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Foreign Corporation Laws: Re-Examining Woods v. Interstate Realty Co. and Reopening the Federal Courts

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FOREIGN CORPORATION LAWS: RE-EXAMINING *WOODS v. INTERSTATE REALTY CO.* AND REOPENING THE FEDERAL COURTS

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Today the federal courts are closed to out-of-state corporate plaintiffs that have not complied with local foreign corporation laws.

Practically all state laws conditioning the admission of corporations chartered by other states provide for the forfeiture of contracts by non-complying foreign corporations, but for many years the federal courts in the exercise of diversity jurisdiction offered a measure of relief from these penalties. They applied a body of law established in opinions by Justices Holmes and Hughes that recognized the forfeiture provisions in areas of state competence, but refused forfeitures where there were federal interests.

In 1949 the Supreme Court radically changed its position in *Woods v. Interstate Realty Co.*[1] and decided to apply all foreign corporation law forfeiture penalties in the federal courts. Ironically, the Court acted to support a complex scheme of state regulation then losing its purposes and principle and now without reason and sustained only by inertia. The *Woods* decision is contrary to the fundamental principles of the federal system and has become a treacherous precedent in federal-state choice of law doctrine that now ought to be removed.

I. THE FEDERAL COURTS CLOSED

The Interstate Realty Co. was aptly named. By its own admission the Tennessee corporation carried on its brokerage business in Tennessee, Arkansas, Missouri, Louisiana, Alabama, Kentucky, and Mississippi.[2] During 1946, commissions from the sale of land in Mississippi alone totaled $14,430 or nearly fifteen per cent of the total commissions received by the corporation during that year.[3] One commission not included in the 1946 total was a fee of $3,450, which the corporation believed it had earned on the sale of a parcel of land located in Panola County,

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[1] 337 U.S. 535 (1949).

[2] Record at 66, Woods v. Interstate Realty Co., 337 U.S. 535 (1949).

[3] *Id.* at 64.

Mississippi. On January 1, 1946, the Panola County property was conveyed by its owner, J. S. Woods, a resident of Mississippi, to Carl A. McCown, but Woods refused to pay the corporation the fee it claimed it had earned by bringing the parties together.[4]

In 1947, Interstate Realty sued Woods for the fee in the United States District Court for the Northern District of Mississippi. Defendant Woods moved for summary judgment on the ground that the plaintiff had failed to comply with the Mississippi foreign corporation law. Woods' motion did not question the sufficiency of the service of process, the subject matter jurisdiction of the district court, or the venue. The Mississippi law required foreign corporations doing business in the state to designate agents for service of process and required them to file copies of their charters or articles of incorporation with the Secretary of State. The law further provided that any foreign corporation "failing to comply with the above provisions shall not be permitted to bring or maintain any action or suit in any of the courts of this state."[5] The motion for summary judgment was granted.

A. The Law of Holmes and Hughes

The first foreign corporation law in the United States was enacted in 1852, but similar laws were not widely adopted until after the 1878 decision of *Pennoyer v. Neff*.[6] By 1902, some forty states had enacted first statutes, and most of this early legislation included forfeiture provisions.[7]

1. The Void-Unenforceable Distinction

The Supreme Court's first statement on the recognition due these penalties in the federal courts came in *Diamond Glue Co. v. United States*

[4] *Id.* at 8.

[5] Law of April 13, 1928, ch. 90 [1928] Miss. Laws 133 (designation requirement and penalty); Law of April 19, 1900, ch. 45 [1900] Miss. Laws 47 (charter filing requirement). The statutes, as collected in the Mississippi Code of 1942, may be conveniently found in Interstate Realty Co. v. Woods, 168 F.2d 701, 702 n.2 (5th Cir. 1948). The Mississippi statutory scheme contained the major elements of foreign corporation laws now found in all fifty states. *See* Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C.L. REV. 1, 19-23 (1968).

[6] 95 U.S. 714 (1878).

[7] *See* Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C.L. REV. 1, 13-15 (1968). Forfeiture penalties continue to be popular, though their impact has been substantially reduced by a trend toward giving retroactive effect to subsequent compliance. In at least eight states, however, losses still cannot be redeemed. 1 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 292 (Supp. 1968).

Glue Co.[8] The plaintiff, an Illinois corporation, brought suit against a Wisconsin corporation in the United States Circuit Court for the Eastern District of Wisconsin for breach of a contract to plan, build, and manage a factory to be located in Wisconsin. The defendant answered that the plaintiff had neither designated a local agent nor filed a copy of its charter and, therefore, the contract was "wholly void on its behalf."[9] The circuit court overruled the plaintiff's demurrer and recognized the defense.[10] The Supreme Court affirmed without dissent. Justice Holmes first noted that the Wisconsin foreign corporation law "provided . . . that every contract made by such corporation affecting the personal liability thereof or relating to property within the state before compliance with the section should be wholly void on its behalf, but should be enforceable against it."[11] He then wrote that "the instrument was signed in Wisconsin, and at all events, if it was executed with a view to carrying on of business in that State by the plaintiff, the law of Wisconsin must be applied . . . . There is no controversy on this point."[12]

The Court's second statement came nine years later in *David Lupton's Sons v. Automobile Club of America.*[13] The plaintiff, a Pennsylvania corporation, entered into a contract in New York by which it agreed to manufacture and install frames and sashes for a building to be erected in that state. A dispute developed, and the Pennsylvania corporation, insisting that it was wrongfully prevented from performing the entire contract, brought suit in New York in the Circuit Court of the United States. The defendant maintained that the suit should not be allowed because the plaintiff had not complied with the New York foreign corporation law. The New York statute required foreign corporations doing business in the state to file copies of their charters, designate their principal places of business, and appoint local agents for service of process. The statute further provided that noncomplying corporations shall not "maintain any action in this state upon any contract made by it in this state."[14] The circuit court entered judgment for the defendant, and the plaintiff corporation appealed. The Supreme Court reversed without dissent. Justice Hughes began by asking whether

[8] 187 U.S. 611 (1903).
[9] WIS. STAT. § 1770b (1898) (enacted Aug. 20, 1897, but not separately printed).
[10] Diamond Glue Co. v. United States Glue Co., 103 F. 838 (C.C.E.D. Wis. 1900).
[11] 187 U.S. at 613.
[12] *Id.*
[13] 225 U.S. 489 (1912).
[14] Law of May 18, 1892, ch. 687, §§ 15-16 [1892] N.Y. Laws 1805-06.

the New York statute made the contract void. He found that in *Mahar v. Harrington Villa Sites*[15] the New York Court of Appeals had held that "a contract made by a foreign corporation doing business within the State without certificate of authority is not absolutely void; that the only penalty prescribed by the General Corporation Law for a disregard of the provisions of sec. 15 is a disability to sue upon such a contract in the courts of New York."[16] He then reasoned that since New York law did not void the contract, the suit should be allowed in the federal court. He wrote that New York "could not prescribe the qualifications of suitors in the courts of the United States, and could not deprive of their privileges those who were entitled under the Constitution and laws of the United States to resort to the Federal Courts for the enforcement of a valid contract."[17]

