intent of the parties. This implies that state interest analysis is
inapposite to contractual conflicts law except when it bears on the plain-
tiff's capacity to contract or some contractual externality. Apart from
these exceptions, all states (should) have a similar interest in maintaining
freedom of contract.\textsuperscript{83}

In the case of tort law, optimal deterrence, and thus the substantive
content of tort law, may be viewed as the result of a meta-contract be-
tween the state, acting on the plaintiff's behalf, and the defendant.\textsuperscript{84}
This implies that tort analysis should balance the state's and the defend-
ant's interests, but not those of the plaintiff. The state has adopted the
plaintiff's individual interest by meta-contracting with the defendant on
behalf of the plaintiff. This is particularly clear in the case of regulation
(where there is no private plaintiff), but is equally applicable to tort,
where private plaintiffs only exist because they are low-cost monitors.\textsuperscript{85}

This economic analysis stresses the roles that parties assume before,
rather than during, litigation. Although the defendant's role is almost
purely reactive in litigation, an economic analysis implies an active ex

del with externalities. For the purposes of my analysis, this latter set of rules should be
treated more like tort than contract. Rules concerning whether a party genuinely con-
sented to the transaction are analytically more difficult.

83. "Should" is an enormous weasel-word, and states are unlikely to view their inter-
ests as unchanged when one of their citizens is a litigant against a non-citizen. The problem
is similar to the one in cartelization. The system (if not every state) is better off if the
states did not pursue individual interests, but the incentives to free-ride are strong. The
assumption of non-opportunistic behavior is certainly often wrong positively, and may also be
wrong normatively when neighboring states are busy administering hometown
justice. See infra notes 93-99 and accompanying text.

84. Cf. Korn, supra note 66, at 799 (state's interests are "best viewed as reciprocal
interests of each state and the people who associate themselves with it as domiciliaries in
regulating and being regulated by each other." )

85. This (meta-)contractualization of conflicts law is intended to serve the purposes of
economic analysis and not the political theory of conflicts law. Nevertheless, I note that
contract need not be viewed through utilitarian blinders, so that a contractualized con-
licts law need not be as "policy"-ridden as conventional choice-of-law principles, and
may possibly serve as the basis for the non-consequentialist theory of conflicts called for
by Professor Brilmayer. See Brilmayer, Rights, Fairness and Choice of Law, 98 Yale L.J.
ante role. The defendant selects activity levels, drafts contracts and chooses the jurisdictions in which to conduct activities. If the deterrence function of contract, tort and regulatory law is paramount, these ex ante roles should determine ex post adjudication.

This discussion of tort and contract implies that the optimality goal of conflicts is only significant for tort or regulatory law. In contract and commercial law, the state plays a referee's role. Barring externalities and issues of contracting parties' competence, the state's contractual and evidentiary rules are mostly designed to ascertain the intent of the parties. Unless one set of rules is clearly superior to another (a dubious empirical assertion), there is no clearly superior adjudicator. For example, it does not matter which state's statute of limitations is used, it just matters that a certain state's statute of limitations is used. To the extent that the state's role in contract is that of impartial referee and enforcer, the optimality goal is insignificant in contract; only the existence and uniqueness goals are important.

This is not the case in tort or regulatory law. In the model, these laws represent meta-contracts between the defendant and the state that protect third parties whom the state represents. Although the plaintiff brings a tort suit (as the cheapest monitor of violations), the state makes the rules and constrains the tortfeasor. The state receives the benefits of its contract only when the tort defendant is the party whom the state intended to deter in formulating the tort rule. The benefits in this meta-contract, however, are clearly not internalized by the meta-contracting parties. When the plaintiff sues, the forum must decide whether its meta-contract with the defendant is applicable or whether another meta-contract with a different state is more appropriate.

We can now better define the optimality goal of conflicts. A conflicts rule leads to an optimal adjudicator or law when the chosen adjudicator or law is the one best suited to enforce the (meta-) contract with the defendant. In contract, this is comparatively simple because the best adjudicator or law is the one that the parties expect. With benign circularity, an inflexible (and transparent contractual conflicts regime reinforces expectations, aligning the optimality and uniqueness goals.

86. I argue below that choosing to use a subsidiary structure is similar to limiting the number of jurisdictions in which to conduct activities. See infra notes 120-36 and accompanying text.

87. This implies that predictability is as much a virtue in tort law as it is in contract law, even though it may be more difficult to craft a predictable tort than contract rule that is consistent with optimality. Not all courts agree with this conception. See Keeton v. Hustler Magazine, Inc., 131 N.H. 6, 17, 549 A.2d 1187, 1194 (1988) (“Predictability of results, the first of our choice [of laws]- influencing criteria, is usually implicated only in suits involving contractual or similar consensual transactions.”)

88. If a contractual conflicts rule runs counter to intuition, inflexibility is a vice, rather than a virtue. The problem is that intuitions tend to be contextual, and an intuitive, flexible rule runs counter to the uniqueness goal and does little to further the optimality goal. The solution in contractual conflicts is to pick a widely-held intuition, and stick by it.
In tort, the issue is far more complicated. The problem is whether the conduct in question breached a meta-contract with a state to protect the plaintiff, and, if so, which state(s) should act as proxy for the others. The plaintiff's interests are insignificant. This observation, of course, is not a significant improvement over conventional conflicts analysis. "Meta-contracting" is unlikely to be any clearer than interest analysis (which it closely resembles) or the Restatement factors. The meta-contractual viewpoint has the small advantage of casting interest analysis in terms of a bargain that the defendant would have made in order to conduct the activity for which it is being held liable. Unfortunately, this will decide few cases.

Greater conceptual returns result from redefining the optimality goal for tort. If optimality-enhancing rules do not seek the best adjudicator, but rather seek to avoid bad adjudicators, then it is possible to align the uniqueness and optimality goals. I call this modified optimality goal "negative optimality." A search to avoid bad adjudicators is also a search to reduce the number of possible adjudicators, which furthers the uniqueness goal. Successful tort conflicts rules, such as "minimum contacts" jurisdiction, are frequently negative optimality rules. The stunning success of the choice-of-law revolution—identification and elimination of false conflicts—is actually a negative optimality rule.

C. Institutional Regimes

The relative weight given the optimality and uniqueness goals depends upon the institutional regime in which the conflicts goals are embedded. Conflicts law in the United States, policed by the Supreme Court, will differ from conflicts law in the international sphere, where each adjudicator is truly sovereign. Broadly speaking, there are three institutional regimes in which conflicts law may be embedded: an "authoritarian" regime, a "republican" regime and a "public-choice" regime.

The authoritarian regime consists of a decentralized federal system where a central authority promulgates conflicts rules for subordinate decision-makers who have some independence in developing substantive law. The authoritarian regime may take several forms. The present United States constitutional conflicts law, in which state conflicts rules are loosely policed by the Supreme Court, is but one example. One may also envision a central court of conflicts in which conflicts questions are resolved before remand to subordinate substantive courts. Supremacy Clause jurisprudence is another authoritarian conflicts regime. At a sufficient level of abstraction, a court's decision to interfere with private or-

89. See supra note 68.
90. The converse is not true. Rules that further the uniqueness goal need not further the negative optimality goal. A search for the worst adjudicator, or even an astrologically based rule, could equally satisfy the uniqueness goal.
91. See supra note 4.
92. Section IV discusses how the subsidiary serves as a negative optimality rule.
The republican and public-choice regimes are clearly distinguishable from the authoritarian regime because both involve completely autonomous decision-makers. The difference is in the goals of the decision makers. A public-choice regime tries to maximize the welfare of its own citizens (or of a dominant interest group), while a republican regime attempts to maximize society's welfare. A republican regime with perfect information and perfect rationality will thus yield the same conflicts law as a perfect authoritarian regime. Real-world sovereigns fit somewhere between the republican and public-choice regimes.

The nature of the optimality goal differs significantly in republican and public-choice regimes. In a republican regime, optimality benefits all, while in a public-choice regime it benefits (some of) each sovereign's citizens. Although the uniqueness goal has the same rationale in both regimes, its weight relative to the optimality goal differs.

It is possible that republican and public-choice regimes will produce similar results. Public-choice conflicts rules do not result in the invariable victory of the hometown litigant. No forum has a "hometown-party-always-wins" rule. Not only does it invite retaliation from other legal systems, but such a forum soon finds itself depleted of all foreign

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94. The dominant-interest-group variant of the public-choice regime can be very significant in the real world. Consider Dow Chemical Co. v. Castro Alfaro, 786 S.W.2d 674 (Tex. 1990), petition for cert. filed, 56 U.S.L.W. 2602 (Aug. 30, 1990), in which the Supreme Court of Texas abolished the forum non conveniens doctrine in order to permit Costa Rican nationals to sue a Texas corporation in Costa Rica. See Alfaro, 786 S.W.2d at 689 (Hightower, J., concurring). This decision could not conceivably benefit Texas, which, if anything, has an interest in exporting toxic petrochemicals to nations whose laws do not adequately internalize the cost of these chemicals. A more limited public-choice model stressing interest groups within the Texas polity may provide a better explanation for the Alfaro decision, as may a genuine republican model. Admittedly, the Texas plaintiffs' bar is strong, but is it strong enough to overcome in-state oil interests without transferring any wealth to Texas non-lawyers?
95. Like a republican regime, an authoritarian regime may also strive to maximize the welfare of all, but it need not cope with the problem of good-faith disagreements among decision-makers. An authoritarian regime can further subdivide into regimes in which the subordinate courts are republican and regimes that attempt to maximize only their own citizens' welfare.
96. "Hometown plaintiff" might be more accurate. If a public-choice sovereign is constrained to write rules facially even-handed towards hometown and foreign litigants, it will tend to favor plaintiffs over defendants, especially if operating in a full-faith-and-credit milieu. There is much more money outside most jurisdictions than within most jurisdictions, and thus verdicts that transfer wealth from abroad to home are more likely than the converse. Such verdicts are maximized if plaintiffs have as many causes of action as possible. Furthermore, there is little wealth to be gained by the local defendants' bar for pro-defendant laws, and considerable wealth to be gained by both plaintiffs' and defendants' bars for pro-plaintiff laws.

A true cynic could carry this reasoning one step further. Lawyers' wealth is increased when rules are uncertain but results can still be affected by lawyers' interventions. Is the Second Restatement of Conflicts, then, a conspiracy by lawyers against the general public?
assets, either through asset mobility or through the transfer of foreigners' assets through hometown judgments. In the long term, this presumptively reduces welfare, although the short-term wealth transfer might arguably exceed the long-term loss of foreign assets. A bit of apparent republicanism, then, is good business for a public-choice sovereign. A public-choice regime, however, is not expected to duplicate the conflicts law of a republican regime. Each public-choice sovereign will find itself in an equilibrium that somewhat favors its citizens over foreigners.

