McGeorge Law Review

Volume 7 | Issue 2 Article 7

7-1-1976

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Recommended Citation
Douglas E. Noll, *California's New General Corporation Law: Quasi-Foreign Corporations*, 7 PAC. L. J. (1976).
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California's New General Corporation Law: Quasi-Foreign Corporations

The New General Corporation Law has been enacted to revise Division One of the California Corporations Code governing the organization and conduct of business corporations in California.[1] One of the most significant additions to the new law concerns the treatment of foreign corporations conducting a substantial portion of their business in California. The provision dealing with this type of corporation states that specified California corporations laws[2] will apply to the *exclusion* of the laws of the state of incorporation if the corporation meets certain criteria indicating that it engages in substantial business activity in California.[3] Section 2115 of the New Corporation Code thus represents

1. CAL. STATS. 1975, c. 682 (*effective January 1, 1977*) [hereinafter all citations and references to the New General Corporation Law, *enacted*, CAL. STATS. 1975, c. 682, will be cited as or referred to as *New* CAL. CORP. CODE or New Code; hereinafter all citations to the General Corporation Law *enacted in* 1947, CAL. STATS. 1947, c. 1038 (*effective until January 1, 1977*) will be cited as CAL. CORP. CODE]. *See generally* REVIEW OF SELECTED 1975 CALIFORNIA LEGISLATION, this volume at 258 (General Corporation Law).

2. Under the New Corporations Code Section 2115, quasi-foreign corporations are subject to the following provisions: *New* CAL. CORP. CODE §§ 301 (annual election of directors), 303 (removal of directors without cause), 304 (removal of directors by court proceedings), 305(c) (filling of director vacancies where less than a majority in office have been elected by shareholders), 309 (directors' standard of care), 316 excluding subdivisions (a)(3) and (f)(3) (liability of directors for unlawful distributions), 317 (indemnification of directors, officers and others), 500-505 (limitations on corporate distributions in cash or property), 506 (liability of shareholders who receive unlawful distributions), 600(b) and (c) (requirement for annual shareholders' meeting and remedy if same not timely held), 708(a), (b), and (c) (shareholders' right to cumulate votes at any election of directors), 1200-1201 (reorganizations), 1300-1312 (dissenters' rights), 1500-1501 (records and reports), and 1600-1605 (rights of inspection); *See generally* Berger, *California's New General Corporation Law: Close and Closely-Held Corporations*, this volume at 585; Comment, *California's New General Corporation Law: Dividends and Reacquisition of Shares*, this volume at 645; Comment, *California's New General Corporation Law: Directors' Liability to Corporations*, this volume at 613; Comment, *California's New General Corporation Law: Prospects for Minority Shareholders*, this volume at 706.

3. *New* CAL. CORP. CODE §2115 provides:

a significant departure from the usual treatment of foreign corporations[4]

(a) A foreign corporation (other than a foreign association but including a foreign parent corporation even though it does not itself transact intrastate business) is subject to this section if the average of the property factor, the payroll factor and the sales factor (as defined in Sections 25129, 25132 and 25134 of the Revenue and Taxation Code) with respect to it is more than 50 percent during its latest full taxable year and if more than one-half of its outstanding voting securities are held of record by persons having addresses in this state. The property factor, payroll factor and sales factor shall be those used in computing the portion of its income allocable to this state in its franchise tax return or, with respect to corporations the allocation of whose income is governed by special formulas or which are not required to file separate tax returns, which would have so used if they were governed by such three-factor formula. The determination of these factors with respect to any parent corporation shall be made on a consolidated basis, including in a unitary computation (after elimination of intercompany transactions) the property, payroll and sales of the parent and all of its subsidiaries in which it owns directly or indirectly more than 50 percent of the outstanding shares entitled to vote for the election of directors, but deducting a percentage of such property, payroll and sales of any subsidiary equal to the percentage minority ownership, if any, in such subsidiary. For the purpose of this subdivision, any securities held to the knowledge of the issuer in the names of broker-dealers or nominees for broker-dealers shall not be considered outstanding.

(b) The following chapters and sections of this division shall apply to a foreign corporation subject to this section (to the exclusion of the law of the jurisdiction in which it is incorporated):

Chapter 1 (general provisions and definitions), to the extent applicable to the following provisions:

Section 301 (annual election of directors);

Section 303 (removal of directors without cause);

Section 304 (removal of directors by court proceedings);

Section 305, subdivision (c) (filling of director vacancies where less than a majority in office elected by shareholders);

Section 309 (directors' standard of care);

Section 316 (excluding subdivisions (a)(3) and (f)(3)) (liability of directors for unlawful distributions);

Section 317 (indemnification of directors, officers and others);

Sections 500 through 505 (limitations on corporate distributions in cash or property);

Section 506 (liability of shareholder who receives unlawful distribution);

Section 600, subdivisions (b) and (c) (requirement for annual shareholders' meeting and remedy if same not timely held);

Section 708, subdivision (a), (b) and (c) (shareholder's right to cumulate votes at any election of directors);

Chapter 12 (reorganizations);

Chapter 13 (dissenters' rights);

Sections 1500 and 1501 (records and reports);

Chapter 16 (rights of inspection).

(c) Subdivision (a) shall become applicable to any foreign corporation only upon the first day of the first fiscal year of the corporation commencing on or after the 30th day after the filing by it of the report pursuant to Section 2108 showing that the tests referred to in subdivision (a) have been met or upon entry of an order by a court of competent jurisdiction declaring that such tests have been met.

(d) Subdivision (a) shall cease to be applicable at the end of any fiscal year during which a report pursuant to Section 2108 shall have been filed showing that at least one of the tests referred to in subdivision (a) is not met or an order shall have been entered by a court of competent jurisdiction declaring that one of such tests is not met, provided that such filing or order shall be ineffective if a contrary report or order shall be made or entered before the end of such fiscal year.

(e) This section does not apply to any corporation with outstanding securities listed on any national securities exchange certified by the Commissioner of Corporations under Section 25100(o).

4. Statutes usually provide for filing of the articles, service of process, and other

because it is a legislative recognition of the "pseudo-foreign" (hereinafter referred to as *quasi-foreign*[5]) corporation. This comment will explore this unique aspect of the New Corporations Code, examining the California law relating to the quasi-foreign corporations prior to the enactment of Section 2115, the application and administration of the new law, and some of the constitutional and conflict-of-laws problems that may arise out of its operation.

THE TRADITIONAL INTERNAL AFFAIRS DOCTRINE AND THE ORIGINS OF THE QUASI-FOREIGN CORPORATION

Corporate planners have traditionally utilized foreign incorporation as a means of obtaining the governmental regulation or lack of governmental regulation most favorable to their intended purposes. The efficacy of this strategem has stemmed from the application of the "internal affairs" doctrine,[6] whereby the forum court will not apply the corporation laws of its state to problems relating to the internal affairs of foreign corporations.[7] This doctrine originally found its logic in the concept that a court could not acquire jurisdiction over the internal affairs of a foreign corporation because the corporate charter governing such matters was an exercise of legislative power by the state of incorporation.[8] To assert control over activities conducted pursuant to powers granted a corporation by its legislative charter would be to exercise power over the legislature itself, and would therefore violate the sovereignty of the sister

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minimal registration requirements which do not affect the internal affairs of the foreign corporation. *See, e.g.,* CAL. CORP. CODE §§6200-6804 (*repealed* CAL. STATS. 1975, c. 682, (*effective January 1, 1977*)); *New* CAL. CORP. CODE §2100 et seq.

5. The term "quasi-foreign" corporation is used instead of the more widely accepted "psuedo-foreign" corporation in an attempt to alleviate the imputation of deceit or wrongdoing that the latter term has acquired. In addition, the term "quasi," defined by WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1861 (1967) as "having a given legal status only by operation or construction of law and without reference to any intent of the parties in interest," more accurately describes the type of corporation incorporated in one state, but doing the majority of its business in another.

6. [W]here the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as a stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meetings or through its agents, the board of directors, then such action is the management of the internal affairs of the corporation, and, in the case of a foreign corporation, our courts will not take jurisdiction.

North State Copper & Gold Min. Co. v. Field, 64 Md. 151, 154, 20 A. 1039, 1040 (1885).

7. Powell v. United Ass'n of Plumbers and Steamfitters of United States and Canada, 240 N.Y. 616, 616-17, 148 N.E. 728, 729 (1925); National Baptist Convention of the United States of America, Inc. v. Taylor, 402 Pa. 501, 504, 166 A.2d 521, 522 (1961); *see generally,* Annot., 72 A.L.R.2d 1211 (1960); Annot., 155 A.L.R. 1231 (1945); Annot., 89 A.L.R. 736 (1934); Annot., 18 A.L.R. 1383 (1922).

8. *See* Bank of Augusta v. Earle, 38 U.S. 519, 588 (1839); Comment, *Corporations—Interference with the Internal Affairs of a Foreign Corporation,* 31 MICH. L. REV. 682, 692 (1932).

state.[9] This logic lost some of its force, however, when corporations ceased to be created by legislative charter. Due to the enactment of enabling statutes designed to give corporations broad powers over the conduct of their business affairs,[10] violation of a sister state's sovereignty by the forum court was no longer the problem it was when corporations existed pursuant to legislative charters. The internal affairs doctrine consequently came to be based upon judicial discretion rather than upon a lack of judicial power.[11]

While the concept of "minimum contacts" gradually gained recognition as the basis of judicial jurisdiction over corporations which conducted business activities within the state,[12] the courts steadfastly refused to exercise such jurisdiction over matters which related to the internal affairs of foreign corporations. Thus, state courts would assert jurisdiction over disputes arising out of a foreign corporation's business activity within the state, such as contract disputes or tort claims, but would refuse to hear cases involving disputes between shareholders, directors, and officers. This reticence was based on the pragmatic consideration that enforcement of judgments beyond state lines was difficult.[13] Frequently, only the courts of the state of incorporation possessed the requisite power to enforce all decrees that justice required[14] and thus the forum court would not exercise its jurisdiction.