For thirty-five years these two cases described the recognition due the penalty provisions of state foreign corporation laws in the federal courts. The rule was relatively clear: Where the laws make the local contracts of noncomplying corporations void, those statutes must be applied in federal courts. On the other hand, where the laws merely close local courts to noncomplying corporations, the federal courts should allow actions by noncomplying plaintiffs.[18]

2. Constitutional Dimensions

The determination by federal courts of the proper recognition due state laws regulating the admission of corporations from other states is an aspect of a more general question—what effect must a federal trial court give to a statute of the state in which that court is located? The primary answer to that question was given by Congress in 1789 when it provided in the Rules of Decision Act that "[t]he laws of the several states, except where the Constitution, treaties or statutes of the United States shall otherwise require or provide, shall be regarded as rules of decision in trials at common law in the courts of the United States in

[15] 204 N.Y. 231, 97 N.E. 587 (1912).
[16] 225 U.S. at 496.
[17] *Id.* at 500.
[18] The Holmes-Hughes distinction obviously focuses on controversies involving corporate contracts. Tort actions by corporations are relatively infrequent and have created few if any problems involving the application of foreign corporation laws in the federal courts. According to the *Diamond Glue-Lupton*'s rule stated in the text, tort actions by noncomplying corporations would presumably have been allowed in the federal courts—statutes affecting contracts would be inappropriate and statutes affecting jurisdiction would not have been applied.

cases where they apply."[19] Clarification was provided by the Supreme Court in *Swift v. Tyson*,[20] which held that this Act does not oblige federal courts to follow local state court decisions, at least as "to the construction of ordinary contracts or other written instruments, and especially to questions of general commercial law."[21] In *Keary v. Farmers & Merchants Bank*,[22] the Court gave notice that federal courts were not to follow certain state statutes by holding the Circuit Court of the United States for Mississippi in error for applying a Mississippi statute requiring joinder of all drawers and endorsers in an action on a promissory note. Justice Storey wrote:

> The statute of Mississippi, proprio vigore, is of no force or effect in the Courts of the United States, it not being competent for any state legislature to regulate the forms of suits or modes of proceeding or pleadings in the Courts of the United States; but the sole authority for this purpose belongs to the Congress of the United States.[23]

Judicial determination of which state statutes must be applied in the federal courts continued into the twentieth century,[24] and the distinction

[19] Judiciary Act of 1789, ch. 20, § 34, 1 Stat. 92 (codified at 28 U.S.C. § 1652 (1948)).

[20] 41 U.S. (16 Pet.) 1 (1842).

[21] *Id.* at 19.

[22] 41 U.S. (16 Pet.) 89 (1842).

[23] *Id.* at 94. In Chicago & N.W. Ry. v. Whitton's Adm'r, 80 U.S. (13 Wall.) 270 (1871), the Court held that a Wisconsin statute establishing a cause of action for wrongful death, but providing that an action for death in the state must be brought in the state courts need not be applied in the federal courts. In Chicot County v. Sherwood, 148 U.S. 529 (1893), the Supreme Court refused to apply an Arkansas statute repealing all laws authorizing suits against counties of that state. On the other hand, during this period the Supreme Court found a number of state statutes properly applicable in the federal courts. *E.g.*, Jellenik v. Huron Copper Mining Co., 177 U.S. 1 (1900) (Michigan statute declaring corporate stock to be personal property); Moses v. Lawrence County Bank, 149 U.S. 298 (1893) (Alabama statute of frauds); Bauserman v. Blunt, 147 U.S. 647 (1893) (Kansas statute of limitations); Townsend v. Todd, 91 U.S. 452 (1875) (Connecticut recording act); Railroad Co. v. Barron, 72 U.S. (5 Wall.) 90 (1866) (Illinois wrongful death act).

[24] In time a now familiar distinction appeared:

> Section 721 of the federal statutes . . . which provides that the laws of the several states, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply, has reference only to substantive law and has no application to the procedure in the federal courts.

McBride v. Neal, 214 F. 966, 969 (7th Cir. 1914). In 1928 Professor Armistead Dobie described the Rules of Decision Act as follows:

> Its primary purpose seems to be to make state statutes controlling sub-

formulated by Justice Holmes and Justice Hughes in *Diamond Glue* and *David Lupton's Sons* provided one of many answers developed by the courts over the years.

Particular products of this long process can be rationally tested. Justice Brandeis clearly emphasized in *Erie Railroad v. Tompkins*[25] that a federal court applying the Rules of Decision Act makes choices of constitutional dimensions, because there is an implicit constitutional demand that in matters of federal competence federal law be applied and that in matters of state competence state law be applied.[26] The degree of proficiency with which this fundamental responsibility is discharged furnishes an appropriate test for determining the correctness of those cases deciding which state statutes must be applied by federal courts. In *Diamond Glue*, the Court required application of a statute that voided the contracts of noncomplying foreign corporations. On the other hand,

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stantive rights binding on, and enforceable in, the federal courts.

. . . .

Again, the statute refers to state statutes governing substantive rights; it does not apply to state statutes of procedure.

A. DOBIE, FEDERAL JURISDICTION AND PROCEDURE 559-60 (1928).

A number of state statutes that fell outside the scope of the Rules of Decision Act were nevertheless probably applied in the federal courts because of the Process Act of 1789, ch. 21, § 2, 1 Stat. 93, which provided that "in suits at common law" the "forms of writs and execution, except their style, and modes of process and rates of fees . . . shall be the same in each state respectively as are now used or allowed in the supreme courts of the same." Chief successor of the Process Act of 1789 was the Conformity Act of 1872, ch. 255, § 5, 17 Stat. 197, which provided "[t]hat the practice, pleadings, and the forms and modes of proceeding in other than equity and admiralty causes in the circuit and district courts of the United States shall conform, as near as may be, to the practice, pleadings, and forms and modes of proceeding existing at the time in like causes in the courts of record of the State within which circuit or district courts are held. . . ." Thus a state statute held to be procedural and outside the scope of the Rules of Decision Act might nevertheless have been properly applied in the federal courts because of this other specific Congressional directive. In an occasional case, statutes proposed for application were found to be beyond the scope of both the Rules of Decision Act and the Conformity Act. McBride v. Neal, 214 F. 966 (7th Cir. 1914), was such a case. There the court held that the Conformity Act "has nothing to do with the prosecution of the common-law writ of error which prevails in federal appellate procedure" and that the Rules of Decision Act "has reference only to substantive law and has no application to the procedure in the federal courts." *Id.* at 969. *See generally*, H. M. HART & H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 581-89 (1953).

[25] 304 U.S. 64 (1938).

