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ANATOMY OF STRATEGIC AFFILIATIONS — A CORPORATION’S LIABILITIES FOR THE ACTS OF ITS AFFILIATES

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I. INTRODUCTION

Affiliations between business entities have occurred with increasing frequency during the seventies and eighties, and have come to be relatively common transactions following relatively well understood structural patterns. While a variety of motives account for the identity of the participants and the structures selected, they nonetheless produce reasonably predictable outcomes in terms of various business and legal issues ranging from market share to the tax treatment of the consideration exchanged.

The affiliation is perceived to be “strategic” in current parlance when it brings together individuals and organizations whose resources complement one another and will facilitate the achievement of identified goals or objectives. This popular formula therefore brings together entities whose planned business activities are perceived to have a tactical affinity or relationship which will generate a synergistic or enhanced result — the “two plus two equals five” effect.

There is however, a collateral effect which is often unanticipated by the business and legal executives involved in the planning and execution of these transactions, and which tends to emerge on the heels of some adversity. The less well understood and less predictable facet of these affiliations is that the more intrinsic good

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sense the affiliation makes, the greater the likelihood that classical concepts of limited liability will be displaced by legal doctrines which place responsibility for the acts of the participants on those who are managing, controlling, or benefiting from the activities.

Fundamental to the recognition of this element of the relationship is the acceptance of a corresponding oversight or audit responsibility to assure that the participants share on an on-going basis common perceptions of what constitutes acceptable conduct and acceptable risk, because they are in all likelihood sharing the resulting exposure. The business and legal executives' fiduciary obligations as well as the dictates of good management and good sense mandate diligence in the scrutiny of the activities undertaken in pursuit of the common objectives to assure that those activities are consistent with the standards imposed within the executive's own company by its own policies and procedures.

In exploring the pitfalls, our methodology will be to first briefly review the basics of a corporation's legal responsibility. Second, to identify the essence of a strategic affiliation. Third, to portray that essence in the context of a fact pattern commonly encountered in technology driven transactional environments. And lastly, the article will analyze the impact of that essence on the relationships between the entities in the context of four concepts or doctrines of law not thought to be particularly unique to California jurisprudence.

II. BASICS OF LEGAL RESPONSIBILITY OF CORPORATIONS

The California corporation exists by virtue of a grant of authority by the state intended to promote economic efficiency. The fundamental elements of the corporation thought necessary to promote that economic efficiency are the potential for continuous existence, the limitation of the owners' liability for the acts of the entity to their investment in the entity, the free transferability of the ownership interests in the entity, and the existence of an entity separate from the natural persons involved.1 The traditional economic rationale for this shift was the perception that the creditor is in a better economic position to evaluate and divert potential risk,2 that intra-organizational efficiencies are created by the shift, and that an


2. Posner, Economic Analysis of Law (1973) (hereinafter Posner). Posner reasons that due to the creditors' market position, they are in a greater position to evaluate and defer the risk of an organization.
investment market is created by this shift.\(^3\)

A corporation as an entity lacks the physical capacity to act for itself and therefore can only act through others, either natural persons or other corporations acting in various capacities such as employee, officer, director, shareholder, or agent. The legal responsibility of a corporation is, therefore, always based on the acts of others. The nature of that responsibility depends on the nature of the relationship between the corporation and the actor. The law defines the relationship, in each case assigning to the actor the authority to act and to the corporation a corresponding responsibility for the act.

In many jurisdictions, the legislative development of the concept of limited liability\(^4\) predated the corporate entity's right to own an interest in another corporation.\(^5\) The underlying rationale for limited liability for the equity investor is arguably not present when that investor is a corporation and not a natural person.\(^6\)

III. THE ESSENCE OF A STRATEGIC AFFILIATION

A strategic affiliation is the coming together of individuals and organizations whose resources complement one another and will facilitate the achievement of an identified business goal or objective.

While the financial resources of one or more of the entities is usually relied upon for financing the undertaking, the essence of the relationship is the existence of a tactical affinity between their re-


\(^4\) See Note, *Should Shareholders be Personally Liable for the Torts of their Corporation*, 76 YALE L. J. 1190 (1967) (quoting Nicholas Murray Butler) "[T]he limited liability corporation is the greatest single discovery of modern man."

