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Corporate Family Matters

Carliss N. Chatman *

Corporate groups dominate the American economy. Known publicly by a single name—Chevron, Apple, McDonald's, or Google—these companies are a web of affiliated entities, each with its own separate legal identity. Yet, corporate laws have failed to develop a statutory scheme that acknowledges these relationships among entities. While corporate personhood, separateness, and the accompanying liability protection are the primary reasons for using the corporate form, or business entities in general, form can be exploited by bad actors who seek to take advantage of the natural legal silos that define each legal entity in a corporate group as a stand-alone person. These legal silos enable bad actors to hide in plain sight, or to give the perception of a full disclosure without consequence, making some of the most egregious conduct either fraud that is difficult to unravel or behavior that is disturbing but legal. This oversight leaves the system vulnerable to market manipulation through complex business structure. As a result, consumers and investors, many concerned with corporate social responsibility and impact investing, and motivated to do business with companies that support their social causes, can be manipulated into investing and spending by the silos and veils of separateness.

When individuals act in a way that defrauds the market or causes harm, criminal law, securities law, and even tort and contract law provide remedies. When companies manipulate the market across business sectors, the antitrust laws intervene. When an individual corporation manipulates the market or engages in fraud, shareholder derivative litigation in conjunction with securities regulation provide a remedy. What is missing is a solution for market manipulation using corporate groups and, in particular, the corporate family. A system is needed for acknowledging entities that work for a common good, as the current

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structure enables these entities to manipulate what is known to investors and consumers for purposes of altering stock price, either intentionally or incidentally. This approach is the first to distinguish corporate groups by merging substantive corporate law with procedural protocols.

This Article proposes a definition and governance regime for a particular type of corporate group—the corporate family. It defines the family as an enterprise formed by weaving corporations, partnerships, and LLCs together into a mix of public and private entities acting for the benefit of a parent corporation or for the personal gain of one or more leaders of the enterprise. A corporation should be treated like a family when (1) there is more than one entity with shared ownership or management, or when an entity is wholly owned by another entity, and (2) that entity operates for the promotion of the parent's business purposes or the manager or owner's business interests. When businesses meet the standard for corporate family treatment, they are required to acknowledge influence and look to the real party in interest when determining what is material, what should be reported to shareholders, and conflicts of interest. This proposed corporate family structure acknowledges influence, while maintaining principles of corporate personhood by taking a procedural approach to determining when an entity should be deemed a family. To disregard all groups and in particular families leaves a gap in the regulatory regime that is easy to manipulate and exploit. By acknowledging influence and treating applicable corporations as a family, the market can gain a clearer and more accurate picture of business operations.

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INTRODUCTION

When you streamed *Free Meek*,[1] the documentary about rapper Meek Mill's ongoing battle with the criminal justice system, did you care who profited?[2] Would it matter more if you went a step further to purchase T-shirts or other merchandise? *Free Meek* aired on Amazon Prime Video,[3] was produced by Meek Mill's record label, Roc Nation,[4] and executive produced by Meek Mill and hip-hop artist and business owner Sean Carter, known as Jay-Z. If you knew that Roc Nation is not owned by Jay-Z, and that it is instead a wholly owned subsidiary of Live Nation Entertainment, Inc.[5] (Live Nation), would your opinion change? The ongoing debate about Jay-Z's newfound possible "sell-out" status,[6] which some are calling a

1. FREE MEEK (Amazon Prime Video 2019).

2. Meek Mill's legal name is Robert Rihmeek Williams. Bobby Allyn, *Meek Mill Pleads Guilty to Misdemeanor Gun Charge, Ends 12-Year Legal Case*, NPR (Aug. 27, 2019, 3:58 PM), https://www.npr.org/2019/08/27/754769378/meek-mill-pleads-guilty-to-misdemeanor-gun-charge-ends-12-year-legal-case [https://perma.cc/6UU3-S4PY].

3. Amazon Prime Video is a streaming platform owned and operated by Amazon and included as part of an Amazon Prime subscription.

4. Roc Nation, LLC, d/b/a Roc Nation, is a wholly owned subsidiary of Live Nation, Inc., and registered in Delaware.

5. Live Nation is a multinational corporation comprised of 739 entities. The most prominent entity is Ticketmaster. Roc Nation, LLC, is a wholly owned subsidiary of Live Nation and is registered as a Delaware Limited Liability Company (LLC); therefore there is no information about the internal structure available to the public. *See infra* Section II.A.1.

6. *See* RANDALL KENNEDY, SELLOUT: THE POLITICS OF RACIAL BETRAYAL 4 (2008) ("A 'sellout' is a person who betrays something to which she is said to owe allegiance. When used in a racial context among African Americans, 'sellout' is a disparaging term that refers to blacks who knowingly or with gross negligence act against the interest of blacks as a whole."); Jemele Hill, Opinion, *Jay-Z Helped the NFL Banish Colin Kaepernick*, ATLANTIC (Aug. 14, 2019), https://www.theatlantic.com/

"seat at the table,"[7] seems to tell us that people care where their money goes. Consumers want to know who, or what businesses, they are contracting with, and investors want information about how their investments are spent.[8] Corporate structure makes it unclear who profited from giving *Free Meek* a platform and obscures who ultimately benefits when we engage in the capital markets.[9] Live

ideas/archive/2019/08/jay-z-helps-nfl-banish-colin-kaepernick/596146/[https://perma.cc/9EBG-2JW5]; *Jay-Z's Roc Nation Entering Partnership with NFL*, NFL.COM (Aug. 13, 2019, 12:16 PM), http://www.nfl.com/news/story/0ap3000001041162/article/jayzs-roc-nation-entering-partnership-with-nfl [https://perma.cc/5V5S-EKLG]; *Inspire Change*, NFL FOOTBALL OPERATIONS, https://operations.nfl.com/football-ops/economic-social-impact/inspire-change/ [https://perma.cc/FB2P-V7EA] (last visited Oct. 16, 2021). Black consumers spend disproportionately in many sectors, and their purchasing decisions often turn on a brand's perception as authentic, culturally relevant, socially conscious, and responsible. Black consumers are also more likely to engage with a brand on social media. *See Black Impact: Consumer Categories Where African-Americans Move Markets*, NIELSEN (Feb. 15, 2018), https://www.nielsen.com/us/en/insights/article/2018/black-impact-consumer-categories-where-african-americans-move-markets/[https://perma.cc/ZQ8V-TW36]; *see also* Felicitas Morhart, Lucia Malär, Amélie Guèvremont, Florent Girardin & Bianca Grohmann, *Brand Authenticity: An Integrative Framework and Measurement Scale*, 25 J. CONSUMER PSYCH. 200, 203 (2015) (finding that consumers consider a brand to be authentic that is faithful to itself, faithful to consumer expectations, motivated by caring and responsibility to the community, and reflects the consumer's values); Amit Bhattacharjee, Jonah Berger & Geeta Menon, *When Identity Marketing Backfires: Consumer Agency in Identity Expression*, 41 J. CONSUMER RSCH. 294, 294–95 (2014).

7. *See* MICHAEL ERIC DYSON, JAY-Z: MADE IN AMERICA (2019); Dayna Haffenden, *Killer Mike Believes Jay-Z's NFL Partnership Gives "a Seat at the Table,"* REVOLT (Aug. 21, 2019, 12:44 PM), https://www.revolt.tv/2019/8/21/20839434/killer-mike-believes-jay-z-s-nfl-partnership-gives-a-seat-at-the-table [https://perma.cc/8J5T-5V8J].

8. There is an extensive body of scholarship on the impact of public reputation, beliefs about corporate responsibility, and other non-financial factors on investing and purchasing decisions. *See, e.g.*, Cary Martin Shelby, *Profiting From Our Pain: Privileged Access to Social Impact Investing*, 109 CAL. L. REV. 101, 108–10 (2021) (highlighting how socially conscious strategies that integrate environmental, social, and governance factors are increasingly being employed by mutual funds and exchange-traded funds and may have a material impact on the performance of those investments); Peter H. Huang, *How Do Securities Laws Influence Affect, Happiness, & Trust?*, 3 J. BUS. & TECH. L. 257, 266 (2008) ("Investors are motivated by not only financial wealth considerations, but also such expressive concerns as equality, equity, fairness, justice, patriotism, status, and social responsibility."); Douglas A. Kysar, *Preferences for Processes: The Process/Product Distinction and the Regulation of Consumer Choice*, 118 HARV. L. REV. 526, 528–29, 531–32 (2004) (stating "consumers may view consumption choices, at least in part, as moral acts that have personal significance irrespective of their instrumental effects" and describing how developments in international trade law, environmental, health, and safety regulation, and constitutional law suggest that consumer preferences are heavily influenced by the willingness of consumers to purchase products).

9. Henry T. C. Hu, *Too Complex to Depict? Innovation, "Pure Information," and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601, 1608 (2012) (noting that not only is it difficult to communicate financial realities when they are fully understood, but it will often be the case that the realities are not fully understood); Mihailis E. Diamantis, *Functional Corporate Knowledge*, 61 WM. & MARY L. REV. 319, 327–28 (2019) (arguing the use of respondeat superior enables corporations to diffuse knowledge across individuals, so that no one has the requisite knowledge in its entirety; today's corporate behemoths do not have to try to spread information widely because of their size and complexity); Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scienter*, COLUM. BUS. L. REV. 81, 113 (2006) ("[W]here the case against a single actor within an organization does not contain all of the requisite elements of the crime, respondeat superior liability would not attach to the corporation."); Dan K. Webb, Steven F. Molo & James F. Hurst, *Understanding and Avoiding Corporate and Executive Criminal Liability*, 49 BUS. LAW. 617, 625 (1994) ("Given the often complex

Nation can induce us to spend as consumers, contract as private actors, or invest based on imperfect and incomplete information[10] about its relationship with and control of Roc Nation and, ultimately, the artists who make up the record label.

Corporate groups dominate the American economy. Known publicly by a single name—Chevron, Apple, McDonald's, or Google—these companies are comprised of a web of affiliated entities, each with its own separate legal identity. Yet, corporate laws have failed to develop a statutory scheme that acknowledges these relationships among entities.[11] While corporate personhood, separateness, and the accompanying liability protection are the primary reasons for using the

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and decentralized nature of many corporations, it is sometimes difficult, if not impossible, to prove that any single corporate agent acted with the necessary intent and knowledge to commit an offense."); Carliss N. Chatman, *Myth of the Attorney Whistleblower*, 72 SMU L. REV. 669, 689 (2019) (discussing the role of complex business structure in the Enron scandal); FIN. ACTION TASK FORCE & EGMONT GRP. OF FIN. INTEL. UNITS, CONCEALMENT OF BENEFICIAL OWNERSHIP 26 (2018) ("A key method used to disguise beneficial ownership involves the use of legal persons and arrangements to distance the beneficial owner from an asset through complex chains of ownership. Adding numerous layers of ownership between an asset and the beneficial owner in different jurisdictions, and using different types of legal structures, can prevent detection and frustrate investigations.").

10. *See* Huang, *supra* note 8, at 286, 288–89 ("Corporate finance scholars, judicial opinions, corporate law and securities regulation scholars, and even the SEC itself, usually employ the word 'efficiency' to mean informational efficiency in the sense of the ECMH [as opposed to fundamental (value) efficiency]. . . . The difference between these concepts is that a securities 'market is "informationally efficient" if certain classes of information are immediately incorporated into a stock's price; a market is "fundamentally efficient" if a stock's price reflects only information relating to the net present value of the corporation's future profits.'"). For discussions of ECMH and informational efficiency see STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 28–33 (4th ed. 2015) for a discussion of three versions of the ECMH; Stephen J. Choi, *Behavioral Economics and the Regulation of Public Offerings*, 10 LEWIS & CLARK L. REV. 85, 111–12 (2006); Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635, 640–41 (2003) distinguishing between informational efficiency and fundamental value efficiency; Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation*, 81 VA. L. REV. 611, 646–47 (1995); Lawrence A. Cunningham, *Capital Market Theory, Mandatory Disclosure, and Price Discovery*, 51 WASH. & LEE L. REV. 843, 844–45 (1994); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851, 854–56 (1992); Lynn A. Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 MICH. L. REV. 613, 618 (1988) (finding "that the connection between prices in the public trading markets for stocks and the allocation of real resources is a weak one, and that stock markets may have far less allocative importance than has generally been assumed.").

11. *See* Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 881 (2012) ("The United States does not recognize the corporate group as a separate legal form."); Phillip I. Blumberg, *The Transformation of Modern Corporation Law: The Law of Corporate Groups*, 37 CONN. L. REV. 605, 607–08 (2005) [hereinafter Blumberg, *Transformation of Modern Corporate Law*]; PHILLIP I. BLUMBERG, THE MULTINATIONAL CHALLENGE TO CORPORATION LAW: THE SEARCH FOR A NEW CORPORATE PERSONALITY (1993) [hereinafter BLUMBERG, THE MULTINATIONAL CHALLENGE]; PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS 5 (1983) [hereinafter BLUMBERG, THE LAW OF CORPORATE GROUPS] (noting that state law definitions are necessary because state business codes provide the parameters for entity formation and governance).

corporate form, or business entities in general,[12] form can be exploited by bad actors who seek to take advantage of the natural legal silos that define each separate legal entity in a corporate family as a stand-alone person.[13] In *Myth of the Attorney Whistleblower*, I explain how these legal silos enable bad actors to hide in plain sight or to give the perception of a full disclosure without consequence, making some of the most egregious conduct either fraud that is difficult to unravel or behavior that is disturbing but legal.[14] This oversight leaves the system vulnerable to market manipulation[15] through complex business structure.[16] Particularly, our system of securities regulation, founded in disclosure, is vulnerable to distortions of the definition of "material."[17] As a result, consumers and investors, many concerned with corporate social responsibility (CSR) and impact investing, and motivated to

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12. *See, e.g.*, Carliss N. Chatman, *The Corporate Personhood Two-Step*, 18 NEV. L.J. 811, 846 (2018).

13. *See* Chatman, *supra* note 9, at 681–82 (arguing that legal silos exist when the operation of the principles of personhood require separate treatment of entities, forcing the siloing of information, and of fiduciary duties or privileges).

14. *Id.* at 682, 684–85; *see also* Diamantis, *supra* note 9.

15. In this Article, I refer to market manipulation as the traditional manipulation of the stock price which impacts investors, the manipulation of other stakeholders, and the impact that corporations can have in shaping and redefining markets. *See, e.g.*, David G. Yosifon, *The Consumer Interest in Corporate Law*, 43 U.C. DAVIS L. REV. 253, 282–83 (2009) (noting that market activity alone does not induce market manipulation; the corporate form and the current nature of investing through institutional investors exacerbates a loss of moral restraint, which in turn can create a space for corporations to engage in conduct that is exploitative); Ryan Calo, *Digital Market Manipulation*, 82 GEO. WASH. L. REV. 995, 1030 (2014) (advocating for a new framework to define market manipulation in light of the access to consumers that a digital market provides) I believe that the same should be true for capital markets.

16. Diamantis, *supra* note 9, at 327–28.

17. *See* George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 607–08 (2017) ("The larger the company, then, the less likely it is that any individual acquisition, legal proceeding, or investment project, however substantial, would be material in the context of the total informational mix."); Hu, *supra* note 9, at 1608; Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1135, 1140 (2003) (arguing that ambiguity in the materiality standard creates problems for lawyers and clients in evaluating the risks and benefits of disclosure); CHOI & PRITCHARD, *supra* note 10, at 49 ("There is an important timing aspect to the determination of materiality. Corporate officers, with the assistance of corporate counsel, must frequently consider the materiality of corporate information they choose to disclose or not to disclose . . . knowing that their decision may be later second-guessed . . . ."). In a speech entitled "The Numbers Game," SEC Chairman Arthur Levitt argued: "[S]ome companies misuse the concept of materiality. They intentionally record errors within a defined percentage ceiling. They then try to excuse that fib by arguing that the effect on the bottom line is too small to matter. . . . When either management or the outside auditors are questioned about these clear violations of GAAP, they answer sheepishly . . . 'It doesn't matter. It's immaterial.'" *See* Arthur Levitt, Chairman, Sec. & Exch. Comm'n, Remarks at the NYU Center for Law and Business: The "Numbers Game" (Sept. 28, 1998), https://www.sec.gov/news/speech/speecharchive/1998/spch220.txt [https://perma.cc/X8AX-UDSQ]; Christine A. Botosan & Mary Stanford, *Managers' Motives to Withhold Segment Disclosures and the Effect of SFAS No. 131 on Analysts' Information Environment*, 80 ACCT. REV. 751, 752–53 (2005) (showing that firms took advantage of latitude in accounting disclosure requirements to withhold information about business segments operating in less competitive industries and inferring that such non-disclosures are motivated by a desire to protect profits in less competitive industries).

do business with companies that support their social causes,[18] can be manipulated into investing and spending by the silos and veils of separateness. This manipulation is fueled by the definitions of "materiality" and the mandatory and permissive reporting regime.

This Article takes a novel approach, applying personhood theory combined with procedural norms to develop a scheme for recognition of a specific type of group—the corporate family. The family is an enterprise formed by weaving corporations, partnerships, and limited liability companies (LLCs) together into a mix of public and private entities acting together for the benefit of a parent corporation or for the personal gain of one or more leaders of the enterprise. A corporation should be treated like a family when (1) there is more than one entity with shared ownership or management, or when an entity is wholly owned by another entity, and (2) that entity operates for the promotion of the parent's business purposes or the manager or owner's business interests.[19] When businesses meet the standard for corporate family treatment, they are required to acknowledge influence and look to the real party in interest when determining what is material, what should be reported to shareholders, and conflicts of interest.[20]

When individuals act in a way that defrauds the market or causes harm, criminal law, securities law,[21] and even tort and contract[22] law provide remedies.

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18. *See, e.g.*, Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 653, 657–58 (2016); Tamara C. Belinfanti, *Forget Roger Rabbit—Is Corporate Purpose Being Framed?*, 58 N.Y.L. SCH. L. REV. 675, 678 (2013–2014); Andrew Johnston, *Facing Up to Social Cost: The Real Meaning of Corporate Social Responsibility*, 20 GRIFFITH L. REV. 221, 222 (2011); Michael E. Porter & Mark R. Kramer, *Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, HARV. BUS. REV., Dec. 2006, at 78; Lyman Johnson, *Reclaiming an Ethic of Corporate Responsibility*, 70 GEO. WASH. L. REV. 957, 964–66 (2002); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 24 J. CORP. L. 751, 803, 806 (1999); Faith Stevelman Kahn, *Pandora's Box: Managerial Discretion and the Problem of Corporate Philanthropy*, 44 UCLA L. REV. 579, 653–57 (1997); David Millon, *Theories of the Corporation*, DUKE L.J. 201, 240–42 (1990).

19. *See infra* Section I.A.

20. *See infra* Section I.B.

21. *See infra* Section II.B.

22. See *infra* note 71 for a discussion of enterprise liability. The general rule is that a corporation will avoid liability for intentional torts of its directors and agents, but may be liable for unintentional torts committed by an employee, unless the intentional tort is foreseeable. The general rule for corporate groups is that if separateness is adequately maintained, no liability will arise across entities. Liability for contracts requires privity, thus corporations are not held liable for contracts made by agents or directors that are not made on the corporation's behalf, and they are not liable for the contracts of subsidiaries. The discussion of parent liability for subsidiary torts and contracts is a subject of increasing debate for multinational corporations, particularly around the issue of human rights abuses. *See* Gwynne Skinner, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law*, 72 WASH. & LEE L. REV. 1769, 1798–99 (2015) ("[V]ictims of subsidiaries' violations of human rights norms and environmental disasters have typically not been able to pierce the corporate veil. In my view, piercing the corporate veil is simply not an adequate solution; the piercing test does not even take into consideration the unfairness limited liability creates in certain situations, where parent corporations benefit financially at the human rights or environmental expense of an often nonconsenting community."); John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N.C. L. REV. 1091, 1114 (2009)

When companies manipulate the market across business sectors, the antitrust laws intervene.[23] When an individual corporation manipulates the market or engages in fraud, shareholder derivative litigation in conjunction with securities regulation provide a remedy.[24] What is missing is a solution for market manipulation using corporate groups, and in particular, the corporate family.[25] A system is needed for acknowledging entities that work for a common good, as this current structure enables these entities to manipulate what is known to investors and consumers for purposes of altering stock price, either intentionally or incidentally. Treating and defining applicable corporations as families is a simple solution, accomplished by merging substantive corporate law with procedural protocols. By acknowledging influence and treating applicable corporations as a family, the market can gain a clearer and more accurate picture of business operations.