The reluctance of many states to apply their own laws to regulate the internal activities of foreign corporations resulted in the removal of shareholder and creditor protections from some states' corporation laws.[15] Eager for the revenue generated by incorporation fees,[16] and

9. *See* Clark v. Mutual Reserve Fund Life Ass'n, 14 App. D.C. 154, 177, 43 L.R.A. 390, 396-97 (1899).

10. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 548-49 (1933) (Brandeis, J., dissenting).

11. 17 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, §8425, at 419-20 (1960 rev. vol.).

12. *See, e.g.*, International Shoe Co. v. Washington, 326 U.S. 310 (1945); Buckeye Boiler Co. v. Superior Court; 71 Cal. 2d 893, 458 P.2d 57, 80 Cal. Rptr. 113 (1969); *see also* CAL. CODE CIV. PRO. §410.10.

13. *See* Mayer v. Oxidation Prod. Co., 110 N.J. Eq. 141, 156-57, 159 A. 377, 383 (1932).

14. 17 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS, §8426, at 425 (1960 rev. vol.).

15. For example, the stated policy of New Jersey towards corporate regulation is as follows:

> The modern corporation's business is frequently national or international in scope; its state of incorporation is largely incidental. Recognizing this fact, and seeking to attract corporations to establish their domiciles within their borders, most states in recent decades have been increasingly flexible and permissive in revising their corporation laws.
>
> Pursuing this policy perhaps further than any other state, the Commission believes that it is following sound public policy for New Jersey. . . . Any attempt to provide [shareholder and creditor protections] in the public interest

knowing that other states would refuse to regulate foreign corporations, certain states began to actively encourage promoters and managers to incorporate in their jurisdictions. Naturally, incorporators looking for freedom from bothersome shareholders, government agencies, public opinion, and judicial review tended to view the states offering minimal corporate requirements with favor, and incorporated or reincorporated in such states while intending to maintain their principal place of business elsewhere.[17] Although federal securities laws protected shareholders from the potentially oppressive activities of the larger corporations regardless of where they were incorporated,[18] the smaller enterprises, exempted from such regulations because of size, could incorporate so as to defeat any shareholder or creditor protections established in the state of the principal place of business.[19] Thus, according to modern practice, a promoter can obtain tailor-made articles of incorporation from the state of his choice, incorporate in that state, move to another state, and in many cases start up a business by merely complying with the minimal registration requirements imposed by the local state on foreign corporations.[20] Such enterprises have been characterized as "tramp"[21] or "pseudo-foreign"[22] corporations because they are foreign in a technical sense only, maintaining a substantial amount of property and business in one state and having little or no contact, other than the fact of incorporation, with the charter state.

In order to provide protection for the shareholders and creditors of this type of corporation, some states, including California, have adopted

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> through state incorporation acts and similar legislation would only drive corporations out of the state to more hospitable jurisdictions.

N.J. STAT. ANN. 14A, at xi (1968) (*N.J. Corporation Law Revision Commission, Report on the New Jersey Corporation Law*).

16. Louis K. Liggett Co. v. Lee, 288 U.S. 517, 557 (1933).

17. *See* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 671-72 (1974).

18. *See, e.g.*, Securities Exchange Act of 1934 §§9, 10, 12, 16; 15 U.S.C. §§78*i*, 78*j*, 78*l*, 78*n*, 78*p* (1970).

19. Corporations with over $1,000,000 in assets and having over 500 shareholders must register their securities with the Securities Exchange Commission. 15 U.S.C. §78*l* (g)(1) (1970).

20.
> Certain corporations are in the business of arranging foreign . . . incorporations for others. A lawyer can phone such a firm, describe what he wants, pay the fees, and a charter from any state, as ordered, will usually be delivered in a day or so. The business of such incorporating concerns is extensive. For example, one advertises that it acts as a Delaware agent for corporations whose total assets exceed $100,000,000,000.

Sobieski, *State Blue Sky Jurisdiction Over Foreign Corporations*, 14 HAST. L.J. 75, 77 (1962).

21. *See* Cumberland Tel. & Tel. Co. v. Louisville Home Tel. Co., 114 Ky. 892, 896-97, 72 S.W. 4, 5 (1903).

22. Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 437 (1968); Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM. L. REV. 118, 1126 (1958); Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137 (1955); Note, *Pseudo-Foreign Corporations and the Internal Affairs Doctrine*, 1960 DUKE L.J. 477, 478 (1960).

a judicially-created exception to the internal affairs doctrine. Upon a determination that the local interest in the internal affairs of the foreign corporation is greater than that of the state of incorporation, the forum state's corporation laws have been applied to a foreign corporation's internal affairs.[23] Recently, this exception has found legislative expression in Section 2115 of the New Corporations Code.[24]

CALIFORNIA POLICY RESPECTING QUASI-FOREIGN CORPORATIONS PRIOR TO THE NEW LAW

The new law partially clarifies the judicial exception to the internal affairs doctrine in that it provides for a more certain test than has been previously applied by the courts.[25] Thus, in order to understand the ramifications of Section 2115 and why it varies from the judicial rule, it is necessary to examine the new provision in light of the California law prior to its enactment. As will be seen, California regulation of the quasi-foreign corporation was primarily of judicial origin until the end of World War II. As a response to the dramatic growth of corporate activity following the war, the Commissioner of Corporations asserted administrative jurisdiction over the issuance of securities by quasi-foreign corporations pursuant to amendments to the California securities law, and maintained jurisdiction until the adoption of the Corporate Securities Law of 1968.[26] Since the enactment of that law, there has been no administrative regulation of quasi-foreign corporations because the law significantly reduced the power of the Commissioner over foreign securities transactions.

A. California Case Law Prior to World War II

California is among the states that have applied domestic corporation laws to quasi-foreign corporations to protect their resident shareholders and creditors. The seminal case in the evolution of the California orientation toward quasi-foreign corporations was the 1909 decision of *Wait v. Kern River Mining Company.*[27] The Kern River Mining Company was an Arizona corporation incorporated for the purpose of developing mining claims in Kern County, California.[28] There was no

23. State *ex rel.* Weede v. Iowa S. Util. Co., 231 Iowa 784, 821, 827, 2 N.W.2d 372, 392, 395 (1942) (*modified on other grounds* 232 Iowa 139, 4 N.W.2d 869 (1942)).
24. *See* CALIFORNIA LEGISLATURE, ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE, REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE 106-07 (Dec. 1, 1975).
25. See text accompanying notes 77-83 and 97-114 *infra.*
26. CAL. CORP. CODE §25000 *et seq.*, CAL. STATS. 1968, c. 88, §2 at 243.
27. 157 Cal. 16, 106 P. 98 (1909).
28. *Id.* at 19, 106 P. at 99.

indication of any contact with the State of Arizona other than the fact of incorporation. All of the corporation's real and personal property was situated in California, its office was in Los Angeles, and its business was exclusively conducted in California.[29] Therefore, the Kern River Mining Company met the classic definition of a quasi-foreign corporation: it was a corporation which, while incorporated in one state, maintained its total corporate existence in another.[30]

The action against the corporation was instituted when the promoter failed to convey a stipulated number of shares to the plaintiff,[31] a California resident, forcing him to seek specific performance against the corporation to compel delivery.[32] During litigation, the defendants asserted that California could not decide a case involving the internal affairs of a foreign corporation. The trial court concluded as a matter of law that it had not acquired jurisdiction over the corporation, ordered judgment for the defendant, and denied plaintiff's motion for a new trial.[33]

On appeal, the California Supreme Court was primarily concerned with determining the situs of the corporate shares.[34] In essence, the court was faced with the question of whether the shares were located in Arizona, the state of incorporation, or California, the state having the greatest interest in the corporation. If the shares were found to be situated in Arizona, the court would be limited in exercising extraterritorial power to compel delivery and would probably refuse relief.[35]

In resolving this issue, the court stated that the situs of the shares was

> within the state where the corporation resides. That state is ordinarily, of course, the state by or under the laws of which the corporation was created. Defendant corporation was . . . originated under the laws of Arizona. But for all practical purposes, according to the record, it is a California corporation. . . . It is a foreign corporation only in the sense that it is created in another state to enjoy corporate life by permission of that state.[36]

The court found that because the plaintiff was a California resident, and the foreign corporation was actually domestic in nature,[37] justice required that relief be granted.[38] In effect, California recognized its

29. *Id.*
30. *See* note 4 *supra.*
31. 157 Cal. 20, 106 P. 100.
32. *Id.* at 21-22, 106 P. at 100.
33. *Id.* at 18-19, 106 P. at 99.
34. *See id.* at 21, 106 P. at 100.
35. *See id.* at 22, 106 P. at 100-01.
36. *Id.* at 21, 106 P. at 100.
37. *See id.* at 21, 106 P. at 100.
38. *Id.*

greater interest in the affairs of the Kern River Mining Company, and granted relief accordingly.