\(^5\) California adopted a standard of limited liability for the shareholders of a corporate entity in 1931. From 1849 to 1931, California held that the equity investors in a corporation would share proportionally in the liabilities of the corporation. For a discussion of this historical background, see Marsh, *supra* note 1, ch. XV § 15.13, pp. 329-33. At the time of this adoption, corporations were not in the position to be shareholders of other corporations, and that limited liability would run to a corporate shareholder was not part of the understanding which led to the adoption of limited liability. See Blumberg, *The Law of Corporate Groups: Substantive Law* (hereinafter Blumberg I) at pp. 56-62.

spective business resources and objectives, rather than merely the existence of financial wherewithal. The existence and utilization of these resources to pursue agreed upon objectives distinguishes the relationship from that occupied by the parties in a mere financing transaction customarily structured by banks or investors.\(^7\)

IV. COMMON FACT PATTERN IN TECHNOLOGY DRIVEN TRANSACTIONAL ENVIRONMENTS

A natural affinity exists between an entity which has developed the ability to mass produce high quality precision products at low cost, and an entity whose fundamental skills involve research and development, product engineering, marketing, and sales. In recent years, this affinity has tended to promote the following hypothetical scenario in computer and other technology driven industries.

MFGCO is a billion dollar manufacturer able to mass produce high quality, electronic products at low cost. MFGCO organized INTERCO to identify and structure business activities which would advance the interests of MFGCO. Mr. PROMOTER was appointed President of INTERCO and allowed to acquire a minority interest in INTERCO which was subject to repurchase rights and pledges in favor of MFGCO.

Two years ago, MFGCO agreed with Mr. PROMOTER to provide several million dollars to fund a program to bring the leading edge Nubox product and manufacturing technology to MFGCO. STARTCO was to be organized and managed by INTERCO to implement the Nubox program without disclosing the involvement of MFGCO until necessary. Funds from MFGCO were channeled through INTERCO to STARTCO through a series of loan and guarantee transactions. Sixty percent of STARTCO common stock was purchased by INTERCO for about five percent of STARTCO's estimated capital requirements. The remaining forty percent of STARTCO stock was made available for grant to STARTCO founders and key managers, all of which was subject to repurchase rights in favor of STARTCO and INTERCO. STARTCO's remaining capital requirements were to be provided by MFGCO in the form of debt.

INTERCO and MFGCO agreed that STARTCO would be funded by INTERCO, and would hire Mr. ENGINEER as a

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7. A comprehensive discussion of the liability exposure of the parties to a financing transaction can be found at Marcellino and Kenfield, Due Diligence as a Two Edged Sword: Potential Liability of Venture Capitalists Funding High-Tech Start-Up, 2 S. C. COMP. H. TECH. L. J. 41 (1986).
founder to assemble the personnel and vendors necessary to develop a Nubox product very similar to the Nubox product recently introduced by TECHCO, and to acquire the necessary expertise and technology needed to manufacture the Nubox product. The Nubox product and manufacturing technology would then be transferred to MFGCO for high volume manufacturing under agreements providing STARTCO with a continuing supply of Nubox products and allocating marketing rights between MFGCO, INTERCO, and STARTCO.

Representatives of both INTERCO and MFGCO knew that Mr. ENGINEER was an ex-employee of TECHCO, that he had been directly involved with the development of TECHCO's Nubox, and that he had had access to TECHCO's Nubox drawings, design information, technical data, vendor information, and trade secrets. MFGCO and INTERCO took no action to assure that Mr. ENGINEER did not utilize TECHCO's proprietary properties in the design of the STARTCO product.

The companies became operationally and structurally entwined as the plan was pursued. Mr. PROMOTER, MFGCO executives, and a variety of other INTERCO and MFGCO agents and employees were involved in and controlled all STARTCO decisions of a traditional corporate or headquarters nature. Most directors and officers of INTERCO and STARTCO, except for Mr. ENGINEER, were directors and/or officers of MFGCO or INTERCO. STARTCO and INTERCO were not engaged in any activities other than the Nubox plan, and were used to procure equipment and material for MFGCO and INTERCO as the plan progressed. The companies often used the same law firms.

