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CALIFORNIA REGULATES PSEUDO-FOREIGN CORPORATIONS—TRAMPLING UPON THE TRAMP?

J. Thomas Oldham*

It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. . . . It must dwell in the place of its creation, and cannot migrate to another sovereignty.¹

INTRODUCTION

Anglo-American courts have traditionally applied the internal affairs doctrine to resolve choice of law problems involving foreign corporations.² The internal affairs doctrine requires that the law of the state of incorporation be applied to questions regarding the internal affairs³ of a corporation. However, a recent amendment to the California Corporations Code provides for a substantially different choice of law approach re-

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1. *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 588 (1839) (Taney, C.J.).

2. For a summary of the views of the early American commentators regarding the law applicable to corporations with multi-state contacts, see generally 1 J. DAVIS, *ESSAYS IN THE EARLY HISTORY OF FOREIGN CORPORATIONS* (1905); G. HENDERSON, *THE POSITION OF FOREIGN CORPORATIONS IN AMERICAN CONSTITUTIONAL LAW* chs. I-II (1918); E. RABEL, *THE CONFLICT OF LAWS, A COMPARATIVE STUDY* ch. 19 (2d ed. 1958); Baldwin, *American Business Corporations Before 1786*, 8 AM. HIST. REV. 449 (1903).

3. Examples of corporate internal affairs include the duties and liabilities of directors, the proper procedure for electing them, the enforceability of by-laws or articles, and the proper procedure for holding directors' and shareholders' meetings.

Courts have disagreed as to what constitutes a question involving the "internal affairs" of a corporation, and the scope of this question has sometimes been severely limited by courts wishing to apply local law to a question involving a foreign corporation. See, e.g., *Toklan Royalty Corp. v. Tiffany*, 9 Okla. 120, 141 P.2d 571 (1943). This definition suggested in an early case has been widely accepted:

[W]here the act complained of affects the complainant solely in his capacity as a member of the corporation, whether it be as stockholder, director, president, or other officer, and is the act of the corporation, whether acting in stockholders' meeting, or through its agents, the board of directors then such action is the management of the internal affairs of the corporation. . . .

North State Copper & Gold Mining Co. v. Field, 64 Md. 151, 154, 20 A. 1039, 1040 (1885). The drafters of the Restatement (Second) suggested this definition: "[A] corporation's internal affairs are involved whenever the issue concerns the relations *inter se* of the corporation, its stockholders, directors, officers or agents." *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 313, Comment a at 347 (1971).

garding the activities of pseudo-foreign corporations.⁴

This article examines California's departure under section 2115⁵ from the traditional approach to choice of law questions involving corporations with multi-state contacts. It includes a discussion of the theoretical underpinnings of the internal affairs doctrine and the judicial efforts to circumvent its application to pseudo-foreign corporations. The social costs of the application of the internal affairs doctrine will be examined in light of differences between California's corporate laws and those of New York and Delaware, where many California pseudo-foreign corporations are incorporated. Due to the differences among the corporate laws of the states, the application of the internal affairs doctrine has induced corporations to avoid incorporating in states with restrictive laws and to incorporate in less-restrictive states such as Delaware, taking their charter fees and franchise taxes with them. Thus, the application of the internal affairs doctrine to pseudo-foreign corporations imposes financial costs upon the forum state as well as social costs. This, in turn, has had a Gresham's Law effect on restrictive states, causing them to abandon their statutory schemes in order to successfully compete for corporate charter fees and franchise taxes.

The article also analyzes the constitutional limitations upon choice of law and evaluates the merit of constitutional challenges to section 2115. Finally, in light of the above, potential problems in the application of section 2115 will be discussed.

CALIFORNIA CORPORATIONS CODE SECTION 2115

Section 2115 represents an accommodation of the interests of pseudo-foreign corporations and the interests of California. It promotes the certainty of regulation desired by pseudo-foreign corporations in order to facilitate their corporate planning, and it advances the social policies of California by requiring that pseudo-foreign corporations conduct their internal affairs pursuant to California law rather than the law of the state of incorporation.

The new California Corporations Code defines pseudo-foreign corporations as those corporations incorporated in another state but whose principal place of business is California

4. Such foreign corporations have pejoratively been characterized as "tramp" corporations. A corporation which has minimal contacts with its state of incorporation and which derives a majority of its revenue within the forum will be referred to herein as a "pseudo-foreign" corporation.

5. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1673-75 (amending CAL. CORP. CODE

and a majority of whose shareholders have California domiciles. Section 2115(a) provides that selected internal affairs of a pseudo-foreign corporation will be governed by provisions of the California Corporations Code to the exclusion of the law of the state of incorporation⁶ when it is ascertained from the officers' certificate, filed pursuant to section 2108, that: (1) the average of its property, payroll and sales factors⁷ (as those terms are defined in sections 25129,⁸ 25132⁹ and 25134,¹⁰ respectively, of the California Revenue and Taxation Code) exceeds 50 percent during its latest full "income" year and (2) more than one-half of its outstanding voting securities are held of record¹¹ by persons having addresses¹² in California.¹³ If these

§ 2115). All statutory references in this article, unless otherwise indicated, are to the CAL. CORP. CODE (West Supp. 1976).

6. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1674 (amending CAL. CORP. CODE § 2115(b)). It should be noted that these provisions apply "to the exclusion of the law of the state of incorporation." *Id.* This provision does not specifically proscribe the application of the law of a third state in such a situation. For example, if a director was a domiciliary of a third state, and that director took certain corporate action in that state which caused harm to a resident of that state, it could be argued that the law of that state should govern the director's standard of care.

7. These "factors" basically represent the respective percentage of a corporation's property, payroll and sales attributable to California. For an extensive discussion of these factors. See generally R. BOCK, *GUIDEBOOK TO CALIFORNIA TAXES* 316-17 (1974); Comment, *California's New General Corporation Law: Quasi-Foreign Corporations*, 7 PAC. L.J. 673, 688-91 (1976) [hereinafter cited as Comment, *Quasi-Foreign Corporations*].

8. The property factor is defined as a fraction, the numerator of which is the average of the taxpayer's real and tangible personal property owned or rented and used in this state during the income year, and the denominator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used during the income year.

CAL. REV. & Tax. Code § 25129 (West 1970).

9. The payroll factor is defined as "a fraction, the numerator of which is the total amount paid in this state during the income year by the taxpayer for compensation, and the denominator of which is the total compensation paid everywhere during the income year." *Id.* § 25132.

10. The sales factor is defined as "a fraction, the numerator of which is the total sales of the taxpayer in this state during the income year, and the denominator of which is the sales of the taxpayer everywhere during the income year." *Id.* § 25134.

11. Any securities known by the issuer to be held in the name of a broker, dealer or its nominee are not considered outstanding for purposes of this section. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1673-74 (amending CAL. CORP. CODE § 2115(a)).

12. This refers to the addresses of the shareholders as of the last record date for a shareholder's meeting. *Id.* § 30.4, at 1671 (amending CAL. CORP. CODE § 2108(a)(1)). It is not clear what it means to "have an address" in California. Presumably, this term refers to the principal address of a shareholder according to the records of the corporation. See also CAL. CORP. CODE §§ 25103(b), (c), (d) (West Supp. 1976).

requirements are met, the laws of the pseudo-foreign corporation's state of incorporation will be supplanted by provisions of California law dealing with shareholder rights,¹⁴ director and officer conduct and liability,¹⁵ shareholder distributions,¹⁶ corporate reorganizations and dissenters' rights,¹⁷ and other provisions which relate to corporate internal affairs.¹⁸ Corporations with securities listed on a national securities exchange¹⁹ are

13. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1673-74 (amending CAL. CORP. CODE § 2115(a)). This information is disclosed in the section 2108 certificate. See text accompanying note 22 *infra*. It should be emphasized that these tests are conjunctive. A corporation that does business only in California but a majority of whose outstanding voting shares are held by persons having addresses outside of California would not be governed by section 2115.

14. Section 2115(b) expressly provides that the following sections of the new code regarding shareholders' rights are applicable to pseudo-foreign corporations: section 301 (annual election of directors); section 303 (removal of a director without cause by the shareholders); section 304 (removal of a director for certain proscribed acts pursuant to court proceedings instituted by the shareholders); section 305(c) (filling director vacancies where less than a majority of the directors then in office were elected by the shareholders); sections 600(b) and (c) (requirement of an annual shareholders' meeting); sections 708(a), (b) and (c) (each shareholder's right to cumulate votes at any election of directors). Cal. Legis. Serv., ch. 641, § 32.5, at 1674 (amending CAL. CORP. CODE § 2115(b)).

15. Section 2115(b) expressly provides that the following sections of the new code regarding director and officer conduct and liability are applicable to pseudo-foreign corporations: section 309 (director's standard of care); section 316 (liability of a director for unlawful distributions), excluding subdivisions (a)(3) and (f)(3); section 317 (indemnification by the corporation of a director, officer or others). *Id.*

16. Section 2115(b) expressly provides that the following sections of the new code regarding shareholder distributions are applicable to pseudo-foreign corporations: sections 500-05 (limitations on corporate distributions to its shareholders); section 506 (liability of a shareholder who receives an unlawful distribution). *Id.*

17. Section 2115(b) expressly provides that the following sections and chapters of the new code regarding corporate reorganizations and dissenters' rights are applicable to pseudo-foreign corporations: section 1001(d) (limitation upon "freezing out" minority shareholders pursuant to a sale of assets); section 1101, the text following subdivision (e) (limitations upon "freezing out" minority shareholders pursuant to a merger); chapter 12 (commencing with section 1200) (reorganizations); chapter 13 (commencing with section 1300) (dissenters' rights). *Id.*

18. Section 2115(b) expressly provides that the following sections and chapters of the new code regarding other aspects of corporate internal affairs are applicable to pseudo-foreign corporations: sections 1500-01 (corporate books and records and reports to shareholders); section 1508 (enforcement action by the California Attorney General); chapter 16 (commencing with section 1600) (shareholder's right of inspection). *Id.*

19. *Id.* at 1675 (amending CAL. CORP. CODE § 2115(e)). Only stocks listed on an exchange certified by the California Commissioner of Corporations under section 25100(o) are exempt. The Commissioner has certified the New York Stock Exchange and American Stock Exchange pursuant to this section. It should also be noted that section 2115(e) expressly exempts those corporations whose voting shares (other than directors' qualifying shares) are entirely owned (directly or indirectly) by an exempted corporation. *Id.*

expressly exempted from section 2115.²⁰

Pursuant to section 2105(a), a foreign corporation must qualify with the California Secretary of State before it transacts intra-state business in California.²¹ Section 2108 requires that after January 1, 1977, any foreign corporation qualified to transact intra-state business in California must annually file within three months and fifteen days after the close of its "income year" an "officers' certificate."²² The certificate must be filed regarding "income years" ending on or after December 31, 1976.²³

The officers' certificate must set forth: 1) the percentage of its outstanding voting securities held as of the record date for the last shareholders' meeting by persons "having addresses in California" (excluding shares held in the name of broker, dealer or its nominee), and 2) its "property, payroll and sales factors," both requirements to be computed pursuant to section 2115(a).²⁴ If the section 2108 officers' certificate is not filed with the Secretary of State within six months after notice that such a filing is delinquent, the Secretary "shall forfeit the right of that corporation to transact intra-state business" in California.²⁵ The Secretary of State is required to mail a section 2108 certificate form to each foreign corporation qualified to transact intrastate business in time reasonably sufficient for such a corporation to comply, but neither the failure of the Secretary of State to mail such a form nor the failure of the corporation

20. Section 2115(e) provides an exemption for "any corporation with outstanding securities listed on any national securities exchange. . . ." *Id.* This section applies to a corporation with any outstanding securities so listed; it does not appear necessary that all of these corporation's outstanding securities be so listed. The same rule applies regarding New York's similar regulatory scheme. See Baraf, *The Foreign Corporation—A Problem in Choice-of-Law Doctrine*, 33 BROOKLYN L. REV. 219 (1967) [hereinafter cited as Baraf].

21. Cf. CAL. CORP. CODE § 2102 (West Supp. 1976) (a foreign corporation which designated an agent for service of process prior to Jan. 1, 1977, need not file a section 2105 statement, but shall file an amended statement and designation when required by section 2107).

22. Cal. Legis. Serv., ch. 641, § 30.4, at 1671-72 (amending CAL. CORP. CODE § 2108). "Officers' certificate" is defined in CAL. CORP. CODE § 173 (West Supp. 1976).

23. Certain foreign parent corporations must also file such reports pursuant to section 2108(a) and section 2115. Cal. Legis. Serv., ch. 641, § 30.4, at 1671-72 (amending CAL. CORP. CODE § 2108(a)); *Id.* § 32.5 at 1673 (amending CAL. CORP. CODE § 2115(a)). This provision was added so that a pseudo-foreign corporation could not circumvent section 2115 by conducting its business via a subsidiary. It should be noted that New York's analogous provisions regarding pseudo-foreign corporations do not encompass pseudo-foreign parent corporations. N.Y. BUS. CORP. LAW § 1320 (McKinney 1963).

24. Cal. Legis. Serv., ch. 641, § 30.4, at 1671-72 (amending CAL. CORP. CODE § 2108(a)).

25. *Id.* at 1672 (amending CAL. CORP. CODE § 2108(d)).

to receive it is an excuse for a failure to comply with section 2108.²⁶

If the officers' certificate, filed pursuant to section 2108, shows that the corporation's California contacts satisfy the section 2115(a) two-pronged test, the provisions of the new code enumerated in section 2115(b) apply to that foreign corporation as of the first day of the corporation's first income year which commences at least thirty days after the date of filing of the officers' certificate.²⁷ A foreign corporation ceases to be governed by the provisions enumerated in section 2115(b) at the end of any income year during which either the officers' certificate shows that the corporation no longer meets the section 2115(a) tests or an order is entered by a court which declares that the tests are not met.²⁸

Section 2115 generally requires that foreign corporations which maintain their commercial domiciles in California be governed by California law. The section attempts to insure that the social policies of California, as manifested in its corporations code, will no longer be circumvented by such corporations pursuant to the internal affairs doctrine.

CIRCUMVENTING THE INTERNAL AFFAIRS DOCTRINE

The Internal Affairs Doctrine

To resolve choice of law questions regarding foreign corporations in the absence of a statute such as section 2115,²⁹ courts

26. Of course, the Secretary of State must send the delinquent filing notice. *Id.* (amending CAL. CORP. CODE § 2108(b)).

27. *Id.* § 32.5, at 1674 (amending CAL. CORP. CODE § 2115(c)). This section also indicates that the sections enumerated in section 2115(b) would govern the internal affairs of those foreign corporations "upon the entry of an order by a court declaring that [the section 2115(a) test has] been met." It is not clear whether those sections would govern the internal affairs of such a corporation immediately after the entry of such an order, or upon the first day of the first fiscal year which would commence at least 30 days after the entry of such an order.

28. *Id.* at 1674-75 (amending CAL. CORP. CODE § 2115(d)).

29. There are constitutional provisions or statutes in a majority of states which generally provide that foreign corporations shall be treated in the same manner as domestic ones. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137, 156 (1955) [hereinafter cited as Latty I]. Although it could be argued that such "equal treatment" provisions subject all foreign corporations transacting local business to local corporation law, such provisions have rarely been so construed. See Kaplan, *Foreign Corporations and Local Corporate Policy*, 21 VAND. L. REV. 433, 471 (1968) [hereinafter cited as Kaplan]; Latty I, *supra*, at 157; Reese & Kaufman, *The Law Governing Corporate Affairs: Choice of Law and the Impact of Full Faith and Credit*, 58 COLUM.

have traditionally applied the internal affairs doctrine.³⁰ It provides that the law of the forum may be applied to questions regarding the external affairs³¹ of a corporation, but the law of the state of incorporation must be applied to questions regarding the internal affairs³² of a corporation.

The internal affairs doctrine is a creature of the vested rights approach to choice of law questions. This approach geographically conceptualizes the rights of parties resulting from a transaction or occurrence with multi-state contacts. The rights of parties are said to vest in the place where they are created. The law of that state must then be applied to govern those rights, regardless where an action upon them is brought.³³

L. REV. 1118, 1118 n.1 (1958) [hereinafter cited as Reese & Kaufman].

30. It should be noted that under the traditional approach no distinction is customarily made between genuine foreign corporations and pseudo-foreign corporations. A pseudo-foreign corporation has been recognized as a validly formed corporate entity, and the law of its state of incorporation traditionally has been applied to questions regarding its internal affairs. *See, e.g., Lancaster v. Amsterdam Improvement Co.*, 140 N.Y. 576, 35 N.E. 964 (1894); *Demarest v. Flack*, 128 N.Y. 205, 28 N.E. 645 (1891); *Nicholson v. Franklin Brewing Co.*, 82 Ohio St. 94, 91 N.E. 991 (1910); *Cochran v. Shetler*, 286 Pa. 226, 133 A. 232 (1926). *But see Hill v. Beach*, 12 N.J. Eq. 31 (Ch. 1858). *See generally* Latty I, *supra* note 29, at 145-48.