As the first California case to recognize the quasi-foreign corporation as *sui generis, Wait v. Kern River Mining Company* was a substantial departure from the internal affairs doctrine. Instead of dismissing the suit for lack of jurisdiction or applying Arizona corporation law, the California Supreme Court decided that because of the corporation's intimate contact with the state, California's laws should be applied as a matter of justice in deciding who had the right to the shares.[39] This conclusion seems proper in light of the fact that the defendant corporation was operated solely within California, having no contact with Arizona other than the fact of incorporation;[40] furthermore, the promoter was not amenable to service, indeed he had disappeared.[41] Therefore, it is arguable that the plaintiff would not have his interests adequately protected elsewhere. In short, the corporation, if allowed to successfully invoke the internal affairs doctrine, would have been free to take advantage of other California shareholders. Consequently, by granting relief, the court started a judicial trend of looking beyond the fact of foreign incorporation in order to protect California residents from questionable corporate activities, a policy that has now been embodied in Section 2115.

Six years after *Wait*, in *Stabler v. El Dora Oil Company*,[42] another Arizona corporation was found to be subject to California laws[43] because the corporation maintained offices, held all of its property, conducted all of its business and had all of its directors residing in California,[44] despite the fact that its principal place of business was ostensibly located in Phoenix.[45] The action against the company was for a writ of mandate to compel the directors to call a shareholders' meeting in Phoenix.[46] The court hesitated to issue the writ against a foreign corporation because the decree would have to be executed outside California, and, as in *Wait*, the court feared that the decree would be an idle act.[47] However, the court was not willing to permit the directors of the corporation to take advantage of California shareholders solely by virtue of foreign incorporation. Thus, the fact that the court's decree

39. *Id.* at 21, 106 P. at 100.
40. *Id.* at 19, 106 P. at 99.
41. *Id.* at 20, 106 P. at 100.
42. 27 Cal. App. 516, 150 P. 643 (1915).
43. *Id.* at 521, 150 P. at 645.
44. *Id.* at 517-18, 150 P. at 643-44.
45. *Id.* at 517, 150 P. at 643.
46. *Id.*
47. *Id.* at 520, 150 P. at 644.

could only result in a shareholder meeting being convened in Arizona[48] did not deter it from finding that El Dora Oil Company, as a quasi-foreign corporation, was subject to California law.[49] Because the court had determined that the corporation's contacts gave California the dominant interest in controlling the internal affairs of the business, it logically concluded that the relief granted was justified to protect the California shareholders.

While it may appear that *Stabler* was simply a forerunner of later jurisdictional tests such as minimum contacts,[50] it seems clear that the question was not one of acquiring jurisdiction in the first instance. Rather, the question was one of exercising existing jurisdiction over the internal affairs of the corporation. The distinguishing feature of *Stabler* and the cases that followed is that the court was not asserting its power because of the presence of corporate activity, which would be a threshold jurisdictional requirement in a contract or tort action. Instead, it was exercising its power based upon continuing and substantial connection with California through the maintenance of corporate property and business activity and the existence of California shareholders. As a consequence of this substantial and continuing interest, El Dora Oil Company was held to be so related to California interests that its *internal affairs* were logically subject to California regulation. In contrast, if a dispute had arisen between the shareholders and directors of a truly foreign corporation, the traditional internal affairs doctrine would be applicable so that the laws of the state of incorporation would be appropriate for its resolution.[51] As in *Wait*, the *Stabler* court made a significant policy decision to hold a foreign corporation accountable for its actions under California law when its contacts with the state rendered it essentially local in nature.

One year after the *Stabler* decision the California Supreme Court decided *Provident Gold Mining Company v. Haynes*,[52] an action which arose out of a judgment against the California shareholders of a foreign corporation.[53] The plaintiff, Provident Gold Mining Company, was seeking to hold the shareholders of Manhattan Securities Company liable for Manhattan's contractual obligation to purchase shares of the

48. The court stated that because the directors resided and held meetings in Los Angeles, the court's powers could be effectively utilized to compel the board of directors to pass a resolution establishing a meeting date in Phoenix. *Id.* at 519-20, 150 P. at 644-45.
49. *Id.* at 520, 150 P. at 645.
50. *See* Buckeye Boiler Co. v. Superior Court, 71 Cal. 2d 893, 458 P.2d 57, 80 Cal. Rptr. 113 (1969).
51. *See* Annot., 18 A.L.R. 1383, 1390-91 (1922).
52. 173 Cal. 44, 159 P. 155 (1916).
53. *Id.* at 44, 159 P. at 156.

plaintiff corporation.[54] In *Provident* an Arizona corporation had been formed with the intent to conduct a majority of its business in California. Unlike the applicable California law,[55] Arizona law gave its corporations the power to "exempt the private property of the members from liability for corporate debts" if so stated in the articles of incorporation.[56] Thus, Arizona corporate law was more favorable to corporate planners because it insulated them from liability in a manner not recognized in California. Manhattan, as an Arizona corporation, had such a provision in its articles, raising the question of whether the laws of the state of incorporation would free the shareholders from personal liability to Provident.[57] Since Manhattan occupied essentially the same relationship with California as did the Kern River Mining Company and El Dora Mining Company as its business offices and property were located in California,[58] the court concluded as a matter of policy that California law was applicable.[59] In the course of the opinion, the California Supreme Court stated:

> [W]here a corporation is formed in some state or country other than California, for the purpose of doing business in this state, the stockholders are, so far as concerns business transacted in California, to be held liable in accordance with the California statutes.[60]

In arriving at its decision, the court noted that any other conclusion would permit corporations planning to conduct business in California to escape the liabilities imposed under California law by incorporating in a foreign state.[61] If the court had followed the traditional internal affairs rule, it would arguably have applied the law of Arizona to the dispute, permitting the shareholders to prevail. The court's conclusion indicated, however, that the activities of the quasi-foreign corporation necessitated the abandonment of the internal affairs doctrine and thus it granted relief to the creditor against the California shareholders.

Provident extended the policy that had evolved from *Wait* and *Stabler* of protecting California *shareholders* from quasi-foreign corporations to the protection of California plaintiffs in general. The court refused to permit the fact of foreign incorporation to defeat the purpose of the local law and reiterated the previously developed policy that any group

54. *Id.* at 44-45, 159 P. at 156.
55. CAL. CIV. CODE §322, *superseded,* CAL. CORP. CODE §§1300-1303, *added,* CAL. STATS. 1947, c. 1038, §§1300-1303 at 2329, *repealed,* CAL. STATS. 1975, c. 682, §7.
56. 173 Cal. at 45, 159 P. at 156.
57. *See id.* at 45, 159 P. at 156.
58. *Id.* at 46, 159 P. at 157.
59. *See id.* at 47-48, 159 P. at 157.
60. *Id.* at 46, 159 P. at 157.
61. *Id.* at 48, 159 P. at 157.

which incorporated outside of California, with the intent of returning to start up business while avoiding corporate liabilities established by the California laws, could expect to be subjected to those laws despite the fact of foreign incorporation.[62]

While the former cases established the policy of protecting shareholders and creditors from the activities of quasi-foreign corporations, the 1940 case of *Sharp v. Big Jim Mines*[63] firmly established the judicial *criteria* to be applied in determining whether or not a corporation was actually quasi-foreign and consequently subject to California law. The dispute arose after a purported shareholders' meeting had authorized an assessment on the outstanding shares.[64] The plaintiff claimed that the meeting and authorization were invalid because of the lack of a proper quorum, and sought an injunction against the company to prevent it from levying the assessment.[65] Big Jim Mines was an Arizona corporation, however, and in defending the action relied on the 1928 decision in *Southern Sierras Power Company v. Railroad Commissioner of the State of California*[66] as authority for the proposition that California law was inapplicable to the internal affairs of foreign corporations.[67] The plaintiff in turn relied upon the *Wait*[68] and *Stabler*[69] decisions, contending that Big Jim Mines was a quasi-foreign corporation and was therefore subject to California law.[70] The court, following the reasoning in *Wait* and *Stabler*, agreed with the plaintiff and found that Big Jim Mines was indeed a quasi-foreign corporation because its principle place of business, the books and records, and the mining interests owned by the corporation were located exclusively within California.[71] The *Sharp* court went on to distinguish the *Southern Sierras* decision by stating that in that case, the corporation's only contact with California appeared to be that it conducted some of its business and had some of its shareholders within the state, but it did not appear to have enough contact with California to be classified as a quasi-foreign corporation.[72]

62. *See id.*
63. 39 Cal. App. 2d 435, 103 P.2d 430 (1940).
64. *Id.* at 437, 103 P.2d at 431-32.
65. *Id.* at 436-37, 103 P.2d at 431-32.
66. 205 Cal. 479, 271 P. 747 (1928).
67. 39 Cal. App. 2d at 438, 103 P.2d at 432.
68. Wait v. Kern River Min. Co., 157 Cal. 16, 106 P. 98 (1909).
69. Stabler v. El Dora Oil Co., 27 Cal. App. 516, 150 P. 643 (1915).
70. *See* 39 Cal. App. 2d at 438, 440-41, 103 P.2d at 432-33.
71. *Id.* at 436-37, 103 P.2d at 431.
72. The *Southern Sierras* court held that the Railroad Commissioner did not have the power to approve the application for issuance of shares of stock of a foreign corporation, 205 Cal. at 482, 271 P. at 748. In coming to this conclusion, the court stated that the legislature had no power to control the internal affairs of foreign corporations, hence the Public Utilities Act could not be applied to Southern Sierras Power Company. *Id.* The court did not state whether or not Southern Sierras Power Company was a quasi-foreign corporation; thus, the case could be distinguishable from *Wait*, *Stabler*, and

From the foregoing cases, it appears that the judicial tests which were applied prior to World War II to determine the applicability of California law were twofold. First, the corporation, by locating all of its property, business and managerial operations in California, could not be said to be a truly foreign corporation. Secondly, the plaintiff had to be a California resident in need of relief which would be denied if the internal affairs doctrine were applied. When these factors coincided, California was found to have the dominant interest in regulating the corporation, and thus the application of its laws to the exclusion of the laws of the state of incorporation was justified.