("[P]arent-subsidiary cases present factual situations that the courts find generally less favorable to piercing. The factors that often support holding individual shareholders of a small business liable, such as commingling of assets and failure to follow corporate formalities, may simply appear less often in corporate group cases."); Kurt A. Strasser, *Piercing the Veil in Corporate Groups*, 37 CONN. L. REV. 637, 652 (2005) ("Giving the plaintiff the deal it made, with the corporate party it reasonably thought it was dealing with, is fundamental to contract law. Thus, the idea is well developed in contract law that enforcement of the contract should be denied when the corporate group has misrepresented the identity of the corporate group party, and conversely, that enforcement should be granted when the plaintiff got the deal and the corporate party it agreed to."). The corporate family may resolve some of the questions that arise with multinational corporations.

23. Even antitrust is impacted by collaborative forces short of market manipulation. For example, common ownership of firms by institutional investors decreases competition, but is not captured by antitrust laws. Antitrust is also challenged by recognizing mergers across sectors that can result in the consolidation of all commerce into a limited number of firms. *See* José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1521 (2018) (predicting that within-industry diversification of influential shareholders can lead to less competition in portfolio firms' product markets); Robert H. Lande & Sandeep Vahessan, *Preventing the Curse of Bigness Through Conglomerate Merger Legislation*, 52 ARIZ. ST. L.J. 75, 79–80 (2020) (proposing model conglomerate legislation due to the loopholes in the current antitrust regime that would allow companies to merge so long as each owned only ten percent of every relevant market, proposing a law that would block exceptionally large corporate mergers in which both firms have assets exceeding $10 billion, unless they spin off assets so that their increase in size falls below this figure, and stating that "[t]his threshold would block at most approximately fifteen to twenty-five mergers each year"); Jonathan B. Baker, *Mavericks, Mergers, and Exclusion: Proving Coordinated Competitive Effects Under the Antitrust Laws*, 77 N.Y.U. L. REV. 135, 139–40 (2002) ("[T]he empirical economic literature does not identify reliably any particular threshold level of concentration, common across industries, at which anticompetitive effects are likely to kick in, and that literature makes clear that firm-specific and industry-specific factors, other than concentration, play an important role in determining whether higher concentration will lead to higher prices."). Corporate family may attach antitrust liability to these arrangements, thus effecting the normative goals of antitrust and corporate law generally.

24. *See, e.g.*, Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 824 (Del. 2019) (holding that when a stockholder brings a derivative suit against executives of a corporation, claiming breaches of fiduciary duties, *Caremark* requires that the board have made a good faith effort to exercise its duty of care and a failure to make such an effort constitutes a breach of the duty of loyalty—providing shareholders with a remedy).

25. *See supra* note 11; *see also* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1526–27 (2005).

In Part I, this Article explains the proposed solution—a new definition of the corporate family combined with a real-party-in-interest standard[26] for governance of the family. To designate an enterprise as a corporate family requires first looking to how the companies define themselves, then analyzing how they operate in the world, to determine whether they fit into the corporate family category.[27] In civil procedure, the real-party-in-interest standard, when necessary, breaks legal silos in order to acknowledge the influence and responsibility a particular entity may have over litigation.[28] The procedural system is focused on rewarding the plaintiff who has actually suffered the harm and on punishing the party who in reality caused the harm, not with conforming strictly to legally defined structures. To implement this solution requires reform of state statutes that define business entities.[29]

Part II of this Article makes the case for the corporate family. Once a corporate family classification is made, securities regulations and other requirements should apply to the family as a whole, not just to the publicly traded and visible entity. This change to the governance norms would alter the impact of the federal regulatory system, providing investors with a clearer and more accurate picture of the market. The ultimate goal of the corporate family structure is to empower market participants to make informed decisions, to minimize the potential for harm to the market as a whole caused by the manipulation of information, and to enable those harmed to receive access to justice without procedural delay.

Part III applies the family definition by explaining the conundrum of a federal regulatory system based on voluntary and mandatory disclosures when it is combined with state common law principles that treat all corporations equally, regardless of ownership or management structure.[30] The corporate family can minimize the ability to rely on legal silos to manipulate the market. Currently, these forces unite to create a loophole for bad actors who may manipulate state business entity laws in conjunction with the federal disclosure requirements to silo information, disclosing mandatory information about a parent in reliance on the limitation to material information, while voluntarily disclosing positive information about entities that are otherwise hidden from the public when it is beneficial.

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26. *See* FED. R. CIV. P. 17.

27. In *Corporate Personhood Two-Step*, I used the same approach to define the corporation. Chatman, *supra* note 12, at 813–14, 816–17.

28. *See* FED. R. CIV. P. 17; *infra* Part III.

29. *See infra* Section I.B.

30. Chatman, *supra* note 9, at 680, 697, 717–18 ("The business structure and management logistics determine whether the various entities are treated as truly separate under the law. Notably, this is often a legal decision made with the advice of counsel."); *see also* Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 277–84 (2020) (analyzing recent corporate scandals and finding that each organization had structure in place to prevent and detect misconduct, but silos enabled significant failures to occur despite awareness within the organization of the risk that inevitably led to each scandal).

I. A PROPOSAL FOR THE CORPORATE FAMILY

Bad actors cause the most harm when they mostly comply with regulations and appear, on the surface, to follow the law.[31] Business culture rewards management when it acts in a similar fashion.[32] As a result, the line between bad actor and forward-thinking management is blurry. Corporate scandals are born out of the fact that the information that is the focus of a particular agency or class of investors does not tell the entire story, and the culture of business does not reward optimal ethical and governance standards in the short term.[33] Preventing crime or fraud requires removing the incentives and the tools used to commit the crime or fraud.[34]

The most successful acts of fraud are based on small lies about complex and difficult-to-understand things, told in a culture that does not punish outcomes that are harmful but intentional and cloaked in process.[35] What is wrongful is the lie, not the outcome of the actions. The wrongful conduct is based on the falsity of representations, a conscious disregard for truth, and the intentions of the parties to harm. But, when companies walk up to the line without crossing, or even cross the line with a defense that shareholders and the markets support, their behavior is rewarded.[36]

Responses to corporate fraud scandals that dominate headlines are often rule based and shortsighted. The Sarbanes-Oxley Act of 2002 (Sarbanes) is an example.[37] In the wake of Enron and WorldCom, it focuses on market-based solutions that are heavy on disclosures and light on systemic and structural changes.[38] What is lost in Sarbanes is an examination of the aspect of corporate governance left to the states—corporate structure and fiduciary duties.[39]

Virginia Harper Ho explores this lack of corporate group governance and regulation in *Theories of Corporate Groups*.[40] She notes that the key defining characteristic of a group is common ownership and defines the group as including

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31. *See* Chatman, *supra* note 9, at 710–16 (discussing the mystery of modern fraud using Enron, Tesla, and Theranos as examples).

32. *See* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 712–14 (2019).

33. *See id.*; *see also* Diamantis, *supra* note 9, at 329–30 (discussing the distinction between information and knowledge).

34. Diamantis, *supra* note 9, at 329–30.

35. *See* Chatman, *supra* note 9, at 695.

36. *See* Pollman, *supra* note 32.

37. Romano, *supra* note 25, at 1526; J. Robert Brown, *The Irrelevance of State Corporate Law in the Governance of Public Companies*, 38 U. RICH. L. REV. 317, 378–79 (2004) (outlining three concerns about public company governance that need to be addressed by federal law, including the imposition of standards that would restrict the ability of management to influence the process of electing directors, and suggesting that, "[c]onsistent with Sarbanes-Oxley and the treatment of audit committees, the nominating committee should have independent financing to enable it to adequately perform its duties without untoward influence from interested members of the board").

38. *Infra* Section II.B.

39. *Infra* Section II.B.

40. Harper Ho, *supra* note 11.

"a parent company and its direct and indirect subsidiaries, each with a separate legal identity."[41] Other countries have statutes and structures that recognize groups.[42] What these countries acknowledge is the special impact that groups can have on commerce and the capital markets.[43] The regulation of corporate conduct in the United States, including groups, is typically not regulated by corporate law, and it does not need to be. The best solution for the regulation of corporate groups is not to focus on restricting behavior but instead to do what American corporate law does best: define entities.

When entities work together to operate for the best interest of the parent, or when a single corporate manager is invested in the maintenance of his or her personal empire, as was the case in Enron and other corporate scandals, these choices should not be given the shelter created by personhood.[44] Corporations act through individuals and are legally defined as individuals. To fully encompass their power to manipulate and their power to be manipulated, there is a need to consider more than who is in control of the entity. We must acknowledge influence to fully encompass the duality of a corporation's existence. This Part explains the proposed solution to address this corporate duality—the corporate family. This Part also explains how procedural elements can give the proposed statute necessary limitations.

A. The Corporate Family

There are numerous theories of corporate personhood.[45] All acknowledge that corporations and other entities are legally separate.[46] The theories vary on the degree of consideration given to state action[47] and stakeholders,[48] but all agree that each business entity is a distinct legal person.[49] This legal separateness enables a business entity to enter into contracts, own property, sue and be sued, and otherwise avail

41. *Id.* at 886.

42. *Id.* at 885; OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 129–30 (1985); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 12−13, 69 (1991).

43. *See* Harper Ho, *supra* note 11, at 885–86, 951; *see also* PETER T. MUCHLINKSI, MULTINATIONAL ENTERPRISES & THE LAW 81–85 (2d ed. 2007) (discussing the regulation of groups internationally).

44. *See* Carliss N. Chatman, *Judgment Without Notice: The Unconstitutionality of Constructive Notice Following* Citizens United, 105 KY. L.J. 49, 92–93 (2016) [hereinafter Chatman, *Judgment Without Notice*]; Chatman, *supra* note 12, at 829; *see also* HENRY N. BUTLER & LARRY E. RIBSTEIN, THE CORPORATION AND THE CONSTITUTION 4 (1995) ("[N]o one is forced to use the corporate form of organization: there is freedom of choice in organizational form. . . . This fundamental choice constrains the ability of corporate managers to misbehave.").

45. Chatman, *supra* note 12, at 818–25.

46. *Id.*

47. *Id.* at 820–22.

48. *Id.* at 822.

49. *Id.*

itself of rights and responsibilities embodied in legal personhood.[50] It gives owners and managers of entities the liability limitations and control they bargained for at formation.[51]

To give proper weight to regulations aimed at improving transparency in the market, the state law system must acknowledge the distinction between a corporation owned by individuals and a family that involves entities owned by other businesses or operating as an individual's empire. There is a measurable and operational difference between a family and a group of individual businesses operating purely for their individual interests. There is a need for state corporate laws to define and distinguish these entities so that regulations may have their intended impact. State laws and the resulting personhood theories are founded on defining bounds of the entities and the limits of their personhood. There is no legal distinction or definition of entities beyond initial formation—leaving a gap in state law regulation.[52]

These groups and families are formed intentionally. It is possible for parties, including business entities, to form an accidental partnership, but all other entity forms require compliance with the parameters set by the state for formation.[53] Because these arrangements are formed intentionally and with a concession to state requirements for formation, it is possible for the state to alter these definitions and impose requirements on these entities.[54] Applying the two-step approach to personhood requires states to first look to how a family chooses to define itself, then look to how it operates in the world, to determine whether it should be treated as a collection of separate entities or as an enterprise.[55] To properly gauge the intentionality of managers, shareholders, parties to contracts, and other stakeholders requires an acknowledgment of more than legally defined control.[56] Influence, as it is defined equitably and procedurally, is a better measure for determining the family structure.[57]

The corporate family structure enables states to mitigate market manipulation by reforming rules and statutes to treat a corporation like a family in limited circumstances.[58] A blanket enterprise treatment of corporate groups and families would have unintended consequences, as it may be overbroad.[59] This includes the risk of imposing enterprise liability in situations where causation and harm may be

50. *Id.* at 823.

51. *Id.*

52. *See, e.g.*, MODEL BUS. CORP. ACT § 2.04 (AM. BAR ASS'N 2016); DEL. CODE ANN. tit. 8, § 102 (West 2021).

53. *See* Chatman, *supra* note 12, at 848.

54. *Id.*

55. *Id.* at 830.

56. Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REGUL. 499, 524, 556 (2020).

57. *See, e.g.*, FED. R. CIV. P. 17.

58. Chatman, *supra* note 12.

59. *See infra* note 71.

too attenuated to impose liability on a parent company, sibling company, or affiliate.[60] By applying the existing real-party-in-interest standards to corporate governance and redefining to whom duties are owed, the siloing of information by companies like Enron loses its force without creating the enterprise liability that has been a source of concern.[61]

This Section provides details on how this definition may be incorporated into a statute, using the Delaware General Corporate Law (DGCL or Delaware Code) as a model. Then it explains how personhood theory, and in particular my two-step approach, gives states the capacity to define the corporate family.

1. Incorporating Families into the Statutes and Regulations

Citizens United v. Federal Elections Commission continues to be the case that comes to mind when people think of corporate personhood.[62] The case demonstrates how judges take varying approaches to corporate personhood theory in combination with substantive law definitions to determine the limits of corporate rights. The beliefs about the corporate form held by judges spill over into how corporate groups are adjudicated and regulated.[63] Courts have not drawn a distinction between stand-alone corporations, corporate groups, or corporate families, relying instead primarily on statutory control-based standards to determine whether a parent should be held responsible for conduct of a subsidiary or affiliated entity.[64] Adding the corporate family definition to business law statutes provides

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60. BLUMBERG, THE LAW OF CORPORATE GROUPS, *supra* note 11, at 5 ("Doctrines that had developed to protect ultimate investors from involvement in the legal problems of the enterprise were blindly adopted to govern the legal relationships between the components of the enterprise itself.").

61. *See* Strasser, *supra* note 22, at 646–48; Robert T. Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L L. 379, 391 (1999).

62. Anne Tucker, *Flawed Assumptions: A Corporate Law Analysis of Free Speech and Corporate Personhood in* Citizens United, 61 CASE W. RSRV. L. REV. 497, 505 (2011) ("[The law] deals with corporations in a cumbersome and often inconsistent way."); Stefan J. Padfield, *A New Social Contract: Corporate Personality Theory and the Death of the Firm*, 101 MINN. L. REV. HEADNOTES 363, 376–77 (2017) ("[T]his exercise matters . . . because decisions like *Hobby Lobby* and *Citizens United* . . . are essentially increasing corporate subsidies by strengthening corporate rights against state regulation. A corporate personality theory analysis can explain how the Supreme Court is justifying these decisions, while at the same time exposing serious flaws in the analysis."); William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 STAN. L. REV. 1471, 1503 (1989) (arguing that the Court's analysis of corporate rights is a "situational practice"); Brandon L. Garrett, *The Constitutional Standing of Corporations*, 163 U. PA. L. REV. 95, 98 (2014) ("What theory explains why corporations have some constitutional rights and not others? The Supreme Court has not offered a general theory."); Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 642–43 (2016) [hereinafter Pollman, *Constitutionalizing*] (arguing that recent decisions have created a "new reliance on state corporate law that gives governance rules a quasi-constitutional dimension that was not originally part of their DNA"); Elizabeth Pollman, *A Corporate Right to Privacy*, 99 MINN. L. REV. 27, 32 (2014) [hereinafter Pollman, *Right to Privacy*] (arguing that "the Court has not developed a coherent method or test for" determining which rights corporations hold).

63. Harper Ho, *supra* note 11, at 943.

64. *Id.* at 943–44.

courts with an approach to corporate groups that is not solely based on a judge's approach to personhood. This Article proposes changes to the Delaware Code because doing so will have the most impact on corporate law. More than one million business entities are based in Delaware, including more than sixty-six percent of the Fortune 500 companies.[65] A similar regime would be necessary under the Model Business Corporations Act, which is the corporate law of twenty-four states,[66] and in other states that have their own version of business entities statutes.[67] Statutes in other areas that integrate business code definitions of corporations may also need to change.[68]

To implement this change within the Delaware Code, legislators should first develop a subchapter for groups, reserving space for future governance of groups generally. This Article does not propose a definition of the corporate group. There are workable definitions of groups found in other statutes and regulations, and there are models in other countries for the definition of groups.[69] Instead, I propose a definition and governance model for families, as most multinational corporations, with the greatest ability to impact the capital markets, would fit into the subgroup.[70]

The Corporate Groups Subchapter should contain the following definition of corporate families:

Chapter 1. General Corporate Law

Subchapter __. Corporate Groups

§ __. Corporate Family Defined

> (a) A corporate family contains at least one entity organized under this Chapter, whose certificate of incorporation contains the provisions required by § 102 of this Title, and in addition
>
> > (1) that entity shares ownership or management with another entity, wholly owns another entity, or is wholly owned by another entity, and
> >
> > (2) the entities operate for the promotion of the parent corporation's business purposes or the manager or owner's business interests.

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65. *About the Division of Corporations*, DEL. DIV. OF CORPS., https://corp.delaware.gov/aboutagency/ [https://perma.cc/66A3-R4GF] (last visited Oct. 17, 2021).

66. *See* Chatman, *Judgment Without Notice*, *supra* note 44, at 68–70 (summarizing the reach of the Model Business Corporation Act); *see also* Jeffrey M. Gorris, Lawrence A. Hamermesh & Leo E. Strine, Jr., *Delaware Corporate Law and the Model Business Corporation Act: A Study in Symbiosis*, 74 LAW & CONTEMP. PROBS. 107, 108 (2011).

67. Chatman, *Judgment Without Notice*, *supra* note 44, at 67–68.

68. *E.g.*, MODEL RULES OF PROF'L CONDUCT r. 1.13 (AM. BAR ASS'N 1983); *see also* Chatman, *supra* note 9, at 672, 680.

69. *See supra* note 11.

70. Virginia Harper Ho, *Team Production and the Multinational Enterprise*, 38 SEATTLE U. L. REV. 499, 503–04 (2015); Peter T. Muchlinski, *Enron and Beyond: Multinational Corporate Groups and the Internationalization of Governance and Disclosure Regimes*, 37 CONN. L. REV. 725, 725–26 (2005) (analyzing how a complex international structure, a lack of oversight, and an aggressive approach to accounting and disclosure combine to undermine expectations about corporations).

(b) When this definition is met, the corporation must look to the real party in interest and acknowledge the influence of a parent corporation, shareholder, director, or officer, instead of relying on control when determining

(1) controlling shareholders,

(2) the requirements of reporting and other regulatory standards that apply to corporate groups, and

(3) conflicts of interest.

§ __. Limitations on continuation of family status.

A corporate family continues to be such and is subject to this Subchapter until any of the provisions required or permitted by § __(a) of this Subchapter ceases to be true.

This definition seeks to provide clarity to courts on when to consider a family as an enterprise and when to treat it as a collection of stand-alone entities.[71] The parent creates subsidiaries because the parent cannot conduct business in the way that is most profitable in the corporate form or because it is otherwise advantageous to divide the enterprise. There are tax, contractual and tort liability, and other advantages to organizing across entities, as opposed to conducting all business through a single corporation.[72] When companies and individuals choose to take advantage of structure, the symbiotic relationship should be acknowledged under the law. A state definition of corporate family will provide a tool for regulating all complex structures, not just those that appear before the right judge in a certain court or fall under the purview of a particular regulatory scheme.

This definition of family may also limit some of the regulatory arbitrage engaged in by national and multinational corporations, who seek the jurisdiction with the most favorable outcomes when forming. The impact of placing toxic assets into LLCs or limited partnerships,[73] or of concealing high-risk activity in numerous entities so that no single entity rises to the level of materiality that would require

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71. Veil piercing and enterprise liability are common subjects of debate in corporate law. Limited liability is a cornerstone of corporate law, but it is not limitless. Piercing the corporate veil is an equitable doctrine that allows creditors to hold an individual liable for the actions and debts of the corporation. When a parent company is a controlling shareholder of a subsidiary, there is legally no distinction between a corporation and an individual in treatment for veil piercing purposes. *See* Strasser, *supra* note 22, at 638–39, 644; Thompson, *supra* note 61, at 388–91. The decision to pierce the veil or to impose enterprise liability, which holds a parent responsible for its subsidiaries, is always left to a judge. Because it is subject to judicial discretion, clarity on the status of parents and subsidiaries could result in more consistent outcomes.