31. Examples of corporate external affairs include the execution of contracts, the commission of torts, the sale of securities, and the conveyance of property. *See, e.g., Merrick v. N.W. Halsey & Co.*, 242 U.S. 568 (1917); *Caldwell v. Sioux Falls Stockyards Co.*, 242 U.S. 559 (1917); *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917); *Commonwealth Acceptance Corp. v. Jordan*, 198 Cal. 618, 246 P. 796 (1926); *Miles v. Woodward*, 115 Cal. 308, 46 P. 1076 (1896); *North State Copper & Gold Mining Co. v. Field*, 64 Md. 151, 20 A. 1039 (1885). *See generally* Baraf, *supra* note 20, at 235; Hohfeld, *The Individual Liability of Stockholders and the Conflict of Laws*, 10 COLUM. L. REV. 283-87 (1910); Latty I, *supra* note 29, at 143; Reese & Kaufman, *supra* note 29, at 1120-28; Note, *Forum Non Conveniens as a Substitute for the Internal Affairs Rule*, 58 COLUM. L. REV. 234 (1958) [hereinafter cited as Note, *Forum Non Conveniens*]; Note, *The Development of the "Internal Affairs" Rule in the Federal Courts and Its Future Under Erie v. Tompkins*, 46 COLUM. L. REV. 413 (1946); Note, *Conflict of Laws: Local Law Applied to Shareholders' Rights in Foreign Corporations*, 1962 DUKE L.J. 109, 110 [hereinafter cited as Note, *Local Law and Shareholders' Rights*]; Note, *Conflict of Laws: Elimination of Cumulative Voting by Foreign Corporation Held Subject to Forum State's Blue Sky Laws*, 46 MINN. L. REV. 785, 787-88 (1962) [hereinafter cited as Note, *Voting and Blue Sky Laws*]; Note, *Corporations: Sale of Securities*, 9 U.C.L.A. L. REV. 242 (1962) [hereinafter cited as Note, *Sale of Securities*]; Note, *The "Internal Affairs" Doctrine in State Courts*, 97 U. PA. L. REV. 666 (1949) [hereinafter cited as Note, *I.A.D. in State Courts*].

32. *See* note 3 *supra*.

33. *See generally* *Intercontinental Hotels Corp. v. Golden*, 15 N.Y.2d 9, 203 N.E.2d 210 (1964); H. GOODRICH, *CONFLICT OF LAWS* §§ 11, 14 (4th ed. 1964).

Some courts have refused to apply the law dictated by the vested rights approach if that law would violate a "fundamental policy" of the forum. *See, e.g., Hausman v. Buckley*, 299 F.2d 696 (2d Cir. 1972). *See also* Cavers, *A Critique of the Choice-of-*

Under the vested rights approach, the general nature of the action is first "characterized" (as *e.g.*, a "torts" or a "contract" action). A choice of law rule (connecting factor) has evolved for each general type of action; all choice of law questions of the same type of action are treated in the same manner. Once the nature of an action is characterized, the application of the appropriate connecting factor leads to the state where the rights of the parties vested and the laws of that state govern substantive questions presented by the action. For example, all tort questions are governed by the law of the state where the alleged wrong occurred. Questions concerning the internal affairs of a corporation have traditionally been decided by reference to the corporations code of the state of incorporation, since the rights and duties regarding such affairs were said to vest there.³⁴

Law Problem, 47 HARV. L. REV. 173, 183 (1933); Nussbaum, *Public Policy and the Political Crisis in the Conflict of Laws*, 49 YALE L.J. 1027, 1031 (1940); Paulsen & Sovern, "Public Policy" in the Conflict of Laws, 56 COLUM. L. REV. 969 (1956). Professors Paulsen and Sovern stated that "'public policy' is one way to avoid the application of a choice of law rule which the forum wishes to avoid." *Id.* at 981.

The Supreme Court has stated that this exception also applies to statutes which would otherwise be entitled to full faith and credit. For example, the Court made this statement in *Griffin v. McCoach*, 313 U.S. 498, 507 (1941):

"Where this Court has required the state of the forum to apply the foreign law under the full faith and credit clause or under the Fourteenth Amendment, it has recognized that a state is not required to enforce a law obnoxious to its public policy."

See also *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941).

34. Many courts initially regarded the internal affairs doctrine as a jurisdictional limit. Courts have stated that a local court would not exercise "visitorial powers" over the management of a foreign corporation. See *North State Copper & Gold Mining Co. v. Field*, 64 Md. 151, 20 A. 1039 (1885); Annot., 8 A.L.R. 2d 1185 (1949); *Latty I*, *supra* note 29, at 143; Note, *Local Law and Shareholders' Rights*, *supra* note 31, at 110. Courts in most jurisdictions now decide whether to dismiss an action regarding the internal affairs of a foreign corporation in accordance with the doctrine of *forum non conveniens*. See *Williams v. Green Bay & W. Ry.*, 326 U.S. 549 (1946); *Rogers v. Guarantee Trust Co.*, 288 U.S. 123 (1933); *Lonergan v. Crucible Steel Co. of America*, 37 Ill. 2d 599, 299 N.E. 2d 536 (1967); *Weede v. Iowa S. Util. Co.*, 231 Iowa 784, 2 N.W.2d 372 (1942); *Travis v. Knox Terpezon, Co.*, 215 N.Y. 259, 109 N.E. 250 (1915); *Latty I*, *supra* note 29, at 144; Note, *Forum Non Conveniens*, *supra* note 31; Note, *Forum Non Conveniens in the Internal Affairs of a Foreign Corporation*, 33 COLUM. L. REV. 492 (1933); Note, *Local Law and Shareholders' Rights*, *supra* note 31, at 111; Comment, *Internal Affairs Rule in the Federal Courts—The Erie Problem*, 115 U. PA. L. REV. 973 (1967); Note, *I.A.D. in State Courts*, *supra* note 31.

The Illinois Supreme Court summarized the modern view in this manner:

In early cases the acceptance or denial of jurisdiction of derivative actions against foreign corporations turned on what the courts determined was or was not interference with the internal affairs of the corporation. . . . We feel that the acceptance or denial of jurisdiction of such actions should be decided under the doctrine of *forum non conveniens* and that interference with the internal affairs of a foreign corporation is

Judicial Circumvention

Of course, the vested rights approach is only one of the various doctrines which may be utilized to resolve conflict of laws problems. By employing a different approach courts have been able to circumvent the internal affairs doctrine, thus enabling them to apply their own law to issues affecting the internal affairs of a foreign corporation. Courts have accomplished circumvention primarily by manipulating the characterization of the issue under the vested rights approach³⁵ or by adopting either the Restatement approach or the governmental interest analysis approach to conflict of laws problems. The Restatement approach requires that the law of the state which has the most significant relationship with the subject matter in issue should be applied.³⁶ On the other hand, governmental interest analysis focuses on the respective policies underlying the laws of the competing jurisdictions, and requires that the law of the jurisdiction whose underlying policy would be advanced by the application of its law, in view of the contacts between the parties and the competing jurisdictions, should be the law which governs the issue.³⁷

Courts manipulating the characterization of an issue under the vested rights approach have held, for example, that questions regarding the inspection rights of shareholders in pseudo-foreign corporations either do not involve the internal

only one factor in determining whether an Illinois court would serve the convenience of the parties and the ends of justice.

Lonergan v. Crucible Co. of America, 37 Ill. 2d 599, 605, 229 N.E.2d 536, 539 (1967).

35. Characterization is basically the classification of facts to fit broad established categories of law such as tort or contract. See A. ROBERTSON, *CHARACTERIZATION IN THE CONFLICT OF LAWS* (1940); Cook, "Characterization" in the *Conflict of Laws*, 51 *YALE L.J.* 191 (1941); Cormack, *Renvoi, Characterization and Preliminary Questions in the Conflict of Laws*, 14 *S. CAL. L. REV.* 221 (1941); Morse, *Characterization: Shadow or Substance*, 49 *COLUM. L. REV.* 1027 (1949).

The discussion of characterization was introduced in this country in Lorengen, *The Theory of Qualifications and the Conflict of Laws*, 20 *COLUM. L. REV.* 247 (1920).

36. *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 6, at 10 (1971). While the cases to be discussed pre-date the *Restatement (Second)*, for the sake of clarity, the approach taken in those cases is referred to as the Restatement approach. See, e.g., *Pearson v. Northeast Airlines, Inc.*, 309 F.2d 553 (2d Cir. 1962); *Auten v. Auten*, 308 *N.Y.* 155, 124 *N.E.2d* 99 (1954).

37. See, e.g., *Mazza v. Mazza*, 475 F.2d 385 (D.C. Cir. 1973); *Reich v. Purcell*, 67 *Cal.* 2d 551, 432 *P.2d* 727, 63 *Cal. Rptr.* 31 (1967). See generally Horowitz, *The Law of Choice of Law in California—A Restatement*, 21 *U.C.L.A. L. REV.* 719 (1974); Millhollin, *The New Choice of Law in the District of Columbia*, 24 *CATH. L. REV.* 448 (1975); Weintraub, *Comment on Reich v. Purcell*, 15 *U.C.L.A. L. REV.* 556 (1968).

affairs of a corporation or, if they do, they are questions which can be adjudicated pursuant to local law.³⁸ Either of these paths is agonizing for a court to take. It is difficult to seriously argue that a question regarding the right of a shareholder to inspect a corporation's books and records is not a question relating to its "internal affairs";³⁹ once it is admitted that such a question relates to a corporation's internal affairs, it is difficult to explain without a tremendous amount of circumlocution why the internal affairs doctrine should not be applied.⁴⁰

Other courts have employed the modern approaches of the Restatement and governmental interest analysis, which, as a means of circumventing the application of the internal affairs doctrine to pseudo-foreign corporations, is less agonizing than the characterization manipulation approach.⁴¹

*German-American Coffee Co. v. Diehl*⁴² involved a stockholder derivative suit brought in a New York court challenging the dividend payment of a New Jersey corporation whose principal place of business was New York. Both New Jersey and New York law forbade the disputed dividend, but New Jersey law authorized only the company's stockholders to challenge such an illegal dividend and did not allow a derivative action.

38. See *Loveman v. Tutwiler Inv. Co.*, 240 Ala. 424, 199 So. 854 (1941); *McCormick v. Statler Hotels Del. Corp.*, 55 Ill. App. 2d 21, 203 N.E.2d 697 (1964); *Donna v. Abbotts Dairies, Inc.*, 399 Pa. 497, 161 A.2d 13 (1960); 5 W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2229 (rev. ed. 1976).

39. Questions regarding shareholder inspection rights commonly occur during a nascent dispute between certain shareholders and management for control. It would be difficult to argue that this initial step in a contest for control of the corporation does not involve the internal affairs of the corporation; it is a dispute among individuals within the corporate structure, and does not involve the rights of third parties.

40. A few courts have expressly questioned the wisdom of applying the internal affairs doctrine to questions regarding the inspection rights of shareholders of pseudo-foreign corporations. See, e.g., *Toklan Royalty Corp. v. Tiffany*, 93 Okla. 120, 141 P.2d 571 (1943). The essence of these decisions may be that the courts believed that shareholder inspection rights may be regulated by more than one state without generating a significant number of problems. Other courts have applied local law to matters relating to the internal affairs of a foreign corporation. See, e.g., *Schwartz v. Art Craft Silk Hosiery Mills, Inc.*, 110 F.2d 465 (2d Cir. 1940) (liabilities of directors and officers for mismanagement and waste of corporate assets); *Stewart v. Bryant*, 122 Cal. App. 690, 10 P.2d 799 (1932) (expenditure of corporate funds). For cases applying local law pursuant to the state "equal treatment" statute, see, e.g., *Hunter v. Merger Mines Corp.*, 67 Idaho 115, 170 P.2d 800 (1946) (judicial inquiry into a corporate election); *Kahn v. American Cone & Pretzel Co.*, 365 Pa. 161, 74 A.2d 160 (1950) (shareholder inspection rights).

41. It should be noted that many of the cases to be discussed involved issues which affected local third party creditors, thus adding to the forum's interest in regulating pseudo-foreign corporations.

42. 216 N.Y. 57, 109 N.E. 875 (1915).

New York law sanctioned either remedy. Judge Cardozo stated that "when countless corporations, organized on paper in neighboring states, live and move and have their being in New York, a sound public policy demands that our legislature be invested with [a] measure of control."⁴³ The court applied local law and permitted the derivative action.⁴⁴ The Supreme Court has cited *German-American Coffee* with approval in determining a state's power to regulate the dividends of foreign corporations.⁴⁵

*Weede v. Iowa Southern Utilities Co.*⁴⁶ involved the proposed recapitalization of a Delaware corporation which did substantially all of its business in Iowa. The Iowa Supreme Court applied Iowa law to the proposed recapitalization, and justified their decision in this manner:

Neither justice nor the practical necessities of the business world can lend a sympathetic ear to the claim of a foreign corporation, with all its business in Iowa—plants, records, officers, etc.—that under its articles issued to it by the authority of a foreign state, it can come into our state and violate its statutory requirements.⁴⁷

43. *Id.* at 64, 109 N.E. at 877.

44. A rather weak argument could be made that the question regarding the appropriateness of a derivative action involved a "question of procedure," and that no substantive conflict of laws question was presented in the case.

45. *International Harvester v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 442 (1944).

The *Diehl* holding was broadened in *International Ticket Scale Corp. v. United States*, 165 F.2d 358 (2nd Cir. 1948), another case involving a challenge to a dividend payment by a foreign corporation. In this case, New York law prohibited the dividend in question, while the law of Delaware, the state of incorporation, sanctioned such a dividend. The proposed dividend would have impaired the capital of the corporation. The Delaware Revised Corporations Code of 1935, section 2066, permitted payment of dividends out of net profits in the case of a capital deficit, while New York Stock Corporation Law, section 58, prohibited dividends when capital was impaired. The court held that New York law governed the question of the legality of the dividend. *Id.* at 360. See also *McQuade v. Stoneham*, 230 App. Div. 57, 242 N.Y. Supp. 548 (1st Dept. 1930), *rev'd on other grounds*, 263 N.Y. 323, 189 N.E. 234 (1934), where New York law was applied without discussion to the question regarding the removal of an officer of a New Jersey corporation whose principal place of business was New York.

46. 231 Iowa 734, 2 N.W.2d 372 (1942), *aff'd sub nom.* *State v. Bechtel*, 239 Iowa 1298, 31 N.W.2d 853 (1948), *cert. denied sub nom.* *Bechtel v. Thatcher*, 337 U.S. 918 (1949).

47. 239 Iowa at 1320-21, 31 N.W.2d at 865 (1948). It should be noted that this quotation is probably dictum, since an Iowa statute expressly provided that Iowa law governed foreign corporations engaged in utility activities, and the Delaware corporation involved was such a corporation.

See also *Goodwin v. Clayton*, 137 N.C. 224, 234, 49 S.E. 173, 176 (1904), where the North Carolina Supreme Court stated that a corporation was "born, it is true, in

*Mansfield Hardwood Lumber Co. v. Johnson*⁴⁸ is another case where the internal affairs doctrine was not applied to a pseudo-foreign corporation. This was an action brought by a shareholder in a Delaware corporation for rescission of the sale of his stock to the corporation. The stockholder alleged, among other things, a fraudulent conspiracy on the part of the officers, directors and controlling shareholders. The court found that Delaware imposed no fiduciary duty upon officers, directors or majority shareholders regarding the purchase of stock from other shareholders, while Louisiana law imposed such a duty. The court applied Louisiana law, stating that "[w]hen . . . neither the charter nor the statutory laws of the incorporating state are applicable, and *all* contact points are in the forum, we believe that the laws of the forum should govern."⁴⁹

Both characterization manipulation and interest analysis were employed to circumvent the result mandated by an application of the internal affairs doctrine in a California case involving an attempt by Western Airlines to eliminate cumulative voting by charter amendment.⁵⁰ Western Airlines was a Delaware corporation that conducted a substantial amount of its business in California and approximately thirty percent of whose shares, other than those held in brokers' names, were held by California residents.⁵¹ The proposed elimination of cumulative voting was lawful under Delaware law, but proscribed under California law. The California Corporations Commissioner contended that this proposed amendment constituted a "sale" of new stock in exchange for the old stock under the California Corporate Securities Law (even though no exchange of certificates was contemplated) and that, therefore, qualification with the California Corporations Commission was necessary.⁵² Western subsequently applied for a permit regard-

New Jersey, but it lives, moves, and has its being in this state." The California Supreme Court has stated that "the fiction as to the situs of the corporate entity being in the state of its creation ought to yield in the interest of justice to the actual facts." *Wait v. Kern River Mining Co.*, 157 Cal. 16, 21, 106 P. 98, 100 (1909).