[26] *See* Friendly, *In Praise of Erie and of the New Federal Common Law*, 39 N.Y.U.L. REV. 383, 384-92 (1964); Hart, *The Relation Between State and Federal Law*, 54 COLUM. L. REV. 489, 509-15 (1954). *But see* Clark, *State Law in the Federal Courts: The Brooding Omnipresence of Erie*, 55 YALE L.J. 267, 278 (1946).

in *David Lupton's Sons* the Court held that a statute that created a disability to sue should not be followed. In the first decision the Court applied state contract law, which is generally if not exclusively a matter of state competence in the federal system.[27] In the second the Court refused to apply state law that operated to limit the jurisdiction of the federal courts, which is certainly a matter of federal competence.

B. The Fifth Circuit Decision

By mid-century there was a considerable body of law indicating the recognition due foreign corporation laws by the federal courts,[28] and the question presented when *Interstate Realty Co. v. Woods* came before the Fifth Circuit could not have seemed an issue likely to reach the Supreme Court. The district court had accurately stated the then controlling principles,[29] and Judge Lee in his opinion for the court of appeals turned immediately to the question of whether the district judge had properly held the contract void.[30] This issue was difficult; although the statute

[27] Federal government contracts may appropriately be controlled by federal common law. Clearfield Trust Co. v. United States, 318 U.S. 363 (1943). *But cf.* United States v. Yazell, 382 U.S. 341 (1966); Bank of America v. Parnell, 352 U.S. 29 (1956).

[28] *E.g.*, McLean v. York Oil Fields Supply Co., 138 F.2d 804 (5th Cir. 1943); Metropolitan Life Ins. Co. v. Kane, 117 F.2d 398 (7th Cir. 1941); Reconstruction Fin. Corp. v. Barnett, 118 F.2d 190 (7th Cir. 1941). Other cases applying the void-unenforceable distinction are collected in Annot., 133 A.L.R. 1171 (1941), which states the Holmes-Hughes rule as follows:

> It appears to be well settled, with respect to actions to enforce contract rights, that whether a foreign corporation or its assignee may maintain in a federal court an action which it could not have maintained in the state court because of its noncompliance with the conditions of its doing business in the state laid down in an applicable state statute or statutes depends upon the effect of the statute or statutes in question. If by reason of its express provisions . . . the effect of the applicable statute is to render null and void any contract made by a foreign corporation which has not complied with its terms, an action may not be maintained thereon in either a state or a federal court. If, however, the effect of the statute is merely to prohibit suit on such a contract, the fact that no action could have been maintained on the contract in question in the courts of the state does not prevent the maintenance of a suit in a federal court sitting in the state or, it would seem, a federal court sitting in another state.

Id. 1172.

[29] The sole question which remains to be determined in this case is whether or not under the Mississippi statute these contracts are void. There is no question that the Mississippi Legislature has a right to say that they might not use the Courts of the State of Mississippi to enforce them. They could not say that the Federal Courts would not take jurisdiction . . . .

Record at 71, Woods v. Interstate Realty Co., 337 U.S. 535 (1949) (the district court opinion was not published).

[30] "Being void, there would be no right in this Court or any other Court to enforce them." Record at 72.

spoke primarily in jurisdictional terms, the Mississippi Supreme Court had on at least two occasions used language suggesting that the statute made the contracts of noncomplying corporations void.[31] The court of appeals examined the Mississippi law thoroughly and reversed, holding that the statute did not void the contracts of noncomplying corporations but only denied them access to local courts.[32] The decision was not changed on rehearing when for the first time the defendant cited the case of *Angel v. Bullington.*[33] In a per curiam opinion,[34] the court distinguished the *Angel* decision as "concerned with the application of the doctrine of res adjudicata under a North Carolina statute prohibiting a suit for recovery on a deficiency judgment"[35] and said that the language in *Angel* referring to *David Lupton's Sons* "was argumentative." "We do not consider it to have overruled the David Lupton's Sons Co. case upon the question with which we are now concerned and with respect to which the David Lupton's Sons Co. case expressly dealt."[36]

[31] In Quartette Music Co. v. Haygood, 108 Miss. 755, 767, 67 So. 211, 212 (1915), the court quoted with approval from Bohn v. Lowery, 77 Miss. 424, 427, 27 So. 604, 605 (1900), and said that "[e]very contract made for, or about, any matter of thing which is prohibited and made unlawful by any statute, is a void contract, though the statute itself does not mention that it shall be so, but only inflicts a penalty on the defaulter, because a penalty implies a prohibition, though there are no prohibitory words in the statute." In Newell Contracting Co. v. State Highway Comm'n, 195 Miss. 395, 406, 15 So.2d 700, 702 (1943), the court wrote that "[w]e are of the opinion that the court below was correct in holding that the appellant was doing business in this state and that there had been no substantial compliance with the statutes here involved . . . and that hence the contract sued on is void and unenforceable."

[32] The court obviously regarded the question of whether the statute voided the contract as the most important and most difficult aspect of the case. Only one additional paragraph was necessary to explain that "the fact that a foreign corporation may not sue in the State courts because it has not complied with the conditions of doing business within the State does not shut the doors of the federal court sitting in that State." Interstate Realty Co. v. Woods, 168 F.2d 701, 705 (5th Cir. 1948). Judge Lee's primary authority was *David Lupton's Sons v. Automobile Club of America.* In a revealing footnote he said that case "is almost on all fours with the one now before the Court and went up on the question of whether the New York law (which is like the Mississippi law) made the contract void or only uneforceable. Held: Unenforceable, hence the Federal court had jurisdiction." 168 F.2d at 705 n.5.

[33] 330 U.S. 183 (1947). See p. 65 *infra.*

[34] Interstate Realty Co. v. Woods, 170 F.2d 694 (5th Cir. 1948).

[35] *Id.* at 695.

[36] *Id.* A troubled future for the court of appeals decision was accurately predicted in 49 COLUM. L. REV. 852 (1949). The writer in 33 MINN. L. REV. 664 (1949) happily predicted that "[t]he court's preoccupation with archaic and incorrect views as to the position of federal courts in diversity cases . . . can only result in complete revision of its decision on appeal." *Id.* 667. A writer from Indiana agreed and said that "no independent judgment was intended to be allowed

C. *Justice Douglas at the Courthouse Door*

Five members of the Supreme Court voted to reverse the judgment of the court of appeals and close the Mississippi courts to the plaintiff Tennessee corporation. The opinion of the Court by Justice Douglas relies heavily on *Guaranty Trust Co. v. York*[37] and *Angel v. Bullington*, but *Erie Railroad v. Tompkins* is the obvious center of the puzzle. Both *Guaranty Trust* and *Angel* grew out of that case and Justice Douglas' opinion shows clearly that five members of the Court thought that the *Woods* result was demanded by the seminal case.

