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FOREIGN CORPORATION LAWS: A CURRENT ACCOUNT

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In an earlier issue of this volume, the author examined the history of foreign corporation laws and concluded that their original justification has disappeared. In this article, he turns to an assessment of the present utility of the laws. The burdens that these laws impose on interstate business outweigh their benefits, according to the author, who argues that they are open to judicial attack under the commerce clause of the Constitution. The article concludes with a suggestion that legislative repeal of the present foreign corporation laws is desirable.

INTRODUCTION

The original reason for foreign corporation laws is lost, and their conceptual foundation is today largely discredited. State qualification statutes were adopted to solve problems created by a nineteenth century constitutional requirement that original legal process be served within the boundaries of forum states. The operating principle of the laws was also the product of an unusual nineteenth century development—the proposition that states can admit out-of-state corporations upon condition because, it was said, they could exclude them entirely. Subsequent Supreme Court decisions have eliminated the service of process requirement and modern juridical thinking has cut deeply into the acceptability of the principle of conditional entry. These developments have been discussed in an earlier article.¹

Time has not supplied a new rationale. The statutes have not developed a major new purpose, and in a number of their aspects—particularly those relating to jurisdiction to adjudicate, choice of law, and taxation—the laws themselves have already caused problems and promise more. At most, the present utility of this expanding and complex scheme is minimal.

Measurement of the current role of the statutes against the conflicting economic interests of a national market suggests both the desirability and the shape of judicial and legislative solutions to this problem of aimless regulation. A more traditional balancing of state and national interests gives the same result. The courts should refuse to enforce the statutes as

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¹ Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C.L. Rev. 1 (1968) [hereinafter cited as Walker].

contrary to the commerce clause, and legislatures should eliminate the laws from corporation codes.

I. PRESENT UTILITY OF FOREIGN CORPORATION LAWS

Occasionally a legal technique outlives its original purpose but develops new and valuable functions. A sound judgment of the foreign corporation law scheme should include consideration of this possibility and a determination of the present utility of the qualification statutes. The diversity of detail in fifty acts demands selection of requirements worth careful attention. The most frequently enacted are discussed below because apparently a number of legislatures thought them to be useful.²

A. Local Agents

The only condition adopted by every state is that foreign corporations name local residents as their agents to accept process. The piecemeal overruling of *Pennoyer* and the consequent development of provisions for service of process on corporations and others outside forum jurisdictions have eliminated any jurisdictional reason to require local agents.³ In those few states that do not have long arm statutes, service on agents within the forum is still required. But it is of little value to speculate about refusal to provide out-of-state service since most states have already adopted the statutes and no doubt within a brief time every state will follow suit. Perhaps requiring local agents is a convenience to local plaintiffs, but where out-of-state service by mail is available it is debatable whether that procedure is less convenient than arranging for local personal delivery.⁴ Moreover, requirements that foreign corporations designate local agents have significant negative impact. Curiously, this effect was brought about by three of the nation's most respected judges.

In *Smolik v. Philadelphia & Reading Coal & Iron Co.*,⁵ the New York

² The special problems presented by essentially local corporations incorporated in another state are not considered in the analysis that follows. In the case of those "pseudo-foreign corporations," as they were named by Dean E. R. Latty, the economic principles discussed at 753-55, *infra* suggest that a high degree of local supervision would be acceptable because there would be little effect on beneficial trade, the corporations being by definition "local in character." For a full treatment, see Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955).

³ See Walker 24-28.

⁴ A recent study by the Boston Bar Association resulted in a recommendation that service by registered mail be permitted as an alternative in purely local actions. The study is briefly summarized in BOSTON B.J., Jan. 1968, at 5. Such a recommendation by practitioners seemingly negates any argument that service by delivery to a designated agent is more convenient than service by mail.

⁵ 222 F. 148 (S.D.N.Y. 1915).

plaintiffs brought suit against a Pennsylvania corporation to recover damages for personal injuries suffered at the site of the defendant's mining operations in Pennsylvania. Service was made in New York on an agent designated by the defendant pursuant to the New York foreign corporation law.⁶ The defendant moved to set aside service, but this motion was denied by Judge Learned Hand who held that the consent to service upon the designated agent was not limited to causes of action arising out of the transaction of business by defendant in New York.

The New York Court of Appeals followed Judge Hand's decision in *Bagdon v. Philadelphia & Reading Coal & Iron Co.*,⁷ an action against the same corporate defendant, again by a New York plaintiff seeking to recover for injuries suffered in Pennsylvania. The New York court, in an opinion by Judge Cardozo, held that service of process on the designated agent was sufficient, though the cause of action did not arise out of business transacted in the state.

In both cases the fact that a New York plaintiff was involved gave some reason to adjudicate the claim in that state. The extreme fact situation, and the leading case, came a year later in 1917 when the Supreme Court decided *Pennsylvania Fire Insurance Co. v. Gold Issue Mining & Milling Co.*⁸ An Arizona corporation brought an action in Missouri against a Pennsylvania corporation to recover under the terms of a policy insuring property located in Colorado. Defendant had designated, as required,⁹ the Missouri Commissioner of Insurance as its local agent. The suit was begun by service on the Commissioner, and the Missouri Supreme Court held that the trial court thereby acquired jurisdiction over defendant¹⁰—although the cause of action arose outside the state and the only contact either party had with Missouri was that defendant had named a local agent. The Supreme Court, in an opinion by Justice Holmes, held as a matter of due process that such designation could confer unlimited general jurisdiction.¹¹

Professors Arthur von Mehren and Donald Trautman suggest in their recent book that, in deciding whether a forum is appropriate, consideration should be given to whether the proposed forum is justified in acting

⁶ Act of Feb. 17, 1909, ch. 28, § 16, [1909] N.Y. Laws 15, printed at N.Y. Cons. LAWS 1985 (1909).

⁷ 217 N.Y. 432, 111 N.E. 1075 (1916).

⁸ 243 U.S. 93 (1917).

⁹ Act of March 24, 1885, [1885] Mo. Laws 183.

¹⁰ *Gold Issue Mining & Milling Co. v. Pennsylvania Fire Ins. Co.*, 267 Mo. 524, 184 S.W. 999 (1916).

¹¹ 243 U.S. at 95-96.

with respect to the parties involved, whether the underlying controversy can properly be decided, and whether the prospective litigation can be conveniently and effectively handled.¹² A Missouri action between Pennsylvania and Arizona corporations involving property located in Colorado allowed on the sole basis of designation of a Missouri agent fails under all three tests.

In his *Gold Issue Mining* opinion, Justice Holmes distinguished two earlier cases, *Old Wayne Mutual Life Association v. McDonough*¹³ and *Simon v. Southern Railway*,¹⁴ which held that service of process upon a statutory agent was not sufficient as to causes of action arising outside forum states. Justice Holmes noted that "in the above mentioned suits the corporations had been doing business in certain States without authority" and that "they had not appointed the agent as required by statute, and it was held that service upon the agent whom they should have appointed was ineffective upon causes arising in other States."¹⁵ He considered the case of service upon a designated agent "untouched"¹⁶ by the precedent. The distinction was unfortunate because it exposed corporations complying with foreign corporation laws to suits in forums with little or no interest in the subject matter but protected non-complying corporations.

This anomaly continues. Section 29 of the *Restatement of Judgments*¹⁷ provides that a court may acquire jurisdiction by service of process on an authorized agent, and comment *b* to section 29 states that the extent of the authority "may be interpreted to extend to all causes of action brought against the Corporation in the State. . . ."¹⁸ Section 30 states that by proper service of process a court may acquire jurisdiction over a foreign corporation doing business in the state as to causes of action arising out of such business. A caveat immediately following states that no opinion is expressed "on the question whether a court acquires jurisdiction over a foreign corporation on the ground that it does business in the state where the cause of action does not arise out of such business."¹⁹ The *Restatement* lends support to the wrong rule in both cases. Where an agent is designated, the suggestion is that non-related causes of action may

¹² A. VON MEHREN & D. TRAUTMAN, *THE LAW OF MULTISTATE PROBLEMS* 631-33 (1965).