B. Statutory Developments

The developing policy towards quasi-foreign corporations in California shifted from case law to securities regulation after World War II, perhaps reflecting the need for administrative rather than judicial control over the increasing number of foreign corporations doing business in California. Thus, the Commissioner of Corporations exercised administrative control over quasi-foreign corporations by regulating their securities transactions, recapitalizations, and other activities which affected the relationship between the shareholders and the corporation.

The Commissioner's control over quasi-foreign corporations developed from the interpretation of the "statutory language 'sold or issued' in former Section 26100"[73] thus vesting in him broad power over all issuer transactions if a sale or issuance took place in California.[74] Consequently, the fact of foreign incorporation was not important in determining the applicability of California securities regulations to issuing corporations, and quasi-foreign as well as foreign corporations were regulated by the Department of Corporations when a securities transaction occurred in California. Further, a post-war amendment to the Corporate Securities Law of 1917 broadened the Commissioner's regulatory power to include non-issuer as well as issuer securities transactions because a "sale" was defined to include "any change in the rights, preferences, privileges, or restrictions on outstanding securities."[75] Thus, any amendment of the articles of incorporation or bylaws which in any

Provident Gold Mining on its facts. In any case, the holding was disapproved prior to *Sharp* in *Gillis v. Pan Am. W. Petroleum Co.*, 3 Cal. 2d 249, 44 P.2d 311 (1935) (*overruled on different grounds*, Mary Pickford Co. v. Bayly Bros., Inc., 12 Cal. 2d 501, 86 P.2d 102 (1939).

73. *See* CAL. STATS. 1917, c. 532, §12, at 679, *amended*, CAL. STATS. 1931, c. 423, §16, at 949, *amended*, CAL. STATS. 1933, c. 898, §5c, at 2316, *amended*, CAL. STATS. 1947, c. 129, §1, at 649.

74. 1 H. MARSH & R. VOLK, PRACTICE UNDER THE CALIFORNIA SECURITIES LAW, §1.03[2][a] (1975) [hereinafter cited as 1 MARSH & VOLK].

75. 1 MARSH & VOLK, *supra* note 74, §1.03[3][d].

way affected the rights of shareholders or creditors was subject to the approval of the Commissioner of Corporations.[76] In effect, the 1947 amendment to the Corporate Securities Law constituted an assumption of administrative control over the internal affairs of both foreign and quasi-foreign corporations.

Corporate planners criticized the amended Corporate Securities Law as an improper interference with the rights vested in shareholders under the laws of the state of incorporation. This criticism culminated with that 1961 appellate court decision of *Western Air Lines v. Sobieski.*[77] In *Western Air Lines*, the Commissioner of Corporations declared that he had the power to compel a foreign corporation doing a majority of its business, but having only 30 percent of its shares held by California residents, to comply with regulations concerning the issuance of permits for the "sale" of securities within the state.[78] Since Western Air Lines, Inc., a Delaware corporation, was attempting to eliminate cumulative voting from its articles, as permitted by Delaware but prohibited by California, the Commissioner felt that a change in the "rights, privileges, preferences and restrictions" was taking place such that there was a "sale" of securities.[79] Hence, he asserted jurisdiction and refused to issue a securities permit.[80] It is important to note that Western Air Lines, Inc., did not meet the judicial criteria previously established for determining whether a foreign corporation had acquired a quasi-foreign status. It had substantial contacts with other states, less than half of its shares were held by California residents,[81] and the action against the Commissioner to compel issuance of a securities permit had been brought by the corporation.[82] Nevertheless, the court concluded that a holding for Western Air Lines "would enable a foreign corporation to destroy the rights which the State of California has deemed worthy of protection by the enactment of the Corporate Securities Act."[83] This statement represented the policy California courts had been developing since 1902 in *Wait v. Kern River Mining.* Whereas the previous

76. *Id.*
77. 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).
78. *Id.* at 402-03, 12 Cal. Rptr. at 721-22; *see generally* Sobieski, *Securities Regulation in California: Recent Developments*, 11 U.C.L.A. L. REV. 1 (1963); Sobieski, *State Blue Sky Jurisdiction Over Foreign Corporations*, 14 HAST. L.J. 75 (1962); Note, *Corporations: Sales of Securities: Foreign Corporations Denied Permit to Eliminate Cumulative Voting for Directors*, 9 U.C.L.A. L. REV. 242 (1962); Note, *Corporations: Shareholders' Rights and the Foreign Corporation*—Western Air Lines, Inc. v. Sobieski (Cal. App. 1961), 49 CAL. L. REV. 974 (1961).
79. 191 Cal. App. 2d at 403, 12 Cal. Rptr. at 721-22.
80. *Id.* at 403, 12 Cal. Rptr. at 722.
81. *Id.* at 402, 12 Cal. Rptr. at 721.
82. *Id.* at 404, 12 Cal. Rptr. at 722.
83. *Id.* at 413-14, 12 Cal. Rptr. at 728.

decisions may have been rationalized as being applicable to high risk mining ventures, with a concomitant state interest in protecting California shareholders from questionable practices, the *Western Air Lines* decision indicated that the policy underlying those decisions was clearly not limited to speculative business corporations, but was applicable to any foreign corporation intending to carry on a substantial portion of its business activity within California.

The *Western Air Lines* decision caused considerable consternation among corporate planners, who questioned the logic of making the application of California's securities regulation turn upon the location of a corporation's business activity.[84] While the earlier cases had dealt with corporations doing substantially *all* of their business in California, the *Western Air Lines* decision made the standard for determining whether a corporation had attained quasi-foreign status far too nebulous. Unlike the earlier cases which involved corporations having substantially all of their property, business, and shareholders in California, the *Western Air Lines* court found that only 30 percent of Western's shares were registered to owners with California addresses and that a "substantial" portion of its business was conducted within the state.[85] The court's decision consequently broadened the concept of the quasi-foreign corporation, and caused corporate managers and promoters to urge the legislature to supply a more definite and precise test as to when jurisdiction would be exercised by California over securities transactions.[86] As a result, when the Corporate Securities Law of 1968 was enacted, the draftsmen determined that the only factor logically relevant to foreign securities regulation was the residence of the shareholders of the issuing corporation.[87] At this juncture, it was argued that the purpose of the law was to protect such shareholders from fraud rather than to regulate the business operations of the corporation.[88] Consequently, Section 25103,[89] which prohibited the Commissioner of Corporations from asserting jurisdiction over any foreign corporation regardless of its business activity within California unless at least 25 percent of its shares were held by persons having California addresses, was included as a part of the Corporate Securities Law of 1968. With this change, the judicial concept of the quasi-foreign corporation was abolished and replaced with a shareholder residence test as the sole

84. *See* 1 MARSH & VOLK, *supra* note 74, §7.06[3].
85. 191 Cal. App. 2d at 402, 12 Cal. Rptr. at 721.
86. *See* 1 MARSH & VOLK, *supra* note 74, at §7.06[3].
87. *Id.* at §7.06[3].
88. *Id.* at 224.
89. CAL. STATS. 1968, c. 88, §2 at 253-54.

determinative factor regarding the applicability of California securities regulations to foreign corporations.[90]

While foreign incorporation would not have been an effective way to evade California regulations if one wished to sell securities *prior* to 1968 due to the broad regulatory power of the Commissioner of Corporations over all corporations, exemptions in the Corporate Securities Law of 1968[91] have permitted small and intermediate-sized quasi-foreign corporations to completely avoid the application of California laws. For example, the small-offering exemption[92] permits a non-public offering (an offer to not more than 25 persons)[93] for the sale of securities to be made *without* obtaining an issuance certificate from the Commissioner of Corporations, thus bypassing his regulatory authority. The availability of this exemption apparently rests on the assumption that there is an insufficient state interest in securities transactions involving less than 25 persons to warrant extensive regulation by the Commissioner of Corporations. However, there has been a tremendous increase in application requests since 1968, indicating that there are many small corporations issuing securities without regulatory supervision. In 1975 the application rate for securities issuance permits was approximately 460 applications per month.[94] In contrast, the number of small-offering qualification applications was approximately 1350 per month, and there is an indication that this trend is increasing.[95] While there are no statistics available from the Secretary of State or the Franchise Tax Board, extrapolations from a 1966 survey conducted by the Department of Corporations[96] indicate that at least ten percent of the applications come from foreign corporations. Thus, there may be approximately 135 foreign corporations per month seeking to issue securities in California under circumstances which preclude the application of California securities regulations. It is submitted that this significant number of corporations not subject to regulation under the old law indicates the basic purpose of Section 2115 of the General Corporation Law of 1975: to subject these corporations to minimal California regulatory standards in order to afford some degree of protection to California shareholders and creditors.

90. 1 MARSH & VOLK, *supra* note 74, at §7.06[4], [5].
91. *See* CAL. CORP. CODE §§25102, 25103.
92. CAL. CORP. CODE §25102(a).
93. 10 CAL. ADMIN. CODE §260.102.1.
94. STATE OF CALIFORNIA, DEPARTMENT OF CORPORATIONS, QUALIFICATIONS & REGISTRATION DIVISION, REPORT OF ACTIVITIES FOR THE STATE (Jan. 1975-Dec. 30, 1975).
95. STATE OF CALIFORNIA, DEPARTMENT OF CORPORATIONS, QUALIFICATION & REGISTRATION DIVISION, REPORT OF ACTIVITIES FOR THE STATE (Jan. 1970-Dec. 30, 1970).
96. Interview with Assistant Commissioner of Corporations, Sacramento, California, October 27, 1975.