Careful review of the STARTCO business plan would reveal that Mr. ENGINEER lacked the technical credentials necessary to reverse engineer Nubox, and that STARTCO was not provided with the time or the money to independently develop Nubox technology. However, over the ensuing months, drawings and prototypes for a Nubox emerged on time and vendors capable of implementing sophisticated processes to produce precision parts were readily identified.

Mr. ENGINEER had secretly taken copies of TECHCO's Nubox drawings and data when he left TECHCO and was copying the drawings and otherwise using the data in the development of STARTCO's Nubox product. In so doing, he infringed the copyrights covering the drawings, and appropriated the trade secrets related to the materials and processes. The STARTCO Nubox
product which emerged incorporated the wrongfully appropriated TECHCO trade secrets and infringed the TECHCO patents issued on the design, reflected in the copied drawings.

As STARTCO's Nubox product and manufacturing technology was developed, it was transferred and taught to MFGCO enabling MFGCO to learn the technology and manufacture the Nubox product.

At some point in time, Mr. PROMOTER as the President of INTERCO and MFGCO executives reasonably should have realized that the STARTCO Nubox resulted from the appropriation and utilization of TECHCO proprietary property. When TECHCO learned that its drawings had been used by Mr. ENGINEER, it so advised STARTCO and MFGCO, but they made no effort to either purge themselves of the materials or to procure a license from TECHCO. STARTCO, INTERCO, and MFGCO continued to transfer and utilize the technology, and attempted to conceal the facts with denials and threats of expensive litigation.

V. IMPACT ON THE AFFILIATES OF FOUR DOCTRINES

A. The Doctrine of Principal and Agent

An agent is an entity which represents another entity in dealing with a third party. As a general rule in California, more is required for the creation of an agency relationship than a parent corporation's majority control of a subsidiary.

At common law, the doctrine of agency relied upon the existence of a consensual relationship between the parties to constitute them as principal and agent. In the absence of a consensual relationship, the courts required a high degree of control by a parent over a subsidiary before an agency relationship could be inferred. In the often repeated words of Justice Cardozo written in 1925 "[d]omination may be so complete, inference so obtrusive, that by the general rule of agency the parent will be a principal and the subsidiary an agent." Consequently, at common law the doctrine of agency was of little value in establishing inter-corporate liability.

8. CAL. CIV. CODE § 2295 (Deering 1987).
However, California recognizes by statute two methods for the creation of an agency relationship.\textsuperscript{11} A traditional consensual agency relationship can be created by an express authorization to act before the fact. A person or corporation is the "agent" of another person or corporation — called the "principal" — if he is authorized to act for or in place of the other person or corporation. The statute also provides that an agency relationship can be created by a subsequent ratification, if a non-consensual relationship has been expressly created. Therefore, conduct of an agent binds the principal if the conduct is either (a) authorized, i.e., within the scope of the agent's authority; or (b) ratified by the principal.

With respect to authorization, it is not necessary that conduct be expressly authorized by the principal to bring it within the scope of the agent's authority. Conduct is within the scope of his authority if it occurs while the agent is engaged in the duties which he was assigned to perform and it relates to those duties. Also, conduct for the benefit of the principal which is incidental, customary, or reasonably necessary for the performance of assigned duties is likewise within the scope of the agent's authority.\textsuperscript{12}

The concept of ratification applies to conduct which was not authorized at the time it occurred. The law provides that if at the time of the conduct the agent lacks authority, the conduct may become binding upon the principal if the principal adopts and thus gives effect to the conduct. The most common way for a principal to ratify conduct is to voluntarily accept the benefits of the agent's conduct.\textsuperscript{13} Once ratified by the principal, the prior conduct of the agent is treated as having been authorized in advance.\textsuperscript{14}

Generally the acceptance of benefits will constitute a ratification only if the principal had full knowledge of the facts at the time of ratification.\textsuperscript{15} The courts will not require the full knowledge if...
the lack thereof is due to the negligence of the principal. That is, if
the principal was ignorant of the facts because of his own failure to
investigate after the circumstances were such as to raise a question
and cause a reasonable person to inquire, the principal will be held
to have ratified the unauthorized conduct of the agent.\textsuperscript{16}

Issues of knowledge and notice assume an additional dimen-
sion in the context of a corporate principal. The court must deter-
mine the point at which an entity lacking any intrinsic capacity to
know is deemed to have known. Corporations are, however, rou-
tinely chargeable with the conduct and knowledge of others.