48. 268 F.2d 317 (5th Cir. 1959). See Note, *Pseudo-Foreign Corporations and the "Internal Affairs" Rule*, 1960 DUKE L.J. 477.

49. 268 F.2d at 321. A case similar to *Mansfield* was *Blazer v. Black*, 196 F.2d 139 (10th Cir. 1952), a suit by a former stockholder against an officer of an Illinois corporation which did substantially all of its business in Kansas. The court held that Kansas law governed. Both *Mansfield* and *Blazer* involved pseudo-foreign corporations.

50. *Western Airlines v. Sobieski*, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961).

51. *Id.* at 402, 12 Cal. Rptr. at 721.

52. *Id.* at 401, 12 Cal. Rptr. at 720. The California securities law at that time

ing the alleged sale and the Commissioner denied the application on the ground that the proposed change was unfair.⁵³ Western appealed this determination on the ground that the Commissioner exceeded his jurisdiction, since any issuance of shares which would occur in connection with the proposed amendment would occur outside California.

The action by the Commissioner was upheld by the court in *Western Airlines, Inc. v. Sobieski*.⁵⁴ The court emphasized the fact that Western conducted a substantial amount of business in California. The court justified its holding both in terms of interest analysis and on the ground that a "sale of securities" was involved. Western contended that the Commissioner was arbitrarily creating a class of "pseudo-foreign corporations" and that such a classification was improper. The court responded by saying:

The commissioner did not create any new class of corporation. He merely named a class of corporations which has, in effect, existed for many years, one with its technical domicile outside of this state but one which exercises most of its corporate vitality within the state. Unless it can be said that the Corporation Commissioner's characterization of such corporation as "pseudo-foreign" is arbitrary, it would appear to be a matter well within his administrative discretion. The concept of a pseudo-foreign corporation as defined by the Commissioner and the well-established concept of "commercial domicile" of a corporation appear to us to be founded upon reality.⁵⁵

contained a definition of "sale" that was unusually broad. No express exemption was provided for foreign corporations with a small number of California shareholders. 1949 Cal. Stats., ch. 384, § 1, at 699 (current version of CAL. CORP. § 25017 (West Supp. 1976)). The California Corporate Securities Law of 1968 added such an exemption to the California regulatory scheme. Foreign corporations now do not need to obtain a permit from the California Department of Corporations in connection with a recapitalization or reorganization unless 25% of the outstanding shares of the corporation are held by shareholders with addresses in California. CAL. CORP. CODE § 25103(b), (c) (West Supp. 1976). See generally Sterling, *California Corporate Securities Law of 1968*, 23 BUS. LAW. 645, 651 (1968).

53. 191 Cal. App. 2d at 401-03, 12 Cal. Rptr. at 720-22. See generally Note, *Voting and Blue Sky Laws*, *supra* note 31, at 785.

54. 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961). See generally Note, *Local Law and Shareholders' Rights*, *supra* note 3; Note, *Voting and Blue Sky Laws*, *supra* note 31; Note, *Sale of Securities*, *supra* note 31.

55. 191 Cal. App. 2d at 412, 12 Cal. Rptr. at 727. The *Western Airlines* opinion is limited to those situations where a corporation does a substantial amount of business within the state, and is arguably limited to those cases involving corporations which fall within the rather broad definition of "pseudo-foreign corporation" advanced by the California Commissioner of Corporation in the case. *Id.* See Kaplan, *supra* note 29, at

Section 2115 carves out a narrow exception to the internal affairs doctrine in situations where California's interests are clearly paramount. In this sense, it accomplishes the same result as does the application of the Restatement or governmental interest analysis approach to choice of law problems regarding pseudo-foreign corporations: California's law will be applied when a substantial interest of California will be advanced. Section 2115 reflects a legislative judgment that California has the most significant relationship to a pseudo-foreign corporation which satisfies the section 2115 tests, and that California has the greatest interest in regulating such a corporation, since its principal place of business in California and the majority of its shareholders reside in California.⁵⁶

APPLYING THE INTERNAL AFFAIRS DOCTRINE TO PSEUDO-FOREIGN CORPORATIONS: COSTS TO THE PRINCIPAL PLACE OF BUSINESS

Avoiding a State's Corporate Policies: A Comparison of the California, New York and Delaware Codes

The internal affairs doctrine has been justified on the basis that a state should have the exclusive power to regulate an entity which it creates.⁵⁷ Such a justification might have been persuasive in an era when corporations were individually chartered by specific acts of the state legislature, subject to whatever conditions the legislature imposed,⁵⁸ but that is no longer the case today; automatic incorporation has long been granted in all states.⁵⁹

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Earlier California cases indicated a receptiveness to an erosion of the internal affairs doctrine regarding California pseudo-foreign corporations. See *Wait v. Kern River Mining Co.*, 157 Cal. 16, 106 P. 98 (1909); *Southern Pac. Co. v. McColgan*, 68 Cal. App. 2d 48, 156 P.2d 81 (1945); *Sharp v. Big Jim Mines*, 39 Cal. App. 2d 435, 103 P.2d 430 (1940); *Stabler v. Eldora Oil Co.*, 27 Cal. App. 516, 150 P. 643 (1915). See generally Comment, *Quasi-Foreign Corporations*, *supra* note 7, at 678-84.

56. The legislative report regarding the new code characterizes section 2115 as a provision which applies California law to those corporations with "certain specified minimum contacts" with California. REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE 19 (1975).

57. See generally Fead, *Jurisdiction Over Foreign Corporations*, 24 MICH. L. REV. 633 (1926).

58. See generally A. BERLE, JR. & G. MEANS, *The Modern Corporation and Private Property* 218-30 (1932); J. HURST, *The Legitimacy of the Business Corporation and the Law of the United States 1780-1970* at 133-39 (1970).

59. Automatic incorporation usually requires that articles of incorporation containing certain mandatory provisions be filed with the appropriate state agency. See authorities cited in note 58 *supra*.

The policy justification normally advanced in support of the internal affairs doctrine is that it promotes certainty regarding choice of law questions involving corporations with multi-state contacts.⁶⁰ Although it does promote certainty, the doctrine also imposes a social cost upon the state where business is primarily conducted, since that state's policies are circumvented. Therefore, the appropriate analysis should be whether the benefit that accrues from such certainty exceeds the costs imposed upon the state where a pseudo-foreign corporation has its principal place of business.

The principal cost incurred due to the rigid application of the internal affairs doctrine to pseudo-foreign corporations is that the social policies of the principal place of business of a pseudo-foreign corporation are supplanted by those of the state of incorporation. The magnitude of this cost, and therefore the utility of the circumvention of the internal affairs doctrine discussed in the preceding section, depends upon the differences among the corporation laws of the various states. Many California pseudo-foreign corporations are chartered in Delaware and New York. A comparison of California section 2115(b) with the analogous Delaware and New York provisions reveals the magnitude of these costs.

The most striking differences among the corporate laws of California, New York and Delaware are found in those provisions dealing with the rights of minority shareholders. The California code generally protects the interests of minority shareholders to a greater degree than do the codes of New York or Delaware. For example, the California code mandates cumulative voting,⁶¹ while New York⁶² and Delaware⁶³ law provide that cumulative voting is optional. Similarly, staggered terms for directors are not permitted under the California code, but are sanctioned by New York and Delaware law.⁶⁴ The California

60. Professor Latty has discussed in detail the possible policy justifications for applying the internal affairs doctrine to pseudo-foreign corporations. See Latty I, *supra* note 29, at 138-43.

61. CAL. CORP. CODE § 708 (West Supp. 1976).

62. N.Y. BUS. CORP. LAW § 618 (McKinney 1963).

63. DEL. CODE ANN. tit. 8, § 214 (1975).

64. The California code requires that all directors must be elected annually. CAL. CORP. CODE § 301 (West Supp. 1976). Under New York law directors may be elected in two, three or four staggered classes of three or more individuals if such a procedure is included in the certificate of incorporation or by-laws. N.Y. BUS. CORP. LAW § 704 (McKinney 1963). Under Delaware law, directors may be elected in one, two or three staggered classes of two or more individuals, if such a procedure is included in the

code also provides safeguards for minority shareholders regarding corporate reorganizations not included in either the New York or Delaware codes.⁶⁵

In addition to the differences among the minority shareholder protection provisions of California, New York and Delaware, there are significant differences regarding the rules governing indemnification⁶⁶ of and liability insurance⁶⁷ for officers

certificate of incorporation or by-laws of the corporation. DEL. CODE ANN. tit. 8, § 141(d) (Supp. 1975).

65. The California code provides that in connection with any merger, other than a short-form merger, the common shares of a disappearing corporation may be converted only into common shares of the surviving corporation, unless all of the shareholders of the disappearing corporation approve another plan. 1976 Cal. Legis. Serv., ch. 641, § 19, at 1653-54 (amending CAL. CORP. CODE § 1101). In connection with a sale of assets transaction, if the buyer controls the seller the principal terms of such a sale must be approved by at least 90% of the seller's outstanding shares, unless the shareholders of the seller receive common shares of the buyer in consideration of the sale. *Id.* § 18.8, at 1653 (amending CAL. CORP. CODE § 1001(d)). In connection with a controlled party reorganization or short-form merger, the new code provides that if a shareholder foregoes shareholder appraisal rights, he may institute an action attacking the validity of the proposed reorganization or short-form merger. *Id.* § 22.5, at 1660-61 (amending CAL. CORP. CODE § 1312(b)). In such an action, the controlling party has the burden of establishing that the transaction is "just and reasonable as to the shareholders of the controlled party." *Id.* at 1661 (amending CAL. CORP. CODE § 1312(c)).

66. In any "proceeding" other than a derivative action, the California code sanctions indemnification of any officer, director or agent "against expenses, judgments, fines [and] settlements," if that person acted "in good faith, and in a manner such person reasonably believed to be in the best interests of the corporation." *Id.* § 11, at 1639 (amending CAL. CORP. CODE § 317(b)). The standard in New York is essentially the same. N.Y. BUS. CORP. LAW § 723 (McKinney 1963). Delaware sanctions indemnification in both derivative and non-derivative actions if the individual acted in "good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation." DEL. CODE ANN. tit. 8, § 145(a), (b) (1975) (emphasis added).

Regarding derivative actions, the California code provides that indemnification may be given for "expenses" but no indemnification may be made, with or without court approval, against amounts paid in settling a derivative action. 1976 Cal. Legis. Serv., ch. 641, § 11, at 1639 (amending CAL. CORP. CODE § 317(c)). In New York a corporation is not permitted to indemnify an officer or director for amounts paid to settle a derivative action, or for amounts expended in defending a threatened action which is later settled or otherwise disposed of without court approval. New York, otherwise, does allow indemnification for expenses, including attorney fees. N.Y. BUS. CORP. LAW § 722 (McKinney 1963).

Delaware, however, allows a corporation to indemnify an officer or director for expenses incurred in connection with a settlement made with or without court approval, as well as for expenses incurred in the defense of a derivative action. DEL. CODE ANN. tit. 8, § 145(b) (1975). Unlike New York, California and Delaware allow indemnification for expenses upon court approval for any matter where the individual has been adjudged liable to the corporation. N.Y. BUS. CORP. LAW § 722 (McKinney 1963); 1976 Cal. Legis. Serv., ch. 641, § 11, at 1639 (amending CAL. CORP. CODE § 317(c)); DEL. CODE ANN. tit. 8, § 145(b) (1975).

In Delaware, the indemnification limits may be extended in the by-laws, by a vote

and directors by the corporation, as well as the standard of care for a director.⁶⁸ California's provisions impose more restrictions

of the shareholders or disinterested directors or "otherwise." DEL. CODE ANN. tit. 8, § 145(f) (1975). California proscribes the extension of the indemnification limits through the articles of incorporation or by-laws. 1976 Cal. Legis. Serv., ch. 641, § 11, at 1640 (amending CAL. CORP. CODE § 317(g)).

67. In California a corporation is granted the power to purchase and maintain insurance on behalf of any agent of the corporation, and such insurance may cover liabilities not otherwise sanctioned under section 317. *Id.* (amending CAL. CORP. CODE § 317(i)). Delaware law expressly sanctions the purchase by a corporation of indemnification insurance covering any liability "whether or not the corporation would have the power to indemnify such liability under the provisions of [section 145]." DEL. CODE ANN. tit. 8, § 145(g) (1975). See generally Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1086 (1968).

New York law provides that a corporation may maintain indemnity insurance, but the insurance maintained may not cover those instances where it is established that the officer or director committed "acts of active and deliberate dishonesty material to the cause of action so adjudicated, or that he personally gained in fact a financial profit or other advantage to which he was not legally entitled." N.Y. BUS. CORP. LAW § 727 (McKinney Supp. 1976).

68. The standard of care for a director is expressly outlined in the California code. 1976 Cal. Legis. Serv., ch. 641, § 9.5, at 1636 (amending CAL. CORP. CODE § 309(a)). The section sets forth a standard of care for directors but does not mention non-director officers. Therefore, an officer may not be able to rely on the factual information to the same degree as a non-officer director. See Committee on Corporate Laws, *Changes in the Model Business Corporation Act*, 29 BUS. LAW. 947, 951, 953 (1974) [hereinafter cited as Committee on Corporate Laws]. See generally Mattes, *The Burden of the Corporate Director Elected Noncumulatively*, 63 CALIF. L. REV. 463 (1975).

An extensive discussion of section 309 is beyond the scope of this article, but the most important provisions will be mentioned. The section expressly provides that a director's duty includes "reasonable inquiry" when the circumstances indicate that such inquiry is necessary. See REPORT OF THE ASSEMBLY SELECT COMMITTEE ON THE REVISION OF THE CORPORATIONS CODE 48-54 (1975). See generally National Auto. & Cas. Ins. Co. v. Payne, 261 Cal. App. 2d 403, 413, 67 Cal. Rptr. 784, 790 (1968). According to section 309(a), a director must act "as an ordinarily prudent person in a like position would [act] under similar circumstances." 1976 Cal. Legis. Serv., ch. 641, § 309, at 1636 (amending CAL. CORP. CODE § 309 (a)). It should be noted that the standard is "an ordinarily prudent person," as opposed to "an ordinarily prudent business person" or the like. It has been suggested, however, that the inclusion of the term "under similar circumstances" was intended, among other things, to increase the standard for a director with business experience. See Committee on Corporate Laws, *supra*, at 954.

The New York standard of care requires a director to act in good faith with that degree of care which an "ordinarily prudent man would exercise under similar circumstances." N.Y. BUS. CORP. LAW § 717 (McKinney 1963).

Delaware's code does not provide an express standard of care for directors, and Delaware courts seem to have evolved a relatively lax "business judgment" standard. See, e.g., Graham v. Allis Chalmers Mfg. Co., 41 Del. Ch. 78, 85, 188 A.2d 125, 130 (Sup. Ct. 1963).

With regard to the provisions in the respective states governing the information upon which a director may rely, compare 1967 Cal. Stats., ch. 843, § 1, at 2268 (amending CAL. CORP. CODE § 829, repealed 1975) with 1976 Cal. Legis. Serv., ch. 641, § 9.5, at 1636 (amending CAL. CORP. CODE § 309(b)); N.Y. BUS. CORP. LAW § 717 (McKinney 1963); DEL. CODE ANN. tit. 8, § 141(e), 172 (1975).

upon the discretion of management regarding indemnification and impose a somewhat higher standard of care, especially in contrast to the Delaware provisions.

There are also a substantial number of significant differences among the corporate laws of California, New York, and Delaware regarding other aspects of the manner in which corporate internal affairs are conducted, especially with respect to reorganizations,⁶⁹ shareholder appraisal rights,⁷⁰ distributions,⁷¹

69. All types of "reorganizations," including exchange reorganizations, sales of assets and mergers (see 1976 Cal. Legis. Serv., ch. 641, § 4.6, at 1628-29 (amending CAL. CORP. CODE § 181)), generally are treated uniformly under the California code. See CAL. CORP. CODE § 1200 (West Supp. 1976). The board of directors of each constituent corporation generally must approve a merger or a "sale of assets," reorganization, while only the board of the acquiring corporation must approve an exchange reorganization. *Id.* Approval by a majority of the outstanding shares is normally required if board approval of the corporation is required. 1976 Cal. Legis. Serv., ch. 641, § 21, at 1657 (amending CAL. CORP. CODE § 1201(a)).