¹³ 204 U.S. 8 (1907).

¹⁴ 236 U.S. 115 (1915).

¹⁵ 243 U.S. at 95-96.

¹⁶ *Id.* at 96.

¹⁷ *RESTATEMENT OF JUDGMENTS* § 29-30 (1942).

¹⁸ *Id.* § 29, comment *b* at 122.

¹⁹ *Id.* § 30 at 123.

properly be adjudicated. Where there is no appointment, but the corporation is doing business in the state, the *Restatement* invites adjudication of non-related causes of action contrary to the small measure of common sense left by the *McDonough* and *Simon* cases. The rule suggested by Justice Holmes has reached such a level of general acceptance that an *A.L.R.* annotator wrote that the weight of authority holds that service upon a designated agent will sustain jurisdiction although the transaction giving rise to the cause of action occurred "beyond the territorial limits of the state of suit."²⁰

Typical of the possibilities for abuse is *Quigly Co. v. Asbestos Ltd.*²¹ A New York corporation brought suit in New Jersey against another New York corporation on a contract between the parties executed in New York and bearing no substantive relation to New Jersey. The defendant had complied previously with the requirements of New Jersey's foreign corporation law²² and had appointed an agent for service of process. A motion to dismiss was denied despite affidavits showing that witnesses, records, and other evidence necessary to determine the claim were located in New York and that the defendant knew of no reason why the action could not be brought in that state. The New Jersey Court held:

[C]ompliance with the statutory condition is not to be construed as defendant's consent to be sued in our court only in particular causes of action, but as a prerequisite required of it that, for the privilege of coming in our borders and doing business herein, it should submit itself to our courts in all causes of action over which our courts assume jurisdiction.²³

The draftsmen of the recently adopted New York Business Corporation Law²⁴ recognized the need for limitations on the exercise of jurisdiction over foreign corporations but failed to meet that need. Section 1314 of the statute carefully defines certain situations in which actions brought by non-resident plaintiffs against foreign corporations will be allowed in New York courts. This approach is sound, but included among the situations is "where the defendant is a foreign corporation doing business in this state"²⁵—an invitation to entertain actions such as those rejected by *McDonough* and *Simon*. Matters were made worse by an

²⁰ Annot., 96 A.L.R. 366, 368 (1935).

²¹ 134 N.J. Eq. 312, 35 A.2d 432, *aff'd*, 135 N.J. Eq. 460, 39 A.2d 135 (1944).

²² N.J. REV. STAT. 14:15-1 to -10 (1937).

²³ 134 N.J. Eq. at 315, 35 A.2d at 434.

²⁴ The effective date of the Business Corporation Law was September 1, 1963. *Explanation to N.Y. BUS. CORP. LAW* at III (McKinney 1963).

²⁵ *Id.* § 1314(5).

amendment in 1965 that substituted for the language above the words "where the defendant is a foreign corporation doing business or *authorized to do business in this state*."²⁶ The italicized phrase in effect added the assertion that New York is interested in adjudicating cases purely because of compliance with its foreign corporation law—much the same situation as in the *Gold Issue Mining* case where the action was allowed though the only forum contact was compliance with a designation requirement.

Thus foreign corporation laws and their agent requirements have encouraged inappropriate expansions of unlimited general jurisdiction and have discouraged worthwhile analysis of the desirability of asserting jurisdiction in particular cases.

B. Charter Copies

More than forty states today require foreign corporations to file copies of their charters or articles of incorporation. The chief purpose of these requirements was to protect local creditors from ultra vires acts by foreign corporations, but this role has largely been taken over by other, more effective legislation.²⁷

The disclosure value of modern corporate charters is very limited—they generally contain little more than the corporations' names, their business purposes, the addresses of their principal offices, and the names of their incorporators.²⁸ Many states also require information about capital structures and related matters, useful perhaps to stockholders, but revealing almost nothing about ability to pay current debts.²⁹ Few businessmen or lawyers would prefer charters to typical credit reports, and few would ask to see charters in addition to such reports.

At one time New Hampshire was the only state that did not require the filing of charters,³⁰ but during the last ten years a number of states

²⁶ N.Y. BUS. CORP. LAW § 1314(5) (McKinney Supp. 1968) (emphasis added).

²⁷ See Walker 21, 28-29.

²⁸ See R. BAKER & W. CARY, CORPORATIONS 23-27 (3rd ed. unabr. 1959); ABA-ALI MODEL BUS. CORP. ACT § 48 (1966).

²⁹ Local investors might benefit from enforcement of the reporting requirements of foreign corporation laws, but such benefit would be unintended. There is a nationwide state mechanism designed to protect local investors. See L. LOSS & B. COWETT, BLUE SKY LAW (1958).

³⁰ Latty, *Some Miscellaneous Novelties in the New Corporation Statutes*, 23 LAW & CONTEMP. PROB. 363, 398 n.238 (1958). Dean Latty noted the elimination of the requirement in New York and Pennsylvania and said that the requirement "probably serves no useful practical purpose, despite theoretical arguments to the contrary, and this break with the past is probably justified." *Id.* at 398.

have eliminated the requirement. Unfortunately, most of those states now ask that certificates of good standing issued by appropriate officers of states of incorporation be filed.³¹ These bare statements that organizations purporting to be corporations are in fact incorporated have little disclosure value. If the fact of incorporation itself were important, few lawyers would rely on a certificate filed as required; most would insist on having fresh evidence of good standing. But the repeal of some charter copy requirements is nevertheless important because it shows legislative recognition that the utility of the requirements is spent.

Provisions that foreign corporations designate agents and file copies of their charters are the only requirements adopted by all or most of the states. Other common requirements have been enacted by a bare majority, or less, of the states. The fact that a large number of states get along without them creates a threshold question as to their utility.

C. Grants of Power and Subjections to Local Law

Some thirty states grant foreign corporations, upon compliance with local statutes, the powers vested by law in domestic corporations, and about the same number provide that corporations complying with the statutes will be subject to local laws.³² The grants of powers and subjections to local law are usually linked in the acts. Grants of power need little discussion. The result could be reached by appropriate recognition of the law of incorporating jurisdictions, a process no more unusual than, for example, recognition of foreign law in a tort action where called for by conflict of laws principles.

The subjection provisions, in effect choice of law rules, require more consideration. Courts can apply local law in actions involving foreign corporations without statutory authorization, just as they can apply local law in other actions though they involve some out-of-state element.³³ The statutory rules are clearly unnecessary. The rules do not apply, typically, to all cases involving foreign corporations, but only to those involving complying corporations. They come into effect upon establishment of certain legal relationships, although there is not, of necessity, a link be-

³¹ *E.g.*, N.Y. BUS. CORP. LAW § 1304 (McKinney 1963); PA. STAT. ANN. tit. 15, § 2004 (1967); MO. ANN. STAT. § 351.585 (1968); OHIO REV. CODE § 1703.04 (Page 1964).

³² See Walker 21.

³³ See Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 460 (1968).

tween facts which bring about those relationships and the individual and state interests that particular cases may involve.