The California Courts have broadly defined the scope of cor-
porate knowledge. In \textit{Monteleone v. Southern California Vending
Corp.}, the court held that evidence demonstrating knowledge by of-
icers and certain employees of the principal corporation was ade-
quate to hold that the corporation possessed sufficient knowledge to
have ratified the agent's actions.\textsuperscript{17}

Another determination of corporate knowledge was made in
\textit{Northern Nat'l Gas of Omaha v. Superior Court}.\textsuperscript{18} This case in-
volves an attempt to quash service of summons for want of jurisdic-
tion.\textsuperscript{19} Mr. Larson was the president of both the parent and the
subsidiary corporations. The court held that based on the doctrine
of imputed knowledge, Mr. Larson was “chargeable of the state-
ment, representations, acts, and conduct of the employees” of the
subsidiary regardless of any actual knowledge.\textsuperscript{20} The court con-
cluded that since Mr. Larson was also president of the parent cor-
poration, the knowledge that was imputed to Mr. Larson as
president of the subsidiary would also be imputed to him as the
president of the parent corporation.\textsuperscript{21}

What conclusions would a trier of fact be most likely to reach
when asked to apply the doctrine of principal and agent to the rela-

\begin{itemize}
  \item \textsuperscript{16} Reusche v California Pacific Title Ins. Co., 231 Cal. App.2d 731, 42 Cal. Rptr. 262
  (1965). Ordinarily, the law requires that a principal be apprised of all of the facts surround-
  ing a transaction before he will be held to have ratified the unauthorized act of the agent.
  However, where ignorance of the facts arises from the principal’s own failure to investigate
  and the circumstances are such as to put a reasonable man on inquiry, he may be held
  to have ratified despite lack of full knowledge.
  \item \textsuperscript{17} Monteleone v. Southern California Vending Corp., 264 Cal. App. 2d 798, 70 Cal.
  Rptr. 703 (1968).
  \item \textsuperscript{18} Northern Nat'l Gas of Omaha v. Superior Court, 64 Cal. App. 3d 891, 134 Cal.
  Rptr. 850 (1976).
  \item \textsuperscript{19} \textit{Id.}
  \item \textsuperscript{20} \textit{Id.} at 992.
  \item \textsuperscript{21} \textit{Id.}
tionship between MFGCO, INTERCO, and STARTCO in our pattern? That:

1. MFGCO was the principal responsible for the Nubox plan; STARTCO and INTERCO were the agents of MFGCO in the execution of the Nubox plan; the acts of Mr. ENGINEER, Mr. PROMOTER, and MFGCO executives in furtherance of the Nubox plan were the acts of their employers and principals.

2. Arguably, Mr. ENGINEER's misappropriation and use was "authorized" by MFGCO because the structure of the Nubox plan made misappropriations and use of TECHCO proprietary property incidental or reasonably necessary.

3. More significantly, however, the misappropriation and use was certainly "ratified" by MFGCO because MFGCO failed to prevent its agents INTERCO and STARTCO from continuing the appropriation and utilization of TECHCO proprietary property after MFGCO knew or should have known what had occurred. MFGCO continued to accept the benefits of the Nubox plan.

4. Having ratified the misappropriation and use of TECHCO proprietary properties by its agents INTERCO and STARTCO, MFGCO has the same legal responsibility for the acts of STARTCO and INTERCO as if MFGCO had directed and authorized the acts in advance.

B. The Joint Venture Doctrine

A joint venture is an undertaking by two or more entities jointly to carry out a single enterprise for profit, and is characterized by the existence of the following elements:

1) a community of interests in the subject of the undertaking.
2) a sharing of profits and losses.
3) an "equal right" or a right in some measure to direct and control the conduct of each other and of the enterprise.
4) a fiduciary relation between or among the parties.