APPLICATION AND ADMINISTRATION OF SECTION 2115

Section 2115 of the New General Corporation Law once more injects the concept of the quasi-foreign corporation into California law.[97] This section specifies that foreign corporations meeting certain criteria will be subject to specified provisions of the New California Corporations Code to the exclusion of the laws of the state of incorporation.[98] However, the provision embodies a legislative rather than judicial or administrative determination that California has the dominant interest in regulating foreign corporations with half or more of its voting securities registered to addresses within the state.[99] Furthermore, it reflects the concern that a number of small and intermediate-sized corporations have effectively evaded California supervision since the enactment of the Corporate Securities Law of 1968. At the outset, it should be emphasized that Section 2115 *does not* apply to corporations with outstanding securities listed on a national securities exchange certified by the Commissioner of Corporations.[100] Except for this restriction, any corporation incorporated in a state other than California which meets a three-factor formula and which has 50 percent of its voting securities registered to owners with California addresses will be subject to Section 2115.

A. The Three-Factor Formula

Departing from the nebulous test used in the *Western Air Lines* case to determine the extent of the corporation's contact with California, Section 2115 has adopted a specific three-factor formula from the Revenue and Taxation Code as a measure of a foreign corporation's business activity.[101] Whereas the cases prior to *Western Air Lines* dealt with foreign corporations maintaining all of their property, payroll and business in California, and whereas Western Air Lines conducted a substantial amount of business activity within California, Section 2115 strikes a balance by providing a test which appears relatively simple to apply and yet precisely determines the amount of business a foreign corporation carries on within the state.

The first factor to be considered in evaluating the extent of the corporation's contact with California is the property factor, which is deter-

97. See note 3 *supra.*
98. See note 2 *supra.*
99. *New* CAL. CORP. CODE §2115(a).
100. *New* CAL. CORP. CODE §2115(e) provides "This section does not apply to any corporation with outstanding securities listed on any national securities exchange certified by the Commissioner of Corporations under Section 25100(o)." The apparent purpose for this exception is to avoid regulating corporations already subject to federal securities laws. Evidently, those laws protect shareholders adequately enough without resort to California regulation.
101. *New* CAL. CORP. CODE §2115(a).

mined by dividing the average value of the corporation's real and personal property owned or rented and used within California[102] by the average value of the *total* amount of real and personal property owned or rented and used, by the corporation.[103] The payroll factor is computed in the same manner as the property factor: the payroll paid in California to employees of the corporation is divided by the *total* payroll paid by the corporation.[104] Finally, the sales factor is determined by dividing the gross sales of the corporation within California by its *total* gross sales.[105] These separate averages are combined and averaged for the final determination of business contact within the state, and if the final average exceeds 50 percent, the foreign corporation is deemed to have such substantial contacts with California that, if the shareholder residence test is met, it is subject to certain provisions of California law.[106]

Because the purpose of the three-factor formula is to accurately reflect the degree of business activity conducted in California by a foreign corporation, a slightly different test is necessary to take into account the effect of minority interests in subsidiary corporations not wholly owned by the parent. It appears that if a subsidiary's activity were not apportioned to take into account these minority interests, the degree of parent activity would be unnecessarily distorted, resulting in either too much or not enough regulation. Thus, the factors for the parent and the subsidiary are to be computed together, eliminating any inter-company transactions, and the percentage of minority ownership of the subsidiary is to be deducted.[107] If, for example, the total factor average is 80 percent and the minority ownership is 25 percent, 25 percent will be subtracted from the total average and the final average will be 55 percent. In general, when the three-factor formula is applied to a corporation with subsidiary companies, only the proportion of property, payroll, and sales equal to the percentage of shares *owned by the parent* is to be considered in determining the degree of contact the corporation has with California.

B. The Shareholder Resident Test

In addition to providing the three-factor formula, Section 2115

102. The average value of the corporation's property is as follows:
(1) Property owned by the corporation is valued at its cost,
(2) Property rented by the corporation is valued at eight times the net annual rental rate.

See CAL. REV. & TAX. CODE §§25130, 25131.
103. This language is derived from CAL. REV. & TAX. CODE §25129.
104. *See* CAL. REV. & TAX. CODE §25132.
105. *See* CAL. REV. & TAX. CODE §25134.
106. *See* note 3 *supra*.
107. *New* CAL. CORP. CODE §2115(a).

specifies that over one-half of the corporation's outstanding voting securities must be held of record by persons having addresses within California before the corporation will be subject to California regulation. The purpose of Section 2115 is to protect shareholders and creditors residing in California from nefarious business activities of quasi-foreign corporations. While the three-factor formula arguably leans towards protecting creditors because of the business activity it registers, the shareholder residence test appears to be designed to further a policy of protecting California shareholders as well.[108] Thus, when less than half of a corporation's shares are held by California residents, the legislature has determined that there exists an insufficient state interest to justify adherence to California corporation laws. It should be noted, however, that the Corporate Securities Law of 1968 remains applicable to foreign corporations with more than 25 percent of their securities registered to California residents,[109] arguably providing a less onerous regulatory scheme as the state interest diminishes.[110]

In counting the number of shares outstanding for the purposes of determining the residence of the shareholders, shares held in the name of broker-dealers or nominees of broker-dealers are *not* to be counted.[111] This provision apparently protects foreign corporations from being unjustifiably subjected to California law because of a large number of shares held by broker-dealers in California, and assures that the California shareholders have a sufficient protectible interest by measuring their interest in the corporation against the interest of all other shareholders.[112]

In view of the fact that Section 2115 is directed at protecting California shareholders and creditors,[113] it seems appropriate that the corporation have a sufficient number of California shares before being required to comply with California regulations. However, it should be noted that the shareholder residence test may be defeated by the execution of a voting trust agreement in a jurisdiction other than California. Because

108. *See* 1 MARSH & VOLK, *supra* note 74, at §7.06[4], [5].

109. CAL. CORP. CODE §25103(b), (c).

110. Regulation under securities laws is less onerous because securities transactions occur less frequently than other types of corporate activities. Consequently, it appears that a foreign corporation with less than 50 percent but more than 25 percent of its shares held by persons having California addresses will not be subject to the provisions regulating corporate internal affairs, but will be subject to securities laws whenever applicable.

111. *New* CAL. CORP. CODE §2115(a).

112. *New* CAL. CORP. CODE §2115(a).

113. CALIFORNIA LEGISLATURE, ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE, REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE 106 (Dec. 1, 1975); *see generally* Comment, *California's New General Corporation Law: Prospects for Minority Shareholders*, this volume at 706 (concerning minority shareholders).

the shareholder of record would be a trustee outside of California, the records of the corporation would show less than 50 percent of its securities as belonging to California residents. Should this occur, it seems arguable that California would no longer have a substantial interest in protecting its resident shareholders, negating the application of Section 2115 to the foreign corporation.[114]

C. Administration of Section 2115

One of the problems with the former judicial and administrative approach to regulation of quasi-foreign corporations was that a foreign corporation could never ascertain when California law would be deemed applicable, and furthermore, what would happen in the event that the corporation ceased having substantial California contacts. While the three-factor formula and the shareholder residence test embodied in the New Code appear to simplify questions concerning the *initial* application of California laws to foreign corporations, Section 2115 also establishes the administrative procedures necessary to alleviate uncertainty as to the *continuing* applicability of California law to the foreign and quasi-foreign corporation.

A foreign corporation must file an annual statement with the Secretary of State on a form supplied by that office[115] if it has qualified to transact intrastate business within California.[116] The statement must include the percentage of the corporation's outstanding voting securities held of record as of the last shareholders' meeting by persons having California addresses,[117] and some indication as to the amount of business conducted in California.[118] The latter requirement may be met by stating that all of the income of the corporation was taxable for California franchise tax purposes, or would have been taxable had there been sufficient income to tax, or alternatively, by stating the property, payroll and sales factors as computed under Section 2115.[119] The effect of this report is not to have any bearing on the corporation's method of preparing reports of its income for franchise tax purposes.[120] The

114. On the other hand, it seems reasonable that beneficial shareholders require the same protections as legal shareholders. Thus, a court could possibly look to substance over form and find that a voting trust may not defeat the shareholder residence test.

115. *New* CAL. CORP. CODE §2108.

116. A foreign corporation qualifies to transact intrastate business by procuring a certificate from the secretary of state pursuant to Section 2105 of the General Corporation Law of 1975. *New* CAL. CORP. CODE §2105.

117. See text accompanying note 112 *supra*.

118. *New* CAL. CORP. CODE §2108(a).

119. See text accompanying notes 101-105 *supra*.

120. Thus, the Franchise Tax Board apparently cannot press a foreign corporation to explain inconsistencies between the Section 2108 statement and the franchise tax return. This may reflect a recognition of the fact that separate books kept for tax purposes will not accurately reflect the corporation's contact with California.

failure of a foreign corporation to file a statement under Section 2108 of the New Code within six months after notice has been given that the statement is delinquent will result in the Secretary of State forfeiting the right of the corporation to transact intrastate business in California.[121]

A foreign corporation is subject to California law only after the Section 2108 statement shows, or a court of competent jurisdiction after a judicial review of the facts finds, that the Section 2115 tests have been met.[122] If the corporation is uncertain as to the applicability of Section 2115 upon an original filing of a Section 2108 statement, it presumably may file an action for declaratory relief against the Secretary of State to obtain a judicial ruling on the Section 2115 tests. If during the fiscal year in which the Section 2108 statement has been filed a foreign corporation believes that it no longer meets the criteria in Section 2115(a), it may submit a later Section 2108 statement indicating the change in status, or it may file an action for declaratory relief alleging that one of the tests is no longer met.[123] In any case, if the Section 2115 tests *are* met, a corporation will become subject to California law on the first day of its first fiscal year[124] in California, which commences on or after the 30th day past the date of the filing of the statement.