Citations to these rules are rare, despite their widespread adoption, perhaps because statutes are an unexpected source of choice of law rules. But their potential for mischief is clear. In *Mieyr v. Federal Surety Co.*,³⁴ suit was brought in Montana in 1932 by a Montana resident seeking to recover on an insurance policy issued by the defendant Iowa corporation. In 1931 the defendant had been dissolved by a court order in Iowa in an action brought by the Insurance Commissioner of that state. The Montana litigation presented the question whether an action could be brought in Montana against a foreign corporation previously dissolved by its state of incorporation. The Montana court referred first to a local statute which provided that as to domestic corporations dissolution would not "impair any remedy given against such corporation . . . for any liability which has been previously incurred,"³⁵ and then to the local foreign corporation law, which provided that "all foreign corporations licensed to do business in the State of Montana shall be subject to all the liabilities, restrictions and duties which are or may be imposed upon corporations of like character organized under the laws of this State. . . ."³⁶ The court read the two statutes together and held that "when the surety company was licensed to do business in the state of Montana, it became subject to the liabilities and restrictions then imposed upon corporations of like character organized under the laws of this state."³⁷

The technique by which the choice of law issue was decided in *Mieyr* shows the potential for undesirable application of such broad statutory rules. The opinion did not consider the interest and expectations of the parties, the state policies involved, or even such traditional considerations as the location of significant events.³⁸ The court determined only that the legal relationship existed and then moved immediately to its conclusion.

Occasionally, where there is no statutory rule, the fact of qualification

³⁴ 94 Mont. 508, 23 P.2d 959 (1933), *rev'd on other grounds sub nom.* *Clark v. Willard*, 292 U.S. 112 (1934).

³⁵ 94 Mont. at 519, 23 P.2d at 962, *quoting* MONT. REV. CODES ANN. § 6013 (1921).

³⁶ 94 Mont. at 521, 23 P.2d at 963, *quoting* MONT. REV. CODES ANN. § 6652 (1921).

³⁷ 94 Mont. at 521, 23 P.2d at 963.

³⁸ For a sample of modern thinking about what courts should consider in resolving choice of law problems, see A. VON MEHREN & D. TRAUTMAN, *THE LAW OF MULTISTATE PROBLEMS* 76-79 (1965); D. CAVERS, *THE CHOICE OF LAW PROCESS* 139-224 (1965).

is nevertheless given considerable weight in deciding choice of law questions. In *Dr. Hess & Clark, Inc. v. Metalsalts Corp.*,³⁹ defendant Metalsalts moved to dismiss as to its codefendant, Metalorganics, on the ground that Metalorganics was an Illinois corporation that had been properly dissolved more than two years earlier and that under Illinois law no action could be brought against a dissolved corporation more than two years after dissolution. The district court applied New Jersey law, which indefinitely preserved actions against dissolved corporations, and denied the motion. The court attached great significance to the fact of qualification: "Metalorganics applied for and received authorization to do business in the State of New Jersey, subjecting itself to such regulations as that state saw fit to impose as incident to that privilege."⁴⁰ The undue concern with the fact of qualification obviously distracted the court from proper analysis of the party and state interests involved.

The choice of law problems created by foreign corporation laws have been recognized. About half the states with choice of law rules disclaim an intention to regulate the internal affairs of foreign corporations.⁴¹ This introduces some much needed flexibility, but application problems remain. The innovations of the New York Business Corporation Law suggest a better solution. Section 1319 lists by section number and description the provisions of the Business Corporation Act that will apply "to a foreign corporation doing business in this state, its directors, officers, and shareholders."⁴² Section 1320 exempts from the operation of certain of the sections listed in section 1319 corporations falling into either of two categories: (1) corporations with shares listed on national securities exchanges and (2) corporations with less than one-half of their business incomes allocable to New York for franchise tax assessments. Thus, by selecting specific statutory provisions to apply to foreign corporations and by exempting certain types of corporations from some of those sections, New York has attempted in a rational way to solve choice of law problems relating to foreign corporations.⁴³ Its statute is a marked improvement over broad, nonselective statutes, but whether any statute can be really useful is open to question.

³⁹ 119 F. Supp. 427 (D.N.J. 1954).

⁴⁰ *Id.* at 428.

⁴¹ *E.g.*, IOWA CODE ANN. § 496A.103 (1962); PA. STAT. ANN. tit. 15, § 2001 (1967).

⁴² N.Y. BUS. CORP. LAW § 1319(a) (McKinney 1963).

⁴³ The New York choice of law scheme hopefully will not be shifted to turn on compliance—as happened with the jurisdictional aspects of the foreign corporation provisions. See pp. 737-38 *supra*.

D. Name Restrictions

A bare majority of the states restrict the local use of certain names by foreign corporations.⁴⁴ Residents, of course, need protection from the confusion and deception that can result from use of a corporate name already claimed locally. Particularly in need of relief are the domestic corporations that suffer when their names are associated with the shoddy business practices of foreign corporations with similar names. But sufficient protection already exists without the restrictions included in the foreign corporation laws.

The right of local corporations to protect their names has long been established.⁴⁵ In *American Clay Manufacturing Co. v. American Clay Manufacturing Co.*,⁴⁶ a Pennsylvania corporation brought an action against a New Jersey corporation to enjoin the use by the defendant of plaintiff's name in Pennsylvania. The defendant argued that since it had complied with the foreign corporation law of Pennsylvania, which imposed no name restrictions, none could be imposed by the court. The court rejected this argument, stating there was "no good reason why the mere absence of a statutory provision as to foreign corporations coming into this state to do business, should oust the courts of equity from their general jurisdiction over the subject, which is exercised independently of statute."⁴⁷

E. Names and Addresses of Principals

A substantial number of states require foreign corporations to file the names and addresses of their officers and, occasionally, their directors. It is desirable to know the names and residences of persons managing out-of-state businesses if major transactions are planned.⁴⁸ The information can, of course, be gotten directly from the corporations. But here, more than with most requirements, it is possible to recognize some local benefit—though it is difficult to imagine any situation likely to recur in which the local availability of names and addresses would be of critical importance. The possible value should be recognized and the question reserved whether such minimal utility justifies foreign corporation law schemes.

⁴⁴ See Walker 21.

⁴⁵ To this effect see the collection of cases at Annot., 66 A.L.R. 948, 952-53 (1930).

⁴⁶ 198 Pa. 189, 47 A. 936 (1901).

⁴⁷ *Id.* at 196, 47 A. at 937.

⁴⁸ See Walker 20.

F. *Withdrawals and Revocations*

Administrative provisions establishing the mechanics of withdrawal by foreign corporations admitted to do business and the procedures for revocation of that authority by the states serve only to support the substantive requirements of the laws. As such they have no utility themselves, but nevertheless figure in any assessment of the general utility of the laws because of the burdens they impose.

G. *Annual Reports*

A number of states require annual reports by foreign corporations. The usefulness of these reports must be judged with respect to their two traditional functions, providing information and facilitating state taxation of foreign corporations.

1. Administrative Aspects

Some thirty states require foreign corporations to file annual reports typically designed to bring up-to-date the information originally supplied. A small minority asks for current financial data,⁴⁹ but whether the benefits of such data outweigh the increased burden is doubtful. The significant fact here is that only a handful of states request this information. Thus the reports must be mainly regarded as support provisions which can be justified only by reference to the positive features of the laws.

2. Tax Aspects

An evaluation of annual report requirements must take into account their relationship, and, indeed, the relationship of foreign corporation laws, to state tax programs.⁵⁰

Capital stock taxes are levied under a number of names such as corporation franchise tax, corporation license tax or corporation business tax. All are annually recurring taxes assessed according to the value of a corporation's capital. The tax base is determined either from the corporation's statement of capital, a so-called capital account base, or in some

⁴⁹ *Id.* at 22.

⁵⁰ The basic source material for the following discussion is the excellent report of the Special Subcommittee on State Taxation of Interstate Commerce, 3 SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE OF THE HOUSE COMM. ON THE JUDICIARY, STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. No. 565, 89th Cong., 1st. Sess. 925 (1965) [hereinafter cited as SPECIAL SUBCOMM. REPORT]. The report drew from the thoughts of leading scholars in the field and from a wide collection of empirical data. Specific references are cited as appropriate.

more realistic manner attempting to reflect the value of the business enterprise, usually called a capital value base.