Another similarity between republican and public-choice regimes is that other sovereigns react to their conflicts law as well as to "extraterritorial" aspects of their substantive law. Indeed, the old conflicts notion of "comity" can be taken primarily as a signal to treat others in an even-handed fashion and thus be treated accordingly. (This rule can be given a republican, as well as a public-choice twist: even republicans need a way to discipline those who try to harm the public good.) A similar point can be made for the rules of international law, including those concerning expropriations of property. Because the economics of signalling is complex and indeterminate, I will not expand on this interesting subject, except to note that signalling may be viewed as a fourth goal of conflicts, and that signalling tends to make republican and public-choice behavior convergent. The authoritarian regime is unique in one respect: signalling has almost no role. Subordinate adjudicators need to communicate only with their superiors and do not have to worry about each other. Most of what follows in this Article implicitly assumes an authoritarian regime. Thus, signalling is not relevant and is not discussed.

D. Forum Shopping

Forum shopping is widely viewed as an evil that intelligent conflicts rules reduce. Although a reasonably satisfactory definition of forum shopping exists, scholars do not seem able to articulate why forum shopping is evil, nor do they even all agree that forum shopping is evil, nor do they even all agree that forum shopping is

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100. See supra note 66, at 282. Professor Korn's definition is not universally accepted, especially by a judiciary that views "forum shopping" as evil but still favors a smart shopper. Cf. Keeton v. Hustler Magazine, 131 N.H. 6, 18, 549 A.2d 1187, 1194 (1988) ("[F]orum shopping in the classic sense refers to a plaintiff's attempt to have a court apply the law that will win her the most favorable verdict, not to her attempt to find a forum whose statute of limitations will allow it to entertain her otherwise legitimate suit."). As Justice Souter pointed out in dissent in Keeton, the majority's rationale was massively unconvincing. See id. at 23-35, 549 A.2d at 1197-1205.

101. The scholarly literature provides little help. See, e.g., Baxter, supra note 72, at 9-10 ("[T]he evils of forum shopping have been exaggerated."); Dane, supra note 73, at
necessarily that bad.\textsuperscript{102} This subsection discusses the economic evils of forum shopping. Forum shopping is evil only because it compromises the \textit{ex post} uniqueness goal of conflicts law. I have already argued that optimality is a legitimate goal that clashes with the uniqueness goal.\textsuperscript{103} Some forum shopping, therefore, should be expected in any conflicts regime that values optimality. This unavoidable forum shopping may be a fair price to pay for a desirable balance between the uniqueness and optimality goals. The question, then, is not whether forum shopping is good or bad. Forum shopping always generates costs, but may also confer benefits. The real question is whether the forum shopping permitted by conflicts rules is excessive or insufficient. The remainder of this subsection addresses the costs of forum shopping.

1. Degraded Information

As discussed above, contract, tort and regulatory laws are designed to deter economic actors in an efficient manner.\textsuperscript{104} Contract law is designed to foster efficient breach; tort law should foster efficient creation of risk; regulatory schemes should internalize costs efficiently. In this economic framework, parties are free to act while legal liability provides general deterrence. This theory assumes that the breaching party knows what its actions are and appreciates their legal consequences.

Forum shopping degrades the information available to the party contemplating breach.\textsuperscript{105} Degraded information lowers welfare, both by forcing unnecessary additional investment in information and by encouraging parties to act in ignorance. As a prospective opponent can shop more possible jurisdictions, the necessary investment in multijurisdictional legal research increases. Of course, resources are limited and only a certain amount of legal research is cost efficient. When parties are efficiently ignorant\textsuperscript{106} of the law, subsequent unexpected litigation represents a pure welfare loss in a deterrence-based notion of the law.

It is important to note that this degraded information does not necessarily imply unpredictability. The problem with forum shopping is not


\textsuperscript{103} See supra notes 79-80 and accompanying text.
\textsuperscript{104} See supra notes 81-89 and accompanying text.
\textsuperscript{105} Some contract-law doctrines address the problem of degraded information. For example, the maxim that contracts should be construed against their drafter clearly serves to improve the quality of information available to the non-drafting party. The law of fraud may be similarly interpreted.
\textsuperscript{106} A party is efficiently ignorant when the marginal cost of gathering further information equals the marginal expected benefits of this information.
unpredictable results, but rather a distressing predictability. Basically, the plaintiff is more likely to win. The plaintiff will pick the forum in which its chances are best—a jurisdiction with favorable laws conjoined with pro-forum choice-of-law rules. The forum is a matter between the plaintiff (who proposes) and the court (which disposes). The defendant's role is confined to attempting to influence the court. Forum shopping, therefore, is different from most other sorts of degraded information, which merely decrease predictability and can favor either plaintiff or defendant.

The effects of this uncertainty differ in tort and contract. The tort (or regulation) effects are easier to understand. Forum shopping clearly increases litigation and legal research costs. The possibility of forum shopping, which invariably expands liability, also reduces activity levels. The same effects occur in contract law, but more subtle effects are also present.

The uncertainty inherent in forum shopping encourages bizarre forms of rent-seeking behavior. Because forum shopping favors plaintiffs, both parties to a contract prefer to make the other party a defendant, assuming that the appropriate law is found. This incentive to litigate first is especially strong if a permissive conflict-of-law regime is conjoined with a full-faith-and-credit rule that permits the judgments of the permissive forum to be honored everywhere. At worst, economic activity is subordinated to rent-seeking as each party attempts to structure the transaction to become the first to accrue a cause of action in some jurisdiction. This phenomenon, the propensity of imperfect information to cause rent-seeking behavior, is well known in conventional contract law. "Fine print," for example, is frequently included in order to create breaches in ways the breaching parties did not expect. Contract law frequently tries to nullify this advantage. This phenomenon has also been used to explain why courts approach stipulated damages clauses with

107. Baxter phrases this concept a little differently. He states that forum shopping hinders "primary predictability" (at the transactional level), while probably improving "secondary predictability" (at the level of litigation). See Baxter, supra note 72, at 9. Forum shopping does not necessarily improve even secondary predictability. Secondary predictability decreases when the case is shopped from a jurisdiction in which the plaintiff will clearly lose to a jurisdiction in which the plaintiff has a sporting chance.

108. Some plaintiffs do not search for favorable substantive laws, but rather seek a favorable trier of fact. Other plaintiffs may seek favorable discovery rules, damages rules, certain forms of preliminary relief or favorable statutes of limitations. See generally Juenger, supra note 102, at 558-60 (reasons for forum shopping other than diversity of substantive law). The Supreme Court occasionally seems to believe that only substantive law can be shopped at forums. Compare Ferens v. John Deere Co., 110 S. Ct. 1274, 1282 (1990) (implying that shopping for venue is not true forum shopping) with Piper Aircraft Co. v. Reyno, 454 U.S. 235, 252 n.18 (1981) (listing plethora of plaintiff's bargains in United States forums, including "malleable choice-of-law rules," jury trials, lack of taxation of losing party with winning party's fees, as well as favorable substantive law).

109. See infra notes 112-14 and accompanying text.
Neither real conflicts rules nor substantive laws, however, are sufficiently divergent to realize the rent-seeker's goal. Furthermore, contractual forum-selection clauses reduce, but do not eliminate, contractual conflict-of-law problems.111

2. Forum Shopping, Permissiveness and Sovereigns' Goals

If economic actors were omniscient, degraded information would not be problematic, but forum shopping still would be. An omniscient ac-


State courts are quite free to ignore forum-selection clauses and such clauses are against public policy in some states. See, e.g., Redwing Carriers, Inc. v. Foster, 382 So.2d 554, 556 (Ala. 1980) (“Contract provisions which attempt to limit the jurisdiction of the courts of this state [are] invalid and unenforceable as being contrary to public policy.”); Fidelity Union Life Ins. Co. v. Evans, 477 S.W.2d 535, 537 (Tex. 1972) (“Venue for the trial of a lawsuit . . . is a matter of public concern and the venue statutes are structured in accord with a number of public policy principles.”); Annotation, Validity of Contractual Provisions Limiting Place or Court in Which Action May Be Brought, 31 A.L.R.4th 404, 409-11 (1984) (citing cases that found forum-selection clauses invalid as against public policy).

Even when a court considers choice-of-law agreements, a court employing the Restatement of Conflicts factors, supra note 68, has adequate flexibility to favor the party it prefers. Compare Cook v. Frazier, 765 S.W.2d 546, 549-51 (Tex. 1989) (contractual choice-of-law provision specifying Utah law for purchase of Utah and Arkansas land, voided for Arkansas contacts on grounds of insufficient contacts with Arkansas and for being an attempt to transact around Texas usury law) with Uniwest Mortgage Co. v. Dadecor Condominiums, Inc., 877 F.2d 431, 436 (5th Cir. 1989) (similar facts, also applying Texas conflicts law, opposite conclusion).
tor's behavior is deterred by the rules of every forum that is willing to hear the case and apply its laws. In this case, the problems are not in contract-type law. These problems can be transacted around (albeit at a cost) if courts enforce their contracts. Instead, the dilemma lies in tort and regulatory law. The most permissive or pro-plaintiff tort and regulatory standards will prevail throughout the system.

Permissiveness is clearly inefficient in a public-choice regime. Some sovereigns benefit from permissiveness through the implicit subsidy that pro-plaintiff standards give to such a country's legal system. A revenue-hungry sovereign would therefore construct rules that maximize litigation. These rules might not even be clearly pro-plaintiff. A system that encourages antagonistic parties to evaluate their chances of success differently promotes litigation over settlement.

This gross sort of permissiveness is not inherent in republican or authoritarian regimes. Permissiveness, however, creates a more subtle problem common to all three conflicts regimes. Let us assume that all three regimes have efficient municipal law (with the public-choice regime efficient only for its citizens). Except perhaps for the authoritarian regime, the resulting multijurisdictional law will be inefficient. To the extent that forum shopping permits the plaintiff to select the forum, each sovereign's pro-plaintiff substantive laws will be accentuated while the pro-defendant substantive laws are attenuated. This will result in a system where different but individually efficient laws become globally overdeterrent of activities. This effect can be adjusted if each sovereign makes its municipal law somewhat underdeterrent. Such an adjustment, however, will be less effective than that in a legal system with optimal municipal laws and good conflicts rules.

Actually, the issue is more complex than it initially appears. I have described a state of affairs in which sovereigns have fundamentally different laws. Loose conflicts regimes ensure that these laws, collectively, are overdeterrent. But a similar problem exists even when the laws are fundamentally the same. Legal systems, even if roughly efficient overall and responsive to similar exogenous conditions, occasionally permit excessively high activity levels and occasionally permit excessively low levels. If forum shopping is allowed, plaintiffs can exploit this variation to their advantage, selecting forums that permit excessively low activity levels in the particular fact pattern of the plaintiff's case. Again, the joint legal system will excessively discourage activity levels, even if all legal systems are roughly similar.

A final problem with permissiveness relates to one of the chief eco-

112. This is reminiscent of the corporate law "race to the bottom," in which Delaware (and the Delaware bar) receives fees for providing the environment most hospitable to incorporators. It is frequently argued that this enhances welfare to the extent that incorporation is a consensual act. Litigation is not a consensual act and a litigious race to the bottom may not enhance welfare.