A joint venture does not require an express agreement between the

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parties. The court will infer such an intention from the actions of the participants in the venture, and once such an inference is drawn, each member of the venture becomes liable for the actions of the other.

The requirements of participation and control are liberally defined for joint venture arrangements, and, for example, can be satisfied by an agreement between the parties that one will simply invest funds, while the other maintains control over the operations. Further, the courts will not dispute the existence of a joint venture for lack of community of interest simply because one party has only contributed capital, another only property, and a third only services.

The lynch pin of the joint venture analysis is an intention to jointly share in profits. California has broadly characterized such arrangements as sufficient to constitute profit sharing for purposes of finding a joint venture. The lack of an intention to share jointly in losses will not negate the existence of a joint venture.

The generally accepted definition of profit sharing distinguishes between profits which are earned jointly and profits which are earned severally. The profits in whatever form earned, however,
must be the joint property of the parties before division. Historically, the courts have narrowly defined the term profits. Recently, courts have been more willing to consider an interest in the product jointly developed as evidence of profit sharing. Rawley provides a helpful explanation of joint profits.

Not every joint operation which results in benefit for the parties constitutes a sharing of profits which characterize a joint adventure. The profits, in whatever form earned, must be the joint property of the parties before division.

The profits to be gained from the Nubox plan took a variety of forms: the technology itself, the rights to use the technology to manufacture the product, the rights to market the product and the right to use the technology in the development and manufacturing of future products, and the more traditional forms of pecuniary profit which could be generated by the sale of these rights or by the sale of products produced by the exercise and utilization of the rights. As between MFGCO, INTERCO, and STARTCO, the rights had been allocated generally giving MFGCO the manufacturing rights and STARTCO and INTERCO the marketing rights.

With respect to the pecuniary profits, at least two opportunities exist for allocation among MFGCO, INTERCO, and STARTCO. The first is a function of the transfer price agreed to between the manufacturer and the re-seller. To the extent the transfer price exceeds the manufacturer's cost, profit appears on the operating statement of MFGCO as the manufacturer. To the extent the transfer price is less than the resale price which the product commands in the market place, profit will appear on the operating statement of STARTCO and INTERCO as the marketers and re-sellers of the Nubox. The agreement setting the transfer price is thus an agreement to allocate the aggregate gross profit representing the delta between the manufacturing cost and the sales price to an affiliated party. Although few courts have had occasion to deal with this sub- tle form of agreement to allocate profits in connection with a joint venture analysis, a discussion can be found in a fairly recent federal court decision.

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33. See Pros v Mid-America Computer Corp., 491 N.E.2d 851, 862 (Ill. App. 2d Dist. 1986). In this case the Illinois court states a willingness to consider the acquisition of title in a software system as evidence of joint profits.
34. RAWLEY, supra note 32.
35. See Saspotes v M/V Sol De Copacabana, 581 F.2d 1204, 1208 (5th Cir. 1978). The court agrees that in certain circumstances transfer price agreements could be sufficient for the joint profits requirement.
A second opportunity to allocate pecuniary profits among MFGCO, INTERCO, and STARTCO as affiliated parties is in the allocation of ownership interests in the entities on whose operating statement the profit occurs. Without actually changing the ownership among the affiliated entities, the profits can also be allocated by changing the rights and preference of the securities representing the ownership.

There is thus an abundant basis for the instruction of a trier of fact which would lead to the conclusion that MFGCO, INTERCO, and STARTCO were joint venturers and as such, each are responsible for the acts of the others taken in the course of their pursuit of the venture including, of course, the wrongful appropriation and use of trade secrets by STARTCO and its employees.

C. The Alter Ego Doctrine

Alter Ego is a judicially created equitable doctrine which disregards the corporate entity and extends liability to its shareholders when necessary to avoid an unfair result and do justice. The doctrine is based on a recognition of the corporate charter as a privilege granted to the shareholders whose separation from the corporate entity will be recognized unless justice demands otherwise.