Capital stock taxes are imposed by some thirty-six states of which more than twenty-five make the levy applicable to out-of-state corporations. At one time the tax was a significant source of state revenue, but by 1963 it accounted on the average for little more than three percent of the revenue of states that used it and is now only a minor source of state income.⁵¹ At least twenty-two of the states that impose a capital stock tax on foreign corporations impose the tax solely on the basis of compliance with foreign corporation laws. In some cases this result is called for by statute.⁵² The *Model Act* provides that "the Secretary of State shall charge and collect from each foreign corporation authorized to transact business in this state an annual franchise tax."⁵³ In other states, essentially the same result is reached because of administrative reliance on the fact of compliance. The House of Representatives' Special Subcommittee on State Taxation of Interstate Commerce reported:

In a number of States, the tax administrators clearly make no attempt to determine jurisdiction on the basis of any pattern of activity within the State. In nine States . . . the administrators explained that the question for them was simply whether the company was qualified.⁵⁴

The ties between capital stock taxes and foreign corporation laws cannot be explained by history. The early foreign corporation statutes were enacted to meet needs unrelated to capital stock taxes or other state tax programs.⁵⁵ This conclusion does not, of course, determine the value of the present relationships where they exist; but it brings into question any suggestion that such relationships are inevitable. The ties, whether statutory or administrative, probably developed because both assessment of capital stock taxes and administration of foreign corporation laws are usually the responsibility of the same state executive officers, usually called the Secretary of State. No doubt these officers found it inconvenient to make separate determinations as to whether out-of-state corporations were subject to the capital stock taxes and whether they were required to comply

⁵¹ SPECIAL SUBCOMM. REPORT 903-17. The data as to the number of states imposing the tax was collected in 1964.

⁵² *E.g.*, ARK. STAT. ANN. § 84-1833 (1947) ("qualified under the laws of this State"); S.C. CODE § 65-602 (1962), as amended (Supp. 1968) ("qualified to do business").

⁵³ ABA-ALI MODEL BUS. CORP. ACT § 126 (1966).

⁵⁴ SPECIAL SUBCOMM. REPORT 934.

⁵⁵ *See* Walker 2-19.

with foreign corporation laws, and began as an administrative matter to decide the issues as one question.

Taxes imposed solely because of compliance are levied without reference to local economic activity. While it is true that qualification may co-exist with significant local activities, it is also true that the relationship may exist where no local business is done at all.⁵⁶ Moreover, the authority upon which businessmen, and their accountants and lawyers, must rely in determining liability for capital stock taxes is developed in a context unrelated to taxation. Most appellate decisions involving foreign corporation laws result from refusals by state courts to allow suits by foreign corporations against local defendants. The results are difficult to rationalize but nevertheless must function as guides for private determinations of tax liability.

These problems were recognized by the Special Subcommittee, which recommended that capital stock taxes and foreign corporation laws be separated: "While recognizing that the privilege of doing business in corporate form within a State has long been considered a suitable subject for the levy of a tax, it may be suggested that both the taxing and regulatory functions would operate more effectively if their incidence were separated."⁵⁷

Recent changes in the law also suggest that the present system causes considerable inconvenience for state administrators. In 1951 the Supreme Court decided in *Spector Motor Service, Inc. v. O'Connor*⁵⁸ that a tax on the privilege of doing business could not be levied where the business was entirely in interstate commerce. Eight years later, however, the Court held in *Northwestern States Portland Cement Co. v. Minnesota*⁵⁹ that the net income of a foreign corporation derived solely from interstate commerce was a proper subject of state taxation.⁶⁰ The practical effect of these two decisions is to allow state income taxes to be imposed on foreign

⁵⁶ Apportionment formulas do, however, often supply some economic reality, considerably improving the practical result if not the logic of the levy. As the Special Subcommittee pointed out, use of the legal relationship test can lead, under typical apportionment formulas, to situations in which returns are required although there are no tax bases. "[T]here are reasons for a company qualifying to do business in a State where it presently neither has any activity or sales." SPECIAL SUBCOMM. REPORT 992.

⁵⁷ *Id.* at 991.

⁵⁸ 340 U.S. 602 (1951).

⁵⁹ 358 U.S. 450 (1959).

⁶⁰ For a concise survey of these developments, see W. BEAMAN, PAYING TAXES TO OTHER STATES 2.1-2.25 (1963).

corporations at a level of contact considerably lower than the level required to allow taxation of the privilege of doing business locally, the subject upon which most capital stock taxes are levied.

Spector and *Northwestern* are open to the criticism that they created an artificial distinction between the two schemes of taxation. But the distinction remains; its effect is that states that subject out-of-state corporations to taxes on net income and capital stock taxes on the privilege of doing a local business take two tax bites at different degrees of local contact. Income tax liability attaches first at a minimal level, and then when there are considerably more contacts capital stock taxes may be imposed. Two administrative judgments are required if the case law is conscientiously followed.

At least five states apparently have recognized some of these problems and now integrate capital stock taxes into their income taxes.⁶¹ The complete integration of capital stock taxes into income tax programs is desirable, particularly from the viewpoint of state officials.

The suggestion is sometimes made that annual reports serve as significant sources of information for officials enforcing other state tax laws. Presumably this suggestion is directed to enforcement of state income and sales and use tax laws—typically the major sources of revenue from foreign corporations.

This suggested utility is subject to two criticisms. First, the *Northwestern* case in the income tax area and *Miller Brothers v. Maryland*⁶² and *Scripto Inc. v. Carson*⁶³ in the sales tax field clearly permit states to require foreign corporations to pay taxes on their net incomes and to collect sales or use taxes in cases where the degree of local contact is considerably lower than that required by the Constitution for application of foreign corporation laws.⁶⁴ The existence of these different thresholds typically means that information comes to state tax officials because of compliance with foreign corporation laws only after considerably more local contact than is necessary to create liabilities for income and sales and use taxes. Enforcement difficulties come in large part where contacts are minimal and tax liabilities arguable, a situation in which corporations usually are not required to qualify. A second criticism is that state tax laws typically impose independent reporting requirements on foreign

⁶¹ SPECIAL SUBCOMM. REPORT 932.

⁶² 347 U.S. 340 (1954).

⁶³ 362 U.S. 207 (1960).

⁶⁴ See pp. 747-53 *infra*.

corporations without reference to foreign corporation laws.⁶⁵ The different contact thresholds explain why this must be so; no doubt officials concerned with the enforcement of tax laws prefer to tailor reporting requirements to fit their particular needs. Even as a cross check, information supplied pursuant to foreign corporation laws is of little value. Corporations that fail to pay income or sales and use taxes but have sufficient local contacts to require compliance with foreign corporation laws are not likely to comply.

Practical analysis, even speculation, thus indicates that at most foreign corporation laws are of minimal value today. The original reason for the laws has not been replaced by a significant new purpose that now justifies this expanding and complex regulatory scheme.

II. JUDICIAL SOLUTION

One solution to the problem of aimless regulation presented by foreign corporation laws could come from an examination by the courts of the impact of these laws on the national market. Ultimately, the Supreme Court would have to decide the constitutional issues that would be presented. Suggestions about the technique and substance of such a decision must begin with an analysis of the Court's work to date.

A. Supreme Court Cases

Apparently, *Cooper Manufacturing Co. v. Ferguson*⁶⁶ is the earliest case in which the Supreme Court considered the effect of the commerce clause on the application of a foreign corporation law. An Ohio corporation brought suit in a Colorado federal court to recover damages from the Colorado defendants for breach of a contract to purchase a steam engine. The plaintiff's agreement to sell the engine was its only business venture in the state. The defendants claimed that the contract was void because, at the time it was executed in Colorado, the plaintiff had not complied with the Colorado foreign corporation law.⁶⁷ The Supreme Court held that under the Colorado statute a single business transaction was not sufficient business activity to require compliance. The Court expressly stated that it did "not find it necessary to decide" whether the

⁶⁵ *E.g.*, GA. CODE ANN. § 92-3102 (1961), as amended (Supp. 1968) (imposing income tax); *Id.* § 92-3202 (1961) (establishing reporting requirement); PA. STAT. ANN. tit. 72, § 3420c (1964) (imposing income tax); *Id.* § 3420d (establishing reporting requirement).