72. *See, e.g.*, Cathy Hwang, *The New Corporate Migration: Tax Diversion Through Inversion*, 80 BROOK. L. REV. 807, 812–16 (2015) ("Inverted companies can save tens of millions—if not hundreds of millions—of dollars in taxes through an inversion and the related restructurings that follow it.").

73. *See infra* Section II.B; *see also* Christopher G. Bradley, *Artworks as Business Entities: Sculpting Property Rights by Private Agreement*, 94 TUL. L. REV. 247, 272 (2020) (discussing why the LLC can be used).

inclusion on a periodic report,[74] will be minimized if management is required to reveal these relationships to investors and factor these entities into determinations of control and conflicts. The family strengthens the ability of a state to regulate an entire corporation while bringing more information into the jurisdiction of the securities regulations.[75]

Common ownership and control are pivotal in considering whether an enterprise is a corporate group. This is not the case with families. The corporate family is intended to give consideration to economic activities outside of joint ownership. By acknowledging influence instead of bright-line measures of control, franchises, distribution agreements, joint operating agreements, and other forms may factor into the determination of a corporate family. This means that not all families will be groups in the traditional enterprise sense and not all groups will be families.

The definition of family is also designed to ensure that joint ventures are only captured by the statute when they occur in scenarios that strain the joint venture status. Sharing ownership alone does not trigger family treatment. If parties are in a joint venture for the promotion of their individual interests and are not collaborating for the benefit of one or the other parties, they would not be treated as a family.[76] Similarly, if a wholly owned subsidiary is acquired purely for synergies, like the reduction of supply chain costs or for diversification, family status will not be triggered merely because a subsidiary is formed. The wholly owned subsidiary would need to operate solely in the interest of the parent or an individual.

2. Corporate Family Personhood

Courts are influenced by individual judges' views on corporate personhood.[77] These beliefs spill over into how corporate groups are adjudicated and regulated.[78] Unfortunately, courts are inconsistent in their interpretation,[79] and in turn, there is little guidance for legislatures and regulators on how to define corporations and groups to ensure that legislation and regulations have their intended consequences on bad actors. This Article attempts a move towards consistency—first with legislation that provides a definition of a particular type of group: the family. While

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74. *Supra* Section I.A.

75. *Supra* Part I.

76. *See, e.g.*, Energy Transfer Partners, L.P. v. Enter. Prods. Partners, L.P., 593 S.W.3d 732, 737–38, 740–42 (Tex. 2020) (holding that a partnership was not formed because certain conditions precedent had not been met such as board approval or definitive agreements). The TBOC provides that an association of two or more to carry on a business for profit as owners creates a partnership, regardless of whether they intend to create a partnership or what the association is called. *Id.* The Texas Supreme Court framed the issue: can parties override the default test for partnership formation by agreeing not to be partners until certain conditions precedent are met? *Id.*

77. *See, e.g.*, Tamara Belinfanti & Lynn Stout, *Contested Visions: The Value Systems Theory for Corporate Law*, 166 U. PA. L. REV. 579, 589–91 (2018).

78. *See supra* notes 40–43.

79. Chatman, *supra* note 12, at 828–29.

the lack of clear guidance on groups and families currently leads to inconsistency when the beliefs of individual judges and courts on personhood are given consideration, the application of personhood theory in conjunction with new legislation can help fill the gap left by the absence of group governance.

In exchange for the benefits of a corporation, the humans who choose to unite in the corporate form create an entity completely separate from themselves.[80] The entity created through this collaboration of the state and the natural person creates a new legal fiction embodied with its own rights, limitations, and responsibilities.[81] Similarly, when people form corporate groups and families, they do so with intention from the outset, either through mergers and acquisitions or contracts. These relationships are represented in formation documents and agreements.

Entity formation is a manifestation of freedom of contract and choice. Those who form a corporation, partnership, or LLC, and even those who work together in a joint venture, are aware that they are making an affirmative choice. The founders have a choice of what they are willing to give up in exchange for the benefits business entities can provide—full liability shields, perpetual life, investment with anonymity, and the ability to proportion profits and losses, to name a few. Mergers and acquisitions, joint ventures, and other collaborations and expansion efforts involve a similar affirmative decision made for economic benefits, including economies of scale. For these reasons, the same theories of corporate personhood that determine the rights and relationships of individual corporations can be relied upon to determine when, and if, corporate families and groups should be treated as enterprises.

As no one theory can fully encapsulate the personhood of an individual corporation, there are hints of the three dominant theories of personhood present in a corporate group.[82] In prior work, I theorize that corporations are hybrids of the artificial entity and real entity theories of personhood because of how they are formed and how they operate in the world.[83] The artificial entity, or concession, theory of the corporation states that corporations are creatures of the state that would not exist without a grant of a charter by a state actor, with rights that are not recognized until the state acknowledges the formation documents or until they engage in actions the state has deemed to meet the threshold for recognition as a business form.[84] Individual corporations are also real entities that exist as stand-alone entities capable of suing, being sued, being legally bound to contracts, committing crimes and frauds, and having other rights embodied in legal personhood. The proposed family structure continues this hybrid nature for each individual corporation but imposes an aggregate enterprise approach when certain

80. *Id.*
81. *Id.* at 846.
82. *See id.* at 824.
83. *See id.* at 824–25.
84. *Id.* at 820–22, 848.

conditions are met. The aggregate theory views the corporation's rights as indistinguishable from the rights of the people who make up the corporation—its shareholders—or in the case of the family, its parent, sibling, and affiliated entities.[85]

The aggregate approach justifies the family and justifies the consideration of the real party in interest to properly limit its application. Supporters of the aggregate theory and its spinoffs, which include the nexus-of-contracts theory, still recognize the existence of a corporate veil and clear legal distinctions between the corporation and its founders.[86] These distinctions, and this aggregation yet legal separateness, is control based—but it is also interest and influence based. The veil is preserved because the group limits the ability of an individual to control the structure while also limiting individual influence.[87] When viewing some aggregate entities as families, it is an acknowledgment that even in the absence of legally defined control, influence alone impacts the governance of entities in a way that demands informing shareholders.

Groups and families are intended, by their founders, to operate together in the interest of a parent corporation or dominant individual with influence. The entities agree to aggregate, so consideration should be given to the enterprise in the aggregate when appropriate. If groups and families are treated as hybrid entities, then they can also maintain their separate real entity identities as they operate in the world on a day-to-day basis but be considered aggregate enterprises when it is required.

An acknowledgment of influence in entities that are either formally and legally related, or which should be deemed related due to a single person or group of persons' collective control over a body of entities, discourages bad actors and allows regulators and potential gatekeepers to ignore de jure barriers between companies that do not exist in reality. This change is necessary because when personhood operates in concert with statutes that enable parties to conceal the identity of owners and managers, the family structure can be used, as it was in Enron, to defraud the investors of the parent company.[88] While corporate governance requires that corporations disclose directors, officers, and, in some circumstances, investors owning a threshold percentage of shares,[89] the governance of LLCs and partnerships, which are often used for special purpose entities (SPEs) and other

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85. *Id.* at 822.

86. *See* Joseph F. Morrissey, *A Contractarian Critique of* Citizens United, 15 U. PA. J. CONST. L. 765, 808–09, 811–12 (2013).

87. *See* Blumberg, *Transformation of Modern Corporate Law*, *supra* note 11, at 606–07 (explaining how each corporation is a separate entity and shareholders have limited liability; this concept is extended to corporate parent shareholders); BLUMBERG, THE MULTINATIONAL CHALLENGE, *supra* note 11.

88. *See* Chatman, *supra* note 9, at 720.

89. *Officers, Directors and 10% Shareholders*, U.S. SECS. & EXCH. COMM'N, https://www.sec.gov/smallbusiness/goingpublic/officersanddirectors [https://perma.cc/NDX8-UF53] (Nov. 28, 2017).

affiliates, allows for silent partners and silent managers.[90] When these secret entities are deployed and mixed with a public entity, a method utilized by Enron, management can rely on both the governance norms for the noncorporate entities and the discretionary nature of reporting to conceal wrongdoing.

An example of an entity that can be integrated into a family for the purpose of concealment is the Delaware LLC. An LLC is a business entity with a full liability shield for owners that combines characteristics of partnerships and corporations.[91] The members and managers of LLCs must comply with state requirements for formation, but those requirements, in Delaware, do not require the level of detail required in corporate reports nor do they have the same legacy found in corporate governance.[92] Members can form a Delaware LLC without placing their name on any public documents.[93] The Delaware tax rules also require an LLC to only pay an annual flat entity tax and do not require an annual report listing directors as is required with corporations.[94] Limited partnerships in all states provide similar protection of identity.

When companies choose to use these entities, either for the purpose of privacy or other benefits of the form, to conduct the business of the parent corporation or of dominant individuals, personhood should not reward their choice to structure separately with the ability to conceal information from investors and the public that is relevant to the operations across the entire enterprise. If there is clear intent to operate in the best interest of another entity or person, then the influence of that person or entity should be acknowledged. The corporate family continues the hybrid nature of corporations,[95] adding in the aggregate theory of the firm when the requisite level of influence exists across entities. It enables courts and regulators to reach the entire entity when it is necessary due to the special relationship of trust across entities, as demonstrated by operating in the interest of a parent company or influential shareholder.

B. Procedural Elements

The corporate formation, governance, and regulatory system is only effective when an adjudication system exists to reinforce the norms. This is undoubtedly true for corporate families. The better the state law for defining and recognizing corporate families, the better the adjudication of the violations that, to date, go unnoticed. The courts will be better able to hold corporations accountable, as

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90. *See* Bradley, *supra* note 73, at 270–71 ("Delaware's required disclosures are almost comically minimal.").

91. *Id.*; DEL. CODE ANN. tit. 6, § 18-104(g) (West 2021).

92. Bradley, *supra* note 73, at 270–71.

93. *Id.*

94. *See Annual Report and Tax Instructions*, DEL. DIV. CORPS., https://corp.delaware.gov/paytaxes/ [https://perma.cc/3TF3-QR8S] (last visited Oct. 17, 2021) (noting an annual tax of $300); DEL. DIV. OF CORPS., DEL. DEP'T OF STATE, DIVISION OF CORPORATIONS FEE SCHEDULE (2020), https://corpfiles.delaware.gov/Augustfee2020.pdf [https://perma.cc/JJU8-BYXB].

95. Chatman, *supra* note 12, at 846–47.

corporate families will be less able to slip through procedural cracks. By wedding procedural principles with state law definitional norms, the corporate family can maximize its impact.

The concept of considering the real party in interest, either the parent corporation or a dominant investor or manager, is not novel in the law; it is simply novel in the realm of corporate governance. In civil procedure, the real-party-in-interest standard requires that the party named in the litigation be the one who actually possesses the substantive right being asserted and has a legal right to enforce the claim.[96] The capacity to sue or be sued is defined by the law where a party is located or, for an artificial entity, the law that defines that entity.[97] A parent or subsidiary can be joined to a litigation and deemed the real party in interest if the special relationship of trust between the parties requires such joinder or if the party ultimately suffering the harm or imposing the harm is not clear from the mere legal definition of the parties.[98]

This concept, that at times equity and justice may require consideration of entities beyond the way they are strictly defined under the law, may be easily applied to the definition of entities as they are found in state business codes.[99] The new definition of family, designed to be within the limits of Federal Rules of Civil Procedure Rule 17, allows a court to break the silos created artificially by the operation of business entity law to give investors and the public an accurate picture of the corporate family's condition when justice requires. If such a measure were in place at the time of Enron, its management would not have been able to utilize SPEs to conceal activity.[100]

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96. FED. R. CIV. P. 17.

97. *Id.*

98. *See* FED. R. CIV. P. 20; *see also* Robin J. Effron, *The Shadow Rules of Joinder*, 100 GEO. L.J. 759, 762–63 (2012).

99. The new standard would actually make FRCP 17 clearer. Applying the equitable parts of the interpretation of Rule 17 would take it from a common law principle to a clearly defined legal requirement. *See* Matthew George Hartman & Rubén H. Muñoz, *Failing to Identify Parent Company as Real Party-in-Interest Proves Fatal to Petition for IPR*, AKIN GUMP STRAUSS HAUER & FELD LLP (Sept. 10, 2018), https://www.akingump.com/en/experience/practices/intellectual-property/ip-newsflash/failing-to-identify-parent-company-as-real-party-in-interest.html [https://perma.cc/59F9-39RR]; S. Christian Platt & Jasper Tran, *Failure to Refute Challenges to Real Parties-in-Interest Terminates 3 IPR Proceedings*, JONES DAY: PTAB LITIG. BLOG (Mar. 6, 2018), https://www.jdsupra.com/legalnews/failure-to-refute-challenges-to-real-38425/[https://perma.cc/FR6Z-MJED]; Paramount Pictures Corp. v. Nissim Corp., Nos. 2:14-cv-04624-ODW(ASx), 2:14-cv-04626(ASx), 2:14-cv-04628-ODW(ASx), 2014 WL 5528455, at *4, *7 (C.D. Cal. Nov. 3, 2014) (holding that neither the third party's status as a parent corporation, nor its status as co-party in the underlying litigation, qualified it as a de facto real party in interest; instead the evidence showing specific instances of the parent corporation's vice president controlling the patent dispute was dispositive); June F. Entman, *More Reasons for Abolishing Federal Rule of Civil Procedure 17(a): The Problem of the Proper Plaintiff and Insurance Subrogation*, 68 N.C. L. REV. 893, 894 (1990); Thomas E. Atkinson, *The Real Party in Interest Rule: A Plea for Its Abolition*, 32 N.Y.U. L. REV. 926, 926 (1957); John E. Kennedy, *Federal Rule 17(a): Will the Real Party in Interest Please Stand?*, 51 MINN. L. REV. 675, 724 (1967); Lewis M. Simes, *The Real Party in Interest*, 10 KY. L.J. 60, 72 (1921).

100. *See infra* Section II.A.2.

Rule 17 states:

(a) Real Party in Interest.

(1) *Designation in General.* An action must be prosecuted in the name of the real party in interest. The following may sue in their own names without joining the person for whose benefit the action is brought:

(A) an executor;

(B) an administrator;

(C) a guardian;

(D) a bailee;

(E) a trustee of an express trust;

(F) a party with whom or in whose name a contract has been made for another's benefit; and

(G) a party authorized by statute.[101]

Real party in interest is based on the law of equity.[102] As such, the standard considers more than what is considered in corporate law statutes, like control or the terms of contracts.[103] Parties may bring in evidence of equitable reasons beyond the seven listed in the Rule for considering a party to be the real party in interest. One of these factors includes influence.[104]

The real-party-in-interest standard, when necessary, breaks legal silos in order to acknowledge the influence and responsibility a particular entity may have over litigation.[105] Courts look to whether parties intended to create a special relationship of trust which would, in the interest of justice, require looking to additional parties for recovery.[106] The procedural system is focused on rewarding the plaintiff who has actually suffered the harm and on punishing the party who in reality caused the harm, not on conforming strictly to legally defined structures.[107]

Similarly, the purpose of fiduciary duty law is to ensure that managers are properly focused on the corporation—their real party in interest—as opposed to acting in their own best interest. Managers are not properly focused on the subsidiary or affiliated corporation, partnership, or LLC if there are forces, such as the interests of a parent corporation or a powerful shareholder, that demand their

101. FED. R. CIV. P. 17.

102. *See* FED. R. CIV. P. 17 advisory committee's note to subdivision (a) ("The real party in interest provision, except for the last clause which is new, is taken verbatim from [former] Equity Rule 37 (Parties Generally—Intervention), except that the word 'expressly' has been omitted.").

103. *See* 6A CHARLES ALAN WRIGHT, ARTHUR RAPHAEL MILLER & MARY KAY KANE, FEDERAL PRACTICE AND PROCEDURE § 1543 (3d ed. Supp. 2021).

104. *See* Roger Michalski, *Trans-Personal Procedures*, 47 CONN. L. REV. 321, 331 (2014); Roger M. Michalski, *Rights Come with Responsibilities: Personal Jurisdiction in the Age of Corporate Personhood*, 50 SAN DIEGO L. REV. 125, 161 (2013); Effron, *supra* note 98, at 806.

105. *See* FED. R. CIV. P. 17.

106. *See* Simes, *supra* note 99.

107. *Id.*

loyalty.[108] This split loyalty is concealed by structure and at times the very structures designed by management to work in the best interest of the corporation.[109]

The acknowledgment of influence in the corporate family statute is intended to invoke the spirit of Rule 17 and its interpretation and application. Incorporating Rule 17 enables the definition of a corporate family to apply at an enterprise level and have predictable application but also be adaptive.[110] This is accomplished by combining procedural elements with substantive corporate law, so that there are no requirements for formal filings or designations. Instead, a corporation is required to acknowledge influence for use in areas of corporate law that tend to involve a degree of discretion—on the part of the corporation itself and courts—when deciding whether the corporation has properly complied with laws and regulations.

Real party in interest and its acknowledgment of influence allow for governance of a corporate family as an enterprise in more scenarios, but the other definitional elements rein in overreach. Further, by limiting the application to the definition of the entity itself, and by placing the procedural element within the definition, there is greater clarity for statutes that seek to govern groups, without an automatic application of enterprise liability. To hold an enterprise liable for torts or contract claims, the other elements of enterprise liability or veil piercing would need to be satisfied.

Corporate groups are not monolithic, nor do all joint ownership relationships foster the market manipulation that is the concern of regulators. Some groups are more prone to manipulation because they involve sophisticated actors, complicated structures, or managers with improper motives. When applying the definition of corporate families, the outcomes will differ and should differ when a two-step approach, combined with a procedural analysis of the real party in interest, is taken. While there is a need to give greater consideration to the impact of groups, it is not necessary to develop a one-size-fits-all theory. Instead, state corporate law can focus on the type of enterprise with the most power, influence, and ability to cause harm.

Litigation is unpredictable and high stakes. In many ways, the corporate family treatment may be more exacting than the current standards for enterprise liability. This is because enterprise liability is a wholly common law doctrine, often with a fact-intensive analysis that can force a parent to settle because of the difficulty of overcoming bad facts. Examples of the fact-intensive analysis are cases with tort liability with very public adverse outcomes. Should a parent corporation lose at summary judgment, the final outcome is too unpredictable for most companies to take the chance on moving forward.[111]

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108. *See infra* Section II.A.

109. *Infra* Section II.A.

110. *See supra* note 40–43.

111. *See* Jessica M. Erickson, *Overlitigating Corporate Fraud: An Empirical Examination*, 97 IOWA L. REV. 49, 83 (2011); John Bronsteen, *Against Summary Judgment*, 75 GEO. WASH. L. REV. 522, 529 (2007) ("A grant of summary judgment would . . . have the advantage of deterring future lawsuits because plaintiffs (or their lawyers, who sometimes receive a contingent fee and are thus the real

A statute with clear parameters for when and how an enterprise should be treated as a family provides corporations with more certainty than common law standards. It is better to have the ability to predict and plan for the possible liability than to face surprise when a court delivers an unanticipated outcome. Even if a court is incorrect and the company wins on appeal, the market impact of the expenses of the victory and the uncertainty while the case was pending cannot be undone.[112]

II. THE CASE FOR CORPORATE FAMILIES

As Congress attempted to provide relief from the economic catastrophe caused by COVID-19, the legal structures that enable some corporations to have their cake and eat it too were highlighted by the CARES Act and the Paycheck Protection Program (PPP), which were intended to aid small businesses.[113] Several national, publicly traded chains were exposed for taking the aid intended for the mom-and-pop businesses that we believe to be the backbone of the American economy.[114] The language of the bill, which provides aid for companies with no more than 500 employees at a location, enabled the publicly traded companies to take advantage, as many are organized as a web of subsidiaries, franchises, and

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entrepreneurs who drive the litigation) would have to pay the costs of discovery to oppose the motion for summary judgment but would receive no award of damages. . . . But perhaps the most important feature of this litigation strategy is what happens when that motion is denied. Typically, the defendant settles the case immediately. This stands to reason because litigating after a denial of summary judgment costs money (attorneys' fees) and risks the nightmare outcome of an adverse judgment."); Samuel Issacharoff & George Loewenstein, *Second Thoughts About Summary Judgment*, 100 YALE L.J. 73, 74–75, 94 (1990).