The California courts have limited the application of the alter ego doctrine to narrowly defined circumstances and only when justice so require. Traditionally the courts have only applied the doctrine upon the showing of abuse, misuse, and fraud. Currently, other jurisdictions are beginning to show a willingness to apply the doctrine in the absence of fraud or illegality to prevent injustice and inequitable consequences. This notion of fairness is evident in the historical application of the alter ego doctrine.

36. Marsh, supra n.1, ch. 15.
38. "... [C]ourts start with the premise that entity law controls and that entity law exists to serve a fundamental principle underlying the corporate system — the principle of 'limited liability.' This leads to the corollary that the disregard of entity should be approached 'reluctantly' or 'cautiously' and should be undertaken only in 'exceptional' cases." Blumberg I, p. 106.
Citing Latty the Court states: "The essence of the alter ego doctrine is that justice be done. What the formula comes down to, once shorn of verbiage about control, instrumentality,
While the doctrine has been applied to both corporate and natural person shareholders, scholars demonstrate that the courts have shown a greater willingness to disregard the corporate entity when the shareholder is a corporation rather than a natural person.\textsuperscript{43} They attribute this willingness to an intellectual difficulty in extending limited liability beyond the corporate group.\textsuperscript{44}

The alter ego doctrine is likewise applied with greater frequency when the injured party is an involuntary creditor.\textsuperscript{45} Here again the courts tend to focus on "fairness." A voluntary creditor is thought to be in a much better position to evaluate the risks of dealing with a particular entity, and equity therefore does not demand the application of the doctrine with such frequency.\textsuperscript{46}

The courts will look to numerous factors in determining alter ego liability.\textsuperscript{47} The California Supreme Court, in the case of \textit{Minton}

\begin{quote}
agency and corporate entity is that liability is imposed to reach equitable results' (LATTY, SUBSIDIARIES AND AFFILIATED CORPORATIONS p. 191 (1936))."
\end{quote}


\textsuperscript{44} See \textit{supra} note 7.

\textsuperscript{45} "An involuntary creditor who has had foisted upon him a subsidiary unable to respond to the damages has a greater equity." \textit{Note, Liability of a Corporation for the Acts of a Subsidiary or Affiliate}, 71 Harv. L. Rev. 1122, 1130 (1958).


\textsuperscript{47} In Associated Vendors, Inc. v. Oakland Meat Co., 210 Cal. App. 2d 825, 26 Cal. Rptr. 806 (1962), the court set out the factors to be considered:

1. Commingling, diversion or manipulation of assets between parent and subsidiary;
2. The treatment of the individual asset of the subsidiary as their own;
3. The subsidiary's failure to obtain authority to issue stock;
4. The holding out by the parent of their responsibility for the debt of the subsidiary;
5. The failure to maintain or the commingling of the subsidiary's corporate minutes or records;
6. Identical, equitable ownership of the two entities;
7. Substantially similar directors, officers, or management;
8. The use of the same business location;
9. Undercapitalization;
10. The use of a corporation as a mere shell, instrumentality or conduit of a single venture or the business of an individual or another corporation;
11. Misrepresentation or concealment of the responsible ownership;
12. The disregarding of legal formalities and the failure to maintain arm's length relationships among related entities;
13. Intent to use the corporate entity as a shield from liability in the dealings with a third party; and
14. The use of the corporate entity to procure labor, services or merchandise for another person or entity.
v. Cavaney, described the process as follows:  

The trier of fact must consider whether (1) such unity of interest in ownership exists so as to dissolve the separate corporate personalities of the parent and the subsidiary, relegating the latter to the status of merely an instrumentality, agency, conduit or adjunct of the former; (2) an equitable result will occur if the conduct is treated as that of the subsidiary alone.

The unity of interest requirement does not mandate the complete ownership of a subsidiary by a parent. The court is concerned with the use of the control that generates inequitable conduct. In the absence of any injustice involving the parent corporation, the court will honor their separateness.

Two factors consistently regarded as the most significant are undercapitalization and economic integration. Undercapitalization is the measure of both the degree and kind of capitalization made available to the entity in relation to the risks and requirements generally associated with the business. The courts are concerned with the reasonableness of the capital structure in comparison to the norms of the industry.