⁶⁶ 113 U.S. 727 (1885).

⁶⁷ Act of March 14, 1877, § 23, printed at COLO. GEN. LAWS 151 (1877).

provisions of the Act "invade the exclusive right of Congress to regulate commerce among the several States."⁶⁸ But Justices Matthews and Blatchford concurred on the ground that the power of a state to regulate local business "cannot be admitted to extend so far as to prohibit or regulate commerce among the States; for that would be to invade the jurisdiction which, by the terms of the Constitution of the United States, is conferred exclusively upon Congress."⁶⁹

In 1899, Kansas enacted a complex foreign corporation law,⁷⁰ and within a relatively brief period it went before the Supreme Court four times. In the first two cases, *Western Union Telegraph Co. v. Kansas*⁷¹ and *Pullman Co. v. Kansas*,⁷² Kansas attempted to prevent the corporations involved from transacting further business in the state because of their failure to pay fees of one-tenth of one per cent of their authorized capital. The fee requirements were part of the Kansas foreign corporation law, but the court treated both cases as tax matters and held that the fees could not be levied, primarily because there was no apportionment provision and thus no attempt to relate the amount of the fee to the local activities of the corporations.

The statute was considered a third time in 1909 in *International Textbook Co. v. Pigg*.⁷³ A Pennsylvania corporation sued in Kansas to recover money due under a contract for correspondence courses. The contract was executed in Kansas by the Kansas defendant and was forwarded to Pennsylvania where it was accepted by the plaintiff. The defendant did not deny making the contract or that he was indebted to the plaintiff but maintained that the plaintiff had not complied with the Kansas foreign corporation law and thus could not sue in the Kansas courts. The Supreme Court reached the commerce question after deciding that the Kansas statute required compliance. Justice Harlan wrote for the Court and stated the following constitutional test:

But this view as to the meaning of the Kansas statute does not necessarily lead to an affirmance of the judgment below if, as the plaintiff contends, the business in which it is regularly engaged is interstate in its nature, and if the statute, by its necessary operation, materially or directly burdens that business.⁷⁴

⁶⁸ 113 U.S. at 735-36.

⁶⁹ *Id.* at 736.

⁷⁰ Act of Jan. 7, 1899, ch. 10, § 2, [1898] Kan. Laws Spec. Sess. 27-28.

⁷¹ 216 U.S. 1 (1910).

⁷² 216 U.S. 56 (1910).

⁷³ 217 U.S. 91 (1910).

⁷⁴ *Id.* at 105-06.

Justice Harlan turned to the plaintiff's business operations and considered in detail the method by which correspondence courses were carried on, concluding that the plaintiff's business was interstate. The Court then examined the requirements of the statute, particularly the requirement of annual reports, and decided that "the statute imposes a direct burden on the plaintiff's right to engage in interstate business, and, therefore, is in violation of its constitutional rights."⁷⁵

Pigg was followed that same year in *International Textbook Co. v. Lynch*⁷⁶ involving the Vermont foreign corporation act⁷⁷ and in *International Textbook Co. v. Peterson*⁷⁸ involving the Wisconsin law.⁷⁹ The Kansas statute came before the Supreme Court for the fourth time in *Buck Stove & Range Co. v. Vickers*,⁸⁰ and the Court applied the *Pigg* holding without elaboration.

In *Sioux Remedy Co. v. Cope*,⁸¹ an Iowa corporation sued in South Dakota to recover the purchase price of merchandise sold to the South Dakota defendant, but the action was dismissed on the ground that the plaintiff had failed to comply with the South Dakota foreign corporation law.⁸² The Supreme Court asked first whether the foreign corporation act had been applied to interstate commerce and, if so, whether it imposed a burden on that commerce. The first question was conceded, and the Court quickly found that the act imposed a considerable burden and reversed.

The same technique was followed in *Dahnke-Walker Milling Co. v. Bondurant*.⁸³ The plaintiff, a Tennessee corporation, brought an action against a Kentucky resident to recover damages for breach of a contract to sell wheat grown on the defendant's farm. The trial court directed a verdict for the defendant on the ground that the plaintiff had not complied with the Kentucky foreign corporation law,⁸⁴ and the Kentucky Court of Appeals affirmed.⁸⁵ The Supreme Court reversed, holding that "the trans-

⁷⁵ *Id.* at 112.

⁷⁶ 218 U.S. 664 (1910) (per curiam).

⁷⁷ Act of Dec. 16, 1902, no. 20, §§ 59-64, [1902] Vt. Laws 29-31.

⁷⁸ 218 U.S. 664 (1910) (per curiam).

⁷⁹ Act of June 20, 1905, ch. 506, [1905] Wis. Laws 932.

⁸⁰ 226 U.S. 205 (1912).

⁸¹ 235 U.S. 197 (1914).

⁸² Act of March 14, 1895, ch. 47, [1895] S.D. Laws 52.

⁸³ 257 U.S. 282 (1921).

⁸⁴ Act of April 5, 1893, ch. 171, §§ 34-35, [1891-93] Ky. Laws 625-26.

⁸⁵ *Dahnke-Walker Milling Co. v. Bondurant*, 185 Ky. 386, 215 S.W. 76 (1919). The Kentucky court's reasons are set out in an earlier opinion in the same case. *Bondurant v. Dahnke-Walker Milling Co.*, 175 Ky. 774, 195 S.W. 139 (1917).

action was a part of interstate commerce" and that the statute "concededly imposed burdensome conditions."⁸⁶ The Arkansas law⁸⁷ came before the Court in *Furst & Thomas v. Brewster*.⁸⁸ The Illinois plaintiffs sued in Arkansas to recover for goods sold to the Arkansas defendants. The defendants asserted that the action could not be brought in the Arkansas courts because the plaintiffs acted in securing the contract of sale as agents for an Illinois corporation that had not complied with the Arkansas foreign corporation law. The Supreme Court examined the plaintiff's business, found that the contract sued upon "constituted interstate commerce,"⁸⁹ and held that the suit must be allowed.

Just as the tide of purpose began to run out of foreign corporation laws the Supreme Court curiously changed its direction. *Union Brokerage Co. v. Jensen*⁹⁰ involved the Minnesota foreign corporation law,⁹¹ though in the confusing circumstance of an enterprise subject to considerable federal regulation. The plaintiff was a North Dakota corporation engaged in the business of customhouse brokerage, securing the entry of goods from Canada into the United States. It brought suit in Minnesota against the Minnesota defendants for breach of fiduciary obligations. The only defense was that the plaintiff had not complied with the Minnesota foreign corporation law. In his opinion for the Court Justice Frankfurter dealt extensively with the issues raised by Congressional action in the customs field and concluded that the federal regulatory scheme did not preclude enforcement of the Minnesota law. Although the plaintiff's business was "related to the process of foreign commerce,"⁹² he found that it had become so "localized" as to be subject to state supervision.⁹³ Following the old test, Justice Frankfurter then asked whether the Minnesota law was a burden on this localized but foreign commerce. He first decided the law was a "supervisory and not a fiscal measure,"⁹⁴ but in estimating its effect, he treated the law as a tax scheme and wrote that "[b]y its own force that Clause does not imply relief to those engaged in interstate or foreign commerce from the duty of paying an appropriate share for the main-

⁸⁶ 257 U.S. at 292-93.