112. For example, in *Energy Transfer Partners, L.P. v. Enterprise Products Partners, L.P.*, 593 S.W.3d 732 (Tex. 2020), the Texas Supreme Court affirmed the Dallas Court of Appeals' reversal of a $535+ million judgment against Enterprise, finding that Enterprise was not an accidental partnership. Issacharoff & Loewenstein, *supra* note 111, at 734, 736. The Court affirmed that Texas law will respect the stated intent of parties to a written agreement to form a partnership only upon the occurrence of conditions precedent, but it gave no opinion about claims from third parties, so the holding is limited to the relationship between the parties. *Id.* at 740–41. To receive this favorable outcome, Enterprise lost at trial in 2014, when the lower court found that the parties were de jure partners in a pipeline joint venture, in spite of a term sheet, confidentiality agreement, and other documents stating they were not. Energy Transfer Partners, L.P. v. Enter. Prods. Partners L.P., No. DC1112667, 2014 WL 10120268 (Tex. Dist. July 29, 2014). They were successful on appeal, but Energy Transfer Partners exercised the right to appeal.

113. Coronavirus Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134 Stat. 281 (2020); Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, 134 Stat. 620 (2020) (describing the Paycheck Protection Program, established by the CARES Act, which provides small businesses with funds to pay up to eight weeks of payroll costs, including benefits and noting that funds may be used to pay interest on mortgages, rent, and utilities and that small businesses, eligible nonprofit organizations, veterans organizations, tribal businesses, and individuals who are self-employed or are independent contractors, are eligible if they meet program size standards).

114. *See, e.g.*, Andy Sullivan, Howard Schneider & Ann Saphir, *Main Street Bailout Rewards U.S. Restaurant Chains, Firms in Rural States*, REUTERS (Apr. 17, 2020, 4:09 PM), https://www.reuters.com/article/us-health-coronavirus-usa-lending-analys/main-street-bailout-rewards-u-s-restaurant-chains-firms-in-rural-states-idUSKBN21Z3FL [https://perma.cc/R8P7-YZ7L].

affiliates, flying the name of the publicly traded entity but legally recognized as small individual businesses.[115] No single location of Ruth's Chris[116] employs more than 500 people—even though the fifteen locations are part of a publicly traded corporation with the benefit of the favorable banking relationships, goodwill, and other aspects of the Ruth's Chris name that the small businesses envisioned by the legislation do not have.

Notably, if we viewed companies like Ruth's Chris, Shake Shack, and others organized with a corporate parent and numerous storefronts with contractual and structural relationships as a single corporate family, they would fall well beyond the parameters of the CARES Act. The structure of these businesses is not illegal or unethical; they follow the norms of most chain restaurants and of many multinational corporations. Nevertheless, when someone in the general public dines in these restaurants, they do not believe they are patronizing a stand-alone independent business. Patrons and investors have an expectation of brand uniformity and consistency that reflects the reputation and goodwill of the enterprise collectively. These restaurant chains hold themselves out as one family, and its consumers and investors engage with them as a single enterprise, so the law should treat them that way.

The failure of the PPP to reach its intended beneficiaries illustrates one of the unanticipated collateral benefits of aligning the way corporate families are defined with the way they do business. Once a corporate family classification is made on a state level, Congress's use of language that has a plain meaning—a single business with 500 employees or less—could be given its intended effect, particularly by bankers, regulators, and others well versed in corporate structure who would be familiar with the new proposed state law distinctions. The definition of corporate family would apply securities regulations to the family as a whole, placing a limit on the ability for companies to rely on size and complexity to alter the meaning of "materiality."[117]

We should look to how companies choose to define themselves when we determine their personhood rights,[118] and we should also give deference to how a group of interrelated companies defines its relationships when determining whether it should be regarded as a series of single stand-alone entities, a group, or as one

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115. *See* 13 C.F.R. § 120.100 (2004) (explaining the basic eligibility requirements); CARES Act. The PPP rules are based on the definitions found in SBA Regs, which rely on control. *See* Business Loan Program Temporary Changes; Paycheck Protection Program—Additional Revisions to Loan Forgiveness and Loan Review Procedures Interim Final Rules, 85 Fed. Reg. 66,214 (Oct. 19, 2020) (to be codified at 13 C.F.R. pt. 120), https://www.govinfo.gov/content/pkg/FR-2020-10-19/pdf/2020-23091.pdf [https://perma.cc/LF6S-RZAY].

116. Ruth's Hospitality Group, Inc., is a publicly traded corporation organized in Delaware. It operates 150 restaurants domestically and has international franchises. *Corporate Overview*, RUTH'S HOSP. GRP., https://ruthshospitalitygroupinc.gcs-web.com/corporate-profile [https://perma.cc/X8W4-ASDJ] (last visited Oct. 18, 2021).

117. *Infra* Section III.A.

118. Chatman, *supra* note 12, at 830.

corporate family operating for the good of the parent. Groups and families are intended, by their founders, to operate together in the interest of a parent corporation or dominant individual with influence. The entities agree to aggregate, so consideration should be given to the enterprise in the aggregate when appropriate. If groups and families are treated as hybrid entities, then they can also maintain their separate real entity identities as they operate in the world on a day-to-day basis but be considered aggregate enterprises when it is required.[119] Doing so in the face of the pandemic would have enabled Congress to address the entities it intended—rather than rely on private investigation and public shaming to prevent corporations from taking advantage.

This definition of family is intended to have the greatest impact on management decisions that are discretionary but impacted by choices made deliberately when structuring entities. For example, corporate managers may deliberately create a separate entity with minority ownership or intentionally choose a contractual arrangement instead of forming a new entity. These formation choices also create room for management discretion when providing information to shareholders or making decisions on the application of regulations.[120] These judgment calls, many with colorable defenses and credible alternative interpretations, are easily manipulated as was the case in Enron and WorldCom.[121] While groups dominate nationally and internationally,[122] the family is in particular need of recognition and regulation because it creates more of these scenarios subject to discretion and judgment. Corporate management is able to decide who the corporation is, including which entities are a part of its group, by relying on current inconsistent definitions across regulatory regimes that are based on control as determined primarily by percentage of ownership, instead of influence.[123]

This Part explores three scenarios in which families can use their overwhelming influence and complex structure to impact the market: (1) manipulation of public opinion in a way that can impact contracting, consumption, and investing; (2) use of complex structure to manipulate financial reporting, committing explicit fraud on the market, and delaying discovery until a time that enables the family to cause excessive harm; and (3) use of the corporate family to promote the best interests of an individual instead of the businesses. This Part explains the market impact of current policies as they operate in the current system that treats all corporations equally, without regard for ownership structure. This Part also explores the role of deference to state law norms on the market

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119. *Id.* at 846. In *Corporate Personhood Two-Step*, I posit that all corporations are hybrid entities that are both artificial and real. All entities can be deemed as hybrids depending on the structure. *Id.*

120. *Infra* Section III.A.

121. *See, e.g.*, Chatman, *supra* note 9, at 691–92 (discussing how Enron's structure enabled management to seek advice from experts, including its attorneys and accountants, then rely on structural irregularities to develop workarounds when the advice did not enable them to prolong the scheme).

122. *See supra* note 78.

123. *See* Blumberg, *Transformation of Modern Corporate Law*, *supra* note 11, at 608–11 (explaining the history of control-based schemes).

impact of the three scenarios. Because securities regulations are designed to defer to state law definitions of entities, and to leave corporate governance to the domain of the states, the corporate family classification would impact the content of mandatory periodic reports and voluntary disclosures.

A. Market Impact

The capital markets reward positive periodic reports,[124] corporate leaders who develop a cult of personality that obfuscates the reality of return on investment,[125] and leaders who are innovative and cutting edge.[126] Disclosure alone cannot work in the face of these incentives. Our securities regulation regime imposes voluntary and mandatory disclosures on publicly held companies. These businesses can utilize complex structure to alter the meaning of "materiality" and in turn what is mandatory. As a result, disclosure-based solutions can become both overburdensome to smaller companies without the ability to utilize size and complexity to evade regulation and a tool of market manipulation in the hands of bad actors at large companies.

When people engage with a company, either through investment or purchases of its goods and services, they consider more than the numbers.[127] Companies can trade on their reputation and goodwill with consumers and investors. Other factors, such as social pressures and cultural beliefs, can also impact how people engage with companies.[128] The heuristics and rules of thumb used by courts and companies to determine materiality put greater weight on measurable outcomes and less weight

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124. There are many examples of companies concealing fraudulent and other harmful misconduct while continuing to post positive periodic reports and thus continuing to induce investment. *See, e.g.*, Bernard W. Bell, *Recalling the Lawyers: The NHTSA, GM, and the Chevrolet Cobalt*, 84 FORDHAM L. REV. 1899, 1904 (2016) (discussing the GM ignition failure); John Carreyrou, *Blood-Testing Firm Theranos to Dissolve*, WALL ST. J. (Sept. 5, 2008, 12:10 AM), https://www.wsj.com/articles/blood-testing-firm-theranos-to-dissolve-1536115130 [https://perma.cc/J7RP-395W].

125. *See infra* Section II.A.3.

126. *See* Pollman, *supra* note 32, at 732; Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 398 (2017) (exploring how "effective regulatory entrepreneurs weave together both time-tested and innovative new tactics to create a larger strategy for changing the law . . . . Many regulatory entrepreneurs follow the maxim that it is better to beg forgiveness than to ask for permission. In this context, that means that it is better to enter markets and start providing services to the public—legally or otherwise—than to seek approval from regulators."). Pollman and Barry provide numerous examples of specific acts of evading regulation. Bitcoin: "Marc Andreessen, the principal of a leading venture capital ('VC') firm, recounted the advice that one of his lawyers had given on the topic of the virtual currency Bitcoin: 'Good news guys. Here you have a financial instrument that can be simultaneously regulated as a currency, a commodity, and a security . . . . [R]egulators will fight over who, exactly, gets to regulate it, and *VC's job is to sneak through the fight*.'" *Id.* at 400 (footnotes omitted). Uber: "When faced with resistance by New York Mayor Bill de Blasio, Uber's user base was its biggest weapon. Uber offered free rides to passengers willing to attend a protest at City Hall on its behalf." *Id.* at 387–88. Tesla provides an example of this kind of innovation with its business model being to sell cars to consumers directly, circumventing franchised dealerships. *Id.* at 387.

127. *See supra* note 8.

128. *See, e.g.*, *supra* notes 114–118; *infra* Section II.A.1.

on this soft information.[129] So positive statements may be deemed mere puffery, and other statements must be taken in the context of the surrounding communications, but concrete factors like diminished stock price as a result of an action are clear evidence of materiality.[130]

The information that influences this soft information is not found in mandatory periodic financial statements.[131] It is found in the easier-to-manipulate voluntary data. Soft information on a micro level may not be deemed material, but in the aggregate, it can influence public opinion, which in turn can influence the market for securities.[132] Because this soft information falls outside of the realm of material information and mandatory reporting, either heuristically or by a rule of thumb, it is the least regulated and the object of the greatest management discretion. Corporations need only to tell us about business arrangements that will alienate some customers, while endearing others to the brand, when the information suits them best.

Company structure is also a subject of management discretion. Management is tasked with utilizing state business entity law to minimize liability and tax burdens,

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129. *See infra* Section II.B.

130. Recent trading of "meme stocks" has challenged the impact of information and what may be material. *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Power of Retail Investors*, 22 NEV. L.J. (forthcoming 2021) (arguing the new generation of wireless investors may not be focused on the traditional indicators but will instead use corporate governance to pursue social and environmental causes).

131. *See infra* Part III.

132. *See supra* notes 7–8 and accompanying text; *see also* Kishanthi Parella, *Reputational Regulation*, 67 DUKE L.J. 907, 940 (2018) (arguing legal sanctions and reputational costs work together with the former influencing the magnitude and effectiveness of the latter); Huang, *supra* note 8, at 293 ("An individual's emotional reactions to any particular stimulus and regulatory policy are likely to be distributed non-uniformly over a population."); Claire A. Hill & Erin Ann O'Hara, *A Cognitive Theory of Trust*, 84 WASH. U. L. REV. 1717, 1785 (2006) ("[A]cquisition of reputational capital is an important benefit of board service; overlooking Enron-level misdeeds could not only limit the reputational capital acquired, but could even have reputational costs that would compromise future earnings possibilities."); Jonathan M. Karpoff, John R. Lott, Jr. & Eric W. Wehrly, *The Reputational Penalties for Environmental Violations: Empirical Evidence*, 48 J.L. & ECON. 653, 655–56 (2005) ("[R]eputation disciplines certain types of wrongdoing because market transactions internalize their costs."); John R. Nofsinger, *Social Mood and Financial Economics*, 6 J. BEHAV. FIN. 144, 147–49, 152–55, 157–58 (2005); Brian M. Lucey & Michael Dowling, *The Role of Feelings in Investor Decision-Making*, 19 J. ECON. SURVS. 211, 218 (2005); Christopher K. Hsee & Yuval Rottenstreich, *Music, Pandas, and Muggers: On the Affective Psychology of Value*, 133 J. EXPERIMENTAL PSYCH. 23, 24 (2004); Richard L. Peterson, *"Buy on the Rumor:" Anticipatory Affect and Investor Behavior*, 3 J. PSYCH. & FIN. MKTS. 218, 218 (2002) ("Many investors are not aware that a positive event outcome does not necessarily cause security price appreciation. Their high levels of risk exposure may surprise naive investors when the euphoric affect that guided the accumulation of their high-risk positions dissipates following the event. Their diminished euphoria motivates increased caution (risk aversion) and investment repositioning (selling) of high-risk positions. In this market environment, a general increase in selling causes negative price pressure. But price decline alone increases investors' negative affect and risk aversion."); Lynn A. Stout, *The Investor Confidence Game*, 68 BROOK. L. REV. 407, 415, 420 (2002); Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 157–58 (2002); Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023, 1050 (2000).

maximize business opportunities, and make other legitimate business decisions. But structure can also be used to silo, complicate, and grow—all tactics that can aid in the obfuscation of fraudulent conduct. Structure can make what is in effect material information when aggregated and viewed collectively, based on the real party in interest, appear to be insignificant and immaterial soft information when diffused across a mix of public and private business entities. The definition of families proposed in this Article provides an opportunity to concentrate information that impacts the real party in interest, either the parent corporation or powerful management or shareholders, shedding a light on when structure is a vehicle for bad actors.[133]

When a company has a complicated structure that is coupled with a culture that disregards governance and internal controls, the inevitable penalties and even the prospect of criminal liability are not enough of a deterrent for bad actors who rely on complexity to profit in the short term without retribution. Because the federal regulatory regime cannot alter the structures used to conceal information, the best it can do is react to market disruptions, not prevent them. The power to de-incentivize this activity lies with the states, who can redefine these structures in a way that enables the securities regulations to have their intended impact.[134]

In contemplating the utility of corporate families, three scenarios come to mind: (1) manipulation of public opinion which may or may not be actionable, (2) clearly actionable crime and fraud, and (3) a cult-of-personality culture of operating as an individual's empire that uses structure to avoid crossing the line to actionable self-dealing. These actions lie on a spectrum in which the same conduct may be proper business judgment, market manipulation, or fraud depending on the intentions of the parties. Three companies illustrate these structures: Live Nation, Enron, and Tesla's relationship with Elon Musk. The three scenarios discussed below would fall within the definition of family, triggering a requirement to consider the real party in interest when determining materiality for mandatory reporting purposes, what information shareholders deserve to know about their investments, and whether conflicts of interest and self-dealing are occurring.

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133. *See* United States v. Ticketmaster Ent., Inc., No. 1:10-cv-00139, 2010 WL 5699134 (D.D.C. July 30, 2010).

134. Hui Chen & Eugene Soltes, *Why Compliance Programs Fail—and How to Fix Them*, HARV. BUS. REV., March–April 2018, at 116, 118–19 ("Many executives are rightly frustrated about paying immense and growing compliance costs without seeing clear benefits. And yet they continue to invest—not because they think it's necessarily productive but because they fear exposing their organizations to greater liability should they fail to spend enough . . . . The DOJ recognized that firms might be spending a lot and creating all the components of compliance programs but actually producing hollow facades."); Romano, *supra* note 25, at 1526–28 (noting that what is effective about Sarbanes is reporting, but any attempts at altering matters in control of the states fails).

1. Live Nation's Invisible Control

At the time of this publication, there are 833 entities in the Live Nation family throughout the world.[135] This includes Ticketmaster and its subsidiaries and affiliates. We know, through public reporting, that Live Nation's Board of Directors has eleven members and is chaired by Gregory B. Maffei.[136] When examining the interlocking relationships of the directors, the partnership with the National Football League (NFL) is no surprise. Many of its board members either serve on the boards of, are owners of shares in, or are employed by other well-known companies including ESPN, DirecTV, Nike, the NFL, and SiriusXM.[137] The President and Chief Executive Officer (CEO) is Michael J. Rapino, who will serve in that role through at least December 31, 2022.[138]

Regulatory focus on Live Nation to date is based on antitrust law and revolves around use of its market dominant position to strong-arm concert venues into using its subsidiary Ticketmaster.[139] When Live Nation, the largest concert promoter, and Ticketmaster, a dominant ticketing service, merged in 2010, it triggered concerns about market power and the potential for abuse, leading to Department of Justice (DOJ) intervention and Live Nation agreeing for a period of ten years to refrain from forcing venues to use Ticketmaster for its tours and from retaliating if the venue used a competitor.[140] In January of 2020, following a DOJ investigation and without admitting guilt, Live Nation agreed to extend the decree an additional five years.[141]

While the relationship with Ticketmaster is the most visible and subject to the greatest scrutiny, Live Nation's power is derived from its operation across various musical genres internationally through a web of individual companies. Live Nation's structure allows for a full integration of its business: the artists at the record labels can promote their work by performing at Live Nation promoted events, which serve as an additional source of revenue for the artist, and which are also ticketed through Ticketmaster, serving as a third source of income for Live Nation. Corporate governance norms do not permit us to know about the individual contractual and business arrangements with entities that are in the Live Nation family, including an entity viewed by many to be a company owned by Jay-Z, Roc Nation.

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135. Bloomberg, Company Report: Live Nation Entertainment, Inc. 3–22 (2021) (on file with author). *See* Section III.A. for a discussion of materiality.

136. *Supra* note 135.

137. Live Nation Entertainment, Inc., Current Report (Form 8-K) (Dec. 18, 2017). Rapino will receive a base annual salary of $3 million and is eligible for a cash performance bonus with a target amount equal to 200% of his base salary. *Id.* He also receives a grant of stock. *Id.*

138. Live Nation Entertainment, Inc., Current Report (Form 8-K) (Dec. 18, 2017).

139. *See* United States v. Ticketmaster Ent., Inc., No. 1:10-CV-00139, 2010 WL 5699134, at *9 (D.D.C. July 30, 2010), *amended by* No. 1:10-CV-00139-RMC, 2020 WL 1061445 (D.D.C. Jan. 28, 2020).

140. *Id.* at *13.

141. *Id.* at *16.

Roc Nation, LLC, is a wholly owned subsidiary of Live Nation. Its CEO is Diseree Perez; its Vice Chairman is Jay Brown.[142] The board includes Jay Brown and Brett D. Yormark, who is also Co-CEO of Roc Nation Unified and President of Business Operations. No other information about the company is publicly available. Roc Nation, LLC, does not rise to the level of materiality to trigger Securities and Exchange Commission (SEC) reporting individually in a sea of hundreds of privately held siblings.[143] This means that on periodic reports, Live Nation is not required to list the specifics of Roc Nation's financials. If defined as a family, more of this information would fit into the mandatory reporting requirements.

The fact that business relationships matter to consumers is illustrated by the scrutiny Jay-Z has faced for the partnership between Roc Nation and the NFL.[144] On August 13, 2019, the NFL announced that Roc Nation will help "advise on the selection of artists for major NFL performances like the Super Bowl," and will play a role in the NFL's Inspire Change initiative, a collaboration between the NFL and the Players Coalition.[145] Inspire Change focuses on education and economic advancement, police and community relations, and criminal justice reform.[146] Jay-Z stated that "[t]his partnership is an opportunity to strengthen the fabric of communities across America."[147] The general public had a different response. Many felt that Jay-Z had finally sold out.[148] Jay-Z faced extensive questioning during the initial press conference and later faced allegations that he traded his allegiance to Colin Kaepernick for an NFL payday.[149]

Ironically, this scrutiny may be undeserved—but not for social or political reasons. While Jay-Z is the face of Roc Nation, it is unclear how much of the company he actually owns, if any at all. It is unclear precisely what the financial arrangement is between Jay-Z, Roc Nation, Live Nation, and the NFL.[150] It could be merely contractual, a joint venture, or Jay-Z could be receiving shares, units, or other ownership interests in one or more companies. For the purposes of this Article, what is most interesting is that, although Jay-Z is known as the founder,

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142. *ROC Nation LLC*, BLOOMBERG, https://www.bloomberg.com/profile/company/8239239Z:US [https://perma.cc/UK65-2Y8V] (last visited Oct. 9, 2021).

