

# FEDERAL CORPORATE LAW, FEDERALISM, AND THE FEDERAL COURTS

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## INTRODUCTION

In the past several years there has been a resurgence in the movement for more federal regulation of the internal affairs of the nation's most powerful corporations.<sup>1</sup> The proposals, described below, to effect such a change raise questions ranging from basic issues of federalism to mechanical jurisdictional problems. For example, Professor Cary's proposal to create federal fiduciary standards for the managers of such corporations, to confer mandatory and exclusive jurisdiction over cases involving such standards upon state courts, and to subject such courts to review by lower federal courts,<sup>2</sup> involves a relationship between state courts and the federal government arguably unprecedented in our 200 years under the Constitution. An example of a more mundane problem is the possibility that exclusive federal chartering—another proposed, less likely, and more drastic form of federalization of corporate law—might well result in the abolition of a large amount of diversity jurisdiction.<sup>3</sup> For those primarily interested in the quality of corporate justice, even nonconstitutional jurisdictional questions have a subtle but vital importance. An argument can be made, for example, that in order to insure the highest quality of justice under new federal corporate law,<sup>4</sup> suits under some of its provisions should be cognizable exclusively in the federal courts.<sup>5</sup> These and other issues of federalism connected with federal corporate law proposals are the subject of this article.

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1. See, e.g., R. NADER, M. GREEN, & J. SELIGMAN, *TAMING THE GIANT CORPORATION* (1976); Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 *YALE L.J.* 663 (1974); Henning, *Federalism and Corporate Law: The Chaos Inherent in the Cary Proposal*, 3 *SEC. REG. L.J.* 362 (1976); Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 *VAND. L. REV.* 433 (1968); Note, *Federal Chartering of Corporations: A Proposal*, 61 *GEO. L.J.* 89 (1972); *Corporate Rights and Responsibilities: Hearings Before the Senate Committee on Commerce*, 94th Cong., 2d Sess. at 57 (1976) [hereinafter cited as *Hearings*] (Statement of A. A. Sommer).

For a sampling of earlier consideration of federal incorporation see NADER, *supra* at 65-71, and authorities cited in Kaplan, *supra* at 480-81 n.127.

2. Cary, *supra* note 1, at 700-05.

3. See discussion part IB2b *infra*.

4. To be distinguished from the federal corporate law currently existing under the federal securities law, but recently circumscribed by the Supreme Court. See note 101 *infra*, and accompanying text.

5. See discussion part IB1b *infra*.

My interests run both to the study of federalism and to that of corporation law. What follows immediately in this introduction, for those who join me only in the former interest, is first, a description of the current state-law dominated system of regulating the internal affairs<sup>6</sup> of national corporations and, second, a sketch of current proposals for increasing the regulatory role of the federal government.

### A. Current Regulation

Federal deference to state regulation characterizes the current system of regulating the internal affairs of corporations with substantial interstate connections. By "internal affairs" is meant those matters concerning domestic corporations which states typically purport to govern by their business corporation laws.<sup>7</sup> While such laws vary in content from state to state, they all deal primarily with various relationships among shareholders, directors, and officers and to a lesser extent with the relationship of such groups to third parties, particularly creditors. With the exception of matters concerning the internal affairs of a very few corporations, such as national banking associations which hold federal charters,<sup>8</sup> the federal government has not chosen to make law governing the internal affairs of private business corporations, no matter how extensive their connections with interstate commerce.

The concept that a person is subject to full in personam jurisdiction only in a state where he is present or domiciled ultimately leads to tension with the original conception of a corporation as a person located only in the state that issued its corporate charter.<sup>9</sup> As long as corporations were, for the most part, active only in the commerce of their chartering states,<sup>10</sup> the tension was more theoretical than real. With the advent of numerous corporations active in interstate commerce, their national nature was sensed by the courts, if not clearly understood. Unlike natural persons, such corporations not only could be, but were, "present" in several places at the same time.<sup>11</sup> Where such presence was substantial, courts found additional forums with full in personam jurisdiction.<sup>12</sup>

Conceptually, matters might have proceeded differently. A corporation's

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6. By "law governing internal affairs," I mean the law which determines the rights and duties of officers, directors, and shareholders *inter sese*. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 301-13 (1971) observe the distinction between laws governing the relationship of a corporation to the external world and the law governing internal affairs. *See id.* § 313 Comments a & b. *Compare id.* § 301 with §§ 302-10.

7. *See* note 6 *supra* and accompanying text.

8. 12 U.S.C. §§ 21-24 (1970 & Supp. V 1975).

9. *See* E. DODD, AMERICAN BUSINESS CORPORATIONS 51 (1954).

10. *Id.* at 179.

11. *See* *International Shoe Co. v. Washington*, 326 U.S. 310 (1945). The concept of multiple presence developed slowly. *See* R. FIELD & B. KAPLAN, MATERIALS FOR A BASIC COURSE IN CIVIL PROCEDURE 677-79 (1973); DODD, *supra* note 9, at 51, 174-78.

12. *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

substantial presence in two or more states might have been made an operative fact triggering a federal scheme of internal affairs regulation. No such choice was made and, as a result, at least theoretical choice-of-law questions arose. Two or more state forums having general in personam jurisdiction over any corporation had, as an apparent consequence, shared power to render judgments affecting its internal affairs. What limitations of reasonableness, and even of constitutional law, are there upon the choices of law such forums may make in deciding matters of the internal affairs of a corporation?

The limitations imposed by reasonableness involve the needs for planning and for coherence.<sup>13</sup> Corporate shareholders, officers, and directors need to know in advance of certain actions what laws will govern such matters as whether preemptive rights exist, what is an appropriate record date for dividends, and whether shares can be voted cumulatively.<sup>14</sup> The need for coherence is distinct from the need for certainty. Even were it to be predictable in advance, the application of differing substantive laws to parts of certain transactions often would be undesirable. For example, the application of one state's cumulative voting rule and another's straight voting rule to different shareholders voting in the same corporate election of directors would lead to results undesirable under any theory.

Such potential conflict-of-laws problems have rarely caused difficulty. Courts which take jurisdiction of suits involving the internal affairs of a corporation incorporated in another state have sensed the need for certainty and coherence in the choice of such law and have used the bright-line solution of applying the law of the state of incorporation.<sup>15</sup> The exceptions are, for the

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13. See note 15 *infra*.

14. For an example of a provision creating preemptive rights see N.Y. BUS. CORP. LAW § 622 (McKinney 1963). For an example of a provision defining appropriate record dates see *id.* § 604 (McKinney 1963). For an example of a provision permitting cumulative voting see *id.* § 618 (McKinney 1963).

15. For the proposition that most American courts have followed this bright-line solution see Kaplan, *supra* note 1, at 440. RESTATEMENT (SECOND) OF CONFLICT OF LAWS generally accepts such a rule (§ 302(1) & (2)) arguing for it as follows in Comment c:

*Rationale.* Application of the local law of the state of incorporation will usually be supported by those choice-of-law factors favoring the needs of the interstate and international systems, certainty, predictability and uniformity of result, protection of the justified expectations of the parties and ease in the application of the law to be applied. Usually, application of this law will also be supported by the factor looking toward implementation of the relevant policies of the state with the dominant interest in the decision of the particular issue.

Uniform treatment of directors, officers and shareholders is an important objective which can only be attained by having the rights and liabilities of those persons with respect to the corporation governed by a single law. To the extent that they think about the matter, these persons would usually expect that their rights and duties with respect to the corporation would be determined by the local law of the state of incorporation. This state is also easy to identify, and thus the value of ease of application is attained when the local law of this state is applied.

In addition, many matters involving a corporation cannot practicably be determined differently in different states. Examples of such matters, most of which have already

most part, predictable and include suits involving the internal affairs of pseudoforeign corporations and other suits where the needs for certainty and coherence pale next to the forum's interest in applying its own corporate law.<sup>16</sup> Earlier in this century the Supreme Court occasionally invalidated, on constitutional grounds, a choice of law made by a state court; but there has never been a Supreme Court case invalidating a state's choice of the law to govern the internal affairs of a classical business corporation.<sup>17</sup> The absence of such a case may be attributable to state courts' faithfully employing the "law of the state of incorporation" conflicts rule. Had state courts not behaved so reasonably in choosing to apply to the internal affairs of a corporation the law of its chartering state, there would have been numerous serious challenges. Had the ability of shareholders, officers, and directors of interstate corporations to plan their actions in light of a certain and coherent set of rules ever been seriously jeopardized, interstate commerce in turn would have been severely harmed and the federal government would have had two options: The first would have been a federalization of the corporate law relating to such corporations; the second would have been to define federal constitutional limitations upon permissible choice of state corporate law.

The lack of a federal corporate law to govern the internal affairs of interstate corporations—at least the largest of them—seems a result of the evolution of this country's commerce. In the early days of the Republic, corporations were largely intrastate enterprises.<sup>18</sup> Slowly more corporations became

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been mentioned in Comment a, include steps taken in the course of the original incorporation, the election or appointment of directors and officers, the adoption of by-laws, the issuance of corporate shares (see Comment f), the holding of directors' and shareholders' meetings, methods of voting including any requirement for cumulative voting, the declaration and payment of dividend and other distributions, charter amendments, mergers, consolidations, and reorganizations, the reclassification of shares and the purchase and redemption by the corporation of outstanding shares of its own stock.

*But see* Kaplan, *supra* note 1, at 476.

16. RESTATEMENT (SECOND) OF CONFLICT OF LAWS at § 302, Comment g. *See also* Western Airlines v. Sobieski, 12 Cal. Rptr. 719 (Cal. App. 1961).

17. An example of the Supreme Court's invalidation of a state's choice of law is Home Ins. Co. v. Dick, 281 U.S. 397 (1930). *See generally* R. J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS, Chapter 9 (1971). The theory of the cases invalidating states' choices of law has been predicated upon the due process or full faith and credit clauses, but not upon the commerce clause.

While the Supreme Court has never invalidated a state's choice of the law to govern the internal affairs of a classical business corporation, it has done something quite similar in the context of fraternal benevolent associations. In four cases decided between 1915 and 1948, the Supreme Court invalidated a state's refusal to apply to the internal affairs of such associations the law of their respective jurisdictions of organization or incorporation. Order of United Commercial Travelers of America v. Wolfe, 331 U.S. 586 (1947); Sovereign Camp of the Woodmen of the World v. Bolin, 305 U.S. 66 (1938); Modern Woodmen of America v. Mixer, 267 U.S. 544 (1925); Supreme Council of the Royal Arcanum v. Green, 237 U.S. 531 (1915). There is at least some doubt as to the continued viability of such cases, *see* R. J. WEINTRAUB, *supra* this note, at 410.

18. DODD, *supra* note 9, at 179.

truly interstate in operations. Because there never was a dramatic beginning of an age of interstate corporations, state regulatory schemes continued to govern them. As we have seen, the states have used the old models with ingenuity, developing their own unofficial federalism by means of parallel choice-of-law rules.<sup>19</sup>

Of course, we cannot conclude that the regulation of activities which developed gradually should be changed simply because the regulation would be different if the activities had developed all at once. A system designed for the regulation of corporations conceptually linked to particular states has been adjusted to permit a reasonably intelligent accommodation to the change in the nature of corporations. The development of the prevailing choice-of-law rule described above is evidence of that.

### B. Recent Proposals for More Federal Corporate Law

The current impetus for more federal corporate law has come entirely from those who feel that the current state-oriented system of regulating truly national corporations—those with substantial interstate operations and a nationwide shareholder constituency—is perverse.<sup>20</sup> The focus of the critics is not primarily upon the abstract abdication of federal responsibility inherent in the current state-oriented system, but rather upon how poorly the states have discharged their responsibility. Weak state substantive laws are seen as no accident. The current system is perverse not merely because it permits the states to regulate national corporations but also because it contains built-in incentives for the states to regulate in a way designed to ignore the interests of small investors.

Under the current system, except in unusual circumstances, the law of the state under which a corporation has been incorporated governs the relations *inter sese* of stockholders, directors, and officers.<sup>21</sup> There are no federal limitations determining in what state a business may incorporate; indeed a business may incorporate in a state where it has no connections of any sort.<sup>22</sup> While there are limitations upon the taxes which may be charged by a state where a corporation is not chartered,<sup>23</sup> a state is free to charge a corporation large

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19. See note 15 *supra*.

20. See, e.g., NADER, *supra* note 1, at 43-61, 246; Cary, *supra* note 1, at 663-92; Kaplan, *supra* note 1, at 437, 476-81; *Hearings, supra* note 1, at 57-58 (Statement of A. A. Sommer), 241-46 (Statement of H. Goldschmid), 333 (Statement of D. Vagts).