Delaware law provides that the board of each constituent corporation and a majority of the outstanding shares of each such corporation must approve a plan of merger. DEL. CODE ANN. tit. 8, § 251 (1975). A corporation's board and a majority of its outstanding shares must approve a plan to sell substantially all of its assets. *Id.* § 271. New York law provides that the board of each constituent corporation and two thirds of the outstanding shares of each corporation must approve a plan of merger. N.Y. BUS. CORP. LAW §§ 902, 903 (McKinney Supp. 1976). A corporation's board and two thirds of its outstanding shares also must approve a plan to sell substantially all of its assets. *Id.* § 909.

70. The California code generally provides appraisal rights for those shareholders who do not consent to a proposed reorganization in those situations where shareholder approval is required, unless the corporation's shares are listed on a national securities exchange. 1976 Cal. Legis. Serv., ch. 641, § 21.3, at 1658-59 (amending CAL. CORP. CODE § 1300(b)). Delaware law provides for shareholder appraisal rights in connection with a merger in which shareholder approval is required, unless the corporation has securities listed on a national securities exchange or has more than 1999 shareholders. DEL. CODE ANN. tit. 8, § 262 (1975). Appraisal rights are not available in connection with an exchange reorganization or a sale of assets transaction. *Id.* § 271. *Hariton v. Arco Elec., Inc.*, 40 Del. Ch. 326, 182 A.2d 22 (1962), *aff'd* 41 Del. Ch. 74, 188 A.2d 123 (1963).

Under New York law, shareholder appraisal rights are generally only available in those situations where shareholder approval is required in connection with a merger or sale of assets transaction. N.Y. BUS. CORP. LAW § 910(a)(1) (McKinney Supp. 1976). *Cf. id.* § 806(b)(6) (a holder of any adversely affected shares who does not vote for or consent in writing to an amendment or change in the corporation's certificate shall have the right to dissent and receive payment for such shares in certain circumstances).

71. A novel test regarding proscribed dividend distributions is employed in the California code. It provides that a corporation may make a distribution only if the amount of its retained earnings immediately prior thereto equals or exceeds the amount of the proposed distribution, 1976 Cal. Legis. Serv., ch. 641, § 14, at 1644 (amending CAL. CORP. CODE § 500(a)), or if the assets of the corporation (exclusive of goodwill) are at least equal to one and one-quarter times its liabilities and the current assets of the corporation at least equal its current liabilities. *Id.* at 1644-45 (amending CAL. CORP. CODE § 500(b)). New York and Delaware law reflect the traditional require-

reports to shareholders,⁷² and the manner by which director vacancies are filled.⁷³

The application of the internal affairs doctrine to a pseudo-foreign corporation results in its internal affairs being governed by the law of its state of incorporation, rather than the law of its principal place of business. Since there are a substantial number of significant differences among the corporate laws of California, New York, and Delaware regarding the manner in which corporate internal affairs are conducted, the application of the internal affairs doctrine to such a corporation results in a significant social cost. That cost is the pseudo-

ment that distributions may be made only out of "surplus." DEL. CODE ANN. tit. 8, § 170(a) (1975); N.Y. BUS. CORP. LAW § 510(b) (McKinney Supp. 1976).

California and New York law proscribe the payment of a dividend which would render the corporation insolvent. CAL. CORP. CODE § 501 (West Supp. 1976); N.Y. BUS. CORP. LAW § 510(a) (McKinney 1963). Delaware law contains no such express prohibition. Such a provision may not be necessary, however, since Delaware has enacted the Uniform Fraudulent Conveyances Act. DEL. CODE ANN. tit. 6, §§ 1301-12 (1975).

72. The California code generally requires a corporation to send an annual report containing certain specified financial information to its shareholders within four months of the close of its fiscal year. 1976 Cal. Legis. Serv., ch. 641, § 23, at 1661 (amending CAL. CORP. CODE § 1501(a)). This requirement may be waived in the by-laws by corporations with fewer than 100 shareholders. *Id.* More detailed reporting is required of those corporations with no class of securities registered under section 12 of the Securities Exchange Act of 1934 which have more than 99 shareholders of record. *Id.* (amending CAL. CORP. CODE § 1501(b)). In addition, holders of at least an aggregate of five percent of the outstanding shares may obtain interim financial information. *Id.* at 1662 (amending CAL. CORP. CODE § 1501(c)).

In contrast, New York law provides that a corporation is required to furnish minimal financial information on an annual basis, and only when the holders of an aggregate of five percent of the outstanding shares or a shareholder of record for at least six months so request. N.Y. BUS. CORP. LAW § 624(e) (McKinney Supp. 1976). Delaware law has no reporting requirement.

73. Under the California code the holders of an aggregate of five percent of the outstanding shares may petition to call a special meeting of the shareholders to elect an entire board when less than a majority of the directors in office have been elected by the shareholders. 1976 Cal. Legis. Serv., ch. 641, § 7.5, at 1634 (amending CAL. CORP. CODE § 305(c)). In New York, director vacancies may be filled by a majority vote of the remaining directors, even if less than a quorum, unless the certificate of incorporation reserves this power to the shareholders. N.Y. BUS. CORP. LAW § 705 (McKinney Supp. 1976). The Delaware code provides that director vacancies generally may be filled by a majority of the remaining directors, although less than a quorum. DEL. CODE ANN. tit. 8, § 223(a) (Supp. 1975). If the directors in office constitute "less than a majority of the whole Board" the holders of at least ten percent of the outstanding shares may petition a court to call a shareholder election to fill any director vacancies. *Id.* § 223(c).

For a further comparison of the differences between the corporate laws of California and Delaware, see Halloran & Hammer, *Section 2115 of the New California General Corporation Law—The Application of California Corporation Law to Foreign Corporations*, 23 U.C.L.A. L. REV. 1282, 1295 (1976).

foreign corporation's ability to ignore the public policies of the state of its principal place of business.⁷⁴

The Financial Costs of the Internal Affairs Doctrine and Gresham's Law

In addition to the social costs which flow from the application of the internal affairs doctrine to pseudo-foreign corporations, the internal affairs doctrine has been criticized for its Gresham's Law effect upon state corporations codes. Gresham's Law is the name given to the following economic principle: when two coins are equal in debt-paying value but unequal in intrinsic value, the one having the lesser intrinsic value tends to remain in circulation while the other tends to be hoarded or exported as bullion. It has been generalized to stand for any situation where the cheap drives out the valuable.⁷⁵

In the present context Gresham's Law effect refers to the situation where the presence of states with enabling type corporation laws tends to force states with more restrictive corporations codes to abandon their statutory schemes and follow suit. Since corporations have been able to circumvent a state's corporations code merely by incorporating in another state, there has been no incentive for a state to enact a relatively strict code.⁷⁶ Similarly, attempts by states to regulate corporate

74. The corporation codes of Delaware, New York and California are now fairly representative of the manner in which states currently regulate corporate activity. If statutory schemes analogous to section 2115 become more common and the Gresham's Law effect (see text accompanying note 75 *infra*) of the internal affairs doctrine on state corporation law is thereby minimized, even greater differences among state corporation codes could result.

75. See Kaplan, *supra* note 29, at 437.

76. See, e.g., Thiokol Holders Move to Thwart Unwanted Takeover Attempts, Wall St. J., Nov. 21, 1973, at 10, col. 4; May, More Firms Adopt Delaware as Legal Home to Benefit from Liberal Corporation Law, Wall St. J., Apr. 16, 1968, at 6, col. 2. See generally Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Downs, *Michigan to Have a New Corporation Code?*, 18 WAYNE L. REV. 913 (1972) [hereinafter cited as Downs]; Folk, *Does State Corporation Law Have a Future?*, 8 GA. ST. B.J. 311 (1972); Henning, *Federalism and Corporate Law: The Chaos Inherent in the Cary Proposal*, 3 SEC. REG. L.J. 362 (1976); Jennings, *The Role of the States in Corporate Regulation and Investor Protection*, 23 LAW & CONTEMP. PROB. 193 (1958); Kaplan, *supra* note 29; Latty I, *supra* note 29; Latty, *Why Are Business Corporation Laws Largely "Enabling"?*, 50 CORNELL L.Q. 599 (1965) [hereinafter cited as Latty II]; Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969).

This attitude is reflected by the approach recently taken by the Chicago Bar Association Committee on Corporation Law regarding the proposed amendment to the Illinois Business Corporation Act which would have made cumulative voting optional in Illinois. The Committee decided that mandatory cumulative voting should be elimi-

activities more stringently have been undermined by those states which have enacted "enabling" type codes.⁷⁷ Under the specter of their domestic businesses incorporating or reincorporating elsewhere, with the concomitant loss of charter fees,⁷⁸ franchise taxes, and control over corporations which transact business in the state, restrictive states have amended their laws to make them more enabling.

nated in Illinois, since the requirement was being circumvented in any event by Delaware incorporation. See Kaplan, *Fiduciary Responsibility in the Management of the Corporation*, 31 Bus. LAW. 883, 885-86 (1976).

77. One commentator has suggested that one of four approaches underlies the various state schemes of regulating corporations:

At one extreme, under the so-called "enabling act" theory, the privilege of incorporation would be made freely available, with a minimum of special conditions and limitations. Somewhat more restrictive is another theory whose adherents, although essentially persuaded of the social efficacy of enlightened self-interest, favor the interposition of legislative safeguards at critical junctures where experience has indicated that difficulties may arise. Another theory would by legislative prescription even more systematically impinge upon freedom to contract, not only to protect investors and creditors, but to create and preserve the atmosphere of public confidence so necessary for business prosperity. And, finally, at the other extreme, the proponents of the so-called "social responsibility" theory urged that corporate power be exercised not primarily for the benefit of investors and creditors, or even customers and employees, but rather for the benefit of the general public.

Shimm, *Foreword*, 23 LAW & CONTEMP. PROB. 175 (1958).

78. "It has been said that [c]harter mongering has a long and somewhat unsavory heritage in state corporation law." Jennings, *The Role of the States in Corporate Regulation and Investor Protection*, 23 LAW & CONTEMP. PROB. 193, 194 (1958). See Latty I, *supra* note 29; Latty II, *supra* note 76.

The state scramble for corporate charter fees was evident in the Delaware statute preamble:

Whereas, the State of Delaware has a long and beneficial history of the domicile of nationally known corporations; and

Whereas, the favorable climate which the State of Delaware has traditionally provided for corporations has been a leading source of revenue for the State; and

Whereas, many states have enacted new corporation laws in recent years in an effort to compete with Delaware corporate business; and

Whereas, there has been no comprehensive revision of the Delaware corporation law since its enactment in 1898; and

Whereas, the general assembly of the State of Delaware declares it to be the public policy of the State to maintain a favorable business climate and to encourage corporations to make Delaware their domicile. . . .

Law of Dec. 31, 1963, ch. 218, 1963 Del. Laws 724. Similarly, a member of the Delaware Law Revision Commission of 1967 noted, when discussing the reasons for the law revision, that "the franchise tax dollar is very important." Carroon, *The Proposed New Delaware Corporation Statute*, 20 J. LEGAL ED. 522 (1968). Franchise taxes represented \$52 million out of a total of \$222 million collected in taxes by Delaware in 1971. U.S. DEP'T OF COMMERCE, STATE TAX COLLECTION IN 1972 at 16 (Dec. 1972).

Many commentators have noted that the trend in recent decades has been to promulgate permissive corporations codes.⁷⁹ Although the wisdom of such a trend is beyond the scope of this article,⁸⁰ there are many indications that the decisions of the respective states regarding this trend were significantly affected by their awareness of the internal affairs doctrine. For example, the report of the Corporation Law Revision Commission of New Jersey states:

It is clear that the major protections to investors, creditors, employees, customers, and the general public have come, and must continue to come, from federal legislation and not from state corporation acts . . . any attempt to provide such regulations in the public interest through state incorporation acts and similar legislation would only drive

79. See generally Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Cary, *Summary of Article on Federalism and Corporate Law*, 31 BUS. LAW. 1105 (1976); Folk, *Does State Corporation Law Have a Future?*, 8 GA. ST. B.J. 311 (1972); Henning, *Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come?*, 21 DE PAUL L. REV. 915 (1972); Jennings, *The Role of the States in Corporate Regulation and Investor Protection*, 23 LAW & CONTEMP. PROB. 193 (1958); Latty I, *supra* note 29; Latty II, *supra* note 76; Schwartz, *A Case for Federal Chartering of Corporations*, 31 BUS. LAW. 1125 (1976); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 61 (1969).

The chairman of the committee which prepared the 1962 amendments to the Model Business Corporation Act stated that "corporate law has tended more and more in the direction of a simple set of workable ground rules for the corporate enterprise, leaving regulation either to the equitable jurisdiction of the courts or to regulation through statutes of a policing nature or through the informed judgment of administrative agencies." Gibson, *Surplus, So What? The Model Act Modernized*, 17 BUS. LAW. 476, 482-83 (1962).

Professor J. W. Hurst has offered an historical explanation for these developments in J. HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970* at 13-57 (1970). Hurst argues that the trend toward enabling corporation statutes began early in the twentieth century as a result of the country's confidence in the constructive uses of the corporate form. In addition, the country's economic boom was just beginning and legislatures were reluctant to restrict corporations. After 1929, however, the need for regulation became apparent, and in an effort "to define and enforce the responsibility of corporate power the law turned more and more to specialized regulation outside the structure of the corporation." *Id.* at xii.

80. The vast majority of commentators have criticized this trend. See generally, H. RUESCHLEIN, *THE SCHOOLS OF CORPORATE REFORM* (1950); R. Nader, *The Case for Federal Incorporation*, at 5, Oct. 30-31, 1971 (presentation to Conferences on Corporate Accountability); Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Harris, *The Model Business Corporation Act—Invitation to Irresponsibility?*, 50 NW. U.L. REV. 1 (1955); Latty, *Some General Observations on the New Business Corporation Law of New York*, 11 BUFFALO L. REV. 591 (1962); Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972). But see Arsh, *Reply to Professor Cary*, 31 BUS. LAW. 1113 (1976); Drexler, *Federalism and Corporate Law, a Misguided Missile*, 3 SEC. REG. L.J. 374 (1976).

corporations out of the state to more hospitable jurisdictions.⁸¹

Statements made by the drafters or sponsors of other state corporations codes indicate that the codes were drafted with a view to encouraging local incorporation. Professor Henn, a member of the Joint Legislative Committee regarding the revision of the New York corporations code, stated that “[o]ne ever-present strand in the thinking of the Joint Legislative Committee was to foster New York incorporation of business and retention of existing business corporations”⁸²

81. *Report of the Corporation Law Revision Commission* in N.J. STAT. ANN. § 14A, at XI (West 1969).

Historian Charles A. Beard made a similar statement in his testimony before the Subcommittee of the Senate Committee on the Judiciary:

Under the leadership of Woodrow Wilson, after he was challenged by Theodore Roosevelt to reform his own state, the Legislature of New Jersey passed a series of laws doing away with corporate abuses and applying high standards to corporations. What was the result? The revenues of the State from taxes on corporations fell. Malefactors moved over into other states. In time the New Jersey Legislature repealed its strict and prudent legislation, and went back, not quite, but almost to old ways It is folly to expect all the States and Territories to apply strict and uniform principles to corporate legislation; the business of controlling corporations engaged in interstate commerce belongs to the Government of the United States. That seems to me to be the lesson we learn from history.

Hearings on S. 10 Before the Subcomm. of the Sen. Comm. on the Judiciary, 75th Cong., 1st Sess. 326 (1937).

Justice Brandeis made this comment regarding Gresham's Law and the internal affairs doctrine: “Companies were early formed to provide charters for corporations in states where the cost was lowest and the laws least restrictive. The states joined in advertising their wares. The race was one not of diligence but of laxity.” *Liggett Co. v. Lee*, 288 U.S. 517, 556-59 (dissenting opinion).

82. Henn, *The Philosophies of the New York Business Corporation Law of 1961*, 11 BUFFALO L. REV. 439, 453 (1962). Tom Downs, the sponsor of the recently enacted revision of the Michigan corporations code, made this statement which reflects a similar intention on the part of the drafters of that revision: “The work of the [revision] was conducted on a bi-partisan basis with the primary purpose of a unified, simple code that would, in the words of some, ‘out-Delaware Delaware.’” Downs, *supra* note 76, at 914.