143. *See supra* Section I.A.

144. *See* Hill, *supra* note 6.

145. *Jay-Z's Roc Nation Entering Partnership with NFL*, *supra* note 6.

146. *Inspire Change*, *supra* note 6.

147. *Jay-Z's Roc Nation Entering Partnership with NFL*, *supra* note 6.

148. *See* sources cited *supra* notes 7–8.

149. Hill, *supra* note 6 ("Clearly Jay-Z's support of Kaepernick only went so far. Regardless, why would Jay-Z waste any of his enormous social and cultural capital on the NFL when he doesn't need the league's platform, money, resources, or validation?").

150. *See* Live Nation Entertainment, Inc., Current Report (Form 8-K) (Apr. 29, 2008) ("[Live Nation] issued a warrant to purchase 500,000 shares of Common Stock at an exercise price of $13.73 per share to Marcy Media LLC, a company affiliated with Shawn Carter . . . in connection with the formation by . . . Marcy Media LLC [and Live Nation] of Roc Nation LLC."); Jeff Leeds, *In Rapper's Deal, a New Model for Music Business*, N.Y. TIMES (Apr. 3, 2008), https://www.nytimes.com/2008/04/03/arts/music/03jayz.html?pagewanted=all&_r=0 [https://perma.cc/P8UY-DA8Y].

owner, and manager of Roc Nation, there is no evidence of this relationship in the public documents of its parent company, Live Nation, or on the website of Roc Nation.[151] Roc Nation, a privately held LLC, exists in a silo. Making Jay-Z and Roc Nation the focus of the arrangement may be a part of an intentional and strategic business decision. Because of the structure, Live Nation can choose which of its entities it would like to showcase in its partnership with the NFL. Given the political climate,[152] what better entity than Roc Nation and the face of the company, Jay-Z?

Roc Nation is a part of the Live Nation corporate family, but due to the principles of business entities law, the general public does not have the right to find out.[153] We know that Jay-Z is the face of Roc Nation, but the law allows all other information to be hidden from us as if it were in a silo. Live Nation and Roc Nation are under no obligation to provide the public with additional details. Shareholders may exercise their statutory right to investigate further, but this right requires a proper purpose, not a naked desire to know more.[154] The acquisition and operation of Roc Nation enables Live Nation to have its cake and eat it too. It can have an urban presence when it wants, without facing any backlash from constituents who may disagree with those political positions. It can distance itself when it is useful and align itself when it is beneficial. Live Nation can report Roc Nation partnerships and financials when they are positive and stay silent when negative, because the operations of one entity out of 833 is not material.

Live Nation's manipulation of public opinion by utilizing structure, while taking advantage of the system of mandatory and voluntary reporting, is not criminal or fraudulent. Live Nation's acquisition of record labels, which ensures that Live Nation has events to promote, that Ticketmaster has events to ticket, and that Live Nation may offer itself as a premier promoter of entertainment in all genres, does not trigger antitrust scrutiny. This is the case even though these acquisitions contribute to Live Nation's incomparable bigness, market dominance, and possibly, monopoly power.[155] State laws allow Live Nation to structure complexly to

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151. *See About*, ROC NATION, https://rocnation.com/about/ [https://perma.cc/2AUU-XNAV] (last visited Oct. 18, 2021) (describing the company's founding, artists represented, divisions, and social initiatives, but not mentioning the management or ownership structure).

152. There is extensive scholarship on the impact of taking political stances on the stock price and business operations of companies. *See, e.g.*, Megan Ming Francis, *The Price of Civil Rights: Black Lives, White Funding, and Movement Capture*, 53 LAW & SOC'Y REV. 275 (2019); Simon Chadwick & Sarah Zipp, *Nike, Colin Kaepernick and the Pitfalls of 'Woke' Corporate Branding*, CONVERSATION (Sept. 14, 2018, 8:53 AM), https://theconversation.com/nike-colin-kaepernick-and-the-pitfalls-of-woke-corporate-branding-102922 [https://perma.cc/32MP-KKY7]; Melissa D. Dodd & Dustin W. Supa, *Conceptualizing and Measuring "Corporate Social Advocacy" Communication: Examining the Impact on Corporate Financial Performance*, 8 PUB. RELS. J., no. 3, 2014, at 1.

153. *See supra* Section I.A.2.

154. *See* DEL. CODE ANN. tit. 8, § 220 (West 2021).

155. Allowing companies like Live Nation to grow unchecked can have implications beyond the manipulation of public opinion and the market. *See, e.g.*, TIM WU, THE CURSE OF BIGNESS: ANTITRUST IN THE NEW GILDED AGE 14–15, 18–19 (2018) (warning that a review of history suggests that of inequality, particularly the wealth disparities caused by a failure to control

minimize taxes, maximize profits, minimize liability, and to pursue any other legitimate business purposes. The securities regulations require it to report material information in periodic and annual reports and allow it to voluntarily disclose additional information.[156] It is a reasonable business decision to take advantage of structure to generate profits in the urban market without any risk of alienating its core mainstream audience by being too political. However, in the current corporate climate that trends toward consideration of stakeholders other than shareholders, and has a focus on impact investing and corporate social responsibility (CSR), the relationship between the companies could be deemed material to some investors. It is information that has a tendency to influence investing and purchasing decisions. To date, no cases have found this manipulation of public opinion to be actionable, nor has the relationship between entities been found to be material. Live Nation fits the definition of family and the requirements for family treatment. The existing governance norms and natural silos prevent us from having public details beyond what it wants us to know about one of its most well-known and visible entities.

The Live Nation conglomerate model, in which we as investors or as mere consumers and other third-party stakeholders are in the dark about the true nature of relationships, fits most national and international conglomerates deemed by economists to be beneficial to the marketplace and free of significant harm.[157] Law-and-economics theory posits that regulation presents a restriction on the market because it chills innovation.[158] The increased liability and expense of compliance makes high-risk behavior too costly for most, so the market is deprived of entrepreneurship. This theory presumes that when entrepreneurs utilize economies of scale, take risks, and avoid personal liability through structure, there are resulting efficiencies that make for optimal economic outcomes, including the best prices and the best products. As a result, there is a presumption that multinational conglomerates are a net positive in the marketplace, so long as they are not a restraint on free market competition.[159]

These presumptions are based on information valued as if it is empirical, but that is impossible to verify. How do we know these entities serve the greater good if we do not have actual knowledge of the potentially relevant information legally

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excessive corporate power, may prompt the rise of populism, nationalism, extremist politicians, and fascist regimes).

156. *Infra* Section III.A.

157. *See* Vojislav Maksimovic & Gordon M. Phillips, *Conglomerate Firms, Internal Capital Markets, and the Theory of the Firm*, 5 ANN. REV. FIN. ECON. 225, 226–27, 242 (2013). *But see* Lande & Vahessan, *supra* note 23, at 77–80.

158. *See, e.g.*, Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789, 822–36 (2002) (arguing that new legislation and regulation causes uncertainty, which increases compliance costs); Frank Ackerman, *The Unbearable Lightness of Regulatory Costs*, 33 FORDHAM URB. L.J. 1071, 1071 (2006).

159. *See* Maksimovic & Phillips, *supra* note 157.

siloed through structure? How do market players know that the market is optimal when the information may be siloed and embargoed by structure?[160]

If our market is not truly free and open because of the cartel and monopoly power these conglomerates are allowed to assume as they integrate fully while also acquiring potential competitors through mergers and acquisitions in a way that does not trigger antitrust law, the information available may be inaccurate. This difficult-to-prove maxim leads us to believe that some cartels are acting properly. The truth is complexity and bigness make it difficult to know. Our financial scandals and the market failures of too-big-to-fail entities show that at these companies, and sometimes across an entire market sector, there is information that our dual system of corporate governance does not adequately reveal.[161] In our current system, instead of having adequate skepticism, we believe being bigger and fully integrated is better until a failure tells us otherwise.

2. Enron's Market Manipulation

What if instead of manipulating public opinion, Live Nation was manipulating financial data? What does it mean for the market if the same business structure, these families, can be used to conceal fraud? Further, what does it mean if the solution to the problem of market manipulation, increased disclosure, is still ineffective at addressing the source of the problem? Enron provides an example of the harmful extreme of data manipulation. Sarbanes,[162] the remedy to Enron, does not resolve the structural problems that contributed to the company's downfall.[163]

At Enron, corporate management took advantage of a complex structure, intentionally manipulating financial reports to further and prolong its scheme.[164] A core group of bad actors manipulated management and the board of directors to approve transactions that violated company policy, which in turn enabled the use of LLCs and limited partnerships (LPs) in the form of SPEs to profit personally while defrauding investors and harming other stakeholders.[165] The bad actors at

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160. In July of 2020 lawmakers held a hearing with Mark Zuckerberg, Jeff Bezos, Tim Cook, and Sundar Pichai, questioning the market impact of their companies. The discussion focused, in part, on anticompetitive behavior. The hearing highlighted the many ways that existing antitrust laws have failed to prevent the harmful consolidation of market power and the ways that structure has concealed many of the most problematic transactions. *See Lawmakers from Both Sides Take Aim at Big Tech Executives*, N.Y. TIMES (July 29, 2020, 6:44 PM), https://www.nytimes.com/live/2020/07/29/technology/tech-ceos-hearing-testimony?auth=login-email&login=email [https://perma.cc/PC2W-ZLP2].

161. *See* Philip E. Strahan, *Too Big to Fail: Causes, Consequences, and Policy Responses*, 5 ANN. REV. FIN. ECON. 43, 43–44 (2013) ("The TBTF problem distorts price signals in debt markets because governments cannot credibly commit to forgo bailouts (or other interventions) that protect the creditors of large financial institutions. TBTF is thus a credibility problem.").

162. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 and 18 U.S.C.).

163. *See, e.g.*, Chatman, *supra* note 9, at 694.

164. *See id.* at 689.

165. *Id.*

Enron were able to hide in plain sight, disclosing to the market that they were being cutting edge in their approach, while burying some of the details of the scheme in the required public disclosures, and using structure to conceal the most relevant facts.[166] To date, nothing has been done to address the use of the corporate family to delay the discovery of a similar scheme.[167] Instead, the Sarbanes changes are imposed on a system that fails to acknowledge the influence a parent corporation or a group of powerful individuals can have across multiple entities. The regulatory system has not and cannot solve the Enron problem.

Enron never missed a filing deadline, raised red flags for disclosures at the federal level, nor triggered shareholder scrutiny of its governance at the state level. Before its downfall, Enron was a market darling, and its investors reaped returns at an exponential rate that stifled any desire to investigate.[168] Touted as the future of energy trading and marketing, Enron was rewarded for its innovation and rapidly rising revenues.[169] For five years straight, Enron was awarded most innovative company by Fortune.[170] But Enron also never disclosed the specifics of SPE financials or structural interlocks. Only one analyst bothered to ask to see the business behind the curtain[171] and quickly discovered that there was no business.[172] Ironically, the information that led to Enron's demise was hidden in plain sight, right in the financial statements for anyone who dared to look beyond the record-breaking profits to read the footnotes.[173] The volume of information provided by Enron, combined with the complex structure and positive public opinion, enabled its unscrupulous management to tell half-truths, prolonging the discovery of its scheme.

Jeffrey Skilling operated the web of Enron-related companies like an empire—similar to Elon Musk's hand across the Tesla-related entities discussed below.[174] Skilling's degree of influence and leadership style alone did not violate securities regulations then, and it is still not a violation now. Under Skilling's leadership, Enron's maintenance of a complicated and disorganized business structure helped it to evade detection.[175] The company rewarded employees

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166. *Id.*

167. Romano, *supra* note 25, at 1523, 1526, 1529.

168. *See* Rebecca Smith & John R. Emshwiller, *'24 Days': Behind Enron's Demise*, WALL ST. J. (Aug. 8, 2003, 10:38 AM), https://www.wsj.com/articles/SB106029336126554600 [https://perma.cc/R2UD-XP9T].

169. *Id.*

170. Marianne M. Jennings, *A Primer on Enron: Lessons from a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163, 169 (2003); Bethany McLean & Peter Elkind, *The Guiltiest Guys in the Room*, CNN: MONEY (July 5, 2006, 10:27 AM), https://money.cnn.com/2006/05/29/news/enron_guiltyest/ [https://perma.cc/32WG-HZPQ].

171. *See* Smith & Emshwiller, *supra* note 168.

172. *See id.*

173. *See id.*

174. *See infra* Section II.A.3.

175. C. William Thomas, *The Rise and Fall of Enron*, J. ACCT. (Mar. 31, 2002), https://www.journalofaccountancy.com/issues/2002/apr/theriseandfallofenron.html [https://perma.cc/5BAX-XU5H].

extensively for improving the bottom line and encouraged them to do so without regard for business units, formal company structures, or internal controls.[176] At Enron, many of the factors that encourage employees to commit fraud existed: (1) incentives and pressures that incentivized fraud, (2) opportunity to commit fraud through weakened internal controls, and (3) a culture that enabled fraud.[177]

Skilling's Enron played fast and loose with its financials, taking advantage of the accounting rules in existence at the time. It used these structural loopholes to borrow money at a rate that could damage its credit ratings and chill investor confidence. Skilling, in conjunction with Enron's Chief Financial Officer (CFO), Andrew Fastow, began manipulating business structures through the use of SPEs to reduce Enron's hard assets while increasing paper profits and concealing this risky behavior.[178] Fastow simply transferred assets off of Enron's balance sheets and into an SPE, in exchange for ownership interest in the SPE.[179] Instead of taking on the debt in the name of Enron, the SPE would borrow from financial institutions to conduct business and purchase assets, which kept the transactions off Enron's financials and kept the credit rating intact. Enron also sold assets to the SPE, often at a price above the asset's value, which enabled Enron to record more profits and park bad assets in the SPE to avoid recording losses.[180] This structure enabled Enron to increase the return on assets and reduce its debt-to-total-assets ratio. This made Enron look more profitable and stable in periodic financial reports, which in turn made the company look more attractive to credit agencies and investors, enabling Enron to obtain more access to capital. Through manipulation of legal structures, Enron was able to evade every control intended to give investors adequate information to make investment decisions.

Enron conducted business through hundreds of these SPEs.[181] Guidelines in existence at the time required that only three percent of a company be owned by outside investors to avoid classification as a subsidiary that should be reported on a company's financials.[182] Enron manipulated this requirement, sometimes partnering with other companies to form SPEs and other times simply granting ownership and management interest in an SPE to an employee in his or her capacity as an individual.[183] Enron's SPEs often took the form of LPs, an entity that has a general partner who serves as manager and limited partners who are investors with

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176. *Id.*

177. *See* Chad Maddox, *SAS 99 Consideration of Fraud in a Financial Statement*, J. CONSTR. ACCT. & TAX'N, Jan.–Feb. 2004, at 19, 20.

178. *See* Neal F. Newman, *Enron and the Special Purpose Entities—Use or Abuse?—The Real Problem—The Real Focus*, 13 LAW & BUS. REV. AM. 97, 113–18 (2007).

179. *Id.* at 117–18.

180. *Id.*

181. *Id.* at 114.

182. *Id.* at 104.

183. *See id.* at 114–16.

limited liability.[184] The Enron employee or outside entity received at least a three percent interest in the SPE and assumed the role of general partner, and Enron assumed the role of limited partner.[185] General partners were incentivized with Enron stock and management fees. Enron also granted stock to the SPEs as the capital contribution, which in turn helped to incentivize lenders to loan to the SPEs due to the increasing value of Enron stock.[186]

Enron's use of SPEs created an echo chamber of artificial value easily concealed from public scrutiny in the fog of complexity. SPEs were used to improve the financial outlook of Enron, which increased the stock price, incentivizing SPE financiers to take a bet on Enron's future stock performance based solely on the artificially created values.[187]

The legal treatment of the SPEs mirrored the accounting treatment. The default rule is that businesses are treated as separate entities and separate legal people responsible for their own liabilities without regard for whether the owners are natural persons or other companies.[188] A parent corporation, sibling subsidiary, or other associated entity may only be liable for the actions of a related company under the theory of enterprise liability, a form of piercing the corporate veil.[189] If Enron's SPEs met the accounting standards for separate treatment, they would also meet the corporate law standard. This is legally significant because each legal person, natural or corporate, is viewed as an individual client for conflicts purposes and sharing information across entities is only allowed with client consent.[190]

Notably, Enron's use of SPEs was not, in and of itself, fraudulent or illegal.[191] Instead, the fraud occurred when Enron misrepresented its relationship to the SPEs in financial statements or, in some cases, buried the details in the footnotes that no one bothered to read.[192] The board did not investigate Fastow's and Skilling's representations that the entities were independent, nor did it challenge the ownership of entities by employees, including Fastow. The fraud occurred when Skilling and Fastow told only partial truths to the board and its experts, resulting in inaccurate opinions and a lack of board action. Enron hedged within itself—like a series of nesting dolls—but it only showed the public the financial outcomes of Enron Corporation, the doll that concealed a complicated network of businesses designed solely for the purpose of manipulating financial statements and obtaining more capital from lenders and business partners.

Enron's behavior resulted in the harm to the market that the securities regulations were designed to prevent, and nevertheless, the Enron-inspired reforms

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184. *Id.* at 113–14.
185. *See id.* at 115.
186. *See id.* at 114–16.
187. *See id.* at 109, 113, 137.
188. *See* Chatman, *supra* note 12, at 861.
189. *See supra* note 61.
190. *See* Chatman, *supra* note 12, at 823.
191. *See* Newman, *supra* note 178, at 118.
192. *See* Smith & Emshwiller, *supra* note 168.

in Sarbanes did not address the complex structure at the root of the scheme. If bad actors learn from Enron's mistakes, maximizing complexity, utilizing cleansing devices properly, and potentially disclosing to avoid suspicion of nondisclosure, the securities regulations are still an inadequate solution. This is because business entities are creatures of state law, so states must address the corporate governance norms that enable for manipulation through complexity. If Enron were treated as a family, the information about SPE ownership, buried in the footnotes, may have been given more prominent treatment in periodic reports. Without family treatment, the market cannot be assured that the information it has is accurate and complete.

3. Elon Musk's Tesla-Based Empire

The corporate family may also be used by individuals to promote a cult of personality, building a modern empire that evades antitrust and other scrutiny designed to prevent monopoly power from improperly influencing the market. These corporate family empires are funded with the assets of others but operate for the benefit of an individual or group of individuals. Elon Musk's self-proclaimed pyramid of businesses—Tesla, SolarCity, and SpaceX—are an example of this use.[193] Through the litigation resulting from publicly traded Tesla's acquisition of privately held and failing SolarCity, the market has learned of overlapping management, use of Tesla's stock to bail out the failing company, and the windfall profits gained by Elon Musk and the other owners of SolarCity through the exchange of Tesla stock for SolarCity stock.[194] Before the transaction, the Tesla and SolarCity relationship would only be known if Tesla chose to report on it in voluntary Form 8-Ks.[195] Tesla shareholders and the market are still unaware of the structure of SpaceX and the details of its dealings with Tesla, even though we do know all ventures operate for the benefit of Elon Musk.[196]

The capital markets reward positive periodic reports, corporate leaders who develop a cult of personality that obfuscates the reality of return on investment, and leaders who are innovative and cutting edge.[197] When a cult-of-personality leader like Elon Musk wears multiple hats, and operates across multiple entities exercising influence, the level of control should not be determined by mere ownership in a single entity.[198] Instead, consideration should be given to the impact across the entire family of entities.

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193. *See In re* Tesla Motors, Inc. Stockholder Litig., No. 12711-VCS, 2020 WL 553902, at *11 (Del. Ch. Feb. 4, 2020); Tornetta v. Musk, No. 2018-0408-JRS, 2019 WL4566943, at *6 (Del. Ch. Sept. 20, 2019); *In re* Tesla Motors, Inc. Stockholder Litig., No. 12711-VCS, 2018 WL 1560293, at *2, *19 (Del. Ch. Mar. 28, 2018).

194. *See In re Tesla*, 2018 WL 1560293, at *2–6; *In re Tesla*, 2020 WL 553902, at *2, *11.