113. See supra note 94.
nomic advantages of a multi-sovereign legal system: its capacity for diversification and experimentation. This advantage is realized, albeit in different ways, in all three conflicts regimes. An overly permissive set of rules that shifts all litigation to the most pro-plaintiff sovereign eliminates this advantage without ensuring the benefit that a single sovereign provides—consideration of the polity’s welfare.

There is one circumstance in which permissiveness is beneficial. Assuming that courts and governments worldwide are generally too slow to impose appropriate safety standards, the most safety-conscious sovereign is the best adjudicator. Because plaintiffs, who control forum-selection, have an interest in the lowest activity levels, permissiveness tends to further the optimality goal. This argument, however, may falter on empirical grounds. Frequently, a sovereign with unique rules is not progressive, but simply unique.114

3. Legal Transitions

To the extent that substantive laws can be circumvented contractually, conflicts problems are limited but not eliminated. Problems still emerge from legal transitions.115 In such cases, conflicts rules become particularly important. International legal transitions are not a hypothetical problem introduced for the sake of intellectual completeness. They have, for example, dominated recent international banking decisions.116

When a legal transition occurs, it has both prospective and retrospective effects. The prospective effects of the legal transition may well be beneficial, but most commentators assume that the retrospective effects are harmful.117 Through careful choice of rules, it is possible to reduce retrospective effects but it is impossible to eliminate them. Forum shopping increases the retrospective effects of a change in laws. If forum shopping is readily available across jurisdictions, the retrospective effects

114. See Keeton v. Hustler Magazine, Inc., 465 U.S. 770 (1984). In Keeton, the statute of limitations in every jurisdiction except New Hampshire had run on plaintiff’s libel claim. See id. at 773. In addition, plaintiff had no contact with New Hampshire except that the magazine that allegedly damaged her reputation enjoyed a small circulation in the New Hampshire market. See id. at 772. New Hampshire nevertheless had jurisdiction to hear the case and decide libel damages for harm caused throughout the entire country. See id. at 773-74. The outcome in Keeton is not outlandish, which suggests the confused nature of contemporary conflicts jurisprudence.

115. Legal transitions are changes in the law that disturb expectations. See Kaplow, An Economic Analysis of Legal Transitions, 99 Harv. L. Rev. 511, 520 (1986).


117. The benefit derives from the social good conferred by the new rule. To an economist, the social good results from the prospective effects of the improved incentive structures designed by the sovereign. A new rule, however, also redistributes wealth retrospectively. To the extent that parties invest real resources into minimizing this wealth redistribution, retrospectivity involves real welfare losses. Also, retrospectivity may result in loss of specific assets. See Graetz, Legal Transitions: The Case of Retrospectivity in Income Tax Revision, 126 U. Pa. L. Rev. 47, 49-52 (1977).
of legal transitions will multiply. For example, consider a conflicts-of-
law regime that permits adjudication of a contract in one of five forums.
To simplify matters, also assume that each forum will apply its own law.
At the time of drafting, the relevant laws of all five forums were congru-
cent. If one of the forums has a legal transition that affects private rights,
the party that benefits from the transition has a strong incentive to sue
the other in that forum. The legal transition problem is different from
the degraded information problem in that the defendant may well have
had perfect information about the pre-transition law at the time the con-
tract was drafted.

Now consider what happens if the parties can specify only one forum.
Again, one of the five jurisdictions undergoes a legal transition, but now
there is only one chance in five that the transitional jurisdiction will be a
forum. The social gain remains the same, but the social loss attendant to
litigation is reduced five-fold because the litigation is a wealth transfer
accompanied by litigation losses. In this case, litigation does not enforce
the intent of the parties, but rather is an unnecessary windfall given to
the plaintiff by the state that effectuated the transition.

To recapitulate, forum shopping causes several kinds of welfare losses:
uncertainty (increased rent-seeking behavior, suboptimal activity levels,
economically useless investment in information, raised transaction costs),
dominance by permissive legal regimes (distorted rules, suboptimal activ-
ity levels, reduced dynamism) and legal transitions. The next section dis-
cusses the subsidiary device, which significantly reduces these losses by
limiting forum shopping.

IV. THE SUBSIDIARY AS A SOLUTION TO CONFLICT-OF-LAW
PROBLEMS

A. Background

The subsidiary doctrine is a remarkably successful transactional con-
licts device, embodying all three design goals of conflicts. It ensures the
existence of some forum to hear a dispute because the subsidiary is al-
most always subject to the law of its state of incorporation. More impor-
tantly, it is a powerful negative optimality device that reconciles the
uniqueness and optimality goals of conflicts remarkably well. The sub-
sidiary enhances uniqueness, allowing actors to minimize the number of
forums in which they are liable, by compartmentalizing activities. Such
compartmentalization generally reduces the number of possible forums
to one or a few. The sovereigns that the subsidiary excludes are unlikely
to be good adjudicators. The subsidiary thus serves a purpose similar to
the notion of domicile in general conflicts law, but permits multiple, non-
overlapping domiciles for enterprises engaged in multijurisdictional ac-
tivities. As with my discussion of conflicts, my discussion of the subsidi-
ary shall be grounded in contract and tort law, although it may also be
applicable to unexpected areas of the law, such as anti-discrimination and corporate law. It is not, however, applicable to antitrust law.

1. The Subsidiary in Contract

The subsidiary works differently in contract and tort. Because contracts frequently involve different places of performance and multiple places of formation, "the contract field is widely thought to be the most intractable in all conflicts." The subsidiary simplifies the complex problems that emerge in contract. By compartmentalizing various aspects of performance, parties may structure agreements to break transactions into sub-transactions, each simple from a conflicts perspective. Much of this simplification stems from jurisdiction. If a party conducts activities only within the home state, it is subject to suit only in this state. The subsidiary is also useful when a choice-of-law analysis is

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118. See Boureslan v. Aramco, Arabian Am. Oil Co., 892 F.2d 1271, 1274 (5th Cir.) (en banc), cert. granted, EEOC v. Arabian Am. Oil Co., 111 S. Ct. 40 (1990). In Aramco, a unitary organization incorporated in the United States allegedly discriminated against an American citizen overseas. The plaintiff lost the case based on the court's interpretation of legislative intent. See Aramco, 892 F.2d at 1273-74. If the organization had compartmentalized into subsidiaries, the case would have been clear-cut: the statute would not have applied to a foreign violation by a foreign party. See also Mas Marques v. Digital Equip. Corp., 637 F.2d 24, 26-27 (1st Cir. 1980) (employment case, corporate veil respected); Note, Title VII of the Civil Rights Act of 1964 and the Multinational Enterprise, 73 Geo. L.J. 1465, 1483-86 (1985).

119. A jurisdictional principle such as the subsidiary is of limited importance in a field like corporate law, where the choice-of-law principles are quite determinate. See Kozys, Corporate Wars and Choice of Law, 1985 Duke L.J. 1, 9-15. Jurisdiction occasionally becomes an interesting issue, however. See Sternberg v. O'Neil, 550 A.2d 1105, 1111-12 (Del. 1988).

120. Korn, supra note 66, at 804.

121. As discussed above, contractual clauses specifying forum and law are extremely useful conflicts devices, although they are not panaceas. See supra note 111. The subsidiary has an advantage over even enforceable conflicts clauses; it makes contracting easier. Most contracts made by lawyers routinely contain conflicts clauses. Nevertheless, many contracts are not made by lawyers. Included in this group are contracts made by very sophisticated parties, such as participants in the interbank placement market. See Citibank, N.A. v. Wells Fargo Asia Ltd., 110 S. Ct. 2034, 2035 (1990). In this sense, the subsidiary device serves as a sort of master conflicts clause made at the highest levels of the corporation as part of strategic planning. It enables lower-level activities to proceed without sophisticated input from high-level management.

122. An excellent example is Citibank, N.A. v. Wells Fargo Asia Ltd., 110 S. Ct. 2034 (1990). This case involved an interbank deposit between a Singapore subsidiary of an American bank and a Manila branch of another American bank. See id. at 2037. The question was whether Philippine or American law would govern the deposit. See id. at 2039. The choice-of-law issue was significant because the Philippine government had imposed a freeze on all Philippine bank liabilities. See id. at 2038. The transaction involved clearance through the American parent of the Philippine branch. See id.

This case, vital to the international banking community, has been remanded to the Second Circuit. See id. at 2039. The separate entity doctrine, which treats international branches as juridically separate entities, provides a simple solution to this problem while avoiding complex choice-of-law problems.

123. Of course, it depends on what is meant by "conducting activities." Cf. Burger King Corp. v. Rudzewicz, 471 U.S. 462, 479-82 (1985) (expansive notion of "conducting
involved, for it tremendously simplifies much of the choice-of-law calculus. If both parties use the subsidiary device or if one party is a single-jurisdictional entity, all choice-of-law rules point to the same forum, except perhaps for the place of contracting: the place of performance is the domicile of the parties; the parties’ intent is clarified by their decision to incorporate in the place of performance; and other states have weak affiliations to the contract.  

As an example of the subsidiary’s power, consider a contract between a Nigerian national and a Nigerian subsidiary of a multinational corporation; the contract will be performed in Nigeria and could have been made anywhere. Assume that this contract does not have an explicit choice-of-law or choice-of-forum clause. Foreign courts will probably not entertain jurisdiction over such a contractual dispute, much less consider applying their foreign laws. Under United States conflict-of-law principles, the mere existence of the parent is not a contact sufficient to justify jurisdiction if the Nigerian parties had no other contacts with the United States.  

The existence of the subsidiary might also point towards Nigerian substantive law, even if United States jurisdiction were somehow established.

If the subsidiary form is not used, a large barrier to foreign jurisdiction is removed. This situation raises the specter of forum shopping. Certainly, the home country of the multinational is a good forum candidate. But what if the Nigerian business is a joint venture between multinationals of two home countries? What if the multinational’s home country is not the country in which it conducts most of its business? What if the multinational’s line of business most closely related to the Nigerian enterprise is in yet another country? Plaintiffs shop hard for favorable forums. The subsidiary device is a means of controlling this problem.  

activities” includes making payments to office in the forum and being subject to that office’s final authority).  

124. See Note, Interest Analysis Applied to Corporations: The Unprincipled Use of a Choice of Law Method, 98 Yale L.J. 597, 610-13 (1989). The author observed that “[t]his Note’s critique of interest analysis in the corporate context will not apply to purely domestic corporations, which, by the nature of their activity, are usually not involved in choice of law litigation.” Id. at 597 n.1. This Article’s thesis is that the subsidiary can transform most corporations into domestic corporations.

This hints at a division of labor between jurisdiction and choice-of-law principles. If jurisdiction serves as a relatively rigid negative optimality device, employing lex fori is a justifiable general rule. The task of choice of law then becomes interstitial: to identify (perhaps even contextually) the cases in which jurisdictional rules, conjoined with lex fori, do not identify a reasonably good law. The discretion provided by Section 6 of the Restatement (Second) of Conflict of Laws is far less threatening if used as an escape from the forum’s law, rather than an excuse for employing such law. A less extreme version of this suggestion may be found in Shreve, supra note 69, at 57-62.