21. Kaplan, *supra* note 1, at 440. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 301-13 (1971).

22. See Kaplan, *supra* note 1, at 435 n.4 and accompanying text.

23. See, e.g., *Cudahy Packing Co. v. Hinkle*, 278 U.S. 460 (1928) (striking down a state's annual tax upon foreign corporations based upon their authorized capital stock). Taxes on foreign corporations must generally be apportioned to the amount of business done within the taxing state. *General Motors Corp. v. Washington*, 377 U.S. 436, 439-42 (1963), *reh. den.*, 379 U.S. 875 (1964).

annual fees for the privilege of holding a corporate charter and the concomitant benefit of having that state's laws rule its internal affairs.<sup>24</sup> Critics of the current system of regulation claim that those who control national corporations shop for corporate law favorable to them and that this, for the most part, means shopping for internal rules which benefit controlling interests by reducing the rights of small investors and others.<sup>25</sup> The rest of the tale, according to the critics, is that the sellers of corporate law are only too pleased to accommodate the buyers by continuously improving their product to make it competitively promanagement.<sup>26</sup> The competition among states to make their corporate laws attractive to the management has been described by a distinguished scholar of corporation law as "the race to the bottom."<sup>27</sup>

The common element of the proposed alternatives to the current system is a concern for the welfare of noncontrolling shareholders.<sup>28</sup> Some proponents of a larger federal role in the governance of national corporations would go further, extending corporate legal protection to employees, creditors, and society at large,<sup>29</sup> classes of persons who are the beneficiaries of few rights under current state business corporation law.<sup>30</sup> While the areas of substantive difference among the proponents' regulatory schemes suggest an infinite number of possible legislative packages, the structural differences suggest two models: (1) retention of the current system with some new federal regulation superimposed<sup>31</sup> or (2) exclusive federal chartering and comprehensive regulation of the internal affairs of national corporations.<sup>32</sup>

The proponents of more federal regulation agree that the most likely objects of such new laws are this nation's largest, most powerful corporations.<sup>33</sup>

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24. See DEL. CODE ANN. tit. 8, §§ 501, 503 (1975 & Supp. 1976) providing that only domestic corporations pay an annual franchise tax based upon authorized capital stock.

25. See NADER, *supra* note 1, at 663-70.

26. NADER, *supra* note 1, at 54-61; Cary, *supra* note 1, at 668-92.

27. Cary, *supra* note 1, at 705.

28. NADER, *supra* note 1, at 75-118, 254; Cary, *supra* note 1, at 902; Henning, *supra* note 1, at 362-67; Kaplan, *supra* note 1, at 478-80; Note, *supra* note 1, at 113-21; *Hearings*, *supra* note 1, at 58 (Statement of A. A. Sommer).

29. NADER, *supra* note 1, at 181-236, 245, 253-54.

30. See, e.g., DEL. CODE ANN. tit. 8 (Supp. 1971); N.Y. BUS. CORP. LAW (McKinney 1963); *Hearings*, *supra* note 1, at 57 (Statement of A. A. Sommer).

31. The main substantive features of Cary's proposal are presented in note 57 *infra*. Nader's proposal is also one of joint state-federal regulation. NADER, *supra* note 1, at 239-40. Indeed, while Nader proposes federal chartering, he proposes that state chartering be retained as well. *Id.* at 239-40.

32. See proposal of A. A. Sommer, note 59 *infra*.

33. Cary proposes that his scheme of partial federal regulation apply to all corporations having more than \$1 million in assets and 300 shareholders, noting that such a scope would parallel the American Law Institute's proposed Federal Securities Code. Cary, *supra* note 1, at 701. This selective test seems to be the product of practical political considerations since Cary states clearly that it might be preferable to apply his mode of regulation to "all public companies engaged in or affecting interstate commerce." *Id.* 702-03.

Other proponents seem satisfied with a fairly selective test for the selection of corporations to

References made below to "national corporations" are to this nation's wealthiest corporations whether defined with reference to *Fortune's* annual listing or by some other similar definition.<sup>34</sup>

This article does not deal with the question of whether state laws regulating national corporations are so inadequate substantively as to warrant federal intervention. That task has been performed admirably by others. Instead, this article deals with matters of jurisdiction and federalism which should be considered by any legislator who has preliminarily decided that some federal intervention is justified by the substantive inadequacy of state regulation.

Part I deals with a host of jurisdictional issues which would be raised by various proposals for more federal regulation. Because, for the most part, both the partial-regulation model and the total-federal-preemption model discussed above raise the same issues to different degrees, they will be discussed together except where context indicates separate discussion. Part II, the concluding portion of this article, deals briefly with problems of federalism which should to some extent influence the precise scope of any federal regulation proposed to remedy the inadequacy of state law.

## I

### JURISDICTION OF STATE AND FEDERAL COURTS UNDER A NEW FEDERAL CORPORATE LAW

#### A. Federalization and the Caseloads of the Lower Federal Courts Under Existing Jurisdictional Grants

In order to consider the potential effect of a new federal corporate law for national corporations upon the caseloads of the lower federal courts, it is useful to discuss separately those effects attributable to federalization alone and those attributable to the difference between the substantive content of such a law and that of current state law. To isolate the former effects we must assume, with respect to whatever federal law we are discussing, that its content is identical to that of the state law it supplants. It would seem natural to suppose that the mere federalization of any aspect of corporate regulation would have the effect of increasing the caseload of the lower federal courts by an amount equal to the litigation which would have been previously main-

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be federally regulated. They propose: NADER (sales of \$250 million or 10,000 employees during any of the previous three years), *supra* note 1, at 240-41; Henning ("the top 200 to 500 corporations" using criteria similar to those defining size for purposes of earlier wage and price control regulations), *supra* note 1, at 370-71; Note, *supra* note 1, at 98-99 (New York Stock Exchange listing test: \$14 million in assets and more than 3000 shareholders). A. A. Sommer would have Congress completely preempt state law including the state chartering process with respect to corporations having more than 500 shareholders and \$1 million in assets. *See* his testimony before a Senate committee quoted in note 59 *infra*.

34. It would include all corporations chosen by criteria described as "fairly selective" in note 33 *supra*.

tained under the identical state standard. To make a more precise guess about the effect of any particular scheme of federalization upon the jurisdiction of the lower federal courts, more analysis is necessary. This is true because some claims arising under current state corporation laws are presently cognizable in the federal courts.

First, notwithstanding recent limitations, many state-law claims continue to be maintainable in federal court as pendent to federal securities laws claims which arise from identical or overlapping facts.<sup>35</sup>

Second, many suits arising under state business corporation laws are maintainable in federal court pursuant to the diversity-of-citizenship jurisdictional grant.<sup>36</sup> This is particularly true of derivative suits brought on behalf of a national corporation against management or controlling shareholders for breach of fiduciary responsibilities.<sup>37</sup> Such suits are extremely unlikely to be brought at all if the corporation does not have a substantial chance of recovering or saving more than \$10,000.<sup>38</sup> If the corporation has a financial interest of more than \$10,000 in such litigation, a federal district court has subject-matter jurisdiction to hear a derivative suit brought by any shareholder with diverse citizenship, regardless of the extent of his shareholding.<sup>39</sup> Similarly,

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35. For examples of state-law claims heard by federal courts because they were pendent to claims under the securities laws *see* *Klaus v. Hi-Sheer Corp.*, 528 F.2d 225, 231 (9th Cir. 1975); *Kasner v. H. Hentz & Co.*, 475 F.2d 119, 120 (5th Cir. 1973), *cert. denied*, 414 U.S. 823 (1973); *Vanderboom v. Sexton*, 422 F.2d 1233, 1241-42 (8th Cir. 1970), *cert. denied*, 400 U.S. 852 (1970); *Strahan v. Pedroni*, 387 F.2d 730, 731 (5th Cir. 1967); *Ellis v. Carter*, 291 F.2d 270, 275 (9th Cir. 1961). My conclusion that the Supreme Court has recently narrowed the possibility of such pendent jurisdiction is based upon the following analysis. First, while a doubtful federal cause of action asserted by plaintiff is sufficient to make available pendent jurisdiction over a related state-law claim even though plaintiff's view of federal law is ultimately rejected (*see* *United Mine Workers v. Gibbs*, 383 U.S. 715, 728 (1966); *Bell v. Hood*, 327 U.S. 678, 685 (1946) (Stone, C. J., dissenting)), a clearly insubstantial one is not sufficient (*Warrington Sewer Co. v. Tracy*, 463 F.2d 771 (3d Cir. 1972); *Williams v. United States*, 405 F.2d 951 (9th Cir. 1969)). Included as insubstantial federal causes of action are those clearly foreclosed by previous decisions of the Supreme Court or otherwise wholly without merit. *Levering & G. Co. v. Morrin*, 289 U.S. 103, 105 (1933). Second, after *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) a larger number of securities law cases are clearly foreclosed by previous decision of the Supreme Court. See discussion note 101 *infra* and accompanying text.

36. 28 U.S.C. § 1332 (1970). For examples of state-law derivative suits maintained in federal courts pursuant to diversity jurisdiction *see* *Himmelblau v. Haist*, 195 F. Supp. 356 (S.D.N.Y. 1961); *Niesz v. Gorsuch*, 295 F.2d 909 (9th Cir. 1961); *Topik v. Catalyst Research Corp.*, 339 F. Supp. 1102 (D.C. Md. 1972); *Irwin v. West End Development Co.*, 342 F. Supp. 687 (D.C. Colo. 1972); *Dowd v. Front Range Mines, Inc.*, 242 F. Supp. 591 (D.C. Colo. 1965); *Weinstock v. Kallet*, 11 F.R.D. 270 (S.D.N.Y. 1951).

37. Sullivan, *The Federal Courts as an Effective Forum in Shareholders' Derivative Actions*, 22 LA. L. REV. 580, 603 (1962). The amount-in-controversy test applies solely to the interest of the corporation. FED. R. CIV. P. 23.1. *See* *Koster v. American Lumbermens' Mut. Cas. Co.*, 330 U.S. 518 (1947) (decided under predecessor rule 23(b)); rule 23.1 did not change the substance of rule 23(b) and under the current rule the jurisdictional amount requirement is satisfied if there is a substantial claim that the corporation has suffered damage in excess of \$10,000. C. WRIGHT, LAW OF FEDERAL COURTS 358, 360-61 (3d ed. 1976).

38. Sullivan, *supra* note 37, at 596.

39. 28 U.S.C. § 1332 (1970). Its requirement of diverse citizenship is met only if the citizen-



the significant subject-matter jurisdictional barriers to a defendant's removal of a derivative suit are (1) the nondiversity of the parties<sup>40</sup> or (2) the fact that one of the defendants has been sued in his own domicile.<sup>41</sup> As a consequence, it is primarily the citizenship pattern of parties which will eliminate the possibility of federal diversity jurisdiction for either plaintiffs or defendants in derivative suits. Federalization of the laws defining the fiduciary responsibilities of management and controlling shareholders to national corporations will increase the caseload of the lower federal courts by the number of cases in which a party to a derivative suit which could be maintained in state court prefers a federal forum but cannot demonstrate the requisite diversity of citizenship.<sup>42</sup>

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ship of each party defendant is diverse from that of each party plaintiff. *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267 (1806). For purposes of determining the existence *vel non* of diversity, only the citizenship of the representative plaintiff shareholder is considered. *See Snyder v. Harris*, 394 U.S. 332, 340 (1969); *Winegar v. First Nat'l Bank*, 267 F. Supp. 79 (M.D. Fla. 1967). It is possible however that more stringent federal procedural requirements—as to the need for demands upon shareholders and as to the need for plaintiffs' stock ownership at the time of the wrong alleged—might also screen out of federal court some derivative suits maintainable in state court even though the requirements of diverse citizenship and jurisdictional amount are satisfied. *See Wright, supra* note 37, at 358-60, concerning the unsettled applicability of such federal rules to diversity-based derivative suits.

40. *See* discussion note 39 *supra*.

41. 28 U.S.C. § 1441(b) (1970) forbids removal of such an action. Barrier (2) discussed in text above is in a sense a special case of barrier (1).

42. Of course beyond establishing diversity jurisdiction, a party seeking a federal forum must find one which (i) has proper venue and (ii) can reach all practically necessary parties with process. The difficulties of finding such a forum are described in the next paragraph of this note. Note, however, that unless an unusually generous service-of-process and/or venue provision were to accompany federal regulation of national corporations, the combined venue-process difficulties in derivative suits brought under federal law would be at least as great as those currently besetting plaintiffs in diversity derivative suits. 28 U.S.C. § 1391(a), (c) (1970) are more generous in providing venue for diversity cases than for federal-question cases and FED. R. CIV. P. 4(d)(7), (f) do not distinguish between the two sorts of cases in defining the process-reach of federal district courts. Note, however, that the effect of the nationwide service-of-process provision which is likely to accompany any new federal corporate regulatory program (*see Cary, supra* note 1, at 702) would completely eliminate the obstacles described in the next paragraph and greatly alleviate some of the inconvenience which currently exists even when there is a forum with venue which can reach all necessary parties.