195. *See* Section III.A.

196. *In re Tesla*, 2018 WL 1560293, at *19.

197. *See supra* notes 124–126.

198. *In re Tesla*, 2018 WL 1560293, at *19 (holding that Tesla stockholders adequately pled that Elon Musk, Tesla's CEO and Chairman, was in fact Tesla's controlling stockholder, despite being a

In 2016, Elon Musk decided to bail out SolarCity, the failing venture in his three-business pyramid that includes Tesla and SpaceX, using Tesla stock.[199] Fully aware of the conflicts of interest that existed, Musk structured the transaction by the book. The company consulted external law firms and investment banks.[200] Musk and others with close relations to SolarCity also recused themselves from the board vote.[201] After consulting these experts, the board chose to disregard their advice, largely due to the influence of Musk remaining in the room during discussions and maintaining an active role in the process of evaluating the merger. Through coercion of other board members, exploitation of conflicts of interest, and mock procedure, Musk was able to secure a majority of shareholders' votes and the full support of the board.

At the transaction's conclusion, Tesla owned what was billed by Goldman Sachs as the worst solar investment on the market.[202] Tesla doubled its debt, taking it from $3 billion to $6 billion, which harmed its position with creditors.[203] Shareholders, directors, and officers of SolarCity, including Musk, his family, and his friends, obtained a windfall and a complete return on investment in SolarCity through the sale at a price that exceeded the business valuation, avoiding the consequences of a bankruptcy. The same Musk associates who mismanaged SolarCity were allowed to continue managing the new wholly owned Tesla subsidiary. Through Musk's influence over institutional investors, many of whom are invested in all three Musk enterprises, and his control of his friends and supporters on the board, he was able to force Tesla into a transaction that, by all accounts, did harm to the company, because it benefited his empire collectively.[204]

Musk's behavior and the transactions are not criminal or fraudulent. They may not even rise to the level of a civil breach of fiduciary duty if a court finds that the recusal, retention of experts, and other measures were adequate to cure a possible

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minority shareholder—Musk exercised his influence as a controlling stockholder, with respect to the acquisition of SolarCity, due to his "voting influence, his domination of the Board during the process leading up to the acquisition against the backdrop of his extraordinary influence within the Company generally, the Board level conflicts that diminished the Board's resistance to Musk's influence, and the Company's and Musk's own acknowledgements of his outsized influence").

199. *Id.*; *see also* Isobel Asher Hamilton, *Angry Shareholders Accused Elon Musk of Using Tesla and SpaceX to Bail Out His Cousins' Solar Company for $2.6 Billion*, BUS. INSIDER (Sept. 24, 2019, 4:00 AM), https://www.businessinsider.com/elon-musk-accused-using-tesla-and-spacex-bail-out-solarcity-2019-9 [https://perma.cc/S5DU-ANSC].

200. *In re Tesla*, 2018 WL 1560293, at *7.

201. *Id.* at *8.

202. *See* Andrew J. Hawkins, *Tesla Buying SolarCity Is a Dangerous Risk That Could Totally Pay Off for Elon Musk*, VERGE (June 22, 2016, 1:08 PM), https://www.theverge.com/2016/6/22/12003316/elon-musk-tesla-solar-city-deal-model-3-powerwall [https://web.archive.org/web/20210429161237/https://www.theverge.com/2016/6/22/12003316/elon-musk-tesla-solar-city-deal-model-3-powerwall].

203. *See In re Tesla*, 2018 WL 1560293, at *11.

204. The case is still pending and stayed due to COVID-19. All directors except Elon Musk have settled.

breach of duties of loyalty, care, or good faith.[205] Instead, it is evidence of a legal loophole for behavior that is oppressive to shareholders and economically inefficient that allows corporate management to manipulate corporate assets for personal gain. Musk views Tesla, a public company, as a part of his personal pyramid of entities, and he did what he could to ensure that every part of the pyramid would survive. The SolarCity acquisition illustrates that the culture and the rules reward bad behavior. An investor or manager can rely on the characterization of entities and the definition of relationships to those entities to manipulate legally created silos.

These scenarios illustrate the various ways structure, as defined by state corporate laws, can interfere with the operation of the federal regulatory regime. Complexity can skew the accuracy of the information that is required for purposes of aiding the investor in making fully informed decisions. It can also delay the discovery of governance failures and fraud. Concealment through complexity can impact the market in other ways, such as the manipulation of public opinion for the purpose of generating sales or maintaining a business reputation. This structural complexity combines with the heuristics commonly used by courts to determine materiality,[206] and the rules of thumb used by corporations to determine when to disclose,[207] to redefine what is mandatory while giving more leeway for what is voluntary. For the company that seeks to take advantage of the system, the outcome is win-win.

The story that drives the market is what is in many circumstances outside of the definition of "material."[208] This data, on facts such as the true ownership of a company or the real relationship between a figurehead and a business, is easily and legally concealed by structure when desired. Live Nation, Elon Musk, and others can take advantage of long-held corporate governance principles to openly engage in questionable behavior without any consequence. The business judgment rule requires courts to defer to the business judgment of corporate management.[209] It presumes that directors and officers are acting in the best interest of a company, even when the outcomes are negative, and places the burden of proving a breach of fiduciary duty on the shareholder-plaintiffs.[210] The principle of corporate personhood creates the fiction of each business as a separate legal entity, embodied

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205. *See* Section III.B.

206. *See* Section III.A.

207. *See* Section III.A.

208. *See* Section III.A.

209. *See* Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, WIS. L. REV. 573, 573–74 (2000); Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 CORNELL L. REV. 261, 283–84 (1986).

210. Because of the business judgment rule, few breach-of-fiduciary-duty cases survive a motion to dismiss. *See* Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 191 (2004); Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 20, 50 (2005); Geoffrey P. Miller, *A Modest Proposal for Fixing Delaware's Broken Duty of Care*, COLUM. BUS. L. REV. 319, 323–25 (2010).

with the legal rights that accompany personhood status.[211] So, when influence is exerted across multiple entities, the current system protects the autonomy of these entities, ignoring that forces short of control can have an impact on behavior.

B. The Role of Deference

Every aspect of the structure that would define and govern a corporate family is a matter of state law.[212] Companies are defined using state business codes. Because securities regulations and other federal regulatory regimes are imposed on systems and relationships that are defined by state law, the federal disclosure and regulatory mechanisms can be altered by redefining state law relationships. When the state definitions are changed, the federal statute and regulations will also change to reflect how a state defines the entities contemplated. Once a corporate family classification is made, securities regulations and other requirements should apply to the family as a whole in addition to the publicly traded and visible entity that is currently the subject of regulation.

The SEC has, historically, given deference to state law on matters of corporate governance.[213] This includes the definition of entities. Although the definition of a security is within the purview of SEC jurisdiction, it does not turn on whether an entity is a corporation, partnership, or LLC alone.[214] States are responsible for bringing corporations into existence, defining the requirements for formation and maintaining that form. The federal regime is focused on regulations outside of the scope of those operations, taking aim at protecting the market for securities by regulating the quality of information available to investors.[215] Bills to federalize corporate governance through the creation of federal charters and federal governance norms—starting as early as 1903 to more recently with the introduction of legislation by Elizabeth Warren in 2018—have been introduced in Congress and

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211. *See* Chatman, *Judgment Without Notice*, *supra* note 44, at 55–56, 63, 73 ("The holdings in *Citizens United* and *Hobby Lobby* require the elimination of distinctions between constitutional 'persons,' regardless of how corporate rights are assigned during chartering. . . . *Citizens United* expands corporate rights, holding that the distinctions between persons and citizens are not proper; instead, corporations should not be restricted any more than a wealthy individual."); Chatman, *supra* note 12, at 824–26, 849 ("Viewing the corporation as a person is necessary for many laws and regulations to have the intended effect, and typically it is the state or federal legislatures that decide when corporate personhood is necessary.").

212. *See supra* notes 45–52.

213. *See* Chatman, *supra* note 9, at 693; *see also* Richard W. Jennings, *The Role of the States in Corporate Regulation and Investor Protection*, 23 LAW & CONTEMP. PROBS. 193, 194, 196 (1958) ("The power to incorporate is conferred by the states under general incorporation laws. . . . [T]he drive for federal incorporation, which has evoked interest from time to time, appears to have been blunted by the enactment of the federal securities legislation administered by the Securities and Exchange Commission.").

214. *See* Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1); Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10); SEC v. Howey, 328 U.S. 293, 297 (1946).

215. Part III.

failed to be made into law.[216] While there is little appetite in Congress to take over corporate governance wholesale, in times of crisis, the federal response, as exhibited by Sarbanes and the Dodd-Frank Act,[217] is to expand into governance in the ways the SEC has been allowed historically, primarily through the expansion of disclosure.[218] If states desire to maintain control of corporate governance, they should heed these warnings, taking an opportunity to address areas where business entities law and the law of fiduciary duties have failed in the past. The symbiotic relationship among state legislatures, state courts, and federal regulatory agencies is only sustainable if states take appropriate measures to curb the market impact of corporate malfeasance.

This spirit of deference impacts many ancillary matters that in other circumstances may trigger federal preemption. This is in part because Congress has been hostile to shareholder litigation over concerns that corporations were plagued with lawsuits by overzealous plaintiffs' attorneys taking advantage of the will to settle.[219] The Private Securities Litigation Reform Act of 1995 (PSLRA) is Congress's solution to what it deemed to be excessive securities litigation based on shifts in stock price rather than fraud and aimed at obtaining fees for attorneys not remedies for investors.[220] Reforms in the PSLRA include a heightened pleading standard that requires plaintiffs to include allegations giving rise to a strong inference of fraudulent intent, an automatic stay of discovery upon the filing of a motion to dismiss, lead plaintiff provisions, and a statutory safe harbor for forward-looking statements.[221]

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216. *See* Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 880–81, 893, 907 (2006); Marc I. Steinberg, *The Federalization of Corporate Governance—An Evolving Process*, 50 LOY. U. CHI. L.J. 539, 540–41 (2019); Lisa M. Fairfax, *Whitman and the Fiduciary Relationship Conundrum*, 89 FORDHAM L. REV. 409, 434 (2020) ("The law of insider trading makes it abundantly clear that demonstrating liability requires the existence of a fiduciary relationship. Yet there is less clarity on whether state or federal law governs the question about what types of relationships are included in the definition of a fiduciary relationship.").

217. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

218. *See* Steinberg, *supra* note 216, at 541–43.

219. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737; Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227; Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA's Internal-Information Standard on '33 and '34 Act Claims*, 76 WASH. U. L.Q. 537, 538, 540 (1998); Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1489–90 (2006). *But see* Érica Gorga & Michael Halberstam, *Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law*,*"* 63 EMORY L.J. 1383, 1395 (2013) (discussing the positives of discovery and shareholder litigation, including the role of discovery in developing corporate and securities laws, and the culture of corporate disclosure).

220. S. REP. NO. 104-98, at 4–9, 12–13 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 690–92; H.R. REP. NO. 104-50(I), at 15, 18–19 (1995) (adopting the view of the "many executives" who "believe that the civil liability system has been twisted and is operating unfairly against them"); *see* Choi & Thompson, *supra* note 219, at 1489–90, 1492; Sale, *supra* note 219.

221. 15 U.S.C. §§ 78u-4(a)(3), 4(b), 78u-5 (2000).

These reforms operate under an assumption that the necessary information for a successful securities fraud claim will be publicly available.[222] But, corporate families are able to conceal the information necessary to pursue litigation using size and complexity to manipulate what they are required to report,[223] which in turn limits the ability of investors to address potential fraud by pursuing litigation.

As a result of the PSLRA, shareholders who believe they have been harmed by conflicts of interest and self-dealing that does not rise to the level of insider trading are left to recover in the state court system. Similarly, when malfeasance is a breach of fiduciary duty under state law but does not meet the heightened standards for misrepresentation and other securities violations, shareholders have only a state remedy.[224] Thus, if the family definition allows more information to come into the domain of mandatory reporting, the SEC's deference to state law norms means that the corporate family structure could have an impact on securities regulations, including the definition of fraud, 10b-5 litigation, and on the definition of conflicts across multiple regulatory schemes. Through private litigation, aided with the additional information accessible to shareholders of corporate families, investors may help uncover fraud and be compensated for their losses.

At Enron, for example, shareholders and analysts were aware that the company was taking an aggressive approach to accounting and utilizing complex business structures.[225] Investors believed that it was this innovation that was responsible for the record growth of the company, so they continued to reward Enron with positive analyst ratings and record stock price gains.[226] These stakeholders were unaware of the fraud, but they endorsed the disruption and innovation.

Post-Enron, the market continues to reward companies that push the envelope and continues to invest in companies that are structurally complex. If shareholders and analysts are aware of and celebrating complexity, without being fully aware of the actions of bad actors who are manipulating that complexity to engage in self-dealing at least and fraud at most, the changes made post-Enron will

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222. *See* A.C. Pritchard, *Securities Law in the Roberts Court: Agenda or Indifference?*, 37 J. CORP. L. 105, 109, 134 (2011); Choi & Thompson, *supra* note 219, at 1489–90, 1492–93; Shannon Rose Selden, (*Self-)Policing the Market: Congress's Flawed Approach to Securities Law Reform*, 33 J. LEGIS. 57, 76–77 (2006) (discussing the reforms in the PSLRA and the overreliance on market theory that results in Congress's belief that information is publicly available).

223. *See infra* Section III.A.

224. *See* Matthew C. Turk & Karen E. Woody, *The Leidos Mixup and the Misunderstood Duty to Disclose in Securities Law*, 75 WASH. & LEE L. REV. 957, 1000–07 (2018) (citing Steckman v. Hart Brewing, Inc., 143 F.3d 1293 (9th Cir. 1998)) (providing an example in which defendants challenged plaintiff's class action on the grounds that their showing was not sufficient to state a cause of action under sections 11 and 12, arguing that alleged violations of Item 303 did not necessarily give rise to a cause of action under sections 11 and 12 of the Securities Act of 1933).

225. *See supra* notes 172–184 and accompanying text.

226. *See supra* notes 168–70, 176–84 and accompanying text.

do little to enable earlier discovery.[227] Enron's investors were not able to intervene and were not able to recover until it was too late. Investors in present-day businesses that are similarly large, complex, and innovative have no greater access to state court remedies or the corrective effects of fiduciary duty and securities litigation.

If the goal of securities regulations is to resolve information asymmetries through disclosure, state laws must aid this cause by breaking the silos that skew those disclosures.[228] What blocks potential plaintiffs from securities litigation and even success in common law breach of fiduciary duties claims is often a failure to meet the heightened pleading requirements or the running of statutes of limitations.[229] This failure is exacerbated by the difficulty of obtaining the necessary information—information that is found outside of the mandatory periodic reports.[230] The implementation of the definition of family can alter the heuristics and benchmarks used by companies to decide whether information is material, and by extension, whether that information falls within the realm of a mandatory disclosure, enabling investors who have been potentially harmed to gain access to the information before it is procedurally too late. A possible collateral benefit of the family structure may be increased access to justice.

To effectuate real change requires a change to state law norms, because there are few incentives to organize simply, or to remain public and small, while facing what many view as draconian and excessive reporting and other regulatory requirements. If a company is not taking advantage of a complex parent-and-subsidiary structure, it may pay additional taxes, face additional regulatory scrutiny, have lower returns on investment, and appear less valuable relative to similar companies that rely on the silos of complexity to improve their financial reporting. Complex structure is the smart economic decision, not merely as a means to commit fraud, but for many legitimate business purposes.

Companies should operate by taking full advantage of available structure—but they should not be rewarded when structure is used for illegitimate purposes. The incentive to grow and utilize complex structures should be based in economics, not in a desire to defraud the market. The pattern of crisis followed by more disclosure does nothing to remove the incentive or limit the ability to use structure to deceive for gain. There must be a change in structure to give the current disclosure regimes proper force.

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227. The Sarbanes changes have been viewed by many as costly, disruptive, and ineffective. *See, e.g.*, Jonathan R. Macey, *A Pox on Both Your Houses: Enron, Sarbanes-Oxley and the Debate Concerning the Relative Efficacy of Mandatory Versus Enabling Rules*, 81 WASH. U. L.Q. 329, 353–54 (2003).

228. *See* Steinberg, *supra* note 216, at 541–42; *see also* Marc I. Steinberg, *The Federalization of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 21, 2018), https://corpgov.law.harvard.edu/2018/06/21/the-federalization-of-corporate-governance/ [https://perma.cc/9W33-QCN4].

229. *See supra* notes 219–224; *see also* A.C. Pritchard, Halliburton II*: A Loser's History*, 10 DUKE J. CONST. L. & PUB. POL'Y 27, 43–48 (2015) (discussing the implications of *Halliburton Co. v. Erica P John Fund, Inc.* mitigating the cost and distractions of securities class action litigation).

230. *See infra* Part III.

An adjustment to the characterization and governance of entities cannot be made at the federal level because of the limits of the Securities Exchange Act of 1934 (1934 Act), the history of deference, and the lack of federal business entities law.[231] Instead, states can, and must, through case law and statutory changes, acknowledge the influence of parent companies, management, and dominant shareholders across multiple entities.

III. THE CORPORATE FAMILY APPLIED: CHANGES IN DISCLOSURE OBLIGATIONS

Corporate scandals are born out of ambiguity and complexity—an ambiguity that is encouraged by a focus on positive periodic reports, payment of regular dividends, and other surface indications of a company's success.[232] The line between good governance aimed at profit maximization and criminal or fraudulent corporate behavior is difficult to discern when the people who are typically the most egregious bad actors are also the same people tasked with aggressively using all the legal tools available to produce positive results. A company may legally paint itself in the best light by manipulating business structures, tax laws, accounting rules, and other regulations with the assistance of attorneys and other experts, and it may be deemed to be in breach of its duties if it fails to do so.[233] "Management is rewarded for painting the part of the story that the market sees quarterly and annually in the best light with positive market reports, increased stock prices, and often additional personal compensation."[234] In order to make a company look as positive as possible in public filings, management will walk as close to the line as possible without crossing it.[235]

The definition of corporate family and its application are intended to minimize judgment calls on the duties imposed by special relationships of trust within corporations. One of the most subjective judgment calls by management is the decision to disclose or withhold information because it may hinge on a determination of materiality, which can be combined with legitimate or self-serving business motivations. For investors in publicly traded companies, the primary source of information about their investments is made publicly available in compliance with securities regulations.

The systems in place to address fraud are all based on mandatory disclosure of information—either to insiders, so that they may make informed decisions, or to

231. *See infra* Part III.

232. *See* Hu, *supra* note 9, at 1608 (arguing that not only is it difficult to communicate financial realities when they are fully understood, but it will often be the case that the realities are not fully understood).

233. *See* Diamantis, *supra* note 9, at 325–26 (noting that "[t]he line between criminal and innocent conduct frequently turns on what defendants knew," making monitoring of employees and compliance leaving the company worse off).

234. Chatman, *supra* note 9, at 722.

235. *Id.*

regulators, so that they may protect the public.[236] Unfortunately, this disclosure regime is prone to manipulation through legal structures that create complexity.[237] A corporation that is a large multinational family has a greater opportunity to utilize these structures to alter public opinion.[238] The system of mandatory disclosures combines with a system of voluntary disclosure that can allow for a disproportionately positive impact on the market or flooding the market with so much information that it is difficult to determine what really matters.

When a company is organized in a network that combines public entities and private affiliated entities, the structure works in concert with disclosures to result in too much information about a parent corporation but not enough information about siblings and subsidiaries. As a result, what is successful about recent reforms, including Sarbanes and the Dodd-Frank, is not the encouragement of whistleblowing and voluntary disclosure but changes to what regulators monitor and the means by which they monitor industries.[239] Placing the corporate family into these regulatory schemes improves the efficacy of efforts to protect the market with disclosure.