1. The Spirit of *Erie*

Erie Railroad v. Tompkins has probably provoked more law review comment than any other case decided by the Supreme Court, and this is not the place to reopen the story.[38] It will be sufficient here to recall that the holding in *Erie* did not by its own terms change the rules controlling the application of state statutes in federal courts. Justice Brandeis clearly recognized that "the oft challenged doctrine of *Swift v. Tyson*"[39] allowed the federal trial courts to ignore only the "unwritten law of the State as declared by its highest court,"[40] and, in fact, at each critical point in his opinion contrasted the then current rules with respect to the recognition of state statutes in federal courts with the rule allowing federal courts to ignore state decisional law.[41]

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the federal court which should therefore have refused to entertain the case, precisely as a state court would have refused." Note, *Effect of State Statute on Jurisdiction of Federal Courts*, 24 IND. L.J. 418, 427 (1949).

[37] 326 U.S. 99 (1945).

[38] It should be noted that further consideration of *Erie* would not be time spent on a moot question. "It is unquestionably true that up to now *Erie* and the cases following it have not succeeded in articulating a workable doctrine governing choice of law in diversity actions." Hanna v. Plumer, 380 U.S. 460, 474 (1965) (Harlan, J., concurring).

[39] 304 U.S. at 69.

[40] *Id.* at 71.

[41] In part one of his opinion Justice Brandeis wrote that "the purpose of the section was merely to make certain that, in all matters except those in which some federal law is controlling, the federal court exercising jurisdiction in diversity of citizenship cases would apply as their rules of decision the law of the State, unwritten as well as written." 304 U.S. at 72-73. In part two of his opinion he criticized *Swift v. Tyson* because "[i]t made rights enjoyed under the unwritten 'general law' vary according to whether enforcement was sought in the state or in the federal court . . . ." *Id.* at 74-75. In part three Justice Brandeis wrote that "[e]xcept in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern." *Id.* at 78.

Why then did five members of the Supreme Court feel compelled to vote for reversal in the *Woods* case? Certainly the answer lies somewhere beyond the actual decision in *Erie*.[42] In *Guaranty Trust Co. v. York*, the Supreme Court held that a federal court sitting in New York was required to apply the New York statute of limitations in a diversity action for damages for breach of trust. No proposal to apply New York decisional law was involved, but Justice Frankfurter nevertheless designated *Erie* "our starting point"[43] and finished with his outcome determination test for the application of *Erie*. He apparently believed that the *Erie* case must be looked to where the application of a state statute is involved because the error of *Swift v. Tyson* was so broad that the attitude of federal courts toward the application of state statutes had been somehow infected.[44] In *Angel v. Bullington* Justice Frankfurter again wrote for a five-member majority. The Court held that a Virginia plaintiff who sold land in that state to a North Carolina resident could not sue in a federal court in North Carolina to obtain a deficiency judgment where a North Carolina statute prohibited deficiency judgments. The Holmes-Hughes distinction[45]—developed for foreign corporation laws—had little to do with the question of whether a statute prohibiting a deficiency judgment should be applied in the federal courts, but Justice Frankfurter interjected the *David Lupton's Sons* case by writing: "Cases like *Lupton's Sons Co. v. Automobile Club* . . . are obsolete insofar as they are based on a view of diversity jurisdiction which came to an end with *Erie Railroad v. Tompkins* . . . ."[46] Justice Frankfurter's impression that the *Swift v.*

[42] For a discussion of the *Erie* holding and its gloss see Meador, *State Law and the Federal Judicial Power*, 49 VA. L. REV. 1082 (1963). *See also* H. M. HART & H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 670 (1953).

[43] Our starting point must be the policy of federal jurisdiction which *Erie R. Co. v. Tompkins* . . . embodies. In overruling *Swift v. Tyson* . . . *Erie R. Co. v. Tompkins* did not merely overrule a venerable case. It overruled a particular way of looking at law which dominated the judicial process long after its inadequacies had been laid bare.

326 U.S. at 101.

[44] Justice Frankfurter, quoting from Vandenbark v. Owens-Illinois Co., 311 U.S. 538, 540 (1941), said:

The matter was fairly summarized by the statement that 'During the period when *Swift v. Tyson* (1842-1938) ruled the decisions of the federal courts, its theory of their freedom in matters of general law from the authority of state courts pervaded opinions of this Court involving even state statutes or local law.'

326 U.S. at 102.

[45] See pp. 57-59 *supra*.

[46] 330 U.S. at 192.

Tyson error contaminated the technique of the federal courts in applying state statutes according to the Rules of Decision Act and his specific suggestion that the technique might be wrong where foreign corporation statutes were involved collected five votes for reversal in *Woods v. Interstate Realty Co.*

2. A View of Diversity

Justice Douglas believed that the issue in the *Woods* case was the validity of the fundamental rule etablished by Holmes and Hughes.[47] He focused on the *David Lupton's Sons* case and wrote that "[i]f the *Lupton's Sons* case controls, it is clear that the Court of Appeals was right in allowing the action to be maintained in the federal courts."[48] The doubt was obviously created by the impression and suggestion of Justice Frankfurter. "We said in *Angel v. Bullington* that the case of *Lupton's Sons* had become 'obsolete' insofar as it was 'based on a view of diversity jurisdiction which came to an end with *Erie Railroad v. Tompkins* . . . .' "[49] The implied question was critical: Did *David Lupton's Sons* in fact represent a "view of diversity jurisdiction which came to an end with *Erie Railroad v. Tompkins*"? The *David Lupton's Sons* case, and the technique for applying foreign corporation laws in the federal courts that it partially established, was thoroughly consistent with the constitutional demands stated by Justice Brandeis in *Erie*, and the case did not, therefore, represent a view of diversity jurisdiction which came to an end with *Erie*. If the Court had considered the question and had answered it correctly, the court of appeals' decision in *Woods v. Interstate Realty Co.* would have been affirmed. But the Court either did not recognize the issue or mistakenly assumed that Justice Frankfurter's statement was both question and answer. Without comment Justice Douglas moved on to apply the outcome determination test of *Guaranty Trust* and to reverse the Fifth Circuit. Curiously, the result was wrong even by Justice Douglas' own rationale that "the contrary result would create discrimina-

[47] He apparently found no fault with the Fifth Circuit's application of the Holmes-Hughes distinction:

> It [the court of appeals] reviewed the Mississippi decisions under the Mississippi statute and concluded that the contract was not void but only unenforceable in the Mississippi courts. It held in reliance on *David Lupton's Sons Co. v. Automobile Club* . . . that the fact that respondent could not sue in the Mississippi courts did not close the doors of the Federal court sitting in that State.