125. See Restatement (Third) of the Foreign Relations Law of the United States § 414 comment h (1986); Restatement (Second) of Conflict of Laws § 52 comment b (1969).

126. Similar hypothetical fact patterns are reviewed in Brilmayer & Paisley, supra note 38, at 8-15.

127. Although I believe that the subsidiary is consciously used in precisely this way, it is remarkably difficult to find writers who note this. But see Thompson, United States
In essence, the subsidiary permits parties to compartmentalize their legal obligations by compartmentalizing their business operations. If two multijurisdictional enterprises perform a transaction that is localized within a jurisdiction, or perform a series of localized\textsuperscript{128} transactions, the subsidiary cleanly separates legal obligations. If both parties use the subsidiary in similar ways, most transactions and the relevant entities will be within the same jurisdiction, making conflicts law invisible in litigation.

2. The Subsidiary in Tort

The subsidiary excludes jurisdictions in which the defendant's connection is only through affiliation. In this respect, the subsidiary refines the "minimum contacts" due process test.\textsuperscript{129} The minimum contacts test, which denies jurisdiction to states in which the defendant has no significant activity, is a negative optimality test. The rationale for the minimum contacts rule in tort is that states having insufficient contacts with the defendant cannot have entered into a meta-contract with the defendant.\textsuperscript{130} Because there is neither an optimality nor a uniqueness rationale for considering such jurisdictions, jurisdictions without minimum contacts should not be considered in tort.

The subsidiary doctrine refines the minimum contacts test by not factoring affiliate contacts into the analysis. Only contacts by the defendant that created the cause of action are jurisdictionally sufficient. The subsidiary is defensible if such affiliate-only contacts are unlikely to result in good\textsuperscript{131} adjudicators. The subsidiary rationale, therefore, depends on the kinds of contacts that are likely to uncover a good adjudicator.\textsuperscript{132} Con-

\textit{Jurisdiction over Foreign Subsidiaries: Corporate and International Law Aspects}, 15 Law & Pol'y in Int'l Bus. 319, 368 (1983) (acknowledging subsidiary's role in reducing number of possible forums in which plaintiff could sue).


129. For a discussion of the Supreme Court's decision in \textit{International Shoe} and the "minimum contacts" test, see supra note 4. This discussion, although crafted with United States law in mind, is sufficiently general so that it is pertinent to international law.

130. Minimum contacts is a much weaker device on the contracts side because I derive contractual conflicts law from the actual intent of the parties, rather than through a meta-intent derived from a state's laws. But the states that the subsidiary would eliminate—those where the defendant does no business—are unlikely to be intended by either of the parties, unless perhaps an excluded state is the domicile of the plaintiff. This was the problem faced by the court in \textit{Burger King} v. Rudzewicz, 471 U.S. 462 (1985). Rather than abandon minimum contacts in contract, the \textit{Burger King} court finessed the issue by holding that the defendant "conducted business" in the plaintiff's jurisdiction.

131. Because the subsidiary is a \textit{negative} optimality test, it does not search for the optimal adjudicator. It merely seeks to distinguish good from bad adjudicators and exclude these inferior adjudicators. See supra notes 90-92 and accompanying text.

132. For reasons previously discussed, this question is pertinent mainly to tort and regulatory law; in contract, the optimality goal is subordinated to the uniqueness goal. See supra text accompanying note 88. But the subsidiary, by reducing the number of possible forums and by naturally compartmentalizing complex multiforum transactions, helps advance the uniqueness goal.
 contacts that are implicated in the cause of action (those creating specific jurisdiction) are certainly likely to produce good adjudicators. But these specific jurisdictional contacts are only dependent on the actions of the defendant implicated in the cause of action, and thus by their nature exclude affiliates. If these specific jurisdictional contacts were the only ones likely to lead to good adjudicators, the subsidiary formalism can be viewed as a sub rosa near-abolition of general jurisdiction. Subsidiary compartmentalization will give each juridical entity an incentive to operate only within the laws of one sovereign. To the extent that this coincidence is achieved, general jurisdiction becomes a meaningless concept: the adjudicating sovereign is always the one in which the particular incident occurred.

The subsidiary's conflicts aspect, then, can be challenged only if general jurisdiction is desirable and if affiliate contacts are useful in establishing general jurisdiction. It is unclear, however, whether general jurisdiction is justifiable in tort. It is difficult to envision a meta-contract in which a sovereign lets all parties sue a given defendant on all causes of action regardless of where accrued, simply because that defendant conducts sufficiently continuous activities within the jurisdiction. Unless it is drumming up business for its legal system, why would a state wish to protect a foreign plaintiff for a foreign cause of action?

Nevertheless, general jurisdiction has a strong intuitive appeal, and my framework should accommodate most consequentialist approaches to conflicts. My inability to justify general jurisdiction is probably due to lack of imagination. But intuitively, general jurisdiction, even if justified, needs some sort of limitation, and cannot extend to every unrelated activity of an enterprise. Even if a theory of general jurisdiction can fit my framework, I am fairly confident that such a theory will have no room for affiliate contacts.

The practical power of the subsidiary to simplify contemporary tort conflicts law should not be underemphasized. As with contract, defendants have an ex ante incentive to structure their affiliates in ways that maximize the subsidiary's jurisdictional benefits. Consequently, the subsidiary structure assures that plaintiffs and defendants are generally placed in one unique jurisdiction where specific and general jurisdiction converge. The subsidiary thus reduces the difficult cases in which the plaintiff, defendant and action are in three separate jurisdictions. In such cases, it is hard to determine which state has entered into a meaningful meta-contract with the defendant to protect the plaintiff's legitimate interests, or which state's laws the plaintiff and defendant may be deemed to have contemplated. In contrast, when the defendant and the plaintiff are in the same jurisdiction, the conflicts inquiry is fairly simple. This is true for both choice-of-law and jurisdictional analysis. The only case in which the new choice-of-law learning gives unambiguous results
is when both parties are domiciliaries of the same state. Although a theory of general jurisdiction might indicate that the subsidiary compromises the optimality goal in tort in a few cases, it doubtlessly aids the uniqueness goal a great deal.

Even though the subsidiary seems useful in tort, most cases that pierce the jurisdictional veil appear in tort and most are correctly decided. Unfortunately, the subsidiary doctrine conjoins limited liability with jurisdictional separateness, which poses problems in tort. Although the jurisdictional separateness branch of the subsidiary doctrine correctly identifies the jurisdiction, its limited liability aspect frequently ensures that sufficient assets cannot be found in the jurisdiction. This recurrent fact pattern strains the subsidiary doctrine greatly and causes most veil-piercing exercises by courts. Such exercises are sensible if specific jurisdiction over local corporations exists, such as when the tort occurred in the forum state. The tort problem will be discussed in more detail below.

133. See Korn, supra note 66, at 788-89.
134. See, e.g., Omega Homes, Inc. v. Citicorp Acceptance Co., 656 F. Supp. 393, 399 (W.D. Va. 1987) (most cases cited to court in which jurisdictional veil pierced were in tort or products liability); Note, Jurisdiction over Alien Corporations Based on the Activities of Their Subsidiaries in the Forum: Whither the Doctrine of Corporate Separateness?, 9 Fordham Int'l L.J. 540, 560-76 (1986) (discussing mainly tort, antitrust and patent cases).
135. The best reasoned of these cases may be Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322 (E.D.N.Y. 1981). In Bulova, the court asserted personal jurisdiction over a foreign parent based on its subsidiary's actions in the forum. See id. at 1340-41. Judge Weinstein reasoned that jurisdiction was proper because the parent owned all the subsidiary's stock and the parent would have had to penetrate and expand the New York market if the subsidiary did not exist to do it. See id. at 1340-42; see also Boryk v. deHavilland Aircraft Co., 341 F.2d 666, 667 (2d Cir. 1965) (parent subject to U.S. jurisdiction where its wholly owned subsidiary has several of the same directors and parent company's employees perform many of subsidiary's services and operations); Waters v. Deutz Corp., 479 A.2d 273, 276 (Del. 1984) (German parent subject to U.S. jurisdiction where forum state is home to affiliate, which is sole conduit for parent's products in United States); Taca Int'l Airlines v. Rolls-Royce, Ltd., 15 N.Y.2d 97, 101-02, 204 N.E.2d 329, 330-31, 256 N.Y.S.2d 129, 131-32 (1965) (parent subject to jurisdiction where it shares several directors with wholly owned subsidiaries, staffs the subsidiary and determines subsidiary's important policies). The courts, however, do not always pierce the corporate veil in such cases. Compare Boryk, 341 F.2d at 668 (piercing veil because subsidiary is a shell) with Cook v. Bostitch, Inc., 328 F.2d 1, 2 (2d Cir. 1964) (refusing to pierce veil even though subsidiary is a shell).

When specific jurisdiction cannot be found, it is not possible to rationalize jurisdictional veil-piercing, barring misrepresentation of the parent-subsidiary relationship. See, e.g., Miller v. Honda Motor Co., 779 F.2d 769, 772 (1st Cir. 1985) (no in personam jurisdiction because parent company lacked minimum contacts with forum); Fogel v. Hertz Int'l, Ltd., 141 A.D.2d 375, 376, 529 N.Y.S.2d 484, 485 (1st Dep't 1988) (jurisdiction over parent could be proper where public led to believe that parent was responsible for its foreign subsidiary). Fogel is particularly interesting. The plaintiffs sued the American parent company for injuries allegedly incurred by the negligence of the foreign subsidiary. The court appeared to treat the plaintiffs' claim as one for American misrepresentation of the foreign subsidiary's safety, rather than as a claim for the subsidiary's negligence. This sort of all-American claim, which compartmentalizes the foreign acts to foreign courts, is formally consistent with the subsidiary doctrine's jurisdictional aspect.
this point, I shall discuss the Cannon doctrine, which underpins the juridical separateness of subsidiaries.

B. The Cannon Doctrine

As discussed above, the main significance of the subsidiary doctrine lies in forum selection rather than in choice of law. Cannon is the leading case supporting the subsidiary doctrine for jurisdictional purposes. In Cannon, the Supreme Court held that “use of a subsidiary does not necessarily subject the parent corporation to the jurisdiction” of the state in which the subsidiary is incorporated. Cannon does not imply that jurisdiction is unobtainable over an affiliate. It merely indicates that jurisdiction over a local affiliate does not necessarily convey jurisdiction over related foreign affiliates. Some other juridical basis is necessary.

Although an old case, Cannon has survived the International Shoe revolution and is still good law. A 1948 case vitiated Cannon, but

136. See infra notes 155-61 and accompanying text.
137. See supra notes 68-70 and accompanying text.
138. The subsidiary may also have some significance in venue, or at least patent venue. See Wydick, Venue in Actions for Patent Infringement, 25 Stan. L. Rev. 551, 578-80 (1973).

The existence of the [wholly owned subsidiary] as a distinct corporate entity is, however, in all respects observed. Its books are kept separate. All transactions between the two corporations are represented by appropriate entries in their respective books in the same way as if the two were wholly independent corporations. This corporate separation from the general Cudahy business was doubtless adopted solely to secure to the defendant some advantage under the local laws.