This Part discusses how the interplay of mandatory and voluntary disclosures allows for manipulation of the information provided to the market, creating a need for reform to the structures defined by state law. It highlights the danger of excessive disclosure and the use of disclosures as a cleansing device for behavior that may violate the duties of loyalty and care. When these disclosures are combined with state standards, they can provide a mechanism for disclosing only what is

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236. *See* Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 146 (2006); *see also* M. Ryan Calo, *Against Notice Skepticism in Privacy (and Elsewhere)*, 87 NOTRE DAME L. REV. 1027, 1054 (2012) ("Privacy policies are not exactly 10-Ks. But these are long documents—Facebook's privacy policy reportedly contains more words (5,830) than the entire United States Constitution. Consumers have a tendency to skip or skim these documents and are not generally capable of processing all the information they contain."); Paula J. Dalley, *The Use and Misuse of Disclosure as a Regulatory System*, 34 FLA. ST. U. L. REV. 1089, 1090–91 (2007); Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 928 (2011) ("Registration is the vehicle for mandatory disclosure under the Securities Act. Liability results from a failure to register offers or sales of securities and from fraudulent or other objectionable activities (e.g., material misstatements or omissions in registration statements and prospectuses) in connection with the registration requirement. Congressional and SEC rulemaking and decision-making under the Securities Act focuses on supporting investor protection and market integrity in this context." (footnote omitted)); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1199–200 (1999).

237. *Supra* notes 15–16; *see also* Lipton, *supra* note 56, at 501–04 (advocating for disclosures to noninvestor audiences due to the breakdown in the system).

238. Georgiev, *supra* note 17.

239. Donald C. Langevoort, *Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's "Duty of Care as Responsibility for Systems*,*"* 31 J. CORP. L. 949, 950 (2006) (explaining controversy over Part 404 of Sarbanes); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 21 (2002) (arguing that Sarbanes is unlikely to do a better job than self-correcting markets); Romano, *supra* note 25, at 1529–43 (evaluating substantive corporate governance mandates of Sarbanes based upon relevant empirical accounting and finance literature).

positive, and concealing what is negative, to generate artificially positive periodic reports.

A. The Interplay of Voluntary and Mandatory Disclosures

When corporations operate as systems of entities, it is possible to disclose properly while concealing relevant, but not material under the securities regulations, information. The information on operations and possible governance failures of a separate company are not relevant or accessible under current systems, especially in a partnership or LLC without clearly defined regulations or nonpublic entities without SEC or stock exchange oversight. These requirements do not reflect the reality when entities and natural persons have influence but not the requisite ownership or control to be considered material.[240]

A regulatory framework focused on the externalities of corporate activities is the basis of federal regulation of corporations. This is in part because the only area of corporate governance subject to federal control is through the regulation of the capital markets,[241] so the federal system is by nature reactionary. The Securities Exchange Act of 1934 is focused on the structure and operation of securities markets, and the SEC's regulation of the market is limited by the bounds of the 1934 Act.[242] As such, the SEC is excluded from the traditional domain of the states, corporate governance.[243] The concern of the regulatory system is the market impact of fraudulent reports, which hide the flaws and failures of a company from the target audience, the "reasonable investor." These structures trigger the strongest penalties and requirements when actions alter the information available to investors on the open market.

If an LLC or partnership is being used to possibly impact the financial outcome of the parent, this information is relevant to the board of the parent and

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240. Dale A. Oesterle, *The Overused and Under-Defined Notion of "Material" in Securities Law*, 14 U. PA. J. BUS. L. 167, 169 (2011) ("Simply put, the abstract formulation of the materiality standard frequently does not fit the holdings on the facts. The reason becomes obvious as the case law accumulates—the concept as defined explicitly by the Supreme Court is over-broad and the courts are crafting specific exclusions." (footnote omitted)); Richard C. Sauer, *The Erosion of the Materiality Standard in the Enforcement of the Federal Securities Laws*, 62 BUS. LAW. 317, 317 (2007) ("Too little information provides an inadequate basis for investment decisions; too much can muddle and diffuse disclosure and thereby lessen its usefulness. The legal concept of materiality provides the dividing line between what information companies must disclose—and must disclose correctly—and everything else. Materiality, however, is a highly judgmental standard, often colored by a variety of factual presumptions. Recent years have witnessed an effort by the Securities and Exchange Commission to recast certain such presumptions to make the standard more inclusive."); John M. Fedders, *Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard*, 48 CATH. U. L. REV. 41, 42 (1998).

241. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 869 (2003).

242. THOMAS LEE HAZEN, PRINCIPLES OF SECURITIES REGULATION 200 (2d ed. 2006); JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 39–40 (3d ed. 2003).

243. HAZEN, *supra* note 242; Business Roundtable v. SEC, 905 F.2d 406, 408 (D.C. Cir. 1990).

possibly the shareholders. It may not, however, trigger reporting requirements because this class of information falls outside of the scope of the 1934 Act. This determination is based in part on how state law defines the entities. In a corporate family, the top of the chain should be the board of the parent, not, as happened with the SPEs at Enron, the highest level of management at a subsidiary or affiliate.[244] As the companies that make up a family are currently defined, each entity is a stand-alone legal person, and the determination of who is management or the client, and whether such an entity must be included on periodic reports of the parent, is determined primarily by how these entities are defined by the states and formed by the founders. The reality of the influence amongst entities is disregarded. Accountants, lawyers, auditors, underwriters, and other intermediaries and experts hired across entities ultimately serve two masters: the actual affiliated entity they are retained by and, if that entity is operated for the benefit of the parent, the individuals at the parent or management of the parent who have influence over their services. The corporate family definition seeks to acknowledge the one supreme master it serves—the parent.

Our regulatory structure is a necessary design in our federalist government, but it prevents the federal government from taking measures that are known to be preventative. Culture is not changed by merely monitoring and reporting. Instead, an enforcement and regulatory regime that mandates compliance with best practices and norms is best for preventing conduct. This gives greater impact to our state law system, providing synergies. But, by leaving corporate governance all to the states, mandating only federal reporting, there is no appetite for establishing these best practices. The norms for misconduct are imposed on those with state-issued professional licenses who have a higher duty to operate using professional judgment and are positioned to serve as intermediaries and gatekeepers. Corporate culture is otherwise limited only by the spectrum from business judgment rule protection to absolute liability for waste.[245]

A typical multinational family will involve a publicly traded American company, comprised of affiliates in the United States and abroad that may also be public corporations, private corporations, partnerships, LLCs, and even joint ventures. The 1934 Act imposes registration and reporting requirements on issuers of certain types of securities.[246] Typically, the publicly traded parent corporation is

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244. *See* Chatman, *supra* note 9, at 696–97 (discussing the way Enron used partnerships to manipulate billions of dollars and the legal treatment of SPEs).

245. There are certainly areas and industries that allow the federal government to do more. The Food and Drug Administration's (FDA) regulation of pharmaceuticals and the food supply is an example. *See, e.g.*, Marchand v. Barnhill (*Blue Bell*), 212 A.3d 805, 822 (Del. 2019). This case illustrates the type of regulation needed to prevent conduct and to provide shareholders with remedies in return because the failure to comply with federal mandates in turn invokes an actionable failure to assume *Caremark* duties. *Blue Bell* also illustrates that securities regulation is not enough as there are limits to the power of market regulation. The litigation is powered by the initial FDA violation; no securities misconduct is discoverable without it.

246. Securities Exchange Act of 1934 § 12, 15 U.S.C. § 78l.

required to file reports quarterly (Form 10-Q) and annually (Form 10-K) with the SEC.[247] Some aspects of Forms 10-Q and 10-K are always required, and others are based on specified numerical thresholds.[248] Other aspects are discretionary, based on a determination of materiality, a standard that requires officers to make a judgment call that could be challenged after the fact.[249]

The 1934 Act also requires officers, directors, and ten percent beneficial owners to file reports of all transactions in the company's shares and requires any person acquiring five percent of an equity security to disclose.[250] Sarbanes empowered the SEC to promulgate additional mandatory disclosures as it deems necessary to protect investors.[251] In determining what must be disclosed under these provisions, the regulations and case law all rely on the materiality standard.[252]

Companies are not expected to predict the future, but they are expected to be honest about the past. The 1934 Act prohibits fraud in connection with all securities transactions under Rule 10b-5, regardless of whether the company is publicly traded.[253] For publicly traded companies, a failure to disclose information having an impact on the business or financial condition must be disclosed either in the next quarter on the Form 10-Q or, for some matters, within four business days on a Form 8-K.[254] Thus, all false statements can trigger liability, but a failure to make statements only imposes liability for issuers of publicly traded securities. There is incentive to remain silent unless there is a benefit to providing the public with information about the nonpublic members of a corporate family. Nondisclosure alone does not violate 10b-5 without an independent duty.

The regulations define material information as "matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the [security]."[255] Although defined in the positive, the application of this definition of "material" revolves around which facts are known to be missing in retrospect. With the benefit of hindsight, the Supreme Court explains that "[a]n omitted fact is material if there is a substantial likelihood

247. Securities Exchange Act of 1934 §§ 12, 13(a), 15 U.S.C. §§ 78l, 78m(a); HAZEN, *supra* note 242, at 203.

248. *See* Business and Financial Disclosure Required by Regulation S–K, Securities Act Release No. 10,064, Exchange Act Release No. 77,599, 81 Fed. Reg. 23,916, 23,925 (Apr. 22, 2016); 17 C.F.R. §§ 229.101(c)(ii), 229.601(b), 229.404 (West 2021).

249. CHOI & PRITCHARD, *supra* note 10, at 49.

250. §§ 16(a), 13(d).

251. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 409, 116 Stat. 745, 791 (codified in scattered sections of 15 and 18 U.S.C.).

252. *See* Georgiev, *supra* note 17, at 617–18 (giving examples of various regulations that require disclosure based on materiality); Oesterle, *supra* note 240, at 170.

253. 17 C.F.R. § 240.10b-5 (West 2021).

254. Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, 69 Fed. Reg. 15,594 (Mar. 25, 2004) (to be codified at 17 C.F.R. pt. 228, 229, 230, 239, 240, 249); Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date; Correction, 69 Fed. Reg. 48,370 (Aug. 10, 2004) (to be codified at 17 C.F.R. pt. 239, 249).

255. 17 C.F.R. § 240.12b-2 (West 2021).

that a reasonable shareholder would consider it important in deciding how to vote."[256] Because the standard is based on hindsight, in many ways, all decisions on what to disclose, even the disclosure of historical facts, involve a bit of forecasting. The materiality determination is fact specific, and corporate management is making a decision about whether actions that have occurred in the past will be deemed by shareholders in the future to be relevant to their investment and voting decisions.[257] Because the standard is evasive, companies use ranges and thresholds, commonly known as rules of thumb. Typically if a matter impacts earnings by three to ten percent, they deem it to be material.[258] Judges also rely on rules of thumb and heuristics to help them simplify the analysis and avoid the complexity of materiality decisions.[259] When analyzing materiality, Professors Bainbridge and Gulati found that courts tend to (1) treat vague statements of optimism by company officials, or puffery, to be immaterial; (2) apply the bespeaks-caution doctrine, requiring statements to be taken in context to be material; (3) deem information that does not result in a price change to be immaterial as a matter of law; and (4) deem matters trivial based on value or size, because they relate to only a small aspect of the business to be immaterial.[260]

The backward-looking interpretation of materiality by courts, combined with the rule of thumb workarounds utilized by companies, and the heuristics used by courts, encourage companies to rely upon size, complexity, and loopholes using disclosure when it suits them and avoiding it, legally and without penalty, when it does not. The heuristics allow companies to (1) make vague positive statements

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256. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976). This definition has been reaffirmed in recent Supreme Court decisions. *See* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011); Halliburton Co. v. Erica P. John Fund, Inc., 573 U.S. 258, 278 (2014).

257. Georgiev, *supra* note 17, at 620; 17 C.F.R. § 240.12b-2 (West 2021); Peter H. Huang, *Moody Investing and the Supreme Court: Rethinking the Materiality of Information and the Reasonableness of Investors*, 13 SUP. CT. ECON. REV. 99, 99, 101–02 (2005); Lawrence A. Cunningham, *Capital Market Theory, Mandatory Disclosure, and Price Discovery*, 51 WASH. & LEE L. REV. 843, 845 (1994).

258. *See SEC Staff Accounting Bulletin No. 99—Materiality*, U.S. SEC. & EXCH. COMM'N (Aug. 12, 1999), https://www.sec.gov/interps/account/sab99.htm [https://perma.cc/X9YJ-4Z2C] (providing guidance in applying materiality thresholds to the preparation of financial statements and holding that a four percent overstatement of net income is immaterial by GAAP standards as long as no item in the registrant's consolidated financial statements is misstated by more than five percent); Elizabeth MacDonald, *SEC Readies New Rules for Companies About What Is 'Material' for Disclosure*, WALL ST. J., Nov. 3, 1998, at A2 ("Most auditors—and their corporate clients—define materiality as any event of news that might affect a company's earnings, positively or negatively, by 3 percent to 10 percent. . . . [This] has become standard practice in corporate America. Thus, if a particular charge or event does not meet the 3% to 10% level, companies feel they don't have to disclose it."); Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of Principles-Based Systems in Corporate Law, Securities Regulation, and Accounting*, 60 VAND. L. REV. 1409, 1458 n.196 (2007) (noting that the SEC repeatedly held that the "three percent rule of thumb test" was a principle, not to be taken as a "one-size-fits-all-test").

259. Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (the Same Way Everybody Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 118–19 (2002) (identifying ten heuristics utilized by judges at the motion to dismiss and summary judgment stages in securities cases related to disclosures).

260. *Id.* at 120–25.

without consequence;[261] (2) shield unsubstantiated positive information in a sea of disclaimers and contradictory information; (3) take their chances that the market will improve when they choose to conceal, which eliminates a shareholder's cause of action as a matter of law; or (4) become large and complex enough that most things can be deemed trivial or not a part of the business of the publicly traded entity. It is in this paradigm that companies can manipulate structure to evade mandatory disclosure requirements: by becoming so large that few issues are material,[262] by creating a web of related companies that can be used to shelter activities through manipulation of principles of corporate personhood,[263] or by avoiding going public altogether.[264]

State business codes define the requirements for corporate formation and for governance.[265] There are no legal requirements for board membership in the state statutes. Market forces tend to impose requirements on corporations with a desire to cultivate outside investors or to go public to choose a board that lends an air of legitimacy and expertise. The board manages the corporation on behalf of the shareholders, acts as a fiduciary, and owes the shareholders duties of loyalty, care,

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261. Although courts deem puffery to be immaterial, there is evidence that investors are unable to distinguish overly positive statements from facts. Stefan J. Padfield, *Is Puffery Material to Investors? Maybe We Should Ask Them*, 10 U. PA. J. BUS. & EMP. L. 339, 341 (2008) ("[W]hile the judges in the four surveyed cases concluded that no reasonable investor could find the statements challenged therein to be material because they constituted non-actionable puffery, between 33% and 84% of reasonable investors surveyed deemed the statements material.").

262. Georgiev, *supra* note 17, at 607–08 ("The larger the company, then, the less likely it is that any individual acquisition, legal proceeding, or investment project, however substantial, would be material in the context of the total informational mix.").

263. *See supra* notes 13–16.

264. There is a growing body of scholarship on the increasing number of privately held companies valued at one billion dollars or more, commonly known as unicorns. Famous unicorns include Uber and Airbnb. *See* Amy Deen Westbrook & David A. Westbrook, *Unicorns, Guardians, and the Concentration of the U.S. Equity Markets*, 96 NEB. L. REV. 688, 690, 716 (2018); Jeff Schwartz, *Should Mutual Funds Invest in Startups: A Case Study of Fidelity Magellan Fund's Investments in Unicorns (and Other Startups) and the Regulatory Implications*, 95 N.C. L. REV. 1341, 1348 (2017) (discussing the rise of unicorns); Jerold L. Zimmerman, *Private Equity, the Rise of Unicorns, and the Reincarnation of Control-Based Accounting*, J. APPLIED CORP. FIN., Summer 2016, at 56, 56, 60; Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 583 (2016) ("Unicorns' dizzying valuations have not been matched with any expansion or recalibration of regulation. As a result, vital information about these companies remains secret, perhaps for years, until an IPO moves a unicorn into the public realm."); Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 155 (2019) ("Despite the enormous social and economic impact of venture-backed startups, their internal governance receives scant scholarly attention. Longstanding theories of corporate ownership and governance do not capture the special features of startups. They can grow large with ownership shared by diverse participants, and they face issues that do not fit the dominant principal-agent paradigm of public corporations or the classic narrative of controlling shareholders in closely held corporations."); Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 165, 167 (2017) (discussing high-profile frauds by unicorns like Zenefits and Theranos, and the recent travails of Uber, which highlight the need to rethink unicorn governance structure). These burgeoning controversies call for reconsideration of legal reforms that allow unicorns to remain for protracted periods in an ill-defined limbo between private and public company status. *See id.*

265. Westbrook & Westbrook, *supra* note 264, at 708 n.91.

and good faith.[266] The board must ensure that information given to stockholders, the government, and the public is accurate and in compliance with both state requirements and the securities regulations. This is accomplished through the institution of proper internal controls, audits, and legal compliance. Corporate officers are hired by the board and handle the day-to-day operations of the corporation. Directors and officers are tasked with exercising care and loyalty for the general well-being of the entire corporation or to outsource when they cannot provide adequate oversight.[267] When considering whether directors and officers are in breach of these duties, courts defer to the business judgment of directors and officers under a doctrine known as the business judgment rule.[268]

A properly structured disclosure regime can protect investors and promote good corporate governance, but when that structure facilitates manipulation, it undermines the purpose of the system. Unscrupulous management can use the federal mandatory disclosure standard in conjunction with the business judgment rule to evade state law duties. To determine whether a breach has occurred, shareholders need extensive information to meet the burden of proof.[269] If a company is too big or too complex for many matters that are potentially triggering to be material, and therefore mandatory, the necessary information can be concealed to defraud and harm investors.[270] Management can also take advantage of voluntary disclosures to disclose just enough to give shareholders the belief that there are no problems with the operations. In other words, the interplay of mandatory and voluntary disclosures facilitates the telling of half-truths or of lies by omission.[271]

Outside of the limited items that must be filed in the interim reports on Form 8-K, all other disclosures under the 1934 Act are voluntary.[272] The existence of

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266. *See* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 245–46 (2009) (recognizing that corporate law is based on the concept that boards of directors owe duties to the corporation and its stockholders).

267. *See* Davis, *supra* note 209, at 575–76; Fischel & Bradley, *supra* note 209, at 290–91.

268. *See* Davis, *supra* note 209, at 573–74; Fischel & Bradley, *supra* note 209.

269. *See supra* notes 197–202.

270. Georgiev, *supra* note 17, at 646 (arguing that materiality blind spots make it easier for management to engage in fraud, waste, or suboptimal practices and can hinder monitoring by a firm's board of directors).

271. *See* Diamantis, *supra* note 9, at 354 n.217.

272. Section 409 of Sarbanes–Oxley provides "[e]ach issuer reporting under Section 13(a) or 15(d) . . . disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer . . . as the Commission determines . . . is necessary or useful for the protection of investors and in the public interest." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 409, 116 Stat. 745, 791 (codified in scattered sections of 15 and 18 U.S.C.); *see also* Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, 69 Fed. Reg. 15,594 (Mar. 25, 2004) (to be codified at 17 C.F.R. pt. 228, 229, 230, 239, 240, 249); Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date; Correction, 69 Fed. Reg. 48,370 (Aug. 10, 2004) (to be codified at 17 C.F.R. pt. 239, 249). Following amendments in 2004, 8-K requirements now include entry into or termination of a material non-ordinary course agreement; creation of a material direct financial obligation or a material obligation under an off-balance sheet transaction; departure of directors or principal officers, election of directors, appointment of principal officers; amendments to Articles of Incorporations or Bylaws. There are also mandatory

voluntary disclosures makes matters worse, not better.[273] When combined with mandatory disclosures based on materiality, and state law definitions that make it clear that each entity is a distinct legal person, voluntary disclosure can be utilized to reveal what is positive about subsidiaries and affiliates, while concealing what is less favorable under the protection of structure and materiality.[274] Voluntary disclosures need not be complete; they need only be true.[275] Companies are also required to correct information previously reported if it becomes untrue.[276]

A large company with an intricate web of publicly and privately held affiliated entities, like Live Nation, can skew market opinion by disclosing details on related entities when it is advantageous but relying on the fact that the company is not required to report the information on a Form 8-K, 10-K, or 10-Q when the information is disadvantageous.[277] Whether the information is material will be determined in hindsight. Live Nation can issue a press release touting the relationship with Roc Nation when it is beneficial but stay in the shadows when Roc Nation is facing a controversy. Musk can tout the development of solar technology through SolarCity when advantageous but conceal the company's dire financial circumstances until civil discovery forces him to reveal it. At the least, corporate families can manipulate this system to present themselves in the best light publicly, both from a financial and public relations standpoint. But, at its most harmful, this regime can be used to conceal real problems with management and governance that do harm to not only the corporation but also the capital markets as a whole.[278] This is, at its core, the Enron problem. Without a change to the

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disclosures under the Foreign Corrupt Practices Act (FCPA) which are designed to combat international bribery and corruption. Under the FCPA companies are subject to sanctions for failure to keep an adequate system of internal controls. *See* Karen E. Woody, *Securities Law as Foreign Policy*, 15 NEV. L.J. 297, 307 (2014).