⁸⁷ Act of May 13, 1907, no. 313, [1907] Ark. Laws 744.

⁸⁸ 282 U.S. 493 (1931).

⁸⁹ *Id.* at 497.

⁹⁰ 322 U.S. 202 (1944).

⁹¹ Act of April 20, 1935, ch. 200, [1935] Minn. 369.

⁹² 322 U.S. at 209.

⁹³ *Id.* at 211.

⁹⁴ *Id.* at 210.

tenance of the various state governments.”⁹⁵ The opinion adds little to the technique of *Pigg*. Justice Frankfurter did not discuss the purpose of the Minnesota law and found it not to be a burden, though the earlier cases suggested the contrary. The significant aspect is the result: for the first time application of a foreign corporation law was upheld by the Supreme Court.

In 1961 the Court decided *Eli Lilly & Co. v. Sav-On-Drugs, Inc.*,⁹⁶ its most recent case in the field. An Indiana corporation sued in New Jersey to enjoin the defendant, a New Jersey corporation, from selling merchandise at prices lower than those fixed by minimum resale price contracts that the plaintiff had entered with a number of other New Jersey retailers.⁹⁷ The defendant moved to dismiss on the ground that the plaintiff had not complied with the New Jersey foreign corporation law.⁹⁸ Both parties submitted affidavits on the nature of the plaintiff's New Jersey business. The trial court dismissed⁹⁹ and the New Jersey Supreme Court affirmed.¹⁰⁰ The Supreme Court affirmed in a five-to-four decision, one Justice concurring specially. The opinion of the Court by Justice Black adopted the *Pigg* test without question:

It is well established that New Jersey cannot require Lilly to get a certificate of authority to do business in the State if its participation in this trade is limited to its wholly interstate sales to New Jersey wholesalers On the other hand, it is equally well settled that if Lilly is engaged in intrastate as well as interstate aspects of the New Jersey drug business, the State can require it to get a certificate of authority to do business.¹⁰¹

Justice Black examined the evidence relating to the plaintiff's New Jersey operations and concluded that Lilly was engaged in intrastate commerce and that the foreign corporation law could constitutionally be applied. There was no mention of the requirements or the purposes of the act.¹⁰²

⁹⁵ *Id.* at 212.

⁹⁶ 366 U.S. 276 (1961).

⁹⁷ Defendant did not sign such an agreement but, according to N.J. REV. STAT. § 56:4-6 (1937), non-signers with notice were bound to observe minimum contract prices.

⁹⁸ N.J. REV. STAT. §§ 14:15-1 to -10 (1937).

⁹⁹ *Eli Lilly & Co. v. Sav-On Drugs, Inc.*, 57 N.J. Super. 291, 154 A.2d 650 (1959).

¹⁰⁰ *Eli Lilly & Co. v. Sav-On Drugs, Inc.*, 31 N.J. 591, 158 A.2d 528 (1960).

¹⁰¹ 366 U.S. at 278-79.

¹⁰² Counsel for Lilly questioned the interest of New Jersey in applying its foreign corporation law. Brief for Appellant at 21-25. New Jersey replied that it had a "legitimate right to know generally who a corporation is, whether it intends to

Even the traditional consideration of the burden imposed by the state law was omitted as unnecessary after a finding that the plaintiff was involved in intrastate commerce.

Justice Harlan concurred, adding some further commerce distinctions. Justice Douglas, in a dissent joined by Justices Frankfurter, Whittaker, and Stewart, discussed the case upon the stated assumption that plaintiff was doing an interstate business. Justice Douglas suggested no new rule but followed his assumption to a conclusion contrary to that of the majority. The main contribution of the dissent was its recognition that the decision "provides the formula whereby a State can stand over the channels of interstate commerce in a way that promises to do great harm to the national market that heretofore the Commerce Clause has protected."¹⁰³

The relation of foreign corporation laws and the commerce clause has not since been before the Court, but in 1964 an application of the Alabama act¹⁰⁴ was considered in *NAACP v. Alabama*.¹⁰⁵ The Attorney General of Alabama sued to oust the NAACP, a New York corporation, on the ground that it had not complied with the act. The Court found that since

act lawfully and in accordance with New Jersey laws, and whether it will be subject to process here." Brief of Intervenor-Appellee at 12. The Court's opinion ignored the exchange.

¹⁰³ 366 U.S. at 292. The *Lilly* case divided the law reviews much as it did the Court. A writer at Yale had doubts about the result primarily because the Court's hair splitting involved tax cases, particularly *Cheney Bros. v. Massachusetts*, 246 U.S. 147 (1918). Note, *Corporate Registration: A Functional Analysis of Doing Business*, 71 YALE L.J. 575 (1962). The writer questioned the utility of statutes such as that involved, but failed to draw significant conclusions. *Id.* at 584-86. A Harvard writer was more sympathetic, apparently in part because "Lilly is in keeping with the recent trend toward increased state power over foreign corporations." *The Supreme Court, 1960 Term*, 75 HARV. L. REV. 40, 139 (1961). The interest of New Jersey was considered "strong enough to warrant a licensing requirement" though the reasons given were that designation of agents can eliminate by waiver litigation of Constitutional minimum contacts questions and that the provisions have some unspecified "informational value to the state." *Id.* at 140. At the extreme was a Cornell writer who suggested that the Court should hold that qualification statutes can be applied where only interstate commerce is involved because typically the "benefits which accrue to a foreign corporation from conducting business within a state outweigh the burdens on interstate commerce effected by such a statute." Note, *State Regulation of Foreign Corporations: Qualification: Interstate v. Intrastate Business*, 47 CORNELL L.Q. 300, 308 (1962). The purpose of the statutes and the state interests were ignored, distorting the limited effectiveness of such a balancing test by in effect balancing the corporation only against itself. For other comment see 40 TEX. L. REV. 717 (1962); 15 VAND. L. REV. 650 (1962).

¹⁰⁴ ALA. CODE tit. 10, §§ 192-98 (1959), as amended, §§ 21 (87)-(96) (Supp. 1967).

¹⁰⁵ 377 U.S. 288 (1963). The case was decided with reference to the Alabama statute as it was prior to amendment. *Id.* at 304 & n.9.

the Alabama statute did not provide for ouster upon noncompliance there was no basis to oust defendant. In passing, the Court noted that "the registration requirements are what they appear to be on their face . . . : provisions ensuring that foreign corporations will be amenable to suit in Alabama courts."¹⁰⁶

B. Techniques

In *Lilly*, the Supreme Court approached the question of the constitutionality of foreign corporation laws under the commerce clause in essentially the same way that it had approached the question fifty years earlier in *Pigg*. The Court still asked whether the business operations of the foreign corporation were interstate or intrastate in character, notwithstanding a Ross Prize essayist's observation six years earlier that "the Court no longer applies what Chief Justice Stone termed the 'mechanical test' whereby the validity of a state law depended on whether it regulated interstate or intrastate transactions."¹⁰⁷

The major failure of the mechanical test is that its result often turns on trivial facts that bear no relationship to the policies expressed by the commerce clause. In *Lilly*, for example, Justice Black carefully considered evidence that the corporation's name was "on the door and in the lobby"¹⁰⁸ of a building in Newark, New Jersey. The decision apparently turned on an analysis of the day-to-day activities in New Jersey of eighteen "detailmen" employed by Lilly to visit pharmacists, physicians, and hospitals to encourage the use of the corporation's products. These facts may have been necessary to relate the case to the traditional test, but this suggests only the irrationality of the old approach.

1. Economic Principles

A more satisfactory analysis of cases involving the application of foreign corporation laws can be developed if it is understood that the commerce clause is primarily a statement of economic policy. A detailed examination of this view is beyond the scope of this article, but it is desirable to discuss certain major principles that will figure later in a suggested solution to the foreign corporation law problem.