A foreign corporation is subject to Section 2115 until its fiscal year has ended, *and* either a subsequent statement has been filed, or a court order procured showing that at least one of the Section 2115 tests is no longer met. However, if a contrary statement or court order is filed before the end of the fiscal year, a prior finding that the corporation is not subject to Section 2115 will be ineffective.[125] The effect of this rule is to subject a foreign corporation to Section 2115 for at least one fiscal year if it originally qualifies under the Section 2115 tests. The corporation will not be able to disqualify itself until the end of the fiscal year, eliminating any uncertainty as to the application of Section 2115. To alleviate uncertainty beyond the current fiscal year, the corporation may seek a court order stating that, as of the next fiscal year, California law will no longer be applicable to it.[126]

In summary, Section 2115 provides a reasonably certain and definite test as to when foreign corporations will be subject to California corpo-

121. *New* CAL. CORP. CODE §2108(d).
122. *New* CAL. CORP. CODE §2115(c).
123. *New* CAL. CORP. CODE §2115(d).
124. *New* CAL. CORP. CODE §2115(c). "First fiscal year" refers to the first year of operation in California. While the corporation may be running on another fiscal year for tax or accounting purposes, its fiscal year for regulatory purposes *begins* 30 days after the Section 2108 statement has been filed.
125. *New* CAL. CORP. CODE §2115(d).
126. *New* CAL. CORP. CODE §2115(d).

ration laws by utilizing a three-factor formula and a shareholder residence test as measures of state interest in regulating the corporation's internal affairs. In addition, the corporation is subject to Section 2115 for at least one year after it files a Section 2108 statement showing that both tests have been met, but may, during that year, take action to relieve itself of California regulation by filing another Section 2108 statement or obtaining declaratory relief indicating that one of the tests is no longer met. By providing an apparently simple and thorough determination of state interest in foreign corporations, the legislature seems to have resolved the uncertainties which arose after the *Western Air Lines* decision, while maintaining a modicum of protection for California shareholders and creditors.

CONSTITUTIONAL RAMIFICATIONS

Section 2115 represents a radical departure from the usual state corporation law provisions because it, in effect, converts a corporation incorporated in State X into a California corporation for certain purposes. This legal metamorphosis, based on the rationale that California has the dominant interest in regulating quasi-foreign corporations, raises potential constitutional obstacles. While an exhaustive analysis of the constitutional issues raised by Section 2115 is beyond the scope of this comment, the following discussion will attempt to highlight some of the major questions posed by the application of California law to quasi-foreign corporations.

In general, the states' power to regulate foreign corporations has been limited by five constitutional doctrines, including prohibitions against the imposition of an "unconstitutional condition" on foreign corporations seeking admission to do business in a state, the creation of a burden on interstate commerce, the violation of due process standards, the violation of the full faith and credit clause, and the violation of the foreign corporation's right to equal protection. Although there have been no cases concerning the constitutional ability of a state to regulate the internal affairs of *quasi*-foreign corporations, decisions regarding each of the five limitations on the states' power to regulate *foreign* corporations may be examined and applied to Section 2115 to indicate how the section might fare if subjected to constitutional challenge in the courts.

A. The Doctrine of "Unconstitutional Conditions"

Section 2115 imposes a condition upon the admittance of quasi-foreign corporations to do business in California by requiring them to comply with specified provisions of the New California Corporations Code.[127] This condition is more onerous than the typical qualification provisions regarding registration and taxation of foreign corporations, because it establishes a minimum level of corporate conduct that must be adhered to for the privilege of doing business in California. The ultimate issue thus concerns the power of a state to limit or condition entry of foreign corporations into intrastate business. It is well settled that a state has broad power to exclude or admit foreign corporations wishing to do business within its territory;[128] however, that power is limited to the extent that the conditions imposed by the state cannot be unconstitutional.[129] The doctrine of "unconstitutional conditions"[130] consequently prohibits a state from imposing any condition on a foreign corporation that would require the corporation to surrender a constitutional or congressionally granted right for the privilege of doing business within the state.[131] The doctrine has typically been expressed when a foreign corporation has been given permission to do business in a state only after it has agreed not to remove actions to federal court.[132] Because the state requires the corporation to give up a right granted to all citizens by Congress, its statute is said to be "repugnant to the Constitution and laws of the United States" and is therefore invalid as an unconstitutional condition to admittance.[133] With respect to Section 2115, the doctrine of unconstitutional conditions would arguably apply only if a Constitutional or Congressionally-granted right was given up for the privilege of doing business in California. It appears that, while the quasi-foreign corporation may be giving up privileges accorded it by the state of incorporation, they are only privileges and not federal rights. Consequently, conditions imposed on the admission of foreign corporations, which, because of their contact with California, will be subject to California law, appear to be constitutionally valid.

B. Commerce Clause Ramifications

It is well established that a state cannot interfere with interstate

127. See note 3 *supra.*
128. *See* Paul v. Virginia, 75 U.S. 168, 181 (1868); Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 443 (1968).
129. G. HENDERSON, THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW 134 (1918) [hereinafter cited as HENDERSON].
130. For a discussion of the doctrine of "unconstitutional condition," see *id.* at 132-47.
131. Insurance Co. v. Morse, 87 U.S. 445, 455-57 (1874), Layfayette Ins. Co. v. French, 59 U.S. (18 How.) 404, 407 (1855), 87 U.S. at 454-55.
132. *See id.* at 454, 457; Wheeling Steel Corp. v. Glander, 337 U.S.562, 571 (1949); State of Washington *ex rel.* Bond & Goodwin & Tucker v. Superior Court, 289 U.S. 361, 365 (1933); Williams v. Standard Oil Co. of La., 278 U.S. 235, 241 (1929); Hanover Fire Ins. Co. v. Harding, 272 U.S. 494, 507 (1926).
133. Insurance Co. v. Morse, 87 U.S. 455, 457 (1874).

commerce in regulating foreign corporations,[134] and local qualification provisions have been challenged on this basis.[135] The requirement that a foreign corporation conducting solely interstate commerce register in a state in which it does business has been said to be invalid because it subjects interstate commerce to local regulation.[136] Consequently, Section 2115, if applied to a corporation conducting solely interstate business, may transgress the Commerce Clause insofar as it would subject such a corporation to local corporation laws.

To determine the applicability of Section 2115 to interstate corporations, one must look to Section 2100 of the New Code which states that the provisions of Chapter 21 relating generally to foreign corporations and including Section 2115, are applicable only to foreign corporations "transacting intrastate business" in California except as otherwise expressly provided.[137] "Transacting intrastate business" is defined[138] to mean that a foreign corporation enters into "repeated and successive transactions of its business" in California, expressly excluding *interstate* or foreign commerce as being intrastate in nature.[139] Thus, from the definitional language of the statute, it appears that purely interstate corporations that transact *no* "intrastate" business in California as defined in the New Code are not subject to California law.

Under California's definition of interstate corporations, corporations that conduct business in other states, as well as in California, are treated as intrastate in nature, a fact that directs the present inquiry to the issue of whether Section 2115, by inhibiting such foreign corporations from transacting business in California for fear of being subject to California regulation, burdens interstate commerce. The United States Supreme Court has applied a balancing test when examining state statutes that regulate intra- and interstate commerce, and has held that:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.[140]

134. *See* Eli Lilly & Co. v. Sav-On-Drugs, Inc., 366 U.S. 276, 278 (1961); Note, *State Regulation of Foreign Corporations: Qualifications: Interstate v. Intrastate Business:* Eli Lilly & Co. v. Sav-On Drugs, Inc., 366 U.S. 276 (1961) 47 CORNELL L.Q. 300, 301-02 (1962).
135. *See* 366 U.S. at 277.
136. *See id.* at 278; Note, *State Regulation of Foreign Corporations: Qualifications: Interstate v. Intrastate Business:* Eli Lilly & Co. v. Sav-On Drugs, Inc., 366 U.S. 276 (1961), 47 CORNELL L.Q. 300, 301-02 (1962).
137. *New* CAL. CORP. CODE §2100.
138. *New* CAL. CORP. CODE §191(a).
139. *New* CAL. CORP. CODE §191(a).
140. Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

Section 2115 represents a legislative determination that California has a public interest in protecting its shareholders from potential abuses by foreign corporations. Nevertheless, this local public policy interest must be weighed against the burden that Section 2115 creates on interstate commerce. The Supreme Court has upheld state statutes requiring foreign corporations to obtain a permit to engage in intrastate business even though the corporation may at the same time be engaged in interstate commerce.[141] These statutes, however, have not had the potential regulatory scope that Section 2115 appears to have, and therefore may be distinguishable. However, in light of the fact that Section 2115 applies to foreign corporations conducting intrastate commerce, that intrastate regulations touching upon interstate commerce have been sustained in the past,[142] and that the states possess broad police power to regulate foreign corporations,[143] it appears that Section 2115 could withstand any assertion that it unconstitutionally burdens interstate commerce.