[48] *Id.*

[49] *Id.* at 537.

tions against citizens of the State in favor of those authorized to invoke the diversity jurisdiction of the federal court."[50] Nonrecognition of foreign corporation laws can never result in discrimination "against citizens of the State in favor of those authorized to invoke the diversity jurisdiction of the federal courts." Exactly the reverse is true because nonrecognition prevents discrimination against nonresidents by allowing access to remedies available to residents.[51]

II. The Impact of *Woods*

The *Woods* decision has played a significant role in a large number of cases not involving foreign corporation laws. It has, for example, recently influenced, with generally poor results, the answers to such a variety of questions as whether a Virginia statute of limitations should be followed by a Kentucky federal court,[52] whether an action against a Navajo Indian could be brought in an Arizona federal court,[53] and whether a local long-arm statute could bring a Wisconsin corporation with occasional local contacts into a North Carolina federal court.[54] The typical effect of *Woods* in tangential areas has been to encourage rigid application of state law, particularly where jurisdictional questions are involved.

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[50] *Id.* at 538.

[51] The use of the outcome determination test in *Woods* was vigorously criticized in Note, 35 Cornell L.Q. 420 (1950):

> Perhaps the feeling that the Guaranty Trust rule has gone too far will concretely manifest itself in a majority opinion when some case which, because of the application of the rule, exhibits that a grotesque miscarriage of justice would result, is presented. Then perhaps a limitation on the sanctity of archaic, discriminatory and unjust state laws—a limitation which is becoming increasingly necessary—will be imposed upon the present rule.

Id. 423. The test was also criticized in 44 Ill. L. Rev. 533 (1949), where the writer said that "an *Erie* doctrine which left some room for inquiry into the policy underlying a state's withdrawal of jurisdiction, as to whether that policy would be subserved by a withdrawal of federal jurisdiction, would promote the ends of justice far more than an inflexible rule of thumb." *Id.* 536. For other comments, see 14 Albany L. Rev. 98 (1950); 16 Brooklyn L. Rev. 121 (1950); 26 N.D.B. Briefs 306 (1950); 24 St. John's L. Rev. 131 (1949).

[52] Atkins v. Schmutz Mfg. Co., 372 F.2d 762 (6th Cir. 1967), *cert. denied*, 389 U.S. 829 (1967).

[53] Hot Oil Serv., Inc. v. Hall, 366 F.2d 295 (9th Cir. 1966).

[54] Bowman v. Curt G. Joa, Inc., 361 F.2d 706 (4th Cir. 1966). For other examples, see Kuchenig v. California Co., 350 F.2d 551 (5th Cir. 1965), *cert. denied*, 382 U.S. 985 (1966); Lewis v. Hogwood, 300 F.2d 697 (D.C. Cir. 1962); O'Donnell v. Elgin, J. & E. Ry., 193 F.2d 348 (7th Cir. 1951), *cert. denied*, 343 U.S. 956 (1952); Seaboard Fin. Co. v. Davis, 276 F. Supp. 507 (N.D. Ill. 1967); Lindley v. St. Louis-S.F. Ry., 276 F. Supp. 83 (N.D. Ill. 1967), *rev'd*, 407 F.2d 639 (7th Cir. 1968).

More relevant, though, to an analysis of *Woods* is an examination of its consequence in cases involving foreign corporation laws.

Woods has produced some shocking losses by out-of-state corporate plaintiffs, which probably resulted in considerable windfalls for local defendants. In *Paisley Products Inc. v. Trojan Luggage Co.*,[55] for example, the plaintiff foreign corporation sued the defendant Tennessee corporation in a Tennessee federal court to recover the price of goods sold and delivered to the defendant in Memphis. The defendant moved to dismiss on the ground that the plaintiff did not qualify to do business in Tennessee until after the contract was made. The court held that according to the law of Tennessee, the subsequent compliance did not make the contract enforceable, and dismissed the suit with the half-apology: "It is our duty under *Erie* to follow the law as announced by the courts of this State and not to substitute therefor our concept of the law as we think it perhaps should be."[56] Another striking loss apparently occurred in *Hicks Body Co. v. Ward Body Works*[57] where the plaintiff, a noncomplying Indiana corporation, was not allowed to sue an Arkansas corporation in an Arkansas federal court for the alleged breach of a contract to manufacture twelve thousand school buses. *Woods* has also resulted in schemes to establish immunity from suit. In *Hulburt Oil & Grease Co. v. Hulburt Oil & Grease Co.*,[58] a Pennsylvania corporation's unhappy minority stockholders organized an Illinois corporation under the same name and obviously expected to carry on business while permanently protected from an unfair competition suit because the Pennsylvania corporation could not sue in Illinois until qualified and could not qualify because of the conflict in names.[59] But the most

[55] 293 F. Supp. 397 (W.D. Tenn. 1968). Apparently the suit would have been allowed under the pre-*Woods* law because the court held that under Tennessee law the contracts of noncomplying corporations are unenforceable but not void. *Id.* at 398.

[56] *Id.* at 400.

[57] 233 F.2d 481 (8th Cir. 1956). Here also the action would have been allowed before *Woods*. *Id.* at 486.

[58] 371 F.2d 251 (7th Cir. 1966).

[59] The scheme failed. The Seventh Circuit found no authority prohibiting the minority's plan, but refused to play its tendered role:

> We think that the Illinois courts, in keeping with their consistent adherence to the basic equitable principles even in the absence of a specifically authorized remedy . . . would not permit the defendant to raise the statute as a bar to the plaintiff's action.

Id. at 255. For examples of the application of foreign corporation laws by the federal courts and dismissals for failure of compliance, see Armor Bronze & Silver Co. v. Chittick, 221 F. Supp. 505 (D. Conn. 1963); Pellerin Laundry Mach. Sales

notable aspect of the cases is that federal trial and appellate judges avoid the *Woods* decision and the result that it demands whenever possible.

A. Evasion By Law

The first federal judge to condemn *Woods* was Justice Jackson. In a strong dissent to the Court's decision, he called the state statute applied by the majority "harsh, capricious and vindictive,"[60] and pointed out that the amount of punishment "bears no relation to the amount of wrong done the State in failure to qualify and pay its taxes. The penalty thus suffered does not go to the State, which sustained the injury, but results in unjust enrichment of the debtor, who has suffered no injury from the creditors' default in qualification."[61]

At least one district court simply refused to follow *Woods* in an identical situation presented by *Emulsol Corp. v. Rubenstein & Son Produce, Inc.*[62] There the defendant moved for summary judgment on the ground that the plaintiff foreign corporation was doing business in Texas but had not complied with the Texas law. The court said:

> It must be conceded that in Woods v. Interstate Realty Company . . . a divided court held as argued by the defendant in the case at bar. But, I am strongly opposed to the doctrine therein announced. The case here is between corporations of different state domicile. The amount in controversy, as well as such diversity of citizenship entitles entry into the national court. It would be an unseemly surrender of sovereignty for the Federal judiciary to be ruled by state statute as to the right to enter a national court.[63]

No other court has been so candid, but the Fifth Circuit managed the same result by finding an exception to the *Woods* rule. In *Waggener Paint Co. v. Paint Distributors, Inc.*,[64] Chief Judge Hutcheson recognized the *Woods* case, but limited its effect by holding that foreign corporation statutes "will not be construed to deal with suits on interstate transactions; and that, if they are so construed, they will not be upheld."[65] Cer-

Co. v. Hogue, 219 F. Supp. 629 (W.D. Ark. 1963); Hutterian Bretheren v. Haas, 116 F. Supp. 37 (D. Mont. 1953); 348 Bloomfield Ave. Corp. v. Montclair Mfg. Co., 90 F. Supp. 1020 (D.N.J. 1950).