Currently 28 U.S.C. § 1391(a), (c) (1970), in effect, specify four proper venues of derivative suits brought pursuant to diversity jurisdiction. They are the judicial districts where (i) all plaintiffs reside, (ii) all defendants reside, (iii) the claim arose, or (iv) the corporation might have sued the same defendants. In at least some cases there will be no federal court which both (i) has proper venue and (ii) can reach all practically necessary parties with process. There are severe limitations upon the process-reach of any federal district court in diversity cases. FED. R. CIV. P. 4(f) limits such reach to the territorial limits of the state in which the district court sits and, in some instances, beyond, as far as within 100 miles of the place where the action is commenced. Additionally, rule 4(d)(7) provides for service in any manner sufficient under state law, giving the court the benefit of any valid state long-arm statute. *See Wright, supra* note 37, at 306-07. It is surprising, however, how few states subject nonresident officers and directors of domestic corporations to in personam jurisdiction for any breach of fiduciary responsibility. The statutes existing as of 1968 are collected in G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 714 n.53 (1959 & 1968 Supp.).

While only the requirement of diverse citizenship currently screens derivative suits out of the federal courts, as a result of Supreme Court decisions defining the relationship of Federal Rule of Civil Procedure 23 to jurisdictional amount requirements, individual shareholder suits will face the additional and formidable hurdle of the amount-in-controversy requirements.<sup>43</sup> In order to maintain an individual suit, a plaintiff must demonstrate a personal financial interest of more than \$10,000 in the litigation.<sup>44</sup> Additionally, a diversity-based class action is possible only if every class member has more than a \$10,000 personal interest in the outcome of the litigation.<sup>45</sup>

To the extent that either the citizenship requirement or the jurisdictional amount requirement currently screens suits to vindicate individual rights under state corporate law, the federalization of such rights by means of a statute supplanting state law would open the district courts to them. While the general grant of jurisdiction over suits arising under the laws of the United States is itself limited by a \$10,000 amount requirement,<sup>46</sup> suits to enforce duties created by federal corporate law would be cognizable without regard to the amount in controversy by virtue of 28 U.S.C. section 1337. Section 1337 confers upon federal district courts jurisdiction over suits arising under any act of Congress regulating interstate commerce.<sup>47</sup> As section 1337 has been interpreted, it confers jurisdiction over any suit to enforce a duty created by an act of Congress if such act is grounded to some substantial extent upon Congress' power under the commerce clause.<sup>48</sup> Were Congress to regulate national corporations' internal affairs in a fairly comprehensive manner but to make no special provision concerning jurisdiction,<sup>49</sup> a great many suits to vindicate small individual claims would become subject to original federal jurisdiction.<sup>50</sup> Because the recent Supreme Court cases narrowing federal

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43. Zahn v. International Paper Co., 414 U.S. 291 (1973); Snyder v. Harris, 394 U.S. 332 (1969).

44. 394 U.S. at 337.

45. 414 U.S. at 301.

46. 28 U.S.C.A. § 1331 (West Supp. 1976).

47. The full text of that statute reads:

The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies.

48. Wenningham v. HUD, 512 F.2d 617, 621 (5th Cir. 1975). See also Leonardis v. Local 282 Pension Trust Fund, 391 F. Supp. 554 (E.D.N.Y. 1975) (suit charging violation of 1974 Employee Retirement Income Security Act); Citizens for Clean Air, Inc. v. Corps of Engineers, 349 F. Supp. 696 (S.D.N.Y. 1972).

49. Congress could impose an amount-in-controversy requirement; it has almost complete power to limit the jurisdiction of the lower federal courts. Sheldon v. Sill, 49 U.S. (8 How.) 441 (1850). There may be, however, some limitations. See Eisenberg, *infra* note 81; Hart, *The Power of Congress to Limit the Jurisdiction of the Lower Courts: An Exercise in Dialectic*, 66 HARV. L. REV. 1362 (1953). For possible limits more germane to the topic of this article see discussion at note 77 *infra* and accompanying text.

50. Any cause of action arising directly or fairly inferable from an act of Congress itself conferring rights upon shareholders would be maintained in federal court without respect to dollar

class action jurisdiction relied upon the jurisdictional amount requirements,<sup>51</sup> these cases would impose no limitations upon class actions brought to vindicate federal rights of classes of shareholders of national corporations.

Given the current record keeping system of the federal district courts,<sup>52</sup> it is impossible, without reading the pleadings in several hundred cases, to guess the extent to which federal jurisdiction is presently both available and employed with respect to claims arising under current state corporate law. It is clear that the inevitable large increase in lower federal court caseloads due to federalization of duties running to the corporation should be discounted somewhat to account for what must be an appreciable amount of currently available diversity jurisdiction.<sup>53</sup> It is also clear that the increase in federal district court caseloads attributable to the federalization of duties running to individual shareholders could be great and should be discounted substantially less because diversity jurisdiction is currently less frequently available in such actions.

While the increase in the caseloads of the federal courts resulting solely from a shift to a federal regulating authority might well be dramatic, the accompanying change in the substance of the regulation would also cause a significant increase.<sup>54</sup> Laws which create new duties enforceable by private damage actions result in increased judicial burdens. Our experience with civil damage actions under rule 10b-5 is a prime indication that a dramatic increase is to be expected.<sup>55</sup>

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amount. See *Garrett v. Time-D.C., Inc.*, 502 F.2d 627 (9th Cir. 1974); *Murphy v. Colonial Federal Savings and Loan Ass'n*, 388 F.2d 609 (2d Cir. 1967). Under exclusive federal regulation, even causes of action to enforce rights arising from optional charter provisions might well be found to be fairly inferable from the structure of a federal business corporation law of the enabling variety. Cf. *Murphy v. Colonial Federal Savings and Loan*, 388 F.2d 609 (2d Cir. 1967), which appears to recognize the proposition that the rights of shareholders of national corporations are to be determined by a federal common law (at 612 n.2) and that a claim under such law is a sufficient predicate of federal jurisdiction under § 1337 (at 614-15). Query whether, in the context of exclusively federally chartered and regulated corporations, a shareholder agreement external to the corporate charter would arise under a federal common law dealing with such contracts.

51. See notes 43 & 44 *supra* and accompanying text.

52. DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, ANNUAL REPORT 1976 presents separate caseload figures for the category "stockholder suits and partnership dissolution." Such figures, however, include only suits predicated upon contract theory. *Id.* 293. The number of such suits commenced in 1975 and 1976 respectively are zero and one. *Id.* A call to the office of the Clerk for the United States District Court for the Southern District of New York confirms that all derivative suits are not reflected in such figures.

53. See *Sullivan*, *supra* note 37, at 603.

54. As noted in footnote 7 *supra* and accompanying text, those who advocate more federal regulation of national corporations do so because of a perceived need for a major change in the substance of the law that governs the internal affairs of national corporations.

55. While I know of no study of the volume of litigation under rule 10b-5, the 246 pages of annotations to § 10 of the Securities Exchange Act appearing in 15 U.S.C.A. § 78j and 1977 pocket part offer ample testimony to its great magnitude. While some cases appearing in such annotations involve only section 10a of the Securities Exchange Act, the vast preponderance arise under section 10b and subsidiary rule 10b-5.

In the section which follows, this article deals with possible congressional response to such an increase.

## B. Allocation of Jurisdiction Under Federal Corporation Law

### 1. *General Considerations*

The analysis presented above assumes a congressional substantive program without its own tailor-made jurisdictional provisions. What would be the best way for Congress to allocate possibly increased jurisdiction under federal corporate law in light of (1) the need for sound judicial development of any such body of law, (2) the familiar strident complaints about the already onerous federal court workloads, and (3) the interests of the states? I will start with Cary's proposal to deal with pressures against increased federal caseloads by creating exclusive state-court jurisdiction over cases arising under new federal corporate laws.<sup>56</sup> After concluding that such exclusive jurisdiction would be unwise, I will discuss the remaining legislative choices: concurrent state-federal jurisdiction or exclusive federal jurisdiction. Cary's minimum-standards proposal is a good example of what the substance of a partial federal regulatory scheme might be. His description of its substantive features is quoted in the footnote hereto.<sup>57</sup> The discussion which follows below is, however, equally applicable to problems of allocation of jurisdiction under schemes of more comprehensive regulation like that proposed by Nader<sup>58</sup> or to problems of federal chartering and complete federal preemption like that proposed by A.A. Sommer.<sup>59</sup>

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56. See Cary, *supra* note 1, at 704-05.

57. The proposal is to continue allowing companies to incorporate in the jurisdiction of their choosing but to remove much of the incentive to organize in Delaware or its rival states. Such companies, nevertheless, must be subject to the jurisdiction of the federal courts under certain general standards. To illustrate, some of the major provisions of such a federal statute might include (1) federal fiduciary standards with respect to directors and officers and controlling shareholders; (2) an "interested directors" provision prescribing fairness as a prerequisite to any transaction; (3) a requirement of certain uniform provisions to be incorporated in the certificate of incorporation: for example, authority to amend by-laws, initiate corporate action or draw up the agenda of shareholders' meetings shall not be vested exclusively in management; (4) a more frequent requirement of shareholder approval of corporate transactions, with limits placed upon the number of shares authorized at any one time; (5) abolition of nonvoting shares; (6) the scope of indemnification of directors specifically prescribed and made exclusive; (7) adoption of a long-arm provision comparable to § 27 of the Securities Exchange Act to apply to all transactions within the corporate structure involving shareholders, directors, and officers.

The foregoing suggestions do not pretend to offer a complete model for a minimum standards act. Indeed it can scarcely be expected that even these would survive political pressure unscathed.

Cary, *supra* note 1, at 702 (footnotes omitted).

58. NADER, *supra* note 1.

59. In recent hearings before the United States Senate Committee on Commerce the follow-

a. Exclusive State-Court Jurisdiction

Near the end of his proposal for the partial federal regulation of national corporations, Cary states:<sup>60</sup>

Concern over the growth of federal litigation is a separate issue. If this is a matter of crucial importance, and if the grant of concurrent jurisdiction would be futile because plaintiffs typically would sue in the federal courts, then I would propose that the federal standards written into corporation law be subject initially to state court interpretation, with some form of certiorari jurisdiction on the part of the courts of appeal to achieve uniformity. If necessary, there could be a special corporate court to handle such cases.

Cary is not proposing exclusive state jurisdiction as an essential or even desirable part of his scheme of substantive regulation.<sup>61</sup> He is, however, proposing

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ing exchange occurred between Senator John A. Durkin of New Hampshire and A. A. Sommer, formerly a member of the Securities and Exchange Commission:

\* \* \*

Senator DURKIN. I gather that you would favor a more restrictive Federal law.

Mr. SOMMER. Yes.

In the remainder of my prepared statement, which I omitted because of time considerations, I state there is a lot to be said for a Federal corporation law that would be of an "enabling" sort, similar to those that exist in States, and I would hope that one of the more enlightened States would be the model for it.

There is a desirability in a uniform set of standards to be developed through statutory law and in cases concerning the relationships between managers, directors, and shareholders. I feel that burdening that sort of statute with a number of regulatory provisions that would apply only to large corporations is not sound policy. I think those regulatory provisions, such as concern for environment, concern for labor, concern for equal employment, should be dealt with across the board and be binding upon all businesses and all corporations. I think they should be dealt with separately from the question of what is the desirable configuration for corporate law.

Senator DURKIN. The corporate law, to allow for pollution, but allow the criminal law dealing with bribery—

Mr. SOMMER. Deal with them separately but reasonably, as has been done in most cases.

I think mixing those matters with corporation law which is designed to deal with the relationship between managers, directors, and shareholders and the procedural matters of how to hold meetings and that sort of thing, is undesirable.

Senator DURKIN. Would you recommend preempting State law?

Mr. SOMMER. With regard to a corporation that would be subject to Federal corporation law, yes. I think some sort of cut should be made. In other words, corporations of only a certain size would be required to incorporate under Federal law. As you probably know, at the present time, the corporations that have more than 500 shareholders and \$1 million of assets are required to file a periodic report with the SEC.

A similar kind of discrimination, I think, would be appropriate with regard to Federal corporation law.

*Hearings, supra* note 1, at 57.

60. Cary, *supra* note 1, at 704-05.

61. Indeed at one point Cary seems to suggest that, in the absence of resistance from those concerned about lower-federal-court caseloads, the lower federal courts would have a significant role to play. *Compare* Cary, *supra* note 1, at 702, 1st sentence, 2d full paragraph *with* the quotation from Cary's article presented immediately above in the text of this article. The precise meaning of the former is, however, not completely clear.

it as a possible way of making more federal corporate regulation attractive to those seriously concerned about increasing the caseload of the lower federal courts.<sup>62</sup> It is because such a solution is likely to appeal to those so concerned and because it seems so unprecedented and unwise that several arguments against it will be presented.