The second factor assigned particular significance is economic integration. The emphasis is on interrelationship, either horizontally or vertically, of the corporate activity. Where the activities are so complementary, the foundation is laid for piercing the corporate veil. As indicated in the Connecticut case of Zaist v Olson:

If plaintiff can show that there was such a unity of interest and ownership that the independence of the corporation had in effect

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49. Id. at 119.
ceased, or had never begun, an adherence to the fiction of separate identity would serve only to defeat justice and equity by permitting the economic entity to escape liability arising out of an operation of a corporation for the benefit of the whole enterprise.  

Since the essence of a strategic affiliation is the existence and utilization of complementary resources to pursue an identified business objective, the relationship is intrinsically economically integrated. The logic enunciated in Zaist, makes it apparent that the better the economic fit, or the more strategic the affiliation, the more likely it is that the separateness of the corporate entities will be disregarded under the alter ego doctrine. The existence of economic integration alone, or even with other factors generally looked to by the courts, will not automatically trigger the application of the alter ego doctrine.  

Alter ego involves a facts and circumstances test, and the courts are fundamentally result oriented in its application. Although the traditional tests have focused on abuse, misuse, or fraud, a strong argument can be made based on current case law that the doctrine should be applied where equity so demands regardless of the presence of illegality.  

The typical fact pattern includes extensive economic integration, undercapitalization, and intrusive control and intervention into the subsidiary's operations. Separate corporate existence of STARTCO would almost certainly be disregarded to render MFGCO amenable to the claims of TECHCO and involuntary creditors.

D. The Enterprise Doctrine

Yet another basis for imposing liability on all participants in a strategic affiliation for the acts of each participant taken in pursuit of their common plan is the doctrine of enterprise liability. The basis of the doctrine is the proposition that damages caused by an economically integrated group pursuing an activity should be borne by those with some logical relationship with the enterprise activity. The doctrine correlates the corporate legal fiction with eco-

59. Supra note 41.
nomic reality by treating interrelated groups of corporations pursuing a common economic motive as a single organizational business unit.61

Professor Latty, in his 1936 work on subsidiary and affiliate corporations, concludes that rather than attempting to fit the interrelated corporate group into a doctrine of "oneness" sought by alter ego, the focus should be on the purpose for limited liability.62 If that purpose is to protect the uninvolved shareholder (whether corporate or natural), it is fully served by permitting liability to spread to other economically involved entities, but not to their respective uninvolved shareholders. Proponents of the enterprise doctrine assert that extending limited liability throughout the corporate members of the integrated group is overprotection and economically unjustifiable.63

The United States Supreme Court recently added its endorsement to the recognition of the existence and significance of the enterprise. Applying the antitrust laws in the case of Copperweld Corp. v. Independence Tube Corp.,64 the Court held that a parent and a wholly owned subsidiary were incapable of conspiring with one another to restrict trade because they are both participants in

61. See Berne Jr., The Theory of Enterprise Entity, 47 Colum. L. Rev. 843 (1947); Stone, The Place of Enterprise Liability in the Control of Corporate Conduct, 90 Yale L. J. 1 (1980).

62. Latty, Subsidiaries and Affiliated Corporations, p. 196 (1936). "Once attention is focused on the denial of limited liability, rather than on some mystical aspect of what a corporation is, entirely disconnected from the pragmatic aspect of what it does, the significant difference between the corporate and individual stockholder suggests itself. The difference is not that the parent corporation is a person 'created by law' while the individual stockholder is a person 'created by the almighty,' or that the parent hath no soul or that it is an intangible, invisible essence into which there can be merged another intangible, invisible essence so as to create a conceptional oneness more easily than in the case of an individual stockholder. The difference is simply that the parent corporation has already achieved limited liability, or rather, its' stockholders have; in other words, in allowing recovery against the parent, there is no denial of limited liability so long as the recovery does not go back to the parent to reach its stockholders and subject them to unlimited liability. But if in allowing recovery against the parent, there is no complete denial of limited liability, there is very obviously a limitation of that accepted principle. This limitation is achieved by recognizing in law what is an economic fact in nearly all of the parent-subsidiary cases reported, viz., that the parent with all of its subsidiaries and sub-subsidiaries constitutes a single economic unit."