[60] 337 U.S. at 539.

[61] *Id.* at 540.

[62] 111 F. Supp. 410 (N.D. Tex. 1953).

[63] *Id.* at 411.

[64] 228 F.2d 111 (5th Cir. 1955).

[65] *Id.* at 113. The court found as a fact that the transaction was in interstate commerce. The Fifth Circuit limitation was adopted by the Seventh Circuit in

tainly the interstate-intrastate distinction is familiar in the field of foreign corporation laws where it has been applied, often with poor results, to judge the federal constitutional implications of state court applications of the statutes.[66] There is no reason to believe that it will lead to any satisfactory resolution of the *Woods* problem.

B. Evasion By Fact

Most federal courts that have avoided *Woods* have not made new law but have looked at the facts of their cases and found reasons to hold that the actions could properly be maintained. In *Wilson v. Williams*,[67] the defendants argued on appeal that the plaintiff, a New Mexico corporation, could not maintain an action in an Oklahoma federal district court because of the plaintiff's failure to comply with the Oklahoma foreign corporation law. The plaintiff corporation owned an interest in Oklahoma leasehold estates and in drilling equipment located in that state and was a party to a drilling and mining venture in Oklahoma, but the court found that the plaintiff's operations did not bring it within the scope of the statute. The court held that the defendants "failed to discharge the burden of showing that the foreign corporation had engaged in or transacted, or was engaging in or transacting, business in Oklahoma."[68] In *Rock-Ola Manufacturing Corp. v. Wertz*,[69] the Fourth Circuit said that *Woods* "put to rest all doubt as to the effect of qualification requirements upon the jurisdiction of Federal courts in diversity cases,"[70] but held that the plaintiff's local activities "were not sufficient to subject the corporation to the qualification statute, and so, failure to qualify will not bar the corporation from maintaining this suit."[71] The same result was reached by the Fifth Circuit in *M & R Construction Co. v. National Homes Corp.*[72] The court acknowledged *Woods* but found nothing in a contract that the plaintiff had made with Alabama residents or in the Alabama activities of plaintiff's field representative that required, as a matter of law, compliance with the Alabama statute. Similarly, in *Bohn*

Stolz-Wicks, Inc. v. Commercial Television Serv. Co., 271 F.2d 586 (7th Cir. 1959).

[66] *See* Walker, *Foreign Corporation Laws: A Current Account*, 47 N.C.L. REV. 733, 747-56 (1969).

[67] 222 F.2d 692 (10th Cir. 1955).

[68] *Id.* at 697.

[69] 249 F.2d 813 (4th Cir. 1957).

[70] *Id.* at 814.

[71] *Id.* at 817-18.

[72] 286 F.2d 638 (5th Cir. 1961).

Aluminum & Brass Corp. v. Storm King Corp.,[73] the Sixth Circuit held that summary judgment for the defendant was improperly granted, though the defendant's affidavits showed that the noncomplying plaintiff corporation maintained an office in Ohio and that its factory representative had made calls on the defendant in that state for many years.

III. New Jurisprudence

The distaste for *Woods* was matched in time by a distaste for *Guaranty Trust* and its outcome determination rule. The difficulties caused by that rule in the application of foreign corporation laws were duplicated in other areas, and in time it became apparent that the dryly logical application of the decision would, if not checked, eliminate substantial parts of the traditional role of the federal judicial system.[74] A major breakthrough came in *Byrd v. Blue Ridge Electric Cooperative, Inc.*[75] where the Supreme Court held that a settled federal practice of assigning the

[73] 303 F.2d 425 (6th Cir. 1962). For recent evasions by district courts, see Bunge Corp. v. St. Louis Terminal Field Warehouse Co., 295 F. Supp. 1231 (N.D. Miss. 1969); LeFebure Corp. v. LeFebure, Inc., 284 F. Supp. 617 (E.D. La. 1968); Textile Banking Co. v. Colonial Chem. Corp., 285 F. Supp. 824 (N.D. Ga. 1967).

In a related area, the court in Power City Communications, Inc. v. Calaveras Tel. Co., 280 F. Supp. 808 (E.D. Cal. 1968), considered and rejected the suggestion that Federal Rule 17(b) can provide relief from a state door-closing statute. The decision is noted with approval in 82 Harv. L. Rev. 708 (1969). *See generally* Kennedy, *Federal Rule 17(b) and (c): Qualifying to Litigate in Federal Courts*, 43 Notre Dame Lawyer 273 (1968). The Rule is ill fitted for the application proposed by the plaintiff in *Power City Communications*.

[74] The most telling criticism was that of Professor Henry M. Hart. He wrote:

> Thus far the Supreme Court's decisions on these matters seem to be founded on no higher principle than that of eliminating every possible reason for a litigant to prefer a federal to a state court. The principle having no readily apparent stopping place, the reach of the decision is unclear. What is more important is the triviality of the principle. The more faithfully it is carried out the more completely the constitutional and statutory grants of diversity jurisdiction are emptied of intelligible meaning. The principle passes over the essential rationale of the *Erie* opinion—the need of recognizing the state courts as organs of coordinate authority with other branches of the state government in the discharge of the constitutional functions of the state—and most of the battery of considerations marshalled by Brandeis as reasons for respecting the constitutional plan.

Hart, *The Relations Between State and Federal Law*, 54 Colum. L. Rev. 489, 512 (1954). *See* Farinholt, *Angel v. Bullington: Twilight of Diversity Jurisdiction?*, 26 N.C.L. Rev. 29 (1947).

[75] 356 U.S. 525 (1958). The plaintiff was employed in the construction of power transmission lines and was injured while connecting a line to a new substation. The plaintiff sued the owner of the power line, a South Carolina corporation, for damages, alleging that the corporation's negligence resulted in his injury.

determination of certain questions to juries should be followed in diversity cases despite a South Carolina state practice that left resolution of the issues to judges.

Justice Brennan recognized that the fact situation in *Byrd* probably presented an occasion for the application of the outcome test but looked beyond that rule. He wrote:

> It may well be that in the instant personal-injury case the outcome would be substantially affected by whether the issue of immunity is decided by a judge or jury. Therefore, were "outcome" the only consideration, a strong case might appear for saying that the federal court should follow the state practice.[76]

The full content of a new federal-state choice of law technique was not described, but a procedure was suggested. The first step is to determine whether a proposed state rule is bound up with the state-created rights and obligations sought to be enforced.[77] If that is the case, the decision apparently requires the application of the state law in question; if not, a second question is presented: Is the particular federal policy involved more important than the state policy proposed for application?[78] This test is not wholly satisfactory, but its statement is a movement toward the ideal of applying federal law in areas of federal competence and state law in areas of state competence.