I assume from Cary's use of the phrases "subject initially to state court interpretation" and "ced[ing jurisdiction] to the state courts subject only to review [by the United States courts of appeals] for purposes of establishing uniform standards,"<sup>63</sup> that under his scheme federal courts would not be open to hear claims under federal corporate law. There are other interpretations of Cary's proposal, equally unprecedented and perhaps unworkable, but these are devoid of serious problems of federalism. For example, the federal courts might be closed off to claims under federal corporate law only in states where the legislatures agreed (perhaps in exchange for federal compensation) that their courts would shoulder the entire burden of deciding cases under federal corporate law.

As I understand Cary's proposal, however, exclusive jurisdiction would be imposed upon the state courts by federal legislation. Whether such jurisdiction is unprecedented or not depends upon how one reads the precedents. Prior to 1875 the lower federal courts had no general federal-question jurisdiction;<sup>64</sup> during this period most of the legal claims which arose under the few extant federal regulatory schemes were heard exclusively by the state courts.<sup>65</sup> Moreover, state courts are currently the only courts open to hear some cases arising under the Constitution and laws of the United States involving an amount in controversy of no more than \$10,000.<sup>66</sup> Federal district

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62. See, e.g., H. FRIENDLY, *FEDERAL JURISDICTION: A GENERAL VIEW* 15-33 (1973).

63. Cary, *supra* note 1, at 705.

64. 13 C. WRIGHT, A. MILLER, & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3503 at 9 (1975). This statement must be qualified by noting that for a period of slightly over a year beginning in February 1801 and ending in March 1802, the United States circuit courts (courts having both original and appellate jurisdiction) enjoyed trial jurisdiction over "all cases in law or equity arising under the Constitution and laws of the United States, and treaties made [thereunder] . . ." Act of February 13, 1801, 2 Stat. 89. The repealing legislation was Act of March 8, 1802, 2 Stat. 132. The legislation restoring such federal-question jurisdiction was Act of March 3, 1875, 18 Stat. 470. Currently federal district courts have such jurisdiction pursuant to 28 U.S.C. 1331 (1970).

65. See, e.g., *Lapham v. Almy*, 95 Mass. 301 (1866); *United States v. Smith*, 4 N.J. L. (1 South) 38 (1818).

66. 28 U.S.C. § 1331(a) (West Supp. 1977), the basic source of federal district court jurisdiction over federal-question cases reads as follows:

The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of \$10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee thereof in official capacity.

Unless some other more specialized federal-question statute is available (see note 47 *supra*), a case arising under the Constitution, laws, or treaties of the United States but involving \$10,000 or less

courts are generally closed to such cases and presumably state courts have an obligation to hear them. On several occasions the Supreme Court has required unwilling state courts to hear federal claims because the state courts' refusals to do so were not based upon "valid excuses."<sup>67</sup> Valid excuses include an application of traditional *forum non conveniens*<sup>68</sup> doctrine and perhaps the inability of state courts to hear similar cases arising under state law.<sup>69</sup> Emphatically excluded from the category of valid excuses is a refusal to entertain a federal cause of action solely because the underlying claim is based on federal law.<sup>70</sup>

It is not hard to read these precedents, taken together, as establishing the power of Congress to force state courts to assume jurisdiction not shared by federal courts over all suits arising under a federal regulatory program. For example, in 1958 the Supreme Court of New Mexico reached a similar view of Congress' power.<sup>71</sup> Citing the United States Supreme Court cases referred to in the preceding paragraph, it declared<sup>72</sup> the following statute of that state, passed in 1947, violative of the United States Constitution:<sup>73</sup>

Jurisdiction of courts to enforce federal law restricted. No court of the state of New Mexico shall have jurisdiction of, or enter any order or decree of any character in any action instituted in the courts of this state, seeking to enforce, directly or indirectly, any federal statute, or rule or regulation . . . where the Congress of the United States has curtailed, withdrawn, or denied

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in controversy generally can be brought only in state court. Under 28 U.S.C. § 1441(a), (b) (1970) a defendant can remove to federal court a federal-question case brought in state court only if the plaintiff could have maintained the action in federal court originally.

67. *Testa v. Katt*, 330 U.S. 386 (1947); *McKnett v. St. Louis & S.F. Ry.*, 292 U.S. 230 (1934); *Mondou v. New York, N.H. & H. R.R.*, 223 U.S. 1 (1912).

68. *Douglas v. New York, N.H. & H. R.R.*, 279 U.S. 377, 387-88 (1929). *See also* *Testa v. Katt*, 330 U.S. 386 (1947) (dictum).

69. *Testa v. Katt*, 330 U.S. 386, 394 (1947) (dictum).

70. *Id.*; *McKnett v. St. Louis & S.F. Ry.*, 292 U.S. 230, 233-34 (1934).

71. *Bourguet v. Atchison, T. & S.F. Ry.*, 65 N.M. 200 (1958), 334 P.2d 1107, 1110-11 (1958).

72. *Id.* (alternative holding). In the proceedings below in *Bourguet*, a state trial court dismissed a case against the railroad brought under the Federal Employers' Liability Act (FELA). Its dismissal was based upon the statute quoted in the text accompanying note 73 *infra*. The defendant's argument was that the jurisdiction of federal district courts over FELA cases was restricted within the meaning of the New Mexico statute. Despite the fact that plaintiffs were given an option to bring damage suits in FELA cases to federal courts, defendant asserted that an absolute prohibition upon removal by defendants constituted a restriction within the meaning of the New Mexico statute. In a state-ground holding the court rejected such an interpretation of the New Mexico statute, 65 N.M. at 201-03, 334 P.2d at 1108-09. Note the court had to determine whether Congress has "curtailed withdrawn or denied jurisdiction," but because those are the words of the New Mexico statute, the question is whether Congress has done so within the meaning of that law. *Id.* In the alternative holding the court decides that the statute, applied to exclude New Mexico courts, would violate the supremacy clause of the United States Constitution. 65 N.M. at 206, 334 P.2d at 1111. The court's rationale would seem to apply to the exclusion of any federally created civil action, if not to all federally created actions.

The preceding description of *Bourguet* was presented for purposes of completeness. For purposes of this article, the fact of primary interest is that the state legislature bridled at perceived federal abuse.

73. N.M. STAT. ANN. § 16-1-7 (1953).

the district courts of the United States the right to enforce such statutes, rules or regulations aforesaid.

The New Mexico statute is evidence of the potential for friction in the federal government's abuse of its partnership with state government. However, it probably does go too far in asserting states' rights.<sup>74</sup> If it is valid, state courts are not obliged to hear those federal-question cases with amounts in controversy of \$10,000 or less which now cannot be maintained in federal court. A plausible constitutional argument can however be made that the current division of labor under the \$10,000 jurisdictional amount requirement and Cary's jurisdictional proposal are significantly different. Whether or not the argument ultimately succeeds as a constitutional argument, it strongly suggests the lack of wisdom of an exclusive state jurisdiction scheme. This argument follows in the next several paragraphs.

All of the Supreme Court cases reversing as error state refusals to hear federally created causes of action involved causes of action of a kind which were concurrently cognizable in the federal courts.<sup>75</sup> Those suits under fed-

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74. The legislative history of § 16-1-7 is instructive:

Chapter 43 of Laws 1947 had a preliminary first section which read: "The legislature of the state of New Mexico hereby finds that: (a) The Congress of the United States has heretofore authorized, and may hereafter authorize, by congressional act, the courts of the several states to entertain jurisdiction of and enforce causes of action created by or arising from federal statutes, or by rules or regulations of federal regulating bodies or agencies, and

"(b) The Congress has no power to require the state courts of the several states to take cognizance of such actions, and

"(c) The Congress has from time to time, and may hereafter, withdraw from the courts of the United States jurisdiction to enforce such statutes or rules or regulations aforesaid or to entertain actions for such purpose or to enter judgments or decrees based thereupon, and

"(d) In such event actions to enforce such statutes or rules or regulations aforesaid, or rights or obligations arising therefrom may hereafter be instituted in the courts of this state, burdening and taxing such courts, and placing upon the courts and people of the state the burden and expense of enforcing such federal statutes, rules or regulations, or settling disputes arising therefrom."

*Title of Act.*

An act relating to the jurisdiction of the state courts of New Mexico to enforce certain federal statutes, rules and regulations under certain circumstances, and declaring an emergency.—Laws 1947, ch. 43.

*Emergency Clause.*

Section 3 of ch. 43, Laws 1947 declared an emergency and provided that the act should take effect upon its passage and approval. Approved March 8, 1947.

Compiler's notes to § 16-1-7, 4 N.M. STAT. ANN. 5 (1953).

75. The three cases in which such reversals occurred are listed in note 67 *supra* and are discussed in the next paragraphs of this note.

*McKnett*, 292 U.S. 230 (1934), and *Mondou*, 223 U.S. 1 (1912), arose under the same version of the Federal Employers' Liability Act (FELA), 34 Stat. 232 (1906), as amended by 35 Stat. 65 (1908) and 36 Stat. 291 (1910) (current version at 45 U.S.C. §§ 51, 54, 56, 60). A reading of such legislative history indicates (i) that private damage suits under the FELA were made explicitly concurrently cognizable in state and federal courts by the 1910 amendments and (ii) that no amount-in-controversy requirement ever existed.

*Testa*, 330 U.S. 386 (1947), arose under the Emergency Price Control Act of 1942, (EPCA), 56



eral law which now can be heard exclusively in state court all involve causes of action which can be brought in federal court as long as more than \$10,000 is in controversy.<sup>76</sup> This pattern results in the federal government's sharing with the states some of the judicial costs of each variety of legal action permitted by each of its substantive programs, and consequently, also results in a practical restraint upon irresponsible (not cost justified) substantive laws. Recent cases and scholarly commentary suggest that the Supreme Court may be recognizing a state sovereignty resistant to at least some otherwise permissible federal regulation under the commerce clause.<sup>77</sup> It has been argued that a congressional attempt to override the valid-excuse doctrine described above might fail as an unconstitutional intrusion upon state sovereignty.<sup>78</sup> Perhaps making the states bear all of the judicial costs of federal substantive programs is another such intrusion.

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Stat. 23 (1942) as amended by 56 Stat. 767 (1942), 57 Stat. 566 (1943), 58 Stat. 633 (1944), 59 Stat. 306-09 (1945), and 60 Stat. 664 (1946) (repealed 1947). A reading of such legislative history indicates that during the existence of the EPCA, private damage suits thereunder were concurrently cognizable in state or federal court without regard to dollar amount.

76. Where jurisdiction is shared on a concurrent basis, the rights of plaintiffs and defendants are not invariably symmetrical. For example, suits under the Securities Act of 1933 can be brought at plaintiff's option in federal court regardless of the amount in controversy. If a plaintiff chooses instead to sue in state court in a case where federal jurisdiction could be based only upon the presence of the Securities Act claim, the defendant has no removal action. 15 U.S.C. § 77(v) (1970). The suits in *McKnett* and *Mondou* (see discussion in note 75 *supra*) were identical in this respect to suits under the Securities Act, because suits against interstate railroads were not (and are not) removable. Act of April 5, 1910, c. 143, 36 Stat. 291 (current version 28 U.S.C. § 1445 (1970)). Under this pattern, despite the restrictions upon removal, the federal courts do share with the state courts the expenses of hearing causes of action under any portion of the Securities Act.

77. In *National League of Cities v. Usery*, 426 U.S. 833 (1976), the Court found unconstitutional that portion of the 1974 amendments to the Fair Labor Standards Act which applied the minimum wage laws to state and municipal public employees. The Court stated:

This Court has never doubted that there are limits upon the power of Congress to override state sovereignty, even when exercising its otherwise plenary powers to tax or to regulate commerce which are conferred by Art. I of the Constitution.

426 U.S. at 842.

The Amendment (10th) expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system.

*Id.* at 843 (quoting *Fry v. United States*, 421 U.S. 542, 547 n.7 (1975)). See also *New York v. United States*, 326 U.S. 572 (1946) (dictum) (rejects proposition that federal government could tax the states except to the extent that they carry on business as would private employers); Redish & Muench, *Adjudication of Federal Causes of Action in State Court*, 75 MICH. L. REV. 311, 340-59 (1976).

78. *Id.* Redish and Muench suggest that *National League of Cities v. Usery*, 426 U.S. 833 (1976), forms the basis of an at least plausible argument that Congress would intrude on state sovereignty if it were to attempt to override the valid-excuse doctrines which permit states to refuse to entertain federal causes of action. *Id.* at 348-49, 358-59. The circumstances discussed by Redish and Muench as possibly appropriate for state refusals involve nondiscriminatory application of state rules of jurisdiction, venue, and forum non conveniens. My argument is similar but not identical. It is that mandatory exclusive state jurisdiction over federal causes of action is plausibly another circumstance in which a state refusal to hear a federal cause of action would be justified as protective of its sovereignty.