C. Due Process

To meet due process requirements when regulating foreign corporations, a state must establish that it has a sufficient governmental interest to justify application of its laws.[144] In general, "a state is without power to exercise 'extraterritorial jurisdiction' [over] activities wholly beyond its boundaries."[145] The standard which appears to be applied in cases involving due process considers whether the forum state has a sufficient governmental interest to justify its action.[146] If it is not established that California has a sufficient and sustained interest in a quasi-foreign corporation before compelling it to adhere to the required level of corporate conduct, the provision will be invalid as violating the quasi-foreign corporation's right to due process because there will be insufficient basis for legislative jurisdiction. As discussed above, Section 2115 does not apply California law to a foreign corporation until half of its business is conducted within the state and half of the shares are held of record by persons having California addresses.[147] This test indicates that the relationship between the corporation and the state is such that

141. *See* Eli Lilly & Co. v. Sav-On Drugs, 366 U.S. 276 (1961).
142. *Id.*
143. Paul v. Virginia, 75 U.S. 168 (1868).
144. *See* Home Ins. Co. v. Dick, 281 U.S. 397, 408-10 (1930); Weinstein, *Problems in the Field of State Securities Regulation*, 3 B.C. IND. & COM. L. REV. 381, 386 (1962).
145. *See* Watson v. Employers' Liab. Assur. Corp., 348 U.S. 66, 70-71 (1954).
146. Home Ins. Co. v. Dick, 281 U.S. 397, 408 (1930); Weinstein, *Problems in the Field of State Securities Regulation*, 3 B.C. IND. & COM. L. REV. 381, 386 (1962).
147. See text accompanying notes 97-114 *supra*.

the state has a substantial governmental interest in regulating the corporation to minimize the threat of harm to local shareholders and creditors. Section 2115 becomes applicable to a foreign corporation only after it has conducted *repeated and successive* transactions of its business and has registered 50 percent of its voting securities to persons with California addresses.[148] Based on these two criteria, the application of Section 2115 to foreign corporations appears not to violate the principle that the state must have a sufficient and sustained interest in the corporation before subjecting it to California law.

D. *Full Faith and Credit*

There has been much academic discussion concerning the possibility that the full faith and credit clause may require a state to give full faith and credit to the corporation statute of the incorporating state and refrain from applying its own laws to the internal affairs of foreign corporations.[149] The full faith and credit clause has been used by the Supreme Court to avoid actual conflicts between different state regulatory schemes,[150] the resolution of such conflicts being provided by the constitutional command that a state recognize the "public acts, records and judicial proceedings of every other state."[151] The cases in which the full faith and credit clause has been utilized, however, have not dealt with the problem of the quasi-foreign corporation and do not appear to be applicable to the particular problems of this type of business entity.[152] However, the cases have indicated that full faith and credit must be given to another state's corporation statutes when the dispute in the forum state is peculiarly within the incorporating state's regulatory power.[153] The commentators have equated this requirement with a due process test mandating sufficient state interest in order to satisfy the full faith and credit clause.[154] As discussed above, Section

148. See text accompanying notes 97-114 *supra.*

149. Kaplan, *Foreign Corporations and Local Corporate Policy,* 21 VAND. L. REV. 433, 445 & n.32 (1968) [hereinafter cited as Kaplan]; *see also* Baraf, *The Foreign Corporation—A Problem in Choice-of-Law Doctrine,* 33 BROOK. L. REV. 219, 240 (1967) [hereinafter cited as Baraf]; Reese and Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit,* 58 COLUM. L. REV. 1118, 1129 (1958) [hereinafter cited as Reese and Kaufman].

150. Baraf, *supra* note 149, at 240.

151. U.S. CONST. art. IV, §1.

152. The cases have generally concerned workers' compensation or fraternal benefit insurance associations. As to workers' compensation, full faith and credit has been equated with due process, and as to the fraternal benefit cases, the reasoning has been narrowly confined to those types of organizations and does not appear applicable to commercial corporations. *See generally* Baraf, *supra* note 149, at 240-47; Kaplan, *supra* note 149, 445-60; Reese and Kaufman, *supra* note 149, at 1129-43.

153. Converse v. Hamilton, 224 U.S. 243, 260 (1912).

154. *See* Kaplan, *supra* note 149, at 447; Baraf, *supra* note 149, at 242; and Reese and Kaufman, *supra* note 149, at 1130.

2115 does not violate due process because it is applied only after a substantial connection with California has been demonstrated to exist. Therefore, it appears that full faith and credit need not be afforded to the corporation laws of the state of incorporation by California when it regulates quasi-foreign corporations.

E. Equal Protection

The final limitation on state regulation of foreign corporations requires that a state afford foreign corporations within its borders equal protection of the laws.[155] Prior to admitting a foreign corporation, however, a state may impose more onerous conditions than it does on domestic corporations.[156] The test used to determine whether unconstitutional discrimination has taken place in areas involving economic regulation is whether or not there is any rational basis for the different treatment.[157] Thus, despite their discriminatory nature, statutes that impose conditions on the admission of foreign corporations would apparently be constitutional if based upon a policy of protecting local shareholders and creditors.[158] Once admitted, however, foreign corporations may not be treated differently than domestic corporations.[159] Section 2115 appears incapable of being construed as treating foreign corporations differently than domestic corporations. In fact, if a foreign corporation becomes subject to California laws under Section 2115, it is subject only to certain specified provisions applicable to all domestic corporations. Consequently, no basis for a denial of equal protection appears to exist.

As between foreign corporations and quasi-foreign corporations, there is discrimination because the foreign corporation is not subject to California laws. However, a quasi-foreign corporation by definition has a significant number of its shares held by persons having California addresses. The holders of such shares should be protected by the exercise of the state's police power. That quasi-foreign corporations are discriminated against in the exercise of that police power appears not be unconstitutional, since the shareholder residence test and three-factor formula embodied in Section 2115 assure a rational basis for the application of California law.

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155. Wheeling Steel Corp. v. Glander, 337 U.S. 562 (1949).
156. Lincoln Nat'l Life Ins. Co. v. Read, 325 U.S. 673, 676-77 (1945).
157. Morey v. Doud, 354 U.S. 457, 465 (1957).
158. For discussion of a state's policy of protecting shareholders and creditors, see text accompanying notes 6-23 *supra*.
159. WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117, 119 (1968).

Conflict of Laws

Section 2115 appears to pose inherent conflict-of-laws questions in that foreign corporations may be subject to more than one state's corporate regulatory scheme. Because the conflict-of-laws field tends to be uncertain, no one solution has been recognized as having universal application to every fact situation. However, certain theories and approaches have received attention by the commenators, necessitating discussion of these ideas in relation to Section 2115.

The conflict-of-laws problems arises when a Delaware corporation conducting its business in California such that it qualifies as a quasi-foreign corporation becomes subject to both Delaware and California law. If Delaware has a different regulatory philosophy than California, the forum court might be forced to make a choice between two competing corporate statutory schemes. Before such a choice can be made, however, it is necessary to determine whether a true conflict exists between the laws of the interested states.[160]

Professor Currie's analysis divides choice-of-law considerations into *false conflicts* problems, which reveal that while an ostensible conflict between two policies may exist, only one state has a truly legitimate interest in the outcome of the litigation, and *true conflicts* problems, in which two or more states have a legitimate interest in the outcome of the litigation.[161] The false conflict situation is easily resolved by applying the law of the interested state.[162] In contrast, Currie states that where both states have a legitimate interest in seeing their corporation laws applied, the conflict-of-laws problem cannot be solved without subordinating one of the two competing state interests,[163] and the issue turns to which law should be subordinated.

If the suit is commenced in California, Section 2115 operates as a legislative directive that the court should apply California law to the

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160. *See* B. CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 189-90 (1963) [hereinafter cited as CURRIE].

161. *Id.*

162. CURRIE, *supra* note 160, at 189. Hypothetically speaking, a situation in which a Delaware corporation meeting the criteria of Section 2115 and faced with an action in a Delaware court may give rise to a false conflict situation. In such a case, the Delaware court could find that the forum state has no interest other than a pecuniary interest stemming from the generation of franchise taxes and fees, especially in light of that corporation's substantial activities in California. Hence, a false conflict would exist. On the other hand, the Delaware court may find that the legislative intent underlying the Delaware corporation law is of a sufficient interest (i.e. to permit flexible corporate action to benefit the business world or to attract persons to serve on corporate boards) so as to take the lawsuit out of the false conflicts area and place it into a true conflicts characterization.

163. *Id.* at 190.

exclusion of the laws of the state of incorporation.[164] On the other hand, if the suit is brought in the state of incorporation and no statutory choice-of-law directive exists in that state's general corporation law, the forum court must determine whether it should apply its own law to its own corporation based on the fact that the corporation is domestic, or apply California law because California may have the predominant state interest.

There may be an initial question as to whether a California shareholder would ever have the desire or need to bring suit in a jurisdiction other than California. Yet such a situation could conceivably arise when no means of obtaining jurisdiction over necessary parties exists in California. For example, a case could arise in which a derivative suit is brought by a California shareholder of a New Jersey corporation against a corporate director to recover an unlawful dividend distribution. The corporation, if found to be a quasi-foreign corporation under Section 2115, would be subject to California law regarding distribution of assets, giving the plaintiff a cause of action against the directors for approving such action.[165] If the director was not amenable to suit within California, the action would presumably have commenced in New Jersey as the state of incorporation. Assuming that the action is commenced in New Jersey, the above case may illustrate the classic "true conflict" situation. The New Jersey defendant may be precisely the person that the New Jersey laws were designed to protect;[166] similarly, the California law was clearly designed to protect the California shareholder.[167]

If the forum state has no statutory directive similar to California's, there are two basic approaches to the true conflicts problem, one stemming from Professor Currie's governmental interest analysis,[168] the other following the orientation of the Restatement Second, Conflict of Laws, which looks to the law of the state having the "most significant relationship" to the matter at issue.[169]

164. *New* CAL. CORP. CODE §2115(b); *see* RESTATEMENT (SECOND), CONFLICT OF LAWS §6(1) (1971).