The Constitution provides that Congress shall have the power "to regulate Commerce with foreign nations, and among the several States,

¹⁰⁶ *Id.* at 305.

¹⁰⁷ Stern, *The Scope of the Phrase "Interstate Commerce,"* 41 A.B.A.J. 823, 873-74 (1955). The language by Chief Justice Stone is from *Parker v. Brown*, 317 U.S. 341, 362 (1943).

¹⁰⁸ 366 U.S. at 280.

and with the Indian Tribes."¹⁰⁹ There is considerable historical data clearly suggesting that one of the principle forces behind the Constitutional Convention of 1787 was dissatisfaction with the chaos in interstate business transactions¹¹⁰ and that the commerce clause was an attempt to solve these problems. In *Gibbons v. Ogden*,¹¹¹ Chief Justice Marshall suggested, but did not decide, that this power granted to Congress was exclusive and that therefore all state power to regulate interstate commerce was lost upon ratification. The Chief Justice drew back from the suggestion of an exclusive commerce power five years later in *Willson v. Black Bird Creek Marsh Co.*¹¹² where the court upheld a Delaware act providing for the erection of a dam across a tidal creek. In *Cooley v. Board of Wardens*,¹¹³ the Court rejected a concept of the power as broadly exclusive and began a long line of decisions attempting to sort out the matters subject and not subject to state control. One group of these decisions is strictly jurisdictional in approach and rests on the interstate-intrastate distinction used in the foreign corporation law cases.

None of the opinions has effectively employed economic principles. Chief Justice Marshall moved in that direction in *Gibbons v. Ogden* when he noted the desirability of commercial regulation constituting a "uniform whole."¹¹⁴ A complete analysis, however, must ask why a uniform whole is desirable, and broadly, what theoretical implications are included in the founders' attempt to create a national market.

In 1776, Adam Smith expounded for the first time a modern theory of economic specialization when, on the first page of his *Wealth of Nations*, he extolled the benefits of a division of labor. Early trade theorists extended his theory to international trade. They reasoned that where a nation enjoyed an absolute advantage in the production of certain commodities, it was to its benefit to trade those commodities to other nations for commodities that it produced at an absolute disadvantage.

David Ricardo refined the theory by pointing out that beneficial trade could take place when the advantage was only relative, and not absolute. A nation or region less efficient in the production of all goods could benefit, he wrote, by exporting the goods that it produced relatively or

¹⁰⁹ U.S. CONST. art. I, § 8.

¹¹⁰ For a survey of the materials, see Abel, *The Commerce Clause in the Constitutional Convention and in Contemporary Comment*, 25 MINN. L. REV. 432 (1941).

¹¹¹ 22 U.S. (9 Wheat.) 1 (1824).

¹¹² 27 U.S. (2 Pet.) 245 (1829).

¹¹³ 53 U.S. (12 How.) 299 (1852).

¹¹⁴ 22 U.S. (9 Wheat.) at 209.

comparatively efficiently and importing the goods that it produced relatively less efficiently. This theory of comparative advantage, out of which grew a full understanding of international trade, is "a closely reasoned doctrine which, when properly stated, is unassailable."¹¹⁵

This theory of international trade has important social implications. The effect of international trade is easily understood through the use of a simple model such as that described by D. A. Snider in his *Introduction To International Economics*.¹¹⁶ The model quantitatively demonstrates that the participating nations will have a larger volume of all goods from the employment of a given amount of resources than would be the case in economic isolation.¹¹⁷ Since the production of goods is ultimately a social cost, increase in the volume of goods produced by the same effort is a net social gain. Paul Samuelson makes it clear that these principles of international trade are fully applicable within the United States:

From the standpoint of pure economic welfare, the slogan "Buy American" is as foolish as "Buy Wisconsin" would be or "Buy Oshkosh, Wisconsin," or "Buy South Oshkosh, Wisconsin." Part of our great prosperity comes from the fortunate fact that there are no restrictive customs duties within our 50 states, which form one great free-trade area.¹¹⁸

Arguably then, the commerce clause is not a jurisdictional device to divide the areas of federal and state economic action; it incorporates very practical economic principles that have the capacity to maximize the social well-being of the entire nation.

2. Balance of Interests

Direct reference to the principles of another discipline is still a radical step for the courts. A traditional, yet improved, method of analysis is also available for the foreign corporation law problem.

¹¹⁵ P. SAMUELSON, *ECONOMICS* 646 (7th ed. 1967). Pages 646-702 of this text are one of two basic sources for this discussion. The other is D. SNIDER, *INTRODUCTION TO INTERNATIONAL ECONOMICS* (4th ed. 1967). A note of appreciation for generous advice is here due Dr. Richard Musgrave, Professor of Economics in the Faculty of Arts and Sciences and in the Law School of Harvard University.

¹¹⁶ D. SNIDER, *INTRODUCTION TO INTERNATIONAL ECONOMICS* 29-56 (4th ed. 1967).

¹¹⁷ The writers of the mercantilistic era, suggesting that one country's gain must be the other's loss, came to the opposite conclusion. This era ended about 1750. *Id.* at 54. It may prove too much to say that the adoption of the commerce clause was a conscious rejection of the old theory and a turn toward the new, but the possibility is interesting.

¹¹⁸ P. SAMUELSON, *ECONOMICS* 666 (7th ed. 1967).

In *Southern Pacific Co. v. Arizona*,¹¹⁹ the state attempted to enforce against the defendant railroad the provisions of a train limit law,¹²⁰ which made it unlawful to operate a train of more than a stated number of cars. The Court found that Congressional activity had not closed the field to state legislation and thereby reached the commerce question. After a brief review of early decisions, Chief Justice Stone suggested a test that called first for determination of the "nature and extent of the burden which the state regulation" imposed, and then consideration of "the relative weights of the state and national interests involved."¹²¹ Applying this test, the Chief Justice thoroughly analyzed the purposes and the effects of the train limit statute and held that, as applied, it was in conflict with the commerce clause. This brought consideration of the substance of state regulation to the forefront and departed from a strictly jurisdictional approach.¹²²

Chief Justice Stone's use of empirical data in considering Arizona's claim that the Train Limit Law was a safety measure and therefore a matter of significant state interest is noteworthy. The persuasive conclusion was that the law caused more accidents than it prevented. The Court said that "the Arizona Train Limit Law, viewed as a safety measure, affords at most slight and dubious advantage, if any, over unregulated train lengths, because it results in an increase in the number of trains and train operations and the consequent increase in train accidents of a character generally more severe than those due to slack action."¹²³ This fruitful inquiry by the Court would not have taken place if it had only looked for interstate or intrastate commerce. Chief Justice Stone's balance of interests tests could be equally revealing if applied to foreign corporation law problems.

C. Applications

The economic principles of the commerce clause can be applied to suggest a judgment about foreign corporation laws and their impact

¹¹⁹ 325 U.S. 761 (1945). The case is discussed in Stern, *The Scope of the Phrase "Interstate Commerce,"* 41 A.B.A.J. 823, 874 (1955).

¹²⁰ Act of May 16, 1912, ch. 43, [1912] Ariz. Laws 195.

¹²¹ 325 U.S. at 770.

¹²² In seeking to balance state and national interests, however, Justice Stone's method incorporates and continues a basic fallacy of dual interests. The interest in question is unitary and the commerce clause makes the Court not the arbiter of competing demands, but the agent for maximizing that interest.

¹²³ 325 U.S. at 779. Slack action is the amount of free movement of one car before it transmits its movement to the next, and was said to be the chief danger diminished by train limit laws. *Id.* at 776.

in particular cases. Models such as that used by Professor Snider to demonstrate the benefits of trade¹²⁴ identify the elements to be assembled and their proper arrangement.