There is strong evidence that at the time the Constitution was framed, it was understood that the creation of lower federal courts was entirely at the option of Congress<sup>79</sup> and that to the extent such courts were not available, state courts were obliged to hear claims under federal law.<sup>80</sup> Indeed, as mentioned above, lower federal courts were not generally available to hear such claims until 1875. In a recent article Theodore Eisenberg<sup>81</sup> argues that even if lower federal courts were optional in 1789, changed circumstances result in their being constitutionally required today.<sup>82</sup> His argument is that in the early days of the Republic, the concept of Congress' power to dispense with lower federal courts was not at war with the concept of the federal judiciary as envisioned by the framers.<sup>83</sup> He argues that today, given the inability of the Supreme Court to decide finally all questions of federal law raised in state courts, those two concepts are at odds.<sup>84</sup> The constitutional argument against mandatory exclusive state jurisdiction over federal causes of action is structurally similar to Eisenberg's.<sup>85</sup> Prior to the great expansion in federal legislative power under the commerce clause,<sup>86</sup> the concepts of state sovereignty and of unlimited congressional power to use state courts as federal forums were not incompatible. As the notion that the federal government is one of limited powers has become less meaningful since the creation of the ICC in 1887, there has developed a real potential for conflict.<sup>87</sup> There seems to be no good reason to challenge the system of concurrent jurisdiction over federal-question cases with which we have lived successfully for over a century. On the other hand, can a departure from that system be justified if it permits the federal government to use the state courts alone for the administration of any federal law? The establishment of such a pattern seems not only a symbolic blow to

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79. See M. FARRAND, *THE FRAMING OF THE CONSTITUTION OF THE UNITED STATES* 79-80 (1913); Warren, *New Light on the History of the Federal Judiciary Act of 1789*, 37 HARV. L. REV. 49, 65-66 (1923).

80. See Note, *State Enforcement of Federally Created Rights*, 73 HARV. L. REV. 1551, 1552 (1960).

81. Eisenberg, *Congressional Authority to Restrict Lower Federal Court Jurisdiction*, 83 YALE L.J. 498 (1974).

82. Without conceding that lower federal courts were ever dispensable, Eisenberg argues that, in light of the current circumstances of the national judiciary, abolition of the lower federal courts would violate an essential aspect of the framers' constitutional plan. *Id.* at 504-14.

83. *Id.* at 504, particularly n.38 and accompanying text.

84. *Id.*

85. *Id.* Of course, under any scheme of exclusive state-court trial jurisdiction over a system of federal causes of action, some costs of judicial administration—the costs of deciding some appeals—would be borne by federal courts. My argument is premised on the probability that the costs of administering justice at the appellate level over a system of federal causes of action would be relatively insignificant when compared with such costs at the trial-court level. Note also that in cases where federal appellate courts had reviewed issues of federal corporate law decided by state courts, the states presumably would have incurred costs themselves at the appellate level.

86. "Large scale regulatory action by Congress began with the Interstate Commerce Act in 1887 and the Sherman Anti-Trust Law in 1890. . . ." G. GUNTHER & W. DOWLING, *CONSTITUTIONAL LAW* 240 (8th ed. 1965).

87. *Id.* See also R. CUSHMAN, *THE INDEPENDENT REGULATORY COMMISSIONS* 19 (1972).

state sovereignty, but also an irresistible invitation to its own replication as a means of reducing the federal costs of future federal programs.

Under prevailing circumstances it seems at least unfortunate, if not unconstitutional, for the federal government to begin to insulate itself from the judicial costs of its regulation and impose them entirely upon the courts of the states. The New Mexico statute described above and never repealed by the state legislature is tangible proof of the potential for state-federal friction inherent in an exclusive state jurisdiction scheme.<sup>88</sup>

The remaining choice between some form of shared state-federal jurisdiction and exclusive federal jurisdiction over cases under a new federal corporate law is the subject of the next subsection.

b. Choice Between Shared State-Federal and Exclusive Federal Jurisdiction

Exclusive state-court jurisdiction over causes of action arising under a new federal corporate law having been rejected as unsound, what is the most desirable alternative? As has been noted, Congress can permit<sup>89</sup> and even require<sup>90</sup> state-court jurisdiction over federal causes of action, at least in cases where that jurisdiction is shared with the federal courts on some reasonable basis. Additionally, Congress can confer jurisdiction exclusively upon the federal courts, as it has previously done in the case of suits under certain federal statutes.<sup>91</sup> In the usual case where no express jurisdictional limitation is provided for a federal cause of action, it is treated as cognizable in both the federal and the state courts.<sup>92</sup> In unusual circumstances, such a cause of action will be found, by virtue of its "nature," to be excluded from state-court

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88. The arguments against mandatory exclusive state jurisdiction presented above are all grounded upon the concept of state sovereignty. Arguments made in the next section that exclusive federal jurisdiction may be a desirable way of dealing with cases arising under certain portions of new federal corporate regulation are, a fortiori, arguments against exclusive state jurisdiction over such cases.

Beyond this, even with respect to cases over which exclusive federal jurisdiction is not needed because there will be little reviewable lawmaking (see notes 105-08 *infra* and accompanying text) a removal option is necessary to protect plaintiffs against the promanagement biases described by Cary. Cary, *supra* note 1, at 670-92. Cary concludes such biases would abate greatly were state courts to apply federal law. *Id.* at 705. I am not sure the promanagement bias he ascribes to Delaware judges is the product of legislative pressures as much as of lifelong perspectives. In any event, as long as the states continue to charter and provide significant forums for the settlement of intracorporate disputes of domestic corporations, management engaged in charter-state shopping would undoubtedly prefer states whose judges read federal law through properly corrected lenses. A liberal removal provision would dispense with these problems; exclusive state jurisdiction would create them.

89. *Claffin v. Houseman*, 93 U.S. 130, 136 (1876).

90. See note 67 *supra* and accompanying text.

91. *The Moses Taylor*, 71 U.S. (4 Wall.) 411 (1866). See, e.g., 28 U.S.C. § 1338 (1970), conferring upon lower federal courts exclusive jurisdiction over suits arising under the patent laws.

92. *Claffin v. Houseman*, 93 U.S. 130, 136 (1876); Redish & Muench, *supra* note 77, at 312-25 (1976).

cognizance.<sup>93</sup> How should a legislator contemplating federal regulation of national corporations decide between the concurrent and exclusive federal modes of jurisdiction?

*i. Benefits of Exclusive Federal Jurisdiction*

A recent article by Redish and Muench offers guidance to courts which are asked to decide, in the absence of an express provision dealing with jurisdiction, whether suits under a particular federal cause of action are to be treated as exclusively within the jurisdiction of the federal courts.<sup>94</sup> As an alternative to the traditional legislative-historical approach, the article suggests that courts engage in "creative judicial lawmaking,"<sup>95</sup> and it further suggests several factors bearing on the wisdom of a finding of exclusivity.<sup>96</sup> A creative judicial lawmaker and his responsible congressional counterpart should be concerned with many of the same problems in choosing a jurisdictional mode. Consequently, the authors' analysis is helpful to our inquiry from a legislator's perspective.

A major factor favoring exclusivity cited by Redish and Muench is that the substantive law in question, in the absence of exclusive federal jurisdiction, would be interpreted without uniformity among the states.<sup>97</sup>

In dealing with this factor, that of the possibility of disuniformity, the authors conclude:

The most significant factor in this inquiry is the nature of the federal statute creating the particular cause of action. In other words, a court should determine whether the federal statute is likely to provide the judiciary wide latitude in developing federal rights, or whether the cause of action is sufficiently detailed in its scope and clear as to its purpose that the likelihood of future judicial gloss is comparatively limited. . . .

. . . [T]o the extent that a statutory right depends upon judicial development for its content, the danger of legal chaos will vary directly with the number of courts independently interpreting the right. In light of the fact that an overworked Supreme Court is capable of providing a uniform practice for only a fraction of the numerous issues of federal law that arise each year, the danger of divergent judicial interpretations must be taken seriously.

Such divergence is likely to be harmful for several reasons. First, to the extent that varying or contrary interpretations are given in different areas of the nation, the nationally unifying force of federal law is undermined, and the post-Civil War development of federal supremacy over local interests is weakened. Second, the arbitrariness of the enjoyment of federal rights that this divergence would produce presents a significant moral problem. . . . Finally, in many cases the proliferation of judicial interpretations of a federal right will unduly undermine the predictability in enforcement of that right, thereby interfering with the often significant planning of primary commercial, social, or personal conduct and decision-making.

93. 93 U.S. at 136; Redish & Muench, *supra* note 77, at 313-25.

94. Redish & Muench, *supra* note 77, at 311-40.

95. *Id.* at 329-40.

96. *Id.*

97. *Id.* at 331-33.

Where, on the other hand, a federal statute is comparatively clear in its directives, the danger of varying or contrary judicial interpretations is presumably reduced, even if the number of courts interpreting the right is substantial.<sup>98</sup>

Any federal regulation of national corporations, whether it follows the Cary model of partial regulation or the comprehensive federal chartering model, might well contain vague standards defining the responsibility of management (and possibly controlling shareholders) to the general body of shareholders. It is the vagueness of such standards which, in at least some respects, render them useful: they are an invitation to courts to deal creatively with a host of situations not foreseeable in advance. An example of such a process of judicial lawmaking is the use made of rule 10b-5<sup>99</sup> by the lower federal courts prior to *Blue Chip Stamps v. Manor Drug Stores*.<sup>100</sup> In that case the Supreme Court severely limited what had been described as the creation of a general federal law of fiduciary responsibility.<sup>101</sup>

Some of the new federal corporation law envisioned by Sommer, Cary, and others could involve an invitation from Congress to some courts for those courts to engage in a process similar to the pre-*Blue Chip Stamps* process described above.<sup>102</sup> It might seem then that any vaguely worded federal

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98. *Id.*

99. Securities and Exchange Commission rule 10b-5, 17 C.F.R. § 240.10b-5 (1976), was promulgated by the Commission pursuant to section 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). It reads as follows:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

100. 421 U.S. 723 (1975).

101. For the proposition that the development of such a federal corporate law was recognized *see, e.g.*, Fleischer, *Federal Corporation Law: An Assessment*, 78 HARV. L. REV. 1146 (1965); Lowenfels, *The Demise of the Birnbaum Doctrine: A New Era for Rule 10b-5*, 54 VA. L. REV. 268 (1968); Note, *Standing Under Rule 10b-5 After Blue Chip Stamps*, 75 MICH. L. REV. 413, 414 (1976).

*Birnbaum v. Newport Steel Corp.*, 98 F. Supp. 506 (S.D.N.Y. 1951), *aff'd*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), restricted the application of rule 10b-5 to transactions involving a purchase or sale of securities. For a discussion of the erosion and occasional rejection of the *Birnbaum* rule prior to *Blue Chip Stamps*, see Lowenfels, *supra* this note, and Note, *supra* this note, at 427 n.94. For a discussion of the Supreme Court's endorsement of a stringent but still imprecisely defined purchaser-seller rule in *Blue Chip Stamps*, see Note, *supra* this note, at 427-44. The Note's author suggests that *Blue Chip Stamps* may be consistent with at least some of the prior erosion of the purchaser-seller rule and may be truly significant only as a limitation upon future erosion. *Id.* at 429.

102. In a 1974 speech, A.A. Sommer recognized that the benefits of at least some vagueness in fiduciary standards could well be worth the resulting uncertainty costs:

fiduciary standard should be interpreted only by the federal courts. In fact more analysis is necessary.

Redish and Muench's argument turns upon the superiority of exclusive federal jurisdiction as a unifier of federal law. Their explanation of such superiority is as follows:<sup>103</sup>

It is true, of course, that even a finding of exclusive federal jurisdiction will not insure uniformity of interpretation. Nevertheless, the likelihood of varying interpretations of federal law, both in terms of degree and occurrence, is substantially reduced when only federal courts are making the interpretations. Since there are only eleven courts of appeals which, though not bound by decisions of other circuits, generally give them significant weight, and since a common basis for the Supreme Court's decision to grant certiorari is the existence of a conflict among the circuits, the danger of proliferation is considerably reduced.

Such an argument seems convincing,<sup>104</sup> but it is relevant only to the extent that a vague standard invites judicial lawmaking in trial courts which is re-

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I spoke of Rule 10b-5 being both fortunate and unfortunate. I think it is unfortunate that we have, because of the circumstances that I mentioned, been impelled to load so much on this Rule, which after all was admittedly adopted in haste, expressed with bewildering and sometimes even angering breadth and generality, and which is only 115 words long. Responsible commentators have suggested that it is wholly inappropriate for the Commission and the courts to try to draw through some alchemy out of those few words a whole code of conduct for the legal profession, the accounting profession, directors, corporate officers, insiders of all types, financial analysts and a host of other people. It would perhaps indeed be better if through the debative process by which legislation is developed greater particularity had become a part of this endeavor and perhaps it would have been better if there had been at some point in time a more comprehensive realization of what was being done, rather than a piecemeal, case-by-case manner of achievement that has characterized the growth of the Rule 10b-5 concept. While such an ordered structural development has much to commend it, I think there would also be within that severe disadvantage: inflexibility. Social commentators have repeatedly warned that the pace of change in our life is steadily accelerating and that our institutions, our psyches and even our bodies must develop a capacity to change more quickly. The corporate world is not immune to this rapidly accelerating pace of change and it is extremely important that the means of social control of this terribly important part of our national economic life be flexible and relatively swift reaction. Through Rule 10b-5 I think we have accomplished a great deal of that flexibility and the ability to adapt that is so necessary.