273. Voluntary disclosure and private ordering, including agreements between industry groups and stock exchanges, while well-meaning, can serve as an end run around securities regulation and what the system is designed to protect. These disclosures can manipulate the market and have even greater consequences. *See, e.g.*, Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 302–09 (2016) (discussing the role of private voluntary disclosure of campaign finance expenditures and the risk of harm).

274. Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse*, 87 WASH. U. L. REV. 115, 118 (2009) ("Excessive amounts of disclosure, or communication of poor-quality information, can actually impede rather than promote corporate accountability. Unintentional obfuscation may turn into bald deception, as corporations seek market advantages by promoting a false socially responsible image.").

275. Georgiev, *supra* note 17, at 607; *see also supra* notes 261–262.

276. *See* Backman v. Polaroid Corp., 910 F.2d 10 (1st Cir. 1990) (en banc); *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236 (3d Cir. 1989).

277. Georgiev, *supra* note 17, at 628.

278. *See* Chatman, *supra* note 9, at 715 ("Depending on so many variables that rely on both human judgment and courage is an inefficient way to make real change.").

characterization of entities, deputizing whistleblowers and requiring additional disclosures will have limited impact, if any.[279]

Our securities regulations are based on the assumption that our free market tends towards perfection, incorporating all available public information into the price of securities.[280] We need only ensure that material information is available to all, and that the information available is accurate, to ensure free and fair markets.[281] This theory fails if companies can use legal structures to define "materiality" and use voluntary disclosures to manipulate. Parties can disclose more than required to inundate the market with immaterial information and hide in plain sight. They silo bad information using non-publicly traded entities. If parties can simply silo bad information and only disclose good information, it cannot be assumed that the capital markets are efficient. The solution is to break the silos, so that all disclosures are more accurate, not to continue the trend of federal encroachment into corporate governance by mandating additional disclosures.

Corporations can use voluntary disclosures to promote a false image or otherwise obfuscate information.[282] Professor Michael Siebecker uses the vagueness that is corporate social responsibility (CSR) as an example of this phenomenon.[283] CSR is a market indicator that investors and customers care about, but that is not deemed relevant by the SEC.[284] He notes that "[i]n an efficient market, fully informed consumers and investors could reward companies that engage in CSR by purchasing their products or stock, and, conversely, punish companies that fail to engage in desired practices by refusing to purchase their products or stock."[285] But, because CSR is not mandatory, the information reported is not consistent or reliable, which enables corporations to engage in what he terms "strategic ambiguity."[286]

The market incentivizes corporations to one extreme, when behaving admirably, report accurately and completely, and at the other extreme report

279. Romano, *supra* note 25; *see* Nizan Geslevich Packin & Benjamin P. Edwards, *Regulating Culture: Improving Corporate Governance with Anti-Arbitration Provisions for Whistleblowers*, 58 WM. & MARY L. REV. ONLINE 41, 46 (2016).

280. *See supra* note 10.

281. *Id.*

282. Huang, *supra* note 8, at 295 (discussing the timing of the release of voluntary information).

283. Siebecker, *supra* note 274. The voluntary nature of CSR disclosures creates a market of lemons as described by Akerlof. George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 500 (1970).

284. Siebecker, *supra* note 274; *see also supra* note 18; Tom C.W. Lin, *Incorporating Social Activism*, 98 B.U. L. REV. 1535, 1600–02 (2018) (discussing the impact of social activists and activism on corporate governance); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1199, 1201–03 (1999) (discussing the SEC and the need for expanded social disclosure requirements for public reporting companies in order to further social and financial transparency).

285. Siebecker, *supra* note 274, at 118.

286. *Id.* (noting that strategic ambiguity is made possible by "a variety of static, yet inconsistent, standards regarding the collection, auditing, and dissemination of information concerning CSR practices"); *see also supra* note 18.

inaccurately, incompletely, and vaguely to take advantage of the market for consumers and investors who want to purchase stock from "responsible" companies. Without audits, enforcement, or required disclosures, it is impossible for consumers and investors to know the difference. Even with audits, enforcement, and required disclosures, without structural change, voluntary disclosures may still be subject to strategic ambiguity at the hands of state law norms that place limits on the operation of the securities regulations.

Siebecker defines this strategic ambiguity as a source of true economic waste.[287] Within his model of CSR, there is no incentive for consumers and investors to pay a premium for good behavior when they cannot rely on the accuracy of corporate statements.[288] This holds true for all information disclosed voluntarily. Once it is revealed that companies release information strategically, skirting a violation of Rule 10b-5 while failing to be completely candid, there is no incentive for investors and consumers to pay more for companies that disclose in good faith. High-volume but low-quality information, in the form of data dumps and structure-based obfuscation, puts the entire market at risk.[289]

Siebecker's phenomenon of strategic ambiguity for voluntary reporting is exacerbated by the phenomenon highlighted in Professor Georgiev's work of using size to manipulate materiality and, as a result, to alter the parameters of mandatory reporting. It is not only size that enables strategic ambiguity and manipulation of materiality, but also complexity. Companies may be too big for otherwise relevant information to be material, which leads to more information falling within the realm of voluntary disclosures that they can be strategically ambiguous in disclosing.

When families operate as a mix of public and private entities, often internationally, the complex structure can render information about any single entity immaterial, while affording the corporation with an opportunity for strategic use of Form 8-Ks. Management can describe details of transactions when necessary for use as a cleansing device,[290] to clear conflicts of interest, or to generate positive public opinion, but otherwise hide details from shareholders and at times even from board view.[291] The corporate family structure proposed in this Article does not seek

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287. Siebecker, *supra* note 274; *see also* Richard H. McAdams, *Relative Preferences*, 102 YALE L.J. 1, 20–27 (1992) (describing how the prisoner's dilemma leads to economic and social waste).

288. Siebecker, *supra* note 274.

289. *Id.* at 128 (discussing risk to the market for CSR practices). Courts do recognize a buried facts doctrine, under which information buried together with other information is not considered disclosed to investors. *See* Kohn v. Am. Metal Climax, Inc., 322 F. Supp. 1331, 1362 (E.D. Pa. 1970); Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 444 (2003); Brian P. Miller, *The Effects of Reporting Complexity on Small and Large Investor Trading*, 85 ACCT. REV. 2107 (2010) ("This study examines the effects of financial reporting complexity on investors' trading behavior. I find that more complex (longer and less readable) filings are associated with lower overall trading, and that this relationship appears due to a reduction in small investors' trading activity."); John C. Coates IV, *Cost-Benefit Analysis of Financial Regulation: Case Studies and Implications*, 124 YALE L.J. 882, 887–88, 898–900 (2015).

290. *Infra* Part III.B.

291. *Supra* Section II.A.2.

to restrict growth or to eliminate the use of economically efficient business structuring. It is, instead, a reorganization and recognition of these economically efficient relationships in a way that acknowledges influence throughout the system as a whole and recognizes the ultimate real party in interest—the parent corporation.

When efforts at reform are made based on disclosure without corresponding structural changes, the system is left vulnerable to manipulation. Securities regulation, which combines both mandatory and voluntary disclosures, creates a system that can be manipulated by companies, especially those that operate as a family. While the requirements for mandatory disclosure are clear and accompanied by penalties for filing fraudulent information, they contain definitions that are at best open to interpretation and at worst easy to manipulate by those intent on committing fraud. Voluntary disclosures, which do not penalize oversharing but could punish a failure to make a timely report, can drive good actors to overreport out of an abundance of caution but bad actors to conditionally report optional information only when it will produce the best market outcomes.

B. Cleansing with Disclosure

The potential for self-dealing by directors, officers, controlling shareholders, and other agents is one of the primary agency costs of the corporate form.[292] When these fiduciaries engage in self-dealing, it diverts wealth away from the corporation and into their own hands, causing harm to investors.[293] Any transaction between the company and a fiduciary constitutes self-dealing. However, there are exceptions, known as cleansing devices, which include fairness,[294] and variations of disclosure,[295] including informed consent.[296]

Delaware General Corporate Law section 144(a) provides:

> No . . . transaction between [the] corporation and [any] of its directors or officers [(D/O)], or . . . [any] organization in which [its D/O] . . . have a financial interest [or serve as D/O], shall be void or voidable solely for this reason, or solely because the [D/O] is present at or participates [or votes] in the meeting of the board or committee which authorizes the . . . transaction, . . . if [the transaction is approved in good faith after full disclosure by a majority vote] (1) . . . of the disinterested directors . . . or (2) . . . of the stockholders; or (3) [t]he . . . transaction is fair as to the

292. Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 430 (2008).

293. *Id.*

294. Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 938, 951 (2019).

295. *See* Faith Stevelman Kahn, *Transparency and Accountability: Rethinking Fiduciary Law's Relevance to Disclosure*, 34 GA. L. REV. 505, 505 (2000) (discussing the relationship between disclosure and fiduciary duties); Veronica Root Martinez, *The Government's Prioritization of Information Over Sanction: Implications for Compliance*, 83 LAW & CONTEMP. PROBS. 85, 87 (2020) (discussing why government agencies prioritize receiving information and prefer disclosure regimes to sanctions).

296. *See* RESTATEMENT (THIRD) OF AGENCY § 8.06(1) (AM. L. INST. 2006).

> corporation as of the time it is authorized, approved or ratified, by the board of directors, a committee or the stockholders.[297]

The interpretation of section 144(a) is as unclear as the definitions of "material" under the securities regulations, but it is undisputed that fairness and disclosure are intended to be safe harbors that prevent conflicts from voiding officer and director decisions.[298] This exception is in the spirit of agency law principles, as all agents can resolve a conflict with disclosure and informed consent. Disclosure alone changes the nature of actions under the law of fiduciary duties, which is already sheltered by the business judgment rule and adequate internal control processes. So, what was once improper self-dealing, and even questionable business and accounting practices, is anesthetized if bad actors inform the board, the board puts systems in place to address concerns and analyze actions, and the board's decisions are informed by those systems. The lies in such a system are always wrong, but biased and misguided decisions are not.

When this state-corporate-law-based safe harbor is combined with the mandatory and voluntary disclosure requirements, it provides an opportunity to use the regimes to defraud by utilizing disclosure combined with complexity. The laws provide "significant immunity from fraud liability for comprehensive disclosure, even if the amount of disclosure arguably renders adequate understanding all but impossible."[299] It is rational to provide more information voluntarily in a system that does not penalize over-disclosure, punishes a failure to disclose, and provides disclosure as a means to avoid liability. Disclosed facts can induce a fraud risk if those facts are half-truths or non-truths, but there can be benefits to over-disclosure of truths.

Over-disclosure can provide a shield, as materiality is defined by the weight of omitted facts, and there are no penalties triggered by oversharing. Given the penalties imposed by Sarbanes[300] and Dodd-Frank,[301] and the list of facts required to be disclosed within four business days in Form 8-K,[302] some may deem it to be reasonable to share anything that could be material to avoid judgment in hindsight.

297. DEL. CODE ANN. tit. 8, §144(a) (West 2021).

298. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 365 (Del. 1993).

299. Siebecker, *supra* note 274, at 132.

300. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 906, 116 Stat. 745, 806 (codified in scattered sections of 15 and 18 U.S.C.).

301. *See* Dodd-Frank Act, Pub. L. No. 111-203, § 929(P)(a), 124 Stat. 1376, 1862–64 (2010).

302. Triggering events include, in part: entry into or termination of a material definitive agreement; bankruptcy or receivership; completion of acquisition or disposition of assets; triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance sheet arrangement; costs associated with exit or disposal activities; material impairments; notice of delisting or failure to satisfy a continued listing rule or standard; unregistered sales of equity securities; material modification to rights of security holders, numerous matters relating to accountants and financial statements; changes in control of registrant; departure, election, appointment, and compensation arrangements of directors an certain officers; amendments to articles of incorporation or bylaws, and changes to the fiscal year; and change in shell company status. *See* U.S. SEC. & EXCH. COMM'N, OMB NO. 3235-0060, FORM 8-K (2021).

Courts assess materiality ex post, with the benefit of additional facts and empirical evidence, including the market reaction, when they determine whether the information was important to investors.[303] This ex-post analysis also means that there is no punishment for disclosing something that is immaterial in hindsight but true or something that is not required but truthful and positive. A corporation could, in good faith, choose to disclose more rather than face penalties for failure to disclose.[304] But, companies can also engage in "data dumping," burying material facts in excessive amounts of information that makes it difficult for investors to discern what should impact their investment decision. With too much information, shareholders and future investors must make their own call regarding materiality. They must discern what, if any, information provided in a data dump has a tendency to influence their vote or their stock-purchasing decisions.[305]

In addition to the potential for data dumps, the interplay of current regimes makes it easier to provide incomplete disclosures.[306] Complexity may render these partial disclosures to be compliant when the rules of thumb and heuristics used to define materiality come into play. Partial disclosure, which complies with reporting requirements and shields management from liability, has the potential to conceal schemes longer, to a time when they are likely to cause significantly more harm to investors.[307] It can also block the ability for good actors inside of a company to intervene to stop the scheme.[308] Through partial disclosure to management, or the consultation of experts, parties who wish to do a company harm can shield their conduct in process, leaving nothing for potential whistleblowers to disclose other than their disagreement with the company's business practices. Bad actors telling partial truths can conceal fraud. This is particularly true when uncovering the fraud turns on the perception of management, investors, and regulators.

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303. Georgiev, *supra* note 17, at 622 (citing Mitu Gulati, Jeffrey J. Rachlinksi & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773 (2004)).

304. Siebecker, *supra* note 274, at 132–33.

305. *See* LISA FAIRFAX, SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION 45–61 (2011) (noting that shareholder voting is emphasized, but state law requires that board control dominates corporate decision-making); MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 72–76 (1995) (discussing the rise of institutional investors and the myth of corporate democracy as a result of shareholder activism).

306. Georgiev, *supra* note 17, at 674.

307. *Id.*

308. *See supra* notes 198–199.

With the proliferation of social media, and more companies using the various services to provide investors with material information on the spot, the potential for data dumps that obscure the facts, improperly highlighting some information and diminishing what is most probative, has increased.[309] As Professor Siebecker states,

> current corporate communications regarding CSR practices resemble a *reverse* Tragedy of the Commons. . . . In the CSR context, the quality public information that would enable an effective CSR movement to thrive does not get overconsumed but instead gets lost in a vast over-*contribution* of information. Relevant and accessible data gets lost like a needle in a haystack. As a result, the public good of quality information gets destroyed.[310]

Companies are motivated to act in their own self-interest, overwhelming the system with data that is positive, using traditional means for data that is less favorable if it is disclosed at all, and contributing to the noise in the market. Or the widespread and instantaneous nature of social media has the potential to move the market prematurely, as has happened repeatedly with Elon Musk's tweets about Tesla value, market price, and registration status.[311]

Our system of corporate governance and our regulatory regime are not concerned with understanding, nor do they pass value judgments on outcomes. Instead, the focus is on the adequacy of inputs; the process in place to interpret those inputs; and when markets fail, the intentions of bad actors who manipulate those inputs. It punishes lack of process and truthfulness at time of action, as opposed to challenging and demanding a disclosure of absolute truth that may be revealed later. A market failure that invokes full disclosure, consultation of qualified experts, and management that is merely negligent is not actionable. To establish the difference between negligence, gross negligence, fraud, and crime requires an understanding of the inner workings and intentions of the actors. More information can provide a reason to investigate, but it does not provide absolutes. And, when information is disclosed, it loses its clandestine status, removing it from the realm

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309. In 2013 the SEC issued a report that made it clear that companies may comply with Reg. FD by releasing information on social media so long as investors are made aware of which platform the issuer will use to disseminate information. Many companies have filed 8-Ks indicating that they will use Facebook or Twitter to announce material information. *See* Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Exchange Act Release No. 69279 (Apr. 2, 2013), http://www.sec.gov/litigation/investreport/34-69279.htm [https://perma.cc/2FJH-9PXR] (noting that the Commission chose not to pursue an enforcement action against Netflix or Hastings for Hastings's use of his personal Facebook page to announce that Netflix had streamed one billion hours of content in the month of June without filing an 8-K or previously using his Facebook profile for official company announcements).

310. Siebecker, *supra* note 274, at 136 (footnote omitted).

311. *See* Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716 (Aug. 24, 2000) (to be codified at 17 C.F.R. pt. 240, 243, 249). Taking effect in October of 2000, Reg. FD addresses the selective disclosure by issuers of material nonpublic information. It is designed to promote the full and fair disclosure of information by issuers. *Id.*

of liability for failure to disclose and eliminating self-dealing as a cause of action for shareholders.

CONCLUSION

What remains post-Enron, post-Sarbanes, and even post-Dodd Frank is a culture that (1) continues to focus on positive quarterly and annual reports that show constant growth, (2) ignores the culture that the need for constant growth and positive reports creates, and (3) leaves in place a system that allows companies to manipulate structures and transactions to get those results on paper without realizing any growth. These actions are legal and not in violation of any laws. A company can meet accounting standards, comply with state corporate laws, and properly report as required by the SEC—and still commit fraud in plain sight using the Enron-model for corporate structure. This is because while accountants are now required to consider the real party in interest when making reports, auditing independently, and prioritizing accounting principles and standards over client relationships, corporate structure did not undergo a similar change. This Article takes this position at a time when the investment culture celebrates stock market highs and businesses that innovate, with the same lack of understanding about where the money comes from that allowed Skilling, Fastow, and others to defraud investors for years. The legal silos at Enron as described in my previous work still exist today. At their core, Enron, and all corporate fraud scandals, are about using legal structures to take advantage of the ignorance of experts and regulators.

To prevent the next Enron requires states to address structural complexity. The corporate family is one structural change that advances that goal. The family is defined as an enterprise formed by weaving corporations, partnerships, and LLCs together into a mix of public and private entities acting together for the benefit of a parent corporation or for the personal gain of one or more leaders of the enterprise. Not all corporate groups as defined by current statutes and regulations are families, and not all families are corporate groups. A corporation should be treated like a family when (1) there is more than one entity with shared ownership or management, or when an entity is wholly owned by another entity, and (2) that entity operates for the promotion of the parent's business purposes or the manager or owner's business interests.

Without any mitigating factors, this definition has the potential to change tort and contract liability across business entities that are affiliated through joint ownership, management, or even just contract. To avoid this outcome, this definition incorporates the real-party-in-interest standard, found in Federal Rule of Civil Procedure 17, which gives consideration to special relationships of trust and other equitable concepts when determining who has the capacity to sue or be sued. With this special-relationship-of-trust limit, businesses that meet the standard for corporate family treatment are required to acknowledge influence and look to the real party in interest when determining what is material, what should be reported to shareholders, and conflicts of interest. These are areas that invoke fiduciary duties

and other equitable circumstances in which the shareholders and other stakeholders entrust management to act in their best interest.

Although corporate groups are prevalent, there is no uniform definition of groups in American corporate governance. As a result, when reforms are enacted postcrisis, they fail to regulate a major component of the capital markets. Securities regulations are backward-looking, focused on the completeness and truth of reports at time of filing, because this regulation of market manipulation is the domain of the SEC. When this regulatory regime is imposed on a corporate governance culture that tends toward entity and not enterprise theories, the regulatory scheme intended to address market manipulation and fraud leaves corporate groups outside of regulation. A state-based solution, starting with how corporate groups are defined and governed, will enable regulatory regimes to reach their intended targets.

The definition of family proposed in this Article acknowledges the influence of a parent corporation or of dominant owners or managers. The definition of family considers more than control. Instead, it gives consideration to which master the management of an affiliate, a director or officer, expert intermediary, or another agent ultimately serves. This enables a situational enterprise treatment without disturbing the principles of enterprise liability. The statute is narrowly tailored, with its procedural limit, to focus on areas that require an analysis of the special relationship of trust between entities and parties. The family itself does not need to be created by the state, or even a new stand-alone enterprise, if the goal of the standard is simply to acknowledge influence, not a wholesale redesign of governance. The corporate family is the start as it is a structure easily identified, easily manipulated, and in need of regulation. What we do with greater diversity and complexity is difficult to determine without first considering the family.