A. Explication

The *Byrd* decision was applied with skill in *Szantay v. Beech Aircraft Corp.*[79] Companion wrongful death actions were brought by Illinois plaintiffs in a South Carolina federal court against Beech Aircraft, a Delaware corporation, and against Dixie Aviation, a South Carolina corporation. The suits were the result of the crash in Tennessee of an airplane manufactured by Beech in Nebraska and serviced by Dixie in South Carolina shortly before the crash. Beech moved to dismiss on the

[76] *Id.* at 537.

[77] "The policy of uniform enforcement of state-created rights and obligations, see *e.g., Guaranty Trust Co. v. York*, . . . cannot in every case exact compliance with a state rule . . . — not bound up with rights and obligations—which disrupts the federal system of allocating functions between judge and jury." *Id.* at 537-38.

[78] "Thus the inquiry here is whether the federal policy favoring jury decisions of disputed fact questions should yield to the state rule in the interest of furthering the objective that the litigation should not come out one way in the federal court and another way in the state court." *Id.* at 538.

[79] 349 F.2d 60 (4th Cir. 1965).

ground that the action against it was barred by a South Carolina statute which provided that an action against a foreign corporation "may be brought in the circuit court: (1) By any resident of this State for any cause of action; or (2) By a plaintiff not a resident of this State when the cause of action shall have arisen or the subject of the action shall be situated within this State."[80] The motion was denied[81] and Beech appealed.

Judge Sobeloff first summarized the developments from *Erie* to *Byrd* and then wrote:

> The spirit of these decisions makes it appropriate for a court attempting to resolve a federal-state conflict in a diversity case to undertake the following analysis:
>
> 1. If the State provision, whether legislatively adopted or judicially declared, is the substantive right or obligation at issue, it is constitutionally controlling.
>
> 2. If the state provision is a procedure intimately bound up with the state right or obligation, it is likewise constitutionally controlling.
>
> 3. If the state procedural provision is not intimately bound up with the right being enforced but its application would substantially affect the outcome of litigation, the federal diversity court must still apply it unless there are affirmative countervailing federal considerations.[82]

The parties were in agreement that the South Carolina door-closing statute is procedural, and, since the action was based on the Tennessee wrongful death act, the South Carolina rule was obviously not bound up with that state-created right. The court thus reached its third postulate and asked whether "the South Carolina rule embodies important policies that would be frustrated by the application of a different federal jurisdictional rule and, if so, is this policy to be overridden because of a stronger federal policy?"[83] Judge Sobeloff found the state policy difficult to determine and after discussing several possibilities[84] concluded that the

[80] S.C. CODE ANN. § 10-214 (1962). Note that the statute is not a foreign corporation law and therefore did not present the same issue as that involved in the *Woods* case.

[81] 237 F. Supp. 393 (E.D.S.C. 1965).

[82] 349 F.2d at 63-64.

[83] *Id.* at 64.

[84] There was no indication that docket congestion was a problem in 1870 when the statute was passed, but in any case, the court said, state docket congestion would certainly not be made worse by keeping open the federal courts. Counsel for Beech suggested that the statute was designed to encourage foreign corporations to do business in South Carolina, but the court was not persuaded. *Id.* at 65.

state's reason "for enacting its 'door-closing' statute is uncertain."[85] The court found, however, clear countervailing federal considerations. "The most fundamental is that expressed in the constitutional extension of subject-matter jurisdiction to the federal courts in suits between citizens of different states."[86] The judgment of the district court that the South Carolina statute did not apply was affirmed. Judge Sobeloff's opinion and its three-step test is the best guide now available for applying the standard of *Byrd.*

B. Back to Holmes and Hughes

Both Justice Hughes in *David Lupton's Sons v. Automobile Club of America* and Justice Douglas in *Woods v. Interstate Realty Co.* dealt with state statutes that denied noncomplying corporations access to local courts and made the contracts of those corporations unenforceable, according to the old distinction, but not void. In that situation foreign corporation laws never furnish or even substantially affect the substantive right or obligation at issue in the litigation; consequently, Judge Sobeloff's first principle would not indicate a requirement that such statutes be applied in the federal courts. The second principle requires a determination of whether foreign corporation law court-closing penalties are bound up with the law establishing the right or obligation sought to be enforced. In a sense all laws are interdependent, and for this reason arguments can be made for positive results under the second test in such a large number of situations that, if accepted, the standard would be no guide at all. In *Byrd,* the Court found that the state law was not bound up with state-created rights and obligations because there was "nothing to suggest that this rule was announced as an *integral part* of the special relationship created by the statute,"[87] and Judge Sobeloff's statement of his second principle requires that state law be followed only where it is *"intimately bound up* with the state right or obligation."[88] Court-closing provisions are undoubtedly integral and intimate parts of foreign corporation laws, but these statutes, of course, never define the claims sought to be enforced by out-of-state corporate plaintiffs. These provisions obviously affect rights and obligations, but only in a general and indiscriminate

[85] *Id.*

[86] *Id.* For a discussion of the *Szantay* case, including speculation about its impact on the foreign corporation law problem, see J. COUND, J. FRIENDENTHAL & A. MILLER, CIVIL PROCEDURE 255 (1968); 66 COLUM. L. REV. 377 (1966).

[87] 356 U.S. at 536 (emphasis added).

[88] 349 F.2d at 63 (emphasis added).

way more characteristic, in the language of *Byrd*, of "merely a form and mode" than of "a rule intended to be bound up with the definition of the rights and obligations of the parties."[89] Moreover, it is possible, as was the case in *Szantay*, that the rights or obligations sought to be enforced may be the products of the law of another state—yet under *Woods* the penalty of the forum state would apply. The foundation of Tennessee substantive law in *Szantay* was proof enough that the South Carolina statute was not bound up with the rights asserted; the possibility of similar situations involving foreign corporation laws is a further indication that the statutes are not, within the meaning of the second principle, bound up with state substantive law.

Judge Sobeloff's third postulate is, therefore, critical. State foreign corporation law court-closing penalties are not an intimate part of state rights and obligations, but their application can substantially affect the outcome of litigation. Consequently, federal courts must, according to the postulate, apply the laws unless there are affirmative countervailing federal considerations. A proper determination requires balancing the state policies supported by the penalties and the federal interests.

1. State Policy

There are virtually no legislative histories of the fifty state foreign corporation laws, but it is possible to describe with reasonable confidence the original purposes of the statutes.[90] By and large they were enacted to solve problems created in the nineteenth century by a federal constitutional requirement that original legal process be served within the territorial boundaries of forum states. The development of that requirement began in the late eighteenth century and was given national scope as an element of due process by the Supreme Court in *Pennoyer v. Neff*.[91] The rule of that case made it extremely difficult for plaintiffs to bring actions in their home states against nonresident defendants. In the case of foreign corporations, however, the principle of conditional entry offered a solution, and the states used that nineteenth-century conceptual development to require out-of-state corporations to appoint local agents for service of process. A secondary purpose apparently involved in a number of the

[89] 356 U.S. at 536.

