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AGAINST THE BACKDROP OF PRESIDENT-ELECT TRUMP'S CARRIER DEAL: THE BREACH OF FIDUCIARY DUTY EXPOSURE CAUSED BY DIRECTING A SUBSIDIARY TO UNDERTAKE A TRANSACTION FOR THE PARENT COMPANY'S BENEFIT

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INTRODUCTION

In February 2016, Carrier Corporation ("Carrier") announced to its Indiana workers it intended to move some of its manufacturing capabilities to Mexico, which would displace approximately 1,400 American jobs. Then-Republican nominee for President of the United States, Donald J. Trump, caught wind of Carrier's plans and began to dedicate a substantial portion of his campaign message to the promise that he would prevent American companies from sending jobs overseas. True to his platform, in late November, President-Elect Trump announced that he had struck a deal with Carrier to keep close to 1,000 jobs in Indiana.

By deciding not to move approximately 850 jobs to Mexico, Carrier will be forfeiting nearly $65 million a year in savings. In exchange, the state of Indiana plans to reward Carrier with merely $7 million in tax incentives over ten years, as long as Carrier invests $16 million in its Indiana facilities. Based on these terms alone, one may question why Carrier would agree to this deal. The tipping point, however, was not what Carrier stands to gain, but the specter of what the new administration could take from Carrier's parent company, United Technologies Corporation ("United Technologies").

United Technologies provides high technology products and services to international customers in several industries, including defense. Notably, the Pentagon is one of United Technologies' largest customers. In 2015, 10 percent of United Technologies' $56 billion in revenue came from the federal

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government. Given that President-Elect Trump has repeatedly warned of "consequences" for companies that move jobs away from the United States, once he set his sights on Carrier, there was concern that United Technologies could lose over $5 billion in government contracts. Thus, in the interest of its financial wellbeing, United Technologies appears to have caused Carrier to forgo yearly savings of $65 million.

On a surface level, the Carrier deal raises serious questions regarding whether Carrier's board members breached their fiduciary duties by placing the interests of United Technologies ahead of the interests of Carrier. Absent the essential details of the deal, including the process employed, it would be improper to speculate on the appropriateness of the actions of Carrier's board. What's more, Carrier is a wholly-owned subsidiary of United Technologies, and under Delaware law[1], it is well-established that a wholly-owned subsidiary may be managed entirely for the best interests of the parent company and its shareholders.[2]

Nevertheless, there are legitimate corporate governance concerns raised by a situation where a parent company exerts its control over a partially-owned subsidiary to force a transaction that serves the best interests of the parent company over the interests of the subsidiary's stockholders. In such a circumstance, Delaware law appears to support the viability of breach of fiduciary duty claims against the parent company.[3]

I. CORPORATE ACTIONS ARE TYPICALLY GIVEN THE PRESUMPTION OF LOYALTY AND DUE CARE

The business of the typical American corporation is managed at the direction of the company's board of directors. In a nutshell, the board's role is to supervise the corporation's affairs. This includes formulating corporate strategy, recommending or approving major corporate transactions,

[1] Looking to Delaware law is appropriate given that both Carrier and United Technologies were incorporated under the laws of that state. In addition, Delaware has a central role in corporate governance matters. More than 1,000,000 business entities have made Delaware their legal home, including over 50% of all publicly-traded companies in the United States and 64% of the Fortune 500. This is largely because of the Delaware General Corporation Law ("DGCL"), a dynamic statute that was drafted to ensure that stockholders, directors, and officers have maximum flexibility when running their businesses, and the Delaware Court of Chancery—the preeminent venue for corporate law disputes.

[2] *See* Anadarko Petro. Corp. v. Panhandle Eastern Corp., 545 A.2d 1171, 1174 (Del. 1988).

[3] *See supra* note 2.

disseminating information about the company's finances, setting salaries and compensation for directors and officers, and distributing corporate assets.