165. *New* CAL. CORP. CODE §§500-505, 309, 316 as applied through *New* CAL. CORP. CODE §2115(b).

166. The New Jersey corporate policy is explicit: the corporation laws of New Jersey are to be interpreted in as liberal a manner as possible in order to encourage incorporation in the state. N.J. STAT. ANN. 14A, at xi (1968) (*N.J. Corporation Law Revision Commission, Report on the New Jersey Corporation Law*).

167. California's policy seems just as explicit: California shareholders and creditors are to be protected from the activities of quasi-foreign corporations by subjecting such corporations to specified provisions of the New California Corporations Code. CALIFORNIA LEGISLATURE, ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE, REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE 106 (Dec. 1, 1975).

168. CURRIE, *supra* note 160, at 188-89.

169. RESTATEMENT (SECOND), CONFLICT OF LAWS §§6, 145, 188, 270(b) (1971).

The first approach, Currie's governmental interest analysis,[170] suggests that once the forum court has determined that a true conflicts situation has arisen, it should apply its own law to the facts of the case. Thus, if the New Jersey court in the hypothetical suit against the director were to follow Currie's approach, it would first determine that California and New Jersey have competing interests in regulating the action of corporate directors, and would then apply New Jersey law in reaching its final decision. The rationale behind this approach is based on the concept that the rational pursuit of self-interest is preferable to irrational altruism, and that it is not a court's function to balance policies established by the legislature.[171] Currie asserts that since no traditional choice-of-law rule appears to predictably solve the true conflicts problem, a state is best off applying its own law, instead of attempting to further the interests of another state by applying that state's law.[172] While governmental interest analysis solves the problem of which law to apply, it fails to deal with the more basic problem of choosing the corporate ideology best suited to an equitable solution of the case. Governmental interest analysis suggests that the forum state automatically subordinate the interests of another state to its own interest, without regard to the legitimate policies articulated in the other state's corporation law.[173] Thus, if a director of a New Jersey corporation subject to Section 2115 violates California law, he might be able to escape liability because of a choice-of-law rule subordinating an arguably more compelling policy protecting shareholder interests. Consequently, governmental interest analysis appears to be a less desirable choice-of-law method in corporate conflict-of-laws problems.[174]

The second approach to the true conflicts situation attempts to apply the law of the state having the "most significant relationship" to the matter at issue.[175] In choosing between two competing regulatory philosophies, the Restatement Second, Conflict of Laws suggests that the forum court consider certain criteria in deciding true conflict of laws problems.[176] Such factors include the forum court's corporate policies,

170. CURRIE, *supra* note 160, at 188-89.
171. *Id.* at 182.
172. *Id.* at 191.
173. It may be argued that the state court has no business examining the corporate policies of another state for its possible use because such examinations constitute a legislative, rather than judicial, function. However, if the court is faced with a true conflicts situation, without legislative direction, it must come to a decision based upon its notions fairness and equity. Consequently, a true usurpation of the legislative function could arguably occur only where the legislature has been silent on the conflicts problem.
174. Interestingly, Currie recognizes that his approach is not a true solution to the problem. He suggests that Congress step in to resolve the conflict. CURRIE, *supra* note 160, at 272.
175. RESTATEMENT (SECOND), CONFLICT OF LAWS §§6, 145, 188, 270(b) (1971).
176. RESTATEMENT (SECOND), CONFLICT OF LAWS §6 (1971).

the corporate policies of the state in which the corporation is considered quasi-foreign, the protection of the justified expectations of the parties, and the certainty and uniformity of results in subsequent cases.[177]

In determining the importance of the forum's corporate policies, a court should examine the purposes for which the particular corporate provisions were enacted and whether they were intended to be applied to out-of-state facts. When a domestic corporation subject to the forum state's laws is also subject to California laws as a quasi-foreign corporation, the forum court should ascertain the purposes underlying the regulation of corporate activity, which calls for an examination of the philosophy of the corporate regulations. The court may find that the legislative purpose of a particular provision is to encourage local incorporation to generate revenue from franchise fees, or that the demands of the modern business world dictate a flexible regulatory scheme to enhance corporate competition.

At the other end of the spectrum, the court might determine that shareholders and creditors should be protected from questionable practices by corporations, or that corporations should be forced to maintain certain minimum standards of conduct as a condition of existence. Once the local policy has been ascertained, the forum court should determine if the policy was intended to apply to the corporation regardless of where it conducts its business. If the purposes sought to be achieved by a local corporation statute would be furthered by its application to out-of-state transactions, there is good reason why the forum may apply its own law.[178] On the other hand, if no such purpose can be found, the state is under no duty to apply its law.[179] However, the interstate nature of many corporations would seem to require application of a state's corporation law regardless of where the transaction or event occurred. Otherwise, there would be no effective regulation of corporation activity unless that activity was local in nature. Thus, while no specific legislative intent may be found to support a corporation statute's application to an out-of-state situation, the forum court could reasonably find its law applicable to a corporation regardless of where the activity occurs.

The Restatement also states that the forum court should consider the regulatory philosophy of other interested states.[180] Since Section 2115 subjects certain foreign corporations to minimum standards

177. *Id.*
178. RESTATEMENT (SECOND), CONFLICT OF LAWS §6, at 14 (Comment *e*) (1971).
179. *Id.*
180. RESTATEMENT (SECOND), CONFLICT OF LAWS §6(2)(c) (1971).

of corporate conduct in California, California's policy of protecting shareholders and creditors should be recognized and compared to the policies established by the forum court's legislature.

Another Restatement factor directs the forum court to determine what the justified expectations of the parties were when they incorporated in the forum state while intending to conduct business in California.[181] It would be unfair and improper to hold a person liable under the local law of one state when he had justifiably molded his conduct to conform to the requirements of another state.[182] However, the forum court should determine whether the parties complied with the conduct required in the state where they intended to do business, or instead, intended to rely upon the standards of the state of incorporation as guidance for their activities. Such a determination could shed light on the justified expectations of the parties, and should purposeful evasion of one state's corporation laws become apparent, the lack of good faith should be a weighty factor in determining which state law to apply.

Predictability and uniformity of results by the courts in general is another Restatement factor the forum court should weigh in determining which corporation law to apply.[183] Where people give advance thought to the legal consequences of their transactions, particularly in the corporate field, predictability and uniformity of result in court decisions is of critical importance. Business in general is conducted under the assumption that the law will demand certain and predictable types of performance in the future. Thus, a plaintiff before the forum court, urging application of California laws, could reasonably argue that a corporation subject to Section 2115 should be subject to California law when the facts indicate that no uncertainty exists as to the applicability of California law. On the other hand, the defendant could argue that since the forum court is dealing with a domestic corporation, if it applied foreign law, it would disrupt local corporate practices because of the uncertainty engendered by the application of local law to transactions occurring outside the state.[184] In addition, the defendant could argue that application of foreign law in an area regulated by the state legislature may be a violation of the separation of powers at the state level. However the arguments are articulated, the forum court will have to weigh the impact of applying California law

181. *See* RESTATEMENT (SECOND), CONFLICT OF LAWS §6(2)(d) and Comment *g* (1971).
182. RESTATEMENT (SECOND), CONFLICT OF LAWS §6, Comment *g* (1971).
183. RESTATEMENT (SECOND), CONFLICT OF LAWS §6, Comment *i* (1971).
184. See text accompanying notes 115-126 *supra*.

to its own corporations through Section 2115 against the impact application of its law will have on *California* policy. Again, the court must engage in a balancing of the state policies.

In general, it can be said that the Restatement approach appears to provide a less mechanical method for determining the appropriate law to be applied by the forum court than does Professor Currie's governmental interest analysis approach. From a pragmatic standpoint, however, it does not seem likely that a foreign court would apply California law to one of its own corporations, regardless of the interest California may have in the outcome. In whatever manner the forum court articulates a "balancing of state policies", the realistic attorney should expect that the forum court would come to the decision it finds to be in its best interests on a case by case basis. Consequently, there appears to be no current approach that can give a reliable indication of which law will be applied in any given true conflicts problem.

CONCLUSION

California has had a continuing policy of protecting its shareholders and creditors from foreign corporations incorporating outside of California but returning to establish their corporate domiciles. The concept of the quasi-foreign corporation was judicially evolved in response to this phenomenon to compel corporations doing a substantial amount of their business in California to comply with the California corporation law. After World War II, the regulatory function was shifted to the Commissioner of Corporations through his broad power over the issuance of securities. Because the decision in *Western Air Lines v. Sobieski* made the standards for finding a corporation to be a quasi-foreign too nebulous, the regulatory power of the Commissioner was substantially limited in the Corporate Securities Law of 1968. Between 1968 and 1975, however, statistics from the Department of Corporations indicated that there had been a tremendous increase in the number of small or intermediate-sized foreign corporations seeking to issue securities in California. In response to this influx of foreign corporations, Section 2115 of the New General Corporation Law has been enacted to provide that if a foreign corporation conducts half of its business in California and has half of its shares held of record by persons with California addresses, it will be subject to specified provisions of the California corporation law to the exclusion of the laws of the state of incorporation. Section 2115 does not appear to present constitutional problems, but may create uncertainty if other states also claim an interest in regulating the quasi-foreign corporation. In such situations, the forum court will have to determine if a true conflict arises and then apply the law of the state having the most substantial interest in regulating the corporation. On the whole, Section 2115 appears to be a step in the direction of increasing corporate accountability to shareholders and creditors, but its ultimate impact on the business community in California should be reassessed if future events demonstrate that uncertainty and frustration in corporate planning outweigh any danger to shareholders and creditors.

Douglas E. Noll