Id. at 335 (emphasis added).
140. 326 U.S. 310 (1945).
141. See, e.g., Keeton v. Hustler Magazine, 465 U.S. 770, 781 n.13 (1984) (jurisdiction over parent does not establish jurisdiction over wholly owned subsidiary); 18A Fletcher Cyclopedia of the Law of Private Corporations §§ 8773-74 (1988) (general service requirements on parents, subsidiaries and holding companies); Restatement (Third) of the Foreign Relations Law of the United States § 414(2) (1987) (state does not necessarily have jurisdiction over parent merely because its subsidiary is operating in that state); Restatement (Second) of Conflict of Laws § 52 comment b (1971) (citing Cannon approvingly but noting that jurisdiction over subsidiary can give jurisdiction over parent if parent controls subsidiary's internal operations). While recent Supreme Court decisions have done much to reinvigorate Cannon, some commentators had thought that International Shoe killed the doctrine. See P. Blumberg, supra note 48, at 66-67; Cardozo, A New Footnote in Erie v. Tompkins: “Cannon is Overruled”, 36 N.C.L. Rev. 181, 185 (1958); Wellborn, Subsidiary Corporations in New York: When is Mere Ownership Enough to Establish Jurisdiction Over the Parent, 22 Buff. L. Rev. 681, 683-85 (1973).
142. See United States v. Scophony Corp. of Am., 333 U.S. 795, 813 (1948). But see National Carbide Corp. v. Comm'r, 336 U.S. 422, 438 n.21 (1949) (contemporaneous post-International Shoe case noting without disapproval that petitioner had adopted subsidiary organization in order to avoid service in every state).

The Court's decision in Scophony can be dismissed as a judicial aberration. Scophony
the Supreme Court has more recently reaffirmed Cannon as a matter of policy and has possibly even constitutionalized it as a matter of due process. Although unpopular among commentators, the case is still viable in the lower courts despite suffering increasing lower-court attack in recent years. For example, in New York the Cannon doctrine is applicable only when subsidiaries seem sufficiently separate from the


Nevertheless, commentators disagree as to Scophony's effect on Cannon. Compare P. Blumberg, supra note 48, at 47 (“The [Scophony] decision even suggested that Cannon might not be good law . . . .”) with Note, supra note 134, at 552-53 (“There is no language in the Scophony opinion that indicates that Cannon is no longer good law.”). 143. See Keeton v. Hustler Magazine, Inc., 465 U.S. 770, 781 n.13 (1984) (court stated in dictum that “jurisdiction over a parent corporation [does not] automatically establish jurisdiction over a wholly owned subsidiary”). 144. See Volkswagenwerk AG v. Schlunk, 108 S.Ct. 2104, 2111 n.** (1988) (dictum). If the substantive standard [for service] tracks the Due Process Clause of the Fourteenth Amendment, it is not self-evident that substituted service on a subsidiary is sufficient with respect to the parent. In the only cases in which it has considered the question, this Court held that the activities of a subsidiary are not necessarily enough to render a parent subject to a court’s jurisdiction, for service of process or otherwise.

Id. at 2111 n.**.

Cannon was not a constitutional case and it is uncertain that International Shoe made it one. See Brunswick Corp. v. Suzuki Motor Co., 575 F. Supp. 1412, 1419 (E.D. Wis. 1983); P. Blumberg, supra note 48, at 43-47; Brilmayer & Paisley, supra note 38, at 3-7. 145. See, e.g., P. Blumberg, supra note 48, at 43-48 (reliance on formalistic Cannon standard still common, though its authority significantly eroded by International Shoe); E. Scoles & P. Hay, supra note 7, at 337 (Cannon may be modified to allow jurisdiction over parent or subsidiary when parent and subsidiary act as a “single functional economic entity”); Cardozo, supra note 141, at 181-87 (Erie overrules Cannon); Wellborn, supra note 141, at 683-89 (criticizing Cannon's general rule that ownership of subsidiary insufficient to subject parent company to jurisdiction in state where subsidiary is doing business); C. Wallace, Legal Control of the Multinational Enterprise 118 (1982) (Cannon “naive”). Only one recent commentator seems to like Cannon, more because the doctrine comports with judicial precedent rather than because of any independent policy rationale. See Note, supra note 134, at 594.

146. See 4 C. Wright & A. Miller, Federal Practice and Procedure § 1069 nn. 29-32 (2d ed. 1987); Brilmayer & Paisley, supra note 38, at 7-8 n.36; see also R. Casad, supra note 4, at ¶¶ 3.02[2][b][ix], 4.03[5], 5.03[3][b][ii] (large collection of cases); Annotation, Ownership or Control by Foreign Corporation of Stock of Other Corporation as Constituting Doing Business Within State, 17-18 A.L.R.2d Later Case Service 282-86 (1987 & Supp. 1990) (citing many cases both denying and supporting service of process); 18 A.L.R.2d 187 (1951) (same).

147. See R. Casad, supra note 4, ¶ 3.02[2][b], at 3-84 (“It does appear from reading the cases, however, that there is a growing uneasiness among the courts about the continued authority of the Cannon rule, and cases in which the requisites for jurisdiction are found are relatively more common than in earlier years.”) (footnote omitted).
whole enterprise. This test is vague enough to have permitted at least one New York court to rule that it is an abuse of a trial court’s discretion to believe that any Cannon argument could possibly be frivolous. Oddly enough, New York law strongly respects the corporate veil on matters of limited liability.

The subsidiary organization’s personality is also recognized in international law. The Restatement (Third) of the Foreign Relations Law of the United States limits a sovereign’s ability to regulate subsidiary organizations more than it does branch organizations:

Unlike a foreign subsidiary, a foreign branch is not a distinct juridical entity; the factor of separate incorporation in the host state being absent, the exercise of jurisdiction by the state of the parent by analogy to the exercise of jurisdiction under the nationality principle . . . is not implausible. . . . However, since there is potential for conflict between the state of nationality and the territorial state, the exercise of jurisdiction over foreign branches by the state of the parent is also subject to limitations.

C. Cannon and Tort: Enterprise and Entity Theories

The cost of linking juridical separateness and limited liability is not particularly high in contract. In contract cases, judges seldom pierce the corporate veil because the plaintiff contracted for the subsidiary structure and should live with its consequences even if the subsidiary is a thinly

148. See Mareno v. Rowe, 910 F.2d 1043 (2d Cir. 1990). The law in Delaware, for example, seems much more clear but scarcely more helpful because almost any non-passive involvement by the parent in the subsidiary is sufficient to enable a court to pierce the Cannon veil. See, e.g., Sternberg v. O’Neil, 550 A.2d 1105, 1125 (Del. 1988) (“We hold that GenCorp’s ownership of RKO General is a minimum contact with Delaware which is sufficient to support an exercise of specific jurisdiction by the Delaware Courts over GenCorp . . . .”); Waters v. Deutz Corp., 479 A.2d 273, 275 (Del. 1984) (similar holding). Nor is it difficult for a New York court to dismiss Cannon when it chooses to do so. See, e.g., Volkswagenwerk A.G. v. Beech Aircraft, 751 F.2d 117, 120 (2d Cir. 1984) (existence of jurisdiction over foreign corporation); Re v. Breezy Point Lumber Co., 118 Misc.2d 206, 209, 460 N.Y.S.2d 264, 267 (Sup. Ct. 1983) (evidence existed to merit a hearing with respect to jurisdiction).

149. See, e.g., American Protein Corp. v. AB Volvo, 844 F.2d 56, 60 (2d Cir.) (interlocking directorates not sufficient proof to allow court to pierce corporate veil), cert. denied, 488 U.S. 852 (1988); Brunswick Corp. v. Waxman, 599 F.2d 34, 35-36 (2d Cir. 1979) (corporate veil not pierced where seller knowingly entered into contract with shell corporation established for specific purpose of entering into this contract); Walkovszky v. Carlton, 18 N.Y.2d 414, 418-19, 276 N.Y.S.2d 585, 588-89, 233 N.E.2d 6, 8-10 (1966) (corporate form will not be pierced merely because subsidiary lacks insurance).

150. Compare Restatement (Third) of the Foreign Relations Law of the United States § 414(1) (1986) (states may exercise jurisdiction for limited purposes with respect to activities of foreign branches of corporations organized under its laws) with id. § 414(2) (states may not ordinarily regulate activities of corporations organized under foreign state’s laws based on fact that they are owned or controlled by nationals of regulating state).

151. Id. at § 414 comment a.

152. Cf. Weisser v. Mursam Shoe Corp., 127 F.2d 344, 347 n.6 (2d Cir. 1942) (“The
capitalized shell,\textsuperscript{153} unless misrepresentation occurred.\textsuperscript{154} The chief cost of this approach is using the inefficient off-the-rack rule of limited liability. Given the subsidiary's advantage in conflicts, it is probably a net winner in contract, at least outside the banking industry.

Tort, however, is a problem. Limited liability makes little sense in tort and cannot be circumvented contractually. As a response to this problem, courts have been developing various strategies for piercing the corporate veil in tort and regulatory cases. In regulatory cases, the courts frequently look to the regulatory purpose of the statutes to determine whether to pierce the veil.\textsuperscript{155} A more general response involves replacing Cannon's formalistic "entity theory" and common-law veil-piercing cases with a contextual "enterprise theory."

The entity theory initially views the subsidiary as an entity separate from the parent and inquires whether any factors exist that militate against this separation.\textsuperscript{156} The "enterprise theory," purporting to follow business reality,\textsuperscript{157} is less solicitous of the separation between parent and subsidiary. This theory respects this distinction only when the parent resembles a passive investor in the subsidiary and tends not to respect the distinction when the parent substantially controls the subsidiary.

The enterprise theory is becoming more popular with time, even in cases in which juridical separateness, as opposed to limited liability, is important. The enterprise theory reigns in United States tax law\textsuperscript{158} and only real [difference] between tort and contract cases in this field [is] . . . the possibility that, in contract cases, the plaintiff chose to deal with the subsidiary . . . ."

\textsuperscript{153} See, e.g., Brunswick Corp. v. Waxman, 599 F.2d 34, 35-36 (2d Cir. 1979) (unjust to pierce corporate veil where seller knowingly transacted with shell subsidiary); Fisser v. International Bank, 282 F.2d 231, 240 (2d Cir. 1960) (refusing to pierce veil where parent's officers expressly indicated that subsidiary would be solely responsible for performing contract).

\textsuperscript{154} The standard for misrepresentation is generally very high in commercial contract. Compare Oriental Commercial & Shipping v. Rosseel, N.V., 702 F. Supp. 1005, 1022-23 (S.D.N.Y. 1988) (intent to deceive implies disregard of corporate separateness) with Fisser v. International Bank, 282 F.2d 231, 240 (2d Cir. 1960) (negotiations conducted by officers of parent company not sufficient reason to pierce veil where officers of parent company stated that negotiations were on behalf of subsidiary that would have sole responsibility for performing contract).

\textsuperscript{155} The leading case is Anderson v. Abbott, 321 U.S. 349 (1944). See generally Note, supra note 47, at 853 (federal common law ought to examine federal statutory policy rather than state corporation law).