63. Blumberg I at p. 99. "Limited liability has unthinkably been carried beyond the original objective of insulating the ultimate investor for debts of the enterprise, so that the doctrine now enables a corporate group to insulate each corporate tier of the group and thus achieve layers of insolation for the parent corporation from the liability from the obligations of numerous subsidiaries."

the same enterprise. The Court considered the economic reality as opposed to the legal formality and concluded that just as the business enterprise should be free to select the structure method of its operations, the Court should be likewise free to deal with the reality of those structures.

In *Connor v. Great Western Savings & Loan Assoc.* the court found that defendant Great Western was part of an economically integrated corporate group that built, sold, and financed a particular real estate venture and was liable to purchasers of structurally defective homes. In applying the guidelines of *Biakanja v. Irving*, the court held that Great Western owed a duty to insure the integrity of the property sold. Great Western's failure to check the land resulted in the breach of their duty, and they were subsequently found liable for the harm caused the injured homeowners.

Although the direct holding of *Connor* as applied to financial institutions has been subsequently overruled by legislative action the case indicates the court's support for the applicability of an enterprise approach to intragroup liability. Further support is found in two subsequent cases applying intragroup responsibility for the actions of individual member entities involving insurance and products liability.

Once again the question is, will the trier of fact examine the relationship of the parties and their respective responsibility for one another's acts? And once again the inquiry has revealed that the character and purpose of the relationships between the parties to a strategic affiliation provide yet another basis in the law for each participant being held accountable for the acts of each of the other

65. Id.
66. Id. at pp. 772-74.
67. 69 Cal. 2d 850, 73 Cal. Rptr. 369 (1968).
68. Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16 (1958). The court looked to:
   1. The extent to which the transaction was intended to affect the plaintiff;
   2. The foreseeability of harm to plaintiff;
   3. The degree of certainty that plaintiff suffered injury;
   4. The closeness of the connection between the defendant's conduct and the injury suffered;
   5. The moral blame attached to the defendant's conduct; and
69. Id.
70. Id.
71. See CAL. CIV. CODE § 3434 (Deering 1987).
participants. Under the enterprise theory, the traditional limitations on liability which would ordinarily insulate the shareholder/parent from the implications of the acts of its corporate subsidiary are set aside because the two have become participants in the pursuit of a common enterprise. Under the enterprise doctrine, the collective resources of the participants which were available to the enterprise will be made available to TECHCO as an involuntary creditor seeking compensation for the misappropriation and infringement of its proprietary properties by STARTCO in its pursuit of the enterprise plans.

VI. CONCLUSION

Taking considerable literary license, the involuntary creditor whose claims arose out of acts of the debtor in connection with a business plan agreed to among the debtor and other entities bringing complementary resources to the table, can in all likelihood be heard to say: "How do I love thee? Let me count the ways.\textsuperscript{74} I love thee as an agent, as a joint venturer, as an alter ego, and as an enterpriser."

The pitfall of the strategic affiliation is a lesser understood and less predictable facet of this type of relationship. That is, the more intrinsic good sense the affiliation makes, the greater the likelihood that classical concepts of limited liability will be displaced by legal doctrines which place responsibility for the acts of the participants on those who are managing, controlling, or benefiting from the activities.

Fundamental to the recognition of this element of the strategic affiliation is the acceptance of a corresponding oversight or audit responsibility. This would assure that the participants share, on a continuous basis, common perceptions of what constitutes acceptable conduct and acceptable risk. This is necessary because they are in all likelihood sharing the resulting exposure. The business and legal executives' fiduciary obligations as well as the dictates of good management and good sense mandate diligence in the scrutiny of the activities undertaken in pursuit of the common objectives to assure that those activities are consistent with the standards imposed within the executive's own company by its own policies and procedures.

\textsuperscript{74} From: ELIZABETH BARRETT BROWNING, SONNETS FROM THE PORTUGUESE, XLIII, ed. W. Peterson (Barre; 1977).