Compliance with state foreign corporation laws imposes a sizeable financial burden on modern corporations with multi-state operations. Some of the costs of compliance can be determined with some precision; others are susceptible only to rough estimates. Examination of these costs, however, does serve to illustrate the magnitude of the financial burden.

Lawyers today rely heavily on the services of corporations organized to assist others in compliance with foreign corporation laws. Local attorneys are sometimes employed, but by and large the paper work is left to service corporations. The Corporation Trust Company is the largest of these companies and with its subsidiaries controls about half the market.¹²⁵ The CT System, as the Corporation Trust Company calls its service, operates in the qualification field by providing research data for lawyers, furnishing work sheets for qualification, preparing and filing applications, maintaining designated agents, and supplying further services as required.

CT's chief research tool is a publication entitled *What Constitutes Doing Business*, an unrivaled collection of the conflicting and obscure decisions on the scope of foreign corporation laws. Information published by the company for businessmen is doleful. Executives are invited to write for booklets with titles such as: *Some Contracts Have False Teeth; Agent for Process; Heads I Win Tails You Lose; Corporate Confusion; and A Pretty Penny . . . Gone*.

The standard fee of the CT System is sixty dollars per qualification. For an additional ten dollars CT will act as a designated agent for one year. After the first year the agency fee is forty dollars annually if the service is used in only one state, and thirty-five dollars per state if CT is used in more than one state. The charge for filing an annual report is fifteen dollars. Filing charter amendments costs fifteen dollars, but, where a charter amendment requires an amended application, there is an additional fifteen-dollar charge. Withdrawal costs range from thirty-five dollars to 100 dollars in states where the procedure is particularly difficult. All out of pocket expenses are billed, a substantial item where publication

¹²⁴ See p. 755 *supra*.

¹²⁵ Information about the operation and fees of the Corporation Trust Company and its subsidiaries was furnished by a representative of its Boston office in 1968.

is required. Charges are perfectly regressive. CT bills Ford Motor Company the same price per transaction that it charges a New York grocer opening a fruit stand in Jersey City.

The fees of service corporations represent only a part of qualification costs. Typically, lawyers must first decide whether to qualify and then see that the procedures are properly completed. Legal fees in most cases equal and probably exceed service corporation charges. The state filing charges are additional costs. The amounts vary a great deal, but over the nation they probably roughly equal service corporation fees. The most difficult costs to estimate are the internal administrative costs of compliance, such as expenditures for collection of the data necessary to prepare applications and annual reports. Though not related to costs of compliance, the potentially great expense of contract defaults should be noted because they increase the costs of engaging in out-of-state business.

The general effect of these compliance expenses is to increase the cost of doing business across state lines in much the same way that tariffs increase the cost of doing an international business. The dollar amounts are not large but they are significant in light of the type of business largely affected. The Special Subcommittee reported in 1964 that the typical interstate business is not a large corporation with heavy administrative support. A majority of them are companies with less than one million dollars in annual sales and about half have fewer than twenty employees. Many have annual sales of less than \$500,000 and fewer than ten employees.¹²⁶ The costs of qualification are a burden to these smaller businesses taking tentative steps toward expansion. While compliance costs are not perfectly analogous to tariffs (for example, no tariff is perfectly regressive), both tend to increase the price of traded goods to the purchaser, a situation that entails the same economic consequences whether the increase in price is occasioned by a tariff or by compliance costs. The usual result of a tariff is that the price of the goods falls in the exporting country and rises in the importing country. This price change induces domestic producers in the importing country to produce more of the affected goods and less of the specialty goods produced for international trade. In the exporting country, the fall in prices tends to slow down production of the local specialty and increase production of other

¹²⁶ 1 SPECIAL SUBCOMM. ON STATE TAXATION OF INTERSTATE COMMERCE OF THE HOUSE COMM. ON THE JUDICIARY, STATE TAXATION OF INTERSTATE COMMERCE, H.R. REP. NO. 1480, 88th Cong., 2d Sess. 69-75 (1964). A summary of findings is at 74-75.

less efficiently produced goods, just as occurred in the importing country. The effect then of a tariff is to reduce the economic efficiency of both the importing and exporting countries and, therefore, to reduce the sum of social well-being.¹²⁷

To this point the conclusion seems clear that since foreign corporation laws increase the costs of out-of-state traders, and ultimately the price of traded goods, the laws tend to restrict trade and should no longer be enforced. But the problem can be more complex.

In the case of some kinds of regulation of out-of-state business—for example, long arm statutes subjecting foreign corporations to suit on the basis of minimal contacts¹²⁸—this analysis which supposes only an increase in the costs of the foreign trader is inaccurate. If local regulation did not exist, the costs to local purchasers would be increased because of a higher incidence of loss through unfair dealing; consequently, the effect of abolishing the regulation in question might depress trade more than the tariff effect created by the regulation.

The economist's solution in such a situation is to create a model of the particular system and, by a series of tests involving first the elimination of one factor and then the other, to determine the separate effects of each and thus accumulate the data necessary to make a judgment as to whether the regulation or the lack of it produces the greatest social good.¹²⁹ Foreign corporation laws do not, however, present judgment problems that require such sophisticated models. The laws are no longer necessary to protect local residents; hence their abrogation would not increase the cost of traded goods to local purchasers. Even if the statutes were found to have some minimal utility, they should be abrogated because they tend to reduce trade which in turn diminishes the sum of social well-being.

Application of the more traditional legal solution proposed by Chief Justice Stone in *Southern Pacific Co. v. Arizona*¹³⁰ would reach the same result. The burden of foreign corporation laws is considerable, as has been indicated in the discussion above of the costs of compliance. The proper solution of the balance of interests equation suggested by the Chief

¹²⁷ D. SNIDER, INTRODUCTION TO INTERNATIONAL ECONOMICS 143-52 (4th ed. 1967).

¹²⁸ See Walker 27-28.

¹²⁹ The promise and the difficulty of using economic analysis in the solution of particular cases is discussed in Bok, *Section 7 of the Clayton Act and the Merging of Law and Economics*, 74 HARV. L. REV. 226 (1960).

¹³⁰ 325 U.S. 761 (1945).

Justice is also clear. Set on one side is the national interest in developing and maintaining a maximum level of trade. This interest has traditionally been accepted by the courts without proof, and the economic materials show it to be stronger than most suspect. On the other side of the equation is the near-zero utility of typical foreign corporation laws. Even some minimal utility set against the national interest in Chief Justice Stone's equation would not put the result in doubt. The statutory scheme, as customarily applied, now conflicts with the commerce clause and therefore should not be further enforced by the courts.

III. LEGISLATIVE SOLUTION

The problem of foreign corporation laws is also susceptible to legislative solution. Many specific improvements could be made: broad choice of law provisions could be carefully limited, local agent requirements could include provisions limiting the jurisdiction of courts over cases begun by service on such agents, and state tax programs could be separated from foreign corporation laws.

Yet these changes could not infuse new purpose in the laws. The best legislative solution would be to eliminate general foreign corporation laws from current corporation codes; certainly no new code should be adopted that includes the scheme. Such action would require, of course, a preliminary analysis of local law, particularly long arm statutes and corporate tax reporting requirements. The *Uniform Interstate and International Procedure Act* provides a good standard for judging the adequacy of long arm statutes and for drafting such a statute if that is necessary. Reporting requirements need only state the requirement and relate it to tax liability. The Georgia statute requiring income tax returns is an example of the simplicity of an act that appropriately relates its requirements to the legal relationships that bring on the tax. The statute provides: "Every corporation subject to taxation under this law shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this law."¹³¹ The same technique could be easily adapted to other taxes.

A majority of states already have adequate long arm statutes and current tax reporting requirements are typically related to liability. In most cases, therefore, few if any changes would be required before legislative action could be taken to repeal foreign corporation laws.

¹³¹ GA. CODE ANN. § 92-3202 (1961).