The preface to New Jersey's recently amended corporation laws proudly proclaims in its heading—“New Law Enabling, Not Restrictive.” It is also stated there that the New Jersey laws as embodied in the amendments are “flexible and permissive” corporation laws “perhaps further than any other state.” [sic]. N.J. STAT. ANN. § 14A at XI (West 1969).

A recent advertisement by the State of Nevada in the *Wall Street Journal* reflects a similar attempt to market the state's corporations code. This advertisement attributed the following statement to Nevada's Secretary of State: “Forming a corporation: Are you considering forming a corporation? If you are, I believe that Nevada and Delaware have the most liberal and workable corporation laws in the United States. I further believe that Nevada has the following distinct advantages over Delaware” *Wall St. J.*, Feb. 4, 1975, at 18 (eastern ed.).

The chronology of the amendments to the corporations codes of various states manifests the Gresham's Law effect. For example, the 1967 amendments to the Delaware corporations code included a provision regarding indemnification which, among other things, expressly sanctioned the payment by a corporation of premiums for indemnification insurance for its officers and directors.⁸³ Delaware was the first state to adopt such a provision. California,⁸⁴ Georgia,⁸⁵ Ohio,⁸⁶ Virginia,⁸⁷ Pennsylvania,⁸⁸ and New Jersey⁸⁹ amended their respective corporations codes in essentially the same manner within one year.⁹⁰ It appears that these states were placed under a substantial amount of pressure to follow Delaware's example regarding this controversial and important issue.

It has been suggested by other commentators that effective regulation of corporate activity and protection of the rights of minority shareholders can only be achieved either through minimum standards of corporate regulation promulgated by Congress⁹¹ or by mandatory federal incorporation.⁹² The federal

One aspect of Professor Folk's initial assignment as Reporter for the Delaware Corporation Law Revision Commission was "to ascertain what other states have to attract corporations that [Delaware does] not have." Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861, 866 (1969). This reflects a similar intent to market the state's corporations code.

83. DEL. CODE ANN. tit. 8, § 145 (Supp. 1970).

84. CAL. CORP. CODE § 830(h) (West 1968) (current version at 1976 Cal. Legis. Serv. ch. 641, § 11, at 1640, amending CAL. CORP. CODE § 317(i)).

85. GA. CODE ANN. tit. 22, § 22-202(16)(1968).

86. OHIO REV. CODE ANN. § 1701.13(E), (Page Supp. 1975).

87. VA. CODE ANN. tit. 13.1, 13.1-3.1 (Supp. 1976).

88. PA. STAT. ANN. tit. 15, § 410 (Purdon Supp. 1976).

89. See N.J. REV. STAT. § 14A: 3-5 (Supp. 1976).

90. In addition, North Carolina amended its indemnification provisions in substantially the same manner in 1969. N.C. GEN. STAT. §§ 55-19, 55-20 (1975). The analogous provisions of the laws of South Carolina and Arkansas were similarly amended in 1973. S.C. CODE § 12-18.18 (Cum. Supp. 1974); ARK. STAT. ANN. § 64-309 (Cum. Supp. 1973).

91. See, e.g., Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974); Cary, *A Proposed Federal Corporate Minimum Standards Act*, 29 BUS. LAW. 1101 (1974); Cary, *Summary of Article on Federalism and Corporate Law*, 31 BUS. LAW. 1105 (1976).

A number of commentators have criticized the approach advocated by Professor Cary. See, e.g., Henning, *Federalism and Corporate Law: The Chaos Inherent in the Cary Proposal*, 3 SEC. REG. L.J. 362 (1976); Schwartz, *A CASE FOR FEDERAL CHARTERING OF CORPORATIONS*, 31 BUS. LAW. 1125 (1976).

92. See R. NADER, J. SELIGMAN & M. GREEN, *TAMING THE GIANT CORPORATION* (1976); Brabner-Smith, *Federal Incorporation of Business*, 24 VA. L. REV. 159 (1937); Grosscup, *The Corporation Problem and the Lawyer's Part in Its Solution*, 39 AM. L. REV. 835, 849-51 (1905); Henning, *Federal Corporate Chartering for Big Business: An Idea Whose Time Has Come?*, 21 DE PAUL L. REV. 915 (1972); Henning, *Federalism*

courts are already evolving a federal common law of corporations pursuant to the federal securities laws,⁹³ partially in response to the "enabling" type state corporations codes. It seems inevitable that federal regulation of the internal affairs of corporations will continue to increase if the internal affairs doctrine is applied to all corporations and its Gresham's Law

and Corporate Law: The Chaos Inherent in the Cary Proposal, 3 SEC. REG. L.J. 362 (1976); Nader, *The Case for Federal Chartering*, in CORPORATE POWER IN AMERICA 67 (R. Nader & M. Green eds. 1973); Schwartz, *A Case for Federal Chartering of Corporations*, 31 BUS. LAW. 1125 (1976); Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972); Snapp, *National Incorporation*, 5 ILL. L. REV. 414 (1911); Note, *Federal Chartering of Corporations: A Proposal*, 61 GEO. L.J. 89 (1972). But see Aranson, *Federal Chartering of Corporations: An Idea Well Worth Forgetting*, 8 BUS. & SOC. REV. 59 (1974). For a history of the proposals for national chartering, see Reuschlein, *Federalization—Design for Corporate Reform in a National Economy*, 91 U. PA. L. REV. 91 (1942). It should also be noted that the National Democratic Party platform for 1972 called for federal action to "establish a temporary national economic commission to study federal chartering of large multi-national and international corporations . . ." 30 CONG. Q. WEEKLY REP. 1728 (1972).

A number of other nations which are similarly comprised of numerous states and territories regulate corporate activity pursuant to national rather than regional legislation. For example, India, which contains 24 states and territories, regulates corporations pursuant to national legislation. Mexico, which contains 29 states with their own respective civil codes, regulates corporate activity pursuant to federal legislation. South Africa, comprised of four provinces, has only one companies act. For an extensive discussion of the corporation laws of various nations, see Conard, *An Overview of the Laws of Corporations*, 71 MICH. L. REV. 623 (1973).

93. See, e.g., *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964) (regarding the validity of proxy and the invalidity of a merger); *Green v. Sante Fe Indus., Inc.*, 533 F.2d 1283 (2d Cir. 1976) (a short-form merger held unfair); *Marshel v. A.F.W. Fabric Corp.*, 533 F.2d 1277 (2d Cir. 1976) (merger enjoined because it was deemed unfair); *McClure v. Borne Chem. Co.*, 292 F.2d 824 (3d Cir. 1961) (regarding security for costs); *Miller v. Steinbach*, 268 F. Supp. 255 (S.D.N.Y. 1967) (regarding appraisal rights). The Second Circuit held in *Green* and *Marshel* that a fully disclosed but unfair transaction in connection with the sale of securities is proscribed by section 10 of the Securities Exchange Act of 1934. This represents a significant extension of the requirements of the federal securities laws since federal courts have generally not found a violation of the 1934 Act solely due to the unfairness of a transaction. Some element of deception has traditionally been required. See generally Patrick, *Rule 10b-5, Equitable Fraud and Schoenbaum v. Firstbrook*, 21 ALA. L. REV. 457 (1969); Note, *The Controlling Influence Standard in Rule 10b-5 Corporate Mismanagement Cases*, 86 HARV. L. REV. 1007 (1973).

Almost all of the decisions cited above are based primarily upon either sections 10 or 14 of the Federal Securities Act of 1934. It should be noted that there are limitations upon the scope of these sections. Section 14, regarding disclosures in proxy statements, only applies to those corporations with 500 or more shareholders of record and \$1,000,000 in assets. 15 U.S.C. § 781(g)(1) (1970). Section 10(b) applies to all corporations, but the plaintiff in such an action must have "purchased" or "sold" a security. See *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). See generally Jacobs, *Standing to Sue Under 10b-5 After Blue Chip Stamps*, 3 SEC. REG. L.J. 387 (1976); Jennings, *Federalization of Corporation Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976).

effect upon state corporations codes is allowed to continue.⁹⁴

The application of the internal affairs doctrine to pseudo-foreign corporations has discouraged states from enacting strict corporation laws, and has encouraged states to adopt permissive corporations codes in order to entice new business to incorporate in the state and generate charter fees and franchise tax revenues. Provisions such as section 2115 should mute these Gresham's Law effects since most pseudo-foreign corporations will no longer be able to circumvent the corporations code of its principal place of business. National corporations and corporations with securities registered on a national securities exchange,⁹⁵ of course, will continue to be able to shop for the most convenient corporations code.

The narrow exception to the internal affairs doctrine embodied in section 2115 represents a constructive attempt to retain the internal affairs doctrine regarding corporations with multi-state contacts, while attempting to insure that the state with the clearly dominant interest in regulating the internal affairs of the corporation will be able to do so. The desired certainty of application of the law governing corporations with multi-state contacts is maximized; section 2115 clearly sets forth which foreign corporations are within its scope and the term during which it governs the internal affairs of such corporations.

SECTION 2115 AND THE CONSTITUTION

There are constitutional limitations upon choice of law decisions. Choice of law determinations have been found to constitute a violation of either the due process clause⁹⁶ or the full faith and credit clause⁹⁷ of the Constitution. In addition, there is some question whether section 2115 violates the commerce clause.⁹⁸ The applicability of these constitutional limitations to section 2115 is explored below.

94. The enactment of state legislative schemes such as section 2115 represents the only way federal incorporation, or at least the promulgation of minimal standards of corporate regulation by Congress, can be avoided.

95. Such corporations are, of course, regulated by their respective exchanges.

96. U.S. CONST. amend. XIV, § 1: "No State shall . . . deprive any person of life, liberty, or property, without due process of law. . . ."

97. U.S. CONST. art. IV, § 1: "Full Faith and Credit shall be given in each State to the public Acts, Records and judicial Proceedings of every other State. And the Congress may by general laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."

98. U.S. CONST. art. I, § 8:

The Due Process Clause

This section discusses whether applying California law to pseudo-foreign corporations which satisfy the section 2115 tests, generally constitutes a violation of the due process clause. Also considered is the potential due process problem that arises where a pseudo-foreign corporation, whose officers' certificate indicates that it satisfies the section 2115 tests, drastically reduces its California contacts prior to the end of the relevant fiscal year.

The Supreme Court has held that it is a violation of the due process clause for a state to apply its law to a matter with which the state has no significant contacts.⁹⁹ Despite early indications that the Court was going to interpret the due process clause as requiring application of the vested rights choice of law approach,¹⁰⁰ it now seems clear that it is constitutionally permissible for a state to apply its law when it has a reasonable connection with the matters in controversy.¹⁰¹

The Supreme Court's decreased inclination to prescribe rigid choice of law rules pursuant to the due process clause is illustrated by its decision in *Watson v. Employers Liability Assurance Corp.*¹⁰² There, the plaintiff, a resident of the forum, brought an action against the insurer of the manufacturer of a product which had injured her. A clause in the policy barred a direct action by an injured party against the insurance company. Such a clause was valid under the law of Massachusetts, the state where the contract was executed, and the law of Illinois, the principal place of business of the insured, but invalid under the law of the forum. The forum applied its law to the

"The Congress shall have the Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian tribes. . . ."

99. *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930); see generally *Slater v. Mexican Nat'l R.R.*, 194 U.S. 120 (1904).

100. See, e.g., *Hartford Accident & Indem. Co. v. Delta & Pine Land Co.*, 292 U.S. 143 (1934); *New York Life Ins. Co. v. Dodge*, 246 U.S. 357 (1918).

101. See generally *Clay v. Sun Ins. Office, Ltd.*, 377 U.S. 179 (1964); *Watson v. Employers Liab. Assurance Corp.*, 348 U.S. 66, 70-73 (1954); *Hoopston Canning v. Cullen*, 318 U.S. 313 (1943); *Pacific Employers Ins. Co. v. Industrial Accident Comm'n*, 306 U.S. 493, 500 (1939); *Alaska Packers Ass'n v. Industrial Accident Comm'n*, 294 U.S. 532, 540-42 (1935); *Baraf*, *supra* note 20, at 237-240; *Hilpert & Cooley, The Federal Constitution and the Choice of Law*, 25 WASH. U. L.Q. 27 (1939); *Kaplan*, *supra* note 29, at 445-50; *Latty I*, *supra* note 29, at 162-66; *Leflar, Constitutional Limits on Free Choice of Law*, 28 LAW & CONTEMP. PROB. 706 (1963). It may not constitute a sufficient connection if one of the parties to the action is a non-resident domiciliary. See *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930).

102. 348 U.S. 66 (1954).

contract, and the insurer argued that this violated due process. The Supreme Court held that the forum's application of its law was constitutional since "more states than one may seize hold of local activities which are part of multi-state transactions and may regulate to protect interests of its own people."¹⁰³ The Court emphasized the forum's interest in protecting injured residents.

A similar approach was taken by the Supreme Court in *Clay v. Sun Insurance Office, Ltd.*¹⁰⁴ This case involved a suit by a forum resident against a foreign insurance company under a policy which the plaintiff had purchased when he resided outside the forum. A term in the policy limited the period during which actions on claims could be brought. This limitation was valid in the state where the contract was executed but invalid in the forum. The forum applied its law and the Supreme Court held that that was constitutional, since the forum had "ample contacts with the transaction."¹⁰⁵

The modern approach taken by the Supreme Court toward constitutional limitations upon choice of law questions is reflected in the following excerpt from *Richards v. United States*:

Where more than one state has a sufficiently substantial contact with the activity in question, the forum state, by analysis of the interests possessed by the states involved, could constitutionally apply to the decision of the case the law of one or another state having such an interest in the multi-state activity.¹⁰⁶

In view of these general principles, applying California law to pseudo-foreign corporations that satisfy the section 2115 tests presents no problem under the due process clause. Such corporations normally have substantial contacts with California during the term they are governed by California law.

103. *Id.* at 72.

104. 377 U.S. 179 (1964).

105. *Id.* at 183. In an earlier dissenting opinion in the same case, Justice Douglas justified the Supreme Court's increased flexibility toward choice of law determinations in this manner:

As business bloomed throughout our growing country giving more states than one an interest in what a contract meant and how it should be enforced for the benefit of the citizens who made it or for whose benefit it was made, practical men began to see that there could not be one single rule of law to govern a contract in which the citizens of many states were interested.

363 U.S. 207, 218 (1960).

106. 369 U.S. 1, 15 (1962).

A different constitutional problem arises when a pseudo-foreign corporation so reduces its contacts with California during an income year for which it initially satisfied the requirements of section 2115(a) that the application of California law until the end of that year could violate the rule of *Home Insurance Co. v. Dick*,¹⁰⁷ which prohibits the forum state from applying its law without significant contacts with the controversy.

Section 2115(d) provides *inter alia* that section 2115(a) shall cease to be applicable at the end of a pseudo-foreign corporation's income year during which a court of competent jurisdiction enters an order declaring that one of the section 2115(a) requirements is not met.¹⁰⁸ Thus, despite the fact that a court may find that a pseudo-foreign corporation no longer meets the section 2115 tests, the internal affairs of that corporation will remain subject to California law for the remainder of its income year following the court's order. Statutes will be given a meaning consistent with constitutional requirements if this can be done by fair and reasonable interpretation,¹⁰⁹ but it is far from certain that this provision can be interpreted to meet the *Home Insurance* requirements. Therefore, it may be advisable to append the following saving clause to section 2115(d):

The provisions of the preceding sentence notwithstanding, Subdivision (a) shall cease to be applicable to any foreign corporation when its contacts with California are so reduced that the application of California law would be unconstitutional.

The addition of such a provision would insure that California law would be applied only when a foreign corporation had sufficient contacts with California to satisfy the minimum constitutional requirements for the application of California law.

107. 281 U.S. 397 (1930). See text accompanying note 99 *supra*.

108. 1976 Cal. Legis. Serv., ch. 641, § 32.5, at 1674-75 (amending CAL. CORP. CODE § 2115(d)).

Section 2115(d) provides that a pseudo-foreign corporation may escape the provisions of California law imposed by section 2115(b) where the officers' certificate shows or a court declares that the corporation no longer meets the section 2115(a) requirements. Therefore, it may be inferred that section 2115(d) can be asserted by a pseudo-foreign corporation as a defense to an action based on its failure to observe California law pursuant to section 2115(b).

109. *Braxton v. Municipal Court*, 10 Cal. 3d 138, 145, 514 P.2d 697, 701, 109 Cal. Rptr. 897, 901 (1973).

Full Faith and Credit Clause

The Constitution provides that a state shall give full faith and credit to the "public Acts, Records and judicial Proceedings of every other State."¹¹⁰ This clause generally has been invoked to avoid actual conflicts between the regulatory schemes of different states.¹¹¹ The issue presented is whether, in a California action, the corporate codes of the states of incorporation of pseudo-foreign corporations must be granted full faith and credit.