The price that is paid for such flexibility and adaptability of course, is the inability to have a photographic rendition of the state of law at any given moment which is fixed, clear, delineated, sharply focused and reliable.

Address by A.A. Sommer, American Bar Association 97th Annual Meeting (August 14, 1974), reprinted in *Hearings*, *supra* note 1, at 72-73.

In other settings Mr. Sommer has indicated his view that it is better to deal with the responsibilities of management of national corporations more directly by means of federal fiduciary standards than by means of adapting laws designed principally to deal with trading abuses. *Hearings*, *supra* note 1, at 65-66 (written statement prepared for submission at hearing). See also *id.* at 58. Presumably general federal fiduciary standards would also need to be somewhat flexible.

103. Redish & Muench, *supra* note 77, at 332 n.88.

104. It should be noted that there is possibly an alternative method for unifying the law which would not rely upon exclusive federal jurisdiction. The United States courts of appeals could be

viewable by appellate courts and, consequently, is capable of being unified by such courts. It is important not to assume that the vagueness of any fiduciary standard will result in a large and constant amount of precedent-making throughout its existence. Assume the following familiar rule is part of a scheme of federal regulation:

Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.<sup>105</sup>

Would this rule result in a great deal of lawmaking? There would be initial questions about whether the standard resembled more an ordinary or a gross negligence model. Once it is determined whether the standard of care for corporate management is to resemble current lenient standards under state law<sup>106</sup> or a more exacting standard, even some additional real lawmaking might occur. For example, courts would determine whether certain familiar recurrent omissions—*e.g.*, missing directors' meetings—constitute *per se* violations of the standard. Perhaps in light of the need for uniformity, the fact that this much lawmaking would result argues in favor of exclusive federal jurisdiction. It seems likely, however, that most decisions applying such a law

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given appellate jurisdiction over cases decided by state courts involving claims under federal corporate law. Cary proposes such review as an adjunct to his scheme of exclusive state-court jurisdiction, presumably because he too perceives a need for law unification which Supreme Court review can no longer fulfill. Cary, *supra* note 1, at 704-05. To the extent such review is considered compatible with our federalism, it would work as well to mitigate uniformity problems generated by concurrent state-federal jurisdiction over a body of cases.

It is tempting to look for constitutional infirmities of such a review system since, with the possible but distinguishable exception of federal habeas corpus jurisdiction over the cases of state prisoners, nothing resembling lower-federal-court review of state-court cases has existed in our federal system. The few judges and scholars who have considered such review in the abstract, however, conclude it is constitutional. See Stolz, *Federal Review of State Court Decisions of Federal Questions: The Need for Additional Appellate Capacity*, 64 CAL. L. REV. 943, 945-48 (1976). While possibly constitutional, such a system of review would be an extraordinarily controversial means of assuring uniformity. This article proceeds upon the assumption that such a system is unlikely.

105. N.Y. BUS. CORP. LAW § 717(b) (McKinney 1963). The transactions which such a corporation may avoid on the ground of unfairness are those which involve an interested director and which have not been insulated from such a power of avoidance by means of the approval of a disinterested majority of fully informed directors or by means of shareholder approval.

106. The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack. Few are the cases in which the stockholders do not allege conflict of interest, still fewer those among them which achieve even such partial success as denial of the defendants' motion to dismiss the complaint. Still, it cannot be denied that there is a small number of relatively recent cases which do seem to lend a modicum of substance to the fears of directors of industrial or mercantile corporations that they may be stuck for what they like to call "mere" or "honest" negligence. My own collection, based on extensive (although not exhaustive) investigation, includes four such specimens.

Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968). See also Cary, *supra* note 1, at 683-84; Address by A.A. Sommer, *supra* note 102, reprinted in *Hearings, supra* note 1, at 61, 75-76.

will be analogous to decisions generally requiring a determination of whether particular conduct was negligent; they will involve the application of its vague standard of care to situations which are sui generis and therefore not of great precedential effect.<sup>107</sup> Another example of a vague standard not having a great capacity to generate hard legal precedents is that of a provision which permits a corporation to avoid certain transactions to which it is a party and in which one of its directors has an interest unless it is demonstrated affirmatively that the transaction is fair and reasonable.<sup>108</sup> The rules as to what is a sufficient interest to trigger the statute's application can be made reasonably clear and therefore could be the subject of relatively little reviewable judicial lawmaking. Decisions about the fairness and reasonableness of various transactions would, for the most part, involve sui generis and unreviewable determination of mixed questions of law and fact.

On the other hand, if, for example, Congress were to write a regulation requiring that management and controlling shareholders of a corporation deal fairly with those holding noncontrolling equity interests, years of true judicial lawmaking would ensue.<sup>109</sup> Perhaps this is an argument for Congress to attempt clearer and more specific standards which would provide fairer notice to those subject to new duties.<sup>110</sup>

The primary thrust of this analysis is that when Congress considers allocation of jurisdiction with respect to any statutory scheme, it should hear expert testimony on the type of adjudication that each significant position is likely to spawn. If after such careful consideration, Congress concludes that the flexibility of a standard vague as to persons or activities aimed at is worth the uncertainty generated, it should then seriously consider exclusive federal jurisdiction for suits brought under such standard.<sup>111</sup> The greater the possibility that reviewable lawmaking will be done by the courts, the greater the benefits of exclusive federal jurisdiction.

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107. In describing the relationship between the fact-finding and the law-declaring processes in negligence actions, Professor Francis Bohlen stated:

The jury has no power to declare the law, using that term in the sense above stated.

But since it is impossible to anticipate the innumerable combinations of circumstances which may arise, it is impossible for the law to formulate in advance definite standards by which the propriety of conduct under every conceivable set of circumstances may be judged. It can at best announce broad general principles, which give the materials and general directions for the construction of the standard to be applied in each specific case.

Bohlen, *Mixed Questions of Law and Fact*, 72 U. PA. L. REV. 111, 113 (1925). See also Address by A.A. Sommer, *supra* note 102, reprinted in *Hearings*, *supra* note 1, at 76-77, suggesting that, while traditional notions of degrees of fault seem obsolete, fiduciary standards for management must be based upon the *Gestalt* of the relationship between the parties. Sommer does however suggest that fiduciary standards be made at least somewhat more specific. *Id.*

108. See, e.g., N.Y. BUS. CORP. LAW § 713 (McKinney 1963).

109. See Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 BUS. LAW. 883, 907-10 (1976).

110. See NADER, *supra* note 1, at 104.

111. A.A. Sommer describes the tradeoff nicely. See note 102 *supra*.



*ii. Costs of Exclusive Federal Jurisdiction*

Assuming a provision of federal corporate law is likely to result in a great deal of judicial lawmaking and is a candidate for exclusive federal jurisdiction, what are the costs against which the benefits of uniformity are to be weighed?

Jurisdiction of suits under the Securities Exchange Act of 1934 is exclusively federal.<sup>112</sup> There are suggestions that this exclusive jurisdiction under the Securities Exchange Act has caused serious problems of efficiency, particularly in the area of proxy regulation. Citing Professor Loss' discussion of such difficulties, the current tentative draft of the American Law Institute's Federal Securities Code opts in favor of concurrent state-federal jurisdiction over most suits under its provisions which are of the sort currently arising under the Securities Exchange Act.<sup>113</sup> The most severe difficulty cited by Loss and presumably troubling those drafting the Securities Code is the possibility that in the context of a particular case, no court, state or federal, could grant relief with respect to all of a plaintiff's claims arising out of one set of factual transactions.<sup>114</sup> At the time Loss wrote, it was possible for state and federal claims to arise out of a common nucleus of fact and yet, in some circumstances, for a federal court to consider itself without power to hear the state-law claims on a pendent jurisdiction theory. As a result, a plaintiff might need to bring two actions to assert all of his rights arising from one set of facts.<sup>115</sup> Additionally, even if a federal court had pendent jurisdiction over all of a plaintiff's state-law causes of action, multiple suits could result from the

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112. 15 U.S.C. § 78 aa (1970).

113. ALI, *STUDY OF THE DIVISION OF JURISDICTION BETWEEN STATE AND FEDERAL COURTS* 183-84 (1969).

114. Loss, *The SEC Proxy Rules and State Law*, 73 HARV. L. REV. 1249 (1960). Two major sorts of difficulties are described by Loss. The first is the difficulty that any court, state or federal, will often have in determining the relationship between the state and federal laws that together govern the process of shareholder voting (both as to directors and on referenda) with respect to the affairs of national corporations. Such problems of fit between federal and state laws are discussed later in this article. The second problem, the one described in the text, is the problem of plaintiffs' need to sue twice to vindicate all their rights, a need which results from a combination of (i) cooperative state-federal substantive regulation with (ii) exclusive federal jurisdiction over claims under federal law, and (iii) the inability of federal courts to grant all the relief under state law which is available in the state courts.

Given the fact that characteristics (i) and (iii) are currently features of our system of regulation, exclusive federal jurisdiction generates the costs described by Loss. Depending upon one's view of the magnitude of uniformity benefits of exclusive federal jurisdiction in the proxy area, it could be entirely proper to reject exclusive federal jurisdiction as not cost-justified.

The continued vitality of characteristic (iii) is at least somewhat in question. See notes 117-123 *infra* and accompanying text. To the extent that it is no longer a factor, one suit in federal court will suffice to vindicate all of a plaintiff's rights. Additionally, Congress may well be able to further cure the need for bifurcation. See notes 119 & 121 *infra* and accompanying text.

Beyond this, if state law were entirely preempted by a federal law regulating the shareholder voting process of national corporations, state-created rights would not exist and a federal court with exclusive jurisdiction could grant all the relief which could be obtained in any forum.

115. *Hurn v. Oursler*, 289 U.S. 238 (1933); see the description of *Hurn's* test in *United Mine Workers v. Gibbs*, 383 U.S. 715, 721-24 (1966).

inability of that court to grant remedies provided for by state law which are different from those permitted to the federal courts.<sup>116</sup>

The former difficulty has been ameliorated by a Supreme Court case, *United Mine Workers v. Gibbs*,<sup>117</sup> which was decided after Loss wrote his original critique. This case permits federal courts, in their discretion, to entertain pendent state claims at least (1) when they arise from a core of operative facts common to the federal claim and (2) where under the circumstances a plaintiff would be expected to join the claims in one lawsuit.<sup>118</sup> Assuming the narrowest view of pendent jurisdiction under *Gibbs*,<sup>119</sup> part of the efficiency costs of exclusive federal jurisdiction of suits brought under any federal law will be that a plaintiff will have to bring a separate state-court suit where either (1) or (2) above is not satisfied. These efficiency costs would continue to be appreciable, as Professor Loss makes clear in his current supplement.<sup>120</sup> Such problems of multiplicity, however, are clearly not as severe as those which seemed possible when Loss first discussed the problems of exclusive federal jurisdiction: the simultaneous prosecution of a state and a federal lawsuit arising from identical or substantially overlapping facts. Additionally, Congress could expand the scope of pendent jurisdiction in cases arising under federal corporate law, permitting all theories to be joined in one suit at the expense of more federal courts' time spent on state-law claims.<sup>121</sup>

The other difficulty described above involves the power of federal courts to grant relief under state law which would not otherwise be available under federal law.<sup>122</sup> There may still be limitations upon the power of federal courts in diversity cases to grant a remedy novel to them but provided for by state law.<sup>123</sup> Such a limitation could result in duplicative judicial effort. Even with

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116. Loss, *supra* note 114, at 1278-84.

117. 383 U.S. 715 (1966).

118. *Id.* at 724-25.

119. The question still open under *Gibbs* is whether both requirements (i) and (ii) described in the text above must be met in order for pendent jurisdiction to be available or whether either will suffice. See Baker, *Toward a Relaxed View of Federal Ancillary and Pendent Jurisdiction*, 33 U. PITT. L. REV. 759, 764-65 (1972).

120. L. LOSS, SECURITIES REGULATION 2962-76 (vol. V 1969 Supp. to vol. II 1961).

121. While there might be legitimate debate about the constitutional limitation upon pendent jurisdiction, a strong argument can be made that, to the extent that lack of pendent jurisdiction would constitute a severe deterrent to the use of a federal forum for a federal claim, there is justification for such jurisdiction. See P. BATOR, P. MISHKIN, D. SHAPIRO, & H. WECHSLER, HART & WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 922-23 (2d ed. 1973).