\textsuperscript{156} Fraud, in which the subsidiary misrepresents its relation to the parent, would be a very good reason to ignore juridical separateness (at least for purposes of granting limited liability).

\textsuperscript{157} See, e.g., P. Blumberg, supra note 48, at 23-25 (companies in a corporate group should be viewed "as a unit" or as a "group enterprise" and not as distinct legal entities); Berle, supra note 27, at 348-50 (fiction of corporate separateness is undermined by economic fact that though there may nominally be two or more corporate personalities, there is only one enterprise).

\textsuperscript{158} Cf. Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425, 440-42 (1980) (economic reality of unified business enterprise is not undermined by fact that income is transformed into dividends from legally separate entities and will not affect the parent's portion of income). Taxation lends itself well to the enterprise ("unitary," in tax jargon)
appears with increasing frequency in tort law. Indeed, cases employing some version of the enterprise theory are sufficiently numerous that at least one commentator suggests that Cannon's entity theory is obsolete and is being replaced in the courts by an enterprise theory of the firm, at least for procedural law.\textsuperscript{159}

Intellectually, the enterprise theory is far preferable to the old-fashioned entity theory, with its ritualistic veil-piercing formulations of "alter ego" or "instrumentality" taken so far that a subsidiary has "no separate mind, will or existence of its own."\textsuperscript{160} What kind of "complete domination" is more complete than 100\% stock ownership? The enterprise theory's distinction between active and passive investment is far more meaningful than the conventional legal formulae. But the enterprise theory suffers from one enormous flaw: haziness of goals. There is a real (if confusing) difference between active and passive investments, but it is difficult to see why jurisdiction or liability should attach to an active investment and not a passive one.\textsuperscript{161} Even a relatively autonomous subsidiary will be monitored sufficiently closely by its sole owner so that the owner will usually satisfy the test of respondeat superior. And why should jurisdiction relate to control?

The trend towards enterprise liability is disturbing. The enterprise theory goes both too far and not far enough. As to limited liability, the corporate form should almost always be breached for torts. As to juridi-

\textsuperscript{159} P. Blumberg, \textit{supra} note 48, at 23-25.

\textsuperscript{160} I have cribbed these incantations from 1 Fletcher Cyclopedia of the Law of Private Corporations \textsection 43.10 (1983). Scholars of the corporate veil have long amused themselves by compiling these lists of incantations. \textit{See} P. Blumberg, \textit{supra} note 48, at 8; Douglas & Shanks, \textit{supra} note 14, at 195.

\textsuperscript{161} The usual goal adduced for jurisdictional law is "fairness"; such a goal, however, is extremely hazy. Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322 (E.D.N.Y. 1981), may be the best-reasoned case decided under the enterprise theory. Judge Weinstein wrote an excellent primer on multinational business relations but could not convincingly justify the relationship between the conclusions of this primer and the jurisdictional issue presented:

To any layman it would seem absurd that our courts could not obtain jurisdiction over a billion dollar multinational which is exploiting the critical New York and American markets to keep its home production going at a huge volume and profit. . . . The law ignores the common sense of a situation at the peril of becoming irrelevant as an institution.

An apparent growing tendency by the Supreme Court to view jurisdictional bases narrowly in the interest of what it considers to be fairness to defendants is reflected in a few recent cases. Unreasoned extrapolation of such cases can lead to unfairness to plaintiffs who may be denied a natural forum unless the court carefully analyzes the economic and social realities of the "significant contacts between the litigation and the forum."


What is the purpose of having "significant contacts" and a "natural forum"? (What is a "natural forum")? But \textit{Bulova Watch} was correctly decided. Two wrong rulings—excessive respect for limited liability and excessive disregard of juridical separateness—produced the right law: a claim under United States law for defendant's assets.
cal separateness, the corporate form should seldom be breached, even in
tort. The enterprise theory can be justified only if it is impossible to un-
bundle juridical separateness and limited liability. In such a case, the
enterprise theory may present a second-best solution, permitting plain-
tiffs to have undesirably generous forum-shopping privileges in return for
undesirably limited liability.

D. The Utility of Juridical Separateness

Section I demonstrated that the subsidiary doctrine was not a welfare-
enhancing risk-shifting device. This section has thus far demonstrated
that the subsidiary doctrine and the resulting juridical separateness is a
transactional conflicts device that may reduce forum shopping. Neither
Section I nor this section has demonstrated that the subsidiary doctrine is
an empirically significant conflicts device. Such a demonstration is very
difficult.

An examination of case law will not prove this hypothesis. Parties
seldom litigate cases that they will definitely lose. Significant case law
usually flourishes where a doctrine is legally unstable or fuzzy. The un-
questioned core applications of a doctrine, even though commercially
significant, will seldom be questioned.

Far better evidence of the subsidiary's conflicts role is the fact that
multinational subsidiaries are usually organized by country rather than
by product line. This tendency is probative, not dispositive. One can
argue that different countries comprise different markets and thus require
separate organizations. The counterargument, that organizational sepa-
rateness does not connote legal separateness, is not fully effective because
it is based on logic and the link may be customary. The overt role
given the subsidiary in international tax planning is further evidence that
the subsidiary is used as a conflicts device. The subsidiary is a conscious
tool of international taxation and international taxation is simply con-

The difficult problem of significance may be attacked with a concept
derived from systems analysis. Well-functioning systems seldom reveal

162. Cf. J. Bonbright & G. Means, supra note 19, at 88 ("Many large industrial corpo-
rations have selling and even manufacturing branches in foreign countries, and it is com-
mon practice to have these branches carried on by separate corporations chartered in the
country in which they operate."); Hadari, The Structure of the Private Multinational En-
terprise, 71 Mich. L. Rev. 731, 748 (1973) ("Most marketing-oriented American-based
MNEs operate abroad through subsidiaries and affiliates, while many service corpora-
tions (particularly banks and advertising agencies) and firms in extractive industries oper-
ate through branches.") (citations omitted); Smedresman & Lowenfeld, supra note 29, at
741 ("Unlike other multinational enterprises, which almost invariably operate through
subsidiaries—i.e., separately organized firms usually incorporated in the country in which
they are established—banks generally operate in countries other than their home base
through branches, without separate incorporation in the countries in which they are
established.")

164. See supra note 8.
their inner workings. A black-box analysis of well-functioning systems only contains information about the goals of the system, not about the means that implement these goals. Poorly functioning systems reveal far more information.\textsuperscript{165} The private international law of contracts works fairly well, but it may not be because the subsidiary is an important doctrine.\textsuperscript{166} In order to establish that the subsidiary is important, it is necessary to disable the doctrine and examine whether the disabled system works as well as the original.

This "experiment" is possible. As I explained above,\textsuperscript{167} banks cannot afford the subsidiary structure. International banks, however, need juridical separateness. The various international private law doctrines in banking law amount to a type of subsidiary, even though they contain no provisions for limited liability. They all serve the conflicts function of the subsidiary. This resemblance is even greater because it did not occur self-consciously. There is little awareness of any relationship between international banking law and the subsidiary doctrine.\textsuperscript{168}

Until 1980, this law worked adequately and thus was not useful in determining the business necessity of juridical separateness. Fortunately (from an analytical perspective), this law has been transformed since 1980 and it is now difficult for a bank to avoid application of United States law to depositors who transact with their foreign branches.\textsuperscript{169} The current doctrine is internally chaotic and its application is unpredictable. It has also provoked a great deal of unfavorable comment from the scholarly community\textsuperscript{170} as well as from the business press.\textsuperscript{171} Many of the

\textsuperscript{165}. Cf. H. Simon, \textit{The Sciences of the Artificial} 13 (1969) ("A bridge, under its usual conditions of service, behaves simply as a relatively smooth level surface on which vehicles can move. Only when it has been overloaded do we learn the physical properties of the materials from which it is built.").

\textsuperscript{166}. In other words, is the subsidiary an insignificant doctrine that causes little harm and evolved by chance (such as the requirement that juries consist of exactly twelve people), or is it required for the successful operation of private international law? Cf. S. Gould, \textit{Wonderful Life} 277-99 (1989) (role of contingency in biological evolution; must reading for common-law efficiency theorists).

\textsuperscript{167}. \textit{See supra} notes 57-59, 162 and accompanying text.

\textsuperscript{168}. \textit{But see} Restatement (Third) of the Foreign Relations Law of the United States § 414 reporter's note 6 (1987) ("[I]nternational banking is conducted primarily through foreign branches of the parent bank rather than through subsidiaries . . . ."). Some vague judicial notice of the connection may also be found in the case law. \textit{See, e.g.}, Trinh v. Citibank, N.A., 850 F.2d 1164, 1169 (6th Cir. 1988) (U.S. law applied to foreign branch office's actions would not have applied to foreign subsidiary's actions); Vichipco Line v. Chase Manhattan Bank, N.A., 660 F.2d 854, 863 (2d Cir. 1981) (same), \textit{cert. denied}, 459 U.S. 976 (1982).

\textsuperscript{169}. \textit{See Smedresman \\& Lowenfeld, supra} note 29, at 736 ("[T]he only rule that emerges from the recent American and English judicial decisions [is] . . . that plaintiffs . . . nearly always win.").

\textsuperscript{170}. Worse than unfavorable comment is the sheer volume of academic commentary. In business law, doctrines work best when they are seldom litigated or discussed. Since 1980, the scholarly commentary on international banking law has gone from thin to dense. \textit{See generally} Bazyle, \textit{Abolishing the Act of State Doctrine}, 134 U. Pa. L. Rev. 325 (1986) (conflicts law of international banking); Chow, \textit{Rethinking the Act of State Doctrine: An Analysis in Terms of Jurisdiction to Prescribe}, 62 Wash. L. Rev. 397 (1987)
resulting cases, and most of the recent cases, attracted government and private amicus briefs,\(^{172}\) a good sign that the affected business communities disagree with the courts. Not all of the private amicus briefs are prompted by special-interest pleading. The Wells Fargo\(^{173}\) and Allied Bank\(^{174}\) courts received briefs from the New York Clearing House Association even though both parties were banks.

While business opinion regarding a legal doctrine is frequently unrelated to the public merits of the doctrine, vociferous business disagreement is a strong indication that a legal doctrine is significant, if not desirable. I previously established that juridical separateness can be a desirable transactional conflicts device and that it is probably not a harm-

\(^{171}\) A recent international attachments case, S.E.C. v. Wang, 699 F. Supp. 44 (S.D.N.Y. 1988), has provoked a small firestorm of controversy. In Wang, the court attempted to attach an account in a Hong Kong branch. This would have been impossible if the branch were a subsidiary, as the court would not have had jurisdiction over the Hong Kong entity. See The Long Arm of the SEC, The Economist, June 10, 1989, at 16; Franklin, Banks Take on the SEC, N.Y.L.J., June 8, 1989, at 5-6; Labaton, U.S. Judges Study Seizure of Cash in Securities Case, N.Y. Times, June 1, 1989, at D2, col. 5; Kalesky, U.S. Appeal Stirs Fear of Financial Intrusion, Fin. Times, May 31, 1989, § 1, col. 8; Sesit, International Furoar Arises over Order From U.S. Court on U.K. Bank's Funds, Wall St. J., May 30, 1989, at B8, col. 5.