Although the phrase "public Acts, Records and judicial Proceedings" has been construed to include statutes¹¹² as well as judicial decisions,¹¹³ the Supreme Court has rarely held that full faith and credit requires the application of the law of one state in the courts of another, and the Court has become increasingly reluctant to so hold. In the choice of law field, the Supreme Court has enforced the full faith and credit clause in only three areas:¹¹⁴ workmen's compensation laws,¹¹⁵ shareholder assessments,¹¹⁶ and fraternal benefit insurance associations.¹¹⁷ These cases can be construed narrowly.

In the area of workmen's compensation, the Supreme Court has held that full faith and credit requires the applica-

110. U.S. CONST. art. IV, § 1.

111. See generally Costigan, *The History of the Adoption of Section I of Article IV of the United States Constitution and a Consideration of the Effect on Judgments of that Section and of Federal Legislation*, 4 COLUM. L. REV. 470 (1904); Holt, *Full Faith and Credit—A Suggested Approach to the Problem of Recognition of Foreign Corporations*, 89 U. PA. L. REV. 453 (1941); Jackson, *Full Faith and Credit—The Lawyer's Clause of the Constitution*, 45 COLUM. L. REV. 1 (1945); Nadelmann, *Full Faith and Credit to Judgments and Public Acts*, 56 MICH. L. REV. 33 (1957); Sumner, *The Status of Public Acts in Sister States*, 3 U.C.L.A. L. REV. 1 (1955); Note, *Conflict of Laws—Full Faith and Credit to Public Acts*, 30 N.Y.U. L. REV. 984 (1955).

112. See, e.g., *Bradford Elec. Light Co. v. Clapper*, 286 U.S. 145 (1932).

113. See, e.g., *Carroll v. Lanza*, 349 U.S. 408 (1955).

114. In addition to the three areas referred to, it should be noted that the Supreme Court has held that it is a violation of the full faith and credit clause for a state to refuse to provide a forum for a suit based upon a foreign wrongful death statute. See *First Nat'l Bank v. United Air Lines, Inc.*, 342 U.S. 396 (1952); *Hughes v. Fetter*, 341 U.S. 609 (1951).

115. See *Crider v. Zurich Ins. Co.*, 380 U.S. 39 (1965); *Carroll v. Lanza*, 349 U.S. 408 (1955); *Watson v. Employers Liab. Assurance Corp.*, 348 U.S. 66 (1954); *Alaska Packers Ass'n v. Industrial Accident Comm'n*, 294 U.S. 532, 547 (1935); *Bradford Elec. Light Co. v. Clapper*, 286 U.S. 145 (1932).

116. See, e.g., *Broderick v. Rosner*, 294 U.S. 629 (1935).

117. See *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).

tion of the workmen's compensation act of the state where the employment contract was entered into if the law of that state attempted to provide an exclusive remedy.¹¹⁸ This was consistent with the Court's early tendency to constitutionally mandate the application of the vested rights choice of law approach in certain situations. This rigid approach has been relaxed; the Court has more recently held in a number of cases that even if the employment contract was executed outside the forum, it is constitutional for the forum to apply its law to a workmen's compensation question if the forum has a substantial interest in the transaction.¹¹⁹

Three Supreme Court cases involving shareholder assessments, however, present a more confused picture of the limitations imposed by full faith and credit. *Broderick v. Rosner*¹²⁰ involved a bank which was incorporated in New York and whose principal place of business was New York. An administrative determination was made in New York that under New York law the corporation's shareholders were subject to assessment. New Jersey had enacted a law which barred suits based on foreign assessment statutes, and pursuant to that law a New Jersey court refused to hear a suit based on the New York assessment determination.¹²¹ The Supreme Court held that full faith and credit required New Jersey to allow such a suit in New Jersey.¹²²

Broderick can be explained on the basis that either in personam jurisdiction existed in the first proceeding due to the shareholder's relationship with the corporation (an implied consent notion) or that the law of the state of incorporation must be enforced in other states pursuant to full faith and credit.¹²³ If the latter interpretation of these cases is accepted,

118. *Bradford Elec. Light Co. v. Clapper*, 286 U.S. 145 (1932).

119. See *Carroll v. Lanza*, 349 U.S. 408 (1955); *Pacific Employers Ins. Co. v. Industrial Accident Comm'n*, 306 U.S. 493 (1939); *Alaska Packers Ass'n v. Industrial Accident Comm'n*, 294 U.S. 532 (1935).

120. 294 U.S. 629 (1935). *Converse v. Hamilton*, 224 U.S. 243 (1912), involved an analogous situation, except a judicial determination was made in the first state, as opposed to the administrative determination made in *Broderick*. The Court held that this assessment must be granted full faith and credit.

121. See generally *Currie, The Constitution and the "Transitory" Cause of Action*, 73 HARV. L. REV. 268, 286-90 (1959) [hereinafter cited as *Currie*].

122. 294 U.S. at 647.

123. The Court in *Broderick* indicated that the latter interpretation was intended. 294 U.S. at 644-45. Cf. *Doggrell v. Southern Box Co.*, 208 F.2d 310 (6th Cir. 1953) (decision by Supreme Court of Tennessee that Arkansas statute governing liability of incorporators was penal and need not be enforced by Tennessee courts was a

it could be argued that the subject of these cases, shareholder assessments, is an example of one of the rare circumstances where the need for uniform national regulation is sufficiently critical to warrant such a limitation upon state choice of law.¹²⁴

In contrast, the Supreme Court held in *Pinney v. Nelson*¹²⁵ and *Thomas v. Matthiessen*¹²⁶ that a court may apply local law which sanctions assessment of the shareholders of foreign corporations, although the law of the state of incorporation proscribes such assessment. These cases involved suits in California by California creditors against shareholders of foreign corporations both of whose charters expressly authorized the corporation to do business in California. California law provided that shareholders could be personally assessed, while the laws of the states of incorporation proscribed such liability. The California court in both instances applied California law. The Supreme Court upheld the decisions as being within the Constitution. In two confusing opinions, the Court justified these holdings on the ground that since the charters of both corporations expressly referred to the corporation doing business in California, the shareholders had contracted with reference to California law.¹²⁷ This justification is puzzling since the corporations were incorporated elsewhere and conducted a significant amount of business outside of California. In any event, it appears constitutional for a forum to apply its law to questions regarding the internal affairs of a foreign corporation when the charter of that corporation expressly authorizes the corporation to do business in that forum.

It is difficult to reconcile an expansive reading of *Broderick* with *Thomas* and *Pinney*. Unless *Broderick* inferentially overruled *Thomas* and *Pinney*, it appears that *Broderick* must be limited to its facts.¹²⁸ If so, it can be construed as holding that

sufficient basis for rehearing to be granted by court of appeals which affirmed district court's holding that Tennessee courts were bound to follow the Arkansas statute.) See generally A. VON MEHREN & D. TRAUTMAN, CASES AND MATERIALS ON CONFLICTS OF LAWS: THE LAW OF MULTI-STATE PROBLEMS 1248-50 (1965).

124. See note 133 and accompanying text *infra*.

125. 183 U.S. 144 (1901).

126. 232 U.S. 221 (1914).

127. *Pinney v. Nelson*, 183 U.S. at 151; *Thomas v. Matthiessen*, 232 U.S. at 234-35.

128. Professor Currie summarizes *Broderick* as follows:

New York had expressly declared a policy of protecting the creditors of banks by imposing personal liability on stockholders. It has a clear interest in the application of the policy to a New York bank, both for the security of local depositors and to enhance the credit of the bank in

when one state has an explicit substantial interest in the application of its law and the forum has no legitimate interest in the application of its law, the full faith and credit clause requires the application of the former state's law. Under this view, *Broderick* could clearly be distinguished from a situation involving the application of local law to a pseudo-foreign corporation, since the forum would have a legitimate interest in the application of its law.¹²⁹

Early cases involving fraternal benefit insurance associations held that the law of the state where the organization was formed must be applied to questions regarding those organizations.¹³⁰ These cases have been severely limited, if not overruled sub silencio by subsequent decisions.¹³¹

general. New Jersey had declared no conflicting policy of protecting its residents, as stockholders, against such liability. Neither had it suggested any reason relating to the administration of its courts why actions to enforce such liabilities should not be brought in New Jersey. It had only pretended a concern for the procedural aspects of such actions In such circumstances, New York having a legitimate governmental interest in the application of its policy and New Jersey having none, the Court quite properly held that New Jersey must entertain the action, and with equal propriety intimated that New Jersey must apply the law of New York.

B. CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 347 (1963).

Another commentator interpreted the case in this manner: "It is submitted that the case of *Broderick v. Rosner* goes no further than to hold that a state may not deny recovery on foreign facts when its own domestic law would award recovery on parallel facts occurring within its own borders." Ross, "*Full Faith and Credit*" in a *Federal System*, 20 MINN. L. REV. 140, 178 (1936). See generally Hilpert & Cooley, *The Federal Constitution and the Choice of Law*, 25 WASH. U.L.Q. 27, 35-36 (1939).

129. Such an interpretation would be consistent with this general statement by the Supreme Court regarding the duty of a state to give full faith and credit to the statutes of another state:

[T]he conflict is to be resolved not by giving automatic effect to the full faith and credit clause compelling the court of each state to subordinate its own statutes for those of the other, but by appraising the governmental interests of each jurisdiction, and turning the scale of decision according to their weight. . . . *Prima facie* every state is entitled to enforce in its own courts its own statutes, lawfully enacted. One who challenges that right, because of force given to a conflicting statute of another state by the full faith and credit clause, assumes the burden of showing, upon some rational basis, that of the conflicting interests involved those of the foreign state are superior to those of the forum.

Alaska Packers Ass'n v. Industrial Accident Comm'n, 294 U.S. 532, 547-48 (1935).

130. See *Order of United Commercial Travelers of America v. Wolfe*, 331 U.S. 586 (1947); *Modern Woodmen of America v. Mixer*, 267 U.S. 544 (1924); *Supreme Council of the Royal Arcanum v. Green*, 237 U.S. 531 (1915).

131. *Clay v. Sun Ins. Office, Ltd.*, 377 U.S. 179, 183 (1964); *Order of United Commercial Travelers v. Duncan*, 221 F.2d 703 (6th Cir. 1955). See generally Baraf, *supra* note 20, at 244; Cheatham, *Federal Control of Conflict of Laws*, 6 VAND. L. REV.

In light of the above, the full faith and credit clause presents no great obstacle to the circumvention of the internal affairs doctrine with respect to pseudo-foreign corporations. The cases referred to above which required the application of a certain state's law have been limited, in all probability, to their facts. Assuming this to be the case, full faith and credit can be generally viewed as not requiring a state to apply a law other than its own in situations where the application of its law would not offend the due process clause.¹³²

The full faith and credit clause may impose limitations upon state choice of law decisions in those rare situations where the need for uniform national regulation is critical.¹³³ Some commentators have suggested that the need for uniform national regulation of some of the internal affairs of pseudo-foreign corporations is sufficiently critical that the full faith and credit clause should be invoked.¹³⁴ These commentators argue that chaos would result if the legality of a corporation's dividends¹³⁵ or stockholders' voting rights, including acceptable

581, 596 (1953); Harper, *The Supreme Court and the Conflict of Laws*, 47 COLUM. L. REV. 883, 895-97 (1947); Kaplan, *supra* note 29, at 446; Note, 15 U. CHI. L. REV. 409 (1947); Note, 33 VA. L. REV. 767 (1947); Note, 57 YALE L.J. 139 (1947).

One commentator has argued that these fraternal benefit society cases represent attempts by the Supreme Court to protect the solvency of the financially weak fraternal benefit organizations. Note, 57 YALE L.J. 139, 141 (1947). Professor Baraf has suggested that fraternal benefit organizations are distinguishable from regular corporations regarding "the prerequisites for entry into membership, the multi-various purposes for which organized, the pecuniary policies it must pursue and the 'non-fraternal' procedures of 'corporate democracy.'" Baraf, *supra* note 20, at 244. See also *Order of United Commercial Travelers of America v. Wolfe*, 331 U.S. 586 (1947).

132. See *Clay v. Sun Ins. Office, Ltd.*, 377 U.S. 179 (1964); *Pacific Employers Ins. Co. v. Indus. Accident Comm'n*, 306 U.S. 493 (1939); Baraf, *supra* note 20, at 237-240; Holt, *Full Faith and Credit—A Suggested Approach to the Problem of Recognition of Foreign Corporations*, 89 U. PA. L. REV. 453-56 (1941); Jackson, *Full Faith and Credit, the Lawyer's Clause of the Constitution*, 45 COLUM. L. REV. 1, 12, 27 (1945); Kaplan, *supra* note 29, at 445-50; Latty I, *supra* note 29, at 162-66; Note, 30 N.Y.U. L. REV. 984 (1955). See generally Reese & Kaufman, *supra* note 29. The similar nature of the limitations imposed upon state choice of law by both clauses is indicated by the fact that Justice Brandeis cited *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930), a due process decision, in support of a decision grounded upon the full faith and credit clause. See *John Hancock Mut. Life Ins. Co. v. Yates*, 299 U.S. 178, 182 (1936).

133. See Weintraub, *Due Process and Full Faith and Credit Limitations on a State's Choice of Law*, 44 IOWA L. REV. 449, 455 (1959). A state may not be required to apply such a law, however, if the law would be obnoxious to the public policy of the forum. See, e.g., *Griffin v. McCoach*, 313 U.S. 498, 507 (1941).

134. See, e.g., Coleman, *Corporate Dividends and the Conflict of Laws*, 63 HARV. L. REV. 433, 466 (1950) [hereinafter cited as Coleman]; Reese & Kaufman, *supra* note 29.

135. See Coleman, *supra* note 134; cf. Reese & Kaufman, *supra* note 29, at 1138 (there are some conflicts between the codes of competing states which can not be

procedures for electing directors,¹³⁶ were to be governed by more than one law. Others have argued that the Supreme Court should determine which pseudo-foreign corporate internal matters require uniform national regulation and have assumed that the law of the state of incorporation would be applied to those matters.¹³⁷ It is submitted that the better view would be to apply the law of the principal place of business of a pseudo-foreign corporation if it were determined that such issues should be regulated by only one state.¹³⁸

As noted above the Supreme Court has suggested, expressly¹³⁹ or implicitly,¹⁴⁰ that where one state has a substantial interest in the application of its law and the forum has no legitimate interest in the application of its law, full faith and credit must be given to the foreign law.¹⁴¹ Pursuant to this standard, the full faith and credit clause may bar the application of the law of the state of incorporation on certain questions dealing with pseudo-foreign corporations, since the state of incorporation would have little interest in applying its law vis-a-vis the interest of the principal place of business of the corporation.

Professors Reese and Kaufman suggest that three factors should be considered in determining whether the full faith and credit clause requires another state to apply the law of the state of incorporation to a question involving the internal affairs of a corporation with multi-state contacts: (1) the corporation's connection with the state; (2) the intensity of the state interest involved; (3) the intensity of the need for regulation of the matters by a single law.¹⁴² Such an approach may require psychic powers to determine "the intensity of the state interest involved."¹⁴³ However, if a corporation has a substantial

resolved by the application of the stricter standard).

136. Reese & Kaufman, *supra* note 29, at 1141.

137. See Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 669 (1974).

138. See Coleman, *supra* note 134, at 466; cf. Reese & Kaufman, *supra* note 29, at 1143 (full faith and credit is thought to require application of the law of the state of incorporation except where another state has a great interest of its own to protect).

139. *Alaska Packers Ass'n v. Industrial Accident Comm'n*, 294 U.S. 532, 547 (1935).

140. *Broderick v. Rosner*, 294 U.S. 629 (1935).

141. See Currie, *supra* note 121, at 290. See also *Aldens, Inc. v. Packel*, 524 F.2d 38 (6th Cir. 1975). The court in *Aldens* stated that the full faith and credit clause requires a court to apply the law of a sister state "when . . . a sister state has a greater interest in regulating the transaction." *Id.* at 44.

142. See Reese & Kaufman, *supra* note 29, at 1134.

143. See generally Currie, *The Constitution and the Choice of Law: Governmen-*

connection with a forum, the forum should be able to apply its law to a question regarding the internal affairs of a foreign corporation unless the need for regulation by a single law in that instance is critical.

Experience has shown that it is not critical that all questions regarding the internal affairs of a corporation be governed by the laws of one state.¹⁴⁴ For example, almost fifteen years

tal Interests and the Judicial Function, 26 U. CHI. L. REV. 9 (1958); Nutting, *Suggested Limitations of Public Policy Doctrine*, 19 MINN. L. REV. 196 (1935).