122. See Loss, *supra* note 114, at 1278-84.

123. There seems to have been some amelioration of this difficulty as well. There are suggestions that in a diversity case, federal courts can grant remedies provided by state law even where such remedies are not otherwise available in federal court. *Susquehanna Corp. v. General Refractories Co.*, 250 F. Supp. 797 (E.D. Pa. 1966) (dictum), *aff'd in part per curiam*, 356 F.2d 985 (3d Cir. 1966). Loss' argument is itself a powerful authority favoring federal courts' power in diversity cases to use state remedies. At a minimum, federal courts seem capable of adapting clearly permissible federal remedies to approximate relief available under state law. See *Stern v. South Chester Tube Co.*, 390 U.S. 606 (1968); *Susquehanna Corp.*, *supra* this note. See generally L. LOSS, SECURITIES REGULATION, *supra* note 120, 2958-59.

respect to wrongs arising out of the same factual transactions, some relief may be available only from state courts, while any relief under federal law generally would be available only from federal courts.<sup>124</sup> Even if one assumes the continued existence of such limitations, they, like the court-defined scope of pendent jurisdiction, would yield to congressional action. Congress could, for example, provide that with respect to any claim for relief under state corporate law properly before a federal district court as pendent to a claim under federal corporate law, the federal court may order any remedy available to a court of the state whose substantive law governs the claim.<sup>125</sup> The resulting costs of such a statute would be the extra judicial costs of providing whatever relief would have been unavailable in federal court prior to the expansion of remedies.

*iii. Some Conclusions: A Trial Period of Exclusivity*

There seem to be few arguments for exclusive federal jurisdiction over suits under any particular federal corporation law if (1) its directives provide little interpretive leeway or (2) its directives, while vague, require a court principally to determine mixed questions of law and fact. With respect to those federal standards which contemplate a great deal of judicial lawmaking, Congress should seriously consider exclusive federal jurisdiction.

Two sorts of costs which must be weighed against the benefits of exclusive federal jurisdiction are (1) the increased workload which results from sharing none of the burden with state courts<sup>126</sup> and (2) the possibility that exclusive jurisdiction would result in two suits, one state, one federal, in instances where one suit in either forum would have sufficed had jurisdiction been concurrent. Not only has the latter difficulty been ameliorated significantly by judicial decision, but it is likely that Congress could virtually eliminate it. The cost of such a solution would be an increase in the time the lower federal courts spend hearing state-law claims.

Ultimately it is such an increase in the workload of the lower federal courts along with that caused directly by the absence of alternative state forums which Congress must weigh against the uniformity benefits described above.

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124. Loss, *supra* note 114, at 1250. But it is arguable that the states might use federal duties as the basis of state-created causes of action. *Id.* at 1263-77.

125. It seems impossible to construct an argument that Congress could not, if it so desires, permit or even require the federal courts to grant a traditionally judicial remedy, available in the state courts, for state-law claims properly before those courts pursuant to diversity or pendent jurisdiction.

126. It could be argued that this cannot legitimately be considered a cost and that Congress should be willing to provide sufficient federal judicial resources to administer litigation under its substantive programs. From a congressional perspective, however, the possibility that some of the federal-question caseload will be absorbed by the state courts could naturally be viewed as a benefit. In any event such a sharing is frequently described as a legitimate end. *See* Redish & Muench, *supra* note 77, at 334.

If these costs and benefits seem too difficult to weigh in the abstract, perhaps the best way to decide about federal exclusivity is to decide after having some experience with both the quantity of litigation and the kinds of legal issues generated by each new federal regulation. This seems workable in the case of the limited federal intrusion envisioned by Cary. Jurisdiction over all claims arising under the new federal corporate law could be made exclusively federal for a period of seven years.<sup>127</sup> The expiration of the seven-year period would provide an occasion for considering the exclusivity issue on the basis of the data amassed.<sup>128</sup> Additionally, although seven years would surely not be long enough for the federal courts to have answered definitively all major questions under the new federal law, the lower federal courts would have at least begun to give it shape.

Under a scheme of federal regulation more comprehensive than Cary's, it seems important to attempt a jurisdictional solution at the outset. The problems peculiar to more comprehensive regulation are discussed in the next section.

## 2. *Special Problems of Comprehensive Federal Regulation*

The discussion in part A above is for the most part germane to questions of allocation of jurisdiction under either partial or comprehensive federal regulation of national corporations. The material that follows in this section deals with issues which are peculiar to a program of federal chartering and comprehensive regulation. If the current system of state regulation of national corporations were modified by the very limited scheme suggested by Cary,<sup>129</sup> the respective chartering states would continue to provide almost all of the law governing such corporations' internal affairs and appropriate forums for hearing disputes under such law. Under a scheme of exclusive federal chartering and regulation of national corporations like that proposed by A. A. Sommer,<sup>130</sup> other problems arise.

### a. Exclusive Federal Chartering—Choice-of-Forum Difficulties

Under a scheme of exclusive federal chartering and comprehensive regulation coupled with concurrent jurisdiction in the state courts, questions about appropriate state forums arise. There no longer would be a state of incorpo-

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127. Such self-terminating laws have been referred to as "sunset laws." See Adams, *Sunset: A Proposal for Accountable Government*, 28 AD. LAW REV. 511 (1976).

128. Of course it would be impossible at the end of such period to compare the effects of exclusive federal jurisdiction with those of concurrent jurisdiction, since the latter would not have been tried. It seems to me that the magnitude of the uniformity benefits is more predictable than that of the increase in pressure on the federal courts. A seven-year period of exclusivity would provide a better understanding of the latter.

129. For the substantive features of his proposal see note 57 *supra*.

130. See note 59 *supra*.

ration for each national corporation. Under these circumstances, and assuming a congressional desire to spare the federal courts some of the burdens of suits under federal law, which states may, or even must, open their courts to suits to enforce the charter rights of shareholders of such a corporation? For example, what would be an appropriate state forum to hear a suit to compel payment of dividends to preferred shareholders of a national corporation? No state has a truly unique interest in the controversy. A preponderance-of-the-shareholders test, or a principal-place-of-business test are not only arbitrary but would require determinations that may be too difficult to make and in any event result in a potential for a frequent change of appropriate state forum. The most workable method of providing concurrent state-federal jurisdiction mandatory upon the states would be for a statute to provide that each national corporation certify the identity of its headquarters state to a federal agency and to expressly provide that the courts of that state have mandatory concurrent jurisdiction over suits under federal corporate law involving that corporation. It is not clear that the federal government has the power to use state courts in this way.<sup>131</sup> Even if Congress could create such concurrent jurisdiction it seems unwise for it to do so under a federal chartering scheme. States are free to permit their courts to refuse on the grounds of forum non conveniens to consider questions involving the internal affairs of corporations chartered by other states. When courts so refuse, the effect is to force such litigation back to the chartering state, which alone can charge such a corporation taxes without regard to the amount of its business or property in the state.<sup>132</sup> Unless, under federal chartering, headquarters states were permitted to charge for the headquartering privilege as states can now charge for the expenses they bear as chartering states, the net result would be a redistribution of wealth to the federal government.

A. A. Sommer's proposal for exclusive federal chartering and total preemption of state law would structurally resemble the current state enabling model and would presumably create in shareholders of national corporations at least all of the individual rights now enjoyed by them under most state laws.<sup>133</sup> As discussed earlier, under 28 U.S.C. 1337 suits brought to enforce rights conferred by federal statute and most probably those to enforce rights granted by the federal corporate charters could be brought in federal court

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131. To the extent that a state's courts refused on forum non conveniens grounds to hear suits involving the internal affairs of foreign-state-chartered corporations, its courts could perhaps invoke that doctrine as a valid excuse for refusing to hear cognate suits involving federally chartered corporations. See note 55 *supra* and accompanying text. Note that state-court refusals to entertain federal causes of action found to rest upon a valid excuse all involved congressional silence as to the duty of the states to hear them. It is, however, an open question whether Congress can override an otherwise valid excuse. See *Missouri ex rel. Southern Ry. v. Mayfield*, 340 U.S. 1, 4-5 (1950); *Douglas v. New York, N.H. & H. RR.*, 279 U.S. 377, 387-88 (1929).

132. See notes 23 and 24 *supra* and accompanying text.

133. See note 59 *supra*.

regardless of the amount in controversy.<sup>134</sup> Beyond the implication for individual plaintiffs with small claims, civil actions could proceed on behalf of classes of shareholders regardless of the fact that some members, indeed that all members, had claims not in excess of \$10,000.<sup>135</sup>

A Congress considering preemption of state corporation laws with respect to national corporations would need to consider how to deal with such small claims. As we have seen, doing nothing would most likely result in federal original jurisdiction concurrent with state courts and unlimited by jurisdictional amount.

Frivolous shareholder suits against management to obtain coercive relief—*e.g.*, to inspect books and records,<sup>136</sup> to enjoin ultra vires acts,<sup>137</sup> and to correct wrongs with respect to shareholder voting<sup>138</sup>—could be particularly vexatious.

Perhaps the best way of avoiding many of the difficulties described above would be to provide for a large measure of exclusive federal jurisdiction divided between a federal administrative agency and the federal courts. Federal chartering would necessarily entail the use if not the creation of an administrative agency to deal with such matters as recording charter amendments. Such an agency could also be given a judicial role. To avoid the familiar problem of agency coziness with those regulated, federal courts could entertain suits requesting large amounts of money damages or nonmonetary relief on behalf of those representing a reasonably large percentage of securities of any relevant class. Suits seeking shareholder lists and other suits for nonmonetary relief pressed against management by those representing a fairly small percentage of securities in any class would be decided initially by the agency. The appropriate U.S. court of appeals would review only determinations of law. Suits to recover small sums of money might be dealt with in the same fashion or farmed out to the states, provided the problem of the choice of the appropriate state forum described above had been dealt with. Depending upon the location of agency offices, a shareholder might indeed be forced to travel a great distance to obtain coercive relief against actions of management which violate charter rights. This would not involve a change for the worse. Today shareholders often must travel a great distance to obtain such relief under state law.

#### b. Exclusive Federal Chartering—Diversity Jurisdiction

If federal regulation of national corporations were to entail the substitution of a federal certificate of incorporation for the state certificate currently

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134. See note 47 *supra* and accompanying text.

135. See note 51 *supra* and accompanying text.

136. See, *e.g.*, N.Y. BUS. CORP. LAW § 624 (McKinney 1963).

137. See, *e.g.*, N.Y. BUS. CORP. LAW § 203 (McKinney 1963).

138. See, *e.g.*, N.Y. BUS. CORP. LAW § 619 (McKinney 1963).

held by each corporation, the result under the existing diversity jurisdiction-conferring statute would most likely be the elimination of diversity jurisdiction over suits to which such corporations are parties.

A literal reading of 28 U.S.C., section 1332(c), hardly compels such a result: "For the purposes of this section and section 1441 of this title, a corporation shall be deemed a citizen of any State by which it has been incorporated and of the State where it has its principal place of business. . . ." From such text alone one could argue plausibly that national corporations would retain citizenship in the state of their principal place of business even though there would no longer be any state of incorporation. Courts which have grappled with virtually identical issues, however, have decided otherwise.<sup>139</sup> They have noted that the addition in 1958 of the possibility of a second citizenship in a corporation's principal place of business was designed to cut back on diversity jurisdiction by creating the possibility of identity of citizenship between a corporation and the citizens of an additional state in which parochial bias against the corporation is unlikely.<sup>140</sup> This purpose of creating additional domiciles is violated when instead of limiting the possibility of diversity jurisdiction against a true state-citizen corporation, the principal-place-of-business domicile is used as the only ground of the statute's applicability. If, as is likely, an exclusively federally chartered corporation would be treated as a citizen of no state under section 1332, then that section's complete diversity requirement would never be satisfied in an action where the corporation is a necessary party.<sup>141</sup>

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139. See *Federal Deposit Ins. Corp. v. National Surety Corp.*, 345 F. Supp. 885 (S.D. Iowa 1972), holding that the Disabled American Veterans, a federally chartered corporation, not domiciled by Congress in a particular state, is the citizen of no state for diversity purposes, not even the state where it has a principal place of business. See also *Rice v. Disabled American Veterans*, 295 F. Supp. 131, 132-34 (D.D.C. 1968).

If the United States Government had owned more than one-half of the stock of the federal corporation involved in either of the two cases described in the preceding paragraph, a special jurisdictional provision would have created federal jurisdiction regardless of diversity of citizenship or the presence of a federal question. 28 U.S.C. § 1349 (1970).

140. 345 F. Supp. at 887; 295 F. Supp. at 134.