[90] See Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C.L. REV. 1-19 (1968). Professor Alfred Hill recognized the importance of analyzing the policies expressed in foreign corporation laws, but made no serious attempt to state those policies. Hill, *The Erie Doctrine and the Constitution*, 53 Nw. U.L. REV. 541, 569 (1958).

[91] 95 U.S. 714 (1878).

original foreign corporation statutes was the desire to protect local plaintiffs from the assertion by foreign corporations of the broad ultra vires defense then available in federal courts. This objective is reflected in the typical inclusion of the requirement that copies of corporate charters be filed with local public officials.

Changes in law in the twentieth century have eliminated both the primary and the secondary need for foreign corporation statutes. A line of cases from *McDonald v. Mabee*[92] to *International Shoe Co. v. Washington*[93] ended the service of process requirement of *Pennoyer* and led to the now nearly universal adoption of long-arm statutes providing for the service of original process beyond the boundaries of forum states. Similarly, the harsh ultra vires rule of the federal courts was effectively abolished by *Erie*, and a majority of the states have resolved the problem through statutes appropriately limiting the use of the defense. Doubts have also arisen as to whether the conceptual basis of the laws, the principle of conditional entry, should be allowed to stand in this century.[94]

Occasionally a legal technique or a statutory scheme outlives its original purpose but develops new and important functions. This has not been the case with foreign corporation laws. The statutes have not developed a major new purpose; in fact, in a number of their aspects, including particularly those relating to jurisdiction to adjudicate, choice of law, and taxation, the laws themselves have begun to cause trouble and give promise of more. The present utility of this expanding and complex scheme of state regulation is at most minimal.[95]

2. Federal Policy

Article III, section 2 of the Constitution provides that the judicial power of the United States shall extend to controversies "between Citizens of different States," and beginning with the Judiciary Act of 1789, the Congress has provided that the subject matter jurisdiction of the federal trial courts includes suits between citizens of different states.[96]

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[92] 243 U.S. 90 (1917).

[93] 326 U.S. 310 (1945).

[94] *See* Walker, *Foreign Corporation Laws: The Loss of Reason*, 47 N.C.L. REV. 24-30 (1968).

[95] Walker, *Foreign Corporation Laws: A Current Account*, 47 N.C.L. REV. 733, 734-47 (1969). *But cf.* 66 COLUM. L. REV. 377, 384 (1966); the tentative policy analysis there suggested focuses only on the penalty provisions of foreign corporation laws and fails to take into account the purposes of the laws.

[96] The current provision is 28 U.S.C. § 1332 (1964). *See generally* D. CURRIE, FEDERAL COURTS 240-300 (1968); H. M. HART & H. WECHSLER, THE FEDERAL

The original purpose of the jurisdictional grant was to provide out-of-staters a haven from local prejudice and thus to encourage personal and, particularly, commercial intercourse among the states.[97] While persuasive arguments can be made that in certain aspects the extent of the present diversity grant exceeds this original purpose, few situations are so squarely within that purpose as those typically presented in cases involving the application of foreign corporation law court-closing penalties. In most instances, the arrangement of the parties is, in Judge Friendly's words, "the classic case of diversity jurisdiction, the suit by an out-of-stater against a true in-stater,"[98] and the state law proposed for application creates substantial suspicion of prejudice because it is fashioned only for nonresidents.[99] It seems reasonable to say that the federal interest in cases such as *David Lupton's Sons* and *Woods* is clearly stated by both the constitutional and statutory grants of diversity jurisdiction and that this statement of interest remains a purposeful one and is arguably critical in guaranteeing the continued prosperity of the nation. In the words of Judge Sobeloff's third principle, there are "affirmative countervailing federal considerations" where it is proposed that foreign corporation law court-closing penalties be applied to require dismissals of actions in federal courts.[100]

A significantly different situation faced Justice Holmes in *Diamond Glue Co. v. United States Glue Co.* There the state foreign corporation law stipulated that the contracts of a noncomplying corporation should

COURTS AND THE FEDERAL SYSTEM 891-943 (1953); Frank, *Historical Bases of the Federal Judicial System*, 13 LAW & CONTEMP. PROB. 3, 22-28 (1948); Friendly, *The Historic Basis of Diversity Jurisdiction*, 41 HARV. L. REV. 483 (1928).

[97] Recently, the American Law Institute thoroughly examined the diversity jurisdiction and found it still to be a necessary element of nation building. ALI STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS 99-110 (1969).

[98] Arrowsmith v. United Press Int'l, 320 F.2d 219, 227 (2d Cir. 1963).

[99] "State rules which are fashioned especially for nonresidents are too likely to bear the imprint of hometown prejudices to be entitled to willy-nilly application in courts which should serve as bulwarks against such prejudices." Carrington, *The Modern Utility of Quasi In Rem Jurisdiction*, 76 HARV. L. REV. 303, 319 (1962).

[100] Judge Sobeloff distinguished the *Woods* case and *Angel v. Bullington* near the end of his opinion in *Szantay*. He said that in *Woods* there was a "clear state policy that would have been frustrated by permitting suit in a federal court"—that policy being "to encourage foreign corporations doing business in Mississippi to register." 349 F.2d at 66. Judge Sobeloff mentioned other bases for distinguishing *Woods* but focused on his belief that the Mississippi statute had a valid policy basis whereas the South Carolina act proposed for application in *Szantay* did not. This is a questionable conclusion and Judge Sobeloff's tangential treatment of the *Woods* case should not be given undue weight.

"be wholly void on its behalf."[101] A legislative statement that in described situations no contract exists is, in the terms of Judge Sobeloff's first and second principles, arguably "the substantive right or obligation at issue" and almost certainly "a procedure intimately bound up with the state right or obligation" in actions by noncomplying corporations to enforce promises.[102]

Application of the *Byrd* jurisprudence thus indicates that if the choice of law issues of *Diamond Glue, David Lupton's Sons,* and *Woods* came to the Supreme Court today for re-examination, the Court would hold that Holmes and Hughes were right and would overrule *Woods* as contrary to the fundamental principles of the federal system.

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[101] See p. 58 *supra.*

[102] Beyond the choice of law question, void contract penalty provisions, of course, raise another serious issue: Are such provisions contrary to the commerce clause of the Constitution? This issue should be resolved differently today than it was in the *Diamond Glue* case. The plaintiff there argued that the penalty was an "interference with commerce between the states," but the Court rejected that claim, probably with an eye to the then viable purposes of the statute supported by the penalty. Those purposes have largely disappeared, and today a court should sustain such an argument. *See generally* Walker, *Foreign Corporation Laws: A Current Account,* 47 N.C.L. REV. 733, 747-60 (1969).