172. On appeal, the Wang court received amicus briefs from the British government, the New York Clearing House Association and the Federal Reserve Bank of New York. The case settled after a hearing before the Second Circuit but before the court rendered a decision. See Kraus, Standard Chartered Bank Wins Release of Funds Frozen by SEC, Am. Banker, August 4, 1989, at 3.


The open question is that of its significance. The strong business and academic reaction to the banking cases shows that juridical separateness is a significant and useful transactional conflicts device.

I now turn to the final question. If the juridical separateness conferred by the subsidiary is significant and welfare-enhancing, and if the limited liability conferred by the subsidiary is significantly welfare-detracting (in the case of torts, at least), why are limited liability and juridical separateness yoked into the subsidiary?

V. WHY THE SUBSIDIARY?

There is no clear answer to this question. Actually, this question consists of two sub-questions: does limited liability make any sense, and, if not, why has it persisted? In response to the first question I can advance one rather subtle argument for coupling limited liability with juridical separateness. In response to the second question I can formulate a hypothesis but cannot arrive at a satisfactory answer.

A. A Limited Apology for Limited Liability

I have argued that the personality conferred by the subsidiary is a necessary conflicts device, while limited liability is an unnecessary risk-shifting device. Although I believe that both statements are independently correct, some of the subsidiary's conflicts efficiency may arise from limited liability.

International law exists in a mixed and decentralized framework of republican and public-choice components. Such a system is strained when substantive laws diverge considerably and distrust of other sovereigns' motives is great. Even a republican sovereign will wish to protect its citizens from having their wealth transferred by a public-choice sovereign. The Cannon doctrine, coupled with unlimited liability, gives public-choice sovereigns a tempting mechanism to transfer foreign wealth, a mechanism that the old-fashioned subsidiary weakens.

Consider a foreign judgment that exceeds the assets of the subsidiary and requires accessing the firm's worldwide assets. The Bhopal litigation is exemplary. The United States district court dismissed the case on forum non conveniens grounds provided that the United States parent accept foreign jurisdiction.¹⁷⁵ Such a disposition is not uncommon and is equivalent to the Cannon doctrine with unlimited interaffiliate liability.¹⁷⁶ My analysis has so far indicated that such a result is desirable.

But what if the motivation behind such judgments is inconsistent with

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the foreign sovereign’s treatment of its local residents who lack foreign assets? Should these judgments then be recognized? Probably not.177 Therefore, under the Cannon-plus-unlimited liability doctrine I have developed, foreign courts will confront the delicate task of substantively evaluating another sovereign’s extraterritorial application of its own law. In some cases, such as the Bhopal litigation, the foreign judgment would probably be enforced. Other judgments might not receive such enforcement.

The same result could occur with limited-liability subsidiaries but in a different procedural posture. If the foreign judgment exceeds the assets of the foreign subsidiary, the foreign sovereign will not collect anything because of the limited liability doctrine. To collect extraterritorially, it must obtain independent judgments against and jurisdiction over the worldwide affiliates according to internationally accepted standards.178 The affiliates’ domestic courts will be in a less delicate position because the rules of jurisdiction are relatively clear and the grounds for non-recognition of jurisdiction are less offensive than other grounds for non-recognition of judgments.179

Although this argument is rational, it is not convincing. International law provides clear grounds for nonrecognition of the most blatant hometown decisions.180 Although it is easier to resolve matters at the jurisdictional stage, rather than at a more substantive stage, I doubt that

177. I did not develop an economic theory of enforcing foreign judgments in Section III, and thus admit that this statement is unsupported. A better developed theory of conflicts would probably focus on an analysis rooted in game theory for non-authoritarian conflicts regimes.


179. Compare id. § 421(2) (clear specific jurisdiction rules) with id. § 482(2)(d) (broad grounds for non-recognition of foreign judgments “repugnant to the public policy of the United States”).

180. See id. at § 712.
the difference is enormous. Furthermore, because the argument does not apply to intrajurisdictional limited liability, it does not establish a general case for retaining limited liability. At most it makes a case for transjurisdictional actions. If the reader agrees that this argument is unconvincing, the question remains why the current version of the subsidiary doctrine persists.

B. The Subsidiary in History

The subsidiary is more than the sum of devices that shift risk and confer juridical separateness. It has a historical dimension. The subsidiary doctrine arose from corporate law rather than finance, tort or conflicts law. The corporation, although generally designed to function in the present, may still bear the marks of its history. Thus, historical, rather than legal, reasons may explain why limited liability is still coupled with juridical separateness.

The key aspects of the corporation emerged at various times. Although limited liability was a general feature of corporate law by the mid-nineteenth century, the subsidiary generally was not possible until an 1889 New Jersey statute permitted corporations to own stock in other corporations. Corporate conflicts law was an intermediate development. “Prior to the 1850s, it was either assumed or required that the operations of corporations would be confined to their chartering state.” After this time, foreign corporations began to operate with increasingly limited restrictions on entry, especially after the Supreme Court decided Paul v. Virginia in 1868. Corporate conflicts law, therefore, had a chance to develop between the 1850s and 1890 without the conflicts alternative of the subsidiary. The nineteenth-century conflicts law applicable to the foreign corporation is familiar: corporations that did business within a state were subject to the state’s jurisdiction in

181. The key case may be Wood v. Dummer, 30 F. Cas. 435, 436 (C.C.D. Me. 1824) (No. 17,994). It is not certain if limited liability had any practical meaning in an era when corporate stock generally remained only partially paid.


The concept of the subsidiary depended on one other key idea: a corporation may limit the liability of even a sole shareholder. This notion seemed to develop in the 1890s. The leading case may be the English case of Salomon v. Salomon & Co., [1897] App. Cas. 22, 1895-9 All E.R. 33.

183. See Butler, supra note 182, at 151. It may be possible to push Professor Butler’s dates back by ten years or so. The first significant corporate conflicts case may have been Bank of Augusta v. Earle, 38 U.S. (13 Peters) 519, 584-97 (1839), overruled on other grounds, International Shoe Co. v. Washington, 326 U.S. 310 (1945), which established that corporations may make valid contracts in foreign states if the foreign states do not explicitly object.

184. 75 U.S. (8 Wall.) 168 (1868), overruled on other grounds, United States v. South-Eastern Underwriters Ass’n, 322 U.S. 533 (1944).
tort and contract but more weakly on matters of internal corporate law. The invention of the subsidiary had little effect on the explicit conflicts law of tort and contract. The subsidiary was used exuberantly in regulatory conflicts, however. Entities initially used the subsidiary to transact around the remaining restrictions on foreign corporation entry, with national holding companies operating regulated industries that were required to have state charters under state law. By the early twentieth century, entities consciously used the subsidiary in other regulatory conflicts situations and for the nascent multinational corporations. I have, however, seen only one express reference in the secondary literature to conscious use of the subsidiary for common-law conflicts.

185. See, e.g., Ex parte Schollenberger, 96 U.S. 369, 376-78 (1877) ("doing business" gives jurisdiction over foreign corporation); Gray v. Taper-Sleeve Pulley Works, 16 F. 436, 442-43 (W.D. Pa. 1883) (same); North State Copper & Gold Mining Co. v. Field, 64 Md. 151, 153, 20 A. 1039, 1040 (1885) (citing Maryland "doing business" statute of 1868); Gibbs v. Queen Ins. Co., 63 N.Y. 114, 124-25 (1875) (New York case involving "doing business").


187. See J. Bonbright & G. Means, supra note 19, at 33; Douglas & Shanks, supra note 14, at 193. These holding companies were used to evade effective state regulation of industries such as utilities and railroads. See J. Bonbright & G. Means, supra note 19, at 35-37. In the days before pervasive federal regulation, a multistate holding company provided many opportunities to avoid local regulation, as the holding company provided services at super-market prices that would evade the cost-plus accounting of state regulators.

188. The Cannon case is one example. Bonbright & Means offer another example: Many large industrial corporations have . . . branches in foreign countries, and it is common practice to have these branches carried on by separate corporations chartered in the country in which they operate. . . . Frequently a subsidiary is maintained to carry on the business of the parent which is local to a particular state. Sometimes this is done to simplify tax accounting or to reduce taxes, and sometimes to meet special franchise conditions. J. Bonbright & G. Means, supra note 19, at 88.

189. See Thompson, supra note 127, at 368. Some writers were aware that the subsidiary involved jurisdictional questions. See Cataldo, Limited Liability with One-Man Companies and Subsidiary Corporations, 18 Law & Contemp. Probs. 473, 489-90 (1953); Douglas & Shanks, supra note 14, at 204-05. These jurisdictional questions, however, were viewed as irrelevant to a discussion of limited liability and were "dismissed . . . without more ado." Douglas & Shanks, supra note 14, at 204-05. The jurisdictional questions received more attention when viewed separately, in terms of the Cannon doctrine. Most of this attention has been paid by proponents of the enterprise theory who would overturn Cannon. See P. Blumberg, supra note 48, at 67-71; Cardozo, supra note 141, at 185; Wellborn, supra note 141, at 683-84.
Why was the subsidiary knowingly used in every context except as a
common-law domestic conflicts device? Perhaps more significantly, why
did limited subsidiary liability continue to be the norm? While I do not
have a well-grounded historical answer, one hypothesis is worth explor-
ing. The corporation was never viewed in a purely functional sense, but
rather continued to carry its historical baggage.\textsuperscript{190} Perhaps unless the
demand for a particular corporate attribute is great, the historical bag-
gage of a corporation can deter the functional development of corporate
law. Similarly, unless the damage done by a particular corporate attri-
bute is great, it may be carried along with the overall concept of the
corporation.

The corporation's historical baggage is most evident in the notion of
the corporate entity. American law consists of nominalist personification
of the corporation wrapped in realist rhetoric. The most elegant realist
wrapper was written in 1927:

\begin{quote}

a corporation is more nearly a method than a thing, and \ldots the law in
dealing with a corporation has no need of defining it as a person or an
entity, or even as an embodiment of functions, rights and duties, but
may treat it as a name for a useful and usual collection of jural rela-
tions, each one of which must in every instance be ascertained, ana-
lyzed and assigned to its appropriate place according to the

\begin{quote}

Yet realism has generally existed only as rhetoric. Judges and legal
scholars frequently invoke a brisk realistic piety and immediately shift to
nominalist personifications based on case law or inapposite analogy.\textsuperscript{192}

\textsuperscript{190}. This notion is very similar to—and perhaps almost identical to—Professor Ha-
ger's notion of an "iconic," as opposed to "logical," dimension of legal argument. Hager, 
Bodies Politic: The Progressive History of Organizational "Real Entity" Theory, 50 U.

\textsuperscript{191}. Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110, 119, 222 N.Y.S. 532, 543-
44 (Sup. Ct. 1927).