141. The statement in the text refers to all suits by or against business corporations chartered exclusively by the federal government, not solely to suits under federal corporate law. Under existing statutes, a federal court can never have diversity jurisdiction with respect to that portion of a lawsuit involving a party who is neither a citizen of a particular state nor of a foreign nation. See *Fahrner v. Gentzsch*, 355 F. Supp. 349, 353 (E.D. Pa. 1972); See *WRIGHT*, *supra* note 64, § 3621 at p. 756 n.5 and accompanying text. It is clear that the citizenship of such a party can never be used to create diversity. *Id.* Can such a stateless United States citizen be an additional party to a suit between other parties whose citizenship pattern otherwise satisfies the requirements of § 1332 (a)(1) or (a)(2)? The *Fahrner* court permitted such a person to continue as a party plaintiff but only on the theory that his claim was pendent to claims asserted in a suit which otherwise met the requirements of § 1332 (a)(2). 355 F. Supp. at 353-54.

It is, however, clear that pendent jurisdiction would at best only occasionally make available diversity jurisdiction over a suit involving a stateless national corporation holding only a federal charter. First, where such a corporation is the only possible plaintiff or defendant there can be no diversity, because (i) neither § 1332(a)(1) nor (2) is satisfied (see *Kaufman and Broad, Inc. v. Gootrad*, 397 F. Supp. 1054 (S.D.N.Y. 1975); *Fahrner* at 353), and (ii) there is no diversity action

In the current climate, as evidenced by the legislative history of the 1958 amendments to section 1332,<sup>142</sup> by American Law Institute proposals to cut back diversity jurisdiction,<sup>143</sup> and by recently proposed legislation,<sup>144</sup> it is possible that Congress would be delighted with the contraction of diversity jurisdiction which would result from combining federal chartering with extant section 1332. Nevertheless, a Congress considering a federal chartering scheme should advert to the probable result of its inaction. To avoid otherwise inevitable litigation, Congress, if it desires such constriction of diversity jurisdiction, should include as a part of any federal chartering law a clear declaration that a federally chartered corporation is a citizen of no state for purposes of diversity jurisdiction. Congress' authority to do so is unquestionable.<sup>145</sup> If on the other hand Congress wishes to retain diversity jurisdiction over national corporations, it should so indicate expressly. While some may doubt Congress' power to make a federally chartered corporation a state citizen for diversity purposes, those doubts seem ill founded.<sup>146</sup> Perhaps, as in current American Law Institute proposals, the best solution would be for Congress to permit federal diversity jurisdiction over suits by or against national corporations in carefully defined situations where discrimination against such corporations seems plausible.<sup>147</sup>

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among other parties to which such a corporation's claim might be appended. Second, even where an action might continue among other parties who satisfy the requirements of § 1332, the availability of pendent jurisdiction in diversity cases is by no means settled. *Cf. Seyler v. Steuben Motors, Inc.*, 462 F.2d 181 (3d Cir. 1972).

142. 2 U.S. CODE CONG. AND ADMIN. NEWS 3101-03 (1958).

143. ALI, *supra* note 113, at 12-13, 125-30.

144. See H.R. 761, 95th Cong., 1st Sess. (1977) currently pending before the House of Representatives and proposing the abolition of federal district court diversity jurisdiction. Recently the members of the Judicial Conference of the United States independently proposed the abolition of such jurisdiction. See release data March 11, 1977, of the Public Information Office of the United States Courts.

145. *Sheldon v. Sill*, 49 U.S. (8 How.) 441 (1850), affirms great power in Congress to limit the jurisdiction of the lower federal courts to less than that which might be given under article III of the United States Constitution.

In 1809 the Supreme Court held that corporations are citizens of no state. *Bank of United States v. Deveaux*, 9 U.S. (5 Cranch) 61 (1809). In 1844 the Court began treating corporations as citizens of their chartering states. *Louisville, C. & C. R. Co. v. Letson*, 43 U.S. (2 How.) 497 (1844). Although the rationale for such treatment has shifted somewhat over the years, the net effect of the *Letson* case has remained constant. For an interesting discussion of judicial difficulties with the notions of the corporate person's state citizenship see *WRIGHT, supra* note 37 at 101.

146. The argument that there are limits upon Congress' power to expand diversity jurisdiction by redefining state citizenship is not entirely frivolous. Article III of the Constitution must impose some limitations. For example, it is unthinkable that the words "citizens of states" in article III are sufficiently broad to permit Congress to expand diversity jurisdiction by designating a person or a corporation a citizen of a state with which he or it has no contact. On the other hand it seems likely that article III would be read to permit Congress' designating an exclusively federally chartered corporation a citizen of the state where it is headquartered or where it has a principal place of business.

147. ALI, *supra* note 113, at 13, 125-30. Note that the current proposal prohibits a corporation from invoking diversity (either originally or by removal) in a state where it has certain sub-



## II

FEDERAL CORPORATE LAW: PROBLEMS OF JUDICIAL EFFICIENCY ARISING  
FROM THE FIT BETWEEN FEDERAL AND STATE LAW

As discussed in the introduction, the structural inelegance of the current system of state regulation of national corporations is by itself an insufficient reason for change. From the perspective of various critics of the substance of state corporate law, however, the benefits of some federal intrusion are clear. Should one consider problems of federalism in determining the scope of any proposed federal intrusion?

From a federal perspective, the possible costs of any scheme of federal regulation are (1) the inevitable initial costs of designing and creating a new regulatory scheme, (2) the continuing costs of running such a scheme, and (3) the intangible injury to federalism caused by federal intrusion into an area formerly regulated by the states. In the case of regulation of national corporations, only potential costs (1) and (2) seem worth considering. There are good arguments that federalism often requires that Congress decline to exercise the legislative power it possesses under the commerce clause. Many local activities having national impact also have a particularly strong local impact as well. Given the vastness of commerce clause power, if the states are to be more than administrative arms of the federal government, some congressional restraint is necessary. Additionally, there is often an independent federal interest in permitting the states to serve as laboratories testing the results of different legislative approaches to similar problems.

Choosing federal restraint based upon federalism in the case of possible federal regulation of national corporations, however, is to apply deferential federalism where it is least justified.<sup>148</sup> The federal interest in regulating the internal affairs of such corporations is obviously great. With respect to a national corporation, no state has a special and legitimate interest in regulating the various relationships among its management and shareholders. As discussed above, the chartering state's only interest is in selling its local law to govern this most national of all contractual relationships. Such an interest is obviously entitled to no weight at all against the great federal interest described above. Finally, is a federal interest served by permitting the laboratory-states a few more experiments? From the perspective of greater management accountability—that of the proponents of federal incorporation—the experimentation would seem to have run a long and useful course. From that viewpoint, there seems to be no need to hold up federal legislation, otherwise quite justifiable by means of a state- and federal-interest calculus, solely on the ground that some good ideas might emerge from a further period of state regulation.

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stantial contacts. *Id.* Diversity could be further restricted by prohibiting the invocation of diversity jurisdiction against a corporation in such a jurisdiction.

148. *But see* NADER, *supra* note 1, at 240.

The remaining costs of comprehensive federal regulation which are of legitimate concern to a federal legislator are those of starting and running the regulatory program. It is difficult to estimate the costs in dollars of any particular regulatory program. Were figures available, each reader would still have to weigh them according to his own system of values against the benefits of increased fairness. Instead of attempting this impossible calculus, I want to assume that the difficult decision has been made in favor of a certain amount of federal regulation and discuss how the regulation can be made most efficient from a judicial perspective.

We have seen in an earlier portion of this article that chaos would have been the result if states had not practiced informal federalism by generally choosing to apply the law of the state of incorporation to govern the internal affairs of foreign corporations appearing in their courts.<sup>149</sup> The chaos would have resulted from the application of different but parallel laws to different portions of a transaction which could be regulated reasonably only by means of one set of coherent rules.

Partial federal preemption of the regulation of national corporations raises no such problems. To be sure, partial preemption involves the existence of two sets of laws—one state, one federal—both regulating conduct within a substantive area. The difference between multiple regulation by several states and joint state and federal regulation is that with respect to the latter there is truly only one set of laws. It is made up of an amalgam of state and federal law, but it is internally consistent.<sup>150</sup> The existence of a conflict between the law of a state of incorporation and a federal regulation and the proper resolution of such a conflict would be determined by federal law.

While the relationship between state and federal law would get worked out in each case, the expenses of nonpreemption are the judicial expenses of working out the relationship. Consequently, the costs are greatest where there are alternative plausible ways of viewing the relationship between state and federal law.

One good example explored by Professor Loss is the complex relationship between state law governing the shareholder franchise and the federal proxy rules.<sup>151</sup> Professor Loss has discussed in detail the difficult judicial decisions which have been and may be occasioned by the necessity of determining the proper fit between state and federal law in this complex area.<sup>152</sup>

A simpler example of such problems of fit can be found in Professor

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149. See note 140 *supra* and accompanying text.

150. The law which governs daily living in the United States is a single system of law; it speaks in relation to any particular question with only one ultimately authoritative voice, however difficult it may be on occasion to discern in advance which of two or more conflicting voices really carries authority. In the long run and in large, this must be so. Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489 (1954).

151. See Loss, *supra* note 114.

152. *Id.*

Cary's proposal to require by federal law that certain provisions be inserted in the state-issued charters of national corporations.<sup>153</sup> Is the breach of such a provision a violation of state or of federal law?<sup>154</sup> Regardless of which law is found to create the duties, is the remedy for a breach of such a duty to be determined by federal or by state law? Can a violation of such a provision be ratified by the shareholders? If so, will federal law or state law determine what is a valid ratification? Ultimately, without legislative guidance, the federal courts would answer such questions of fit between state and federal laws which clearly continue to operate together but in a way only vaguely if at all suggested by federal statute.

Congress could, however, save courts and litigants time and trouble by spelling out clearly and in advance the more important features of the contemplated relationship. In regulating the internal affairs of national corporations, because no strong state interest justifies deferential federalism, the simplest way to spell out the relationship is for Congress to preempt completely the law in a convenient area.

The same problems can arise in substantive areas other than those discussed immediately above. Should federal fiduciary standards be minimum standards in the sense that more stringent state laws are not preempted?<sup>155</sup> This pattern works well where federal objectives are clear, limited, and quantifiable. In the area of pollution control, Congress requires of industries in all states a quantifiable level of cleanliness, but permits states to require even more.<sup>156</sup> A fiduciary standard, on the other hand, represents an attempt to vindicate not only vague but diverse substantive ends. Even if the question is how much care is required of a director, it is possible to harm the national shareholder constituency of a corporation by requiring either too much or too little from corporate managers. While it may not seem realistic to assume that states would impose more exacting standards, litigants will nevertheless so argue. Why should federal courts have to concern themselves with the relationship between state and federal law in the area of no legitimate localized interest? Again, the proper solution seems to be a thorough federal preemption of a conveniently isolable area of regulation.

One might, I suppose, attempt an argument that corporate regulation is such an interlocking system that total preemption is necessary because none of its parts is truly isolable. This seems untenable. The partial regulation described above—for example, Professor Cary's proposal—seems to involve sub-

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153. See note 57 *supra*.

154. Cf. Loss, *supra* note 114, at 1263-77.

155. Professor Kaplan suggests such a minimum federal standard pattern. Kaplan, *supra* note 1, at 481.

156. See 33 U.S.C. § 1370 (Supp. II 1972) (Federal Water Pollution Control Act); 42 U.S.C. § 1857d-1 (1970) (Clean Air Act of 1970); 42 U.S.C.A. § 6929 (Resource Conservation and Recovery Act of 1976).

stantive areas which are reasonably isolable from other corporate regulation. Occasional unforeseeable problems of fit may occur in any scheme of partial preemption; what is important is to avoid those which are foreseeable.

The suggested approach is for the legislature to think much more carefully about the potential interaction of state and federal law. Beyond this, the suggestion is that when Congress is partially regulating in an area of no legitimate state interest, it should clearly eliminate some of the most foreseeable and troublesome potential connections between its regulation and state laws. One device helping to accomplish this would be a provision to accompany any scheme of partial federal regulation. It might read as follows:

Sections \_\_\_\_ through \_\_\_\_ of this title preempt state laws governing the same subject matter and are to be construed liberally to effectuate their purposes. The following determinations shall be made solely according to federal law determined by the courts in accordance with the purposes of this title:

- (a) the nature and scope of the rights and duties created by or recognized under such sections;
- (b) the identity of beneficiaries of rights, or the objects of duties, created by or recognized under such sections;
- (c) the existence, nature and scope of any cause of action created by or recognized under such sections or of any defense thereto;
- (d) the waiver of any rights created by or recognized under such sections; and
- (e) the existence, nature, and scope of any remedy for the violation of any right or the breach of any duty created or recognized under such sections.

In determining the federal law contemplated by this section the laws of the several states may be considered but shall be without binding effect.

While such a provision would enlarge the area on the federal side of the inevitably blurred line which separates state and federal regulation, I believe it would help bring that line into somewhat sharper focus.