144. Civil law countries, for example, reject the view that the law of the place of incorporation governs a corporation's internal affairs. See generally Latty I, *supra* note 29, at 167 n.134. Courts in those countries apply the law either of the "social seat" (*le siège social*), sometimes referred to as the real seat (*la siège réel*), or the principal place of business (*le centre d'exploitation*) to questions regarding the internal affairs of a corporation. See generally A. FARNSWORTH, *THE RESIDENCE AND DOMICILE OF CORPORATIONS* (1939); Conard, *Organizing for Business*, in *AMERICAN ENTERPRISE IN THE EUROPEAN COMMON MARKET—A LEGAL PROFILE* 1, 61-65 (E. Stein & T. Nicholson eds. 1960); Stein, *Conflict of Laws Rules by Treaty: Recognition of Companies in a Regional Market*, 68 MICH. L. REV. 1327, 1332-36 (1970); Vagts, *The Multinational Enterprise, A New Challenge for Transnational Law*, 83 HARV. L. REV. 740 (1970); Note, *The Nationality of International Corporations Under Civil Law and Treaty*, 74 HARV. L. REV. 1429 (1961). Most Western European countries, with the exception of the Netherlands, adhere to the "social seat" doctrine. See 2 E. RABEL, *THE CONFLICT OF LAWS* 33-35 (2d ed. 1960).

The French were apparently prompted to adopt this conflict of laws rule at least in part as a result of England's relatively lax corporation laws in the 19th century. French businesses apparently became chartered in England and then conducted business in France. See Latty I, *supra* note 29, at 166 n.130.

The place of central administration of a corporation is its "social seat"; the principal factors considered in the determination of a corporation's social seat are where its executive offices are located and where its shareholders' and directors' meetings are held. See Hadari, *The Choice of National Law Applicable to the Multi-National Enterprise and the Nationality of Such Enterprises*, 1974 DUKE L.J. 1, 7; Latty I, *supra* note 29, at 167 n.136. The social seat cannot be fictitious and must be the actual center of the enterprise. Latty I, *supra* note 29, at 170 n.151. It is possible, however, to establish a social seat (e.g., a main office and shareholders' and directors' meetings) in any jurisdiction where there are significant contacts with the corporation. See 2 RABEL, *CONFLICT OF LAWS*, 44-45 (1947); Latty I, *supra* note 29, at 171 n.152. A number of commentators have argued that a corporation's apparent social seat should be honored only if there is a business reason for establishing the social seat in that jurisdiction. See generally R. PENNINGTON, *COMPANIES IN THE COMMON MARKET* (2d ed. 1970); Latty I, *supra* note 29, at 170.

The location of a corporation's social seat is somewhat unclear if its executive offices and shareholders' and directors' meetings are not in the same jurisdiction. For example, *Chandora v. Fondateurs et Administrateurs de la Banque Europeene*, Tribunal Correctionnel de la Seine, Feb. 10, 1881, 8 Clunet 158 (France 1881), involved a bank incorporated in Belgium whose shareholders' and directors' meetings were held in Belgium and whose executive offices were in France. The bank had a "considerable number" of employees in Belgium and it invested a substantial percentage of its resources in Belgian companies. The court there held that the corporation's social seat was Belgium. Latty I, *supra* note 29, at 168. Applying the law of a corporation's social seat to matters regarding its internal affairs has generally been a workable approach.

ago New York enacted a law which is analogous to section 2115, and this law has not generated a significant number of problems. It does not seem, therefore, that it would be necessary to establish a constitutionally mandated uniform rule regarding the matters regulated by the New York statute.¹⁴⁵

The Commerce Clause

It could be argued that section 2115 violates the commerce clause of the United States Constitution¹⁴⁶ since the Supreme Court has struck down state regulations which place too great a burden on interstate commerce. For example, when compliance with one state's safety regulations regarding mudflaps would have been illegal in another state, the Court struck down the former state's statute as an unreasonable restraint upon commerce.¹⁴⁷ In addition, the Court has struck down a state statute which prescribed the maximum length of trains in that state.¹⁴⁸

It is doubtful that section 2115 could be successfully challenged as an excessive burden upon interstate commerce. An unanimous Court recently stated that a state regulation which affects interstate commerce will be reviewed in this manner:

Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree, and the extent of the burden that will

See generally 2 E. RABEL, *supra*; Latty I, *supra* note 29, at 166-72; Vagts, *The Multinational Enterprise, supra*; Note, *The Nationality of International Corporations Under Civil Law and Treaty, supra*.

145. See N.Y. BUS. CORP. LAW §§ 1315-1320 (McKinney 1963). New York pseudo-foreign corporations are subject to the following provisions of the New York corporations code: section 1315 (the release of a list of shareholders to a shareholder upon demand); section 1316 (voting trust records); section 719, except subsection (a)(3) thereof (liability of directors); section 720 (actions against a director or officer for misconduct); section 1318 (disclosing certain specified information to shareholders); section 623 (the enforcement of dissenters' rights); section 626 (the right of a shareholder to bring a derivative action); section 627 (security for expenses in a derivative action); sections 721-27 (indemnification of directors and officers); and section 907 (merger of domestic and foreign corporations). *See also* N.Y. BUS. CORP. LAW §§ 1315-19 (McKinney 1963).

146. U.S. CONST. art. I, § 8, cl. 3.

147. *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959).

148. *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945).

be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities. Occasionally, the Court has candidly undertaken a balancing approach in resolving these issues, but more frequently it has spoken in terms of "direct" and "indirect" effects and burdens.¹⁴⁹

California could not promote its substantial state interest embodied in section 2115 in another manner which would have "a lesser impact on interstate activities" and it is unclear what is required to constitute more than an "incidental" effect upon interstate commerce.

Professor Dowling has suggested that a state regulation will be struck down when its burden upon commerce exceeds its local benefits.¹⁵⁰ The Court has recently struck down state statutes as unreasonable burdens on interstate commerce only when they found that the burden was substantial and the local benefits minimal or nonexistent.¹⁵¹ In addition, the Court has generally upheld those state statutes which further local health or safety or protect local citizens from fraud¹⁵² and which do not discriminate against interstate commerce vis-a-vis local commerce.¹⁵³ Since the local benefits which will flow from section 2115 are substantial and since one of its purposes is to protect California shareholders and creditors from fraud, it is highly

149. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). See generally *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945).

150. See *Aldens, Inc. v. Packel*, 524 F.2d 38, 46 (3d Cir. 1975); see generally Dowling, *Interstate Commerce and State Power*, 27 VA. L. REV. 1 (1940).

151. See *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959); *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945).

152. See *H.P. Hood & Sons v. DuMond*, 336 U.S. 525 (1949).

153. See *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964); *Edwards v. California*, 314 U.S. 160 (1941). See generally Cowett, *Reorganization, Consolidations, Mergers and Related Corporate Events Under the Blue Sky Laws*, 13 BUS. LAW 760 (1958); Dowling, *Interstate Commerce and State Power*, 27 VA. L. REV. 1 (1940); Dowling, *Interstate Commerce and State Power—Revised Version*, 47 COLUM. L. REV. 547 (1947).

It should be noted that the Court held that the various state blue sky laws were constitutional exercises of the police powers of the respective states, and not unreasonable burdens upon interstate commerce. See, e.g., *Hall v. Geiger-Jones Co.*, 242 U.S. 539 (1917).

Some commentators have suggested that state statutes regulating certain activities of foreign corporations would unconstitutionally burden interstate commerce. See Cowett, *Reorganizations, Consolidations, Mergers, and Related Corporate Events Under the Blue Sky Laws*, 13 BUS. LAW 760 (1958); Comment, *Commerce Clause Limitations upon State Regulation of Tender Offers*, 47 S. CAL. L. REV. 1134 (1974).

doubtful that a court will find that section 2115 violates the commerce clause.

In light of the above, it appears that the most serious constitutional challenge to section 2115 is that it may violate the rule of *Home Insurance Co. v. Dick* in certain situations. Otherwise, the contacts which must exist under section 2115(a) before California law will be applied to a foreign corporation's internal affairs are clearly sufficient to satisfy the requirements of the due process, full faith and credit, and commerce clauses.

POTENTIAL PROBLEMS IN THE APPLICATION OF SECTION 2115

The Resolution of Conflicts Between Section 2115 and the Laws of Other States

The effect of most of the requirements enumerated in section 2115 (b) will be only to require pseudo-foreign corporations to establish additional procedures or to obtain shareholder approval in an increased number of situations; actual conflict between the laws of the respective states should be rare. For example, it would be advisable for officers of a pseudo-foreign corporation to permit shareholder inspection when the claims of a shareholder meet the requirements of either the California code or the law of the state of incorporation. Similarly, a corporation should satisfy the approval requirements of both the new code and those of the state of incorporation before effecting a proposed reorganization, and appraisal rights should be granted to any shareholder given such rights by the law of either state. Dividend distributions and indemnification of directors and officers should only be made if the protective requirements of both California and the law of the state of incorporation are satisfied. A director should behave in a manner consonant with the highest standard of care prescribed in either the California code or the law of the state of incorporation. And, of course, the corporation should cumulate votes at any election of directors, and such elections should be held annually for all directors.

The most onerous type of conflict which might result from a regulatory scheme such as section 2115 would be a situation where the law of the state of incorporation mandates certain behavior proscribed by the new California code, or vice versa. A potentially significant conflict of this type which could arise under section 2115 stems from the regulation of dividend distributions of pseudo-foreign corporations. The codes of certain states may, in the future, provide that a shareholder can com-

pel a dividend distribution in certain situations.¹⁵⁴ If any such mandatory distributions would be prohibited by the California code, a serious conflict could result. It is unlikely that any current mandatory dividend provisions give rise to such a conflict at this time.¹⁵⁵ However, if such a conflict should arise, artifice should bow to reality; the law of the state which has the most significant contacts with the pseudo-foreign corporation should be applied.¹⁵⁶

Enforcement of Section 2115

If a pseudo-foreign corporation is unwilling to comply voluntarily with the provisions enumerated in section 2115(b), shareholders of such a corporation generally could insure compliance through an action in a California court. Obviously it would be possible to obtain a judgment and an affirmative order regarding the activities of a pseudo-foreign corporation in California and regarding those officers and directors of the corporation present in California. However, the degree to which these California judgments and orders would be entitled to full faith and credit in other states is unclear.¹⁵⁷ It is clear that a

154. North Carolina is the only state with such a provision now in effect. See N.C. GEN. STATS. ANN. § 55-50 (Supp. 1975).

The corporations codes of most states now provide that dividend distributions are discretionary. In these states a court will compel a dividend distribution only if it is shown that the directors are acting either in bad faith or clearly unreasonably. See *Leibert v. Grinnell Corp.*, 41 Del. Ch. 340, 194 A.2d 846 (1963); *Farmers Warehouse of Pelham, Inc. v. Collins*, 220 Ga. 141, 137 S.E.2d 619 (1964); *Cashman v. Petrie*, 14 N.Y.2d 426, 201 N.E.2d 24, 252 N.Y.S.2d 447 (1964).

155. No mandatory distribution ordered pursuant to the North Carolina provision would be proscribed by the California code. The North Carolina provision provides for the mandatory distribution of one-third of a corporation's "net profits" for the preceding fiscal year in certain circumstances. In California, section 500(a) generally authorizes any distribution made from the retained earnings of a corporation. 1976 Cal. Legis. Serv., ch. 641, § 14, at 1644 (amending CAL. CORP. CODE § 500(a)). Regarding other mandatory dividend provisions which have been repealed, see generally *Malone v. Armor Insulating Co.*, 131 Ga. 146, 12 S.E.2d 299 (1940); *Rubens v. Marion-Washington Realty Corp.*, 116 Ind. App. 55, 59 N.E.2d 907 (1945); *Koppel v. Middle States Petroleum Corp.*, 272 App. Div. 790, 69 N.Y.S.2d 784 (1947); *Cannon v. Wiscasset Mills Co.*, 195 N.C. 119, 141 S.E. 344 (1928).

156. For further discussion of the burdens imposed by section 2115(b) upon pseudo-foreign corporations, see Comment, *The Pseudo-Foreign Corporation in California*, 28 HASTINGS L. J. 119, 132 (1976).

157. See generally *Moore & Oglebay, The Supreme Court and Full Faith and Credit*, 29 VA. L. REV. 557 (1943); *Page, Full Faith and Credit*, 1948 WIS. L. REV. 265; *Paulsen, Enforcing the Money Judgment of a Sister State*, 42 IOWA L. REV. 202 (1957); *Reese & Johnson, The Scope of Full Faith and Credit to Judgments*, 49 COLUM. L. REV. 153 (1949); [hereinafter cited as *Reese & Johnson*]; *Sumner, The Full Faith and Credit Clause—Its History and Purpose*, 34 ORE. L. REV. 224 (1955); *Sumner, Full*

valid, nonmodifiable,¹⁵⁸ final¹⁵⁹ California judgment¹⁶⁰ on the merits generally would be entitled to full faith and credit.¹⁶¹ Other states may not refuse to recognize such a judgment on the basis that the judgment offends its public policy;¹⁶² the only generally accepted ground for not granting full faith and credit to such a judgment is that the judgment is rendered without jurisdiction.¹⁶³ California judgments rendered in connection

Faith and Credit for Judicial Proceedings, 2 U.C.L.A. L. REV. 441 (1955); Yntema, *The Enforcement of Foreign Judgments in Anglo-American Law*, 33 MICH. L. REV. 1129 (1935). It should be noted that the Supreme Court has held that a judgment may not be entitled to full faith and credit when both parties are corporations. See *Anglo-American Provision Co. v. Davis Provision Co.*, 191 U.S. 373 (1903).

158. See, e.g., *Halvey v. Halvey*, 330 U.S. 610 (1947); *Lynde v. Lynde*, 181 U.S. 183 (1901). Judgments which remain subject to modification in the rendering state have not been deemed entitled to full faith and credit. See generally A. EHRENZWEIG, *CONFLICT OF LAWS* 269-80 (1962); Kelso, *Reciprocal Enforcement of Support: 1958 Dimensions*, 43 MINN. L. REV. 875 (1959); Note, *Interstate Enforcement of Modifiable Alimony and Child Support Decrees*, 54 IOWA L. REV. 597 (1966); Note, *Uniform Reciprocal Enforcement of Support Act*, 13 STAN. L. REV. 901 (1961). The law of the rendering state governs the question whether a judgment is "modifiable." See, e.g., *Barber v. Barber*, 323 U.S. 77 (1944).

159. A judgment generally lacks "finality" if further judicial action by the court rendering the judgment is required to resolve the matter litigated. See generally Note, *The Finality of Judgments in the Conflict of Laws*, 41 COLUM. L. REV. 878 (1941). Appeals, stays, and interlocutory orders may affect the finality of a judgment. *Id.* The law of the rendering state governs the question of finality. See *Paine v. Schnectady Ins. Co.*, 11 R.I. 411 (1876).

160. Declaratory judgments as well as equity decrees, except possibly those decrees ordering an extrastate act or forbearance, and those decrees purporting to affect title to extrastate land or personal status, such as custody of a child (see A. EHRENZWEIG, *CONFLICT OF LAWS* 182-83 (1962)), constitute "judicial proceedings" entitled to full faith and credit. See RESTATEMENT (SECOND) OF JUDGMENTS § 76 (Tent. Draft No. 1, 1973); Note, *The Res Judicata Effect of Declaratory Relief in the Federal Courts*, 46 S. CAL. L. REV. 803 (1973).

161. See, e.g., Sumner, *Full Faith and Credit for Judicial Proceedings*, 2 U.C.L.A. L. REV. 441 (1955) [hereinafter cited as Sumner].

162. *Fauntleroy v. Lum*, 210 U.S. 230 (1908).

163. See, e.g., Sumner, *supra* note 161. If the question of personal jurisdiction was litigated in the first proceeding, the first adjudication is res judicata regarding that issue, unless the state where the judgment was rendered would permit subsequent collateral attack. See, e.g., *American Surety Co. v. Baldwin*, 287 U.S. 156 (1932); *Baldwin v. Iowa State Travelling Men's Ass'n*, 283 U.S. 522 (1931); *Vander v. Casper*, 12 N.Y.2d 56, 236 N.Y.S.2d 33 (1962). It is unclear whether the subject matter jurisdiction of the rendering court may be collaterally attacked if the issue was raised in the initial proceeding. Compare *Durfee v. Duke*, 375 U.S. 106 (1963) with *Kalb v. Feuerstein*, 308 U.S. 433 (1940) and *Davis v. Davis*, 305 U.S. 32 (1938). See generally Boskey & Braucher, *Jurisdiction and Collateral Attack*, 40 COLUM. L. REV. 1006 (1940); Dobbs, *The Validation of Void Judgments: The Bootstrap Principle*, 53 VA. L. REV. 1003 (1967).