In discharging their obligations, directors owe fiduciary duties of care and loyalty to each company they serve. The duty of care mandates that directors make decisions in an informed manner while the duty of loyalty requires that the board acts only in the best interests of the corporation and its stockholders. Delaware courts generally afford wide latitude to a board that is independent, disinterested, informed, and motivated simply to obtain the best transaction reasonably available for shareholders. Indeed, the business judgment rule prohibits the Delaware Court of Chancery from interfering with decisions of independent and disinterested directors who are acting in good faith and engaging in an informed decision-making process. That is because the business judgment rule presumes that "in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action take was in the best interests of the company."[4]

II. A PARENT COMPANY WILL OWE FIDUCIARY DUTIES TO ITS PARTIALLY-OWNED SUBSIDIARY

Because of the intertwined relationship between parent companies and their subsidiaries, and the control that a parent may exert over its subsidiary, parents of partially-owned subsidiaries share the same fiduciary duties as the subsidiary's board.

In the parent-subsidiary relationship, the parent typically controls the subsidiary through majority or complete stock ownership. Owning a majority of the subsidiary's stock will allow the parent to select or influence the selection of the members of the subsidiary's board of directors. In many cases, this results in the subsidiary's board consisting primarily of individuals who are also officers, directors, and/or employees of the parent. And, in turn, many of the subsidiary's senior officers often will be officers or other employees of the parent as well. The parent company's influence over the partially-owned subsidiary's board and senior management allows the parent to monitor or to even control the subsidiary's operations. That influence, coupled with ownership of a substantial portion of the subsidiary's shares, classifies the parent company as a "controlling stockholder." In that capacity, the parent company owes fiduciary duties to the subsidiary and its minority stockholders.

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4 *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

The rationale is that by exercising control over the corporation's directors and officers, who make decisions for the corporation in a fiduciary capacity, the parent assumes the duties of a fiduciary.

III. ALLEGATIONS OF SELF-INTEREST COULD FORM THE BASIS OF BREACH OF FIDUCIARY CLAIMS AGAINST A PARENT COMPANY

In circumstances where a subsidiary's board approves a corporate action that jeopardizes stockholder value simply because the undertaking was favored, recommended, or proposed by its parent company, the presumption of loyalty and due care is not afforded.[5] Rather, the burden is on the parent company to prove that the transaction was entirely fair.[6] Under similar facts, the Delaware Court of Chancery has affirmed the existence of valid breach of fiduciary duty claims against the parent company.

Wallace v. Wood[7] is instructive on this point. In that case, the plaintiffs-limited partners asserted derivative claims for breach of fiduciary duty against the defendants-parent corporations, alleging they caused the general partner to engage in leveraged acquisitions that were financed by affiliates in order to generate fees for the defendants. The parents' control stemmed from the fact that the general partner was the subsidiary of one of the defendants, which was a subsidiary of another defendant/parent corporation.[8] The defendants-parent corporations moved for judgment on the pleadings on the basis that they did not owe or breach any fiduciary duties to the limited partners. The Court of Chancery denied the defendants' motion, holding that the allegations that the defendants-parent corporations wielded and used their control over the partnership to cause it to enter into transactions that benefit the defendants at the expense of the partnership were sufficient to state a claim for breach of fiduciary duty.[9]

CONCLUSION

Although President-Elect Trump's Carrier deal can be summarized as Carrier appearing to forgo tens of millions of dollars in yearly savings for the financial benefit of its parent company, given that Carrier is a wholly-owned

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[5] *Orman v. Cullman*, 794 A.2d 5, 21 (Del. Ch. 2002).
[6] *Id.*
[7] 752 A.2d 1175 (Del. Ch. 1999).
[8] *Wallace*, 752 A.2d at 1178.
[9] *Id.* at 1178, 1180–81.

subsidiary, United Technologies faces no exposure based on fiduciary duty claims. Parent companies that exert similar control over their partially-owned subsidiary, however, will not be similarly shielded. Instead, Delaware law appears to support breach of fiduciary duty claims against a parent company that directs its partially-owned subsidiary to enter into a transaction for the parent company's benefit.