\textsuperscript{192}. My favorite example is Hawaiian Oke & Liquors, Ltd. v. Joseph E. Seagram &
denied, 396 U.S. 1062 (1970). In trying to extend the "subsidiary-conspiracy" doctrine of
antitrust law to unincorporated divisions, the judge wrote:

\begin{quote}

We, as judges and lawyers, should not be restricted by the semantics chosen to
describe a particular factual situation. Historically and legally a corporation
has been deemed a person — and normally so personified as if a man, a creature
with but one brain, one medium of thought and action \ldots . But are all corpora-
tions, in fact, "persons", each with one brain, one nerve center, at which all
decisions are reached? It is well settled that in corporate structures which con-
ist of a parent corporation and incorporated subsidiaries, each entity is capable
of conspiring. There, we have no difficulty in envisioning separate and in-
dependent conspirators \ldots . The question, then, is what, if any, magic occurs
when the paper partition is removed. Is a business group which chooses to
organize as a single corporation with unincorporated divisions automatically
cast in the form of a normal person? Or may we have a corporate "person" in
the form of a multi-headed Siva, or as portrayed by Dali or Artzybasheff?

\textit{Id.} at 919. Perhaps worse was Berkey v. Third Ave. Ry., 244 N.Y. 84, 155 N.E. 58
The boundaries of the corporation are seldom set by analysis, but are established by personification and precedent. The realists may have succeeded in reducing the corporation to a bundle of sticks, but the shape of the bundle is that of the old devil, corporate personality.

The corporation's nominalist personification has proven so vigorous that not even realists are immune. There are at least two reasons for this. First, a satisfactory non-legal theory of the corporate entity has not yet been developed. Second, the contextual response demanded by realists to the problem of corporate personality may not permit predictable rules of commercial and corporate law. Perhaps a corporate personality with rare inexplicable gaps is better than a fact-specific and sophisticated inquiry into each case, especially when the criteria for such an inquiry are highly debatable.

Although the personification of the corporation may have caused more overall good than harm, it has prevented serious consideration of the wholly owned subsidiary corporation as totally distinct from the publicly held corporation. These two devices, so different under economic analysis, have received similar legal treatment. This personification myth extends beyond coupling limited liability with juridical personality. It is also responsible for the myth of subsidiary independence. To be "real," subsidiaries must somehow be independent of the parent, much as the parent corporation, to be "real," must be more than the alter ego of a stockholder. The myth of subsidiary independence reached its high-water mark in antitrust jurisprudence. For example, the ultra-formalistic notion of inter-enterprise conspiracy among affiliates has only recently (1926). Immediately after articulating the realist sentiment with which I began this Article, Judge Cardozo ruled—in an amazing non sequitur—that the court had to respect the corporate veil because piercing it would imply criminal behavior by the defendant. See id. at 94-95, 155 N.E. at 61. Legal scholars have behaved in a similar, if less exaggerated fashion. See, e.g., Douglas & Shanks, supra note 14, at 198-99 (realist introduction, followed by uncritical mass of case law). Certainly, many realist manifestos on corporate personality were actually accompanied by real realism. See, e.g., Farmers' Loan & Trust Co. v. Pierson, 130 Misc. 110, 114-19, 222 N.Y.S. 532, 538-44 (Sup. Ct. 1927) (Bijur, J.) (deconstructing corporate personality); T. Arnold, The Folklore of Capitalism 185-206 (1937) (personification of corporation and related symbolism created bizarre legal rights, resulting in unrealistic economic policies).

193. Before Landers initiated the contemporary microeconomic debate with his 1975 article, the best analytic attempt to delineate the corporation was perhaps the "enterprise theory" first propounded by Berle and more recently by Blumberg. See P. Blumberg, supra note 48, at 23-25; Berle, supra note 27, at 344; Landers, supra note 11, at 591-92. Although correctly recognizing the weak foundations of the subsidiary doctrine, the enterprise theory suffers from fuzzy goals and—depending as it does on distinguishing active and passive parental roles—leads itself to excessive contextuality. See supra notes 155-61 and accompanying text.


195. There is no question that such inquiries can be made, and even successfully made. See Bulova Watch Co. v. K. Hattori & Co., 508 F. Supp. 1322, 1341 (E.D.N.Y. 1981) (Weinstein, J.). The question is whether scarce judicial rationality should be expended in such inquiries.
been interred in the *Copperweld* case.\textsuperscript{196}

The subsidiary's independence must be predicated on lack of control by the parent. Consequently, the notion of "control" has always had a mystical importance in the law of subsidiaries.\textsuperscript{197} Indeed, the tort liability of corporate parents for the actions of their subsidiaries is predicated on excessive control by the parent.\textsuperscript{198} Courts may obtain jurisdiction over a foreign parent because the parent controls the subsidiary.\textsuperscript{199} With the exception of the *Copperweld* case and subsequent antitrust jurisprudence, judges have avoided the obvious fact that parents usually control their subsidiaries to the extent that it is efficient to do so.\textsuperscript{200}

The unity of control has conjured up a unity of legal personality. In order to maintain the fiction that subsidiaries have separate legal personality, courts frequently resort to the fiction that subsidiary corporations are separately controlled. Hence, it becomes essential for subsidiary corporations to observe corporate formalities punctiliously. This requirement may account for the fragility of the separate entity doctrine in banking, in which control of the branches by the head office has always been acknowledged.\textsuperscript{201}

It is amazing that the unrealistic subsidiary doctrine has survived this long. While the corporation may indeed remain a nominalist construct, it is a surprisingly functional legal institution. The corporation has evolved over time. Most of the evolution has been quite functional even though some of it has been inadvertent.\textsuperscript{202} Apparently, as long as an


\textsuperscript{197} See 1 Fletcher Cyclopedia of the Law of Private Corporations \textsection 43 (1990). One of the clearest statements of the role of control in subsidiary veil-piercing was made by Judge Hand: "The test is therefore rather in the form than in the substance of the control . . . ." *Kingston Dry Dock Co. v. Lake Champlain Transp. Co.*, 31 F.2d 265, 267 (2d Cir. 1929). To this statement, one can only ask: why?

\textsuperscript{198} This makes some economic sense. See supra text accompanying note 44. The degree of control required by the decided cases, however, is far beyond the modest degree of control that would be rationally required to impute liability from control. See, e.g., *Weisser v. Mursam Shoe Corp.*, 127 F.2d 344, 348-49 (2d Cir. 1942) (parent liable where it represents to third parties that it is responsible for subsidiary's liability); *Luckenbach v. W. R. Grace & Co.*, 267 F. 676, 681 (4th Cir.) (separate companies treated as one unit in breach of contract action where one officer owned 94% of one company, 90% of other and exercised operating control over both), cert. denied, 254 U.S. 644 (1920).


\textsuperscript{200} This point was also noted by Wellborn, supra note 141, at 685-86.


\textsuperscript{202} For example, abolition of the notion of a corporation as a limited-life, limited-
aspect of corporate law works tolerably well, nominalist mumbo-jumbo will suffice and close analysis is unnecessary and even discouraged. The subsidiary doctrine has worked fairly well. One of its components, juridical separateness, is welfare-enhancing. The other component, limited liability, causes limited social harm. The internalized harms that limited liability inflicts on contracting parties can be tolerably minimized, except within the banking industry. The externalized harms have been easy to neglect. An unpredictable veil-piercing law has always been available to salve the shocked conscience and, in any case, the vast majority of personal injuries do not lead the entity that inflicted the injury to insolvency. Because courts cannot disperse the analytic haze of corporate law and perceive any difference between wholly owned subsidiaries and other corporate forms, they feel justified in preserving the corporate veil in the case of subsidiaries. While not causing too much harm, the subsidiary confers one great benefit: a powerful conflicts device. This benefit has been extensively and consciously used in regulatory matters, but may be insufficiently employed in domestic contract or tort law.

C. The Subsidiary As an Institution

This Article argues that the subsidiary should be strengthened as a jurisdictional doctrine and eliminated as a risk-shifting doctrine. Curiously, the case law seems to be moving in the opposite direction. The subsidiary is apparently holding its own as a risk-shifting doctrine and, in many states, being increasingly weakened as a jurisdictional doctrine. This trend may be attributable to institutional factors.

The vitality of limited subsidiary liability in contract is easy to explain purpose entity did not occur because some policymaker realized that unlimited corporations were economically superior. Rather, it occurred because of the political corruption displayed by legislatures in granting corporate charters, as well as a race to the bottom among states. See generally Louis K. Liggett Co. v. Lee, 288 U.S. 517, 549-64 (1933) (Brandeis, J., dissenting) (history of corporate evolution). 203. See, e.g., Horwitz, Santa Clara Revisited: The Development of Corporate Theory, 88 W. Va. L. Rev. 173, 175 (1985) ("[A] 'natural entity' theory of the corporation was a major force in legitimating big business . . . "). 204. It is possible to argue that the subsidiary is already being optimally employed as a conflicts device, except in the banking industry. Subsidiary compartmentalization has a cost. Part of this cost is inherently unavoidable, such as the need to compartmentalize activities to avoid veil-piercing. Part of this cost may be more contingent (such as possible tax benefits from unitary operations), but is nonetheless real. If state laws are sufficiently similar, interstate subsidiary compartmentalization is not particularly desirable, whereas international compartmentalization remains sensible. Given the current weakened state of the Cannon doctrine, however, interstate compartmentalization of personality may make little sense. In any event, fifty-state compartmentalization of personality is probably unnecessary. The subsidiary is still useful in segregating comparatively few states with aberrant laws, such as Mississippi (permissive statute of limitations) or Texas (no forum non conveniens in state courts). If this is true, the Cannon juridical veil may well require strengthening.

205. See supra note 147.
if one believes that common-law legal reform occurs in an evolutionary manner. An inefficient law that is easily avoided is unlikely to change through evolutionary processes because the somewhat preferable end result of legal reform is not justified by the intermediate period of uncertainty that evolution engenders. Limited liability in contract might be metastable. The same argument is somewhat harder to make in tort but is still plausible. Perhaps veil-piercing jurisprudence, inarticulate as it is, is preferable to a transitional period of legal uncertainty.

But this rationale does not explain the general erosion of the *Cannon* doctrine. Another institutional explanation is necessary. Consider the *Bulova Watch* case, discussed above as an exemplary application of the enterprise theory. Judge Weinstein joined the Japanese parent company because the Japanese company’s United States subsidiary (which inflicted damage in the United States) was a shell corporation and thus judgment-proof. This result is almost the same as that which would have been reached by the *Cannon* doctrine coupled with unlimited interaffiliate liability. In order to achieve the correct result, Judge Weinstein had to pierce either the liability veil or the jurisdictional veil. If piercing the limited liability veil would have caused greater doctrinal disruption, then Judge Weinstein may have been correct in piercing the jurisdictional veil. The lesson of *Bulova Watch* is that strengthening the limited liability veil, at least in tort, will place greater strains on the jurisdictional veil. Paradoxically, limited liability may be eroding the *Cannon* doctrine.

206. See supra notes 135, 161.
207. *Cannon*, coupled with unlimited liability, would only have made a difference if the plaintiff had desired to litigate in Japan. The *Cannon* approach would bar such forum shopping; Judge Weinstein’s approach would not.