The argument has been made that full faith and credit should not be granted to judgments in certain situations where a competing national policy overrides the policy justifications for full faith and credit. See *Kovacs v. Brewer*, 356 U.S. 604, 611 (1958)

with the provisions of section 2115 would not fall within the scope of "penal judgments" to which a second state arguably may refuse full faith and credit.¹⁶⁴

It is unclear whether a state must grant full faith and credit to an extraterritorial affirmative order given by a California court in connection with the California judgment.¹⁶⁵ Such a remedy may be necessary, for example, if a pseudo-foreign California corporation held its shareholders' meeting in a state other than California and did not permit cumulative voting in the election of its directors. A shareholder either would have to bring suit in California and attempt to obtain an extraterritorial order or bring suit in the state where the shareholders' meeting was being held in order to attempt to enforce section 708, the provision which provides that cumulative voting is mandatory. Since it is doubtful that another state would apply California law to the question of mandatory cumulative voting, especially if that state were the state of incorporation,¹⁶⁶ a shareholder most likely would pursue the former procedure and obtain an extraterritorial order from a California court.¹⁶⁷

(dissenting opinion); *Halvey v. Halvey*, 330 U.S. 610, 620 (1947) (concurring opinion); *Yarborough v. Yarborough*, 290 U.S. 202, 215 (1933) (dissenting opinion); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 103, Comment b (1971). See generally Reese & Johnson, *supra* note 157. But see Ehrenzweig, *The Second Conflicts Restatement: A Last Appeal for Its Withdrawal*, 113 U. PA. L. REV. 1230, 1240 (1965); Note, *Full Faith and Credit to Judgments: Law and Reason Versus the Restatement Second*, 54 CALIF. L. REV. 282 (1966). This alleged exception to full faith and credit has only been advanced regarding cases involving divorce or child custody. *Id.* It does not appear that granting full faith and credit to judgments involving pseudo-foreign corporations will similarly conflict with crucial state and national policies.

164. The Supreme Court has stated that this basis for refusing to grant full faith and credit, if it is available at all, is limited to those judgments regarding offenses against the state or the public at large, as opposed to those resulting from private or individual action. See *Milwaukee County v. M.E. White Co.*, 296 U.S. 268 (1935); *Huntington v. Attrill*, 146 U.S. 657 (1892). The Supreme Court has held, for example, that a judgment resulting from a private suit involving the liability of directors and shareholders of a corporation does not constitute a "penal judgment." *Id.*

165. See *Durfee v. Duke*, 375 U.S. 106 (1963); *Fall v. Eastin*, 215 U.S. 1 (1909). See generally A. EHRENZWEIG, CONFLICT OF LAWS 182-83 (1962); Paulsen, *Enforcing the Money Judgment of a Sister State*, 42 IOWA L. REV. 202 (1957); Reese, *Full Faith and Credit to Foreign Equity Decrees*, 42 IOWA L. REV. 183 (1957) [hereinafter cited as Reese]; Reese & Johnson, *supra* note 157; Sumner, *supra* note 161; Yntema, *The Enforcement of Foreign Judgments in Anglo-American Law*, 33 MICH. L. REV. 1129 (1935).

166. See, e.g., DEL. CODE ANN. tit. 8, § 121(b) (Cum. Supp. 1968), which provides that every Delaware corporation shall be governed by the Delaware corporations code.

167. An analogous situation would result, for example, if a corporation refused a shareholder's request to inspect certain records of the corporation stored outside of California pursuant to his inspection rights as provided in section 1605.

A substantial amount of the uncertainty regarding the degree to which extraterritorial affirmative orders must be given full faith and credit in other states stems from the case of *Fall v. Eastin*.¹⁶⁸ In that case, a Washington court with personal jurisdiction over the defendant ordered him to convey Nebraska land to his wife. The defendant left Washington before complying with the decree. The Washington court then ordered a statutory officer to execute a deed regarding the Nebraska land. In the wife's suit thereafter to quiet title, the Supreme Court held (in a very confusing opinion) that the Washington deed was invalid and refused to require full faith and credit for the Washington decree, even though the Court acknowledged that the Washington court possessed personal jurisdiction. Professor Currie suggests that the case should be interpreted to mean that a decree should be accorded full faith and credit, but that an attempted state commissioner's deed regarding foreign land is invalid.¹⁶⁹ A number of state courts have held that decrees regarding foreign land are entitled to full faith and credit.¹⁷⁰ Furthermore, Professor Reese suggests that certain types of equity decrees should always be entitled to full faith and credit.¹⁷¹ He suggests that decrees which either order the payment of money or create, affect or destroy a status should be entitled to full faith and credit.¹⁷²

In addition to the cases involving orders to convey foreign land, the question of the extraterritorial effect of other types of decrees has arisen in cases involving injunctions either against bringing suit or enforcing a judgment.¹⁷³ For example, injunctions have been obtained regarding the enforcement of a judgment fraudulently procured in another jurisdiction. When the

168. 215 U.S. 1 (1909); See generally Currie, *Full Faith and Credit to Foreign Land Decrees*, 21 U. CHI. L. REV. 620 (1954).

169. Currie, *Full Faith and Credit to Foreign Land Decrees*, 21 U. CHI. L. REV. 620, 639-40 (1954). This distinction is somewhat undermined by the fact that the Court in *Fall* disapproved of *Burnley v. Stevenson*, 24 Ohio St. 474 (1873), a case which granted full faith and credit to a foreign land decree and ignored the deed issued in connection therewith. 215 U.S. at 12-14.

170. See *Varone v. Varone*, 359 F.2d 769 (7th Cir. 1966); *Roza v. Roza*, 49 Cal. 2d 322, 330-32, 317 P.2d 11, 15-16 (1957); *Zorick v. Jones*, 193 So. 2d 420 (Miss. 1966); *Weesner v. Weesner*, 168 Neb. 346, 95 N.W.2d 682 (1959); *Higginbotham v. Higginbotham*, 92 N.J. Super. 18, 222 A.2d 120 (1966). But see *Roza v. Roza*, 129 N.W.2d 694 (N.D. 1964); *McRary v. McRary*, 228 N.C. 714, 47 S.E.2d 27 (1948).

171. See Reese, *supra* note 165.

172. *Id.* at 192. Professor Reese also suggests granting full faith and credit to other types of decrees in certain situations. *Id.* at 196.

173. *Id.* at 196.

plaintiff has attempted to enforce such a judgment in the rendering state subsequent to the issuance of the injunction in the foreign state, the rendering state has granted full faith and credit to the injunction promulgated by the foreign state and has refused to enforce its own judgment.¹⁷⁴ Similarly, if the foreign court should find that the judgment was *not* procured fraudulently, such a finding would also be entitled to full faith and credit.¹⁷⁵

Courts have also enjoined a defendant from bringing suit in another state.¹⁷⁶ Such an injunction generally is sought either on the grounds of *forum non conveniens* or that the threatened suit would generate a multiplicity of actions.¹⁷⁷ Courts have almost uniformly refused to grant full faith and credit to such injunctions.¹⁷⁸ Professor Reese contends that it would constitute a "forbidden infringement of some legitimate domestic interest of a state to require it to give full faith and credit to such an injunction."¹⁷⁹ Although most commentators agree that such injunctions should not be granted full faith and credit in a foreign state, a minority of commentators argue that such judicial proceedings are so entitled.¹⁸⁰ Even if such injunctions are not entitled to full faith and credit, of course, a person who violates such an injunction could be punished for contempt in the rendering state.

The Effect of Foreign Judgments on Section 2115

Provisions of section 2115 might be circumvented pursuant to a judgment obtained in another state. If a *bona fide* case or controversy regarding a California pseudo-foreign corporation was adjudicated in a court in another state, and if that court

174. See, e.g., *Dobson v. Pearce*, 12 N.Y. 156 (1854).

175. See *Fidelity & Deposit Co. v. Gaston, Williams & Wigmore*, 13 F.2d 267 (S.D.N.Y. 1926).

176. See generally Reese, *supra* note 165, at 197.

177. *Id.*; Rogers, *Injunctions Against Suits in Foreign Jurisdictions*, 10 LA. L. REV. 302 (1950).

178. See, e.g., *James v. Grand Trunk W.R.R.*, 14 Ill. 2d 356, 152 N.E.2d 858 (1958). See generally Ginsburg, *Judgments in Search of Full Faith and Credit: The Last-in-Time Rule for Conflicting Judgments*, 82 HARV. L. REV. 798, 823-30 (1969); Reese, *supra* note 165; Comment, *Forum Non Conveniens, Injunctions Against Suit and Full Faith and Credit*, 29 U. CHI. L. REV. 740 (1962); Comment, *Full Faith and Credit to Foreign Injunctions*, 26 U. CHI. L. REV. 633 (1959).

179. Reese, *supra* note 165, at 198.

180. See, e.g., Ginsburg, *Judgments in Search of Full Faith and Credit: The Last-in-Time Rule for Conflicting Judgments*, 82 HARV. L. REV. 798, 823-30 Comment, *Full Faith and Credit to Foreign Injunctions*, 26 U. CHI. L. REV. 633 (1959).

applied the law of a state other than California, section 2115 would be circumvented if California were required to give full faith and credit to such an adjudication.¹⁸¹ It is uncertain whether courts of other jurisdictions will apply section 2115 to the internal affairs of California pseudo-foreign corporations. The failure of such a court to apply section 2115¹⁸² may violate the full faith and credit clause, if the state whose law is applied has no legitimate interest in the application of its law. If that court applied other than California law, however, and that application did not violate the full faith and credit clause, a question would arise whether the adjudication must be granted full faith and credit by a California court.

It was suggested in the preceding section that full faith and credit generally must be granted to nonmodifiable final judgments on the merits.¹⁸³ If such a judgment were rendered by a foreign court regarding a California pseudo-foreign corporation, then, such a judgment generally would be entitled to full faith and credit; the choice of law determination in the original proceeding usually is not considered subject to collateral attack. However, certain policy exceptions have evolved regarding the extent to which such judgments are entitled to full faith and credit.

It has been suggested that in certain special situations a judgment which is valid under the due process clause may not be entitled to full faith and credit because of the particular interests of the forum state.¹⁸⁴ In *Williams v. North Carolina*¹⁸⁵ a man and a woman, each North Carolina domiciliaries, left their respective spouses and went to Nevada. There they instituted divorce proceedings and a Nevada court found that they were Nevada domiciliaries and granted a divorce decree. The couple then married and returned to North Carolina where they were prosecuted for bigamy and found guilty. The Supreme Court held that the Nevada judgment did not have to be granted full faith and credit *by the state of original marital domicile*.¹⁸⁶ Although it is far from certain, the case suggests

181. Such a situation could result, for example, if a director violated the standard of care for a director prescribed by the new code but did not violate the standard of care prescribed by the law of the state of incorporation.

182. See text accompanying notes 125-27 *supra*.

183. See note 158 & accompanying text *supra*; Reese & Johnson, *supra* note 157.

184. Reese & Johnson, *supra* note 157, at 169.

185. 325 U.S. 226 (1945).

186. *Id.* at 239.

that even though an initial judgment satisfies due process requirements, it still may not be entitled to full faith and credit if the interests of the state in which it is sued upon are sufficiently great.¹⁸⁷ Although section 2115 might be circumvented by a final judgment on the merits rendered in another state, the substantial interests of California regarding such a corporation or the substantial national policy regarding uniform national regulation of pseudo-foreign corporations should override the policy considerations in favor of granting full faith and credit to foreign judgments.

It should also be noted that a suit could be filed in the state of incorporation of a California pseudo-foreign corporation in order to attempt to obtain an injunction against prosecuting an action in California. If such an injunction were rendered, although it would not be entitled to full faith and credit, a party could be imprisoned for contempt by the court in the state of incorporation if the party was before that court and the party continued to prosecute an action in California.¹⁸⁸ Conversely, a party could bring an action in a California court to attempt to enjoin another party from prosecuting an action in a court in the state of incorporation.¹⁸⁹

187. According to Reese & Johnson:

Speaking for the majority, Justice Frankfurter was explicit in stating that this result was not based upon the invalidity under due process of the divorce decree, but that instead "If this Court finds that proper weight was accorded to the claims of power by the courts of one State in rendering a judgment the validity of which is pleaded in defense in another State . . . and that a finding adverse to the necessary foundation for any valid sister-State judgment was amply supported in evidence, we cannot upset the judgment before us. And we cannot do so even if we also found in the record of the court of original judgment warrant for its finding that it had jurisdiction. [William v. North Carolina, 325 U.S. at 234.]" The reason he gave was this: "But those not parties to a litigation ought not to be foreclosed by the interested actions of others; especially not a State which is concerned with the vindication of its own social policy. . . . *The State of domiciliary origin* should not be bound by an unfounded, even if not collusive, recital in the record of a court of another State. [*Id.* at 230 (italics supplied).]"

In short, the basis of the decision is that even though the divorce decree may have been valid under due process, it still was not entitled to full faith and credit in North Carolina because of the interest of the latter state "in the family relation of its own people." [*Id.* at 232].

Reese & Johnson, *supra* note 157, at 169. It has also been suggested that judgments will not be entitled to full faith and credit in those situations where a competing national policy is more compelling. See Reese & Johnson, *supra* note 157, at 178.

188. See *Platt v. Woodruff*, 61 N.Y. 378 (1875).

189. See generally Comment, *Jurisdiction of Forum to Enjoin Contempt Pro-*

The Responses of Other States to Section 2115

Section 2115 extends to foreign corporations if more than fifty percent of its shares, excluding those held in street name, are held by persons "having addresses" in California, and if the average of its property, payroll and sales factors in California exceeds fifty percent. The fifty percent minimums, as well as the two-prong nature of the section 2115 test, will insure that California will have the most substantial contacts with all corporations governed by section 2115.

Critics of section 2115 have predicted that other states will enact statutes in retaliation to section 2115, presumably with provisions allowing them to acquire jurisdiction over the internal affairs of foreign corporations on the basis of fewer contacts than are required under section 2115, thereby causing the law governing the internal affairs of a corporation to become increasingly uncertain. Even if other states enact provisions similar to section 2115, but set forth a different type of test for the provision, an overlap with section 2115 could result.¹⁹⁰ If the overlap should be substantial, or if states should begin to enact retaliatory statutes, it would appear that the minimum percentage of one or both aspects of the section 2115(a) test could be increased without substantially undermining the purpose of the provision. Such an increase would reduce any overlap as well as assuage the belligerence of sister states.

CONCLUSIONS

Section 2115 encroaches upon the cherished legal concept that a corporation "exists" in its state of incorporation.¹⁹¹ It is submitted, however, that the policy justifications discussed above for section 2115 warrant the severance of the conceptual umbilical tie between a pseudo-foreign corporation and its state of incorporation.¹⁹² It is not questioned that the internal

ceeding on Foreign Decree Enjoining Prosecution of Lawsuit Within State of Forum, 46 HARV. L. REV. 1030 (1933); Comment, *Forum Non Conveniens in Minnesota*, 31 MICH. L. REV. 963 (1933); Comment, *Extraterritorial Recognition of Injunctions Against Suit*, 39 YALE L.J. 719 (1930).

190. For example, certain sections of the New York corporations code govern a foreign corporation if one-half of its business income for the preceding three fiscal years was allocable to New York. See N.Y. BUS. CORP. LAW § 1320(2) (McKinney 1963).

191. See, e.g., *St. Clair v. Cox*, 106 U.S. 350 (1882). See generally Fead, *Jurisdiction over Foreign Corporations*, 24 MICH. L. REV. 633 (1926).

192. Since it could be argued that the provisions enumerated in section 2115(b) represent fundamental public policies of California, section 2115 can also be characterized as an example of the traditional exception to general state choice of law rules: a

affairs doctrine is both simple and consistent. The application of this doctrine to pseudo-foreign corporations, however, results in regulating its activities, to the detriment of the state in which the corporation derives a majority of its revenue and in which a majority of its shareholders reside. Section 2115 resolves this anomaly. It represents a significant step by California to regain control of corporations whose principal place of business is within the state. Laws which reflect a substantial public policy of California will thereby begin to govern many more corporations whose principal place of business is in California.

forum will not apply a law of another state that violates a fundamental public policy of the forum. Of course, section 2115 is somewhat different in that it applies only to corporations with a certain level of contacts with California.